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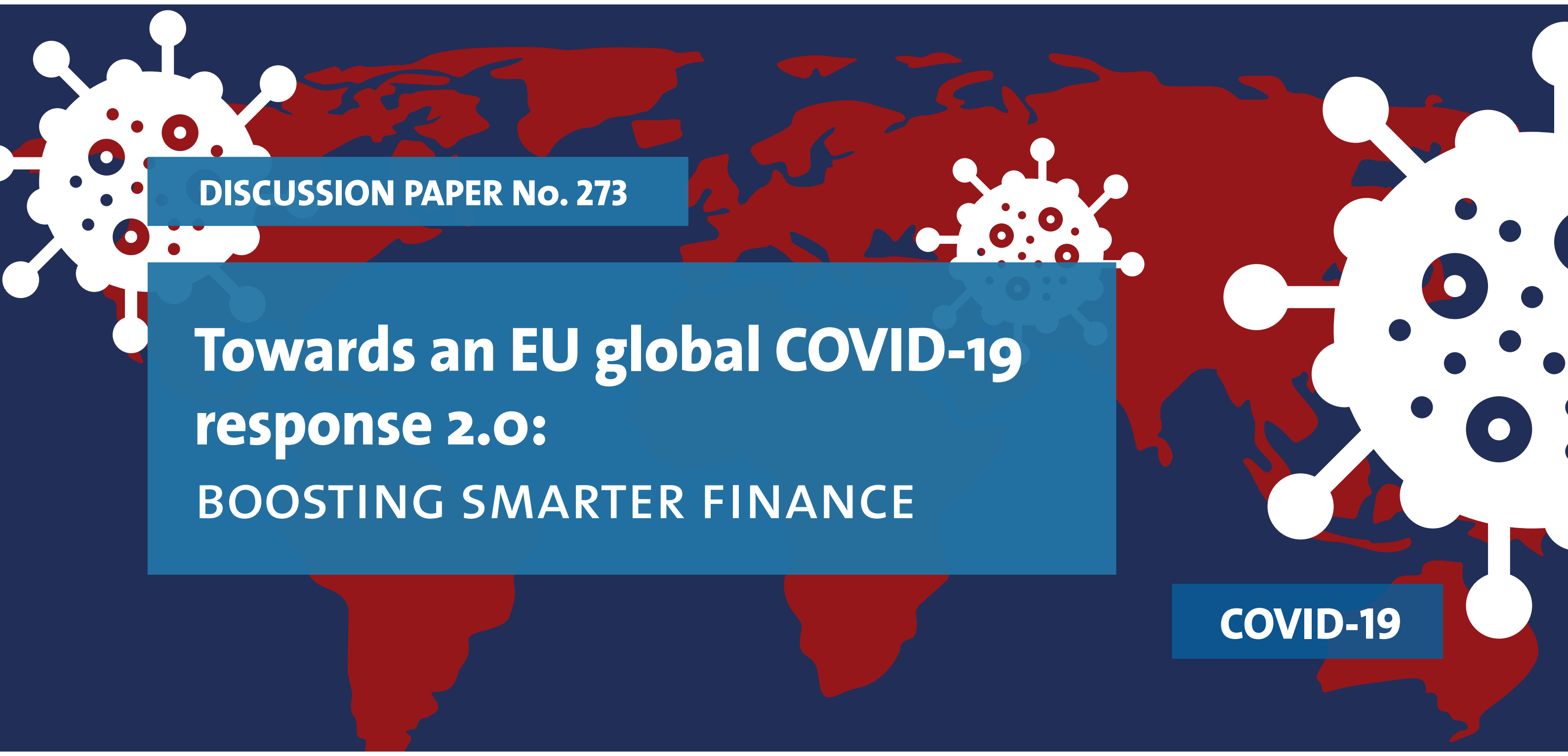

DISCUSSION PAPER No. 273

Towards an EU global COVID-19 response 2.0:
BOOSTING SMARTER FINANCE

COVID-19

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June 2020

The European Union (EU) has responded promptly to the unprecedented crisis caused by the COVID-19 pandemic – within, but also beyond its borders. The EU global response to COVID-19 includes quickly reallocating EU support to developing countries to address immediate COVID-19 challenges, amounting to some €20.8 billion. The ‘Team Europe’ approach adopted provides ample opportunities for cooperation and synergies among EU institutions, member states and their development finance institutions, as well as with international actors. These are vital first steps.

Given the global economic contraction resulting from COVID-19, very sharp in Europe as well, the capacity to mobilise public resources is too limited to support the huge emergency and recovery needs of the most vulnerable countries and people. A strategic countercyclical response is required.

The EU and its member states should thus seek to move towards a collective and well-coordinated global response 2.0, building on the initial one, and following in the footsteps of the proposed €2.4 trillion recovery plan for Europe. This collective EU global response should aim to mobilise additional resources more effectively, better leveraging private finance, and to stimulate greater cooperation and synergies among EU and with international actors, notably development finance institutions, supporting developing countries’ own initiatives. It should include initiatives to stimulate risk capital, promote investment coordination platforms, enhance economic governance, and support debt restructuring and reduction.

The ‘Team Europe’ approach should be a rallying point for the active engagement of EU member states and financial institutions, to respond to the COVID-19 crisis and achieve the Sustainable Development Goals. While keeping its priorities, notably towards a value-based approach, resilient health systems, a greening of the recovery and digitalisation, the EU should put greater emphasis on food security and sustainable food systems. Moreover, women should have a central place in the EU’s global response 2.0.

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Acknowledgements

The author would like to thank the many experts and officials, including in key EU institutions, development finance institutions and international organisations, for kindly sharing their insights with me over the last couple of months, and for their passion and efforts in seeking to address in the most effective way the challenges of the COVID-19 crisis. Thanks also to Alexei Jones for his helpful comments.

The views expressed in this study are those of the author only and should not be attributed to any other person or institution. San Bilal (sb@ecdpm.org) welcomes feedback on this paper and possible ways forward.

