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# Table of Contents

**Acknowledgements** **vi**

**I. Introduction** **1**

A. Economic context 2

B. Political context 3

C. African development priorities 3

D. Finance and other means of implementation 4

**II. Finance since the Monterrey Consensus: Trends, lessons and challenges** **5**

A. Public domestic resources 5

B. Domestic private financial flows 6

C. International private financial flows 12

D. Public international resources 17

E. Trade 19

F. Conclusion: lessons and challenges 22

**III. Policy priorities for development financing** **25**

A. Challenges of structural transformation 25

B. Development priority I: Investments in people 26

C. Development priority II: infrastructure for structural transformation 28

D. Development priority III: Agriculture and sustainability 30

**IV. Issues and challenges for increased mobilization of development finance** 33
A. Mobilizing the public sector 33
B. Domestic resource mobilization by the public sector 33
C. International public finance 38
D. Multilateral and bilateral development banks 42
E. National development finance institutions 43
F. Mobilizing private finance 44
G. Non-financial means of implementation and systemic issues 51

**V. African priorities for financing structural transformation** 54

**References** 56

## Figures

Figure 1: Taxes as a percentage of gross domestic product by country income category 6
Figure 2: Domestic credit to the private sector (2002-2013) 7
Figure 3: Domestic credit to the private sector (2013) 8
Figure 4: Growth in domestic credit to the private sector (2002–2013) 8
Figure 5: Saving rates (2002-2014) 9
Figure 6: Stock market capitalization (2002-2012) 11
Figure 7: Investment funds* (2002-2010) 11
Figure 8: Foreign direct investment (2002-2013) 13
Figure 9: Portfolio flows (2002–2013) 15
Figure 10: Remittances (2002–2012) 16
Figure 11: Official development assistance as a share of GDP (2002–2012) 19
Figure 12: Other official flows (millions of United States dollars) 20
Figure 13: Regional shares of global merchandise exports 21
Figure 14: African trade volumes with key regions 22
Figure 15: Sources of infrastructure finance (billions of United States dollars) 29
Figure 16: Country programmable aid relative to tax revenue 34

Figure 17: Sector allocations of official development assistance in Africa 40
Figure 18: Country programmable aid per capita and country income (above) country programmable aid per person living in extreme poverty and country income (below) 41

## Boxes

Box 1: Mobilizing official development assistance for structural transformation 26
Box 2: African capacity-building 28
Box 3 Mobilizing international public financing for climate mitigation and adaptation 30

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# I. Introduction

Two years before the Monterrey Conference on Financing for Development, which was held in Mexico in 2002, Africa was labelled "the hopeless continent" by The Economist magazine. Two years before the 2015 conference in Addis Ababa, the same magazine called Africa "the hopeful continent". Stories of optimism and praise for African economic progress are now common place in the world's media.

Africa's share of global financial direct investment (FDI) is rising, with the continent frequently described as the investment destination offering the highest returns in the world. Rather than being confined to the resource sector, foreign investors are increasingly attracted to the burgeoning consumer sector that is serving the growing African middle-class. Africa has started the transition from an originator of commodities to an originator of (and destination for) finished goods.

What does this mean for Africa's agenda following the Addis Ababa Action Agenda of July 2015? First and foremost, in contrast to Monterrey, the international community should no longer perceive financial assistance to Africa as money wasted, or best confined to the social sectors. At the Addis Ababa negotiations, the debate was about balancing investments for structural transformation and growth against the immediate needs of poverty alleviation and inclusive development. The Addis Ababa Action Agenda includes several new commitments by Governments, including a new social compact to provide social protection and essential public services for all, a global infrastructure forum to bridge the infrastructure gap, an "LDC package" to support the poorest countries, a technology facilitation mechanism to advance the Sustainable Development Goals, and enhanced international tax cooperation to help raise resources domestically and substantially reduce illicit financial flows by 2030.

But the swing from foreign pessimism to optimism also poses risks for Africa, namely the perception that help is no longer so urgently needed. This may sound far-fetched in view of the continent's many development needs, but there is a well-documented tendency for financial markets and policymakers to overreact to good (and bad) news.[1] Africa remains

1 For example, Maor (2012) on policy, and Shiller (2005) on financial markets.

a continent with urgent development needs, but it is now also a continent that is relying more on its domestic resources and where international support will be channelled for structural transformation and inclusive growth. African Governments know that they are responsible for their countries' development and that financing for development is as much about their own actions as it is about international support.

## A. Economic context

The economic outlook for Africa remains relatively bright, but external conditions have become less favourable. Although Africa's growth is less reliant on raw materials than in the past, they are still a main driver of economic activity.

Forecasts from the World Economic Situation and Prospects report (United Nations, 2015a) indicated that the rate of African economic growth would rise from 3.5 per cent in 2014 to 4.6 per cent in 2015 and 4.9 per cent in 2016. Growth is being driven by consumer confidence, an expanding middle class and improvements in the business environment. Although some countries are benefiting from increased investment in mining and natural gas production, the pattern of economic activity is becoming more broad-based, with the fastest growing countries witnessing expansion in the financial services, telecommunications and transport sectors.

While the global economic context has worsened, African economies have been more resilient than ever.[2] Growth forecasts have been revised downwards recently, but only moderately so. In its January 2015 World Economic Outlook update, the International Monetary Fund (IMF) trimmed its forecasts for growth in sub-Saharan Africa for 2015 and 2016 by almost a percentage point in each year, to 4.9 per cent and 5.2 per cent, respectively, and revised them downwards again in April to 4.5 per cent and 5.1 per cent, respectively (IMF, 2015). Those adjustments reflected falling commodity prices, combined with diminished expectations about medium-term growth in many advanced and emerging market economies.

One of the most important external factors for Africa is the performance of its major trading partners. China has been Africa's largest trading partner since 2009 and now accounts for roughly double the volume than that of the next nearest trading partner, the United States of America (Sun, 2014). Natural resources account for around 80 per cent of China's imports from Africa. Chinese economic growth fell from 7.8 per cent in 2013 to 7.4 per cent in 2014, a shade below the Government's target of 7.5 per cent.

Prices have fallen for a broad range of important African commodities (platinum, gold, diamonds, iron, phosphates and copper), affecting economies from South Africa to Morocco. As of January 2015, oil prices in United States dollars had declined by about 55 per cent since September 2014 (IMF, 2015), although prices have since rebounded somewhat. Algeria, Angola, Cameroon, the Congo, Equatorial Guinea, Gabon, Libya and Nigeria are African countries where oil production is most important to the economy.

Some African economies, which are net commodity importers, may benefit from the recent price changes, but many more African countries are reliant on

2 The April 2015 update of the IMF World Economic Outlook headlined its coverage of Africa with, "Resilience in the Face of Headwinds".

commodity exports so the overall impact of lower prices is negative. In particular, fiscal space will shrink in economies that are reliant on commodity exports. African macroeconomic and fiscal policy is widely regarded as having improved in recent years – Africa's average fiscal deficit widened from 3.6 per cent of gross domestic product (GDP) in 2013 to 4.6 per cent in 2014, but the deficit should narrow to 4.2 per cent in 2015 (ECA, 2015a). The picture, however, is a mixed one. In some countries, fiscal deficits widened as a result of front-loaded infrastructure investment, and in others, because of higher levels of recurrent expenditure. Lower government revenue from commodity exports will put some countries under fiscal pressure, and borrowing costs have risen for countries perceived to be exposed to that dynamic. Some countries face potential sustainability issues – for example, in Egypt, Ghana and the United Republic of Tanzania, deficits are expected to average 8 per cent, 10.7 per cent and 7 per cent, respectively, of GDP over 2014 through 2016 (ECA, 2015a).

## B. Political context

The overall picture of Africa is one of positive political and social development. Those seeking examples of deteriorating political and social conditions can find them, but those cases represent a minority of African countries.

On the political front, outright autocracies are largely a thing of the past, but robust democracies with genuinely free and contested elections are not yet the norm in many African countries. The Polity IV Project, which is run by political scientists at the University of Maryland in the United States, scores countries along a spectrum of qualities for democratic and autocratic authority, and characterizes the majority of African countries as having "mixed, or incoherent, authority regimes" (Gylfason, 2013). Since 1990, however, what are termed as "fully institutionalized democracies" have been on the rise in Africa, and are now present in roughly a third of African countries (although this rising trend has experienced some setbacks since 2008).[3]

Similarly, while some African countries remain afflicted by violence, most are not. The continent's ability to tackle conflict has been greatly strengthened – approximately 65 per cent of peacekeepers deployed to the United Nations and the African Union peace operations in Africa are now Africans, representing a major increase since 2002, when the African Union was formed.[4] The African Union has recently backed a 10,000-strong multinational force to neutralize the Boko Haram movement in Nigeria. Peace and security has been identified as a top priority for Africa in the sustainable development agenda.

## C. African development priorities

The first pillar of Africa's development priorities, as articulated in the common African position on the 2030 Agenda for Sustainable Development, is structural economic transformation and inclusive growth. In part, this priority stems from the concern that the benefits of Africa's resources have been

3 There are many approaches to evaluating political systems; other approaches paint a different picture. For example, the Economist Intelligence Unit Democracy Index 2014 classifies Mauritius as the only full democracy in Africa, while 27 countries are classified as authoritarian or a democracy in name only (Economist Intelligence Unit, 2014).

4 United States Department of State, African Leaders Summit, 4-6 August 2014. See https://www.whitehouse.gov/us-africa-leaders-summit.

concentrated in a few enclave sectors and limited to narrow segments of society. Africa is the only developing region where the number of people living in extreme poverty has been rising – from 290 million in 1990 to 414 million in 2010 (United Nations, 2014) – as population growth outweighed the number of people rising out of poverty.[5] Poverty in Africa includes limited access to education, healthcare, housing, potable water and sanitation.

Many social indicators have improved, but the ambitions embodied in the Millennium Development Goals have not been met in most countries.[6] For example, the under-five mortality rate fell from 177 deaths per 1,000 live births in 1990 to 98 deaths in 2012, representing a decline of 45 per cent, compared to the Millennium Development Goals target of two thirds. The ratio of girls to boys enrolled in primary school is approaching parity in many countries, and has reached parity in 18 countries, although progress at the secondary and tertiary levels has been much slower. A similar story of creditable progress – but with much more to be done – holds in the case of HIV/AIDS, where the rising incidence has now been reversed in Africa, and access to antiretroviral drugs has increased. The HIV/AIDS incidence rate declined from 0.85 to 0.32 over the 1995-2012 period, but the number of people living with AIDS is now roughly four times higher than it was in 1990 (United Nations, 2014).

5 The proportion of Africans living in extreme poverty fell from 46 per cent in 1990 to just under 40 per cent in 2011 (World Bank PovCal database, 2015).

6 Although scholars have long argued that the Millennium Development Goals were poorly calibrated to the African contexts, demanding rates of progress that was often far more rapid than historically achieved by today's rich nations. For example, see William Easterly, "How the millennium development goals are unfair to Africa", *World Development*, vol. 37, No. 1, pp. 26–35 (2009).

While the Millennium Development Goals are widely acknowledged to have driven progress in Africa, they also had some deficiencies from an African perspective that must be tackled by the Sustainable Development Goals (Lopes, 2014). In particular, the Millennium Development Goals: had limited focus on economic growth and transformation; did not sufficiently emphasize the role of domestic resource mobilization; tended to neglect issues relating to the quality of service delivery; were silent on inequality, with the exception of goal 3 of the Millennium Development Goals[7]; and, disproportionately focused on outcomes with limited consideration of the enablers of development, thereby excluding the role of factors such as infrastructure and peace and security in facilitating socioeconomic advancement.

## D. Finance and other means of implementation

The present paper concerns the mobilization of domestic and external resources for African structural transformation. The credibility of the financing for development agenda will rest on all means of implementation, which includes not only financial resources, but institutional capacity-building, trade and technology transfer, and systemic issues such as the governance of international financial institutions. These issues will be discussed briefly in chapter III.

7 Goal 3: Promote gender equality and empower women.

# II. Finance since the Monterrey Consensus: Trends, lessons and challenges

Financial flows to Africa have changed dramatically since the Monterrey Consensus of 2002. These changes have brought considerable opportunities and challenges to the region, as it seeks financial resources to meet urgent development needs. This chapter will review these trends.

The chapter will conclude by examining how financial flows evolve as countries develop, and as they graduate from low-income to middle-income status. It will also examine how African countries might anticipate financial flows to evolve in the near future. These expectations should inform the ongoing policy dialogue to mobilize finance for Africa's structural transformation.

## A. Public domestic resources

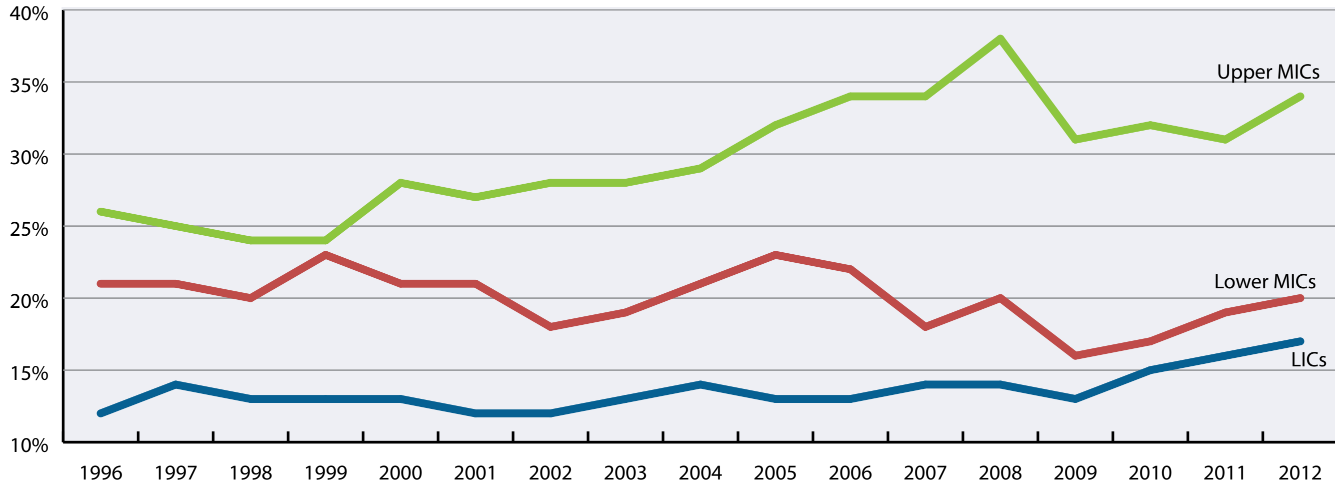
Public domestic resources are the most important source of development finance. In terms of volume, they are the largest: total external financial flows into Africa amounted to $200 billion in 2014; domestic taxes $530 billion (AfDB, OECD, UNDP,[8] 2014). Domestic resources are also the key to fiscal sustainability and African self-sufficiency. Public resources are a uniquely powerful form of finance for development because they can be spent at the discretion of Governments in the pursuit of national development strategies, and can be invested in efforts to combat poverty and achieve other development objectives without requiring a short-term financial return. To a great extent, private flows are spent in the pursuit of private objectives, and may not be well aligned with African development priorities.

Domestic resource mobilization is also bound-up with wide issues of State legitimacy and improving public sector accountability and effectiveness; progress on taxation often reflects (and requires) growing State capacity in the broader sense.

On the basis of headline numbers, tax revenue has grown significantly in Africa: total collected tax revenue in Africa grew from $137.5 billion in 2000 to $527.3 billion in 2012. The majority of this increase,

8 AfDB, African Development Bank; OECD, Organization for Economic Cooperation and Development; UNDP, United Nations Development Programme.

**Figure 1:** Taxes as a percentage of gross domestic product by country income category




*Abbreviations: LICs, low-income countries; MICS, middle-income countries.*

*Source: African Economic Outlook (AfDB, OECD, UNDP, 2014).*

however, was accounted for by natural-resource related revenue. In 2012, resource revenue was roughly $242 billion. With respect to non-resource revenue, there have been recent signs of improvement, especially in low-income African countries that have long-struggled with low levels of domestic resource mobilization (see figure 1).

Tax capacity is below its potential in many African countries but it should be possible to improve performance by introducing revenue-enhancing policies and practices, and improve tax administration and management. The experience of low-income countries in Africa suggests that it is possible even for such countries to increase tax revenue by 0.5 to 2 per cent in one to three years and by 2 per cent to 3.5 per cent over periods of five to ten years. It is therefore possible for tax revenue to increase in the coming years, with supportive domestic and international reform (European Development Report, forthcoming).

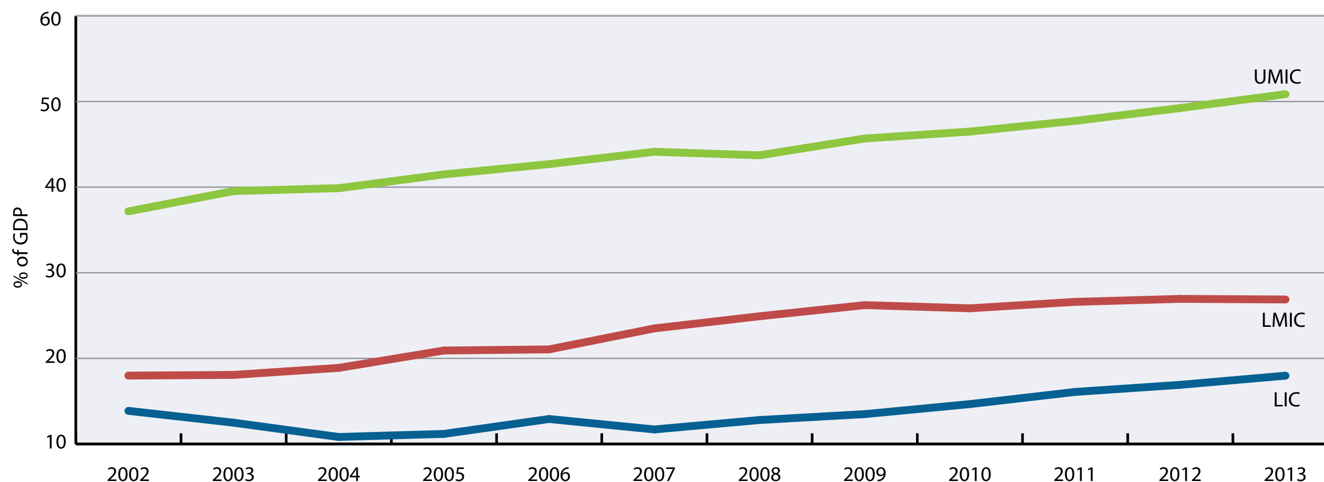
## B. Domestic private financial flows

Three aspects of domestic private financial flows are focused on: credit to the private sector, savings, and the development of capital markets.

