2015: A CRUCIAL YEAR FOR FINANCING DEVELOPMENT IN AFRICA

Amadou Sy, Senior Fellow & Director, Africa Growth Initiative

THE PRIORITY

Achieving the 17 sustainable development goals set at the Rio+20 Conference (2012 United Nations Conference on Sustainable Development) will require an effective sustainable development financing strategy. In fact, in 2015, world leaders will meet in Addis Ababa, Ethiopia for the third International Conference on Financing for Development. The conference will focus on (i) assessing the progress made in the implementation of the 2002 Monterrey Consensus and the 2008 Doha Declaration on Financing for Development; (ii) addressing new and emerging issues; and (iii) reinvigorating and strengthening the financing for development follow-up process. In preparation for the Addis Ababa meetings, the Intergovernmental Committee of Experts on Sustainable Development Financing, a United Nations group tasked with following up on member states' commitments, has proposed a number of options for a financing strategy, with a focus on domestic and international, public, private and blended resources.

The Addis Ababa conference is timely as the context for African countries has changed considerably in the 12 years since Monterrey. Public domestic resources have increased thanks to debt relief, better revenue collection and gains from the commodity price boom. However, tax mobilization remains low in spite of significant efforts and recent reforms in many countries. Private international flows, especially foreign direct investment and portfolio flows to African countries, have also increased since Monterrey. Before 2006, only South Africa had issued a foreign-currency denominated sovereign bond in sub-Saharan Africa. Now, 12 other countries have issued a total of $15 billion in international sovereign bonds. On the other hand, domestic private financing remains limited as most African capital markets continue to be small, and banks dominate the financial system. International public flows to Africa are slowing down as official development assistance (ODA) declines. This shift has caused many to consider how aid dollars might be used to catalyze private investment, forming "blended" development financing. At the same time, China and other emerging market countries are playing an increasingly important role in financing African infrastructure and other investments. Financing for development, a vision conceptualized in the 2002 Monterrey Consensus and the 2008 Doha Declaration, suggests that governments should focus on policies that increase and improve the quality of finance from domestic and international partners, through public, private and blended finance. Therefore, foreign direct investment—considered "stable, patient money"—should receive more attention than private capital flows, which provide unstable "hot" money. In addition, governments should aim to foster inclusive, sustainable growth through financial flows by creating policies that better link skills and technology transfer to financing. Clearly, in order to achieve the Sustainable Development Goals (SDGs) "more and better financing for development will be needed" (Sy 2013a). (For more on the SDGs, see **"Africa Looks Forward to the Post-2015 Development Agenda."**)

WHY IS IT IMPORTANT?

Quantifying needs is a difficult exercise, but the Intergovernmental Committee of Experts on Sustainable Development Financing estimates that the cost of a global safety net to eradicate extreme poverty in all countries is about $66 billion annually and that annual investment requirements in infrastructure—water, agriculture, telecoms, power, transport, buildings, industrial and forestry sectors, etc.—amount to $5 trillion to $7 trillion globally. The unmet need for credit for small and medium enterprises has been estimated to be up to $2.5 trillion in developing countries (United Nations 2014a). There are also large financing needs for the provision of global public goods to make investments "climate-compatible." Although data on financing needs specific to African countries are not readily available, it is clear that they are disproportionately large relative to the size of their economies, especially for landlocked as well as post-conflict countries.

Current models of finance for development focus on two complementary questions: (1) how to raise *more* finance and (2) how to attract *better* finance (Sy 2013b).

The more finance argument: Domestic resources provide the bulk of sustainable development finance. Thus strengthening tax systems, expanding domestic tax bases and enhancing local financial markets, as recommended by the United Nations High-Level Panel on the Post-2015 Development Agenda, should continue to be a top priority for African governments. Yet, domestic revenues are only part of the solution and cannot provide all of the necessary resources for meeting the SDGs. Official development assistance, private capital flows (foreign direct investment, portfolio and loan flows), remittances and other forms of external flows will also be essential as a complement to domestic financing.

