United Nations
Economic Commission for Africa

No. ECA/16/107

ECA POLICY BRIEF

Reflections on Africa's priorities in financing for development

Introduction

Africa's growth recovery since the start of the twenty-first century has not been sufficiently transformative. Although the overall macroeconomic performance has been remarkable across Africa over the past 15 years, most African economies remain largely agrarian and heavily dependent on natural resources and commodity exports, making them highly vulnerable to commodity price fluctuations. To achieve the overarching goal of structural transformation, many African countries have established a number of special initiatives focusing on infrastructure and human capital development, agricultural transformation, and inclusive and sustainable industrialization. However, the financial implications of Africa's transformation agenda remain substantial.

Africa's vision on financing for development is informed by continental consultations for the Third International Conference on Financing for Development and is reflected in the Addis Ababa Action Agenda as well as the 2030 Agenda for Sustainable Development and Agenda 2063. These agendas notably commit to improving domestic resource mobilization, maximizing innovative financing, implementing existing commitments, and promoting the quality and predictability of external financing. Fundamental to the success of the plans developed by African countries to attain structural transformation is the ability to mobilize resources and allocate such resources to productive sectors that will support the growth and diversification of the economy and thus be the driver for sustainable and inclusive development.

The Addis Ababa Action Agenda moves the debate on financing for development beyond the mere focus on mobilization of resources, by linking Africa's development financing needs to the broader issue of structural transformation, underpinned by capable, inclusive and accountable institutions at the national, regional and global levels. As such, the Third International Conference on Financing for Development offered African countries an opportunity to clearly articulate the continent's priorities for development finance and make specific recommendations on the commitments made by member States, as well as development partners, for financing their development over the next decade and a half. This is a huge task, given the staggering financing needs in the continent. This policy brief outlines the key priorities in financing Africa's structural transformation agenda, focusing on the key messages and recommendations.

Domestic resources are the main imperative of Africa's development finance agenda

To finance its structural transformation and sustainable development agenda, Africa has recently stepped up its policy initiatives aimed at addressing the financing gap, by relying more on public and private domestic resources. These initiatives include the work of the Planning and Coordination Agency of the New Partnership for Africa's Development, the Ninth African Development Forum and the High Level Panel on Illicit Financial Flows.

Domestic resource mobilization will undoubtedly continue to underpin development financing in Africa. The region is making significant progress in mobilizing tax revenue, the main source of domestic finance on the continent. As presented in the table below, total tax revenue in Africa increased from about $368 billion in 2010 to $468.5 billion in 2013, after which

it slightly declined to $461.2 billion in 2014 due to falling resource revenues, mainly as a result of plunging oil and metal prices (AfDB, OECD and UNDP, 2016). Despite the notable growth profiles and significant tax reforms, the performance of tax revenue mobilization in Africa has been mixed, limited by structural factors such as low per capita income, a large informal sector, a large amount of peasant agriculture, and very small manufacturing and modern services, implying very low effective tax bases. Moreover, domestic revenue losses are a significant drain on domestic resource mobilization for many countries in the region. This is often the result of a lack of coordination between investment promotion objectives and resource mobilization needs, excessive tax incentives and large drains through illicit financial flows (Elhiraika ***et al.***, 2015).

Africa: Tax revenues, remittances, foreign direct investment (FDI) and official development assistance (ODA), 2010-2015, US$ billion

	2010	2011	2012	2013	2014	2015 (e)
Tax revenues	367.8	453.2	458.8	468.5	461.2	....
Remittances	52.5	57.0	61.9	61.2	63.8	64.6
ODA	47.7	51.5	51.1	56.7	54.2	56.4
FDI	43.6	47.8	55.2	52.2	58.3	54.1

Sources: UNCTAD (2016) for data on FDI, and AfDB, OECD and UNDP (2016) for the rest of the data.

According to some estimates, Africa loses more than $50 billion every year in illicit financial outflows (African Union Commission and Economic Commission for Africa, 2015a). The recent estimates of Global Financial Integrity puts it at $80 billion (Kar and Spanjers, 2015). Indeed, these estimates may well be short of reality, as accurate data does not exist for all transactions and for all African countries. Enhanced domestic resource mobilization also requires the important role of central banks that could be extended to contribute to unlock idle resources and channel them into productive investments. Currently, more than $1 trillion of excess reserves have not been effectively put to work to finance Africa's development.

Stock market capitalization in Africa increased from $113 billion in 1992 to $1.5 trillion in 2013 (Applied Capital Markets Ltd., 2013). Further, innovative sources of finance present a largely untapped pool of capital to finance Africa's structural transformation. Hoverer, due attention should be paid to the institutional arrangements governing these modes of finance. For example, the region is home to 15 sovereign wealth funds. African pension funds also represent a growing domestic source of capital for private equity estimated at more than $29 billion (Ashiagbor ***et al.***, 2014). These funds can fuel investment in local businesses, infrastructure projects and services that are desperately needed for Africa's continued transformation and growth. The insurance sector also has similar potential in the financing of Africa's development. This also applies to the better management and use of extractive industries, as recent proven stocks of extractable energy resources in Africa (oil, natural gas, coal and uranium) are worth between $13 trillion and $14.5 trillion. In addition, $1.7 trillion of potential wealth and additional production potential has been identified in six key sectors – agriculture, water, fisheries, forestry, tourism and human capital (Africainvestor, 2010).

