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Implications of COVID-19 and Russia's war in Ukraine for EU-Africa relations

Development finance

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KEY MESSAGES

- The current multi-crises context is gravely affecting the African continent (and especially Sub-Saharan Africa), and the EU must critically mobilise and expand the range of tools to support African initiatives for greater resilience, and sustainable and inclusive recovery and transformation.
- Some of Africa's sources of external finance, such as foreign direct investment or trade, are following a downward trend, and debt pressure experienced by African countries is accentuating. It is thus crucial to boost the role and impact of African and European public development banks to mobilise sustainable and transformative investment. Africa and Europe should implement trade-inducing initiatives such as avoiding new barriers or supporting the African Continental Free Trade Area negotiation and implementation process. They should cooperate to explore innovative and tailored debt solutions together. This can include adopting common positions in multilateral fora and contemplating different debt-swap mechanisms. The European Union should collectively commit to speedily rechannelling 30% of their special drawing rights, through the International Monetary Fund and innovative leveraging mechanisms.
- Other sources of African external finance, namely official development assistance, migrants' remittances and development finance, should be strengthened, and their development impact leveraged. This can be achieved through stronger cooperation and a renewed commitment also by European actors to understand the current state of affairs, engage with all actors involved and contemplate appropriate solutions. Such a cooperative mindset can also contribute towards the fight against illicit financial flows.

SUMMARY

The global multi-crises, ranging from the climate emergency and COVID-19 pandemic to Russia's war in Ukraine, and their ripple impacts, have disproportionately affected developing countries, and in particular those in Sub-Saharan Africa. The European Union (EU), along with its member states, as a key partner to Africa, a major global economic and geostrategic actor, and the main international aid provider, stands at the forefront of the international response to support Africa's resilience and recovery from crises, as well as its longer-term sustainable, green and inclusive development. Yet, the question is to which extent the framework and initiatives for EU-Africa relations are still fit for purpose, in particular in terms of mobilisation of resources for Africa's resilience and sustainable development, or must be adapted to better respond to the new era of poly-crises. In economic and financial terms, the following dimensions deserve particular attention.

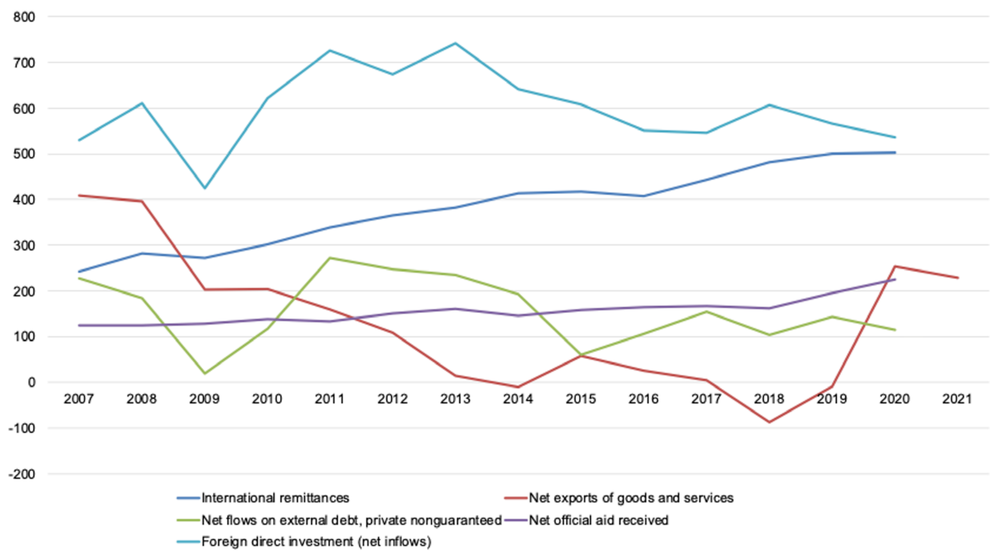
A SNAPSHOT OF GLOBAL FINANCE TO DEVELOPING COUNTRIES AND AFRICA

The Addis Ababa Agenda Action (AAAA) approved in 2015 aims at identifying and maximising all possible forms of development finance in order to cover the implementation of the Sustainable Development Goals (SDGs). This includes domestic resources (such as fiscal revenues) but also external funds that may come in the form of exports, external debt, foreign direct investment (FDI), international migrants' remittances or official development assistance (ODA). Although these different sources respond to diverse economic dynamics and stakeholders (from remittances involving purely personal decisions to ODA responding entirely to State policies), all of them might play a role in sustainable development and can be shaped (to different extents) via a coherent approach to development on the part of the international community.

