BROOKINGS | QUALITY. INDEPENDENCE. IMPACT.

Financing for Development
Regional Perspectives—Africa
G-24 Technical Group Meeting

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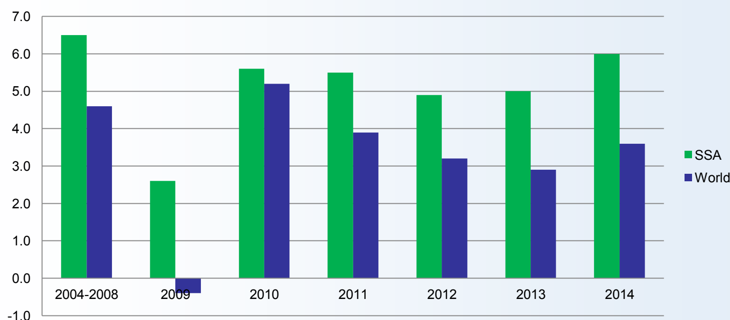
Africa's Convergence

- Over the past 10 years, SSA grew 5% per year and at this rate, it can DOUBLE its size before 2030.
- Over the same period, the world economy grew 3.2% per year.
- SSA's GDP is projected to rise by at least 6% in 2014.
- Its GDP per capita grew from $220 in 1970 to $1,600 in 2012



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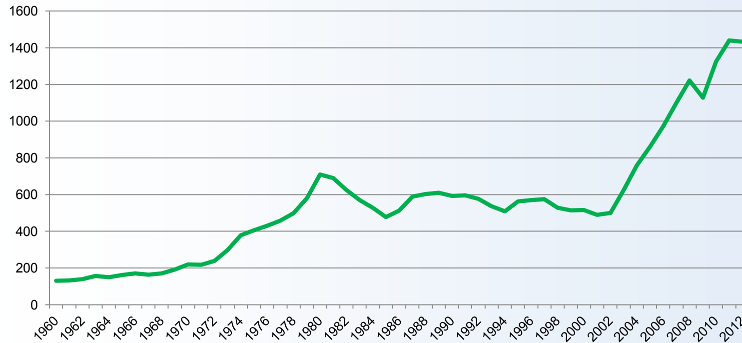
Africa's Convergence

Sub-Saharan Africa
GDP per capita (current US$)



Source: World Bank Development Indicators

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The "Africa Rising" Narrative

May 2000

December 2011

March 2013

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Africa's Convergence

- Africa's GDP per capita is not growing fast enough to converge to the level reached by "peer" countries (Brazil, Chile, Indonesia, Malaysia, Singapore, S. Korea, Thailand, & Vietnam):
  - » 1970: $100 GDP per capita for SSA and peer countries.
  - » 2012: $170 GDP per capita for SSA vs. $530 for peers.
- Rapid economic growth has not resulted in sufficient job creation and reduced inequality and there has been uneven progress towards achieving the MDGs.
- As a result, African policymakers are focusing on economic "transformation."
- Funding Africa's transformation is a key priority.

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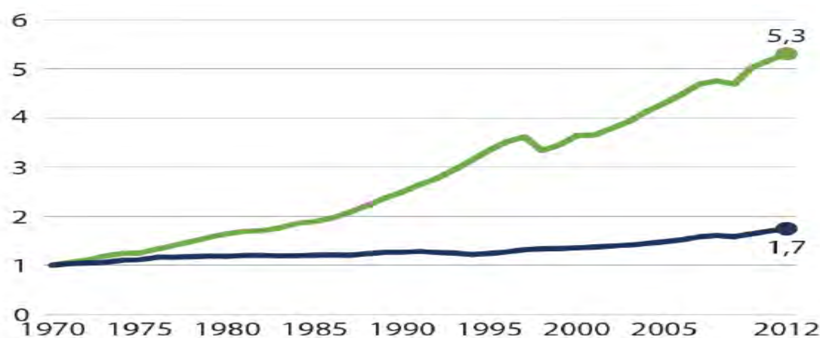
Africa's Convergence

SSA and Peer Group: GDP per capita
(1970 =1)



Sub-Saharan Africa
Peer Group
Brazil, Chile, Indonesia, Malaysia, Singapore, South Korea, Thailand, & Viet Nam

Source: ACET (2014)