Acronyms

ACP	Africa, Caribbean and Pacific
AFD	Agence française de développement
DFC	Development Finance Corporation
DFI	Development finance institution
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECDPM	European Centre for Development Policy Management
ECSDB	European Climate and Sustainable Development Bank
EDFI	European Development Finance Institutions
EEAS	European External Action Service
EFP	European Financing Partners
EFSD	European Fund for Sustainable Development
EFSI	European Fund for Strategic Investment
EIB	European Investment Bank
EU	European Union
EUBEC	EU Platform for Blending in External Cooperation
FMO	Dutch development bank (Financierings-Maatschappij voor Ontwikkelingslanden)
GDP	Gross domestic product
GNI	Growth national income
ICCF	Interact Climate Change Facility
IIF	Institute for International Finance
IMF	International Monetary Fund
LCI	Low-income country
MDB	Multilateral development bank
MFA	Macro-Financial Assistance
MFF	Multiannual financial framework
NDCI	Neighbourhood, Development and International Cooperation Instrument
NPBI	National Promotional Banks and Institutions
OCT	Overseas countries and territories
SME	Small and medium-sized enterprise
SPV	Special purpose vehicle
UN	United Nations
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
WBIF	Western Balkan Investment Framework
WHO	World Health Organization

1. The prompt EU global response

The **COVID-19 pandemic has major, drastic impacts around the globe**, the extent of which still remains mostly uncertain. The health, human, social and economic costs are huge.

The European Union (EU) has responded promptly and appropriately to address some of the most urgent COVID-19 challenges within its borders, and beyond. One task consists in mobilising vast amounts of resources to address the health emergency and its immediate economic impact, as well as to prepare for a longer-term recovery. Another task consists in fostering collective coordinated responses, at the EU level and internationally, for solidarity reasons but also for self-interest.

While the EU is working hard to bring a collective European response, including a long-term recovery package of unprecedented size,[1] it should not lose sight that its own recovery will also depend on the global recovery. This recovery and ultimately the stability of its neighbours and key partners will affect the success of its own way out of the crisis.

This interdependence, combined with the moral imperative, are among the driving forces for the EU Global Response to COVID-19 outlined on 8 April, in particular towards poorer and more vulnerable countries and people. This prompt **EU Global Response has many positive features**.

It recognises the need for "a fast, massive and coordinated response to protect all people, save lives and tackle the economic fallout", and identifies the leading roles the EU will play. Europe is the largest donor, providing about 57% of the total global development assistance and remains a major international economic power, still accounting for about a fifth of the global economy. The von der Leyen's European Commission has also the ambition to have "a stronger Europe for the world", with the EU becoming a more prominent geopolitical actor.

The EU framed its response around the 'Team Europe' **approach**, a useful framework for combining the firepower of the EU institutions, including the European Investment Bank (EIB) and the EU member states and their financial institutions, as well as the European Bank for Reconstruction and Development (EBRD). This approach has the potential to draw on the diversity of European actors for greater complementarity and synergy.

The 'Team Europe' approach is also meant to enhance the EU leverage on the international scene and promote global coordination with multilateral institutions (the United Nations (UN) system, and notably the World Health Organisation, the Bretton Woods Institutions - the World Bank and the International Monetary Fund (IMF), the World Trade Organization), but also with an active engagement in the G7 and G20, and with regional partnerships such as with the African Union.

[1] The Eurogroup agreed on 9 April a €540 billion COVID-19 economic rescue package for states, companies and workers, endorsed on 23 April by the Council, and also agreed to work towards an economic recovery package. The Franco-German initiative for Europe foresees a recovery fund of €500 billion. Spain proposed a recovery fund of up to €1.5 trillion, while the European Parliament asked for a € 2 trillion recovery package, matching the European Commission internal own estimates for the stimulus package needed could reach € 2 trillion. On 27 May, the European Commission proposed a Recovery Plan for Europe totalling €2.4 trillion, composed of €1.1 billion for the long-term 2021-2027 budget of the EU, up to €750 billion borrowed by the Commission in a new recovery instrument Next Generation Europe, and €540 million of the safety nets for workers, business and sovereign already agreed on 23 April.

The EU reallocates €15.6 billion (see Table 1), keeping a strong focus on Africa and the Neighbourhood, articulated around three broad priorities:

- **emergency response action**: immediate needs to address the health crisis and related humanitarian emergency;
- **support research, health and water systems**: support to combat the spread of the coronavirus, improving hygiene, water and sanitation systems, supporting research to develop health solutions and making health systems more resilient;
- support to **address the socio-economic consequences** of the COVID-19 crisis, including in the longer-term recovery (see Box 1).

Box 1: Some key socio-economic priorities in the EU global response to COVID-19

- **Providing guarantees and liquidity provisions to local banks** via international financial institutions and European development finance institutions, supported by the European Fund for Sustainable Development (**EFSD**);
- **Macro-Financial Assistance (MFA)** Instrument for the Western Balkans and Neighbourhood countries
- Supporting temporarily national governments via technical assistance, direct budget support and if relevant concessional financing, complementary to World Bank and IMF interventions, to adopt fiscal, monetary, social and public health policy reforms so as to, amongst others, prioritise public expenditure for socio-economic development and poverty reduction;
- Supporting temporarily **financial intermediaries, such as public banks and supervisory/regulatory bodies**, via technical assistance or guarantees to adopt more conducive financing strategies and regulatory frameworks, and have improved access to concessional financing;
- Supporting the **private sector** – in particular small and medium-sized enterprises (**SMEs**) and the self-employed – via **guarantees, liquidity provisions and technical assistance** to the private sector:
    - **supporting local banks via international financial institutions and European development finance institutions** to have increased **access to liquidity support**, **working capital** and **trade finance**;
    - further **reorienting guarantees from the EFSD towards shorter-term risk-sharing on loans for micro-entrepreneurs and SMEs**.
    - The Commission welcomes the reactivation of the **Vienna Bank Coordination Initiative**, which will help banks to remain actively engaged in financing the economies of EU and partner countries.
- Providing **public sector loans from the EIB**, notably for healthcare equipment and supplies;
- Working with international organisations, partner countries and the European private sector to **build strong and resilient value chains in strategic sectors** and ensure that sustainability, labour rights and corporate social responsibility criteria are respected throughout value chains despite the drop in demand and when the economy recovers;
- Promoting **forms of debt relief** (under consideration by multilateral financial institutions, in particular by the IMF) especially in countries affected by the coronavirus downturn.

