Chapter 2

External financial flows and tax revenues for Africa

Despite falling commodity prices, Africa's external financial flows have remained stable overall. This chapter analyses trends in those flows; from foreign direct investment and portfolio equity which fell, to remittances and official development assistance which are increasing. It also studies Africa's tax revenue collection that has dropped because of lower resource revenues. The chapter looks at the policy challenges and opportunities related to attracting financial inflows ranging from the need to stabilise foreign inflows and implementing medium- to long-term structural policies as part of the African Union's Agenda 2063 to step up the continent's development.

In brief

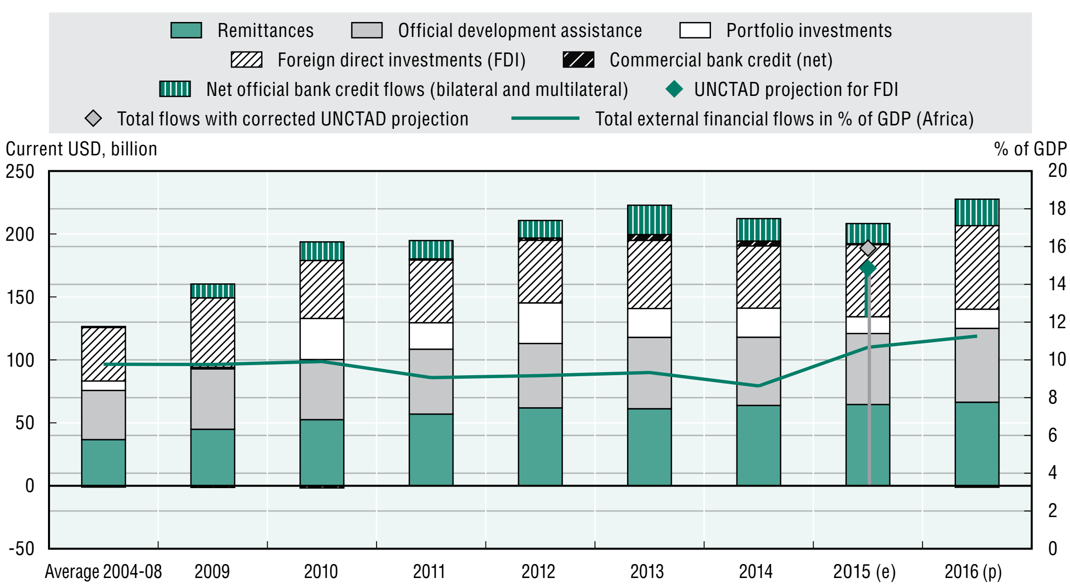
The estimated 208.3 billion USD of external finance – foreign investment, trade, aid, remittances and other sources that Africa attracted in 2015 – was 1.8% lower than the previous year. The total sum is projected to rise again to USD 226.5 billion in 2016. Falling commodity prices, particularly for oil and metals, were one of the key causes for the 2015 fall. Portfolio equity and commercial bank credit flows dried up, reflecting tightening global liquidity and a market sentiment wary of risks. Rising remittances and increased official development assistance largely kept the figure up. African governments have to stabilise financial inflows in the short term and use them for sustained economic diversification for the longer term. Falling resource revenues mean governments must also find ways to broaden the tax base away from oil and commodities.

Africa depends heavily on foreign private and public capital

Flows of finance into Africa – foreign direct investment, portfolio equity and bonds, commercial bank, bilateral and multilateral bank credit, official development assistance and public domestic revenues – have remained broadly stable despite weak conditions in other parts of the world.

Total external flows to Africa for 2015 were estimated at USD 208.3 billion, down from an estimated USD 212.2 billion in 2014. But the figure was predicted to pick up to USD 226.5 billion in 2016.

Figure 2.1. **External financial flows to Africa, average 2004-08, 2009-16**
current USD billion and % of GDP



Note: ODA estimates (e) and projections (p) are based on the real increase in country programmable aid (CPA) in OECD (2016). The forecast for remittances is based on the projected rate of world growth according to the World Bank.
Source: Authors' calculations based on IMF (2014b, 2015c); OECD (2016); *African Economic Outlook* data; World Bank (2015a).
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There are two starkly different numbers of crucial foreign direct investment (FDI). According to International Monetary Fund (IMF) (2015a) estimates released in October 2015, foreign investment into Africa increased by 16% over the year. In contrast, the United Nations Conference on Trade and Development (UNCTAD) (2016) estimated a 31.4% drop (Figure 2.1) from 2015. Such a decline would suggest that total external finance decreased to USD 188.8 billion, a sharp 11% fall from 2014. Portfolio inflows dropped by 42%. Commercial bank credit also declined considerably in 2015, though the overall effect was minimal as it is a minor source of external finance in Africa.

Remittances and official development assistance (ODA) played a key role in the overall figure. Remittances increased by 1.2% and ODA by 4.0%. Gross inflows of multilateral and bilateral official credit flows increased, but because of a heavy amortisation schedule in 2015, the net contribution to financial flows decreased 10%.

Falling portfolio investment sends private flows to Africa down in 2015

Private financial flows to Africa increased from an average of USD 87 billion in 2004-08 to USD 129 billion in 2011 despite the downturn after the 2008-09 global financial crisis. However, since 2012 the private finance decreased from USD 146 billion to USD 136 billion in 2015. It is projected to increase by 8% in 2016 (Table 2.1).

Foreign direct investment into Africa grew steadily from 2007 to 2013. In 2014, however, FDI fell back to USD 49.4 billion, but increased to USD 57.5 billion in 2015, according to IMF (2015a) estimates. Africa has attracted investment from industrialised countries such as France, the United Kingdom and the United States and emerging economies such as China, India, South Africa, and United Arab Emirates. Investment is still mainly directed at resource-rich countries, but non-resource-rich countries are becoming more attractive. The extractive sector, infrastructure and consumer-oriented industries are the main draws for investment.

The lower UNCTAD estimate for investment in Africa in 2015 reflects a sharp drop into Mozambique (-21%), Nigeria (-27%), and South Africa (-74%). If UNCTAD rather than IMF data were used, private finance to Africa would have dropped by 19.5% to USD 116 billion in 2015. Total financial flows would have decreased 12.8% to USD 188.8 billion.

Portfolio flows decreased from USD 23 billion in 2014 to USD 13 billion in 2015. There was a net portfolio equity exit in the second half of 2015. Bond flows remained relatively stable. Compared to other sources of foreign finance, net commercial bank credit is very small. Since 2014, net commercial bank credit flows fell from USD 3.8 billion in 2014 to USD 500 million in 2015 and are expected to further decrease in 2016. Remittances remain the most important single source of external finance with USD 64 billion in 2015. Compared to volatile foreign investment and portfolio flows, remittances are considered more stable and may even be counter-cyclical in the face of external economic shocks (UNDP, 2011). While developed countries such as the United States, France and the United Kingdom dominate remittances to Africa, Arab states and money moving from Cameroon, Côte d'Ivoire and South Africa are also important. The World Bank predicts a slight increase in remittances for 2016 to USD 65.6 billion. But Europe's weak growth and the slump in oil prices for Gulf producers may affect remittances to Africa (Table 2.1).

Table 2.1. **Financial flows and tax revenues to Africa, 2004-16, current USD billion**

			2004-08	2009	2010	2011	2012	2013	2014	2015e	2016p
Foreign	**Private**	Inward foreign direct investments (FDI)	42.8	55.1	46.0	49.8	49.7	54.2	49.4	57.5	66.3
		Portfolio investments	7.5	1.2	32.7	21.0	32.3	22.8	23.1	13.4	15.2
		Remittances	36.7	44.9	52.5	57.0	61.9	61.2	63.8	64.6	66.4
		Commercial bank credit (net)	0.5	-1.3	-1.7	0.8	1.8	4.5	3.8	0.5	-1.2
	Public	Net official bank credit flows (bilateral and multilateral)	-1.0	11.0	14.8	14.5	14.0	23.3	17.8	16.0	21.0
		Official development assistance (net total, all donors)	39.0	48.0	47.7	51.5	51.1	56.7	54.2	56.4	58.7
		Total foreign flows	125.5	158.9	192.0	194.8	210.7	222.8	212.2	208.3	226.5
Domestic		Tax revenues	281.0	302.9	367.8	453.2	458.8	468.5	461.2		

Note: ODA estimates (e) and projections (p) are based on the real increase in country programmable aid (CPA) in OECD (2016). The forecast for remittances is based on the projected rate of world growth according to the World Bank.
Source: Authors' calculations based on IMF (2014b, 2015c), OECD (2016) and *African Economic Outlook* data, World Bank (2015b).

Official financial flows have remained stable

Official development assistance in grants and concessional loans increased in 2015, after a small drop in 2014. At USD 56 billion in 2015, ODA remains the most important source of public finance for Africa and is expected to increase by 4.1% in 2016. Net official bank credit from bilateral and multilateral stakeholders have decreased from USD 17.8 billion in 2014 to USD 16 billion in 2015 but is expected to reach USD 21 billion in 2016.

Important lenders for Africa's infrastructure investment are the People's Bank of China, the China Development Bank, and the Export-Import Bank of China. In addition to established lenders such as the World Bank, the African Development Bank and the European Investment Bank, the New Development Bank BRICS, founded in 2014, is expected to significantly contribute to Africa's campaign to reach the United Nations' Sustainable Development Goals by complementing existing public and private financial institutions (UN DESA, 2015b; UN DESA, 2016).

Overall, African countries' total domestic public revenues are down. This is mostly due to a fall in taxes on resource revenues. While countries with commodities have been confronted with a drop in tax-GDP ratios across all categories, non-resource-rich countries have increased tax revenues and tax-GDP ratios.