By the time the AAAA was adopted, FDI and remittances were the two main sources of external finance for the Global South, followed by ODA, debt and net exports (Figure 1). Since then, and until the eruption of the COVID-19 pandemic, FDI inflows steadily declined and net exports became negative, while external debt stagnated overall until 2020. Now more developing countries are experiencing debt vulnerabilities, with a record number of them in debt distress or at high risk of debt distress. Meanwhile, migrants' remittances kept on increasing, and ODA sustained its upward trend.

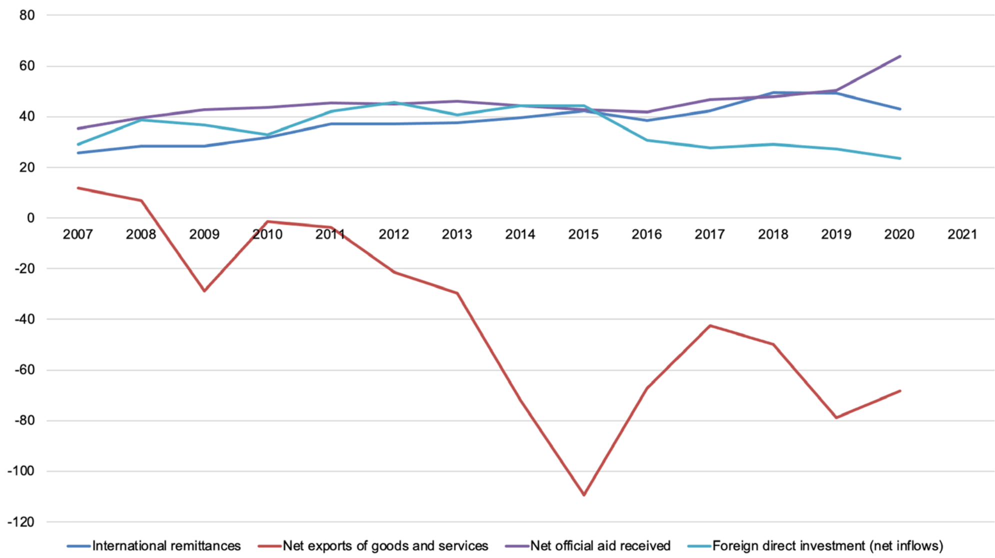
The main sources of external finance in Sub-Saharan Africa (and their evolution in recent years) are fairly different: the contribution of external trade is structurally negative, FDI has been decreasing in absolute terms since the adoption of the 2030 Agenda, and only ODA and international remittances have managed to preserve a parallel and upward trend until the eruption of the pandemic (Figure 2).

Figure 1. Diverse sources of external finance in low- and middle-income countries (in billions of current US dollars)



Source: World Bank (World Development Indicators online) for data on remittances, debt, FDI and exports, and OECD (OECD.Stat) for data on ODA. Data retrieved 27 October 2022.

Figure 2. Diverse sources of external finance in Sub-Saharan Africa (in billions of current US dollars)



Source: World Bank (World Development Indicators online) for data on remittances, FDI and exports, and OECD (OECD.Stat) for data on ODA. Data retrieved 27 October 2022.

The EU is a relevant economic partner of the African region.

As for trade, according to the European Commission's (EC) figures, the EU actually contributes to the African structural trade deficit as Africa's trade balance was at -€8 billion in 2019. This is partly explained by the fact that, while the EU mostly exports manufactured goods to Africa, it imports primary goods from this same region. Moreover, geographically, EU trade is concentrated in North Africa, with this trade volume more than doubling that of the second regional destination, Western Africa.