The role of development partners in unlocking Africa's domestic resources

The African agenda also calls upon members of the international community to respect Africa's vision and aspirations, and to align their partnerships accordingly. Despite the various aid commitments of development partners, ODA continues to be based on conditional and changeable donors' priorities. Besides, it is sometimes difficult to access once the financing agreement has been signed (African Union Commission and Economic Commission for Africa, 2015b). For African countries to make better use of concessional finance, there should be a greater focus on investment- and trade-oriented ODA, which can be used to unlock and leverage domestic resources.

Improvements required for aid effectiveness were recognized in both the Monterrey Consensus and the Addis Ababa Action Agenda. However, more needs to be done to ensure that donors support national planning processes; use country systems for resource allocation and implementation; improve predictability of resource provision; and improve systems to be more results-focused, transparent and accountable. Therefore, in order to assist the transformative agenda in Africa, development partners should support African countries to address development challenges by focusing on the key pillars to promote structural transformation, such as building infrastructure and supporting local industries.

South–South cooperation — which often focuses on areas such as infrastructure, technology transfer and experience-sharing — remains an important vehicle for mutual benefit and growth. South–South cooperation is complementary to — not a replacement for — more traditional North–South

cooperation. More efforts are expected from both traditional and emerging partners to embrace science and technology-led agendas in Africa by partnering with African institutions of higher education, research centres and technological entrepreneurs, to bolster economic growth and make the transition away from dependency on foreign aid.

Remittances have also become a more stable source of development finance for Africa. They are also more important to Africa, in terms of magnitude, than both ODA and FDI, particularly since 2010. Their inflow to the region is estimated to be about $65 billion in 2015, up from an average annual inflow of only $36.7 billion during the period 2004–2008 (Economic Commission for Africa, 2016). However, channeling remittances for sustainable development remains a challenge.

One of the main challenges facing the development impact of FDI over the previous two decades has been its high concentration in the extractive sectors, with limited backward and forward linkages and spillover effects. However, the most recent figures depict a different picture. In 2014, the service sector accounted for 51 per cent of the total inward FDI stock to Africa, whereas manufacturing accounted for 20 per cent and the primary sector 28 per cent (UNCTAD, 2016). This confirms the importance of effective policies to leverage FDI flows to strategic sectors.

Greater transparency is required

The emergence of an international arbitration industry and the growing recourse by investors to investor–State dispute settlements reveal that countries often deal with such situations in a private setting, reducing the transparency of State settlements.

It is also important to ensure that the policies of advanced economies and regulatory reforms of standard-setting bodies do not place an undue burden which leads to unintended consequences for banking and financial institutions in African countries. The role of regional and multilateral development banks is critical in this regard, primarily in providing advisory services on such policies, addressing market failures and preventing future economic and financial crises, as well as providing emergency (humanitarian) interventions.

Monitoring and evaluation systems are critical for the successful implementation of Africa's financing agenda

One of the critical weaknesses of the Monterrey Consensus and the Doha Declaration was the lack of a monitoring and evaluation system which would enable countries to establish a baseline for their resource mobilization efforts and develop a mechanism to track improvements and the extent to which resources were channeled to key priority areas. However, at the Third International Conference on Financing for Development, the Inter-Agency Task Force on Financing for Development was established and tasked not only with following up the process by reporting annually on progress in implementing commitments in the Addis Ababa Action Agenda and the means of implementation of the 2030 Agenda for Sustainable Development, but also with advising the intergovernmental follow-up thereto on progress, implementation gaps and recommendations for corrective action.

Policy implications

To fill capacity gaps and ensure effective implementation of initiatives for the mobilization of Africa's domestic resources, more attention needs to be paid to planning and governance frameworks, and widening alternative sources of finance. Domestic resource mobilization through taxation could be further enhanced by fighting tax fraud and tax evasion as well as formalizing the informal sector. There is also a critical need for effective tax frameworks for monitoring the extractive industries, to maximize benefits from Africa's natural resources. This will also help to address the increasing amount of resources leaving the region every year.

Greater transparency at the national, regional and global levels is needed to achieve accountable taxation, enhance the regulation and supervision of underregulated financial markets, and reduce systemic risks of banking and shadow-banking systems.

Unlocking idle reserves at central banks, deepening and broadening financial systems, strengthening microfinance institutions, and better governance are also critical in boosting domestic resource mobilization in Africa. High on the agenda is the importance of tapping into the various financial sources available, such as private equity, sovereign wealth funds, and pension and insurance funds.

ODA should be used as a complementary tool to support African countries in their domestic resource mobilization efforts. Development partners need to provide effective technical support to enhance tax capacity-building efforts

and improve tax administration in priority areas defined by African countries.

African countries' sustained growth and sound management of the macroeconomic environment are critical for debt sustainability. The international community should also ensure that any potential debt relief does not lead to a reduction in ODA to Africa.

South–South cooperation should be more transparent to improve accountability and establish a sustainable relationship with Africa.

Development partners should also help to facilitate the flow of remittances to African countries by considerably cutting the cost of remitting money to the region, as it is currently the highest in the world.

In the attempt to attract greater levels of FDI, African countries should avoid harmful tax competition among themselves. It is equally important to ensure that FDI treaties are fully aligned with long-term performance and sustainable development in Africa.

While tackling the high levels of illicit financial flows from the region, African countries should also increase efforts to improve public financial management systems.

The new financing for development framework should be supported by a robust and responsive framework for periodic monitoring and evaluation, and the production of timely data, with realistic and ambitious targets and specific commitments to leverage technical assistance in this regard.

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