Africa faces volatile FDI inflows

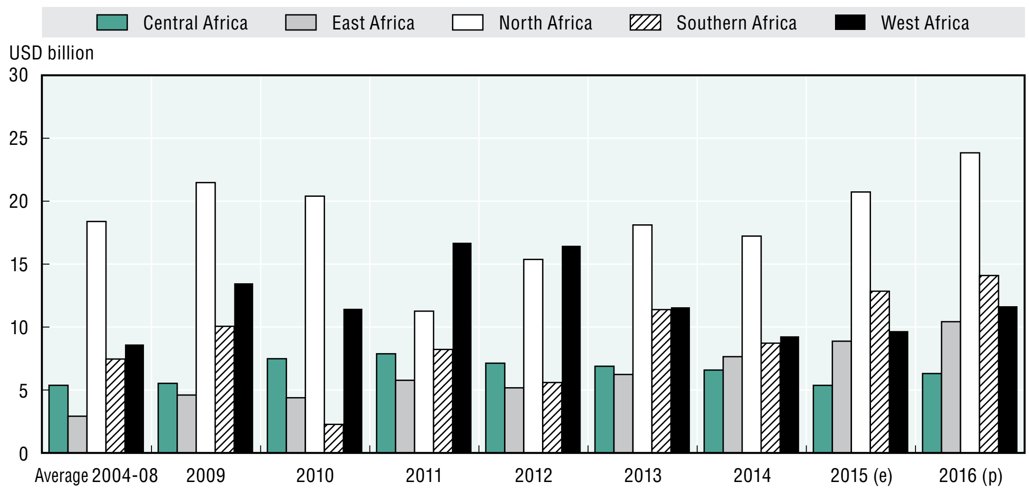
Foreign investment into Africa increased by 16% from to USD 57.5 billion in 2015, according to IMF figures. Flows to North Africa reversed a downward trend, as investment increased by 20% from USD 17.2 billion in 2014 to USD 20.7 billion in 2015. East Africa has seen higher FDI since 2010. In 2015, the figure rose 16% to USD 8.9 billion in 2015 from USD 7.7 billion the previous year. For West Africa investment rose from USD 9.3 billion to USD 9.7 billion. Central Africa saw a decline from USD 6.6 billion in 2014 to USD 5.4 billion. Southern Africa received USD 12.9 billion of FDI in 2015 against USD 8.7 billion in 2014, and USD 11.4 billion in 2013.

The leading African investment destinations in 2015 were: Egypt (USD 10.2 billion), Mozambique (USD 4.7 billion), Morocco (USD 4.2 billion), South Africa (USD 3.6 billion), Ghana (USD 2.5. billion), the Democratic Republic of the Congo (USD 2.5 billion), Zambia (USD 2.4 billion), Tanzania (USD 2.3 billion), Ethiopia (USD 2.1 billion), Guinea (USD 1.9 billion), and Kenya (USD 1.9 billion). Africa has attracted foreign investment from many countries, notably from the United Kingdom, France, the United States, and from the emerging economies China, India, South Africa, and the United Arab Emirates (Figure 2.2).

Terrorist activity and deteriorating security in some Sahel countries and political instability are a threat to investment. External and domestic factors influence Africa's investment return, including economic slowdowns in emerging economies and the weak recovery in the European Union. Declining oil and metals prices have led foreign investors to scale down operations in resource-rich countries. There is a positive side too. African manufacturing and services may benefit from increased inflows due to the stronger US dollar and China's yuan renminbi. Investment from the emerging economies in Africa's skills and infrastructure development can help to overcome the reliance on resource-driven FDI.

Without Egypt, investment to North Africa would have dropped. FDI to Egypt increased from USD 5.5 billion in 2014 to USD 10.2 billion in 2015. United Arab Emirates investors have played an important role in Egypt's recovery. Flows into Morocco fell to USD 4.2 billion in 2015 from USD 4.7 billion in 2014. But Morocco became the third-largest recipient of foreign investment in Africa in 2015. European firms were leading investors in Morocco, which benefits from historic ties and proximity to Western Europe, as well as a proactive FDI policy and skilled workers who earn lower wages than in Europe. Investment into Tunisia has been seriously affected by political and economic turbulence since 2009. FDI has declined by more than 40% since 2012 to USD 1.1 billion in 2015. The precarious political and security situation in the Sahel is a risk for West and Central Africa.

Figure 2.2. **Inward FDI by regions 2004-16, USD billion**



Source: Authors' calculation based on IMF data (2014b, 2015c).
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Investment in commodities has suffered. Nigeria has seen a sharp decrease in investment over the past five years from USD 8.1 billion in 2011 to USD 1.4 billion in 2015. Ghana attracted the biggest share of West African FDI (USD 2.5 billion), followed by Guinea (USD 1.9 billion), Côte d'Ivoire (USD 1.0 billion) and Mauritania (USD 0.8 billion). Countries such as Liberia, Senegal, Sierra Leone, and Togo received less than USD 500 million each in 2015.

In East Africa, Tanzania (USD 2.3 billion) and Uganda (USD 1.3 billion) received stable investments in 2015. Uganda's oil sector is expected to be the country's main investment magnet in future. Kenya's investment has risen from USD 500 million in 2013 to USD 1.9 billion in 2015. Ethiopia's has gone up from USD 1.2 billion in 2013 to USD 2.1 billion in 2015. Ethiopia's FDI is mainly in labour-intensive areas. Although the 32 projects launched there in 2015 accounted for only 4.4% of total investment in Africa, these made up 18.5% of the jobs from the FDI in Africa. Ethiopia has slowly been opening up to foreign investment in the manufacturing and retail sectors (fDi Markets, 2016).

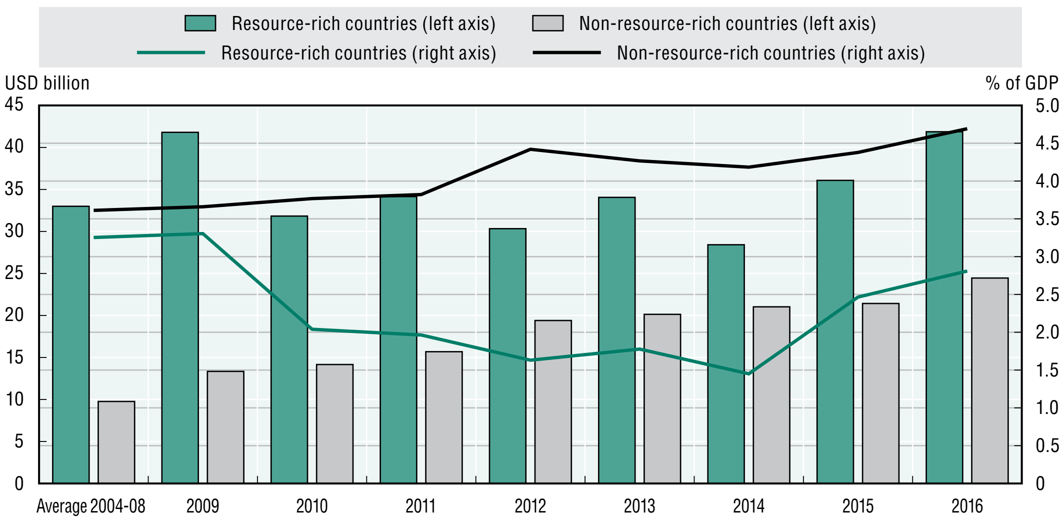
The Democratic Republic of the Congo received USD 2.5 billion in 2015 and the Republic of the Congo USD 1.5 billion, in each case half of the 2014 levels. South Africa remains a key foreign investment destination in Southern Africa but its USD 3.6 billion was down from USD 8.2 billion in 2013 and USD 4 billion in 2014. Mozambique – the biggest recipient of foreign investment to Southern Africa in 2015 – attracted USD 4.7 billion.

Consumer-oriented sectors in Africa attract growing foreign investment

Resource-rich countries still get the most foreign investment, but countries with no major commodities to rely on are taking a larger share of FDI. Countries that are not resource-rich received an estimated 37% of Africa's FDI in 2015, compared to 30% in 2010 (Figure 2.3). In 2015, the FDI-to-GDP ratio for non-resource-rich countries stood at

4.4%, up from 3.8% in 2010. The ratio for resource-rich countries increased from 2.0 % to 2.5% from 2010 to 2015. Several countries without significant resources are attracting investors, including Kenya, Tanzania and Uganda, reflecting the shift towards consumer goods. Kenya is becoming an East African business hub for manufacturing, transport, services and information and communications technology (ICT) (McKinsey, 2015a and 2015b).

Figure 2.3. **Foreign direct investment to Africa: Resource-rich vs. non-resource-rich countries, 2000-16**



Source: Authors' calculations based on IMF (2014b, 2015c).
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The Herfindahl-Hirschman index, a concentration ratio, indicates a shift to ICT, services, and manufacturing across Africa. The index went down from 0.43 in 2003 to 0.18 in 2014 and 0.14 in 2015. This trend is also confirmed by data on announced greenfield projects in 2015 which showed that services and manufacturing accounted for about 54% of the total value of projects in Africa (fDi Markets, 2016). Investment is starting to diversify into consumer-market oriented industries, including ICT, retail, food and financial services.

African cities are future hubs of investment

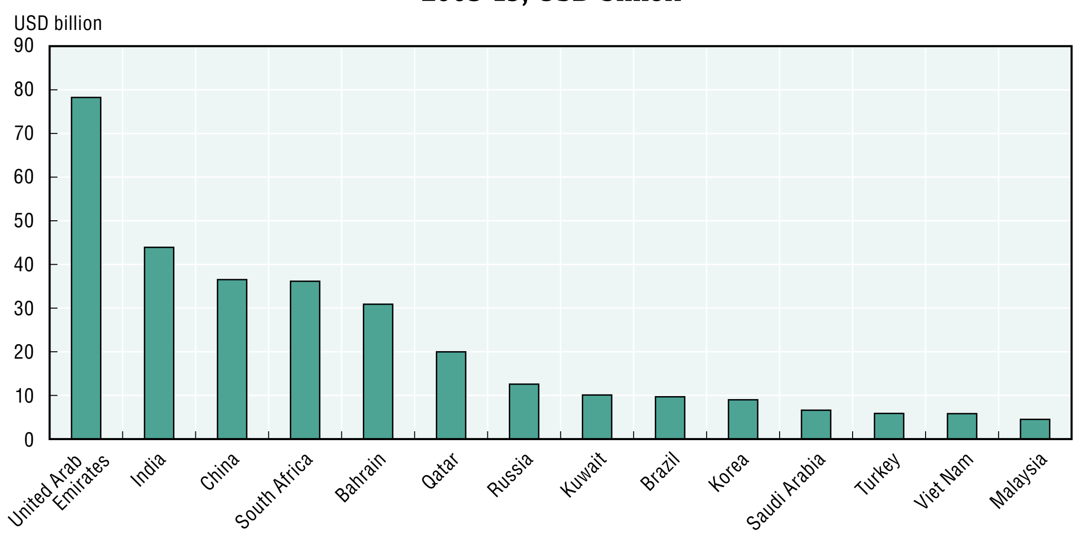
With urbanisation, African cities are growing consumer markets increasingly targeted by foreign investors. Disposable income and spending power in Africa's major cities will grow (Oxford Economics, 2015). Forecasts show that the GDP of major cities is increasing. The most important ones will be Cairo, Cape Town, Johannesburg, Lagos and Luanda. This ranking reflects the quality of the business climate, infrastructure and logistics, and availability of skilled workers.