Source: European Commission - HRVP, 2020.

Table 1: Overview of EU Contribution to 'Team Europe' Global Package (€ billion)

Total EU Contribution to Team Europe Global response Package		**15.642**
Priorities	Emergency response action	0.502
	Strengthening research, health and water	2.858
	Socio-economic consequences	12.281
Geographic areas	Africa	3.25
	• North Africa	1.19
	• sub-Saharan Africa	2.06
	Neighbourhood	3.07
	• Southern	2.072
	• Eastern	0.962
	• Western Balkans	0.412
	• Turkey	0.388
	Asia and Pacific	1.22
	Africa, Caribbean and Pacific (ACP) region	0.291
	Latin America and Caribbean	0.918
	Overseas Countries and Territories (OCT)	0.111
Other	European Fund for Sustainable Development (EFSD)	1.42

Source: European Commission, 2020b

Given the resources available to the EU are limited in the last year of its current pluriannual budget cycle, the EU has started to quickly **reallocate its support**, redirecting resources where it is most needed to address the COVID-19 pandemic, simplifying some of its procedures, fast-tracking and front-loading its support wherever possible, in line with some of our recommendations.

In this spirit, the EU has for instance partly adjusted its **European Fund for Sustainable Development** (EFSD), beefing up some of the guarantees for the proposed investment programmes most relevant for COVID-19 and readily operational (on health, support to SMEs and agriculture, local currency facility and support to local authorities). This means that other proposed investment programmes have been postponed to the next long-term budget of the EU for the period 2021-2027.

In doing so, the EU has shown its ability to respond quickly given the existing constraints, in an effort to use its existing flexibility and strengthen cooperation.

The **EIB, as part of the 'Team Europe' response**, also committed to contribute up to **€5.2 billion (including some €1.3 billion for sub-Sahara Africa) to address COVID-19 outside the EU**. This accounts to over half of the €9 billion foreseen by the EIB for its activities outside the EU in 2020. The EIB approach consists in focusing on health sector, access to finance for business and SMEs in particular to address liquidity shortage, as well as support to economic resilience for public and private entities (directly and through financial intermediaries), targeting not only health, but also other vulnerable sectors such as tourism and hospitality, trade, public services. The EIB is doing so by reallocating and fast-tracking investment (with simplified and accelerated procedures), scaling up existing credit lines, increasing concessional financing, supporting existing clients and initiating new investment, providing technical assistance and sharing expertise. As part of 'Team Europe', the EIB follows the EU 'policy first' principle in complementarity with the EU support, including through blended finance, combining loans and grants, and guarantees (including under the EFSD boosted programmes, as in the case of the EIB's SME access to finance programme). The EIB cooperates and partners with the UN organisations (WHO, UNDP, UNICEF), local public and private financial entities, and other international and European development finance institutions.

Overall, the initial **EU Global Response to COVID-19 will reach up to some €20.8 billion**: €15.6 from the EU and €5.2 billion from the EIB.

EU member states are also adapting their development cooperation to respond to the COVID-19 crisis, including with **their development finance institutions (DFIs)**, which have also committed to collectively work together, under the DFI Alliance. Other bilateral financial institutions have reframed their engagement, adopting specific initiatives, such as the Agence française de développement (AFD) COVID-19 – Health in Common initiative, a €1.2 billion initiative (combining €150 million of grants and €1 billion of loans) to address the immediate health dimensions of the COVID-19 pandemic and start preparing for the socio-economic aftermath worldwide, with an emphasis on African countries.

The EBRD is also part of the 'Team Europe' response. The EBRD **Solidarity Package of emergency financing for addressing COVID-19 crisis**, initially set at €1 billion, was beefed up over a month later to **€4 billion**. The EBRD now expects that all its activities in 2020 and 2021 will be geared towards addressing the consequences of the COVID-19 pandemic, amounting to up to €21 billion. The immediate focus of EBRD support is to provide, through its "**Resilience Framework**", short-term financing to its existing clients facing liquidity and credit constraints due to COVID-19 and to financial institutions supporting SMEs, balance sheets and existing loans restructuring, local currencies facilities, and technical assistance. The EBRD is also significantly expanding its trade finance (increased by over 30% from March to April, to reach half a billion euros), through its Trade Facilitation Programme.

The **Team Europe global response is a commendable emergency package**. The European Commission and the European External Action Service have jointly set up the basic principles based on core values for the EU international action to address the COVID-19 pandemic, such as interdependence and solidarity, humanitarian emergency, international cooperation and multilateralism, leadership, collective action and coordination, fact-based and transparent, and good governance. They have sought to use and even stretch the available flexibility in the EU mechanisms and remaining budget available. They have initiated a collective response framework to which EU member states and financial institutions can contribute, and have sought to stimulate international cooperation.

But **the EU as whole must and can do more to address the COVID-19 pandemic and its socio-economic consequences**, at home, as currently hotly debated within the EU, and abroad, in particular in more vulnerable and poorer countries. To do so, it must build on its strong track record in supporting poorer countries, mobilise more resources, and deploy in a more ambitious and innovative way its arsenal of instruments and policies, leveraging its financial and political clout in cooperation with partner institutions and countries, at local and global levels.

2. Recommendations for a countercyclical EU response 2.0

The health crisis generated by the COVID-19 pandemic has brought about a combined global supply and demand shocks. This has led to a **major contraction of the global economy**, whose level, estimated around -4% of global GDP, remains vastly uncertain. The EU economy is expected to contract by over 7%, and sub-Saharan Africa will enter into recession for the first time in 25 years, estimated between -2% and -5% of its GDP, at least 5 percentage points lower than projected half a year ago by the IMF. **Fiscal space is drastically reduced** in advanced economies. It is even more so in many developing countries, which have also suffered from trade contraction, large capital outflows, a drop in commodity prices and revenues, a fall in remittances, foreign exchange shock and rising debt burden. Food access and security become more precarious, with an emerging food crisis in some countries. Businesses and the financial sector are more fragile. Jobs and the livelihood of millions of people are critically affected, in particular women, poor and vulnerable people, even more so in the informal economy. To face the large socio-economic challenges of the pandemic, many developing countries, in particular in Africa, will need significant additional support as they face financial distress.

