How can the European Union help developing countries address the socioeconomic impacts of the coronavirus crisis?

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Key messages

- The EU's response package of aid, development finance, trade and business should be a crucial part of a more ambitious G20 action plan that addresses the socioeconomic cost of coronavirus in developing countries.
- The EU should step up, fast-track, front-load and leverage its aid and development finance, and foster coordination.

Introduction

With the global economy going into a steep recession, developing countries are facing considerable financing shortfalls. The UN Conference on Trade and Development warns of a $2.5 trillion finance shortfall; Asian forecasts are down by 5–10 percentage points; Africa is already facing major impacts. The UN Secretary-General has called for a $2.5 trillion fund for developing countries. African finance ministers have called for $100 billion. The average fiscal stimulus in Europe so far (12% of gross domestic product) is 15 times higher than in the poorer African countries (0.8%) – as the latter cannot afford it. This note discusses EU actions to support developing countries to address the coronavirus crisis.

Why should the EU support developing countries now?

Confronted with its most severe crisis since WWII, Europe needs to adopt a global perspective, as it cannot successfully address it in isolation. There is a moral imperative to help vulnerable people in distress and foster global solidarity to prevent catastrophic outcomes. Addressing the COVID-19 pandemic is a global public good; not providing it globally will come back to haunt Europe, negating the EU's own internal efforts to build a better and more open world. In addition, helping global recovery, including in poor countries, will pay off for Europe, through prosperity, stability and peace. European aid (though untied) generates more economic returns to the EU than it costs.[1] As a major provider of aid and finance, the EU should act countercyclically.

What can the EU do now?

The EU should **refocus its development priorities** to address the humanitarian, health-related and socio-economic needs of developing countries resulting from COVID-19, as in the financial crisis response.

EU aid and finance

The EU and its member states provide 57% of global aid. European institutions delivered €14.5 billion or 19.6% of EU aid in 2018 and were more countercyclical than other aid during the 2008-2009 crisis. For the EU budget over 2021–2027, the Commission has originally proposed a Neighbourhood, Development and International Cooperation Instrument (NDICI) worth €89.2 billion ($101.6 billion). The EU should **step up its development efforts**, targeting the most vulnerable, fragile and poor countries and segments of the population. It can do so by **beefing up** aid budgets; **reallocating** existing aid where it is most needed (redirecting unspent and flexible funds); **front-loading** and **fast-tracking** existing aid commitments, with simplified procedures; and increasing efforts to use aid budgets to **leverage new (private) resources**. EU institutions and member states should **act collectively** if possible, with special attention to the socioeconomic impacts of COVID-19 on the informal sector predominant in poorer countries and on fragile and vulnerable groups, including women.

Immediate efforts should focus on humanitarian aid and grant support, targeting the most urgent health-related issues. The EU should also mobilise **its development tools**, in a **comprehensive and coordinated manner**, combining short- and longer-term interventions. This should include **budget support**, accelerated and redirected to the health sector in the most vulnerable countries, and **macro-financial assistance**, in cooperation with the IMF, for countries with critical balance of payment problems, with special attention to African countries. The Vulnerability-Flex mechanism (an 'absorption mechanism for exogenous shocks') provided much-needed resources delivering at scale and speed during the global financial crisis.

[1] ODI has found that, for every $1 in EU aid, EU exports go up by between $1.02 and $3.69.

The EU has limited resources available and should **deploy its aid budget in a more strategic way**, protecting declines in and leveraging additional private resources. It can enhance **blended finance and guarantees**, as in the European Fund for Sustainable Development (EFSD), and harness development finance institutions (DFIs). The EU and its member states should:

- **reorient, front-load and enhance** investment programmes and projects approved under the **EFSD** towards COVID-19-related interventions
- **provide additional contributions to the EFSD**, to boost blended finance and guarantees capacities
- **mandate and capacitate (with dedicated grants) the EIB**, as the EU bank, to act countercyclically in more vulnerable countries, with an **EIB COVID-19 Response Initiative**, building on the experience and expansion potential of the Economic Resilience Initiative and the African, Caribbean and Pacific Investment Facility (and in particular its Impact Financing Envelope); EIB external finance was €5.7 billion in 2018 and was countercyclical over 2008-10
- **enhance risk-guarantee mechanisms**, to stimulate development finance as the risk exposure of DFIs and their clients surge with COVID-19.