A recent surge in infrastructure investment indicates that states are investing in transport corridors to connect urban agglomerations and transform them into urban clusters. Examples include the Greater Ibadan-Lagos-Accra urban corridor, the Maputo Development Corridor, and the Northern Corridor between East and Central Africa. These investments will surge with deeper market integration through reduced transport and trade costs. They will also foster competition and productivity, which will make African hubs more attractive for foreign investors.

China, India and other emerging economies are important FDI providers

While the European Union countries and the United States remain the largest investors in Africa, the emerging economies are a vital source too. India's share of announced greenfield investment projects grew from 3.3% in 2003-08 to 6.1% in 2009-2015. China's share, however, fell from 4.9% to 3.3%. In 2015 the United States had a 9.7% share of all greenfield investment, while the EU accounted for 37.4% (fDi Markets, 2016). The most important emerging investors are Bahrain, China, India, Qatar, South Africa, and United Arab Emirates (Figure 2.4). Middle East investors, who have injected more than USD 100 billion over the past decade, lead the way.

Figure 2.4. **Total FDI inflows into Africa from emerging economies, 2003-15, USD billion**



Source: Authors' calculations based on fDi Markets (2016).
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Greenfield investment in Africa fosters services and manufacturing

Although greenfield investment declined in 2015, there is a trend toward services, manufacturing and special economic zones, which can nurture structural change in Africa. In 2015, the leading investors in terms of announced greenfield investment were Italy (USD 7.4 billion), the United States (USD 6.9 billion), France (USD 5.8 billion), the United Kingdom (USD 4.9 billion) and the United Arab Emirates (USD 4.3 billion). The United States had 96 greenfield projects in 2015 and the United Kingdom 77 projects. The United Arab Emirates had 50 projects and India 45 projects (fDi Markets 2016).

Services and manufacturing remain key investment areas. Some 39.7% of announced greenfield FDI projects in Africa and 24.6% of related capital expenditure were in manufacturing in 2015. The services sector took 51% of projects and 28.4% of capital expenditure. There were large investments in manufacturing, mainly in electronic equipment, motor vehicles and food. Africa's services-related FDI stock increased considerably (fDi Markets, 2016).

The relocation of manufacturing and services from emerging and advanced countries to Africa due to wages and efficient special economic zones may gain momentum if support programmes are effectively managed. East African countries are an example of how the continent can exploit comparative advantages:

- East African countries are economically more diverse than resource-rich countries and relatively well-integrated as a region. Kenya, Tanzania, Uganda, Burundi and Rwanda form the East African Community (EAC) which has established a common market.
- The EAC countries plus the wider East Africa, including Ethiopia, Madagascar, Mauritius and Seychelles, together have 300 million people with a combined GDP of USD 530 billion.

Portfolio equity flows are down, but new bonds remain resilient

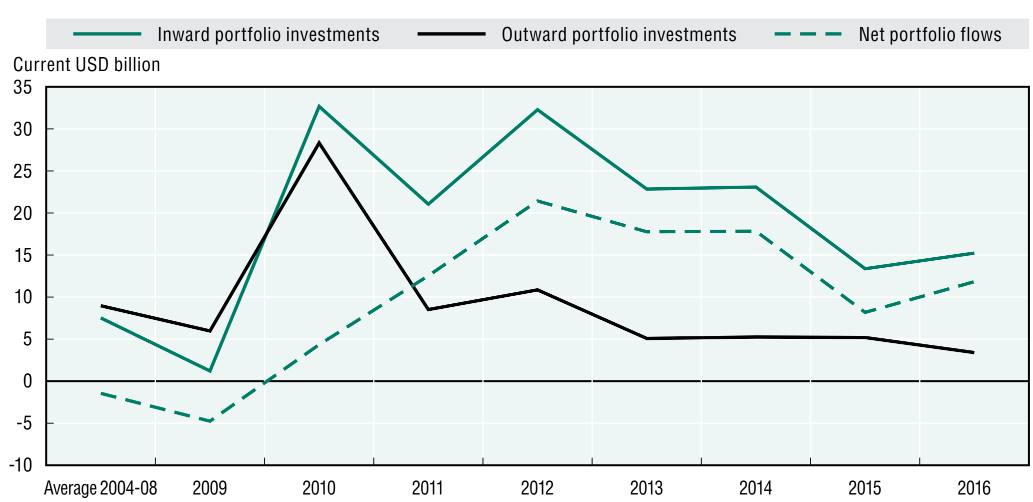
Portfolio inflows to Africa in 2015 were half the size of the period from 2012 to 2014. While bond issuances have remained resilient, portfolio equity inflows were reversed in the second half of 2015. Over the last decade, portfolio equity inflows to Africa have increased their share of total investment, with peaks in 2006 and 2012. A key development during the 2000s has been the increasing reliance of African governments on markets for foreign and domestic debt financing.

Compared to the emerging economies, portfolio flows to Africa's leading markets have been relatively resilient. According to the World Bank (2016a), global investors withdrew about USD 52 billion from emerging market equity and bond funds in the third quarter of 2015.

During the 2008-09 global financial crisis, portfolio inflows fell sharply. Since 2010, by contrast, gross portfolio inflows to Africa have stayed positive. They peaked in 2010 and 2012, adding up to more than USD 32 billion each year. The ending of quantitative easing in the United States, oil market uncertainty and political risks have weighed on investor sentiment towards Africa recently, however. In 2015, gross portfolio inflows to Africa fell by USD 10 billion compared to 2013 and 2014, to USD 13.4 billion. For 2016, they are expected to stay flat.

Gross portfolio outflows from Africa stayed at roughly USD 5 billion each year from 2013 to 2015. Consequently, Africa's net portfolio flows (inflows minus outflows) have remained positive since 2010. On balance, they have contributed net foreign savings to Africa worth USD 82 billion during 2010-15, or USD 13.7 billion annually on average.

Figure 2.5. **Africa's inward and outward portfolio flows, 2004–16, USD billion**



Source: Authors' illustration based on IMF (2015c).
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Equity portfolio flows have been volatile over the past two decades. From a net equity outflow for 2009 they jumped to a net inflow in 2010 of almost USD 20 billion. Since then, they have levelled off, to a mere USD 1.2 billion for 2015. While equity flows can be an important form of participatory finance, they are not a reliable source of foreign finance. International public offerings (IPOs), by contrast, matter more for corporate finance in Africa. From 2010 to 2014, Africa has successfully raised corporate capital through IPOs and further offers that exploited booming African stock markets. Box 2.1 provides detail.

Volatile portfolio equity flows were reflected in most African equity markets that produced negative returns in the second half of 2015. Many observers see the US Federal Reserve's policy tightening as the culprit for the recent retrenchment. Domestic factors have also contributed to reduced investor demand for assets from emerging economies. Slower world growth added to investor concerns, particularly against the backdrop of the commodity price slump.

Box 2.1. **Raising capital through initial public offerings**

The ease with which firms list on stock markets through international public offerings (IPOs) matters for Africa's corporate finance. *IPO Watch Africa* 2014 found that USD 37.4 billion was raised through 90 IPOs and further offers from 2010 to 2014 in African capital markets. The IPOs brought in USD 6.3 billion. Twenty-four African companies were listed on equity markets in 2014, raising USD 1.7 billion through 24 IPOs and some further listings. Listings on the Johannesburg Stock Exchange accounted for 32% of Africa's total IPO capital in 2013 and 44% in 2014.

Reflecting improved investor sentiment across the continent during 2010-14, recent IPO trends indicate a greater share of capital raised on markets outside of South Africa. Further offers, in contrast to IPOs, remained dominated by capital raised in South Africa, which accounted for 87% of proceeds in 2014.

Several top IPOs in 2013 and 2014 had a notable international component, either foreign companies raising capital directly on African exchanges, or African companies marketing shares to international investors through dual listings or sales to institutional buyers abroad. In addition to the USD 31.1 billion raised through further offers on African exchanges from 2010 to 2014, USD 1.2 billion of further offer capital was raised by African companies on international exchanges.

Johannesburg (South Africa) has the most companies listed and the biggest capitalisation in Africa, followed by Cairo (Egypt), Lagos (Nigeria) and Casablanca (Morocco).

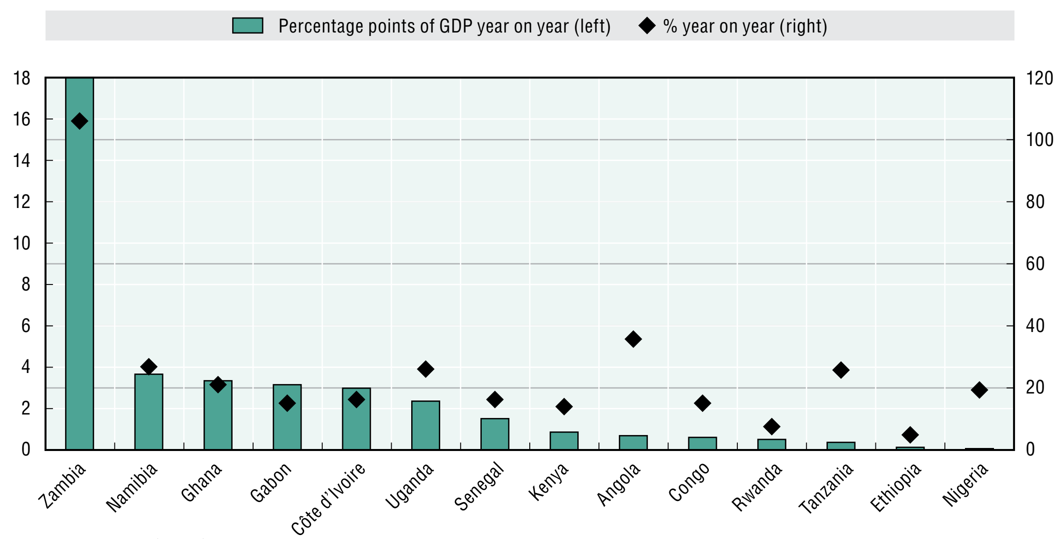
Source: PWC (2014).