### 1. Domestic credit to the private sector

Domestic credit tends to increase with per capita income, reflecting financial deepening as economies grow. Upper-middle income countries showed the highest levels of credit, rising from 37.1 per cent of GDP in 2002 to 50.8 per cent in 2013 (see figure 2). South Africa dominated, with private credit being 156 per cent of GDP in 2013. Namibia, Cabo Verde,

**Figure 2:** Domestic credit to the private sector (2002-2013)




***Abbreviations:*** LIC, low-income countries; LMIC, lower-middle income countries; UMIC, upper-middle income countries.

***Source:*** World Development Indicators (World Bank, January 2015a).

Morocco, Tunisia and Mauritius also achieved rates exceeding 50 per cent of GDP by 2013 (see figure 3).

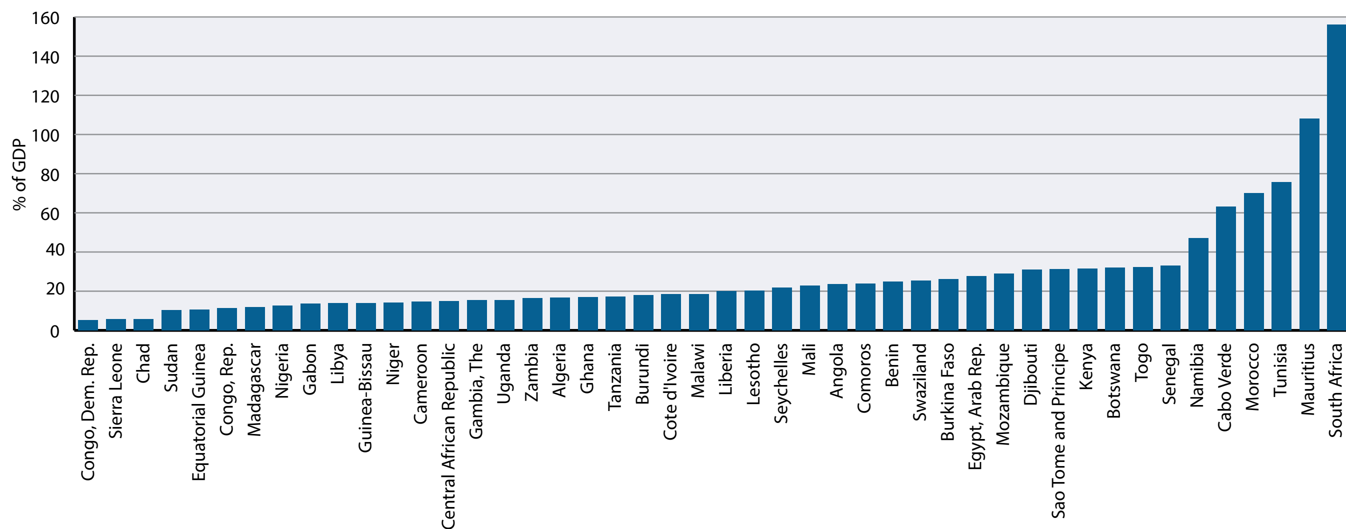
Levels of domestic credit to the private sector remained shallow for lower-middle income countries and low-income countries, but showed stronger growth. Lower-middle income countries' domestic credit averaged 17.9 per cent of GDP in 2002, rising to 26.9 per cent in 2013, an increase of 49.4 per cent – the strongest of any group. Low-income countries' domestic credit averaged 12.5 per cent and 17.9 per cent of GDP in 2002 and 2013 respectively, a growth rate of 29.7 per cent (see figure 2).

These rising levels of domestic credit are important because they indicate improvements in levels of financial access for both households and corporations – particularly small and medium-sized enterprises for whom access to finance remains a significant constraint to growth (Beck, and others, 2011).

Such rising levels of domestic credit, however, need to be assessed not only in relation to their absolute levels, but in relation to the use of credit and its impact on structural transformation. In some African countries, growth in credit by the private sector either has not fully used available funds for lending, or has been directed into sectors that are suboptimal for structural transformation.[9] In relation to not fully using funds, many banks in the region continue to be adverse to risk and hold high levels of liquid securities – reflected in liquidity ratios well above regulatory thresholds – such as government securities, or limit lending to selected low risk borrowers, such as

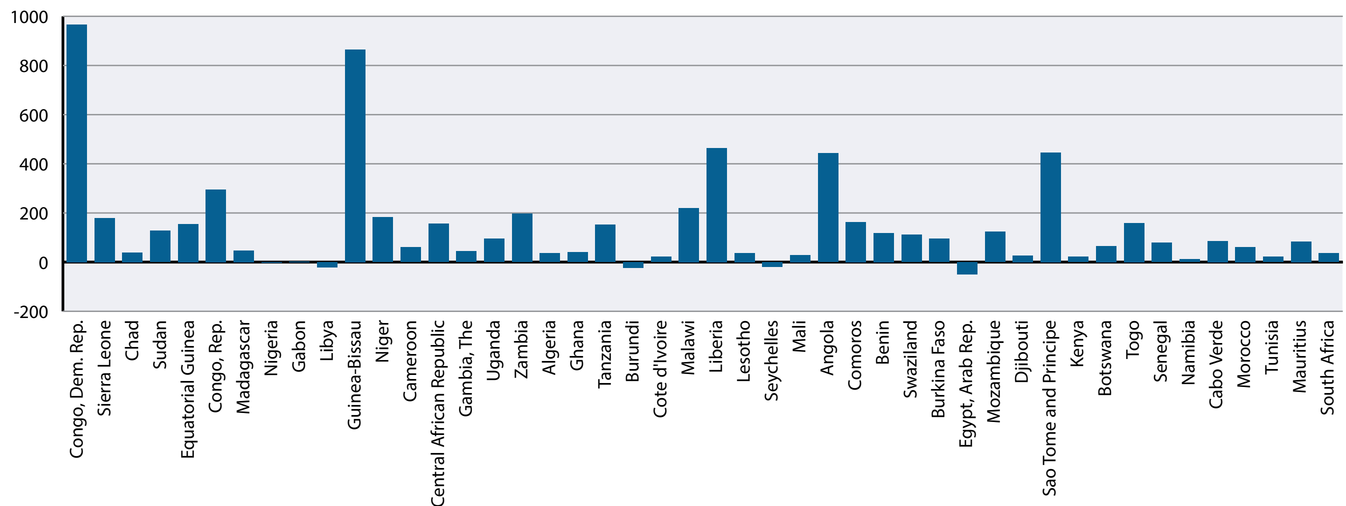
9 Ghana, Kenya, Nigeria and Zambia.

**Figure 3:** Domestic credit to the private sector (2013)




*Source:* World Development Indicators (World Bank, January 2015a).

**Figure 4:** Growth in domestic credit to the private sector (2002–2013)




*Source:* World Development Indicators (World Bank, January 2015a).

top tier businesses. This restrains lending, especially to the small and medium-sized enterprise sector.

Even where there has been growth in the ratio of credit to GDP, much of the expansion of credit has been to sectors that make only indirect contributions to economic growth, rather than financing investment. This has included significant portions of credit growth being accounted for by consumer finance and short-term business activities. Part of the explanation for this lies with the incentives faced by commercial banks, which, although now expanding into lending that has higher risk profiles, are attracted to short-term lending and high returns. By contrast, there has been limited growth in credit for sectors important to structural transformation, including agriculture, manufacturing and infrastructure (Tyson and Patel, forthcoming).

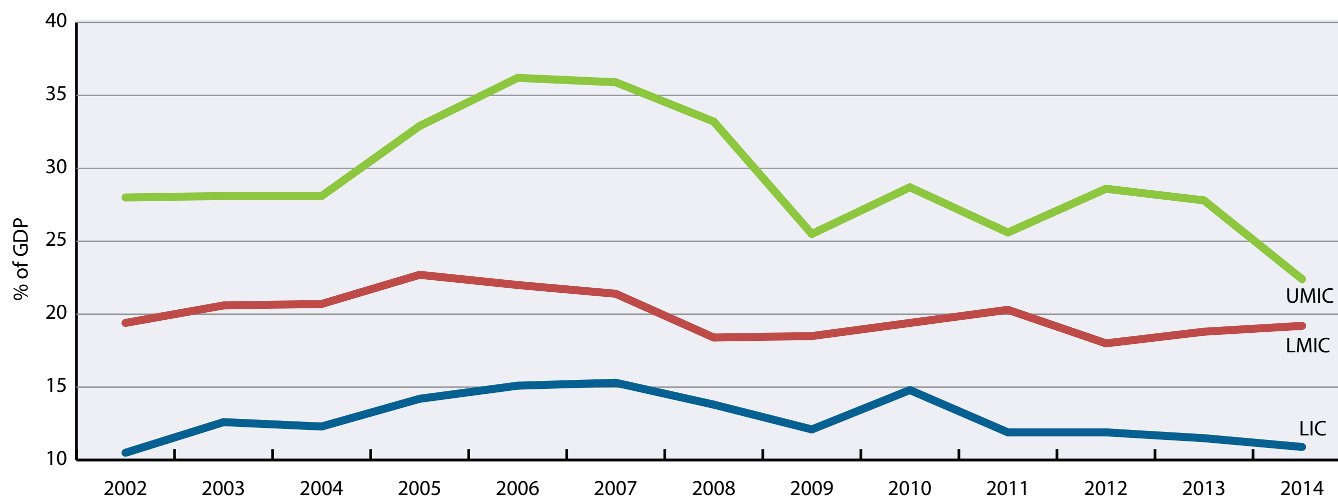
Growth in credit relative to GDP notwithstanding, the overall lending to sectors critical to structural transformation remains constrained.

## 2. Savings

Mobilizing domestic savings is an important goal in developing financial systems. Savings by households provide a stable, low cost and low risk source of financing compared to, for example, international private capital flows (African Development Bank, 2009).

African savings rates, however, are the lowest for any region globally (African Development Bank, 2012) and progress has been limited since 2002. Savings rates for lower-middle income countries and low-income countries have been effectively stagnant between 2002 and 2014 (see figure 5). Low-income country savings were 10.5 per cent of GDP in 2002 and 10.9 per cent in 2014. Lower-middle income country savings were 19.4 per cent of GDP in 2002 and 19.2 per cent in 2014. While progress has been mixed, some countries have made great strides to raising domestic saving rates, such as Ghana, which had rates below 10 per cent for decades, but since

**Figure 5:** Saving rates (2002-2014)




*Source:* International Monetary Fund (2014a).

2010, has been around 20 per cent – Ethiopia and Uganda have also raised saving rates by around 5 to 10 per cent of GDP over the past decade.

Upper-middle income country rates declined sharply over the period 2002–2014, with savings being 28.0 per cent of GDP in 2002 and 22.4 per cent in 2014. This decline was partly due to a collapse in savings in countries such as Libya. Even when Libya is excluded, saving rates showed little growth with other African upper-middle income country saving rates. This contrasts unfavourably with upper-middle income countries globally whose 2014 saving rates averaged 32.8 per cent of GDP. Both GDP and savings, however, increased in absolute terms.

These issues are partly driven by the strong correlations between saving levels and per capita income and with the use of formal financial service in developing economies (African Development Bank, 2012). Even where financial access is expanded – as it has in any African country since 2002 (Beck, and others, 2011) – saving rates remain dependent on economic growth being achieved.

## 3. Capital markets

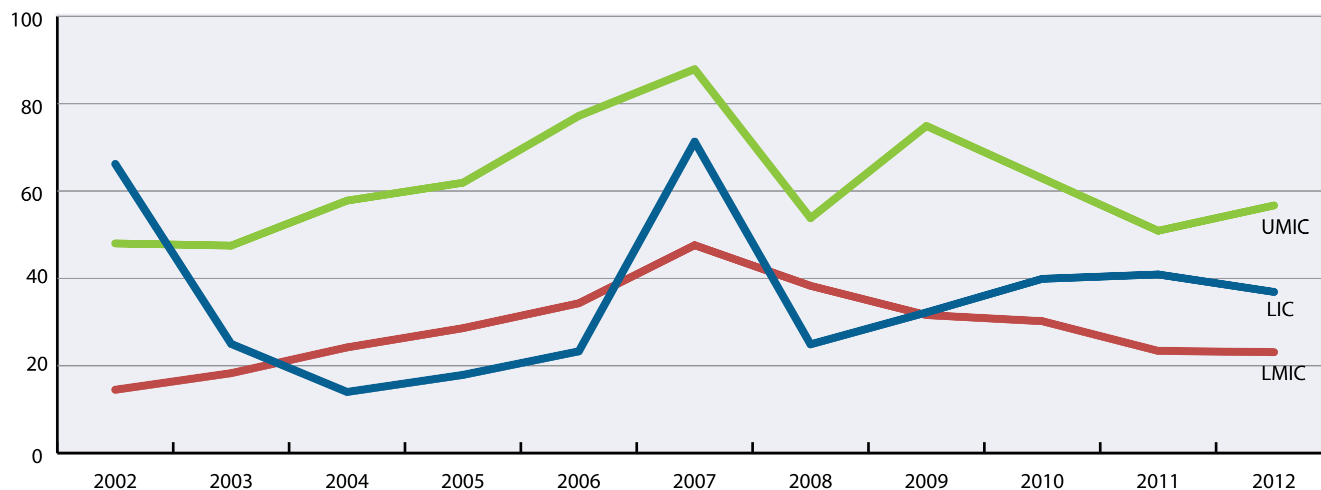
Capital markets – compromised mainly of equity and bonds – are essential components of the financial infrastructure needed to support private financing for development. In mature financial markets, capital markets predominantly serve professional investment funds. These include, regulated funds that manage savings for households and corporations (such as pension funds) and less regulated funds (such as hedge and private equity funds).

Domestic capital markets in Africa remain underdeveloped. Prior to the global financial crisis, growth had been gathering pace especially in upper-middle income countries. In 2007 and 2008, progress stalled before picking up again in 2013 and 2014, but with divergent trends between sources.

Equity – as indicated by stock market capitalization – remains low with declines since 2007 (see figure 6). There have been some notable listings of African corporations since 2007, including in Kenya, Nigeria and South Africa. Nevertheless, stock markets remain underdeveloped with major corporations in the region seeking listings on exchanges outside the region (for instance, London or New York). These stock markets offer important advantages over national stock exchanges, including much greater levels of liquidity for both primary issuances and secondary trading and strong market regulation and legal jurisdictions. They encourage investor participation in primary issuances, especially from international institutional investors, and so enlarge the pool of potential capital and ensure optimal pricing for such issuances. They are suitable mainly for larger companies, and so the development of national and regional exchanges remain important for medium-sized companies. The small scale and limited liquidity of national exchanges remains an issue, but regional exchanges could assist in this, which would require further harmonization of regulations, tax regimes and trading systems.

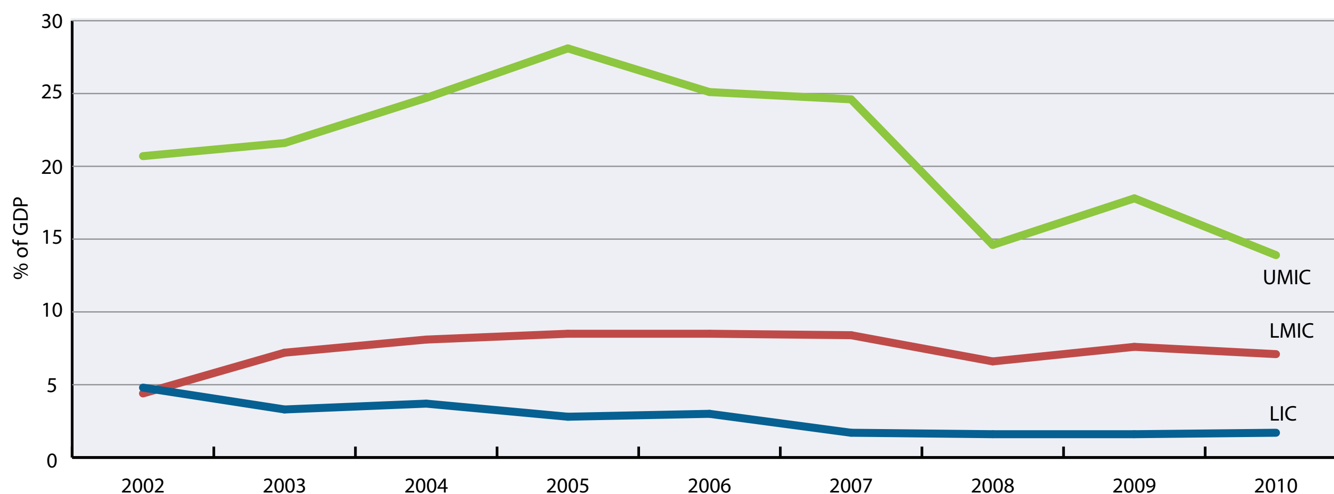
Local currency bond markets in Africa are underdeveloped with market capitalization concentrated in public (government) securities and in upper-middle income countries – particularly South Africa. Capitalization of government bonds was 15.6 per cent of GDP in 2012. Capitalization of corporate

**Figure 6:** Stock market capitalization (2002-2012)




*Source:* World Development Indicators (World Bank, 2015a).

**Figure 7:** Investment funds* (2002-2010)




*Source:* World Development Indicators (World Bank, 2015a).

* Funds are defined as mutual funds, pension funds and insurance funds. Data are only available up to 2010.

bonds was lower with the 2010 market capitalization of 1.8 per cent of GDP in 2012 (Mu, Phelps and Stotsky, 2013).

