

**INNOVATIVE  
FINANCING** for the  
ECONOMIC  
**TRANSFORMATION** of  
AFRICA



United Nations  
Economic Commission for Africa

Edited by Abdalla Hamdok



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## List of abbreviations

AfDB	African Development Bank
AU	African Union
AUC	African Union Commission
CAADP	Comprehensive Africa Agriculture Development Programme
ECA	Economic Commission for Africa
ESG	Environmental, social and corporate governance
FDI	Foreign direct investment
GDP	Gross domestic product
IATA	International Air Transport Association
IFF	Illicit financial flows
ICT	Information and communications technology
NEPAD	New Partnership for Africa's Development
ODA	Official development assistance
OECD	Organization for Economic Cooperation and Development
PIDA	Programme for Infrastructure Development in Africa
REC	Regional economic community
SME	Small and medium-sized enterprise
UNFCCC	United Nations Framework Convention on Climate Change

## Acknowledgments

This book on *Innovative financing for the economic transformation of Africa* is a publication of the Economic Commission for Africa (ECA). It is a compilation of reworked versions of the well-researched and evidence-led issues papers that were presented at the Ninth African Development Forum, which was organized by the Economic Commission for Africa and its strategic partners in Marrakech, Morocco, in October 2014. The book was prepared under the direct supervision of Abdalla Hamdok, Deputy Executive Secretary of the Economic Commission for Africa and the overall leadership and guidance of Carlos Lopes, Executive Secretary of the Economic Commission for Africa.

The chapters in this book were put together by: Abdalla Hamdok and Francis Ikome (chapter I, Introduction); Adam Elhiraika, Gamal Ibrahim, Derrese Degefa and Uzumma Erume (chapter II, Domestic financial resources mobilization for Africa’s development); Adeyemi Dipeolu; Gamal Ibrahim, William Davis and Oladipo Edmond Johnson (chapter III, Illicit financial flows: why Africa needs to “track it, stop it and get it”); Stephen Karingi, Daniel Tanoe and Emmanuel Chinyama; (chapter IV, Private equity and Africa’s economic growth: Demystifying the asset class for policymakers); Fatima Denton, Bruk Tekie, James Murombedzi, Johnson Nkem, Aloysius Fomenky and Thierry Amoussougbo (Chapter V, Climate financing: implications for Africa’s transformation); Steven Karingi, Daniel Tanoe, Giovanni Valensisi, and David Luke (chapter VI, New forms of partnerships and innovative sources of financing Africa’s transformation); and Abdalla Hamdok and Francis Ikome (chapter VII, Conclusion).

In drafting the chapters of this book, the authors also tapped from the rich and engaging discussions among various participants that occurred during the Ninth African Development Forum in Marrakech, Morocco, and express their sincere appreciation to them, as well as to the Director of ECA’s Subregional Office for North Africa, Karima Bounemra Ben Soltane, and her staff. In addition, the publication of this book would not have been possible without the support of the following: Collen Kelapile, Jimmy Occiti, Demba Diarra, Marcel Ngoma-Mouaya, Charles Ndungu, and the entire Economic Commission for Africa Publications Section team; as well as Peter Mundala, Rebecca Benyam and Lia Yeshitla in the Office of the Deputy Executive Secretary.

# FOREWORD

**S**trong voices from the four corners of the globe have continued to tell the compelling story of an African continent that is resolutely on the rise and within the threshold of economic transformation and take-off. One of the most important planks which supports the growing optimism about Africa's imminent economic take-off is the continent's impressive economic growth rates during a greater part of the last two decades. Economic growth has averaged about 5 per cent a year, making it one of the fastest-growing regions. However, some of the shine generated by this impressive economic growth rates has been dulled by its non-inclusive character and because the growth has not been accompanied by economic transformation that generated employment. Increasingly, therefore,

various segments of African societies, including its leadership, have come to recognize the imperative of economic transformation as a means of engendering sustainable development on the continent.