The magnitude of the COVID-19 shock means that redirecting resources where they are most needed to face the emergency situation cannot suffice. Much more needs to be done.

The EU must adopt an ambitious, countercyclical response, collectively mobilising additional resources and other forms of support, aligned to the efforts and dynamics in developing countries, and in particular in Africa. This can be stimulated by the European Commission, but will require the active commitment and participation of the EU member states and their financial institutions. This does not require a departure from the EU initial Global Response, but on the contrary building on it to achieve more ambitious goals.

The European Commission has already shown the lead in the right direction, notably by coordinating the Coronavirus Global Response, a global financial pledging effort for the collaborative development and universal deployment of diagnostics, treatments and vaccines against coronavirus, which reached €7.4 billion in early May.

The EU can take several additional steps to beef up its global response to the COVID-19 pandemic.

2.1. Increased EU budget, leveraging more, in greater synergy

An increased budget...

As recognised by the High-Representative of the EU and Vice-President of the European Commission Josep Borrell "We have put together €15 billion [...]. It is a fact, however, that much more resources would be needed". The obvious point to start, though by far not the only one, is the next EU budget for the 2021-2027 period.

The main part dedicated to the EU external action is the Neighbourhood, Development and International Cooperation Instrument (NDICI) under the EU multiannual financial framework (MFF) 2012-2027. Initially proposed at €78.9 billion (in 2018 constant prices) by the European Commission, the NDICI envelope was revised downward, to €75.5 billion, in the compromised budget tabled by the President of the European Council, Charles Michel, and rejected at the Special European Council of 20-21 February 2020. This was before the COVID-19 shock. Since, the President of the European Commission **Ursula von der Leyen called for a powerful new European budget to be "the mothership" of the COVID-19 recovery**. This is not only needed for the actions within the EU, but also externally, in developing countries. It is not only a moral imperative, but also in European own interest. To help address COVID-19 pandemic consequences is a global public good. As acknowledged by the European Commission's Communication on the EU budget, "[w]ithout a global response, every country and region in the world, including the Union, will remain vulnerable". Besides, supporting recovery abroad helps European economic and strategic interests in partner countries, including by preserving achievement of past aid efforts. As stated by European Commissioner for International Partnerships Jutta Urpilainen, "we are the geopolitical Commission, so I hope we will be able to see that funding for external relations, neighbourhood and international cooperation policy increased in our proposal." There is no better time than now for the EU to stand up for its partners, and show its support. Solidarity, economic self-interest and geopolitical ambitions: all call for a stronger global response from the EU.

In a boosted revised EU budget to cope with COVID-19, the proportion allocated to international and development cooperation and humanitarian aid should be significantly increased. The COVID-19 pandemic has illustrated once more the strong relationship between humanitarian aid and development cooperation in responding to crisis situations. In particular, **the health emergency and economic impact of COVID-19 are closely linked**, and not always in the same sequence, as the economic consequences of the global pandemic have been felt first in some emerging countries. **Greater capacity, flexibility and synergy in combining the two types of support should therefore be enhanced in parallel**.

The budget proposal of the European Commission on 27 May is moving in the right direction, but not forcefully enough. The NDICI envelope remains at a reduced €75.5 billion, as proposed by Charles Michel in February. In that respect, it is a disappointment. Its share of the overall new EU budget, at 6.9%, has not increased.[2] Besides, the Commission does not propose to frontload the NDICI spending to respond to the crisis. **The important good news though is that an additional €10.5 billion from the new temporary recovery instrument Next Generation EU will be made available under NDICI**, bringing the total amount up to €86 billion. Given the temporary nature of Next Generation EU for the period 2021-2024 only, it will allow frontloading for emergency and countercyclical measures. This is a smart way to increase by 14% the financing envelope for development. Yet, this additional €10.5 billion accounts for only 1.4% of the €750 billion total borrowing by the European Commission for the Next Generation Europe instrument, a share that should be increased if the EU were to fully recognise its responsibilities and its own interests in addressing the socio-economic consequences of the pandemic for its own recovery.

Humanitarian aid, which is also not increased and hardly frontloaded, remains at €9.76 billion in the proposed MFF. But thanks to an additional €5 billion under the Next Generation EU instrument, humanitarian aid will in fact jump by 51% to €14.76 billion, in a frontloaded manner. This is the most significant improvement.

[2] It is worth noting that the overall EU budget also remains at the level of Charles Michel's proposal in February (which was not approved by the Council), at €1.1 trillion. Arguably, this is already ambitious, given the European recession, meaning the EU budget will account for a larger share of a higher percentage of EU growth national income (GNI).

...more strategic, leveraging more...

Irrespective of its efforts, the financial means of the EU to respond to international needs will remain limited, as it is the case to address the EU's own needs. **The EU budget should thus be used in a more strategic way**. While grants are and should remain an important component of the EU support, in particular to lower income and more fragile countries, the EU budget can be **used more effectively to mobilise more and a broader range of financial resources**.

Loans and guarantees have been widely used by governments to help address the economic impact of COVID-19, in particular on businesses and financial institutions. The EU can do the same, using its budget to mobilise and guarantee investments. This was the essence, for instance, of the Juncker Plan (the European Fund for Strategic Investment - EFSI), and now the proposed InvestEU in the next MFF, for investment within the EU. The same mechanism is at play in the current EFSD and proposed enhanced EFSD+ under the next MFF. As stated by the European Commission President Ursula Von der Leyen, "[t]he principle — leveraging money that is guaranteed by the member states — the Commission has done it before. This is a huge advantage, so it's known territory … never, ever before at that size, but it has the mechanism, is a well-known, a trusted one and a proven one." The Recovery Plan for Europe proposed on 27 May, and in particular the new recovery instrument Next Generation EU, do entail these strong strategic and leverage dimensions. The same guiding principle should drive the EU global response.