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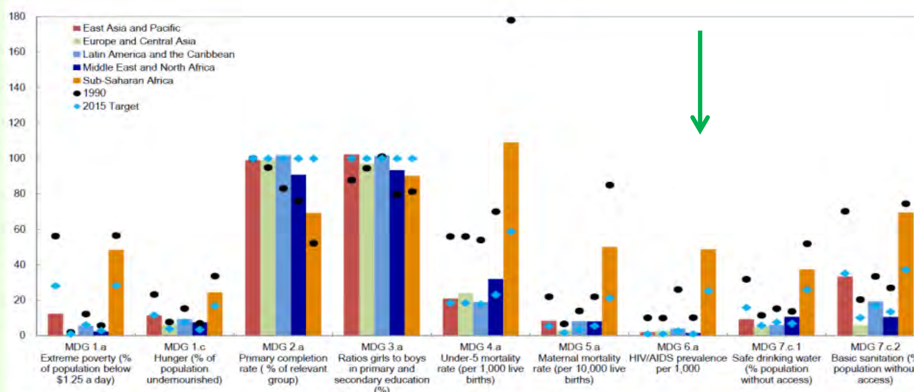
Inclusive Growth

- There has been uneven progress towards achieving the MDGs



Sources: World Bank Development Indicators; and IMF staff estimates.

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Finance for Development

- **Current models of Finance for Development seek to attract MORE finance:**
  - ✓ most resources will continue to come from domestic resources and countries should continue efforts to invest in stronger tax systems, broaden their domestic tax base, and build local financial markets;
  - ✓ Raising domestic revenues to expand public services and investments remain vital for sustainable growth and creates ownership and accountability for public spending;
  - ✓ However, domestic revenues alone—especially in low-income and fragile countries—will not be enough given the scale of the resources needed to attain the SDGs
  - ✓ External finance (ODA, FDI, portfolio & loan flows, remittances) and other flows will help complement domestic resources.

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Finance for Development

- **Current models of finance for development seek to attract BETTER finance:**
  - ✓ External flows can bring risks such as the volatility associated with *hot* money (short-term and volatile capital flows).
  - ✓ The vulnerability of countries to the volatility of private capital flows can be reduced by attracting more stable long-term finance.
  - ✓ Efforts are under way to match the demand for long-term funding for development with the potential supply from institutional investors including sovereign wealth funds, private corporations, development banks, and other investors.

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Financing for Development

- International initiatives in Monterrey and Doha have two interrelated and mutually reinforcing objectives:
  - » **Stability** of the global financial system.
  - » **Reallocation of global investment** toward sustainable development.

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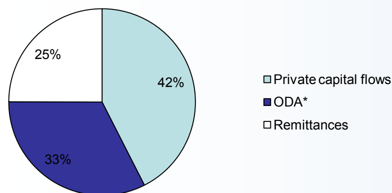
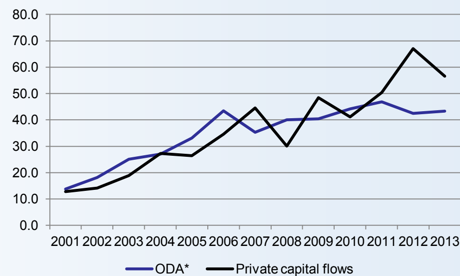
12 years after Monterrey

- Private capital flows (FDI, portfolio Flows, and loan) to SSA grew by 19.4% per year to reach $67bn in 2012 from $14bn in 2002.
- Private capital flows have overtaken ODA.

SSA: Total External Flows (2013)





Sources: IMF

Sources: IMF

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Finance for Development 12 years after Monterrey

- FDI remains the engine of private capital flows with South-South investment from BRICS countries rising quickly.
- FDI averaged about 75% of total private capital flows to SSA.
- BRICS countries' share of FDI flows reached 25% in 2010.
- Portfolio flows—negligible in 2002—have averaged $9.5bn over the decade and have grown faster since 2006.
- Remittances have averaged $21.8bn over the decade or twice (some SSA countries receive 10% of GDP in remittance flows).
- Illicit Financial Outflows may have been twice as important as ODA.

ODA 12 years after Monterrey

- ODA is not growing all that much but there is growing interest in the use of aid to support/work with private sector;
- G8 pledged at Gleneagles in 2005 to increase aid by $50bn by 2010, half of which would go to Africa.
- Ultimately, aid increased by $30bn and only $11bn of this went to Africa.
- More recently, aid to the continent fell from 2012 to 2013 and the latest forecasts have aid to the continent falling further (OECD aid data).
- Non-OECD aid is almost certainly trending up thanks to China.

