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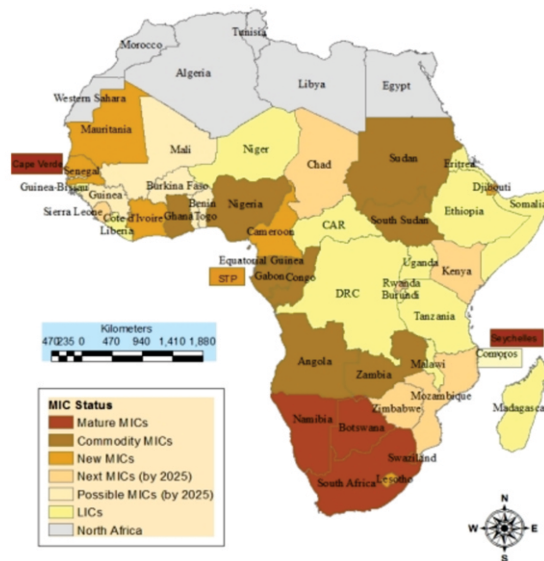
Graduation of Low-Income Countries:
Opportunities, Risks and Challenges for Mobilising Development Finance and Achieving the SDGs in Africa



1. Introduction

*Caption 1: ODA Graduation Map for Africa*Since 1960 when the International Development Association was established, atleast 47 low-income countries (LICs) have joined the ranks of the world's middle-income countries (MICs) with 22[1] coming from sub-Saharan Africa. This signifies the 'strong' and 'sustained economic growth' achieved in most parts of the developing world. Ideally, graduation indicates that a country has achieved and sustained levels of economic growth that entail and affirms its capacity to develop economically with limited to no official development assistance. The benchmarks or thresholds that give eligibility or qualifies a state to graduate include Gross National Income (GNI per capita of not less than $1,230 or income-only of not less than $2,460.[2] Other criterion that may be used include the Human Assets Index (HAI) which should be atleast 66 points or above and the Economic Vulnerability Index (EVI) which should range below an indicator of 32.[3] As a result of these improved indicators, various aspects of the development finance landscape are likely to evolve for these counties, these include the sources of finance and financial instruments available to them, including the volume of aid and the conditions attached to it. More-so, graduation entails that these countries have reduced need for traditional forms of aid thus the likelihood in the reduction in aid receipts from bilateral and multilateral financiers and a fundamental change from grants to loans. The terms and conditions of sovereign loans from multilateral development banks (MDBs) will become harder and more stringent. The shift from grants to so-called 'soft' and then 'hard' loans can also alter the way in which aid is allocated between sectors. This may make financing for social sectors such as health and education dwindle and difficult to resource thereby subduing hopes of fighting poverty and inequality as donor support will be cut-off.

Using the cases of a few select African countries in Table 1, this briefing paper argues that graduating to MIC status is not the end and goal in itself as being a MIC requires sustained growth that is pro-poor; and for African countries: maintaining the middle income status entails the need for political stability and sound macroeconomic management that addresses challenges of structural transformation, human and physical capital deficits and unemployment.

[1] Angola, Cape Verde, Cameroon, Comoros, Congo Republic, Djibouti, Egypt, Eswatini, Ghana, Kenya, Lesotho, Mauritania, Morocco, Nigeria, Sao Tome and Principe, Senegal, Sudan, Tunisia, Zambia and Zimbabwe are the countries meeting the $1,026 – $3,995 income threshold for fiscal year 2020 using 2018 World Bank Atlas method.
[2] The $1.230-$2.460 threshold is the traditional/historical benchmark that has been used over the years
[3] https://www.un.org/development/desa/dpad/least-developed-country-category/ldc-graduation.html

More-so, it argues that graduation reform proposals centred on scaling back multilateral finance are idealistic as they seem to disregard the importance of the concessional loan windows provided by international financial institutions in the fight against poverty, rising inequality and global governance failures that inhibit effective pro-poor policy solutions. In this light, it proposes that experiences from mature MICs need to play a critical role in influencing how and ascertaining that the process and tenets of graduation should be met and sustained.