According to the United Nations Conference of Trade and Development (UNCTAD), European investors remain by far the largest holders of foreign assets in Africa, led by the United Kingdom (holding an FDI stock of US$65 billion) and France (US$60 billion). In addition, African inward FDI plays a relevant role in economic activity, amounting to roughly 8% of the region's gross fixed capital formation (GFCF) – above this same rate in both developed and Asian countries where FDI / GFCF stand at 6%. Although the effects of FDI on sustainable development are not systematic and therefore should not be taken for granted, these flows can play a key role in structural change, the provision of goods and services, employment creation and balance-of-payments equilibrium. In this sense, it should be noted that Africa is, according to UNCTAD, the region receiving the lowest share of world FDI, with an important proportion of such share invested in traditional (extractive) sectors.

In general terms, migrants' remittances proved to be unexpectedly resilient during the pandemic. However, as shown in Figure 2, according to World Bank data, remittances to Africa decreased in 2020. Here again, Africa receives a fairly low share of this type of global finance: Sub-Saharan Africa received 6% of the world's remittances in 2020 according to the World Bank. And Europe is a relevant origin of such flows. The remittances corridor linking, on the one hand, the United Kingdom and the EU and, on the other, Sub-Saharan countries, has been identified as one of the three main corridors in the region.

Regarding aid, the EU (including both EU institutions and member states) is the largest donor globally and in Africa – the member states and EU institutions together provided 67 billion euros in Official Development Assistance in 2020, over 35% of which went to African countries. Although a large share of European ODA is distributed in East European and North African neighbour countries, recently launched EU development tools (Global Europe, Team Europe, Global Gateway) are aimed at dealing more effectively with African challenges.

Lastly, the funds that Africa loses in the form of illicit financial flows (IFFs) pose a serious setback for the financing of sustainable development in the continent. The fiscal pressure derived from the COVID-19 pandemic and the alterations to the financial system provoked by Russia's war in Ukraine call for the EU to engage more effectively with African partners to try to counter this reality.

FOREIGN DIRECT INVESTMENT

The COVID-19 pandemic provoked a sudden stop in FDI flows globally. According to UNCTAD, FDI flows, which had been decreasing since the mid-2010s, dropped dramatically. However, they rebounded the following year, with total inflows at 1,582 billion US dollars, the highest figure since 2017 and 64% more than the previous year. But this recovery was unevenly distributed across regions. Africa's FDI inflows reached 83 billion US dollars in 2021, which although it represents a 256% increase with respect to the previous year, is nonetheless the result of one single major operation in South Africa. Therefore, all in all, FDI inflows in Africa remained at low levels.

UNCTAD expects global FDI trends to stagnate, at best, in the course of 2022. This is due to several factors. Russia's war in Ukraine is having a significant impact on European economies (which are major FDI investors and recipients) and provoking inflationary pressures that are resulting in increasing interest rates. The latter may ultimately anchor EU investment locally, trading off outward FDI. Also, the 'COVID zero' strategy in China is leading to extended periods of lockdown that are cooling all sorts of economic activities, including investments abroad. These economic trends can have a deep impact on FDI outflows to Africa since, as mentioned above, EU countries and China are major investors in Sub-Saharan economies.

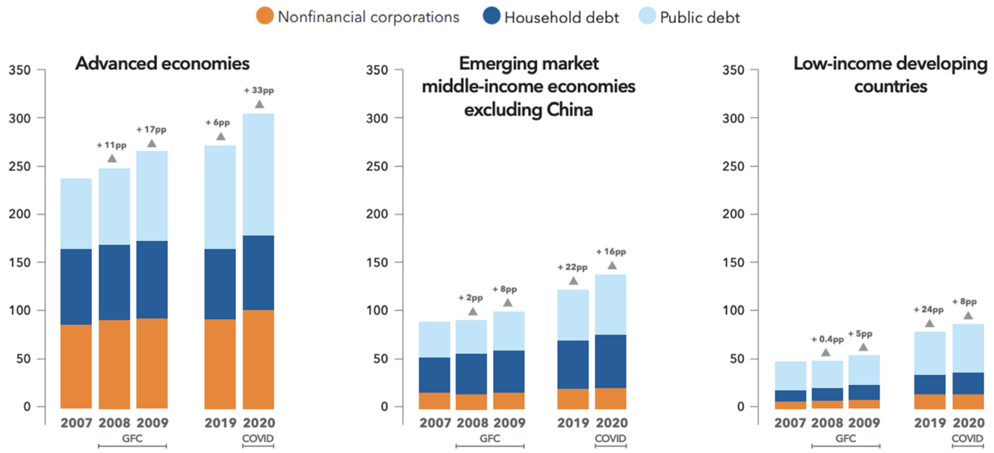
Given the current situation of FDI flows to Africa and the expectations for the near future, EU development finance institutions (DFIs) can play a major role, particularly now that reimbursable aid is experiencing a new momentum, given the extraordinary financial needs associated with implementation of the 2030 Agenda. Investments made, backed, guaranteed or leveraged by EU DFIs are particularly fit for purpose: they can fill the void left by market mechanisms alone, and can also shape FDI projects towards development-oriented solutions, balancing the African FDI portfolio towards non-extractive activities.