While focusing grants where they are most needed (notably on human capital development), **a greater proportion of the NDICI budget should be allocated to the EFSD+ or similar mechanisms**. The Commission proposal to allocate **an additional €1 billion to the EFSD this year is an excellent news**. A noteworthy characteristic of the EFSD and forthcoming EFSD+ mechanism is that it can be complemented by additional contributions from the EU member states. In setting up the EFSD, the European Commission was expecting EU member states to match its initial €4.1 billion contribution, with the hope to double the amount of investments leveraged, from €44 billion to €88 billion with direct EU member states participation. So far, the external contributions to the EFSD have been very small, at €440 million. **A 'Team Europe' approach could entail a much beefed up EFSD and future EFSD+, under the EU budget, and through additional direct contributions by EU member states and philanthropic investors**. In addition, off EU budget mechanisms can be set in place. This could take the form of a special purpose vehicle (SPV) for EU blended finance and guarantees, as discussed below in Section 2.3, to complement the EFSD(+).[3]

Besides the EFSD(+), **the EU could also directly contribute to the European Investment Bank, with additional funding and guarantee**. Existing mechanisms, such as the ACP Investment Facility and the Economic Resilience Initiative, could possibly be enhanced and reshaped. Alternatively, new trust funds under the EIB's Partnership Platform for Funds could be established, as in the case of the EIB's €25 billion guarantee fund on COVID-19 set up to support EIB activities within the EU.

The EU could also contribute directly to a newly European development bank or mechanism (as foreseen in the current EFSD Regulation (EU) 2017/1601 and the NDICI proposal), an option under consideration, depending on the future EU development finance architecture, as discussed below in Section 2.5.

[3] A similar option is currently under discussion for the EU own internal action, with a possible off-budget EU Recovery Fund. Like for the EU own Recovery Fund, an SPV could have the advantage to enhance the control and hence ownership of the contributing EU member states, and could adopt simplified and fast-tracked procedures. But it could also lead to duplications with the EFSD+. It would also not be accountable to and subject to scrutiny and approval of the European Parliament. Note that in this paper, 'EFSD(+)' is used to refer to both the current EFSD and forthcoming EFSD+.

...enshrined in an integrated approach

To be effective, **investment support cannot be a stand-alone approach**, focused on maximising leveraging. **It has to be transformative, and enshrined in a more comprehensive approach**, entailing other forms of support, and policy engagement. That is, investment support must be accompanied by targeted technical assistance, to help develop and accompany the implementation of a pipeline of projects, but also broader forms of grant (e.g. budget support, aid-for-trade, education, etc.), policy dialogue and regulatory reforms.[4] Building on the rationale of the European External Investment Plan and its three pillars (EFSD, technical assistance, investment climate), investment support should be articulated in a more strategic and integrated approach to programming, in the context of NDICI and beyond.

2.2. Better combine EU efforts, including through DFIs

The 'Team Europe' approach is smart and strategic. It rests on the notion that collective action at the EU level can lead to greater synergies: "the whole is greater than the sum of its parts". In times of crisis, when resources are scarce and efforts required in many directions, a coherent EU response becomes a necessity. Yet, the 'Team Europe' as articulated in the initial EU global response remains short of concrete and coordinated strategic actions. **An EU global response 2.0 should identify concrete venues for enhancing the EU collective action externally**.

The EU and its member states should start by outlining in a transparent manner their respective COVID-19 initiatives outside the EU. They should then identify possible cooperation and synergy at country and regional levels. This endeavour should build on the pre-programming exercise for NDICI, initiated by the European Commission and European External Action Service (EEAS) before the global pandemic at the end of last year. With COVID-19, the programming exercise has been delayed. But the need to respond to the pandemic and its economic consequences **calls for a greater sense of urgency and increased efforts, including at the level of EU member states, to exchange information and identify opportunities for joint efforts and complementarities**.

With respect to investment, **coordination should be strengthened between the respective European financial development institutions**, through the European Development Finance Institutions (EDFI) of course, but also with the EIB, EBRD, AFD (France), KfW (Germany) and CDP (Italy), and with the European policy makers. Within Europe, five leading National Promotional Banks and Institutions (NPBIs) - CDC (France), CDP (Italy), ICO (Spain), BGK (Poland) and KfW (Germany) - have agreed, together with the EIB, to enhance their cooperation and work together in a countercyclical manner to address the COVID-19 economic impact. At the international level, major multilateral development banks (MDBs) have already enhanced their cooperation, and hold weekly virtual COVID-19 related meetings led in alternance by the World Bank and the IMF, to share insights and identify strategic collaboration opportunities.

So far, coordination has been mainly *ad hoc*. Such **flexibility should be preserved**, as it allows variable geometry cooperation in a simple and a rapid response manner. **Yet, more structured and institutionalised forms of coordination and cooperation should be encouraged**.

[4] For instance, building more resilient health systems will require investments, but not only. Support for basic infrastructure, education, training and skills development, innovative research, and appropriate policy frameworks (for health, but also movement of people for medical staff, procurement, etc.) are just random examples of the need for an integrated approach to investment.

The EIB, as the EU bank following a policy-first approach, already collaborates closely with the European Commission and EEAS, and the EU Delegations in EU partner countries, at least in principle, and is involved in many MDBs joint initiatives.

European DFIs have joined forces with their transatlantic counterparts, the U.S. International Development Finance Corporation (DFC) and FinDev Canada, in establishing a year ago the **DFI Alliance**. In response to COVID-19, the DFI Alliance members have committed to work more closely together. EDFIs have also joined forces since early May with other DFIs and MDBs towards enhanced cooperation to help address the COVID-19 crisis. The group of over 25 DFIs and MDBs stresses that "[a]n unprecedented level of coordination is needed" and that "[c]oordinating [their] efforts with the public sector will be needed to promote reforms and create the regulatory environment to attract investors back to developing countries."

Building on these dynamics, **the EU should establish COVID-19 External Investment Response Platform(s)**. The EU and its member states could do so by building on or reviving existing platforms, or setting up new coordination platforms for investments, including to address COVID-19 impacts.