Bond issues rose substantially in sub-Saharan countries from 2011 to 2014. In 2011, there were USD 1 billion in bond issues. By the end of 2014 the figure was USD 6.2 billion (Vellos, 2015). Some countries had benefited from debt relief programmes such as the Heavily Indebted Poor Countries initiative and the Multilateral Debt Relief Initiative. Up to mid-2014, steady global market conditions and the potential for higher returns for investors had paved the way for more access to international markets, where the average return for these bond issues is about 6.6%, with an average maturity of 10 years. In 2015, in the face of declining bank credit flows and net portfolio outflows, some countries continued to tap the international bond market to finance investment programmes. Côte d'Ivoire's sovereign bond issue in 2015 was followed by Gabon, Zambia, Ghana, Angola, and Cameroon. Angola and Cameroon issued maiden 10-year bonds (World Bank, 2016c). The six countries issued bonds worth USD 6 billion by the end of 2015. Eurobond issues by sub-Saharan countries with stronger economies (excluding South Africa) held up well in 2015 (Masetti, 2015). Bond issues in 2015 compare to annual volume at record levels in 2013 and 2014 when 12 countries, many of them debut issuers, placed bonds worth USD 12 billion in international capital markets.

Bond spreads reflected the tough economy, the change in investor sentiment and rating changes, especially in the second half of 2015. While new issues went ahead, Africa's borrowers had to offer significantly higher yields, and yields on secondary markets jumped to multi-year highs. For Zambia and Côte d'Ivoire, primary market yields increased by 70 and 100 basis points respectively, and for Ghana, by 260 basis points to 10.8% in relation to the last issues in 2014. Angola, a new bond debt issuer, had to offer a yield of 9.5%.

As all outstanding sovereign Eurobonds in Africa are denominated in US dollars, any depreciation will affect the local currency value of debt service payments. This is potentially more harmful for interest burdens than rising spreads. Currency falls against the US dollar since mid-2014 have been most severe for the Zambian kwacha, the Angolan kwanza, the Namibian dollar, the Ugandan shilling and the Tanzanian shilling which lost between 20% and 51% year-on-year against the US dollar. Zambia has been hit hardest. Its debt service costs rose in 2015 by 18 percentage points of GDP (left-hand scale in Figure 2.6) and by 106% in local currency terms (right-hand scale).

Figure 2.6. **Change in debt service cost, sub-Saharan Africa, 2015**



Source: Masetti (2015).

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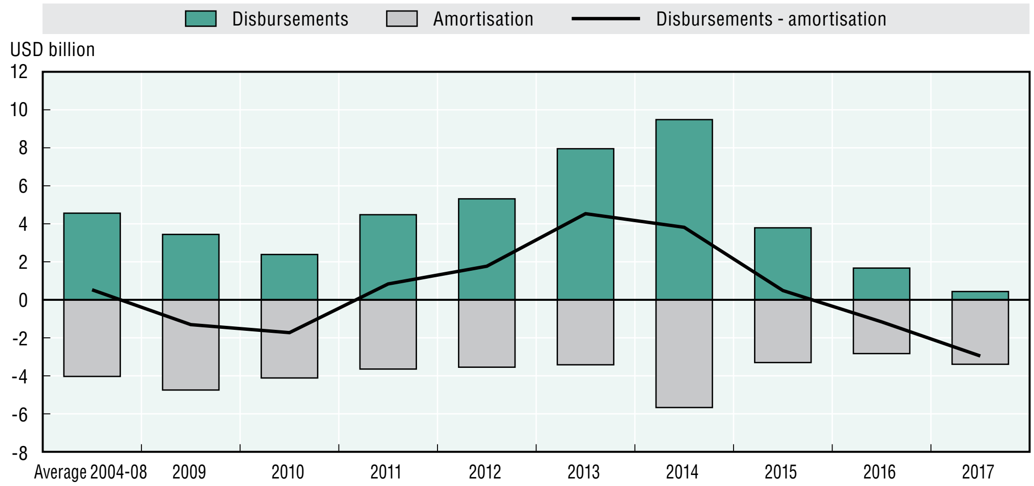
Bank credit flows slow as repayments grow

Official bank credit flows to Africa from multilateral sources rose again in 2015, while bilateral official bank credit was sharply curtailed. Commercial bank credit to the continent has turned negative in net flow terms as shrinking disbursements fell short of rising amortisation payments. Some countries are increasingly vulnerable to deteriorating debt financing profiles and sensitive to macro-fiscal shocks.

Net bank credit flows to Africa concentrated overwhelmingly on official bank credit in 2015. Figure 2.7 reveals that, by contrast, private commercial banks sharply reduced their new lending. Commercial bank lending was particularly cut for North African borrowers. Gross commercial bank credit flows to Africa fell from USD 9.5 billion in 2014 to USD 3.8 billion in 2015. Allowing for amortisation, net commercial bank lending to the continent shrank from USD 3.8 billion in 2014 to just USD 500 million in 2015. Future commercial bank lending is projected to fall further in 2016 and 2017. Despite scheduled repayments contained at roughly USD 3 billion for 2016 and 2017, respectively, net commercial bank credit flows will likely subtract from rather than add to Africa's domestic savings. Net private bank credit flow is projected at a negative USD 1.16 billion in 2016 and USD 2.96 billion in 2017.

Figure 2.7. **Net commercial bank credit flows to Africa, 2004-17, USD billion**



Source: World Bank (2016c).

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Data on sources for bank credit to Africa is hard to find. The People's Bank of China, the China Development Bank, and the Export-Import Bank of China have supported large-scale investment in African infrastructure but do not publish up-to-date information (Pigato and Tang, 2015). For other bilateral and multilateral lenders, Economist Corporate Network (ECN) (2015) lists the World Bank, African Development Bank, Development Bank of Southern Africa, Export-Import Bank of the United States, African Export-Import Bank, European Investment Bank, Agence Française de Développement (AFD), Japan Bank for International Cooperation (JBIC), Islamic Development Bank and Kreditanstalt für Wiederaufbau (KfW) as the largest creditors.

Despite steady growth in private sector funding over the past decade, official development finance backs 80% of infrastructure funding with China heading the list of investors, according to a 2015 report by ECN. An important source of foreign finance for Africa stems from official creditors, including export credit agencies (Box 2.2). According to the *Infrastructure Consortium for Africa Report 2013*, grants compose around 30% of funding extended, while 67% comes from bank credit and export credit flows.

Box 2.2. **Who is funding Africa's infrastructure?**

The Infrastructure Consortium for Africa (ICA) acts as a platform to increase infrastructure financing, help remove policy and technical barriers, facilitate co-operation, and increase knowledge through monitoring, reporting and sharing best practices. Its annual reports provide some evidence on funding commitments for Africa's infrastructure in four sectors – energy, transport, water, and information and communication technology. Table 2.2 provides data for the biggest creditors with annual commitments above USD 1 billion reported.

Table 2.2. **Funding commitments by origin, USD billion**

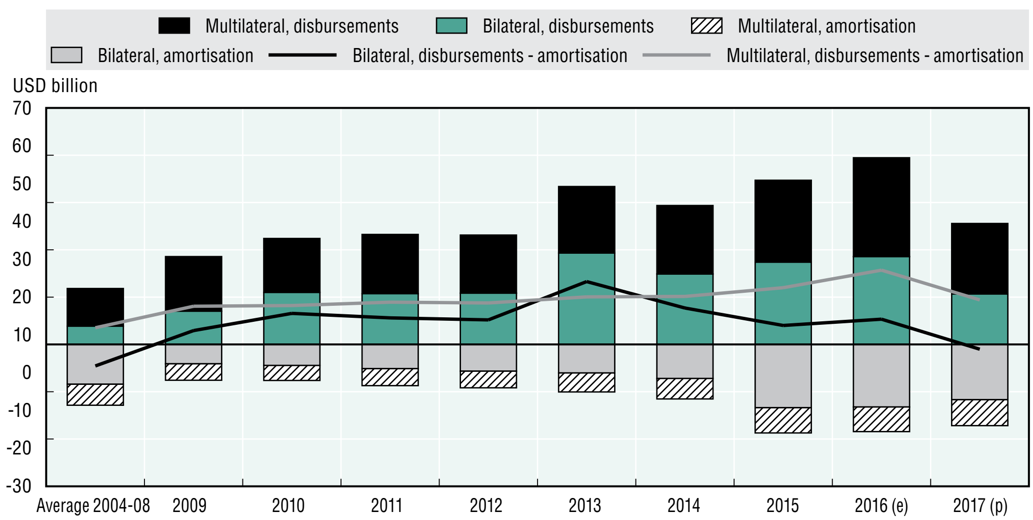
Origin	2013	2014
China	13.4	3.1
Europe	7.4	6.4
United States	7.0	n.a.
World Bank	4.5	6.5
AfDB	3.6	3.6
Arab Coordination Group	3.3	3.5
Japan	1.5	2.1
South Africa	1.2	1.0
Total	99.6	74.5

Source: ICA (2014, 2015).

Official bank credit disbursements to Africa, from bilateral and multilateral sources, have almost doubled since 2008 (Figure 2.8). Then, these sources provided USD 18.6 billion. By 2015, they had reached USD 34.7 billion and are projected to rise in 2016 to USD 39.5 billion. Allowing for amortisation in each corresponding year, Figure 2.11 also provides evidence on net official bank credit flows.

Net official credit flows (disbursements minus amortisation) have declined in 2015, mainly due to a heavy amortisation schedule on bilateral liabilities. Payments to bilateral official creditors jumped to USD 13 billion in 2015 and are projected at that level for 2016, too. This compares to much lower payments for 2009–14 when amortisation to bilateral official creditors averaged USD 5.4 billion. Northern Africa has seen net official bank credit flows curtailed, as bilateral credit to the region turned negative from 2014, mostly as a result of Egypt's heavy amortisation schedule. The main bilateral borrowers in sub-Saharan Africa were Republic of the Congo and Côte d'Ivoire, mainly through agreements with China. While bilateral official lending accounted for 53.7% of total to Africa in 2013, it fell below multilateral lending in 2014.