2. Graduating from IDA

Within the context of development cooperation, graduation entails positive shifts on three separate benchmarks or classification, that is, (i) graduation from multilateral concessional assistance, (ii) graduation from LDC status, and (iii) graduation from Official Development Assistance eligibility. A key determining factor of all three contexts is a country's per capita income, though other factors such as the Human Assets Index (HAI) and the Economic Vulnerability Index (EVI) are also considered.[4] Graduation from multilateral concessional assistance, particularly the concessional windows at MDBs, is based primarily on per capita income, along with creditworthiness. Graduation from LDC status is based on income per capita, vulnerability and the level of human assets whilst graduation from ODA eligibility is based on income per capita alone.[5] It is worth noting that a country's access to concessional finance from bilateral providers and some global funds may also be impacted as income per capita rises and eligibility for IDA support depends on a country's relative poverty defined as a threshold for gross national income (GNI) per capita.[6] However, a country above the operational threshold can be given transitional support for the duration of a replenishment period, which can subsequently be renegotiated during the subsequent replenishment meetings. In such cases, countries will face conditions that are stricter than under IDA, but leaner compared to IBRD terms. Table 1 below shows graduation of selected African LICs to LMICs over the past decade.

Table 1: Selected African Countries' Graduation 2009-2018

Data for calendar year :	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Low income (L)	<= 995	<= 1,005	<= 1,025	<= 1,035	<= 1,045	<= 1,045	<= 1,025	<= 1,005	<= 995	<= 1,025
Lower middle income (LM)	996-3,945	1,006-3,975	1,026-4,035	1,036-4,085	1,046-4,125	1,046-4,125	1,026-4,035	1,006-3,955	996-3,895	1,026-3,995
Upper middle income (UM)	3,946-12,195	3,976-12,275	4,036-12,475	4,086-12,615	4,126-12,745	4,126-12,735	4,036-12,475	3,956-12,235	3,896-12,055	3,996-12,375
High income (H)	> 12,195	> 12,275	> 12,475	> 12,615	> 12,745	> 12,735	> 12,475	> 12,235	> 12,055	> 12,375
Angola	LM	LM	UM	UM	UM	UM	UM	LM	LM	LM
Cameroon	LM	LM	LM	LM	LM	LM	LM	LM	LM	LM
Congo Republic	LM	LM	LM	LM	LM	LM	LM	LM	LM	LM
Eswatini	LM	LM	LM	LM	LM	LM	LM	LM	LM	LM
Ghana	L	LM	LM	LM	LM	LM	LM	LM	LM	LM
Kenya	L	L	L	L	L	LM	LM	LM	LM	LM
Lesotho	LM	LM	LM	LM	LM	LM	LM	LM	LM	LM
Nigeria	LM	LM	LM	LM	LM	LM	LM	LM	LM	LM
Sudan	LM	LM	LM	LM	LM	LM	LM	LM	LM	LM
Zambia	LM	LM	LM	LM	LM	LM	LM	LM	L	L
Zimbabwe	L	L	L	L	L	L	L	L	L	LM

Source: World Bank Analytical Classifications 2020

*Green signifies points of classification change.

The Table points out to the fact that atleast 5 of the selected 11 countries have either graduated or regressed from an economic classification respectively. These are Angola, Ghana, Kenya, Zambia and Zimbabwe. Whilst graduation signifies enhanced growth and sustained economic progress, regression also raises concerns of graduation without sustainable measures to avoid backsliding. Countries such as Angola and Zambia resemble the fears of premature withdrawal and eventual cutting off of IDA aid when a country is not economically stable to tap into the capital markets to finance its development, a move that has several side effects on the graduating countries.