Several existing structures could serve as a potential template. At a strategic level, the EU could seek to revive the EU Platform for Blending in External Cooperation (EUBEC), inactive since late 2018, which could become a new EU platform bringing EU institutions and member states together with their financial institutions. Alternatively, the EU could build on the EFSD Strategic Board structure, expanding it to address strategic coordination beyond the EFSD, fostering coordination between European policy actors and development finance institutions. Another option would be to establish a new COVID-19 Investment Platform drawing on the features and lessons of the Western Balkan Investment Framework (WBIF).

In practice, **coordination can take place at different levels** (headquarter levels and at country/regional levels) **and can take several forms**, from strategic, policy to operational levels. Its composition could also be variable, depending on objective and level adopted. It could include DFIs only (as in the DFI Alliance or group of DFIs and MDBs mentioned above), or DFIs with public entities. It could be restricted to European actors or involved international and local actors as well. A combination of these options could be adopted, for the response to COVID-19 and beyond. For instance, EU investment programming and coordination could start between the European Commission and the EIB. Then other European financial institutions, including the EBRD, and EU member states could be included, to foster a truly Team Europe cohesive approach. Such a European approach should be pursued in constant dialogue with key local and international actors, to ensure local ownership and synergetic relevance.

2.3. Increase the firepower of the EIB and DFIs

The recession induced by COVID-19 has heightened the liquidity and credit constraints faced by many businesses and financial institutions. In the EU, and advanced economies in general, governments and central banks have responded by providing massive loans and guarantees packages, as part of broader fiscal, monetary and regulatory measures. The fiscal constraints in many emerging economies and prevalent pre-COVID-19 vulnerabilities have restrained the state capacity to address the economic impact of the global pandemic, jeopardising public investment capacities and financial sustainability, including for their private sector. Without appropriate remedies, and in the case of a prolonged crisis, this will significantly increase the solvency-risk of many private entities.

DFIs and MDBs have a critical role to play, in the emergency response and longer term recovery process. **So far, they have been very responsive**. By mid-April, major MDBs had already committed €240 billion to help address the COVID-19 crisis. But most of it has consisted in swiftly redirecting their interventions towards health and economic COVID-19 responses, notably by supporting their existing clients, but also beyond, targeting SMEs and financial intermediaries support, trade finance, sovereign and sub-sovereign lending. **The depth of the COVID-19 crisis calls for the MDBs and DFIs to step up their engagement further, so as to increase their overall investment in a countercyclical wa**y.

To more forcefully respond to the crisis, **DFIs must stretch their balance sheet**, increase their prudential flexibility while maintaining their credit rating, increase where appropriate the concessionality (and adjust the structure) of their loans, increase their equity investment, lower at least temporarily their return requirement, and ultimately increase their capital. In general, DFIs have adopted a sound but very conservative approach to their banking activities, while pursuing their sustainable development objectives. With the COVID-19 crisis, **DFIs will have to revisit their business model and modes of operation**, so as to scale up and adjust their engagement and impact. At the same time, DFIs are facing increased and diversified risks combined to greater uncertainty related to COVID-19 and its consequences, including: higher defaults risks from their borrowers and thus potentially higher losses, lower returns, higher currency risk, increased macroeconomic instability, and higher political risk. While their financial model has to be adjusted, **DFIs also need to provide more guarantees to their current and future clients, as well as be able to cover their own risks (through capital increase and/or state guarantees).**

Changes in DFIs operations can partly be done by their internal management, such as redirecting some investment, restructuring some loans, simplifying internal procedures to speed up decision-making and disbursement process, and relaxing internal guidelines from their risk department. But **more substantial adaptations of DFIs require the approval of their shareholders**. Therefore, **EU member states should also become more active shareholders.**

The EU and its member states should set up a coordinated agenda to support an increased firepower of DFIs. They can do so directly through their own development finance institutions, as shareholders of major MDBs and through accompanying mechanisms.

Through its own mechanisms, **the EU can provide additional support to DFIs, foster their blending capacity and offer greater guarantees**. The **EFSD(+)** can be mobilised to that effect, as discussed in Section 2.1. The adjustments to the EFSD guarantees undertaken so far as an immediate response to COVID-19 have left out all the members of the Association of European Development Finance Institutions, to the exception of FMO and Cofides. Yet, a truly European response must include the European DFIs, which account for 50% of private sector investment by European financial institutions (as much as the EBRD and the EIB combined). Additional resources should be allocated to the EFSD (from the EU budget and from EU member states). Provisions should be made to enhance the EDFIs participation in the EFSD and future EFSD+, and provisional modalities should be identified for them to benefit from EU guarantees, or from guarantees from their respective states. The Commission proposal of 27 May to allocate an additional €1 billion to the EFSD this year would make this possible.

Recommendations have been made on how to empower European DFIs to better respond to the crisis,[5] all of which require the concerned EU member states approval. These include “a combination of risk-sharing, capital and new flexibility” to enhance DFIs capacities; in particular, “[g]overnments should replenish capital injections and top-up risk-sharing schemes for European DFIs, while also making more funding available for technical assistance to African businesses.” A coordinated approach at the EU level, notably through EDFI, would be highly desirable.

[5] Key recommendations supported by an eminent group of personalities have been outlined in Alonso et al. (2020), building on the analysis by Bilal et al. (2020).

In considering additional EU responses, it is worth noting that **the EFSD guarantees are not meant to help the DFIs own balance sheet**, but to be passed on to their clients, which are much more needed than ever to help private and public actors in developing countries. Therefore, while the EFSD guarantee does help DFIs, it does not fully solve the increased risk exposure of DFIs in the time of crisis. This can be done either by **increasing the capital of DFIs**, which EU member states can do as shareholders, or by **setting a new guarantee fund**, so as to mutualise a risk-sharing mechanism.

A capital increase of European DFIs might seem costly to European governments which may prefer to focus their limited fiscal space to address challenges in their own economies. This is a short-sighted reasoning. First, DFIs operate on a (quasi) commercial basis, with overall good returns on investment. Second, by intervening now governments would help protect the DFIs' portfolios, preventing future losses. Third, DFIs have a strong leverage, effectively mobilising much needed private capital. Investing on DFIs is an effective investment for Europe, for sustainable development and financial sustainability. It is also worth noting that **a capital increase of the EIB does not increase the EU member states debt**, as it is considered a remote liability, off EU member states' balance sheets. **This makes the EIB an ever more attractive financial institution in times of crisis**.