ODA 12 years after Monterrey

- Aid to Africa can claim some responsibility for the dramatic improvements in human development in the past couple of decades, especially in health.
- The link with economic growth is more tenuous. That's partly because aid has been less focused on this objective, but also there is less certainty about whether aid in support of growth is effective.
- There is growing interest right now in the use of aid to support and work with the private sector, including from the US, the UK, Australia, Canada, and others. Whether this will deliver results remain unclear.

FDI 12 years after Monterrey

- As Africa consolidates its macroeconomic fundamentals and improve governance, many countries can aspire to attract FDI.
- FDI flows exceeded ODA flows in 17 countries in 2005-2012, compared to 8 countries in 1990-2000.
- But most FDI flows go to natural resource-rich countries. Even land is attracting investors, raising land tenure and environmental issues
- Non-OECD FDI is also certainly trending up thanks to China and other BRICS countries, which account for more than one quarter of capital investment to the continent.
- Some small fragile countries receive the most FDI as a share of GDP with associated vulnerabilities.

FDI 12 years after Monterrey

- In most SSA countries, the linkage between FDI in extractive industries, local firms and employment markets, and domestic financial systems are tenuous;
- How can FDI to SSA be associated with knowledge and skills transfer from multinational companies to the domestic private sector?
- At what stage of the value chain should governments require local content? Or should they?
- How are domestic education and training policies taking into account current or future FDI?

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Remittances 12 years after Monterrey

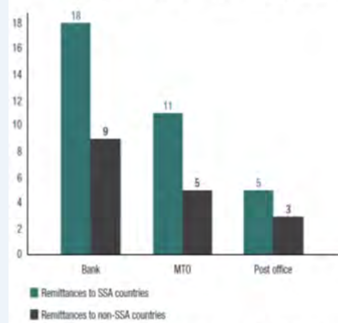
- Remittances to Africa are the most expensive in the world and intra-regional remittances are even more costly.

U.S. dollar cost of transferring $200

5 Most Costly Corridors in USD	Average Cost	5 Least Costly Corridors in USD	Average Cost
South Africa > Zambia	21.06	Saudi Arabia > Pakistan	1.73
South Africa > Botswana	20.18	Singapore > Thailand	2.05
South Africa > Mozambique	19.81	UAE > India	2.68
South Africa > Angola	19.55	UAE > Sri Lanka	2.87
South Africa > Malawi	19.51	Singapore > Bangladesh	3.03

Source: World Bank

Africa's disadvantage: % cost of transferring $200



Source: Remittance Prices Worldwide database of the World Bank, 2013.

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African countries perspective

- African countries have gone a long way to developing their own development strategies, both individually and regionally in the context of the African Union's focus on economic transformation.
- Infrastructure is a key priority (AfDB) and many countries have sectoral plans in infrastructure (PIDA), agriculture (CAADP), sustainable energy, health (Global Fund programs), education, regional integration.
- Increasingly external sovereign borrowing is being used to implement the agenda. Domestic portfolio equity markets have attracted foreign investors.

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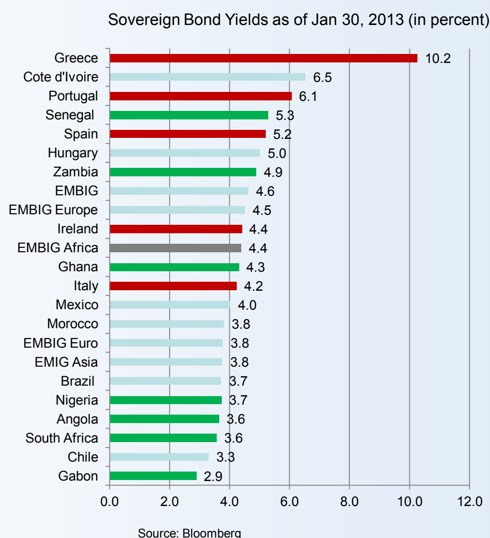
Eurobonds

- SSA countries have been able to tap international bond markets…
- Are debt management practices keeping up?



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Foreign investors' perspective

- Foreign investors favor natural resources-rich countries, *hot* money investments and sectors where cash flows can be identified and ring-fenced (ITC and the success of mobile phone in Africa, terminal concessions, power generation, banking and retail services).
- Outside those sectors, perception of risks are typically high and foreign investors focus on risk mitigation strategies (guarantees, insurance such as from MIGA). However, debt limits on non-concessional borrowing may prevent African governments from giving their own guarantees.
- Governance is often seen from the perspective of reducing risks and increasing the stability of regulation and policy volatility. How about competence and capacity?

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Frontier Markets

- African frontier markets are becoming attractive foreign investors.