3. Implications of graduating on attaining the SDG targets

Least development countries enjoy various benefits from the global development financing architecture as a result of their LDC status, these include favourable access to markets, trade facilitation, technology transfers and development assistance. However, when these LDCs graduate to MIC status the perception of their economic progress assumes that they would have acquired sufficient capacity to wean themselves from external development

[4] https://developmentfinance.un.org/sites/developmentfinance.un.org/files/AUV_2020%20FSDR.pdf
[5] http://unohrlls.org/en/about-ldcs/criteria-for-ldcs/
[6] http://www.netpublikationer.dk/UM/evaluation_case_study_ghana_may_2018/Html/kap03.html

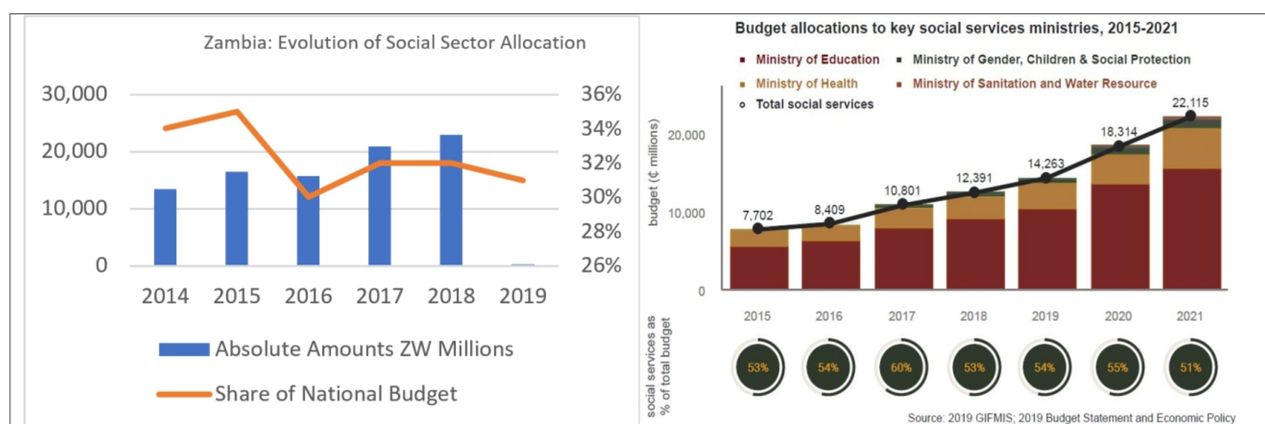
assistance for the provision of quality and equitable social services for their citizens.[7] The graduates are also expected to forge high impact partnerships with international communities for beneficial terms of educational and cultural exchanges, technological transfers, favourable capital market rates and trade amongst other development oriented ventures. Through the process of forging new partnerships, the countries also assume a higher negotiating status within regional and international forums such as the African Union and the African Development Bank, the World Bank, World Trade Organization (WTO) and the United Nations. African states will need to assess what forms of newer partnerships they could enter into and with whom, and the minimum in-country obligations for these. This entails that any country graduating is expected to work continuously towards maintaining and improving on all the standard indicators of development, including human capital development, however with limited to no development assistance, graduation has varying implications on meeting the targets set in the sustainable development goals and this mainly affects the financing of public good related goals such as education, health, social protection and labour programs (SPL)[8]

Although IDA support mechanisms to countries such as Ghana and Kenya are phased out gradually and in a predictable manner, the move from low-income to lower middle-income country status may have several implications. For example, as post-graduation debt service requirements have been increasing, Ghana and Kenya have faced and will face fiscal management challenges as they still endeavour to sustain public investment levels in the longer term through the 40-Year National Development Plan and the BIG Four respectively since these (National Development Plans) are preconditions for achieving the SDGs. More-so besides a potential decline in ODA, the composition of development finance may fundamentally change, altering the size as well as the overall composition of aid allocations, including allocations between sectors and this may have a structural impact on the countries abilities to adequately finance their development sustainably.[9] Graduation will likely increase the demand for alternative sources of external financing. Both Ghana and Kenya have structural current account deficits and are vulnerable to shocks on foreign financing as well as commodity markets bearing in mind the fact that they have a considerable reliance on oil. This is also a similar case for Angola (oil) and Zambia (copper). It is therefore of great importance for these countries to mobilize alternative financing sources to fill the gap in the waning of ODA which is already dwindling at the global level.