Figure 2.8. **Multilateral and bilateral official bank credit flows to Africa, 2004-17, USD billion**



Note: (e) estimates; (p) projections.

Source: World Bank (2016c).

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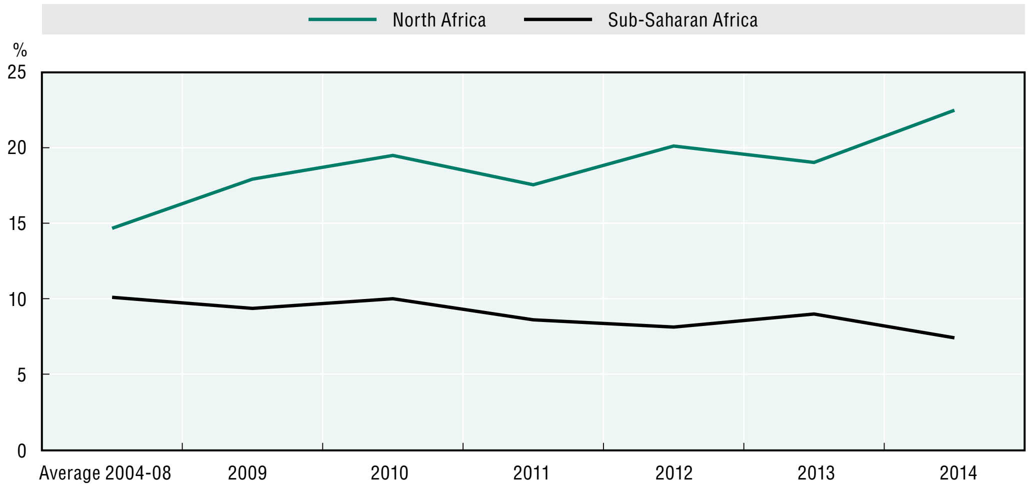
Multilateral development banks currently provide the most significant volume of bank credit resources to Africa (Figure 2.8). While net bilateral bank credit flows have dropped since 2014, the rise of net multilateral bank disbursements to sub-Saharan Africa has continued unabated. New gross multilateral disbursements for African borrowers have risen to record levels, USD 17.3 billion in 2015. Disbursements are projected to rise in 2016 to more than USD 21 billion, but the World Bank predicts they could drop sharply after.

There is a striking divergence in the percentage share of short-term debt (with a maturity of less than one year) in total external debt between sub-Saharan and North Africa (Figure 2.9). In sub-Saharan Africa, the prevalence of official over private flows and the dominance of multilateral development bank credit has helped to keep the share of short-term debt in total external debt contained below 10% in recent years. As a result, the external debt is less volatile and reversible. By contrast, the percentage share of short-term debt in total external debt has been rising in North Africa. In 2014, the share reached 22.5%.

Figure 2.9. **Africa's short-term debt, % of total external debt, 2004-14**



Source: World Bank (2016c).
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Lower oil and base metal prices since 2014 will make commodity exporting countries more vulnerable to debt. The latest list of debt sustainability analyses for low-income countries (for the Poverty Reduction and Growth Trust Fund) shows that during 2015 the debt sustainability outlook had worsened for Cameroon, Central African Republic, the Republic of the Congo, Ethiopia, Ghana, and Zambia. Debt vulnerability had already been high in Burundi and Chad, while Sudan and Zimbabwe were listed as in debt distress. Among trust fund eligible countries, the debt sustainability outlook improved during 2015 only in Senegal, thanks to the incorporation of heavy remittances in the country's debt analysis.

Remittances are a major, stable resource for African development

Remittances represent a key source of capital for African countries. They can be leveraged to spur investment and growth, but efforts to maximise their development impact face major obstacles. And recent developments in the resource-rich countries of the Middle East and Russia and the relative stagnation of European Union growth suggest that remittances will slow.

Of an estimated 23.2 million migrants from sub-Saharan Africa, 26% live in OECD countries and 65.6% in Africa (World Bank, 2016b). The largest home countries of migrants were Burkina Faso, the Democratic Republic of the Congo, Côte d'Ivoire, Nigeria, Somalia, and Sudan. Africa hosted 18 million migrants, with the majority going to Côte d'Ivoire, Ethiopia, Kenya, Nigeria, and South Africa.

Developed countries dominate remittances to Africa, but African countries like Cameroon (USD 2.4 billion in 2015), Côte d'Ivoire (USD 1.3 billion), and South Africa (USD 1.1 billion) transferred large remittances to other African countries. Four countries account for nearly half of remittances sent to Africa: the United States (USD 8.4 billion), Saudi Arabia (USD 8.3 billion), France (USD 6.9 billion), and the United Kingdom (USD 5.2 billion) (World Bank, 2015a). Bilateral remittances to Africa amounted to USD 63.8 billion in 2015. Low-income countries such as Liberia, Gambia, Comoros and Lesotho received the largest amount of remittances as a share of GDP (Table 2.3).

Table 2.3. **The 15 largest recipients of remittances in Africa, 2015**
ranked by % of GDP

	% GDP	USD per capita	Current USD, billion
Liberia	28.18	132.17	0.57
Gambia	23.74	91.24	0.18
Comoros	22.76	167.74	0.13
Lesotho	19.87	211.17	0.40
Cabo Verde	11.81	369.47	0.19
Senegal	11.54	107.84	1.61
Sao Tome and Principe	8.93	143.33	0.03
Togo	8.30	48.00	0.34
Mali	8.17	54.90	0.89
Morocco	6.48	199.37	6.68
Tunisia	5.17	206.17	2.29
Madagascar	4.49	17.64	0.43
Guinea-Bissau	4.41	25.68	0.05
Nigeria	4.23	116.75	20.86
Uganda	4.22	26.39	1.05
Benin	2.70	19.13	0.21

Source: Authors' calculations based on World Bank (2015b).

The regional distribution of remittances will remain uneven

Official remittances to African countries are unevenly distributed, with North African (49.5%) and West African (40.8%) countries receiving the bulk of flows in 2014 (Figure 2.10). Remittances to North Africa were expected to remain stable in 2015, rising to USD 31.7 billion. They are expected to increase to USD 32.1 billion in 2016 (World Bank, 2015b). Egypt has seen steadily increasing remittances (USD 7.1 billion in 2009 but USD 20.4 billion in 2015) and is now the largest recipient of remittances in North Africa. Large amounts also went to Morocco (USD 6.7 billion in 2015, USD 6.9 billion in 2014), and Tunisia with USD 2.3 billion (2014 and 2015).

Remittances to sub-Saharan Africa are projected to rise 1.6% to USD 32.3 billion in 2015 and are expected to grow again to USD 33.6 billion in 2016. Nigeria alone accounts for about two-thirds of total remittances to sub-Saharan Africa, but these are estimated to have remained flat in 2014 and 2015 at roughly USD 21 billion. There was however strong growth in Kenya (10.7%), South Africa (7.1%) and Uganda (6.8%).

Remittance dependency varies. In Gambia, Lesotho, Liberia and Comoros remittances equalled about 20% of GDP in 2015.

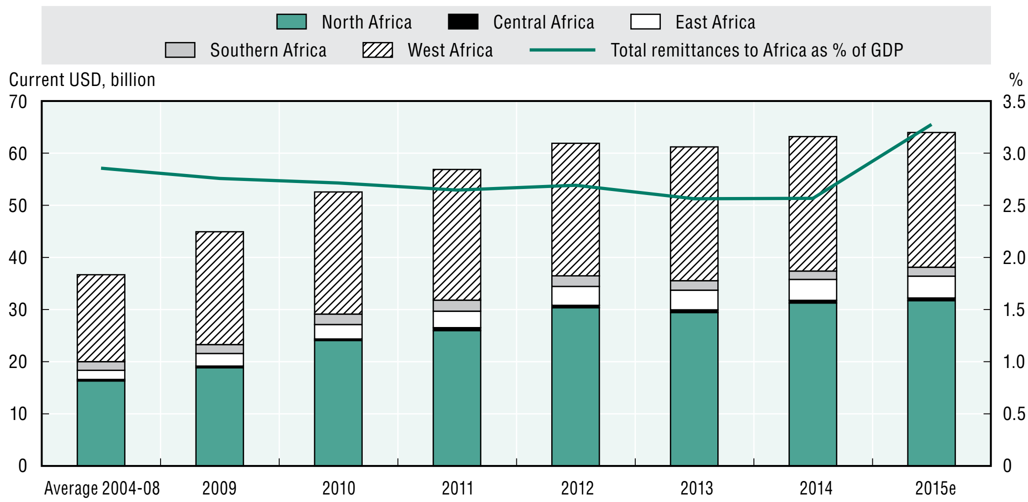
Growth in African remittances is expected to slow due to the weak economic growth in Europe, the impact of lower oil prices in the Middle East, the depreciation of the euro and the tightening of migration controls in many remittance source countries.

Countries with a large population of migrants could harness the potential of remittances to develop their financial sector and spur investment and growth. But more transparency is needed.

Several African countries are tapping into the pool of remittances' funds by issuing bonds for investments in their homelands. Money raised through diaspora issues could be used to finance projects of interest to overseas migrants, such as housing, schools, hospitals and infrastructure. According to the African Development Bank, Africa could potentially raise USD 17 billion a year by using future remittances as collateral. A number of obstacles prevent African countries from deriving the full benefit of remittances.

Low international oil prices could reduce remittances from the Gulf states in the medium-to-long term. In the short term, however, significant foreign exchange reserves and strong fiscal positions could support current spending, delaying the impact of low oil revenues on migrant jobs. Remittances to all of Africa are expected to grow to USD 65.7 billion in 2016 (World Bank, 2016b). Conflict in the Middle East is causing international displacement and remains a major risk factor for remittances.