Since 2002, levels of private investment funds have been stagnant in lower-middle income countries and low-income countries, and have declined in upper-

middle income countries (see figure 7). Mobilizing these funds is dependent on both the level of financial development and on demand. Demand-side constraints include low savings rates, the lack of awareness and financial literacy, and low public confidence in financial institutions. In addition, the structure of the financial sector can be problematic for the mobilization of private investment funds. Non-life insurance is predominant, which limits the ability to mobilize long-term contractual savings through insurance, which is more closely related to life insurance penetration (Tyson, 2015a). There are limited private pension funds with a number of countries having government pension provision and coverage being limited largely to the formally employed. Public pensions are often being funded through government budgets rather than dedicated funds (Beck, and others, 2011).

## C. International private financial flows

The scale of required investments for sustainable development makes complete reliance on domestic finance impossible. The importance of cross-border capital flows has been reiterated in both the Monterrey Consensus and the Doha Declaration (United Nations, 2013; Tyson and McKinley, 2014).

The post-2002 period has been characterized by the internationalization of the financial system and the integration of developing economies into it, facilitating strong growth in cross-border private flows globally. Flows during the 2007–2008 financial crisis, however, sharply contracted, which affected some developing countries (Ocampo and others, 2010).

Since then, flows have resumed, driven by expansionary macroeconomic policies in advanced economies, which has led to a "search for yield" by investors to the benefit of developing countries that offer better growth prospects (Ocampo and others, 2010; Tyson, 2015b). Africa has been an increasingly important recipient of these flows (Tyson, Kennan and Hou, 2014).

Also important to Africa has been the rise of South-South financing, particularly financing the BRICS[10] group of countries. This shift has been notable both in intergovernmental lending and in private sector lending. China has been active in making financing available to Governments in sub-Saharan Africa, including for commodity extraction and infrastructure. Interregional financing had also tripled from 2008 to 2012, primarily driven by financing from South Africa (United Nations, 2013). Sovereign wealth funds, particularly those in the Middle East, are also believed to have been active in such financing. But there has been little transparency with regard to such funds (Griffiths, Jones and Ocampo, 2008). To date, Brazil and India have been more focused on technical cooperation and social aspects of development rather than providing large flows of development finance. This may change in the near future, as Brazil established its first office in Africa – the Brazilian National Development Bank – in 2013, and India has recently stepped up collaboration between its Ex-Im Bank and the African Development Bank; and the new BRICS development bank has the potential to increase the role of emerging economics in Africa.

10 Brazil, Russia, India, China and South Africa.

The following subsections give a detailed review of each of the components of international capital flows – FDI, portfolio flows, and remittances – in relation to Africa in the post-2002 period.

## 1. Foreign direct investment

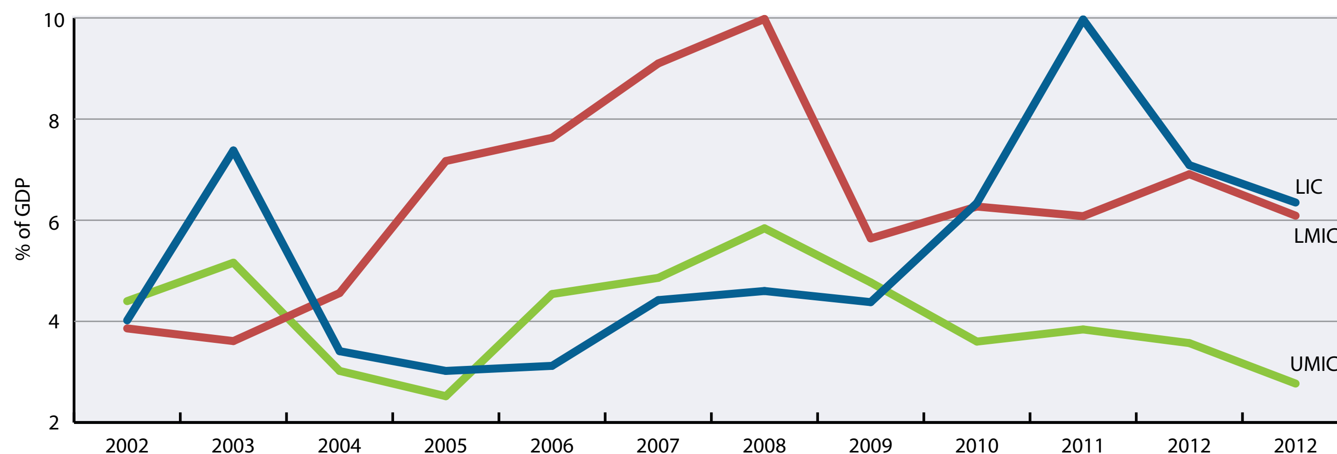
This type of investment is a major flow to developing countries, with the potential to provide a stable and long-term source of investment funds (Griffith-Jones, 2000). Globally, FDI responded relatively little to the 2007–2008 financial crisis, and by 2012, FDI inflows to developing countries exceeded inflows to developed countries for the first time (United Nations Conference on Trade and Development, 2013).

In Africa, overall FDI growth has been moderate since the Monterrey Consensus, increasing by 1.5 per cent of GDP between 2002 and 2013 (see figure 8). Historically concentrated on the extractive industries, FDI to Africa has seen increasing diversification (UNCTAD, 2014).

Poorer countries have seen stronger growth than the wealthier ones. In low-income countries, FDI has shown significant increases from a low of 3.0 per cent of GDP in 2005 to a peak of 9.9 per cent of GDP in 2011. Indeed, from 2010 onwards, low-income countries have received more FDI relative to GDP than middle-income countries. Countries that saw strong growth in that period included Equatorial Guinea, Liberia, Mozambique and the Niger (UNCTAD, 2014). In low-income countries, FDI has shown significant increases from a low of 3.0 per cent of GDP in 2005 to a peak of 9.9 per cent of GDP in 2011. Indeed, from 2010 onwards, low-income countries have received more FDI relative to GDP than middle-income countries (UNCTAD, 2014).

There were also important new trends in the post-2002 period. First, as aforementioned, there has been

**Figure 8:** Foreign direct investment (2002-2013)




***Source:*** World Development Indicators (World Bank, 2015a).

a diversification in sectors receiving FDI away from extractives. These include tourism and consumer services (e.g. retail, finance, foods and information technology services) and infrastructure. There has also been FDI for manufacturing in some countries, such as Egypt, Ethiopia and Morocco (UNCTAD, 2014).

Second, foreign investments have started flowing into research and development based in Africa, which – while still small – is notable because it offers prospects of broader employment creation and higher-skilled employment opportunities. Nairobi has become a favoured business hub for information technology, oil and gas exploration and business services, attracting FDI in these areas. For example, IBM established a research centre in Nairobi in 2013, and Google and Microsoft have both funded start-up hubs in Kenya. Other countries have seen similar examples of such foreign investment. For example, DuPont (United States) has announced a research hub in South Africa to open in 2017 to develop seeds for the region, Google and Microsoft are developing information technology centres in Lagos, Nigeria, and Barry Callebaut (Switzerland) has established a new centre in Côte d'Ivoire to develop more advanced agricultural techniques in cocoa production (UNCTAD, 2014).

Third, the sources of FDI continue to diversify. FDI from China continues to increase in value. Interregional FDI has grown – especially from Angola, Kenya, Nigeria and South Africa. These flows reflect the emergence of regional corporations, including in telecommunications, financial services and manufacturing. Smaller African economies in particular have benefited from interregional FDI – by 2013, it represented about 30 per cent of FDI stock for Benin, Burkina Faso, Guinea-Bissau, Lesotho, Rwanda and Togo (UNCTAD, 2014).

## 2. Portfolio flows

Portfolio flows (mainly equities and bonds) are another key ingredient in Africa's financial development, although their potentially short term and volatile nature presents risks (Tyson, te Velde and Griffiths-Jones, 2014a). Portfolio flows can be attracted by opportunities for speculation and have been associated with asset bubbles, especially in real estate and stock markets, and with financial crises in developing countries. This association is explained partially by the fact that the scale of such inflows has often contrasted with the relatively small size of the recipient domestic markets (Griffiths-Jones, 2000).

In 2013 and 2014, there have been strong portfolio flows to Africa (Tyson, 2015b). These trends reflected "push" factors in advanced economies as investors sought yield opportunities outside advanced economies because quantitative easing had driven down interest rates. Such flows have already seen periodic reversal because of speculation about the ending of quantitative easing in 2013 and 2014, and their stability remains uncertain (Tyson, te Velde and Griffiths-Jones, 2014a).

Also interesting in the post-2007 period, has been a trend to greater "risk appetite" among portfolio investors with flows increasing into lower-middle income countries and low-income countries (see figure 9). Flows to upper-middle income countries were lower and in fact have remained below their 2007 peak. Flows have also been concentrated into certain countries – such as Mauritius, Nigeria and

**Figure 9:** Portfolio flows (2002–2013)

*Source:* World Development Indicators (World Bank, 2015a).

South Africa – with many other countries having minimal or no portfolio flows.

## 3. Remittances

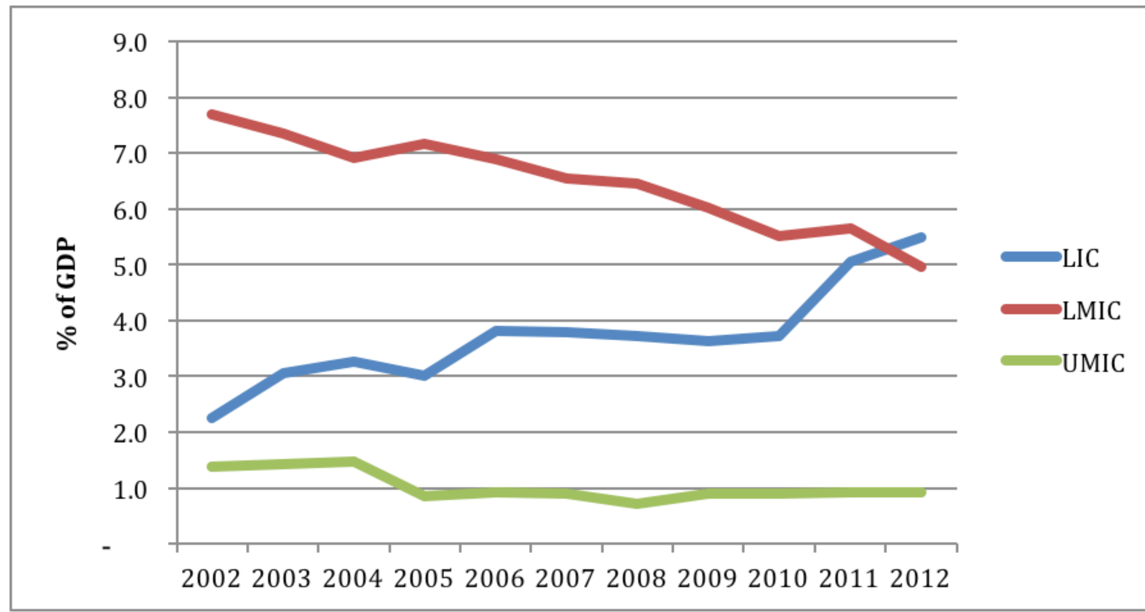
Remittances are primarily transfers from migrant workers to households in their country of origin. They are defined as "all current transfers in cash or in kind made or received by resident households to or from non-resident households" (IMF, 2009, p. 20). Globally, remittances have shown strong and fairly consistent growth since 2002, reaching $518 billion by 2013. They are a significant source of monetary inflows for many developing countries.[11]

In Africa, although the rate of growth has been more muted, remittances had surpassed FDI as the largest source of external finance in 2010. In 2014, remittances were the equivalent of 4.5 per cent of African GDP and projected to be 4.6 per cent in 2015, or $71.8 billion in absolute terms (ECA, 2015a). As a proportion of GDP, remittances have been falling for upper-middle income countries, rising for lower-middle income countries and flat in low-income countries (see figure 10). Remittances are concentrated in a handful of African countries. In absolute terms, the economies of Egypt ($18 billion), Morocco ($6.8 billion) and Nigeria ($21.3 billion) are by far the largest recipients, although as a proportion of GDP, remittances are most important to Lesotho (24 per cent), the Gambia (20 per cent), Liberia (19 per cent) and Senegal (11 per cent).[12] Remittances

11 Data prior to 2002 may have been underrated because new regulations were introduced, which broadened the scope of reporting entities to include non-bank remitting companies (Clemens and McKenzie, 2014). Also, data exclude the negative impact of lost output of migrated labour.

12 Data are from the October 2014 Migration and Development brief

**Figure 10:** Remittances (2002–2012)




***Source:*** World Development Indicators (World Bank, 2015a).

in Africa from internal migrants, especially payments from urban workers to their rural families, are also extremely significant.

These remittance patterns reflect labour migration patterns and diaspora trends. For example, in Nigeria, which accounts for about 67 per cent of all remittances outside North Africa, about half of remittance flows originated from the United States and the United Kingdom, with another 40 per cent coming from Benin, Cameroon, Chad, Germany, Ireland, Italy and Spain (World Bank, 2013a).

published by the World Bank, based on data from the International Monetary Fund, the World Development Indicators and staff estimates.

The recent financial crisis had a significant effect on remittance flows; for example, Morocco and Egypt, who receive remittances from France and Spain, experienced sharp contractions. By contrast, migrant employment in Gulf countries was relatively stable and overall transfers to Africa proved fairly resilient during the financial crisis (Ocampo, and others, 2010).

Many rich countries have also adopted stringent Anti-Money Laundering regulations for fund transfers and several banks in the United States and the United Kingdom have closed the accounts of money service businesses to avoid incurring penalties for not complying with regulations. This has had a major impact on countries thought to be most at risk of terrorism financing, such as Somalia, where around

40 per cent of households are thought to rely on remittances to meet their basic needs.

Transaction costs for remittances to Africa are higher than for other developing countries (Watkins and Quattri, 2014). As remittance volumes are highly responsive to transaction fees (Yang, 2011), reductions in fees through, for example, creating greater competition, would potentially increase remittances to Africa (ECA, 2013). New technologies, such as mobile money, offer the potential to lower transaction costs and a number of new entrants have recently started to challenge the dominant money transfer companies. Special measures to keep remittances flowing to places such as Somalia are also being explored.[13]

### 4. Other sources

Prior to the financial crisis of 2007–2008, bank lending to developing countries had expanded reaching a peak of $853 billion globally in 2007. It then fell very sharply to a mere $9 billion in 2008 and has since remained at low levels. Given the current process of regulatory reforms – and especially Basel III, which increases capital requirements in relation to developing countries – it is likely to remain at low levels for the foreseeable future (Tyson, te Velde and Griffiths-Jones, 2014a).

Non-regulated funds – in particular private equity funds and sovereign wealth funds – have been active in Africa since the financial crisis and are becoming important new sources of finance. Public information about their activities is limited. It has been publically disclosed, however, that they have been active in infrastructure investments – including through funds and partnerships with development agencies and Governments – and in the telecommunication and financial services sectors (te Velde, Tyson and Steele, 2015).

## D. Public international resources

This section presents data on two broad categories of public international finance – highly concessional flows, or "official development assistance" (ODA), and less-concessional flows, or "other official finance".

### 1. Official development assistance

This source of finance remains an important one, particularly for low-income countries and countries emerging from conflict. It can assume a number of forms, from outright grants to concessional loans and technical assistance. The biggest donors of aid are the United States, Japan and the European Union, either through multilateral organizations or bilateral arrangements.

ODA was the subject of political commitments made at the Monterrey Conference in 2002, by the European Union and the Group of 8 Summit in Gleneagles, Scotland in 2005. Total flows of ODA from members of the OECD[14] Development Assistance Committee (DAC) have been flat at around $135 billion since 2010, after having dipped to $113 billion

13 For more information on new entrants, see Paul Breloff and Jeff Bond, "Picking Winners in the Great Remittance Disruption", *Consultive Group to Assist the Poor* [CGAP] (2015). The Government of the United Kingdom recently established an Action Group on Cross Border Remittances and is piloting a Safer Corridor system for United Kingdom-Somali transfers, in collaboration with the World Bank.

14 OECD, Organization for Economic Cooperation and Development.

in 2007 during the global financial crisis.[15] Globally, ODA is at an all-time high, although still far short of the commitments made by donor countries and substantially below the sums estimated to be required to achieve the Millennium Development Goals. Global ODA is expected to stagnate in the 2015–2016 period, with only middle-income countries expected to see an increase in aid. Results of the recent Survey on Donors' Forward Spending Plans had forecast that country programmable aid to Africa (those elements of aid that are available for spending in recipient countries) would fall from $47 billion in both 2013 and 2014 to $46 billion in 2015, and to $45 billion in 2016.[16]

Levels of aid intensity (aid as a share of recipient GDP) are higher in poorer countries, and ODA still finances a major part of government expenditures for many African countries (see figure 11). Based on data from the World Development Indicators database, the African countries where country programmable aid was above 10 per cent of gross national income were: Burundi, Cabo Verde, the Democratic Republic of the Congo, Lesotho, Liberia, Malawi, Mali, Mozambique, Rwanda, Sao Tome and Principe, and the United Republic of Tanzania. The largest recipients in absolute terms were – Egypt ($4.7 billion), Ethiopia ($3.3 billion), the United Republic of Tanzania ($3.3 billion), Kenya ($3.1 billion), Nigeria ($2.7 billion), Mozambique ($2.2 billion), the Democratic Republic of the Congo ($1.8 billion), Uganda ($1.7 billion), Morocco ($1.4 billion), Ghana ($1.3 billion), South Africa ($1.3 billion), Mali ($1.1 billion), and Zambia ($1.1 billion).