Capital increase might also be considered more generally for MDBs, as indicated for instance by the Institute of International Finance and by eminent personalities. The EU and its member states should seek to coordinate their position on this issue in each MDB where they are shareholders, as well as the adjustments they would like to promote by the concerned MDBs in response to COVID-19. **A more structured approach to this European shareholders coordination should urgently be put in place**, as recommended already a few months ago by the High-Level Group of Wise Persons on the European financial architecture for development.

European member states should also allow MDBs and DFIs to stretch their balance sheet. Shareholders contribute to MDBs in the form of paid-in capital, as well as unpaid capital, as a guarantee, which can be called in exceptional circumstances. **Should DFIs have recourse to this callable capital, they would significantly increase their firepower**, with an additional financing capacity of over US$1 trillion, and this without jeopardising their credit rating.[6]

Each MDBs and DFIs has its specificity, in terms of business model and context in which it operates. As a consequence, **there is no 'one-size-fits-all' approach** to how best they should respond to COVID-19 and increase their impact. But a 'Team Europe' approach should be explicitly formulated to ensure greater coordination among European shareholders in DFIs and greater coherence and complementarity of their position across financial institutions and other response mechanisms to COVID-19.

Coordination and synergies among DFIs, in particular European ones, should also be strongly encouraged and facilitated (as discussed in Section 2.2.). The establishment and use of trust funds, as under the EIB's Partnership Platform for Funds (see example in Section 2.1), or other forms of special purpose vehicles, such as the Interact Climate Change Facility (ICCF) and European Financing Partners (EFP), jointly owned by European DFIs and the EIB, could be enhanced. This is an attractive way of fostering cooperation, mutualising projects, stimulating syndication, and sharing and diversifying risks, hence allowing some DFIs to undertake projects which they would have otherwise not been able to engage in. The EU and its member states could also directly contribute to the capital of SPVs such as the EFP, or provide guarantees for their operations, to further enhance not only their financial leverage, but also their impact, notably in

[6] Such recommendations have been detailed and analysed in Humphrey (2020), Landers et al. (2020) and Lee (2020a).

poorer and more fragile contexts, and more critical dimensions of COVID-19. Setting such as the EFP can also allow a lead DFI ('the promoting partner') that would benefit from a guarantee (for instance under the EFSD) to extend it to the other co-financing DFIs of the EFP. At the international level, 'Team Europe' could engage in the proposal to set up a Stretch Fund, as a public-private entity to help DFIs taking on more risk and expand the range of their investments towards more impactful and transformative engagement, notably in poorer and more vulnerable countries.

2.4. Support ambitious debt management and relief initiatives

Debt is a major issue for advanced countries and emerging economies alike. While the debt-to-GDP ratio is very much country dependent, it tends to increase for most countries. More critically, the capacity to borrow and servicing the debt, and the cost at which it can be done, is much more limited in some emerging economies and poorer countries. Addressing the debt issue will be paramount for many developing countries. The EU can help in several ways.

First, the EU and its member states can support actions at the G20, G7 and IMF levels, towards a comprehensive global approach. It can do so by fostering united positions among EU member states, in coordination with other leading nations and EU partner countries. These should go beyond the current temporary suspension of debt services for low-income countries (LICs), as agreed mid-April in the G20 Action Plan. It could include supporting **proposals for debt management and debt relief**:

- tailored extension of the temporary suspension of debt services, including towards some most indebted non-LICs countries,
- targeted debt restructuring and cancellation,
- extending the eligibility criteria for debt relief beyond LICs to other emerging economies facing particular distress,
- encouraging private creditor participation to debt relief, such as the Institute for International Finance (IIF) establishment of common terms of reference for the voluntary participation of private sector to the G20 debt initiative,
- IMF reallocation of unused Special Drawing Rights by advanced countries to emerging economies in need,
- the issuance of additional Special Drawing Rights to increase the IMF's resources to respond to the crisis,
- the creation of an international special purpose vehicle, to provide bridge finance for countries in needs, on a voluntary basis, reducing their debt costs,
- mechanisms to provide funds and partial guarantees to government (and semi-sovereign) bonds of specific developing countries, to facilitate their access to financial markets[7].

A 'Team Europe' approach should foster a common EU position on these proposals, working closely with concerned developing countries, and seeking alliances with other creditors. As shareholders of MDBs, they should also seek a way to include MDBs in debt relief, working together with institutions such as the IIF, as well as in dialogue with ratings agencies on ways to prevent a credit downgrading of MDBs for their participation in debt relief initiatives.

Second, **the EU and its member states should enhance their budget support programmes** to countries most affected by the COVID-19 economic consequences, with particular attention to improving the resilience

[7] For instance, as pointed out by Mohanty (2020), to help address the financial crisis in the late 1990s in Asia, "the Japanese government has offered to provide funds and guarantees for the acquisition of sovereign or semi-sovereign bonds issued by other Asian countries", as part of the New Miyazawa Initiative.

of the health sector and the sustainability of socio-economic measures to address the consequences of the crisis. A '**Team Europe' approach should also lead to a better coordination** of the grant-based budget support provided by the EU with the loan-based budget support provided by some EU member states and MDBs, so as to promote greater complementarity, synergies and ultimately impact of the budget support provided.

Third, the EU should consider the **further extension of its macro-financial assistance to third countries beyond its enlargement and neighbourhood countries,[8] in particular towards African countries** most in need.[9] This should be done in close consultation with the IMF and the countries concerned.

The EU should also pursue a strong collective action towards improving the economic governance of developing countries it supports, to ensure transparent and accountable management of public finance and support received. Similar endeavours should be undertaken at the international level, notably by stimulating comprehensive international efforts to effectively tackle illicit financial flows, so as to preserve much-needed financial resources for developing countries.