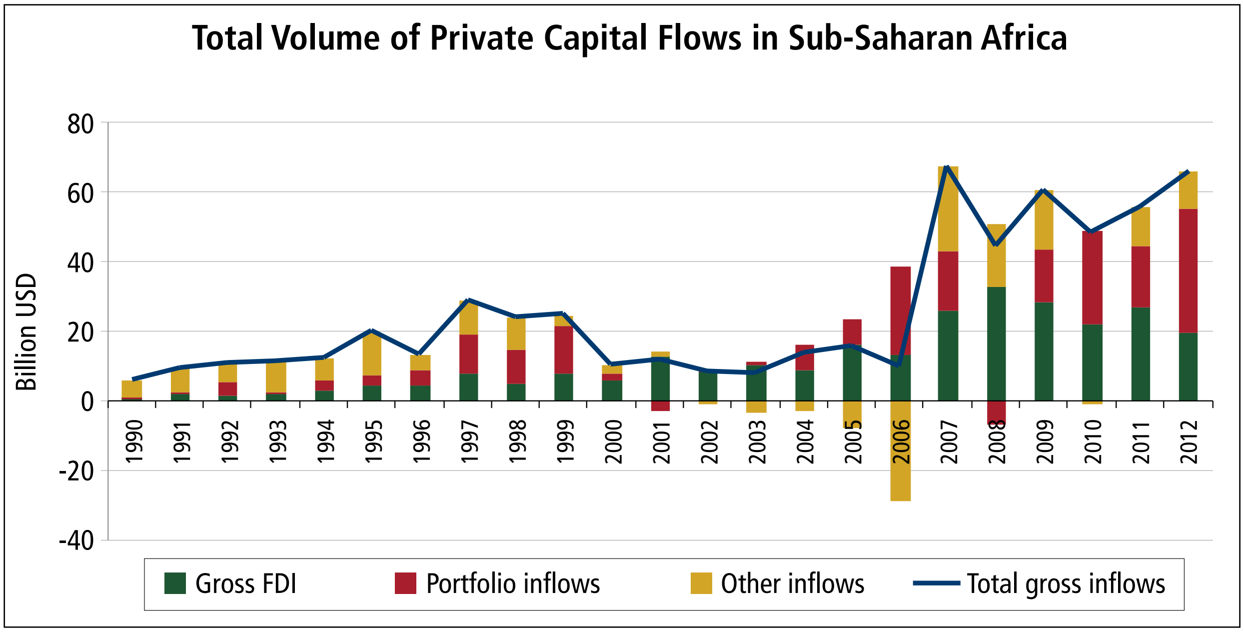
The better finance argument: The volatility and short-term nature of external capital flows present risks to African countries. However, these risks can be mitigated by prioritizing more stable and long-term finance from sovereign wealth funds, private companies, and development finance institutions.

While improving the quality and quantity of finance will be crucial for African governments, it will also be integral for them to optimize the use of their resources so that they get the most value for money as they work toward meeting the SDGs. For instance, attracting more finance into enclave sectors such as extractive industries that do not create jobs may be less useful in achieving the SDGs compared to financing agribusiness or manufacturing industries (assuming that the revenues from extractive industries are not used for pro-employment policies as is often the case).

Where Do We Stand 12 Years after Monterrey?

Analysis of financial flows to sub-Saharan Africa since the 2002 Monterrey Consensus indicates that financing to the region has increased in quality and quantity over the past decade. Gross private capital flows to sub-Saharan Africa have surpassed official development assistance, growing by 19.4 percent per year (see Figure 1). Stable, long-term foreign direct investment (FDI) now comprises 75 percent of total private capital flows, making it the major

FIGURE 1



Source: IMF 2014.

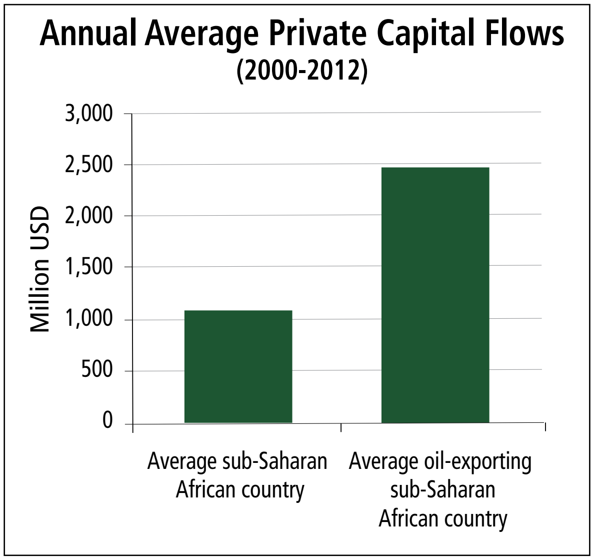
"engine of external finance" to sub-Saharan Africa (Sy 2013a).

In 2010, BRICS (Brazil, Russia, India, China and South Africa) countries contributed 25 percent of sub-Saharan African FDI, and their share is growing. Similarly, portfolio flows have experienced explosive growth in recent years, jumping from negligible levels in 2002, to an average of $9.5 billion over the past decade (IMF 2014).