Education and Health Spending and implications on Inequality

Education, health, social protection and labour programs are critical sectors of development that when adequately financed they ensure that poverty and inequality are sustainably tackled. On public spending a 2017 World Bank publication notes that the fiscal position of the country in relation to SDG fulfilment for Ghana since graduation to LMIC has had glimmers of hope albeit constraining public spending. Initially, education spending currently represents the largest share of the government's social sector spending activities. Significant investments have been made to improve service delivery through hiring atleast one hundred and fifty thousand additional teachers between 2009 to 2015 in a bid to reduce the teacher-pupil ratios with expectations of a positive student achievement effect.[10] This expected quality effect remains to be seen as education spending has not increased as a share of the total government budget over the 2015 to 2019 fiscal years.[11] For Ghana and Zambia, their graduation vis-à-vis implications on public spending to attain the SDGs shows that the share of social sector spending is declining as illustrated in Figure 1 below:

Figure 1: Social Services Allocation Zambia (Left) and Ghana (Right)



Source: (a) ZIPAR and UNICEF 2019: (b) GoG, UNICEF 2019

7 https://www.odi.org/sites/odi.org.uk/files/resource-documents/12662.pdf

8 https://www.undp.org/content/dam/laopdr/docs/Reports%20and%20publications/2017/5th%20NHDR%20-%20Lao%20PDR.pdf

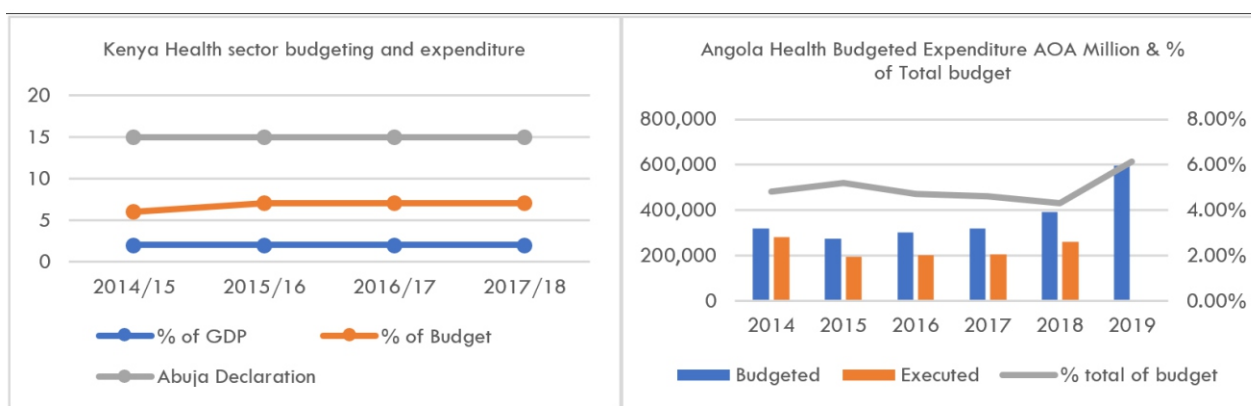
9 https://ferdi.fr/en/publications/graduation-from-the-category-of-least-developed-countries-rationale-achievement-and-prospects

10 http://www.netpublikationer.dk/UM/evaluation_case_study_ghana_may_2018/Pdf/evaluation_case_study_ghana_may_2018.pdf

11 http://www.netpublikationer.dk/UM/evaluation_case_study_ghana_may_2018/Pdf/evaluation_case_study_ghana_may_2018.pdf

When looking at the health sector, comparisons with the overall development in Ghana, its health sector is lagging behind as public health spending is low by international standards. Whilst Ghana made efforts on recruitment of health workers (18 000 were hired between 2009 and 2015) to facilitate service delivery upgrade, continued support from the donor community to the sector has enabled an increase in per capita health spending over the past decade. For Kenya and Angola (Figure 2) spending for health has been commendable with both countries thriving to meet the international standard indice of 15% of total budget for health as stipulated in the Abuja declaration. However, there is concern about public capital investments in the sector as progress in coverage of essential health services has not been impressive. Atleast over 80% of the budget is spent on recurrent expenditures whilst the donor community is still playing a pivotal role in financing the developmental budgets; an act which remains important if the countries are to stay on track towards meeting the SDG targets.[12] This therefore illustrates the fact that graduation should be principled on gradual transition to avoid countries from backsliding as is the case for Angola as shown in Table 1.