Enhance cooperation within the EU and globally

The EU should **foster a collective response for its action outside the EU**, strengthening synergy and cooperation between EU institutions and EU member states as well as with the international community.

EU member states could take measures similar to the Commission's, including enhancing the capacity of their own DFIs. Next to **highly concessional loans** to support sovereign, sub-sovereign and public development finance institutions, **European DFIs, in conjunction with international and local DFIs,** have a critical role to play in financing **health projects and innovation**, supporting **MSMEs** and Midcaps (through financial intermediaries) most affected by the crisis, enhancing targeted **risk-sharing** mechanisms and **guarantee** schemes and providing **liquidity for private sector activity** that is crucially lacking during the crisis.

At the EU level, the Commission can help foster greater cooperation among member states and DFIs. Building on the ESFD governance, the Commission could usefully **bring together all European DFIs** (EIB, EBRD, AFD, KfW, CDP, and EDFI members who invested €7.2 billion in 2017) and other multilateral development banks (MDBs) (AfDB, IFC) benefiting from the EFSD to coordinate actions. The Commission and the EU External Action Service could also help **establish a coordination platform for EU shareholders** in MDBs to help foster a more coherent EU position on their interventions. It needs DFIs to solve lack of liquidity in the private sector.

The EU and its member states should also consider **boosting the development financial envelope** (NDICI) under the revised proposal for the next multi-annual budget of the EU in light of COVID-19 crisis, including an increased capital for the **EFSD+** (and much needed **European Development Bank**), so as to better leverage the EU budget, and **make health and COVID-related issues a priority** for its development interventions. The aid programmed should be heavily **front-loaded**, to respond to the urgent COVID-19-related needs and stimulate a prompt recovery.

The EU should also coordinate to more effectively influence and better cooperate with **international fora** such as the **G7, G20, IMF, World Bank and UN,** towards a significant comprehensive response for developing countries. Stronger cooperation should also be pursued with regional institutions, as in the case of the **EU–Africa Partnership**, to address COVID-19 impacts. So far, the G20 has insufficiently addressed the needs of the poorest and most vulnerable. The EU should take a lead.

The EU could support the following initiatives:

- active **coordination with the UN Agencies**, toward global responses and tailored actions on the ground
- **enhance IMF intervention capacity**, by boosting the Special Drawing Rights (SDRs) allocation for low- and some middle-income countries, and support issuance of new SDRs for poorer countries
- support the **temporary suspension of debt services** for poorer countries (as proposed by France and Germany) and encourage **debt relief** for some developing countries
- support a **comprehensive stimulus package** (as part of the G7 and G20) for low-income countries
- further stimulate **investment in economic transformation initiatives** led by developing countries, focusing on (informal) **job creation**
- ensure a strong **climate, environmental and biodiversity focus**, to turn a post-COVID-19 investment boom into an opportunity, including towards a circular economy and sustainable food systems, in line with the European Green Deal
- consider the issuance of **COVID-19 development bonds** by relevant MDBs (as by the African Development Bank and IFC social bonds), and use recovery-linked repayments
- stimulate comprehensive international efforts to **effectively tackle illicit financial flows,** so as to preserve much-needed financial resources for developing countries
- **preserve open trade**, and prevent export restrictions, notably of critical medical goods and basic foods, support regional integration efforts and comprehensive trade agreements covering health services and retool Aid for Trade to support safer trade, such as by TradeMark East Africa
- **coordinate lead European buyers and brands** to ensure COVID-19-proof due diligence in EU-led value chains, such as worker protection on garments, flowers and electronics.