EU DFIs form a complex network of agencies and banks with major coordination challenges, both among them and with cooperation agencies. If such challenges are correctly addressed, following the Team Europe spirit, and aligned with the ambitious Global Gateway strategy, potential benefits for African economies might be substantial.

DEBT

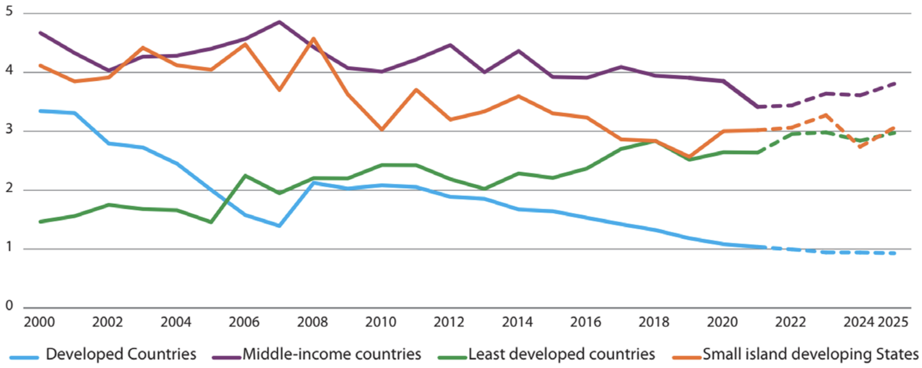
The multi-crises have led to increasing debt globally. But while the stock of debt is higher in advanced economies, the cost of borrowing is about three times higher in developing countries (Figures 3 and 4). As a result, recent crises have further exposed the debt vulnerabilities of many

Figure 3. Debt (as % of GDP)



Note: GFC = Global Financial Crisis; pp = percentage points.
Source: IMF, based on IMF, Global Debt Database; IMF, World Economic Outlook; and IMF staff calculations.

Figure 4. Average interest cost of outstanding government debt (in %)



Source: Volz, Ulrich and Aitken, D. 2022. Public debt in the time of COVID-19 and the climate crisis. Background paper for the Financing for Sustainable Development Report 2022. Figure compiled with data from the IMF and Institute of International Finance. Cited in UN.

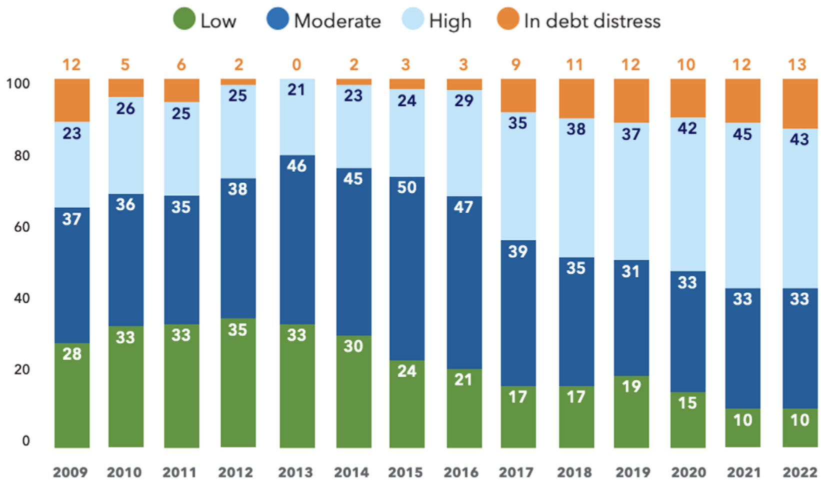
developing countries, with 54 countries – accounting for nearly 60% of the poorest economies and 28 of the top 50 most climate-vulnerable nations – in debt distress or at high risk of it. This concerns 19 of the 35 low-income countries in Sub-Saharan Africa.