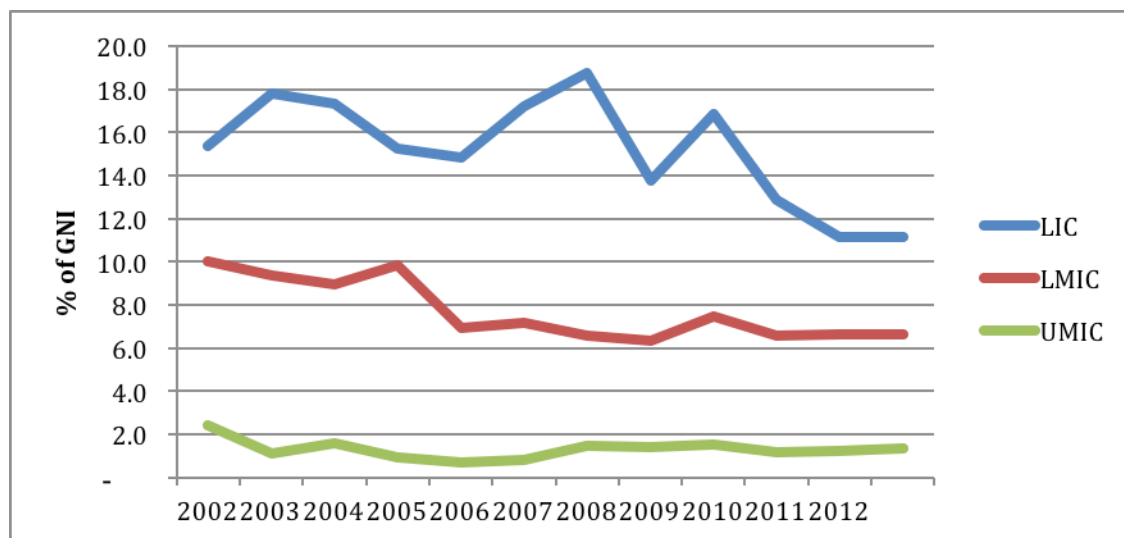
Concessional development finance is also increasingly becoming a South-South flow. By 2010, South-South concessional development finance (ODA-type flows) was estimated to have reached between $12.9 billion and $14.8 billion (United Nations, 2013). Important non-Group of 7 providers included new emerging economies, such as Brazil, China, India and South Africa, although their aid remained significantly smaller than that of OECD donors. By the end of 2009, 45.7 per cent of the cumulative foreign aid from China, amounting to yuan ¥256 billion (around $41 billion) had been given to countries in Africa (Sun, 2014). China, the most important middle-income country donor, tends to provide a small amount of loan financing to a broad range of low-income countries. The majority of South-South ODA, however, has assumed the form of bilateral programmes for project funding and has often been integrated into commercial transactions involving trade, investment and loans (United Nations, 2013).

International focus on mitigating climate change has helped to propel increases in ODA to upper-middle income countries, as these countries have received a significant increase in ODA to deal with such challenges over the past decade (European Development Report, forthcoming). This trend highlights one of the key questions in discussions on the future of ODA: the degree to which it should be focused on dealing with global public goods; and issues such as climate change, rather than on more traditional development and poverty reduction objectives.

15 In these data, the full face value of a loan is scored as ODA, if it has a grant element of at least 25 per cent. OECD will switch to treating only the grant-equivalent of a concessional loan as ODA, and there will also be changes to the discount rates used and associated conditions (OECD, 2014a).

16 Data taken from "Global Outlook on Aid, Results of the Survey on Donors' Forward Spending Plans, World Development Indicators", OECD (2014b).

**Figure 11:** Official development assistance as a share of GDP (2002–2012)




***Source:*** World Development Indicators database (World Bank, 2015a).

## 2. Other official flows

Other official flows are defined as official financing provided to countries on the OECD ODA eligibility list but which does not qualify as ODA, either because it is not aimed primarily at development, or because it is not sufficiently concessional.17 Less-concessional financing from emerging donors who do not report to DAC18 is increasingly important to Africa – for example, China is now the single largest investor in African infrastructure. But historical data are hard to find. Figure 12 shows net and gross flows to Africa, including non-DAC donors who nonetheless report to DAC. Net flows include debt relief.

The recent trend has been negative and there are concerns about the future of this source of finance, which can be so important for middle-income countries, especially for those where access to more concessional forms of financing is constrained, yet financing from capital markets is expensive (Kharas, 2014).

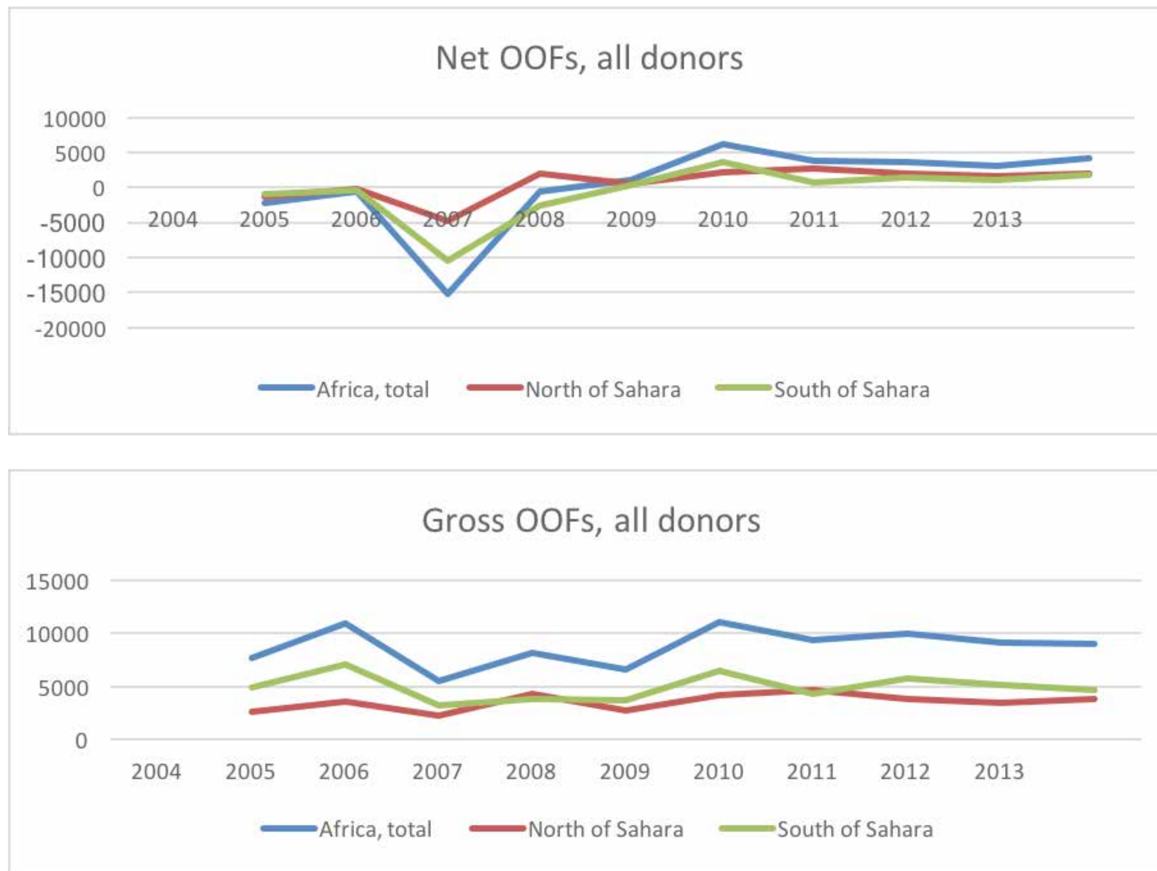
# E. Trade

Trade was identified as an engine of growth in the Monterrey Consensus on Financing for Development. With that in mind, Africa faces two trade challenges: first, to grow the volume of trade, both internationally and in Africa; and second, to diversify trade away

17 OECD proposes to replace other official flows with a new measure – total official support for development – to include a broader set of objectives (e.g. climate, security) and instruments (e.g. equity, guarantees).

18 DAC, Development Assistance Committee.

**Figure 12:** Other official flows (millions of United States dollars)




***Source:*** http://stats.oecd.org/Index.aspx?DataSetCode=Table2A.

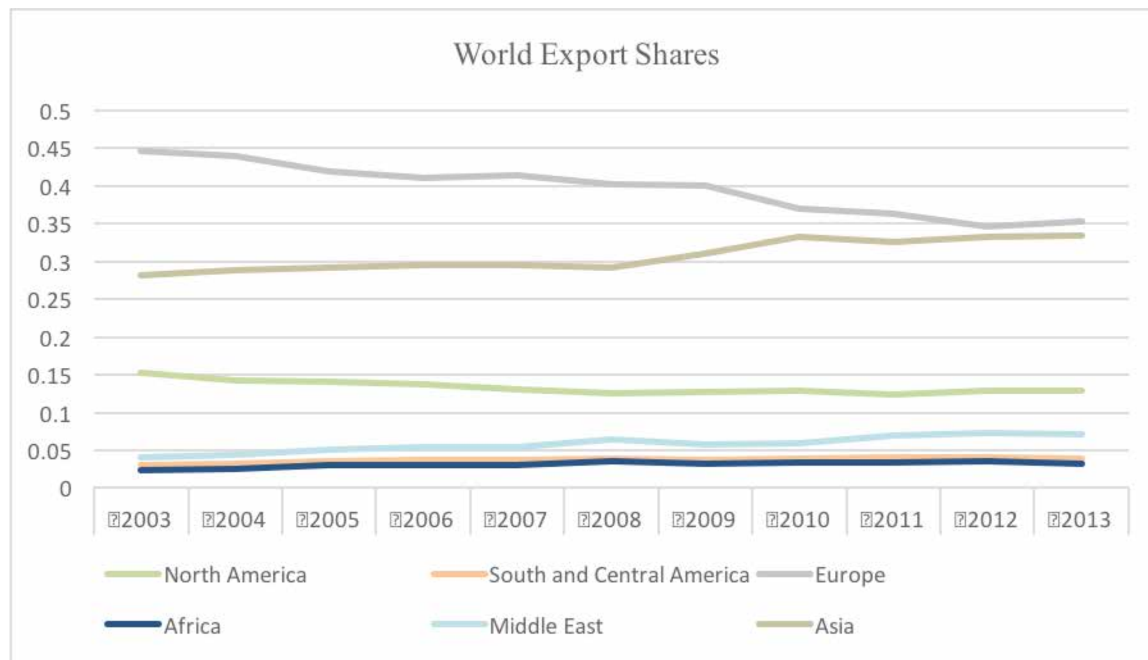
***Note:*** In 2012 constant dollars.

***Abbreviation:*** OOFs, other official flows.

from raw materials, into a variety of manufactured goods, and traded services. Progress has been slow on all fronts. Figure 13 shows that Africa's share of global exports has been stagnated at around 3 per cent since 2005.

Figure 14 shows the recent increase in trade with China and other emerging economies, and a recent encouraging increase in intra-African trade. But the share of primary products (including food, raw materials and oil) in African exports is very high, accounting for 82 per cent of exports to developed

**Figure 13:** Regional shares of global merchandise exports




***Source:*** World Trade Report 2014 (World Trade Organization, 2014).

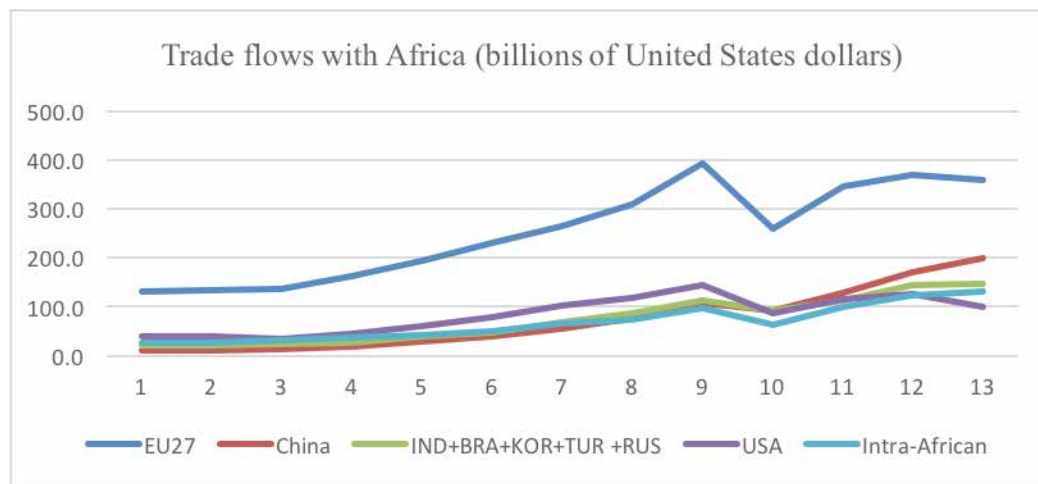
economies and 90 per cent of exports to Asia in 2012 (World Trade Organization, 2014).

Intra-African trade remains comparatively low, but averaged 13.5 per cent annual growth between 2000 and 2010, growing faster than Africa's exports to the rest of the world (AfDB, OECD, UNDP,[19] 2014). Manufactured and intermediate goods account for a higher proportion of intra-African trade, than external trade, although lightly processed exports still dominate. Barriers to trade (such as tariffs, onerous customs procedures and corruption, and inadequate infrastructure) are notoriously high in Africa; many countries find it easier to trade overseas than with their neighbours.

A recent survey of trade finance in Africa estimated unmet annual demand at around $110 billion, and identified barriers to meeting that demand as low United States dollar liquidity, low regulation compliance, and the inability to assess the credit-worthiness of potential borrowers. The lack of capacity in commercial banks implies that Governments and development finance institutions have a major role to play in financing trade.

19 AfDB, African Development Bank; UNDP, United Nations Development Programme.

**Figure 14:** African trade volumes with key regions




***Source:*** African Economic Outlook 2014 (AfDB, OECD, UNDP, 2014).

***Abbreviations:*** EU, European Union; IND, India; BRA, Brazil; KOR, Korea; TUR, Turkey; RUS, Russia; USA, United States of America.

In a series of papers, economists Ricardo Hausmann and Cesar Hidalgo have described the process of economic development as one of acquiring the capability to produce more complex products, and in particular have focused on trade, tracing how countries enter new markets and start to produce more sophisticated products (Bahar, Hausmann and Hidalgo, 2014). Based on trade data, they produced an Atlas of Economic Complexity, which ranked countries according to the complexity of their trade. The highest-ranked African country is South Africa (57) and the next highest ranked African county is Kenya (83). Eight out of the ten least-complex trading economies in the world are African.

## F. Conclusion: lessons and challenges

This chapter has reviewed the trends in finance since the Monterrey Consensus of 2002 and the trends in private and public flows and from domestic and international sources. The main findings were that:

- Domestic public resources are the top priority for African development finance. There have been recent signs of improvement, but many countries are starting from a low base and there is much to be done in terms of enhancing tax administration and policy.

- In the private sector, domestic resource mobilization has improved – especially in relation to domestic credit – but savings and capital markets development remains weak. Financial deepening, and the expansion of pension and sovereign wealth funds into private equity, offer paths to increase domestic private investment.

- International private flows have been strong in the post-2008 period. There have been increasing flows to both low-income countries and lower-middle income countries, and a broadening of the investor base and of the sectors to which flows are going. A key challenge will be aligning private flows with national development priorities and attracting private investors to territories and sectors that are neglected at this time.

- International public sources are declining in both absolute and relative terms and the outlook for any change to this trend is pessimistic. This is utterly inconsistent with the commitments that developed countries have made – the scale of development challenges that remain, and the opportunities for financing structural transformation in Africa.

Chapter III will discuss African priorities for development finance and means of resource mobilization. In doing so, two issues need consideration: first, as countries grow, how will these flows change; and second, what are the risks associated with these trends?

ODA, as a share of gross national income, tends to decrease sharply once countries surpass a low level of income, with tax revenue outstripping ODA, on average, by the time GDP per capita reaches $500 (although this may not be true for smaller countries). In addition, the decline in ODA is faster than the rise in tax, meaning that as countries grow they can experience falling levels of total public revenue.[20] As Africa is expected to continue to see per capita income grow, this suggests an urgent need to raise tax generation levels and to make selective policy choices regarding the use of public funds. These issues are discussed in more detail in chapter IV.

By contrast, private finance generally becomes more significant as incomes rise consistently with GDP per capita in relation to both domestic and international financing.[21] There may be particular challenges involved in ensuring that private finance is available in a form suited to the large scale and long duration commitments needed for investments in structural transformation.

While public financing carries risks – ODA is volatile and tax revenue cyclical – these risks can usually be managed through prudent fiscal policy and sound economic and financial governance. Macroeconomic management in Africa has markedly improved, but progress is bound up with the development of political accountability and State capacity, which must be prioritized by African Governments and their development partners. Risks relating to private finance – and in particular international finance – are significant and less easily mitigated. Risks include foreign exchange movements, disruptive capital flows, and the failure of financial institutions. These risks can accumulate and create fragility in the financial systems of developing countries and, in the worst case, lead to damaging financial crisis (Reinhart and Rogoff, 2009; Griffith-Jones and Tyson, 2012; Tyson and McKinley, 2014). Since 2013, vulnerabilities have increased

20 This is based on the 2015 European Report on Development and covers a period when ODA had reached its highest ever level. The rate of decline in levels of public resources, as countries move from low-income country and upper-middle income country status, may be more severe than the historical experience.

21 Data exclude portfolio flows. FDI flows may also be historically specific because of the high levels of FDI to China in the period that the data cover (McKinley and Tyson, 2014).

and partially materialized – there have been sharp capital outflows from developing countries recently, in response to the end of quantitative easing in the United States. (IMF, 2014b; Hou and others, 2014; Tyson, Kennan and Hou, 2014; Tyson and McKinley, 2014; Tyson, 2015b).

Financial fragility can also occur in domestic financial markets. The 2009–2010 Nigeria banking crisis is an example of where such risk materialized.[22] At present, there are indicators of domestic financial sector vulnerabilities. This includes: from bank balance sheet weaknesses associated with rapid credit growth (Côte d'Ivoire, Kenya, Mozambique, Nigeria and Senegal); a sharp rise in foreign liabilities as per cent of domestic credit (Côte d'Ivoire); and stretched loan-deposit ratios (Cameroon and Kenya) (IMF, 2014b; IMF, 2014c; Tyson and Patel, forthcoming).

The following chapter will, therefore, discuss not only policies for mobilizing finance for development, but doing so while minimizing risks.

22 According to the Governor of the Nigerian Central Bank, the causes of the crisis included "macroeconomic instability caused by large and sudden capital inflows, major failures in corporate governance at banks, lack of investor and consumer sophistication, inadequate disclosure and transparency about financial position of banks, critical gaps in regulatory framework and regulations, uneven supervision and enforcement and weaknesses within the Central Bank of Nigeria" (Sanusi, 2010).

# III. Policy priorities for development financing

## A. Challenges of structural transformation

Structural transformation is the process behind economic development: reallocating economic resources from low to high productivity activities. The shift away from subsistence agriculture into modern agriculture, manufacturing and then into services, is one of the great "stylized facts" of development, a path trodden first by today's rich nations, and presently being followed by the emerging economies of Asia and Latin America. Africa has now begun that journey.