Figure 2: Health Sector Spending Kenya (left) and Angola (right) 2014/15-2019



Source: KIPPRA 2019, UNDP Angola 2019

4. Impact on Public Finance Management

a. Public Debt Sustainability

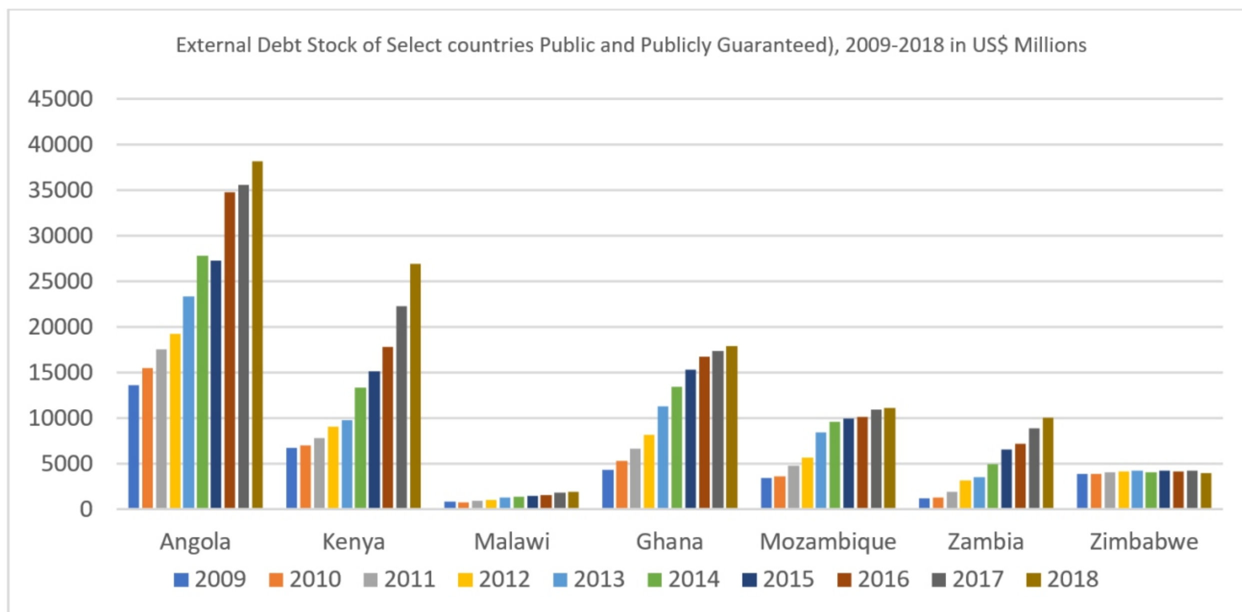
With a likely decline in the flow of ODA in the future, the governments of Ghana, Kenya, Zambia and Angola amongst other African countries such as Zimbabwe moving from low income countries to middle income will need to rely on other alternative sources of revenue to fill the gap for the dwindling ODA disbursements. More expensive non-concessional financing which is likely to replace ODA may be the main source of alternative financing for these countries. However, this may affect the public finance management capacities of these countries as they struggle to adequately resource their development domestically. Not only will the availability of revenues through interests on principal be affected but also on the countries' debt sustainability where current trends point toward a looming debt crisis on the African continent.

Long-term public and publicly guaranteed (PPG) external debt for selected countries that graduated from LIC to LMICs in Figure 3 shows a rising trend in external debt stocks with Angola's stocks reaching $ 38.2 billion in 2018 from $13.6 billion in 2009 whilst that of Ghana rose to $17.9 billion in 2018 from $5.3 billion from the point of its graduation in 2010. As for Kenya, there has been a steep increase in external PPG since its year of graduation (2014) from $13.2 billion to $26.8 billion as at 2018, a 49.2% increase in only four years.[13] The increase in public and public guaranteed external debt stocks, and especially the shift towards non concessional domestic public debt, implies that the government will have to spend more on interest repayment and debt service therefore exerting pressure on the fiscus as there tends to be fewer resources available for critical development interventions such as education, health and social protection.

[12] UNDP Angola Economics Unit Technical Brief: Based on the Law 16/19, 27 June 2019.