Despite the strong consensus around the need for the economic transformation, the challenge of how to finance the transformation is well-known but has yet to be addressed adequately. The financial resources needed for Africa's structural transformation, including for filling its huge deficits in infrastructure and energy, which are critical for industrialization, are enormous and well-documented. The quest for solutions to the resources requirements for Africa's structural transformation has to be viewed from the prism of the growing unreliability and inadequacy

of traditional sources of development finance, particularly those from external provenance, such as foreign direct investment (FDI) and official development assistance (ODA).

Although development assistance and other external sources of development financing continue to be relevant, they cannot be relied upon as the principal sources of funding for the industrialization and economic transformation of African countries. Rather, in light of the scale and scope of the resources needed for transformation and development priorities, the continent's policymakers increasingly have to prioritize attracting and retaining both new and old domestic sources of finance and developing innovative mechanisms that can leverage hitherto unexplored

sources such as remittances, savings from the curtailment of illicit financial flows (IFFs), diaspora funds, better negotiated mineral contracts and the expansion of Africa's fiscal space. In a nutshell, Africa's transformation agenda must be met with internally mobilized financial resources, which ideally should only be supplemented by external sources.

This book builds on the issues papers and synthesis of discussions of the Ninth African Development Forum, organized by the Economic Commission for Africa and its strategic African partners, and examines five thematic issues areas of development financing. These are deemed to have the potential to respond to Africa's quest for alternative and innovative

sources of finance to underwrite its economic-transformation agenda. The five thematic areas are: Domestic resources mobilization, illicit financial flows, private equity, climate financing and new forms of partnership. These innovative sources of finance offer the continent a range of options and opportunities. If they are properly leveraged, they would considerably reduce its dependence on external resources and provide the requisite resources for the implementation of regional and global development agendas, such as the evolving African Union Agenda 2063 and the post-2015 global development agenda.

It demonstrates that a number of characteristic features of African economies are at the root of the rather low levels

of mobilizing domestic resources, including: low public and private savings rates; narrow tax bases; complex administrative and bureaucratic procedures; corruption; tax evasion; deficiencies in the growth and development of financial systems; and the high levels of dependence on external financing. It makes a very strong case for robust policy measures to alter these features, with a view to enable African countries to be better equipped to capture sources of finance that are currently unexplored or poorly developed, including closing the loopholes that facilitate the haemorrhage of the continent's financial resources through illicit financial outflows.

The book analyzes the various dimensions, sources and impacts of illicit financial flows

from the continent and the strategies that could be deployed to halt and redirect them towards Africa's development. It demonstrates that the scale of these flows in Africa is higher than the volumes of official development assistance inflows. If Africa could halt illicit financial outflows successfully, it would not need development assistance. The book also provides analysis of private equity. It argues that Africa lags behind other regions of the world in developing this potentially lucrative source of development financing, partly because of the lack

of adequate knowledge and understanding. It unpacks the potential benefits of private equity and makes proposals on ways African countries could better leverage them for development.

This book also establishes the critical linkages between Africa's transformation agenda and climate change and clearly demonstrates the inseparability of climate finance from development finance. It concurs with dominant scientific consensus on the fact that Africa is the region that is most vulnerable to the

impacts of climate change and least able to cope with them, owing in part to its relatively low levels of economic development. It highlights the high adaptation costs that the continent faces and the various challenges related to getting access to various global climate funds. The book also documents the commendable efforts that African countries have deployed to address the challenges posed by climate change, including the establishment of the Climate for Development in Africa programme (ClimDev-

Africa) and the ClimDev Special Fund.

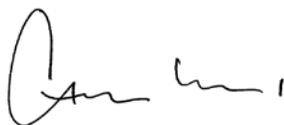
The book also speaks to the imperative for a paradigm shift in Africa's partnerships with various global actors, particularly in the area of development finance. It lays bare the shortcomings in current donor-recipient relationships, including the lack of mutual accountability and the reluctance by the more powerful global actors to concede to the reform of existing global trade and financial institutions. It urges a fundamentally different approach to

development finance, underpinned by innovative forms of international partnerships that are cognizant of the new realities of the global political economy and which accord Africa its rightful place.