But this path is becoming increasingly hard to follow. The enormous gains in automation and productivity in manufacturing means the sector's scope for absorbing labour is shrinking. Several recent reports have raised concerns about "premature industrialization" in Africa (Ansu, 2014; ECA, 2013; ECA, 2014a; Rodrik, 2015). A corollary of this is that Africa's urbanization has occurred without accompanying structural transformation. Rather than being driven by the pull of manufacturing or the push of agricultural mechanization, many African urban centres are what Jedwab (2013) calls "consumption cities", where resource windfalls are spent on urban goods and services. Many researchers have reported that structural change in Africa has been "growth reducing", moving workers away from high productivity sectors into low productivity employment, notably in the informal services sector.

Recent research has produced a more nuanced picture. According to McMillan, Rodrik and Verduzco-Gallo (2014), from 2000 onward, structural change contributed positively to Africa's overall growth, with over half of the countries sampled seeing some modest expansion of the manufacturing sector. McMillan and Harttgen (2014) argue that for the first time, growth in Africa is being driven by an exit from agriculture. They found that between 2000 and 2010, in Sub-Saharan Africa the share of workers employed in agriculture declined by roughly 10 percentage points, manufacturing grew by 2 percentage points and services by 8 percentage points. Ghani and O'Connell (2014) argue that the services sector can be a "growth escalator" in low-income countries, meaning that African structural transformation may

not have to wait for China and other East Asian Tigers to become rich and uncompetitive in manufacturing.

Although the path of structural transformation in African countries may take a different route to the historical experience of other countries, the need for investment is unchanged. The modernization of agriculture, manufacturing and services will require modern energy, communications and transportation infrastructure, and well-educated and healthy workers. African firms are, on average, far less productive than firms in other regions in the world, but Harrison, Lin and Xu (2014) show that after taking into the account the low quality of infrastructure, lack of access to finance, and low levels of political competition, African firms are actually relatively more productive than firms elsewhere.[23] This implies that infrastructure, finance and the political and institutional environments are the key constraints holding the continent back.

The following sections focus on three key African development priorities for structural transformation – infrastructure, agriculture and sustainability, and investments in people. Means of mobilizing finance are examined in subsequent sections. All of Africa's development priorities require continuing improvements in political accountability, State capacity, and public service delivery.

**Box 1:** Mobilizing official development assistance for structural transformation

The greatest and most obvious financing priority for structural transformation is infrastructure. But there are also more oblique paths to the same objective. For example, donors could create a new multilateral mechanism to provide long-term financing to support the accelerated roll-out of social transfers and social protection in Africa. Although not superficially related to structural transformation, putting cash into the hands of poor households allows them to make productive investments, avoid having to sell productive assets during hard times, help keep children in school; and it has a positive impact on local market development. As there is a strong connection between transfers and the first sustainable develop goal (ending poverty), such a fund should resonate with donors, increase the total flow of financial resources into Africa, and accelerate the process of structural transformation. IMF researchers, Ostry, Berg and Tsangarides (2014), find that the redistributive fiscal transfers, of an average size, seem to be robustly associated with higher and more durable growth.

## B. Development priority I: Investments in people

Good health and a good education are ends in themselves, and should be part of national development strategies in their own right. In this section, however, the focus is on the role that investments in people have in the process of structural transformation.

Investments in people include targeted cash transfers and social protection. The third pillar of the common African position on the 2030 Agenda for Sustainable Development is people-centred development, a dual-track approach of eradicating poverty through job creation and growth, and access to social protection that leaves no individual below the poverty line. Such schemes have been introduced with great success in emerging economies, but in Africa, programmes are few and small scale. According to estimates of Fiszbein, Kanbur and Yemtsov (2013), less than one per cent of the sub-Saharan African population has been lifted out of poverty by social transfers.

23 The authors found that the longer a single political party remains in power, the lower are firm productivity and sales growth rates.

This is not because such schemes are ineffective. A study of social safety nets in 22 African countries showed that even a small amount of regular income support can help households diversify livelihoods, increase investment, build human capital, and kick-start small enterprise development (Monchuk, 2013). Structural transformation is held back by an underdeveloped market economy, particularly in rural areas. Putting more money in the hands of poor people has been shown to increase growth at the local level through the multiplier effects of increased local consumption and improved labour market outcomes. Social protection allows Governments to more effectively bring about other economic reforms that have positive effects on economic growth, and there is no evidence it breeds dependency or has a negative impact on labour supply (Mathers and Slater, 2014).

On an individual level, ill-health can obviously have a devastating impact on household earnings. In the absence of universal health coverage, the probability of experiencing poor health with catastrophic cost (defined as costing more than 40 per cent of annual disposable income) is very high (Dupas, 2011). On a macro level, there is evidence for a causal relationship from population health to economic growth, but the magnitude is small (Weil, 2014).

There is a stronger link from education to growth and structural transformation, but evidence only really emerges once quality, as opposed to enrolment, is accounted for. Schoellman (2012) uses a quality adjusted measure of education and finds it accounts for 20 per cent of the variation in income levels across countries. Hanushek and Woessmann (2012) develop a measure of education attainment and use a variety of techniques that permit a causal interpretation, finding a strong impact of cognitive skills on growth rates across countries.

The Millennium Development Goals put the focus on school enrolment and completion, but attention is increasingly focused on education quality. Jones, and others, (2014) find that many African children remain functionally illiterate and innumerate, irrespective of having completed many years of education.

Relative to economic growth, African government education expenditure has grown as a proportion of GDP, from 3.8 per cent in 1999 to 4.7 per cent in 2011. Per capita expenditures remain significantly below many other developing country regions, plausibly a reflection of inadequate attention to quality of education (ECA and OECD, 2014). Cost sharing between public providers and private households remains common. Current ODA for education volumes remain incompatible with donors' pledges that no Government committed to achieving Education for All by 2015 should falter due to lack of resources.

Starting from a low baseline, considerable progress has been made in healthcare. Under-five mortality rates have fallen rapidly, HIV/AIDS infection rates have fallen by 25 per cent in Africa (excluding North Africa) since 2001, and malaria incidence and death rates are down by 31 per cent and 49 per cent between 2000 and 2012, respectively. Government health expenditure has increased modestly as a proportion of GDP, from 2.3 per cent to 2.7 per cent, over the past decade. Over 55 per cent of ODA for health in 2012 supported population policies and reproductive health, including HIV/AIDS. By contrast, assistance for

health systems and research has remained unchanged over the past decade, at around $0.8 billion a year. The Ebola epidemic in western Africa has drawn attention to the under-resourcing of national health systems and the need for improved governance in the health sector.

It must be emphasized that the things that money can buy (e.g. infrastructure, drugs and training) only explain some of the variation in the quality of healthcare across African countries, and less tangible factors that determine the behaviour of medical staff in health organizations play a major role (Das and Hammer, 2014). Similar results have been found for education (Murnane and others, 2014). The behaviour of the workers who deliver public services is largely determined by the incentives in those organizations, and that goes all the way back to the nature of the political settlement in a country. Wild, and others (2015) argue that development finance must be accompanied by a local-led problem-driven approach to overcoming barriers to service delivery, and that genuine support from politicians and ministries is essential.

## C. Development priority II: infrastructure for structural transformation

For African countries, the transformation into modern economies will be impossible without infrastructure. Firms cannot produce goods and services without a reliable supply of inputs, such as power and water, and they cannot get goods to market or communicate with customers without transportation and communications infrastructure.

**Box 2:** African capacity-building

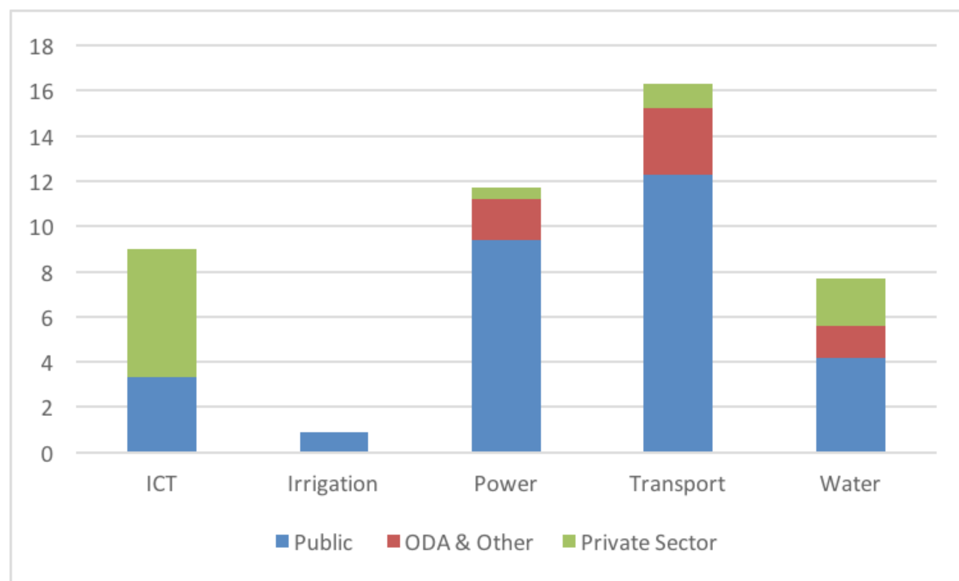
Analysts may estimate that Africa needs to spend (invest) $100 billion a year on infrastructure, but that's quite a different thing from claiming that there are $100 billion worth of projects waiting to be implemented. A recent statement by the heads of multilateral development banks said: "The critical barrier to achieving an uplift in infrastructure investment ...is not a lack of available finance, but an insufficient pipeline of bankable projects ready to be implemented" (World Bank, 2014, para. 7).

Dedicated project preparation facilities at development finance institutions may be part of the answer, such as the "Africa 50" fund of the African Development Bank, which emphasized project development in partnership with the private sector. But it is also important to build the capacity of African Governments. Many of the continent's infrastructure needs, particularly those in sectors that lack revenue streams from paying private customers, may be most efficiently met via traditional public sector investment. There is also the need for African policy and regulatory institutions to have greater capacity to provide an enabling environment in which infrastructure investment will flourish.

While there is no doubt untapped potential for private sector investment, African countries should recognize the need to have the capacity to develop and finance public infrastructure in investments. The Programme for Infrastructure Development in Africa, approved by the African Heads of State and Government in 2012, is an important vehicle for coordinating national and regional investments.

The benefits of infrastructure development and integration in Africa are high, and increasing trade would contribute to market efficiency and economic growth (World Bank, 2014). Low quality infrastructure acts as a constraint on trade (OECD, 2014a). This is particularly true of internal trade, which accounts for only 12 per cent of total trade in Africa compared to 53 per cent in emerging Asia (WTO, 2013). Landlocked countries pay up to 84 per cent more than coastal countries to export goods. Bouët and others (2008) show that poor transport and communication infrastructure

**Figure 15:** Sources of infrastructure finance (billions of United States dollars)




***Source:*** World Bank, IFC, and World Economic Forum, 2013.

***Abbreviations:*** ICT, information and communications technology; ODA, official development assistance.

accounts for most of Africa's underperformance in trade. Potential gains from developing African infrastructure for energy and water are also high. They include direct improvements in living standards and benefits in enabling manufacturing, trade and agriculture. Current levels of access to power and water are low in sub-Saharan Africa. Only 30 per cent of the population has access to electricity, compared to 70–90 per cent in other developing countries; and only 5 per cent of agricultural land is under irrigation.[24] The African Development Bank (2014) has estimated that infrastructure services for water and energy cost twice as much on average, compared to other developing regions.

24 For more information, see the Programme for Infrastructure Development in Africa, "Closing the Infrastructure Gap Vital for Africa's Transformation", African Development Bank (2012).

From a geographical and economic perspective, Africa has immense potential for a sustainable power and water network that could be used for hydroelectric power, and plentiful solar energy with the potential to bring off-grid power to isolated settlements. The potential benefits of the creation of energy networks to create large scale, cost effective energy resources are huge and would allow for interregional power trading (Hart and others, 2015).

Finance is an important constraint on infrastructure development. Figure 15 shows that the vast majority of infrastructure is publicly financed. Domestic public finance is increasing – for example, in the national budgets of 21 African countries, general expenditure budgets grew by a compound annual growth rate of 3 per cent in the period 2011-2013, while

infrastructure budgets grew 8 per cent annually over the same period (Infrastructure Consortium for Africa, 2014)[25] – but Africa's infrastructure requirements are estimated to run to $93 billion per year (Foster, 2008). In most countries, the sums required far exceed public resources. Countries emerging from conflict would require the equivalent of 37 per cent of their GDP per year and stable low-income countries 23 per cent of their GDP (Ncube, 2013).

To date, private finance in Africa has primarily financed the telecommunications sector, with some minor financing of power plants and container terminals. Further effort is needed to leverage private capital (World Bank, 2014).

## D. Development priority III: Agriculture and sustainability

Around 55 per cent of Africans work in agriculture, 80 per cent of landholdings are smaller than two hectares (Lowder and others, 2014) and productivity is extremely low by international standards.

Nutrition is a development objective in its own right. While Northern Africa has had a consistently low prevalence of hunger at less than 5 per cent, outside of that region, one in four Africans are chronically hungry (Food and Agriculture Organization of the United Nations, 2014). At the twenty-third ordinary session of the Assembly of the African Union in June 2014, African Governments had pledged to end hunger by 2025.

25 Of the countries surveyed, the average per capita spending on infrastructure is $122 per capita, but the range is immense, from $8.64 to $548 per capita, with Botswana and South Africa at the top end of the range.

**Box 3: Mobilizing international public financing for climate mitigation and adaptation**

There is a clear moral principle that African countries should not pay for the problems that rich countries have wrought through historical carbon emissions. Also in principle, funding for climate mitigation and adaptation should be additional to finance for development, although most parties acknowledge that funds are essentially coming from the same pool of resources.

One idea for dramatically increasing the flow of financing for adaptation to climate change in Africa, in a way that does not substitute for the present flows of development finance, is emissions trading. African countries emit far less carbon per capita than rich countries. If countries were issued carbon permits, on an equal per capita basis – that change over time in a fashion compatible with keeping global warming within safe limits – then rich countries could buy permits from African countries. They may also find it cost effective to invest in mitigation measures, such as reforestation, in Africa. While there are some nascent carbon trading schemes, a full-blown global system is a distant prospect.

Raising agricultural productivity is also vital for African structural transformation. In almost every African country, agriculture's share of employment is substantially higher than its share of output, because output per worker in agriculture is lower than in other sectors (McMillan and Headey, 2014). Yet Africa's rapidly growing population requires food. Increased African food production cannot happen while moving workers out of agriculture, without a dramatic increase in productivity. Food and Agriculture Organization of the United Nations data show that during the period 1961–2007, per capita food production had risen only by about 0.06 per cent annually.

Africa is already worryingly dependent on imports. The gap between Africa's food imports and exports started widening in the 1980s, and now stands at record levels (Rakotoarisoa, Iafrate and Paschali, 2011). Basic foodstuffs account for the majority of

food imports, implying food security is heavily reliant on countries having access to foreign exchange to purchase imports.

Even this precarious situation is at risk of deterioration because of climate change. Of all the regions in the world, Africa is the most exposed to climate change and, through its reliance on agriculture, the greatest economic impact.

Climate models predict that, based on emissions trends and mitigation pledges, average global temperatures will be 4°C higher by 2100 (Schaeffer and ECA, 2014). Even if temperatures are held to 2°C above pre-industrial levels, the impact on Africa will be substantial. Consequences include: more frequent and severe episodes of extreme summer heat, drought and desertification, increased annual flooding and saltwater intrusion to river deltas, and the loss of marine fisheries. Africa can also expect more frequent extreme weather events, particularly larger tropical cyclone-induced storm surges.

At warming around 3°C, virtually all of the present maize, millet, and sorghum cropping areas across Africa could become unviable for the present current crop varieties. Maize and wheat productivity is projected to decline for a below 2°C warming by 5 per cent and 17 per cent, respectively, for sub-Saharan Africa by the 2050s. Food production will become even more erratic in regions where agricultural productivity is already low. Decreases in production could lead to price increases for staple crops of 25–150 per cent by 2060.

Climate change redoubles the urgency of investment in African agriculture. There are opportunities to invest in many areas. For example: approximately 4 per cent of land is irrigated, exposing African agriculture to the risks of increasingly sporadic rainfall; and, there is a widely acknowledged lack of transport, storage, and marketing infrastructure, which prevents smallholders from accessing output markets. The gains from agricultural investment are proven, as is the connection between agricultural productivity and structural change. McArthur and McCord (2014) find that higher yields lead to a lower labour share in agriculture in the medium term and higher non-agricultural value added in the long-term. They also find a clear role for fertilizer, modern seeds and water in boosting yields.

ECA (2014b) proposed a 6-point plan for climate-resilient economies in Africa. Vital agricultural investments include new reservoirs, large-scale irrigation, drip irrigation, water recycling and reuse, and improved water management. Sustainable land management, crop diversification and soil conservation could help reverse land degradation and nutrient depletion, as could adding “biochar” to soil, which improves yields and plant response to fertilizer. There is urgent need for more drought-resistant crop varieties, and the development of seed varieties suited to African circumstances. Infrastructure is part of the solution. For example, Gollin and Rogerson (2014) argue that high transport costs can explain why so many African workers remain in subsistence agriculture. Financial elements of the solution include weather-based insurance schemes for crop and livestock production.

In recognition of these challenges, the New Partnership for Africa’s Development launched a Comprehensive Africa Agriculture Development Programme in 2003,

with the goal of integrating and invigorating regional and national agricultural markets, boosting agricultural exports, and reducing rural poverty. The total cost of the programme was estimated at $18 billion a year. African Governments have committed to investing 10 per cent of their budgets in the agricultural sector. In many African countries, spending is significantly below these levels.

Traditional donors clearly have a role to play in providing resources for Africa to accelerate agricultural investments, but there is also a major role for South-South cooperation and collaboration with the private sector, as exemplified by the New Alliance for Food Security and Nutrition.

# IV. Issues and challenges for increased mobilization of development finance

This chapter builds on the analysis of progress since the Monterrey Consensus, and discusses African priorities for increasing the quantity and quality of development finance for the Sustainable Development Goals era.