The current multilateral system has so far not been able to propose comprehensive remedies.

The Debt Service Suspension Initiative (DSSI) has proved too limited and unattractive to many indebted countries, who also fear sending the wrong signal to creditors by requesting debt service suspension. Prudential measures for debt management should be actively pursued, thereby preventing future debt crises, as suggested by the IMF. More effort should also be made to adopt systemic yet tailor-made solutions to the rising debt vulnerabilities of Africa and other developing countries. Such endeavours towards structural debt management reforms must encompass all major credits – that is, not only Paris Club members but also China and private creditors. This is possible, as illustrated by the debt restructuring efforts in Zambia, for instance.

Europe and Africa should cooperate on identifying innovative debt solutions while stimulating inclusive and sustainable investment and development endeavours and jointly promoting them at the international level. In particular, they could:

Figure 5. Proportion of countries in debt distress, or at high risk of debt distress



Note: Percent of DSSI (Debt Service Suspension Initiative) countries with LIC DSAs (low-income countries debt sustainability analyses).
Source: IMF, based on LIC DSA database.

- Adopt common positions on debt management and restructuring at the G7, G20, V20, IMF, and other relevant international fora.
- Jointly pursue debt-for-climate, debt-for-nature and debt-for-SDGs swap mechanisms, promoting the conversion of debt into climate, nature-based, blue, social and sustainable investments, through mechanisms such as the United Nations Economic Commission for Africa (UNECA) proposal to establish a Sustainable Sovereign Debt Hub, linking debt to climate-resilient key performance indicators, using green, social, sustainability and sustainability-linked (GSSS) bonds, the Liquidity and Sustainability Facility (a UNECA-sponsored finance mechanism aimed at improving the liquidity of African sovereign debt) and the adoption of Brady bond–like structures.

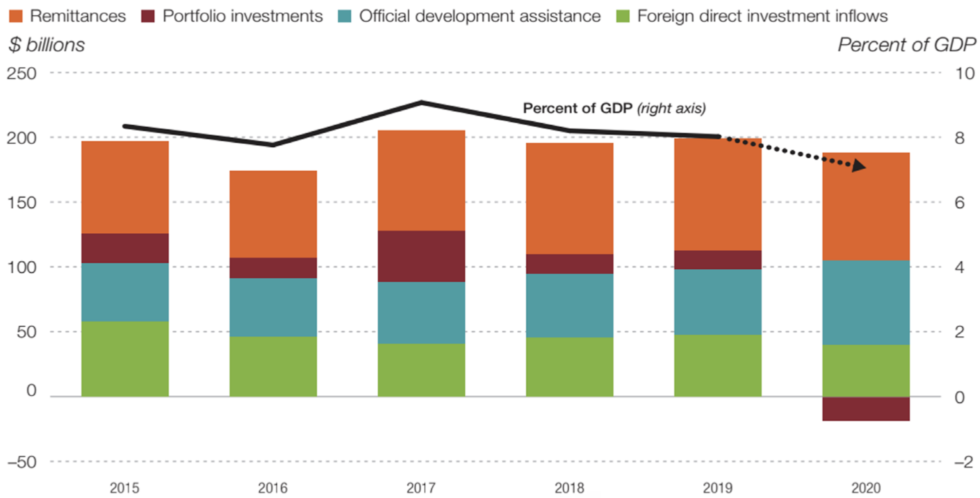
EU member states should also make collective commitments to rechannel at least 20%, or even 30% of their special drawing rights (SDRs) issued by the IMF in August 2021, following the example of France, Germany, Italy, the Netherlands and Spain, and along G20 commitments. They could do so through the IMF Poverty Reduction and Growth Trust (PRGT) and the new Resilience and Sustainability Trust, as well as through direct transfer of SDRs – or their equivalent – to multilateral development banks such as the African Development Bank, and possibly through alternative (African, or joint African-European) mechanisms. The EU and its member states should also collectively provide accompanying grant contributions, in particular to the PRGT's subsidy reserve account. On processes, Europe and Africa could work together towards common solutions and speed up the effective implementation and disbursement of SDRs through existing channels.