2.5. Pragmatically tailor the EU financial architecture and pursue partnerships

The EU had engaged in an intensive strategic exercise about the shape and adequacy of the future EU financial architecture for development. The European Commission, building on the European External Investment Plan, has outlined its perspectives in a Communication; the EIB has initially proposed to set a subsidiary for its activities outside the EU, suggested internal reforms to enhance its development activities outside the EU, and positioned itself as the EU Climate Bank; the EBRD has proposed to expand its activities to Sub-Saharan Africa. Following a Franco-German request, the Council has set up a high-level group of wise persons who made recommendations on how to strengthen the EU financial architecture for development. The one that attracted most attention was their **proposal to have one single European Climate and Sustainable Development Bank (ECSDB), either the EBRD, the EIB** or a brand new institution. The rationale was to reduce the perceived inefficient fragmentation of the EU development finance landscape by concentrating energy and political clout behind one single institution. The Council, having dismissed the option of setting a brand new development institution, has launched a new enquiry into which of the EBRD or the EIB would be the most suited, should a decision be made to establish a ECSDB.

In earnest, **this beauty contest between the EBRD and the EIB is rather futile, and appears as a huge distraction in the face of COVID-19**. Rather than wondering which financial institution should be undermined to the benefit of the other, **the principle of the Team Europe approach calls instead for harnessing all possible energies to tackle the pandemic and its disastrous socio-economic consequences.** This means that the EBRD should be allowed, and even encouraged, to expand its geographic coverage to Sub-Saharan Africa. The EIB should be allowed to implement as soon as possible gradual ('6-step' adjustment) reforms, to make it more effective outside the EU. As indicated in Section 2.3, they should both also be allowed to stretch their balance sheet and receive additional capital and guarantees,

[8] The European Parliament and the Council have just approved the European Commission proposal to extend macro-financial assistance for up to €3 billion to ten enlargement and neighbourhood countries to help them address the economic consequences of the COVID-19 crisis: the Republic of Albania (€180 million), Bosnia and Herzegovina (€250 million), Georgia (€150 million), the Hashemite Kingdom of Jordan (€200 million), Kosovo (€100 million), the Republic of Moldova (€100 million), Montenegro (€60 million), the Republic of North Macedonia (€160 million), the Republic of Tunisia (€600 million) and Ukraine (€1.2 billion).

[9] Some of the Sub-Saharan countries most vulnerable to the COVID-19 economic fallouts, in terms of fiscal deficit, debt and balance of payment shocks, include Angola, the Republic of Congo, Ghana, Nigeria, Rwanda, South Africa and Zambia (IIF, 2020b, 2020c and 2020e; see also IMF, 2020d Figure 1.6; and UNECA, 2020a Table 2.2).

as appropriate and possible, following due processes and proper needs assessment. The objective should be to increase their respective firepower, not to arbitrarily restrain it.

As important, efforts should be dedicated to **enhance cooperation between the EBRD and the EIB institutions, with other European financial institutions, and European donors**, as discussed in Section 2.2. This is the essence of the 'Team Europe' approach: fostering cooperation, complementarities and synergies. It is also the most effective way to reduce fragmentation in the short run.

It is **necessary that the European development finance architecture be further harnessed to local dynamics and local institutions, public and private, in developing countries**. In particular, European donors and DFIs should seek to strengthen their cooperation with local development finance institutions, national and regional development banks, as well as private financial institutions. They should seek to accompany and support financing facilities and other mechanisms set in place in several developing countries to cope with the consequences of the COVID-19 crisis, such as business finance facilities. The principle should be to 'work with' (i.e. crowding in) local institutions and finance, not to substitute for them (i.e. crowding out). This is crucial to help enhance the resilience of local economies and institutions, mobilising more resources and strengthening their capacities as they deal with and recover from the crisis.

Cooperation and partnership should also be actively pursued at the local level on the **priorities** already identified in the EU Global Response, including **health, sanitation, climate** (with the urgent need to already prepare for a **green recovery**), and **digitalisation**.

In addition, **much more emphasis should be put on food security** and access to food in the short-term, to prevent a food crisis, and more broadly on **sustainable and resilient food systems** in the recovery phase, to be pursued in an integrated manner.

Moreover, addressing the socio-economic consequences of COVID-19 necessitates to put women at the forefront of the response, because of their vulnerability, but also because of the critical role they play, during the crisis, and for any sustainable recovery. **Women should have a central place in the EU Global Response 2.0 to COVID-19**.

3. Conclusions

The European Union has responded promptly to the unprecedented crisis caused by the COVID-19 pandemic, including by quickly reallocating its development support to developing countries to address immediate COVID-19 challenges. The Global EU response to COVID-19 is a vital first step.

But the emergency and recovery needs are huge, and existing resources will not suffice to support in particular the most vulnerable countries and people. The response needs to be scaled-up to be countercyclical. It must be operationalised in a more comprehensive manner that is well coordinated with the member states.

Given the global economic contraction resulting from COVID-19, very sharp in Europe as well, the capacity to mobilise public resources is limited, including for the recovery phase of developing countries.

The EU should thus seek to adopt a Global Response 2.0, building on the initial one, to more effectively mobilise additional resources, by more significantly leveraging its public funding and efforts, enhancing private finance, creating new cooperations and synergies, among EU and international actors, notably development finance institutions, and developing countries own initiatives. This includes initiatives to stimulate risk capital, promote investment coordination platforms, enhance economic governance, and support debt restructuring and reduction. The Team Europe approach should become a rallying point for the active engagement of EU member states and financial institutions, for the COVID-19 response and achievement of the SDGs. While keeping its priorities, notably towards a value-based approach, resilient health systems, a greening of the recovery and digitalisation, the EU should put greater emphasis on food security and sustainable food systems. Moreover, women should have a central place in the EU Global Response 2.0 to COVID-19.

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- European external affairs
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- Migration
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In addition to structural support by ECDPM's institutional partners: The Netherlands, Belgium, Estonia, Finland, Ireland, Luxembourg, Sweden, Switzerland, Denmark and Austria, this publication also benefits from the European Union's Horizon 2020 research and innovation programme under grant agreement number 770680 (RESPECT project).

ISSN1571-7577

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