[13] https://data.worldbank.org/indicator/DT.DOD.DPPG.CD

Figure 3: Public and Publicly Guaranteed External Debt Stocks of Selected Countries 2009-2018



Source: AFRODAD 2019 Debt Profiles and World Bank Data 2019

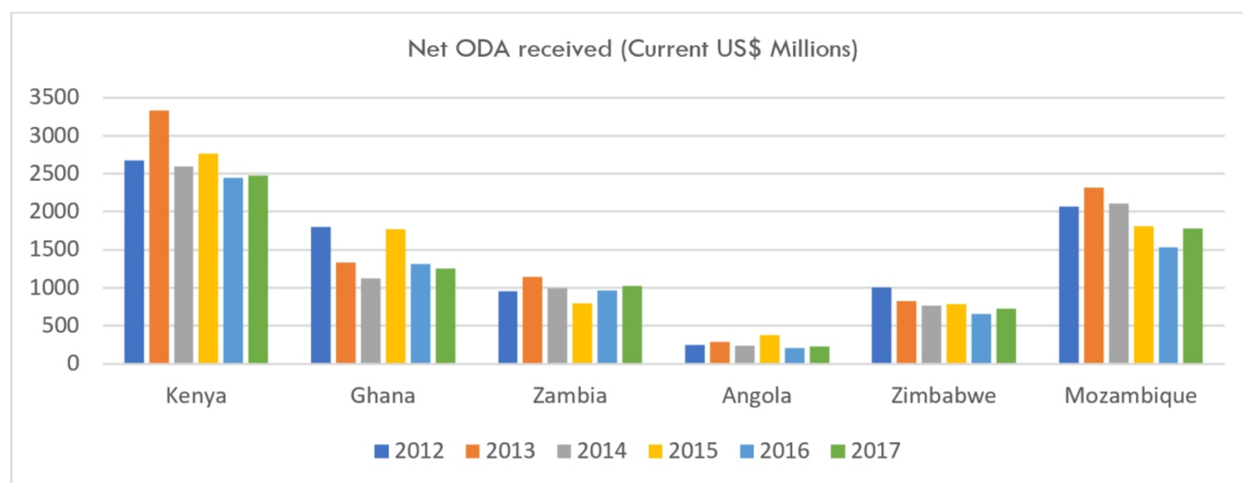
Whilst debt financing is not all bad, the rising trends in its accrual and increased appetite by African countries is worrying. In Southern Africa, Angola accounts for about 60% of the commercial credit in the region while South Africa and Mozambique account for 15% and 8% respectively. In East Africa, between 2009 and 2018 bilateral debt grew by 146% with main contributors being Ethiopia (27%), Sudan (26%) and Kenya (24%).[14] Public debt in bonds also started around 2014 with Kenya raising significant debt in bonds followed by Ethiopia and Rwanda. This increase in debt accrual is mainly driven by infrastructure deficits and a large proportion have been financed through blended finance mechanisms such as public private partnerships (PPPs). However, this fast-paced growth of loans especially from commercial banks threatens debt sustainability in the African regions since interest rates are high and restructuring the debt may be complicated thus the need to caution graduating countries from immediate weaning of from official development assistance.

5. Weaning and Graduating from ODA

Given that the global development finance landscape is shifting rapidly as ODA becomes a less prominent financial flow to developing countries. The global development community is grappling with what this entails for resources devoted to fighting poverty, reducing economic inequalities as-well as gender disparities, considering that ODA has been playing a critical role in financing initiatives on these. ODA in itself includes IDA-type loans but not IBRD-type ones (which are classed as OOFs), so IDA graduation is deemed to automatically reduce ODA disbursements directly, it also reduces ODA indirectly by signalling to bilateral donors to reduce their support and or harden their terms of aid eligibility. Whilst there is no debate that ODA disbursements to LICs have been low as compared to middle income countries, it is however concerning, for graduating countries, that IDA ODA also decreases upon and within the graduation zone and this can be seen as illustrated for Kenya and Ghana whom within the first 1st and 2nd years into graduation respectively saw ODA disbursements to Kenya significantly falling from $3.3 billion in 2013 to $2.5 billion in the year of graduation in 2014 and steadily decreased to $2.47 billion as at 2017. For Ghana, net disbursement fell from $1.7 billion in 2012 to $1.2 billion in 2017.