Figure 2.10. **Remittances per African subregion, 2004-15**
current USD billion



Source: Authors' calculations based on World Bank (2015b).
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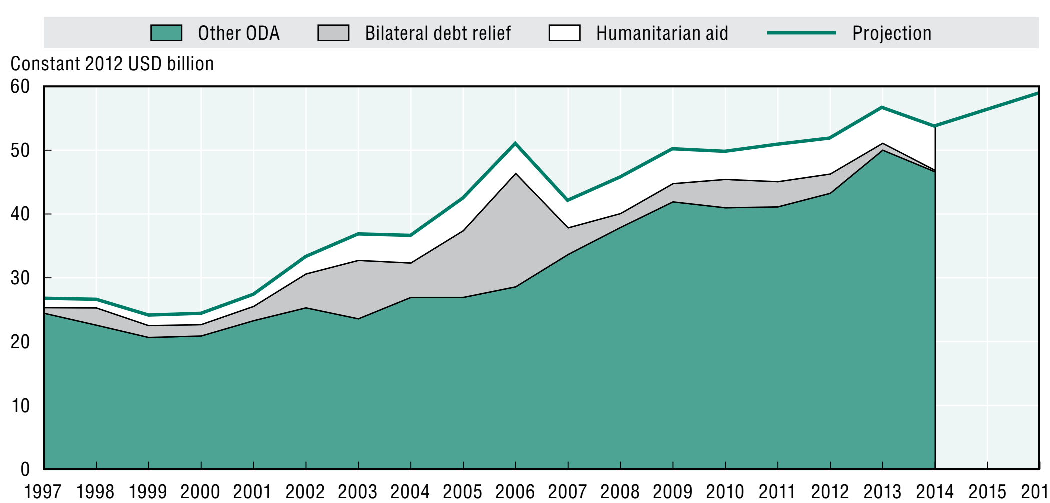
Official development assistance remains stable but falls short of official pledges

There has been a rise in net official development assistance from a low of USD 21 billion (at constant 2012 values) to a 2013 peak of USD 50 billion (Figure 2.11). According to the OECD, in 2014, total net ODA to Africa dropped by USD 3 billion. With Africa's strong GDP growth, the value of the assistance has fallen from a 2009 peak of 2.63% of African recipients' GDP to below 2% by 2014. Country programmable aid (CPA), the amount of aid which donors can allot to an individual country and which is considered a good predictor of ODA, had been programmed to increase from 2015. The projection of net ODA disbursements for 2015 and 2016 is based on CPA projections, adjusted to total ODA.

Figure 2.11. **Net official development assistance disbursements to Africa, 1997-2016**
constant 2012 USD billion



Source: Authors' calculations based on OECD (2016).
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In the *Addis Ababa Action Agenda* (UNDESA, 2015a) adopted at the Third International Conference on Financing for Development, and endorsed by the UN General Assembly in 2015, ODA providers reaffirmed past commitments. Many developed countries promised to reach the target of devoting 0.7% of gross national income (GNI) to ODA and 0.15% to 0.20% of GNI to least developed countries. Members of the OECD's Development Assistance Committee (DAC) have also committed to reverse the decline of ODA to Africa by adhering to the 0.7% target. In the *Addis Ababa Action Agenda*, donors are specifically asked to maintain 2013 ODA levels as a minimum.

Multilateral aid and ODA from DAC donors remain stable

Multilateral aid to Africa remained stable in 2014 and reached USD 20.6 billion. A similar figure was reached in 2013. The most important contributors in 2014 were European Union institutions (USD 6.7 billion), the International Development Association (IDA) (USD 6.4 billion), the Global Fund (USD 2 billion) and the African Development Fund (USD 1.9 billion). While EU institutions increased ODA to Africa by 13.6% between 2013 and 2014, the Global Fund decreased disbursements by 22%.

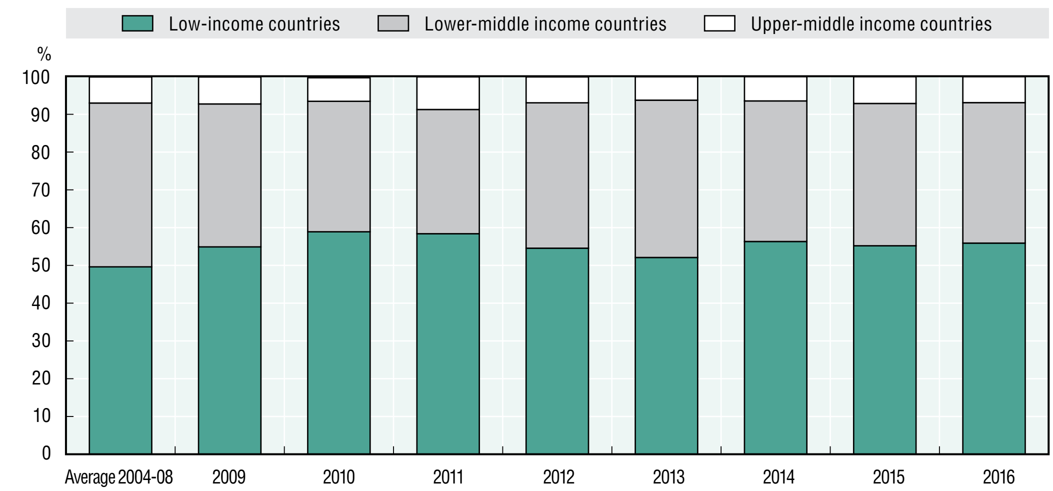
Multilateral aid to Africa may be replaced by non-concessionary multilateral lending and thus fall over the next decade. When countries' per capita income grows above thresholds for IDA eligibility, they lose their entitlement to multilateral aid, despite the fact that they may have a great number of people in extreme poverty. Reisen and Garroway (2014) project that Cameroon, Guinea, Kenya, Mauritania and Senegal will by 2025 move out of IDA eligibility (per capita GNI below USD 1 215 in 2016). They also project Côte d'Ivoire, Ghana, Lesotho and Nigeria to graduate from the higher, historical IDA eligibility of USD 1 965.

Bilateral ODA from DAC donors also remained almost stable in 2014 at USD 29 billion. The major donors have been the United States (USD 9.3 billion), the United Kingdom (USD 4.3 billion), Germany (USD 3 billion) and France (USD 2.9 billion). ODA from non-DAC members listed in OECD statistics decreased in 2014, mainly because of aid cuts by the United Arab Emirates, Turkey and Kuwait. Non-DAC aid fell about 25% to USD 4.4 billion, mainly because of a 31% reduction in aid from the United Arab Emirates and Saudi Arabia to Egypt.

Just over half of ODA to Africa reaches low-income countries

Just over half of ODA to Africa goes to low-income countries (LICs) (Figure 2.12). The LIC share of Africa-bound development assistance declined from a peak of 58.9% in 2010 to 52.1% in 2013. There was a slight rebound in 2014. In USD terms, ODA to African LICs has remained stable at roughly USD 27 billion from 2011 to 2014. It is estimated to have risen to USD 27.5 billion in 2015. According to CPA projections, the distribution of ODA to low-income, lower-middle income and upper-middle income African countries is expected to remain almost stable in 2016.

Figure 2.12. **Net official development assistance disbursements to African countries by income group, 2004-16**



Source: Authors' calculations based on OECD (2016).

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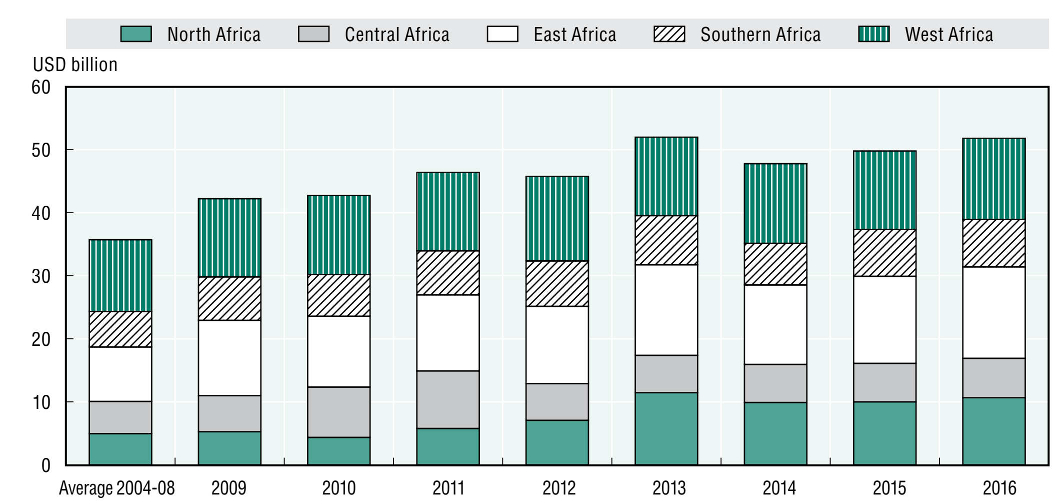
East Africa and West Africa are the main recipients of ODA

East and West Africa are the continent's leading recipients of official development assistance from all recorded donors (Figure 2.13). Ethiopia (USD 3.6 billion), Kenya (USD 2.7 billion) and Tanzania (USD 2.6 billion) topped the list in East Africa. Nigeria (USD 2.5 billion) was the leader in the West. Other major recipients in 2014 were Egypt (USD 3.5 billion), Morocco (USD 2.2 billion) and Mozambique (USD 2.1 billion). These seven countries accounted for 36% of total official assistance to Africa.

Several Southern African countries, notably Lesotho, Swaziland, Angola and South Africa, saw less aid in 2014 against 2013. North African countries received 13.5% less, largely due to declining ODA to Egypt and Sudan.

Figure 2.13. **Net official development assistance disbursements to African countries by region, 2004-16**



Source: Authors' calculations based on OECD (2016).

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Survey predicts increased country programmable aid to Africa

The 2015 Global Outlook on Aid (OECD, 2015) survey indicates that country-specific aid to the poorest countries should recover, in line with recent donor pledges, after several years of decline.

The survey provides an overview of global aid allocations up to 2018 based on the 2015 DAC Survey on Donors' Forward Spending Plans, tracing CPA flows. The survey highlights programmed increases starting in 2015 (Table 2.4).

Table 2.4. **Africa's country programmable aid estimates and projections, USD billion**

	2014	2015	2016	2017	2018
Sub-Saharan Africa	35.1	37.1	38.6	38.9	39.4
North Africa	8.8	8.7	9.0	9.3	9.4
Africa, Total	45.5	47.4	49.3	49.9	50.6

Source: Authors' calculations based on OECD data (2016).