## A. Mobilizing the public sector

Public revenue, specifically domestic taxes and grant aid, can be a particularly powerful form of financing for development because, unlike loans, they can be spent without requiring direct financial returns, and unlike remittances or FDI,[26] they can be invested at a Government's discretion.

The headline figures may show that domestic revenue in Africa now dwarf grant aid – $40 billion of country programmable aid versus $530 billion of tax revenue in 2012 (AfDB, OECD, UNDP, 2014). As highlighted in chapter II, resource revenue accounted for the lion's share of the continent's total taxation. Moreover, five countries (Algeria, Angola, Libya, Nigeria and South Africa) accounted for roughly 67 per cent of African taxes in 2012, while ODA was the largest external resource inflow for 33 mostly African low-income countries (Development Initiatives, 2015).

Figure 16 shows the ratio of country programmable aid to tax revenue for African low-income and middle-income countries.[27] The reality is that ODA remains an essential source of finance for many African countries, particularly low-income countries.

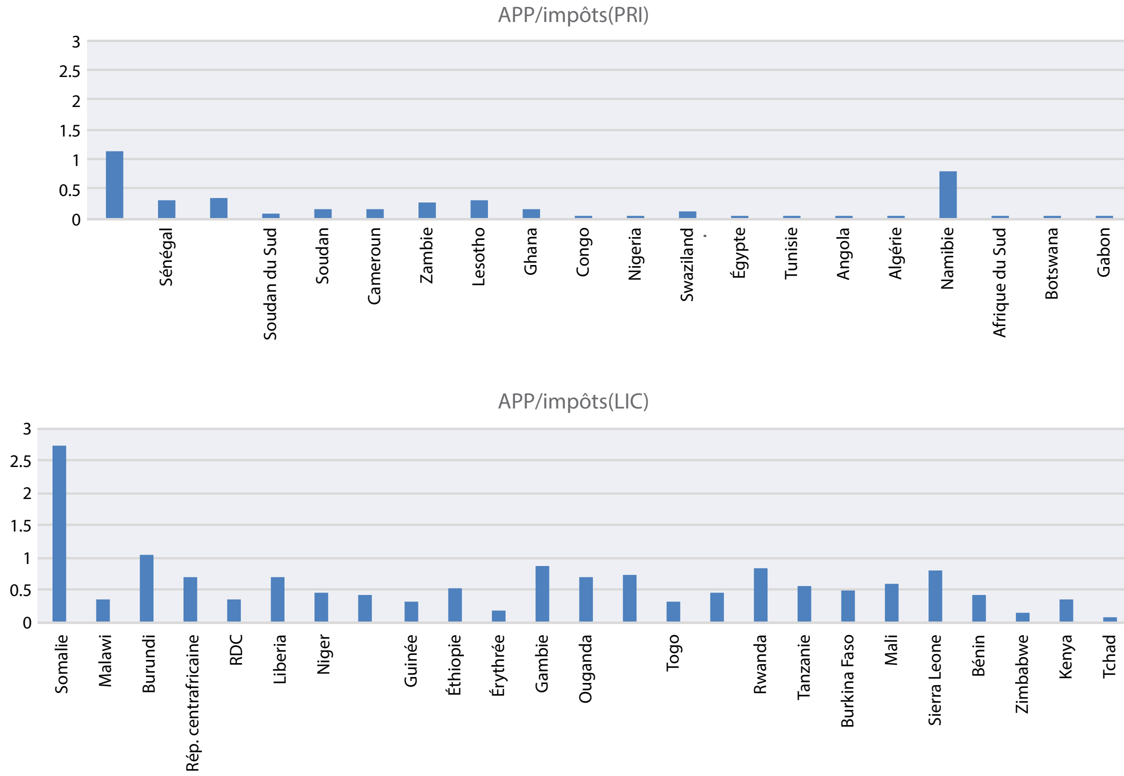
## B. Domestic resource mobilization by the public sector

Levels of tax per capita vary widely across Africa, with resource-rich countries reporting healthy levels. There are around 20 African countries with annual tax per capita of around $100 or below, and a dozen with $200 or below. For most African countries, aside from resources-related revenue, tax revenue had stagnated over the past two decades from 1990 to 2010 – but since then, there have been some very encouraging

26 FDI, foreign direct investment.

27 Country programmable aid data are averages 2013–2015. Tax data are for 2012 from most recent IMF Fiscal Affairs Database.

**Figure 16:** Aide programmable par pays (APP) en pourcentage des recettes fiscales




***Source:*** Enquête sur les plans prévisionnels des dépenses des donneurs (OCDE, 2014b), FMI, base de données sur les affaires financières.

signs of improvement, especially in poorer countries (AfDB, OECD, UNDP, 2014).

The links between taxation and development have been well documented – efficient tax administration has been described as one of the three pillars of prosperity, along with peace and justice (Besley and Persson, 2011). One mechanism that links tax to development is that a Government wishing to raise higher levels of tax must support functioning markets. Besley and Persson (2013, p. 2) call, "how does a Government go from raising around 10 per cent of GDP in taxes to raising around 40 per cent?" the central question of public finance and development.

African economies are characterized by a shallow tax base, weak tax administrations staffed by poorly trained and low-paid officials, and low levels of perceived fiscal legitimacy. African economies are also largely constituted of hard-to-tax sectors, such as small enterprises, agriculture and a large informal sector (AfDB, OECD, UNDP, 2014).

Moore (2013) catalogues the institutional barriers to increasing tax revenue. This includes tax administrations that gather money illegally for the benefit of their own staff, often handing over some of it to their political masters, and in doing so, bringing tax collection into disrepute and decreasing willingness to pay. Governments also use the ability to grant tax exemptions, typically on the grounds that this is an incentive to bring in more investment, as an instrument through which Governments command support and political financing.

There is also the notorious "race to the bottom" of attracting international investment, where firms use the threat of relocation to bargain for tax exemptions. The excessive granting of tax preferences and tax treaties agreed on disadvantageous terms cause major losses of revenue in Africa (AfDB, OECD, UNDP, 2014). In an increasingly globalized world, African countries must navigate the complexities of international tax law. This topic is hard to separate from the issue of illicit financial flows, which will be covered in subsection 2. IMF (2014c) states that spill-overs from rich-country tax rules are especially marked and important for developing countries, which typically derive a greater proportion of their revenue from corporate tax.

ECA (2014c) argue that while reforms to tax policy and administration seem technical, the real constraints are often political will and leadership. Reform-minded African politicians face great difficulties overcoming the entrenched political incentives and structural constraints.

### 1. International support for African tax reforms

The role that ODA and ODA-type flows play in this area is complex. There can be a risk that international public finance could displace domestic public finance by relieving domestic governments of the need to raise taxes, in some cases. The latest research, however, suggests that, on average, there is no evidence for this (Carter, 2013; and Morrissey, Prichard and Torrance, 2014). It seems that recipients of ODA either tend not to reduce tax effort or that joint efforts to deal with that risk tend to be successful.

But the efforts of the international community to assist Africa's domestic revenue mobilization have not

been terribly great, although there has been a recent expansion of activity in this area. Prichard, Brun and Morrissey (2012) and Fjeldstad (2014), have surveyed these efforts and argue that technical reforms should not be the primary areas of focus. There are some more technocratic reforms, such as the introduction of semi-autonomous revenue authorities or large taxpayer units, that can raise tax revenue by few a percentage points of GDP, but meaningful progress on reforming tax systems is a thorny political challenge, and is bound up with improvements in public service delivery and public perceptions of government accountability that African countries have long struggled with. In addition to proving technical assistance, donors should endeavour to support local leadership reform efforts, and account for political dynamics. Any tax-related conditionality must be based on more nuanced performance indicators, and donors must coordinate their efforts and provide assistance on international taxation issues.

## 2. Curbing illicit financial flows

Africa is estimated to lose many billions of United States dollars to illicit financial flows, although data are hard to find and approximations are believed to be underestimates. The recent Report of the High-level Panel on Illicit Financial Flows from Africa, suggested that Africa is losing more than $50 billion annually in illicit flows (although that number pertains mainly to trade misinvoicing) (ECA, 2015b). The concept of illicit financial flow covers a broad range of activities, encompassing crime, bribery, tax evasion and more. It does not necessarily represent outward flows that reduce financing for development in the same sense as, for example, an inward loan increases available resources. In some cases, it may be better to think of the lost resource for development as the forgone taxation on the illicit flow, rather than the gross flow itself.

The diversity of illicit financial flows requires a diversity of policy responses, and to a great extent, overlaps with the fight against crime and corruption more generally. The political economy of this problem is tremendously difficult. In some cases, where political elites benefit from the weaknesses of present systems, asking them to create an effective system to tackle this problem amounts to asking the fox to create a better hen house (Reuter, 2014). The High-level Panel's report recognizes that much of the responsibility for finding solutions to the problem of illicit financial flows lie in Africa's hands, but that ultimately, global solutions are needed. The Panel's call was echoed in the Addis Ababa Action Agenda, which commits to substantially reducing illicit financial flows by 2030, with a view to eventually eliminating them altogether, including by combating tax evasion and corruption through strengthened national regulation and increased international cooperation.

In the context of the finance for development negotiations, there is great scope for international cooperation. Increased support for local capacity-building is an obvious need. The High-level Panel notes that African countries would need an additional 650,000 new tax officials to have the same ratio of tax officials to their population as OECD countries (ECA, 2015b). In an international context, the present paper endorses the need for public registers of beneficial owners of companies and trusts, and comprehensive and public country by country reporting of company accounts. The Automatic Exchange of Information for Tax Purposes is also endorsed, but, reflecting a lack

of capacity, African countries should be allowed to receive information initially, even if they are not in a position to transmit it.

Tax treaties between developed countries and African countries are often on unfavourable terms, and African countries risk "making unbalanced concessions with regards to double taxation agreements" (ECA, 2015b, p. 58 and 59). The report encourages developed countries to analyse the impact their own tax regimes have on African countries. IMF (2014c) states that the sums at stake in Africa from international tax issues are large, relative to their overall revenue.

The High-level Panel report also criticizes the OECD[28] base erosion and profits shifting initiative for not being "principally geared to developing country concerns" (ECA, 2015b, p. 66). Instead, it calls for Africa to "act in concert with its partners to ensure that the United Nations plays a more coherent and visible role in tackling illicit financial flows" (ECA, 2015b, p. 76). One option is to greatly strengthen the United Nations Tax Committee, to create a viable alternative to the current OECD-led process. Some observers have suggested that a group of developing countries could unilaterally move forward with the formula-based unitary taxation of multinational companies, based on employment.

## 3. Extractive industries

A growing number of African countries have recently discovered large hydrocarbon deposits that, in some cases, will generate flows of foreign currency far in excess of anything provided by official donors. Large discoveries – oil or gas fields that contain at least 500 million barrels of recoverable oil or gas equivalent – have already been made in Ghana, Kenya, Liberia, Mozambique and the United Republic of Tanzania (Arezki and Banerjee, 2014). It is not clear how the international community will respond to these discoveries, but official support may fall as hydrocarbon revenue start to flow.

Recent research has suggested that the well-known "resource curse" may be a statistical mirage. James (2015) argues that slow growth of total GDP actually reflects a slow-growing resource sector during periods when commodity prices fall, and there is little evidence that resource dependence impedes growth in the non-resource sectors. Other researchers report a negative effect of resource wealth on the level of income per capita (Arezki and Van der Ploeg, 2011). There is a well-documented negative relationship between resource wealth and governance. Arezki and Brückner (2011) show that an increase in oil rents lead to corruption and deteriorating political rights. Tsui (2011) explains that large oil discoveries tend to be followed by a move to political authoritarianism.

The optimal response to a resource windfall is to invest in productive assets, perhaps via the accumulation of foreign and domestic assets in a sovereign wealth fund. Van der Ploeg and Venables (2011) study the developing country context, where capital is scarce and the economy is below its long-run growth path. They show that investing in domestic assets and reducing distortionary taxes could be preferable to establishing a sovereign wealth fund, presuming the Government is capable of making productive domestic investments.

28 OECD, Organization for Economic Cooperation and Development.

Not surprisingly, the political and institutional challenges of implementing optimal policy are severe. There are international initiatives, such as the Extractive Industries Transparency Initiative, aimed at overcoming these problems. Twenty four countries in Africa are members of this initiative, with 19 designated as complaint and 5 as candidate countries. Its membership involves disclosing government revenue from natural resources, production figures and the ownership of license holders, among other information. Another idea for sharing the benefits of resource rents in an open and equitable manner is to establish an explicit citizens' dividend, modelled on a scheme in Alaska (Moss, 2010). Such a scheme requires a Government that is capable of surrendering discretionary control of massive sums of money, which would be quite a challenge given the realities of African politics.

***Resource financed infrastructure***

An emerging model, to allow countries with recent natural resource discoveries to accelerate infrastructure investments, is "resource financed infrastructure" – by pledging future government revenue from resources flows. Halland and others (2014) explore this idea in depth, and highlight both its great potential and concerns of transparency and how hard it is to know whether African countries are getting a good deal. In some circumstances, the resource financed infrastructure model could be a useful commitment device, if Governments would otherwise find it hard to invest resource revenue productively, once cash has started flowing.

## C. International public finance

No African country wants to be dependent on aid. ECA (2013) called on African countries to develop clear and time-bound strategies to exit aid dependence. At the same time, many African countries lack the financial resources to fund urgently needed investments in infrastructure, and in its people and institutions. While steps can be taken immediately to increase the mobilization of domestic resources and external finance on market terms, in the long run, only economic structural transformation and inclusive growth will ensure that African economies generate the resources needed to finance their own development strategies. International public finance – from highly concessional flows such as grants, to loans on close to market terms from multilateral development banks – is needed to finance the investments required to put Africa on the path to self-reliance. More aid is still urgently needed today, to reduce the need for aid tomorrow.

***Official development assistance***

There is a strong case for higher volumes of ODA to Africa. A good deal of political attention is paid to the commitment by OECD countries to provide 0.7 per cent of gross national income in the form of ODA, although the current economic and political environment in contributor countries means the prospects for rapid progress on that front are slim.

As part of the Addis Ababa Action Agenda, member States have recommitted to achieve the target of spending 0.7 per cent of gross national income on official development assistance (0.15 to 0.20 per cent for least developed countries). The Agenda also included a package of measures for the poorest

countries, as developed countries are encouraged to increase aid to least developed countries to 0.2 per cent of gross national income by 2030. Member States also agreed to adopt or strengthen least developed countries investment promotion regimes, including with financial and technical support. Governments also aim to operationalize the technology bank for this group of countries by 2017.

But the quality of aid is as important as its volume. Both the Paris Declaration on Aid Effectiveness (2005) and the Busan Partnership agreement (2011) recognized that the purpose of aid is to help recipient countries achieve their broader development objectives. This requires aligning their aid delivery to the recipient country's development strategy. Project proliferation and donor coordination remains a problem, as does the unpredictable nature of aid. African countries should take the lead in requiring donors to streamline their interactions with their Government and coordinate their activities in national development strategies.

The gulf between African priorities and the nature of ODA is evident in sector allocations. Not only politicians, but the African people seem to perceive infrastructure and economic development as their top priorities, yet ODA is overwhelmingly allocated to social services in Africa (Pritchett, 2015). To an extent, a focus on social services is appropriate in countries where large numbers of people live in extreme poverty and lack access to basic services, but the bias against service sectors in Africa appears to be excessive.

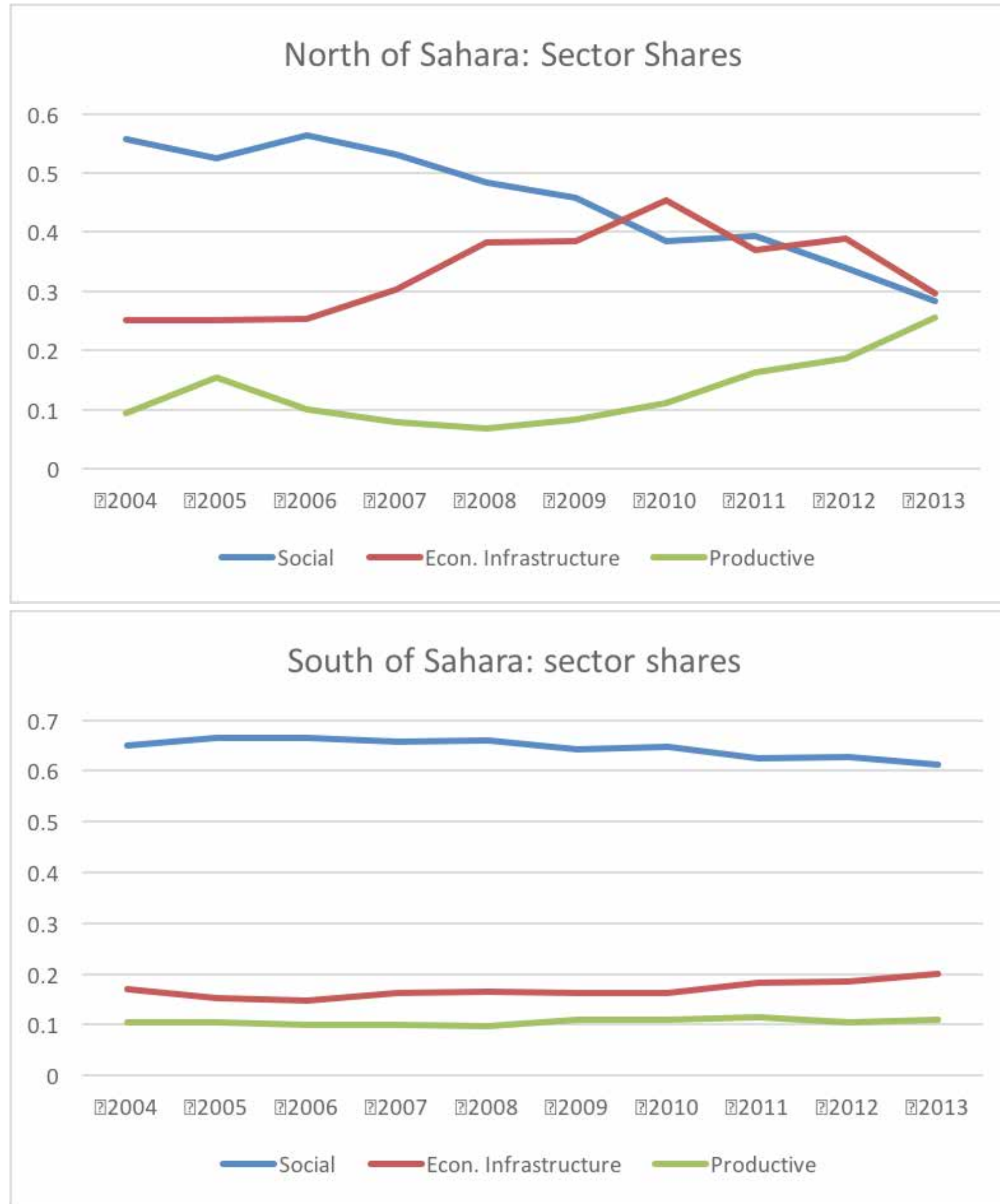
Figure 17 shows the share of ODA accounted for by three key sectors – the social sector, economic infrastructure, and the production sector. The share of the social sector is highest in sub-Saharan Africa – although north of the Sahara, the sector allocation has changed markedly in recent years. The share of aid allocated to economic infrastructure and production has started to climb recently in sub-Saharan Africa, but only modestly.