[14] AFRODAD 2019 Debt Profile

Figure 4: Net ODA to selected countries (current US$ millions)



Source: OECD and World Bank Aid Data 2019

These subsequent decreases of ODA have implications on financing for the social sectors ODA has traditionally targeted over the years. This comes amid the facts that social services budget allocations are pre-dominantly spent on re-current expenditures such as wages thus reduced or frozen budget support through aid would dent progress made on poverty alleviating initiatives aimed at achieving SDG targets. Given this dilemma, questions get asked; **When is the right time to graduate?** The seemingly simple answer to the question of when the time is right for a country to graduate from receiving ODA is when (i) poverty has been reduced to an acceptable minimum level in that country, and (b) the loss of ODA will not threaten the progress made.[15] This would be the ideal phenomenon as determining the sustainably precise indicators remains a controversially complex process because the GNI per capita and credit worth criteria touted by the World Bank has limited poverty and inequality assessment. As such, IDA and its donors should re-evaluate the policy on how to determine a country' readiness to graduate and what type of support should be prioritized as concessional finance contributions to a given country diminish.[16] This is critical as this paper asserts that ODA and other concessional finances are even still critical in the development and transition of middle-income countries.

6. Conclusions and Recommendations

Given the achievements, opportunities and challenges entailed by graduation from low income status to middle income. It is important that the graduation process be encompassed by the tenets of the development agendas of nations, regions as well as the global development goals in which world leaders assented to leaving no one behind. As such, transitions from LIC to MIC should ensure that targets and progress on the SDGs remain pro-poor with the fight against equality and poverty being central to all efforts. In this regard, both graduating countries and the global development finance system ought to ensure inclusivity and realism in the development of states and should thus take heed of the following recommendations:

a. *Recommendations to countries*

- There is need for graduating African countries to articulate and be clear on priorities for external development finance and develop strategies for managing the transition away from aid. The terms and conditions are, in most cases, likely to change at the global level especially rises in interest rates
- African countries also need to prioritise tax mobilisation and tax administration as a key element of their financing strategies.
- Graduating countries need to protect gains achieved in the social sectors by ring-fencing the share of government spending that goes to social sectors especially education and health. This should also encompass synergies with effective civil society led initiatives as CSOs are critical in social sector programming.
- Countries need to plan for changes in the

[15] https://oxfamilibrary.openrepository.com/bitstream/handle/10546/620879/dp-financing-development-vietnam-ida-graduation-251019-en.pdf

[16] Ibid

composition of development finance to mitigate fiscal risks and rising costs, especially when countries have limits to external borrowing.

- Given the scourge of climate change, countries also need to increase their efforts to mainstream their climate change response within sectoral and provincial programs, mobilize resources for climate change response activities, human and technical resources as-well as promoting public awareness on climate change and its impacts on the environment and vulnerable populations.

b. *Recommendations to the Global Aid System*

- IDA needs to adjust its graduation process transparently, reflecting the current indicators and data available. The GNI per capita indicator was useful in the last century, but it is long overdue to be replaced by a combination of poverty and social development adjusted indicators.
- Development partners should also affirm that meeting the SDGs is the operational objective for the allocation of aid, with country-level SDG-based poverty reduction strategies at the heart of development support based on a combination of needs and aid effectiveness criteria through which risked are assessed.
- IDA transition periods should be extended beyond the current timeframe, ensuring a gradual decline in access to concessional financing (instead of such financing peaking shortly before graduation) that is responsive to the country context including inequality and more comprehensive development indicators.
- The recent focus on private sector involvement in aid should not distract from the need to use ODA for priority public investments in social sectors. Directing ODA to social sectors will maximize progress in achieving the SDGs in sectors for which private sector involvement is either not possible or risks having a negative impact on poverty and inequality

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ON DEBT AND DEVELOPMENT
31 Artkinson Drive, Hillside, Harare
+263 242 778531/6
afrodad@afrodad.co.zw

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