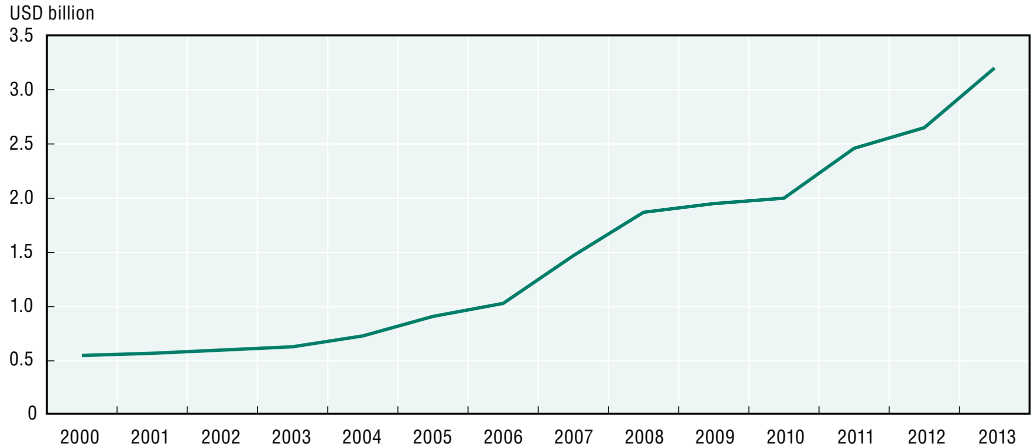
According to the 2015 survey on forward spending plans, CPA was to increase by USD 2.7 billion in 2015. Multilateral agencies are stepping up their efforts with larger disbursements after receiving cash injections. Least developed and low-income countries will benefit most from this increase, with aid expected to grow by 5.7% in real terms in 2015. Overall CPA to low- and middle- income countries (LMICs) was projected to remain stable in 2015, signalling that donor finance to this group of countries is safeguarded. For upper middle-income countries, overall CPA levels are expected to fall by 4.4%, mostly to the higher income countries.

On a geographical basis, CPA to sub-Saharan Africa was projected to grow more than for other zones, with a predicted rise of 5.7% because of more concessional lending. Global CPA is projected to remain stable up to 2018 with more help to least developed countries after DAC members decided in December 2014 to allocate more ODA to the countries most in need. Two thirds of the least developed countries will see a rise in CPA, with Ebola-affected countries such as Guinea getting significant help.

China's aid to Africa is increasing

China's aid to Africa is believed to be increasing even though estimates of the total vary widely. China's aid to Africa is not reported by the OECD and therefore not included in the above data. The Chinese government also does not provide detailed information about its overseas aid. The China Africa Research Initiative provides information based on the China Statistical Yearbook and other Chinese sources. Figure 2.14 shows a clear upward trend of Chinese aid to Africa from about USD 600 million in 2000 to USD 3.2 billion in 2013.

Figure 2.14. **China's external assistance expenditures, USD billion**



Source: China Africa Research Initiative (2016).

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Domestic revenues fall as resource revenues tumble

After a decade-long improvement in domestic resource mobilisation, falling resource prices have brought down African domestic public revenues, according to data collected by the African Development Bank through country missions for the *African Economic Outlook*. Countries without resources have increased tax revenues and tax-GDP ratios, however.

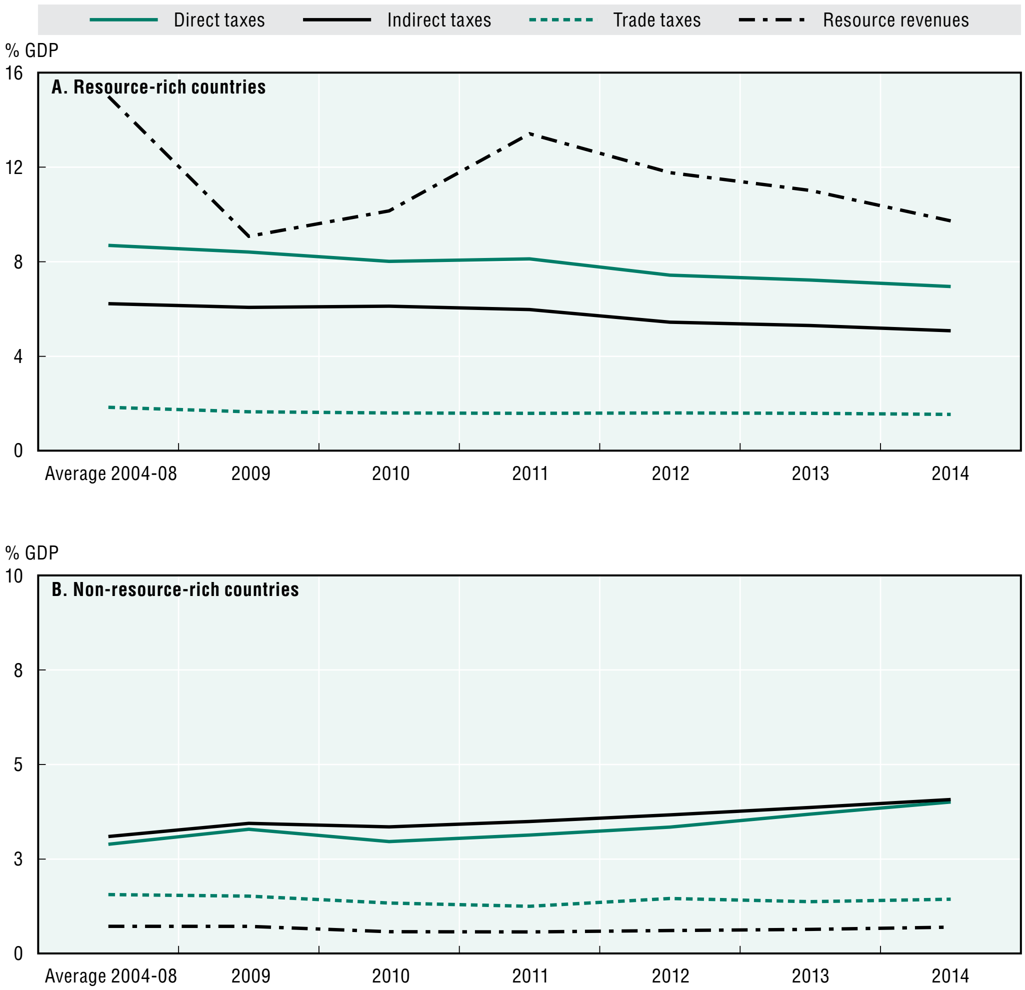
The 2015 *Addis Ababa Action Agenda* (UN, 2015a) made domestic public revenues the top action area. Mobilising public revenues is central to achieving the United Nations Sustainable Development Goals on increasing productivity levels and making growth more inclusive. Domestic resource mobilisation reinforces a country's ownership of public policy and allows it to move towards financial autonomy. African countries still face formidable challenges raising more and better taxes, mostly as a result of economic structure and the prevalence of the informal sector.

A big fall in resource revenues has lowered Africa's total revenues since 2013

Africa increased public domestic revenues up to 2013, collecting a total of USD 468 billion in that year. Since then, however, the amount has declined because of falling resource revenues. In 2014, Africa's tax authorities collected USD 461 billion, an annual decrease of 1.5%. As public revenues tumbled in large resource-rich countries in 2015, Africa's total public revenues decreased. Public revenues in Africa's resource-rich countries (USD 373 billion) far outweighed those in non-resource-rich countries (USD 88 billion) in 2014.[1]

Resource revenues – from oil or mineral extraction but also some crops such as cocoa exports – are the main contributor to Africa's revenue. However, after peaking at USD 171 billion in 2012, resource revenues have fallen. They shrank by 8.3% in 2014, compared to 2013, to USD 155 billion. In 2015, resource revenues fell markedly in Algeria, Angola, Ghana, Libya, Nigeria and South Africa, mostly as a result of plunging oil and metals prices. In some countries there was a 20% fall from 2013 resource revenues. Côte d'Ivoire, Sudan and Zambia, however, escaped the trend despite lower oil and copper prices. The revenue-GDP ratio in resource-rich African countries has fallen from 26.3% in the peak year 2012 to 23.3% in 2014.

Figure 2.15. **The revenue mix in resource-rich vs. non-resource-rich Africa**
revenue-GDP ratios, 2004-14



Source: Authors' calculation based on *African Economic Outlook* data.
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Non-resource-rich countries have increased tax revenues and tax ratios

Non-resource-rich countries have steadily increased public revenues by diversifying from trade sources to direct income and profit taxes, as well as indirect consumption-based taxes. Public revenues rose from USD 62 billion to USD 88 billion between 2010 and 2014. As revenues rose faster than GDP, the average tax ratio in non-resource-rich countries has gradually climbed from 8.2 % of GDP in 2010 to 10.2% of in 2014.

The tax ratios are still very low by international standards. Tax revenues are 34.4% of GDP on average in OECD countries. Correcting tax-GDP ratios for structural differences (mainly GDP per capita, sectoral composition of output, degree of urbanisation and trade openness) produces a measure of tax efforts – how much a country collects against its potential tax revenues. Africa displays a large heterogeneity in tax efforts. Daude et al. (2012) find that many African countries topped an international tax effort index in 2008.

Box 2.3. **A new database of comparable revenue statistics in Africa**

To enhance the comparability, quality and accessibility of public revenue data in Africa, the African Union Commission, the African Tax Administration Forum and the OECD launched the first edition of *Revenue Statistics in Africa* in March 2016, with the support of the AfDB, the World Customs Organisation and the *Centre de rencontres et d'études des dirigeants des administrations fiscales* (CREDAF) (see Box 2.4 in AfDB et al., 2015).

Tax officials from Cameroon, Côte d'Ivoire, Mauritius, Morocco, Rwanda, Senegal, South Africa and Tunisia worked with the partner institutions to organise their revenue data for 1997-2014 according to a tax classification system already used by 57 other countries in the world. It made their statistics effectively comparable between themselves and with other countries for the first time.

This new database will facilitate policy analysis, help measure or forecast the impact of reforms, devise common policies within regional economic communities, identify best practices, engage in international dialogue and peer learning, and report to citizens and elected representatives.