The allocation of ODA in Africa is also hard to justify, at least on the basis that the purpose of ODA is to fight poverty. Figure 18 shows the relationship between country programmable aid per person and average income per capita in each country.[29] There is no visible correlation, but low income countries, which represent close to half of Africa's population, received $66 per capita, on average, compared to $89 in lower-middle income countries (AfDB, OECD, UNDP, 2014).

The trends look even harder to justify when the focus is on extreme poverty. The second chart in figure 8 focuses on countries with GDP per capita below $2,000, in 2012 dollars, and shows country programmable aid per person living in extreme poverty (under $1.25 per day). The correlation runs in the wrong direction – poorer countries receive less aid, in relation to the number of citizens living in extreme poverty, than better-off countries. There is an urgent need to mobilize greater volumes of ODA for Africa's poorest nations. If OECD countries delivered on their

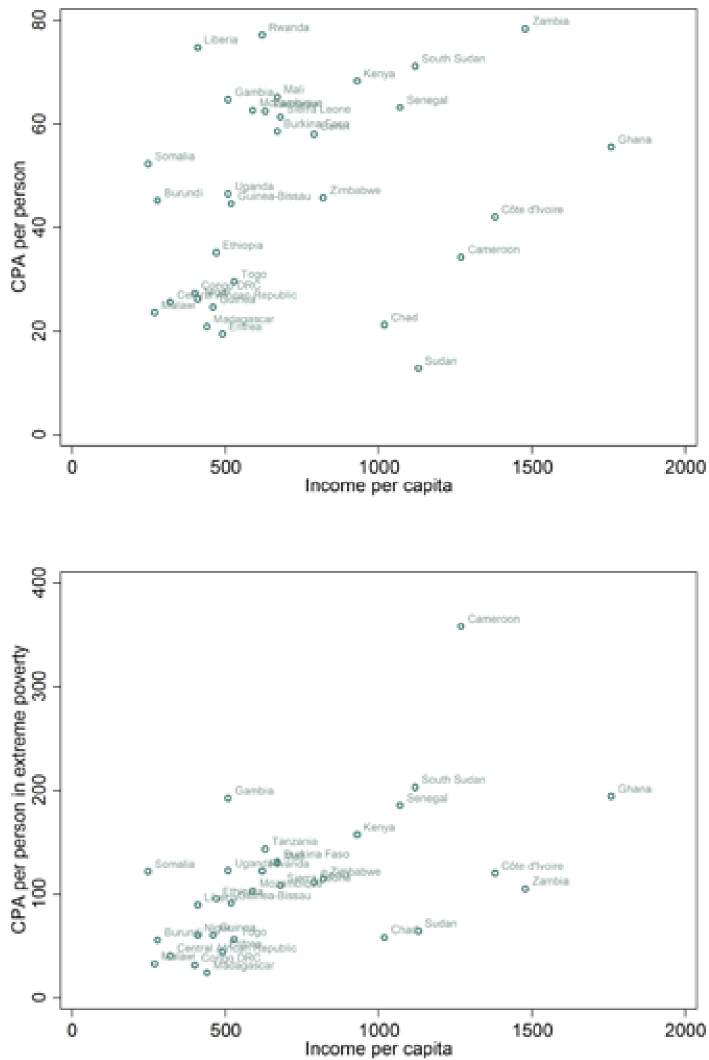
29 Data are country programmable aid allocations averaged over the period 2013–2015, one outlier (Namibia) is excluded.

**Figure 17:** Sector allocations of official development assistance in Africa




***Source:*** https://stats.oecd.org/Index.aspx?DataSetCode=CRS1

**Figure 18:** Country programmable aid per capita and country income (above) country programmable aid per person living in extreme poverty and country income (below)




***Source:*** Survey on Donors' Forward Spending Plans, World Development Indicators (OECD, 2014b).

0.7 per cent commitment, there would be ample funds to lift allocations to the poorest countries without penalizing other African aid recipients.

## D. Multilateral and bilateral development banks

Official finance remains crucial to Africa's investments in infrastructure for structural transformation. The Infrastructure Consortium for Africa estimated that just under $100 billion was invested in infrastructure in 2013,[30] – of which, 44 per cent was provided by external official finance, 46 per cent from African government budgets, and the remaining 10 per cent from private investors (Infrastructure Consortium for Africa, 2014).

The multilateral development banks – World Bank Group, African Development Bank, European Investment Bank – committed roughly a combined $9 billion in 2013, but China remains the single largest lender for infrastructure in Africa, committing $13.4 billion. Other emerging lenders operate at a smaller scale. For example, in 2011, India said it would commit $5 billion over a three-year period, and the Arab Coordination Group committed almost $3.1 billion in 2013. The largest provider of non-ODA financing among members of the Infrastructure Consortium for Africa was the Development Bank of Southern Africa ($1.2 billion). According to the European Development Finance Institutions (2013), European bilateral development banks reported euro 1.2 billion of new projects in the Africa, Caribbean and Pacific region.

30 This figure may include some double-counting of domestic government spending financed by external official lending.

Recent trends in the supply of multilateral funds for Africa are superficially flat, although the continent will probably enjoy a greater share of allocations from the World Bank's International Development Association (IDA).

The most recent replenishment of the African Development Bank's soft window fund, the African Development Fund, saw a slight decline in donor contributions in real terms. Its largest borrowers are Morocco and Tunisia. The Bank's hard window fund has a few clients in sub-Saharan Africa, notwithstanding the growing number of African Development Fund clients raising funds on the international bond market. In early 2014, the Bank amended its credit policy to allow creditworthy borrowers to access limited amounts of hard window funds for high priority projects (Manning, 2014).

The recent replenishment of the World Bank's soft fund window – IDA – also experienced a modest decline over the previous round, but the supply of its resources to poorer African countries is likely to rise because the number of qualifying borrowers is falling. In population terms, IDA-eligible borrowers are projected to fall by two-thirds by 2025 (Moss, 2012). Of the remaining countries, more than 80 per cent (25 out of 31) will be African. IDA has also established an allocation regime for countries facing "turn-around" situations, and it has reduced the weight on "country performance rating" in its allocation rule. Both measures will benefit many African countries.

In 2014, the World Bank took steps to increase funds available from its hard lending window – the International Bank for Reconstruction and Development (IBRD). These include revising its

minimum equity-to-loan ratio and changing loan terms, offering longer maturities with increased maturity differentiation. Combined, the World Bank expects these measures to expand annual lending from $15 billion to more than $25 billion per year.

As African countries grow, the process of graduation from soft to hard lending windows will be of increasing concern to many. Galliani and others (2014) show that ODA, as a share of gross national income, more than halves after countries cross the IDA threshold, on average. Their analysis, based on the 35 countries that graduated between 1987 and 2010, show that this reduction in ODA is associated with a significant growth slow-down, which they attribute to reduced infrastructure investment. Reisen and Garroway (2014) recommend four reforms of multilateral finance institutions: redefining the eligibility criteria for concessional funds, perhaps using the United Nations Human Development Index or similar; smoothing transition periods from IDA-only via blend to IBRD-status; strengthening subsovereign allocation to take account of the rural-urban inequalities; and opening the multilateral soft windows for regional and global public goods, especially climate related.

## E. National development finance institutions

Development banks have played a very prominent role in the economic development of countries that have successfully initiated the process of structural transformation, particularly in fast-growing middle income countries such as Brazil, China and India.

There are more than 140 development financial institutions in Africa with a mandate to foster economic development in the jurisdictions, but almost nothing is known about their effectiveness. In a global survey of development banks – undertaken for the World Federation of Development Financial Institutions and the World Bank – de Luna-Martinez and Vicente (2012) provides a wealth of information about their activities, but lack of data precludes analysis of development impact. Another dimension worth exploring is their role in helping countries respond to shocks. Calice (2013) notes that in addition to promoting development generally, development financial institutions can play an important countercyclical role by expanding their activities during downturns.

Evidence from country case studies is mixed (many focus on explaining notable failures). For example, Lazzarini and others (2015) study loans and equity investments by the Brazilian National Development Bank and find no consistent effect on firm-level performance and investment, except for a reduction in financing costs. The overall macroeconomic impact of national development banks is unknown, but it seems intuitive that large providers of subsidized credit would have a positive impact on investment, even if they do crowd out the private sector to an extent.

The expansion of African national development banks would pose severe capacity and governance challenges, and international cooperation could prove especially valuable. But as African countries want to take control of their economic destinies, a greater role of domestic development financing seems desirable.

## F. Mobilizing private finance

Trends in private financial flows, from both domestic and international sources, have been positive since the 2002 Monterrey Consensus. As African countries continue to grow – graduating from low-income countries to lower-middle income and then upper-middle income country status – the trend looks likely to continue. This represents an opportunity for Africa to source the capital it needs, and offset the anticipated decline in ODA relative to GDP. But private flows are not always well aligned with national development strategies, and (with some exceptions) by their nature, tend not to reach countries with the most urgent development needs. The challenge Africa faces is twofold: to mobilize private finance and align it with development priorities.

There are also important linkages to public sector financing – African Governments must balance the need to tax private economic activity and raise the revenue needed to fund public services and public goods against the burdens taxation can impose on the private sector. In addition, enthusiasm for private sector financing should be tempered by the need to ensure that the damaging financial instability experienced by other developed countries after integration with global capital markets, does not recur.

This section focuses on three policy options – with the potential to remove barriers to private finance in Africa – for Governments to consider. This needs to be set in the context of private finance being, by definition, driven by private risk capital; and, private capital seeks (as a rule) profits. The fundamental role of Governments in this context is indirect, creating an "enabling environment" in which private investment can flourish (European Report on Development, 2015). Here, as elsewhere, the quality of political and economic institutions is paramount. This is why peace and security and good governance are the most important things African Governments can contribute to the financing for development agenda.

The three policy reforms identified in this section are: supporting domestic financial sector deepening; international private capital – opportunities for Governments to address "missing markets" areas that are unlikely to be financed privately without policy support; and, ensuring financial stability – domestic and international policies needed to promote financial stability.

### 1. Supporting domestic financial sector deepening

Financial deepening in Africa has been accomplished by a proliferation of financial institutions, including regional banks, microfinance-orientated banking institutions and mobile banking providers.

This growth in credit has not been matched by increased savings mobilization (including through investment and pension funds). Financial inclusion quadrupled between 2004 and 2011, but 60 per cent of Africans remain unbanked (IMF, 2013a). Financial exclusion is highest in rural areas and in certain countries, and there is still widespread use of informal financial services.[31]

31 For example, the Central African Republic, the Democratic Republic of the Congo and the Niger have access levels below 5 per cent.

As noted in chapter II, savings mobilization is closely correlated with increasing GDP per capita, so causality between savings and growth runs in both directions. Nevertheless, good policy can help create a virtuous circle. Institutional soundness and market integrity are essential, and policy needs to tackle demand-side constraints on financial access.

***Micro-prudential regulation of markets and institutions***

African public financial institutions, including central banks and regulators, need to continue to build their institutional capacity. For private financial institutions, especially systemically important ones, there is a need for enhanced monitoring and management of risks, such as excessive dependence on wholesale and external funding, declining asset quality, and foreign currency mismatches. Policy can directly support these goals through adequate resourcing of institutions and through technical support (IMF, 2014e).

Private institutions, including banks, need to also continue to build internal capacity that matches their increasing scale and risk profiles. At present, capital and liquidity ratios are typically sound (Beck and others, 2011). The emergence of regional banking institutions is also positive in this regard because such larger institutions typically have stronger institutional capacity and have risk diversifications benefits (Tyson, 2014).

There have been, however, recent institutional failures in the region. These have been concentrated in smaller, domestic private sector institutions. Causes have been identified as credit exposure to macroeconomic cycles, inadequate regulation and supervision, poor governance, contagion between banks, illiquidity and insolvency (Reinhart and Rogoff, 2009; Mezui and others, 2012).

***Expanding financial access***

As aforementioned, significant progress has been made in expanding financial access in Africa, but low access continues in rural areas, among women and in particular countries.

Supply-side constraints remain – these include low population densities, poor transport and limited communications infrastructure. Exclusion may also occur because of documentation and collateral requirements, or because of costs (such as high transaction fees or substantial minimum requirements for savings balances or loan amounts). Working with the private sector to reduce these barriers remain an important policy goal.

Demand-side constraints to formal financial access include a lack of trust in institutions as guardians of the savings of the poor (Collins and others, 2009). Policy can also tackle these issues through regulatory actions in consumer protection and deposit insurance.

***Domestic investment funds***

Africa is now home to 15 sovereign wealth funds (ESADE, 2014). The largest sovereign funds are the Libyan Investment Authority and the Revenue Regulation Fund in Algeria with $65 billion and $57 billion, respectively, of total assets. The oldest sovereign funds in Africa are the Pula Fund in Botswana and the Mineral Development Fund in Ghana, both established in 1994. The Pula Fund accounts for roughly two thirds of total African sovereign wealth fund assets, outside North Africa. In 2012, three funds were established by Angola, Ghana and Nigeria.

Sovereign wealth funds can direct investments to structural transformation. For instance, the Angolan fund targets investments in infrastructure and hospitality. It can also be used for macroeconomic stabilization. In particular, resource-rich African countries that are exposed to commodity price fluctuations, have an opportunity to smooth their revenue and expenditures across commodity cycles.

Governance, especially lack of transparency and accountability, and poorly articulated and executed investment strategies, are the most important issues facing sovereign wealth funds in Africa. The original "Norwegian" sovereign wealth fund model involved investing in overseas assets purely in pursuit of financial returns, but an emerging African model seeks to exploit the potential of these funds as sources of domestic development finance. Poor democratic oversight and a lack of transparency and accountability, raises the risk of sovereign wealth funds being diverted to inefficient politically motivated investments.

Africa's pension fund landscape is developing rapidly. The long-established Public Investment Corporation in South Africa is the continent's largest asset manager, with $150 billion under management. New entrants are growing rapidly. In 2006, Nigeria transformed its defined benefits system into a defined contribution system, and the fund has now tripled in size to $25 billion. Pension assets now equate to some 80 per cent of GDP in Namibia and 40 per cent in Botswana.

Pension funds have the potential to become major investors in domestic markets because of their need for assets in currencies that match their long-term liabilities. Regulatory barriers and shallow local capital markets, however, constrain asset allocation by African pension funds to predominantly government bonds[32] (Commonwealth Secretariat, 2014). There is great untapped potential for investment in the African private sector. A survey of the 10 largest African pension funds found that of $379 billion in total assets, about $35 billion is allocated for private equity but just $5.7 billion is invested.

## 2. International private capital

International private capital is flowing into Africa. Much of this capital should be channelled into sectors that would enhance economic growth. There are two key areas that Governments should consider in order to maximize the positive impact of these flows. First, seek to crowd private sector capital into sectors that are important for structural transformation. These include agriculture, small and medium-sized enterprises, and infrastructure. There is often a mismatch between private and social returns in these sectors, and without policy intervention, they would not attract sufficient capital. Second, Governments can improve national financing through tapping into these flows. These two areas are discussed in detail below.

***Partnering with international private capital***

The most critical barriers for private sector investment in priority areas are:

- A lack of bankable projects, in part because of the inherent complexity and lengthy project preparation requirements of infrastructure investments, and in part reflecting a lack of local

32 For example, Manson, Katrina, "Private equity remains a rarity in African pension portfolios", *Financial Times* (5 October 2014).

technical capacity to plan and execute national investment strategies.

- Short investment horizons relative to the required investment periods. For infrastructure investments, average preparation times are six years and project duration can be over decades (te Velde and others, 2015).

- Political risk, which can undermine the certainty of commercial returns and related incentives (Tyson, te Velde and Griffiths-Jones, 2014a and 2014b).

Policy approaches have taken two basic forms, which are often combined in the same project. They are:

- Providing project preparation facilities to create a pipeline of bankable projects and the provision of technical assistance to create an enabling environment for private investment. The Programme for Infrastructure Development in Africa, hosted by the African Development Bank, has produced a priority action plan consisting of 51 infrastructure projects in energy, water, transport and information technology, requiring an investment of $68 billion to be realized by 2020. Other development banks have also recently strengthened their project preparation facilities.

- Mitigating or sharing risk with the private sector. This includes providing guarantees, co-investment vehicles, and partnerships, including public-private partnerships – which are discussed in detail below. Such policy needs to be carefully designed to avoid creating a moral hazard among private sector investors, and to avoid subsidizing projects that would have happened anyway.

These approaches are being most widely used in relation to infrastructure financing. It is too soon to conclude on their effectiveness (te Velde, Tyson and Steele, 2015).

***Guarantees***

Infrastructure deals in Africa are often regarded as too risky by international private investors. Some institutional investors, such as pension funds, have particularly low appetites for risk. Guarantees provided by multilateral development finance institutions or major bilateral donors have the potential to unlock large flows of private capital. Guarantees can be issued in combination with other financing structures, such as public–private partnerships, and the involvement of a development finance institution can also help reduce underlying risks.