Yet, despite these gains in more stable forms of financing, these investments are still highly concentrated geographically and sectorally, with approximately three-quarters of investments over the last decade destined for resource-rich countries and extractive industries (see Figure 2). Recent discoveries of natural resources foreshadow additional growth in these sectors. However, considering the tenuous links between extractive industries and domestic financial systems, it is unclear whether this growth will provide benefits to local firms and employment markets.

ODA is not increasing all that much but there is growing interest in the use of aid to support and work with the private sector, including from the U.S., the U.K., Australia, Canada and others. Whether this approach will deliver results remains unclear. The G-8 pledge at Gleneagles in 2005 to increase aid by $50 billion by 2010 (half of which destined for Africa) has not materialized. Aid increased by $30 billion and only $11 billion went to Africa. More recently, aid to the continent fell from 2012 to 2013, and the latest forecasts indicate that it is falling further. In contrast, aid from countries that are not members of the Organization for Economic Cooperation and Development (OECD) is almost certainly trending up driven by China. ODA, whether from OECD or non-OECD countries, will remain an important source of finance for least developed and post-conflict countries. Remittances from non-resident Africans have averaged $21.8 billion over the decade with some countries such as Nigeria and Senegal receiving about 10 percent of GDP in remittance flows. Again, countries with a large population of African migrants can play an important role in supporting remittances as a catalyst for job

FIGURE 2



Source: IMF 2014.

creation and investment. Illicit financial flows, on the other hand, can be highly detrimental to development efforts. Precise figures on illicit flows are difficult to capture, but estimates suggest that they may have been twice as important as ODA (Africa Progress Panel 2013). A concerted international effort to reduce such flows and make up for the lost fiscal revenues could free up more resources for African governments to invest in job creation and skills development.

WHAT SHOULD BE DONE IN 2015

In sum, next year in Addis Ababa, African and world leaders must not only seek more and better finance, but also more value for money if they are to support sustainable, inclusive development in the most efficient way. Initiatives such as U.N. Global Compact can serve as a platform for governments to engage with the private sector and discuss how best to mobilize finance to achieve the SDGs.

African governments can better extract benefits from financial resources when they partner with foreign governments. For instance, the U.N. High-Level Panel on the Post-2015 Development Agenda recommends to infuse global partnerships and cooperation into all the SDGs.

To harness financial flows for long-term economic growth in sub-Saharan Africa, African policymakers will need to foster linkages between multinational companies and the domestic private sector, specifically facilitating the transfer of knowledge and skills to the region. In the near term, African governments can incentivize investors to integrate local businesses into their value chains and to help provide educational, training and employment opportunities to local workers. Several companies in the information, communications and technology sector, including Google, Microsoft, and Huawei have already implemented programs to train youth in Kenya and other countries. Furthermore, developing local content legislation that promotes the SDGs will require a flexible and strategic view from policymakers. They can also, in the medium to long term, formulate commercial strategies around the type of FDI their countries anticipate attracting and then develop the technologies and skills that will be necessary for the expected investments.

It will also be important to think carefully about the role aid donors can play in supporting job creation and skills acquisition while also addressing sectors that private sector investment typically neglects. For instance, ODA complements other sources of finance when it comes to the infrastructure sector. Indeed, while the private sector has primarily financed the information and communications technology sector and (more recently) the energy sector, it does not focus much on the transportation and water sectors, where ODA funding is more important. Even in the energy sector, ODA can help leverage more private financing as illustrated by the United States' Power Africa initiative where $7 billion of public funding has so far leveraged $20 billion of private sector money, from both

U.S. and African corporates. As global policy leaders are framing the agenda on climate finance with $20 billion pledged for the Green Climate Fund, it will be important for African leaders to ensure that the new global priorities on climate finance are consistent with the continent's sustainable development agenda.

Finally, the focus on finance should not divert policymakers' attention from measures to reduce existing efficiency losses through better governance and other measures. For instance, the estimated spending required to address Africa's infrastructure needs is approximately $93 billion per year, 40 percent of which should be used to bolster the power sector, according to the Africa Infrastructure Country Diagnostic (AICD). African governments, supported in part by international donors and private sector actors, already spend about $45 billion annually on infrastructure. Nearly two-thirds of these expenditures are used for existing infrastructure operations and maintenance while one-third funds new projects. This leaves a financing gap of $48 billion and begs the question of how to finance this amount (Foster and Briceño-Garmendia 2010).

A first step to reduce the financing gap is to more efficiently use existing infrastructure. Indeed, rectifying inefficiencies in existing infrastructure, improving subsidies and enhancing budget execution, can reduce the financing gap by $17 billion, from $48 to $31 billion a year and have a significant impact on African power sectors.

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