Source: MSCI

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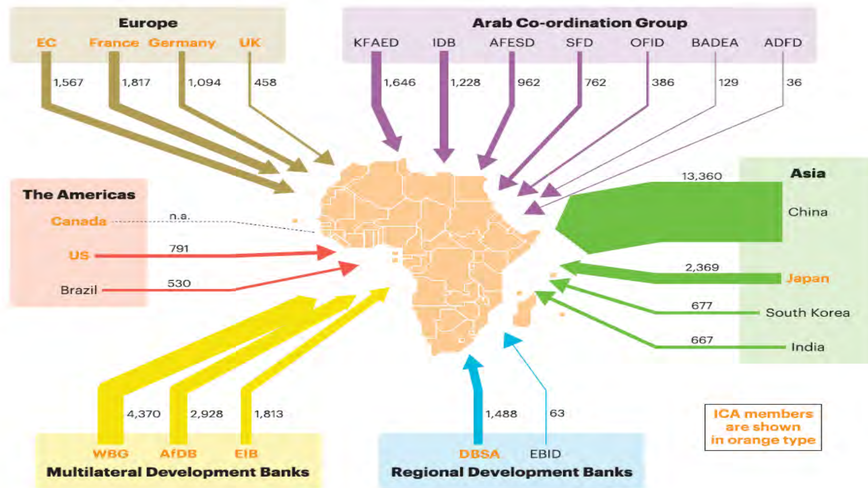
Bilateral donors' perspective

- There is a spectrum of models:
  - ✓ China stand out in terms of its supply of large-scale funding for infrastructure projects and the speed of its delivery.
  - ✓ US Power Africa model is based on leveraging private sector resources and the coordination of 12 US agencies.
  - ✓ US-AGOA is non reciprocal while EU-EPA is not; AGOA focus on getting a better uptake in utilization (phytosanitary standards, non-tariff barriers, infrastructure, value chains)
  - ✓ Coordinating bilateral donors: like herding cats?
  - ✓ Interesting development: Guinea's iron ore (Simandou) investment framework between Rio Tinto, Chinalco, and World Bank Group (IFC).

Multilateral donors' perspective

- Current initiatives to help fill the infrastructure gaps include:
  - ✓ Africa 2050 (AfDB), Global Infrastructure Fund (World Bank Group), Infrastructure Consortium for Africa, Private Infrastructure Development Group but also Power Africa (US), China Infrastructure Bank…
  - ✓ Focus on attracting long-term funding from the private sector but so far (outside China) most efforts are on establishing a pipeline of "bankable" projects
  - ✓ Is there excessive focus on the money and financial innovation (e.g. green bonds, infrastructure projects as an asset class)?
  - ✓ Will we create orphans such as urban projects? Are we taking into account all stakeholders (domestic private sector and SMEs, public sector, especially utilities)

Who's financing Africa's infrastructure?



Source: Infrastructure Consortium for Africa (ICA)

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Conclusions

- **More and Better finance will not be enough to attain the SDGs:**
  - ✓ How can we attain a virtuous circle between external and domestic finance and policy objectives?
  - ✓ How should new growth opportunities and Africa's transformation agenda lead to changes in donor behavior and in the private sector?
  - ✓ Is there excessive focus on attracting more finance? What financiers require may not always be the best from a welfare perspective.

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Conclusions

- **More and Better finance will not be enough to attain the SDGs:**
  - ✓ Are we paying enough attention to all types of external finance? How different are remittances as a source of finance? Do they help develop domestic financial markets? Can they lead to more investment in addition to consumption?
  - ✓ How about illicit financial flows? Should African governments adopt policies such as thin capitalization rules? How can they better negotiate contracts?
  - ✓ What is the potential role of technology? How about financial infrastructure?

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Conclusions

- Recent trends in Africa point to five additional areas to encourage the reallocation of global investment toward sustainable development:

1. Redefining and rethinking the role of aid: coordination is needed in areas such as infrastructure.
2. Getting more "bang for the buck": Governments need policies to associate financial flows (FDI) with the other inputs of sustainable growth such as the transfer of skills and technology, and job creation. Carefully calibrated local content regulation can work.
3. Strengthening South-South partnership: China is standing out in terms of supply of funds but there is a need for more transparency and long-term sustainability analysis.

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Conclusions

4. Reducing illicit financial flows: international buy-in is needed; regulation such as thin capitalization rule could help.
5. Engaging the African diaspora: Beyond reducing the cost of remittances, there is a need to tap the potential of this source of private finance for "better" consumption (health and education), investment and financial deepening.