The work contributes to the financial chapter of the African Charter on Statistics in rolling out the Strategy for the Harmonisation of Statistics in Africa. It also supports the first 10-year implementation plan (2014-2023) of the African Union's Agenda 2063, which aims to "develop and implement frameworks for policies on revenue statistics and fiscal inclusiveness for Africa." At a global level, the work will support the Sustainable Development Goals' target 17.1 to "improve domestic capacity for tax and other revenue collection" and target 17.19 to "support statistical capacity building in developing countries."

Source: OECD/ATAF/AUC (2016).

Revenue-to-GDP ratios in African resource-rich countries fall across all categories

There are two diverging country groups in terms of revenue-GDP ratios. Ratios fell across all broad tax categories in resource-rich countries after a steep decline in international prices cut their revenues. Since 2011, resource revenues as a proportion of GDP have dropped by 3.7 percentage points from 2011 to 2014, down from 13.4% to 9.7%. Resource revenues had accounted for more than 80% of total revenue collection and 20% of GDP in oil-rich Algeria, Angola, Congo, Equatorial Guinea and Libya still in 2013 (AfDB/OECD/UNDP, 2015).

Resource-rich countries also suffered a pro-cyclical drop in the tax-GDP ratio of direct income and profit taxes as well as indirect taxes, as shown in Figure 2.15. As long as resource-based income permeates the economies of resource-rich countries, it is a formidable policy challenge to diversify revenues toward income, profits and consumption. These tax bases are also affected by the slump in commodity prices in resource-rich countries unless the entire economy is moved away from resource sectors. Progressive income taxes could really attenuate the pro-cyclical features of income taxation.

Direct and indirect taxes rise gradually in non-resource-rich Africa

Countries that are not resource-rich have, conversely, broadened their tax base and raised revenues through higher direct and indirect taxes. Figure 2.15 shows a continuous rise in the GDP ratios of direct and indirect taxes. This helped non-resource-rich countries to increase their total (unweighted) tax ratio from 8.5% in 2011 to 10.2% in 2014.

Good growth performance and improved tax collection have enabled domestic resource mobilisation, although the tax ratios in Africa's non-resource-rich countries remain comparatively low.

Several countries in East Africa were noted in 2015 for increasing revenues from indirect (mostly consumption-based) taxes and direct taxes on incomes and corporate profits. Ethiopia doubled indirect and direct tax revenues between 2012 and 2015; Kenya and Rwanda displayed a dynamic upward trend in tax revenues as well into 2015. Overall, non-resource-rich countries in East Africa have a well-balanced mix of indirect, direct and trade taxes, which should help them to maintain a more stable and predictable flow of resources to finance public action.

Sustainable benefit is needed from financial flows and public revenues

Mobilising domestic and foreign resources in the face of lower commodity prices and a rebalancing Chinese economy throws up policy challenges – and opportunities. Policy questions arise about how governments of commodity exporting countries absorb the earnings shortfall in the short term. It is also important for Africa's governments to move in the longer term to diversify their economies to ensure sustainable benefit from financial flows and public revenues.

A wide range of policies are possible for a great diversity of different countries. The main structural distinction runs between countries that are net exporters or importers of fossil fuels and industrial metals. The main financial distinction applies to the level of domestic savings, whether external debt is sustainable and the level of foreign-reserve buffers. A further distinction relates to the degree of exchange rate flexibility. Finally, the quality of domestic governance and institutions play a key role in how successful financial resources will be in helping to make growth inclusive and sustainable.

Stabilising finance for development is a major short-term challenge. Reduced financial foreign flows require higher domestic tax revenues, more stimulus for foreign inflows and better use of foreign reserves, if austerity measures are to be contained:

- **Savings needed**. Africa is the developing region with the world's lowest saving rate. This is holding back investment and future output. Africa's saving rate has been declining since 2009 and the IMF (2015a) projects that the 2015 domestic savings rate will drop further to just 15.4 % of GDP. This compares to an estimated average rate of 31.9% for all the emerging and developing countries in 2015. Recent IMF (2015c) analysis suggests that the median country in sub-Saharan Africa has a potential for a three to 6.5 percentage point increase in tax revenue. With oil prices down, countries may consider removing oil subsidies and increasing non-oil fiscal revenues. They can raise the value-added tax (VAT). However, economic diversification is needed to support non-oil fiscal revenues.
- **Fiscal reforms**. As resource revenues recede, governments need to broaden the tax base away from the resource sector towards consumption-based taxes. Resource-based revenues can give unexpected answers to challenges, as the case of Democratic Republic of the Congo (DRC) shows. The government received a record USD 2 billion in 2014, despite falling commodity prices. The Extractive Industries Transparency Initiative (EITI, 2016) has reported on DRC's efforts to increase financial transparency. Resource-rich countries tend to be energy and carbon intensive. Carbon taxes, as planned in South Africa, help to reduce greenhouse emissions and diversify the tax base.
- **Higher tax-GDP ratio**. African countries without resource wealth need to augment their tax-GDP ratios to the minimum benchmark of 20% proposed by the Sustainable Development Solutions Network (SDSN, 2013). Countries must invest

in strengthening systems to assess and collect taxes, as well as enforce compliance, improve spending efficiency and curb illicit financial flows.

- **Risky bonds**. Stimulus for foreign inflows must go hand in hand with financial discipline. Issuing short-term foreign-currency bonds to bridge financing gaps is risky. Certain financial flows can create credit boom distortions and exchange rate appreciation due to the implicit credit guarantee and ill-regulated financial sectors. Sudden withdrawals can cause a slump. The ensuing bail-out cost and the slump in turn cause lower savings. Debt-creating financial flows are inferior to foreign direct investment, which in turn is associated with higher GDP growth (Reisen and Soto, 2001).
- **Stronger reserves**. The use of official foreign reserves (or buffer stocks as in Chile) may help some prepare for periods of trouble. However, depleting reserves below certain levels (such as the level of short-term domestic and foreign debt) will trigger currency attacks as seen in Zambia in 2015. The difference between the rising local currency cost of Eurobonds – an average 20% in Africa – and a fall in growth rates to low single digits creates unpleasant debt dynamics, which are unlikely to be compensated by a surplus in the non-interest current or fiscal accounts.

Apart from dealing with the short-term effects of the external shocks, Africa's governments need to determinedly implement medium- to long-term structural policies. The African Union's Agenda 2063 (AU, 2015) specifies seven aims, including economic and social transformation. With almost 200 million people aged between 15 and 24, Africa has the world's youngest population and it is growing rapidly. Half of the increase in the global labour force over the next 25 years will originate in Africa.

Africa must create productive jobs for its 500 million potential new labour force. The commodity sector is too capital intensive to offer hope to Africa's young population. While commodity exporters, like Nigeria, Angola and Zambia, have been hit hard by China's slowdown, others like Ghana, Kenya, Uganda, Mozambique and Ethiopia are showing greater resilience. They have been forced to diversify their economies, in part because of their dearth of raw materials. Whether African economies come through the challenges generated by lower commodity prices will depend on comparative advantages, the quality of economic policy and the fast implementation of measures. As spelled out in the AEO 2015 (AfDB/OECD/UNDP, 2015), no single sector holds the solution. Labour-intensive manufacturing, commodities processing, higher productivity agricultural and rural employment, all need to absorb the labour force. Regional economic integration is essential for Africa to realise its full growth potential, to participate in the global economy and to share the benefits of an increasingly connected global marketplace. Regional trade is still hampered by Africa's deficient infrastructure. Among the Agenda 2063 aims, building infrastructure, lowering barriers to business investment and fostering education merit special attention to help Africa's structural transformation aims:

- **Cut volatility**. Foreign direct investment, bank credits and portfolio equity flows reflect the global economic environment, but domestic factors also have contributed to turbulence. There is a need for regulatory reforms and stability, including stronger action against militant threats, which have had a cut growth in affected countries.
- **Boost aid**. Africa's aid outlook should observe the *Addis Ababa Action Agenda*. Donors are asked to maintain 2013 official development assistance levels as a minimum. ODA should be prioritised for low-income and lower middle income Africa.
- **Remittances**. Money from overseas workers represent a key source of finance for Africa. This finance could spur growth and can be used as a catalyst to develop the financial sector.

- **Integration**. Some countries benefit from stronger intra-regional co-operation, proximity to Western Europe and deeper co-operation with emerging markets. These countries can assist the growth of others. Further international support of intra-regional investment in corridor roads, electricity, Internet networks and railways will boost growth and regional exchange.
- **Infrastructure gap**. There has been significant investment in infrastructure in recent years, much of it from China, but African countries are still chasing other developing countries in almost all measures of infrastructure coverage. Access to water, road transport and electricity are particularly limited. Quickly closing the infrastructural gaps would boost growth. A 2014 analysis by Ernst and Young and the Infrastructure Consortium for Africa (ICA) showed that with funds available and projects started, the gap is being closed. But it found that work had yet to begin on two-thirds of identified projects. Africa does not need to identify new sources of funding but rather ensure that planned projects are completed within a reasonable timeframe. This will ensure projects deliver returns to investors and help to attract new investment. Africa needs to remove barriers to finishing projects by lowering the cost of doing business.
- **Business costs**. The benefit from infrastructure investment is greatly reduced if there are no accompanying improvements to institutions and regulations. According to the World Bank's (2015c) Doing Business indicators, median African countries rank 151st out of 189, compared with a median 48th for all emerging market countries. Reducing the cost of doing business attracts local and foreign investment. The region undertook the largest number of regulatory reforms making it easier to do business, accounting for about one third of worldwide reforms in 2015 (see Chapter 5).
- **Human capital**. Though progress has been made in the past decade, Africa still trails other world regions for health, education and training – human capital. More investment is needed in these areas to support industrial development. High vacancy rates while there is also large scale unemployment confirms Africa's skills mismatches.

Note

1. In line with IMF (2015b), we consider Algeria, Angola, Botswana, Cameroon, Chad, Democratic Republic of the Congo, Republic of the Congo, Côte d'Ivoire, Egypt, Equatorial Guinea, Gabon, Ghana, Guinea, Liberia, Libya, Mauritania, Namibia, Nigeria, Sierra Leone, South Africa, South Sudan, Sudan, and Zambia as resource-rich countries.

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