DEVELOPMENT FINANCE

The climate, COVID-19, Russia's war in Ukraine, food and energy crises, combined with inflationary pressures, dollar appreciation and tighter fiscal and monetary policies, have significantly reduced the capacity of many African countries to stimulate productive and structural investments. The much tighter budgetary and fiscal constraints of EU member states and the strategic imperative to support Ukraine also limit the capacity of Europe to significantly increase its aid support to African countries to face these crises. External financial flows have also declined as a result of the COVID-19 pandemic (Figure 6), while the needs have increased, estimated by the African Development Bank at about US$432 billion in additional resources needed for the period 2020–2022.

Mobilising development finance for inclusive and sustainable investment at scale, for greater impact, is therefore critical for Africa's capacity to weather the storm of crises and for the recovery, resilience and sustainable long-term development of the continent. Financial institutions for development, and in particular multilateral development banks (MDBs), have responded overall in a counter-cyclical manner to the COVID-19 crisis, many of them expanding the volume of their financial operations in consequence, including compared to the global financial crisis (Table 1). But the capacity of these financial institutions to respond to multiple crises is put to the test while they also have to significantly increase their climate action, notably for climate adaptation and resilience.

Figure 6. External financial flows to Africa, 2015–2020



Source: African Development Bank

Table 1. Comparison of responses to the global financial crisis and the COVID-19 pandemic by major financial institutions for development

	Global financial crisis			Covid pandemic			Change 09 v 08	Change 20 v 19
	2008	2009	2010	2019	2020	2021		
EDFI	7.9	6.1	6.1	10.1	9.1	10.6	-23%	-10%
OPIC/USDFC	4.1	3.5	2.4	5.3	4.8	6.8	-15%	-9%
IFC	11.4	10.5	12.6	8.9	11.1	12.5	-8%	25%
MIGA	2.1	1.4	1.5	5.5	4.0	5.2	-33%	-29%
EBRD	6.3	9.1	8.8	8.4	9.6		45%	15%
IDB Invest	0.3	0.3	0.4	4.7	6.2		0%	32%
AsDB	2.0	1.7	2.1	3.0	4.5		-12%	50%
Total excl EIB & AIIB	**34.0**	**32.6**	**33.9**	**45.9**	**49.3**	**35.1**	**-4%**	**7%**
EIB				2.6	4.9			
AIIB				1.3	1.2			
Total				**49.8**	**55.5**			

Source: ODI, based on annual reports for USDFC/OPIC, IFC, MIGA, EBRD, IDB Invest, AsDB, EIB and AIIB, and website data for EDFI.

The following priorities should be considered:

- Adjusting development finance institutions and framework to respond to crises. DFIs and, more broadly, development finance, such as the European Fund for Sustainable Development Plus (EFSD+), are geared towards longer-term sustainable investments. They often appear ill-equipped to address multiple crises where agile, flexible, fast, coordinated counter-cyclical responses are needed in the face of higher risks and uncertainty.
- Pursuing active women-economic empowerment and gender-sensitive approaches to development finance (for example, along the 2X Challenge), essential for both stimulating the recovery and ensuring longer-term inclusive development.
- Supporting an ambitious reform agenda for MDBs to release their potential. In these turbulent times, MDBs can unleash their firepower by various means, including recalibrating their capital adequacy and hybrid capital funds for the rechannelling of SDRs. The World Bank Group should also adopt a more ambitious climate action plan, in coordination with other MDBs.
- Mobilising more effectively development finance at scale, through de-risking mechanisms, blended finance and greater coordination among local and international development actors, for:
  - climate adaptation and resilience, just energy transition, loss and damage, biodiversity and nature protection.
  - upstream project pipeline development.
- Providing mechanisms for (concessional) finance in local currency.
- Promoting more structured collaborations and partnerships between African and European DFIs and Public Development Banks (PDBs), possibly articulated around key geographic, sectoral or thematic issues, such as: boosting climate adaptation, addressing food security and sustainable food systems, pharma and health products, key transport corridors, access to finance for Micro, Small and Medium-sized Enterprises (MSMEs), trade finance and the implementation of the African Continental Free Trade Area (AfCFTA).
- Adopting tailored and coordinated approaches for stronger engagement of DFIs and PDBs, alongside other development actors, in poorer countries and more fragile and conflict-affected contexts, focused on enhanced risk appetite for higher impact investment, and accepting lower leverage ratio.
- Supporting reliable (public and private) initiatives on carbon credit mechanisms for green and sustainable investments supported by DFIs and PDBs.

REMITTANCES

International remittances proved to be a stronger anti-cyclical source of financing for many developing countries than initially expected during the COVID-19 pandemic. While this global trend was not necessarily mirrored in Sub-Saharan Africa, where remittance inflows declined in 2020 by 8.1% compared to the previous year, 2021 saw again an increase in international remittances received across the continent (of 14.1% in Sub-Saharan Africa and 7.6% in the Middle East and North Africa region). This is partly explained by stronger needs experienced by recipients, by fiscal stimulus packages in many Global North countries and by an inevitable shift from informal to digital (formal) transfer channels during lockdowns.

Russia's war in Ukraine is taking a toll on remittance flows in 2022. The upward trend has started to slow down, although remittance flows still surpass FDI and ODA. While the direct effects of the war on remittance sending are more pronounced in other regions (Europe and Central Asia), the supply issues with and rising prices of oil, wheat, fertilisers and energy, coupled with the inflationary pressure, are boosting a greater need for remittances in import-dependent countries in Africa.

Remittance-related knowledge and responses tend to be dispersed, so the EU should aim to coordinate its efforts to improve response efficiency, both internally – among Directorates-General within the Commission, EU institutions, member states, European banking and financial actors – and with other relevant partners like the World Bank and the International Fund for Agricultural Development (IFAD). For instance, in light of the crucial need for better data on remittances, the EU's contribution to the World Bank's recently launched International Working Group to Improve Data on Remittance Flows can be leveraged and strengthened.

The EU needs to understand the new challenges to reducing remitting costs, such as a potential diversification in payment systems since Russia's exclusion from SWIFT, that build on pre-existing challenges: insufficient physical and digital infrastructure, inadequate financial regulatory environments and infrastructure, monopolistic behaviours and informality. EU development cooperation, financial actors and authorities should further coordinate with their African counterparts to tackle financial and digital inclusion, prevailing lack of trust in banking services, banking literacy and local policies for an adequate investment environment, all of which currently hinder (safe) remitting and its potential derivatives.

On the sender side, it is important to expand and deepen engagement with remittance senders in the EU by, for instance, ensuring their familiarity with the available formal remittance services and access to all cost-related information (where France already has some experience) to incentivise secure formal remitting and track its development impact.

ILLICIT FINANCIAL FLOWS

Illicit financial flows (IFFs) could amount to 10% of the world's economy. More specifically, according to UNCTAD, Africa could be losing approximately 88.6 billion dollars per year in IFFs. This amounts to 3.7% of its GDP, half the finance gap for achieving the SDGs in the African region. IFFs not only drain development finance from the Global South by diverting private investment and eroding the tax base (and hence the fiscal margin of manoeuvre and the possibilities for public investment). They also imply corruption, illicit or even illegal activities (such as terrorism, organised crime or drug trafficking), posing additional challenges to sustainable development.

The COVID-19 pandemic, and the additional fiscal pressures that come with it, amplify the case for fighting IFFs. In addition, Russia's war in Ukraine, and the different measures for freezing Russian funds abroad, have created a new momentum in this fight.

Additional efforts on the part of EU and African parties could focus on at least two fronts.