But the impact of guarantees from multilateral banks has so far been limited (Prizzon and Humphrey, 2014). The Multilateral Investment Guarantee Agency of the World Bank, which offers political risk guarantees, has been more successful, but multilateral banks, which mainly offer credit guarantees, has been less successful. Bilateral donors are not banks and with sovereign backing can, at least in theory, be more aggressive in terms of pricing guarantees, which is one possible avenue for increased activity in this area.

***Co-invested and co-managed funds***

An increasingly popular approach by international development agencies is to pool their funds with private investors with the aim of "catalysing" investment. Public funds may simply be used as a

subsidy to raise risk-adjusted expected returns for the private investor, but the more important contributions may be non-financial, including technical expertise.

Funds may also act as a vehicle for bundling financing from multiple investors to diversify risk and achieve the scale needed for major infrastructure projects. Recent examples include the Africa-50 Fund of the African Development Bank, and the Global Equity Infrastructure Fund of the International Finance Corporation. To date, the most common private sector co-investors in such funds have been sovereign wealth funds and private equity funds. It is hoped that pension funds may be substantial investors in the future.

This approach to mobilizing the private sector is contentious. It offers the potential to catalyse investment on a scale that matches Africa's development needs, but it also risks using scarce public funds to subsidize private profits. Identifying projects where there are both development benefits and where the investment would not have occurred anyway without public assistance, is an inexact science. If the public sector tries too hard to ensure all the projects it participates in are truly "additional", it may end up funding too few projects. So a balance must be struck. Participating with the private sector is more likely to serve developmental ends in regions and sectors where private sector investment is rare, and where there are more direct links to the economic activity of poorer citizens. Crudely put, a shopping mall in Nairobi is less likely to justify public participation on developmental grounds than an irrigation infrastructure in a low-income rural region. Development finance institutions, such as the International Finance Corporation of the World Bank, and the Commonwealth Development Corporation (CDC) in the United Kingdom, have operational guidelines designed to minimize their chances of simply subsidizing private investment, but their track record is mixed.[33] If African national development banks decide to enter this arena, transparency will be of the upmost importance. African Governments could do more to ensure that the activities of donors intent on catalysing the private sector is better aligned with national development strategies.

***Public-private partnerships***

Partnerships may take many forms, but a typical public-private partnership will involve a government-provided concession where the private sector participants own, finance and manage the project for a defined period. The key idea is to design an incentive structure for private participants that encourages quality and efficiency.

But while public-private partnerships have the potential to be more efficient and can solve some financing problems, there is also a risk that the current enthusiasm for "catalysing" the private sector will lead to these partnerships being used where traditional public sector investment would have been more suitable. This is especially likely in sectors where there is no natural source of revenue from private paying customers, and the public sector is the ultimate source of revenue for the private firms.

Public-private partnerships are attractive in infrastructure as they potentially avoid the need for the public sector to assume large debt burdens

33 See the Independent Evaluation Group, "Assessing the IFCs poverty focus and results", World Bank Group, (2011).

in order to finance projects. But these partnerships still entail taking on long-term liabilities, something that is not always fully appreciated by public actors (OECD, 2013). Public-private partnership projects have also been affected by gaps between public and private sector expectations, inadequate legal and regulatory frameworks, poor management and poor transparency. In addition, partnerships can be subject to problems relating to economic viability as investors typically seek returns of over 20 per cent on projects where that may not be achievable or politically palatable (International Finance Corporation, 2013).

***Sourcing government finance from international capital markets***

African Governments have relied heavily on concessional loans and grants, and as economies mature, these sources of finance can be expected to decline. Private international capital markets offer an alternative, with the potential advantage over official financing of being more liquid, and free of conditionality. Since 2013, more than $18 billion has been raised in sovereign bonds for Africa (Tyson, 2015b).

Private equity and other investments funds are also becoming increasingly active in the region (it is difficult, however, to quantify the levels of funds because they are not publicly disclosed). Even though these sources of capital offer an unprecedented opportunity to finance development – in both the public and private sectors – they also carry risks of creating macroeconomic and financial instability. Such issues have been the source of damaging crisis in other developing countries, including in Asia and Latin America.

These types of capital sources require careful management.[34] They can also be vulnerable to rapid changes in cost. The foundation of debt sustainability is the productive investment of borrowed funds, to deliver economic growth and maintain appropriate debt to GDP ratios. In some countries, borrowing from international capital markets has been associated with increased infrastructure investment – these include the Côte d'Ivoire and Rwanda. But some countries appear to have used funds for purposes with little or no developmental impact (IMF, 2014b; Tyson, 2015b). In Africa, the institutional environment for debt management has significant weaknesses (IMF, 2014b). Institutional weakness can create significant problems, such as poorly executed transactions, misuse of funds and ultimately, public finance crisis. Access to international capital markets should receive high levels of parliamentary oversight, public transparency and independent auditing (Tyson, 2015b).

Other risks include the build-up of foreign exchange, which can swell the debt repayable in local currency terms (in both the public and private sectors) because they are typically denominated in hard currencies. This risk has been highlighted repeatedly by IMF and other commentators and, again, has been a trigger for financial crisis in other regions in the past. This is especially because a number of sub-Saharan African currencies have recently suffered volatility and deprecation, including the Nigerian naira and the Ghanaian cedi. Although a number of countries in the

34 Full detailing of these structures is beyond the scope of the present paper. The World Bank, however, highlights the core requirements for debt management as being: governance and strategy development; coordination with macroeconomic policies; borrowing and related financing activities; cash flow forecasting and cash balance management; operational risk management; and debt records and reporting (World Bank, 2013b).

region have managed or pegged exchange rates, these typically offer only shorter-term protection where national reserves are limited and so these countries should not be complacent about allowing such risks to rise.

Such flows also make countries vulnerable to their reversal. Again, this is a very immediate risk: the expected reversal of loose monetary policy in advanced economies has been repeatedly highlighted. Portfolio flows are particularly vulnerable to these risks because of their liquid nature and the ability of international investors to rapidly withdraw funds or put a "sudden stop" to the flows, which causes an economic shock to growth. Again, such risks have been triggers for financial crisis in Asia and Latin America, and in advanced economies, during the financial crisis in 2007 and 2008. Protective factors can be the use of funds in "sticky" investments – where funds cannot be rapidly withdraw – such as those often made through FDI[35] rather than portfolio flows. Capital flow management is also now considered an appropriate policy tool in the case of destabilizing short-term outflows, and should be prepared for, and employed by, countries in the region (IMF, 2013b).

## 3. Ensuring financial stability

Developing countries have repeatedly experienced damaging financial crisis as they have engaged with private finance. Middle-income countries that experience inflows of international private capital are particularly vulnerable to such problems.

35 FDI, foreign direct investment.

African financial markets have been relatively stable since 2002.[36] But a recent study by the African Development Bank highlighted the continued risks of systemic crisis in the region (Caggiano, Calice and Leonida, 2013). Policy options to maintain financial stability are detailed below.

### *Macroprudential regulation*

Macroprudential regulation focuses on the risks to the entire financial system rather than risks to individual institutions.[37] Its absence has been identified as a key failure that led to the global financial crisis (Independent Commission on Banking, 2011).

Macroprudential frameworks that are relevant to African countries are being developed. Some countries in Africa are in the process of adopting tools such as reserve requirements, caps on FX positions and limits on loan concentration. Nevertheless, most countries do not have a macroprudential framework in place or an explicit regulatory objective to prevent the build-up of systemic risk (Caggiano, Calice and Leonida, 2013).

### *Capital account management*

Evidence on the benefits of open capital accounts, in terms of economic growth, is lacking. One authoritative review concluded: "Free trade in assets seems to have

36 Since 2002, there has been less financial instability in the region than in the 1990s (Rogoff and Reinhart, 2009; Beck and Maimbo, 2013). There has, however, been one financial crisis – in Nigeria in 2009 (Sanusi, 2012) and indicators of rising fragility, including increasing non-performing loans in Kenya, the Gambia and the United Republic of Tanzania (Lunogelo and others, 2009; Central Bank of Kenya, 2013; IMF, 2010), and rising sectoral concentration in Kenya and Rwanda (Caggiano, Calice and Leonida, 2013),

37 They can include, countercyclical provisioning, loan-to-value ratios, and direct controls on lending to specific sectors to manage procyclicality (Krishnamurti and Lee, 2014).

little benefit in terms of long run growth and …there is a good case to be made for prudential and other non-distortive capital controls" (Jeanne, Subramanian and Williamson, 2012, p. 5).

At the same time, "disruptive capital flows" (IMF, 2012) – most commonly rapid cross-border flows of private capital – have repeatedly caused macroeconomic instability and have been triggers for financial crisis in developing countries. Economies with relatively small and underdeveloped financial systems, such as those in Africa, are particularly vulnerable (Tyson, Kennan and Hou, 2014).

Capital flow management has repeatedly proved effective in protecting countries from financial instability, and is gaining a broad consensus as an acceptable policy (IMF, 2012). In circumstances where capital flows threaten financial and economic stability, capital flow management should be adopted.

***Representation in the reform of global financial architecture***

Since the financial crisis of 2007, there has been ongoing reforms of the international financial architecture. Most reforms, however, have been focused on advanced economies with less consideration of developing countries.

This was highlighted by the Financial Stability Board who commented on the need for adaptation of Basel III to developing countries, the need for international cooperation to manage spill-over effects, and the need for bilateral supervisory arrangements (FSB, 2011). To date, little has been done to effectively tackle these issues. Africa needs greater representation in forums that enact reforms, including the Basel Committee[38] and the Financial Stability Board.

## G. Non-financial means of implementation and systemic issues

The present paper has focused on mobilizing finance for development, but the financing for development conference in Addis Ababa consider a broader agenda that includes so-called non-financial means of implementation. The general idea is to develop coherent policies that are conducive for sustainable development, domestically and internationally. Policy coherence is a key issue – for example, advanced countries subsidize both fossil fuel exploration and climate change mitigation (Whitley, 2013). The European Commission has identified five key areas for international policy coherence: trade and finance, climate change, food security, migration, and security (European Commission, 2014).

These questions are beyond the scope of the present paper, but some African potential priorities are briefly mentioned here.

A key weakness in the international system is that African countries remain highly underrepresented in global economic and financial policymaking structures and institutions, even though they are being increasingly affected by global financial and economic shocks (ECA, 2013). The current international architecture for dealing with international tax issues is dominated by OECD,[39] and some voices have called for the United Nations tax committee to be allocated

38 Only South Africa is a Basel Committee or Financial Stability Board member.

39 OECD, Organization for Economic Cooperation and Development.

more resources and responsibilities, and become the focus of international action on tax matters. However, given the crucial importance of the behaviour of multinational corporations and the global financial system, a United Nations body – with little leverage over these entities – needs to be strengthened to duly undertake this mandate.

Many important systemic issues (e.g. trade) were dealt with in other international forums, such as the tenth World Trade Organization Ministerial Conference in Nairobi, in December 2015, but African requirements were signalled in the financing for development conference in Addis Ababa. The Agenda calls on WTO members to redouble their efforts to promptly conclude the negotiations on the Doha Development Agenda, emphasizes the importance of policy coherence and regional integration, commits to expand trade financing, which can alleviate constraints on capturing trade-expansion opportunities, and invites the General Council of WTO to consider how it can contribute to sustainable development.

There is also much work to be done in Africa. At the ninth ordinary session of the African Union Conference of Ministers of Trade, held in Addis Ababa, in December 2014, the trade ministers again committed to establishing a continental free trade area – and removing physical barriers to trade is a main focus of Africa's Programme for Infrastructure Development in Africa. External resources for this task can be mobilized under the Aid for Trade initiative, led by the World Trade Organization. ODA[40] to Africa classified as aid for trade, saw average annual growth of 8.4 per cent between 2002 and 2012, with assistance for transportation and storage leading the way.

The Monterrey Consensus voiced support in principle for a sovereign debt workout mechanism, and recent events in Argentina and Greece have pushed this issue back up the agenda. As African countries gain access to international capital markets, this will be an issue of increasing relevance. IMF has put forward some proposals; and in its resolution 68/304, the General Assembly has called for the "establishment of a multilateral legal framework for sovereign debt restructuring processes". Although this issue will not be resolved in Addis Ababa, it is an opportunity for Africans to express their views, and add shape and momentum to the creation of a comprehensive sovereign debt workout mechanism that balances the interests of all parties.

***Trade and financing for development***

The economic structural transformation of Africa will require the emergence of inter-African "multinationals" and value-chains producing efficiently on a continent-wide scale. Many of the barriers to external and internal trade in Africa are home grown – such as, poor infrastructure, onerous (and sometimes corrupt) customs procedures, and so forth – and, with financial support, are Africa's to solve. Anecdotes abound about how it can be easier for Africans to trade with a country on the other side of the world than the country next door. Tariff and non-tariff barriers to inter-African trade remain stubbornly high, and progress in moving forward the much-needed Continental Free Trade Area, is slow.[41]

40 ODA, official development assistance.

41 A Common Market for Eastern and Southern Africa–East African Community–Southern African Development Community (COMESA-EAC-SADC) Tripartite Free Trade Area is planned for 2015, which,

Africa's regional economic communities take different approaches to trade regulation, imposing a large administrative burden (ECA, 2015a). There are also problems related to a lack of trade finance availability, as aforementioned in chapter II, section E.

But other barriers to African trade cannot be lifted without international cooperation. Africa has benefited from preferential access to major development markets for decades, but to date, this has been insufficient to spur African industrialization. The critical issue for African countries lies in the imbalance between productive capacity and rules of origin. Many of the trade preference programmes have rules of origin imposing minimum levels of local production that most African economies cannot achieve. Africa would benefit from less stringent preferential rules of origin (in line with the voluntary guidelines adopted at the ninth World Trade Organization Ministerial Conference, which was held in Bali, Indonesia, in 2013). Similarly, stringent standards and sanitary and phytosanitary measures – because of Africa's lack of quality assurance and easily accessible standards bodies – disproportionately affect African producers. Given the large fixed setting-up costs of these bodies, there is a case for coordinated regional action with external financial support. Among non-trade barriers, trade facilitation stands out (ECA, 2015a). Africa must also fight for policy space in trade agreements – for example, appropriate tax policy in developing countries must account for the constraints that tax administrations face, which may call for taxes on trade that international agreements might seek to proscribe. In this context, the Addis Ababa Action Agenda welcomes the new WTO process to monitor the implementation of its policy on special and differential treatment of developing countries and reaffirms the right of WTO members to take advantage of the flexibilities to protect public health that are available in the agreement on protecting intellectual property rights and encourages WTO members to accept the amendment of the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement to improve access to affordable medicines. Member States also endorse aid for trade and further commit themselves to providing technical assistance to landlocked developing countries to support their participation in trade negotiations. Furthermore, Governments resolve to enhance support for various efforts to address illegal wildlife trade, fishing, logging and mining, which are a challenge for many countries.

if successful, would add momentum to a continent-wide agreement, scheduled for 2017 (ECA, 2015a).

# V. African priorities for financing structural transformation

The overarching objective of African Governments is structural economic transformation. It needs to be achieved in order to deliver development in its three dimensions – inclusive economic growth, protecting the environment, and promoting social inclusion (United Nations, 2015b).

The financing requirements for these goals are enormous. A credible way to raise these funds in a manner that promotes the goals of structural transformation needs to be found. Central, is domestic resource mobilization in both the public and private sectors.

In the domestic sector, the mobilization of tax, and the effective and efficient use of public funds needs to be strengthened. This will be led by national governments. Initiatives will include continuing to strengthen development planning systems and improve domestic enabling environments, such as through ensuring the rule of law and combating corruption. More efficient and comprehensive tax systems, encompassing the informal sector, need to be built. Technical assistance from donors can help build domestic institutional capacity to meet these goals.

Development agencies and the international community have important roles to play. International coordination and cooperation is needed to stem illicit flows and establish tax transparency and compliance. African countries should join the Automatic Exchange with donor support to convert this into enforceable tax claims. Other proposed remedies, such as country-by-country reporting by multinational corporations and global registers of beneficial ownership and transparency in tax havens, need to be considered.

Private finance will also play a critical role. In the medium term, this includes domestic private finance. Mobilization of savings is needed as per capita incomes rise. Long-term bond and insurance markets are important vehicles for enabling these trends.

International flows have an important role to play, particularly in the short term. Foreign direct investment, management of destabilizing short-term capital flows, and a stable and equitable international financial system in which African Governments are active leaders, are all vital aspects.

The present paper has considered three priorities for domestic and international flows: infrastructure, agriculture and resilience, and investments in people. National governments and international development agencies need to use policy to align them more effectively.

International public finance will play an important role in complementing domestic resource mobilization. Africa should push rich countries to meet their ODA commitments, and has a very strong case for being allocated a larger share of global ODA budgets.

It is now commonplace that ODA is a relatively minor source of finance for Africa, and it is a concern that access to concessional finance is reduced as countries' transition into middle-income status. Shareholders in multilateral development banks are encouraged to develop graduation policies that are sequenced, phased and gradual. Multilateral development banks are also encouraged to explore ways to ensure that their assistance best deals with the opportunities and challenges presented by the diverse circumstances of middle-income countries, and to devise methodologies to better account for the complex and diverse realities of middle-income countries.

For least developed countries, ODA remains important. This is especially because these countries find it difficult to attract private capital, given that they have limited investment opportunities that are commercially attractive to investors. As a result, the OECD proposal, that least developed countries receive 50 per cent of ODA, does not go far enough – in the category of least developed country, the poorer African countries must receive a greater share.

Donor countries are intent on using ODA to "catalyse" the private sector. The appeal of this tactic is likely to vary across African countries, depending on how well aligned development priorities are with profitable investment opportunities. African countries should ask that these activities are done in coordination with their national development strategies, and that as much information as possible about the contract terms are made public.

Specific initiatives need to be set in motion to directly tackle these priorities. For example, contributing countries could be encouraged to set up new initiatives to finance renewable energy generation and extend energy access to families across Africa. The Extractive Industries Transparency Initiative could be supplemented with more resources to help African countries re-examine resource contracts and better monitor resource industry outputs. While there is a proliferation of funds and initiatives targeting agriculture in Africa, these could be complemented by greater efforts to bring African produce to world markets. The Comprehensive Africa Agriculture Development Programme of the New Partnership for Africa's Development would benefit from scaled-up external support.

New initiatives are needed. African Governments, contributing donor countries and private sector actors must partner together to ensure that the finance needed for Africa's structural transformation is found.

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