One major obstacle in the fight against IFFs is the lack of reliable data. Without accurate information, EU and African authorities lack the very basic tool for a consistent and effective political response. Since leveraging better information on the issue requires all parties to be involved, both the EU and African countries could actively collaborate in ongoing initiatives for measuring illicit flows, such as the pilot programme launched by the UN and implemented in 14 countries, 12 of which are African (Angola, Benin, Burkina Faso, Egypt, Gabon, Ghana, Namibia, Nigeria, Mozambique, Senegal, South Africa and Zambia).

According to the UN, significant steps have been undertaken in the specific domain of asset recovery. The Stolen Asset Recovery Initiative run by the World Bank and the United Nations Office on Drugs and Crime found a marked increase between 2017 and 2021 in cases where funds stolen by corruption were traced and recovered.

Since 2010, 9.7 billion dollars in corruption proceeds have been either frozen, seized or confiscated in their destination country or returned to the country where they were stolen. However, there is an important gap between frozen or confiscated assets and those that can be effectively repatriated to their home economies.

TRADE

The recent crises, including the COVID-19 pandemic and Russia's war in Ukraine, have exposed the vulnerabilities of global value chains and reliance on international trade. The pandemic has led many countries to adopt protectionist barriers and apply export restrictions as a result of lockdowns and to have access to key (such as health) products. Strategic autonomy considerations and distortive market interventions have been given further impetus with the geo-economic fragmentation and polarised world resulting from Russia's war against Ukraine. Notions of re-shoring, near-shoring and friend-shoring, and value chain fragmentation have tended to replace multilateralist rhetoric and calls for better integrated global value chains.

At the same time, the impact of Russia's war in Ukraine has also exposed the trade vulnerabilities of many developing, and in particular African, countries to the dwindling and higher priced food and fertiliser imports from Ukraine and Russia. Beyond the direct trade effects, rising food and energy prices, combined with higher inflation, the appreciation of the dollar and tighter fiscal and monetary policies, have further reduced the ability of many African countries to benefit from international trade. Higher uncertainties and pressures on access to trade finance have also reduced trading opportunities.

African and European initiatives to prevent the imposition of new barriers to trade, and to promote trade facilitation and finance, have a key role in fostering trade and investment within Africa and with the EU. In this respect, speeding up the conclusion of remaining negotiations of the AfCFTA and boosting its implementation should be a priority for both the African Union and the EU. Linking this continental trade and structural AfCFTA agenda with investment and development finance support should be a priority. Trade finance and local currency financing should, in particular, become part of the EU's arsenal of support to Africa. By doing so, greater synergies between Africa's own integration agenda and Africa-EU trade and investment relations could be unleashed. The EU should also effectively help African countries green their trade and investment, and address the increasing climate-related, sustainability, deforestation, due diligence and human rights requirements imposed by the EU on its trading partners, to ensure that they do not de facto lose access to the EU market. This is particularly important for MSMEs and poorer countries, which may not have the capacity to comply with higher EU regulatory and sustainability requirements.

The EU and Africa could also set up better coordination mechanisms to jointly address the impact of multi-crises and higher uncertainties on their trade and investment relations and to adopt common positions at the multilateral and plurilateral levels, based on joint interests.

PARTNERS IN TIMES OF MULTI-CRISES

It is in times of crisis and need that you find out who your real friends are. With the permanent poly-crises of our times, further heightened by Russia's war in Ukraine, the saying applies both ways to Africa and Europe, calling for a truly equal partnership. Yet, the global crises lead to divergent recovery paths on the two continents. Mobilising resources at scale to face multi-crises is a common challenge, felt far more acutely in Africa. This calls for joint approaches to boost development finance and investment for a sustainable and inclusive recovery and greater resilience. It requires building on existing initiatives and mechanisms, as well as engaging in ambitious, innovative approaches, to more effectively and efficiently mobilise and leverage African, European and international resources and adopt more conducive approaches to sustainable, resilient, inclusive and gender-focused recovery. It also means adopting approaches and mechanisms able to promptly address repeated and compounded crises. The Africa-EU relationship should therefore be adjusted to enhance its capacity to respond to crises in addition to identifying longer-term objectives. ■

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