Taken together, the five areas of innovative and alternative sources of financing analysed in this book have the potential greatly to reduce Africa's dependence on external sources for the resources for its development. More importantly, if these new sources are properly

developed and leveraged, they would provide the resources required to finance Africa's development agenda, embodied in Agenda 2063, and facilitate meeting the ambitious goals set out in the evolving post-2015 development agenda.

It is against this background that we strongly believe that this publication would constitute a useful input into the forthcoming United Nations Third International Conference on Financing for Development, scheduled for Addis Ababa in July 2015.



**Carlos Lopes**  
**United Nations Under-Secretary-General**  
**and Executive Secretary of the Economic Commission for Africa**

# CHAPTER

# 1

# INTRODUCTION AND BACKGROUND

---

*Abdalla Hamdok and Francis Ikome*

***“Africa is changing rapidly and is poised to become the world’s next emerging economy. The issue at hand is how to ensure that the continent’s transformation is bolstered by sufficient and innovative sources of funding. That is the challenge we now face. One solution would be to speed up the development of our financial markets with a view to sparking the transformation of African economies. To do so, we must come up with innovative financial products and set up effective national and regional financial institutions and services.”***

President Alassane Ouattara, Marrakech

October 2014

**A**frica's economic performance since the turn of the twenty-first century has been very remarkable. It has registered average economic growth rates of about 5 per cent per annum, making it one of the world's fastest growing regions. Although part of Africa's growth can be attributed to booms in global demand for natural resources and minerals, a greater part of the growth has been the result of a confluence of dominantly internal factors, such as: improvements in governance and macroeconomic management; rapid urbanization and growing domestic demand (itself a product of the growth in Africa's middle class); remarkable increases in investment and trade with both traditional and new partners; considerable expansion in regional markets; as well as some level of diversification of production and exports by some African countries (see ECA, 2014a, and also see McKinsey Global Institute, 2010, and ECA and AUC, 2014). Africa's economic growth has also coincided with declines in the number and intensity of conflicts, considerable narrowing of the levels of inequality in several countries, and a burgeoning youthful population (Ernst & Young, 2013a), which has the potential

to boost the continent's labour force considerably if properly harnessed.

The African continent is unquestionably a region on the rise and there is much optimism about the prospects of the continent entering a phase of structural transformation and sustainable long-term inclusive economic growth and development. However, to translate this optimism into tangible reality, Africa needs to address resolutely a number of binding constraints and challenges, not least the challenge related to galvanizing the requisite volumes and quality of financial resources to underwrite its development at a time when access to development finance is becoming more difficult and complex. Although Africa has been able to articulate a number of impressive development agendas, including that of the New Partnership for Africa's Development (NEPAD), the implementation of many of these agendas has often depended on expectations of external financial support and this partly explains why many of them have struggled to achieve their lofty goals and objectives fully. Similarly, for many years external financial resources, particularly overseas development assistance, accounted for substantial portions of the national budgets of many African Governments. Sometimes the share

of external resources was greater than that of nationally-generated resources. This has partly happened because many African countries have had very weak cultures and traditions of robust mobilization of domestic resources.

Awareness has been growing among African peoples, their governments and development partners that traditional sources of development finance, including external sources, have their limitations. In particular, there is recognition that although official development assistance has helped Africa's development efforts, it has not been able to deliver sustainable growth and desired development results. Not only has this help been unpredictable historically, it has increasingly become even more unreliable because of the rapidly changing ecology of global development finance, brought about in part by the financial difficulties faced by leading donor countries since the onset of the global financial crisis in 2007. In 2013, for instance, aid commitments for donor countries that are members of the Development Assistance Committee accounted for 0.3 per cent of their gross national income and only Denmark, Luxembourg, Norway, Sweden and the United Kingdom exceeded the 0.7 per cent target. In the medium term, it is now almost certain that aid budgets are likely to be affected by fiscal consolidation in the traditional donor

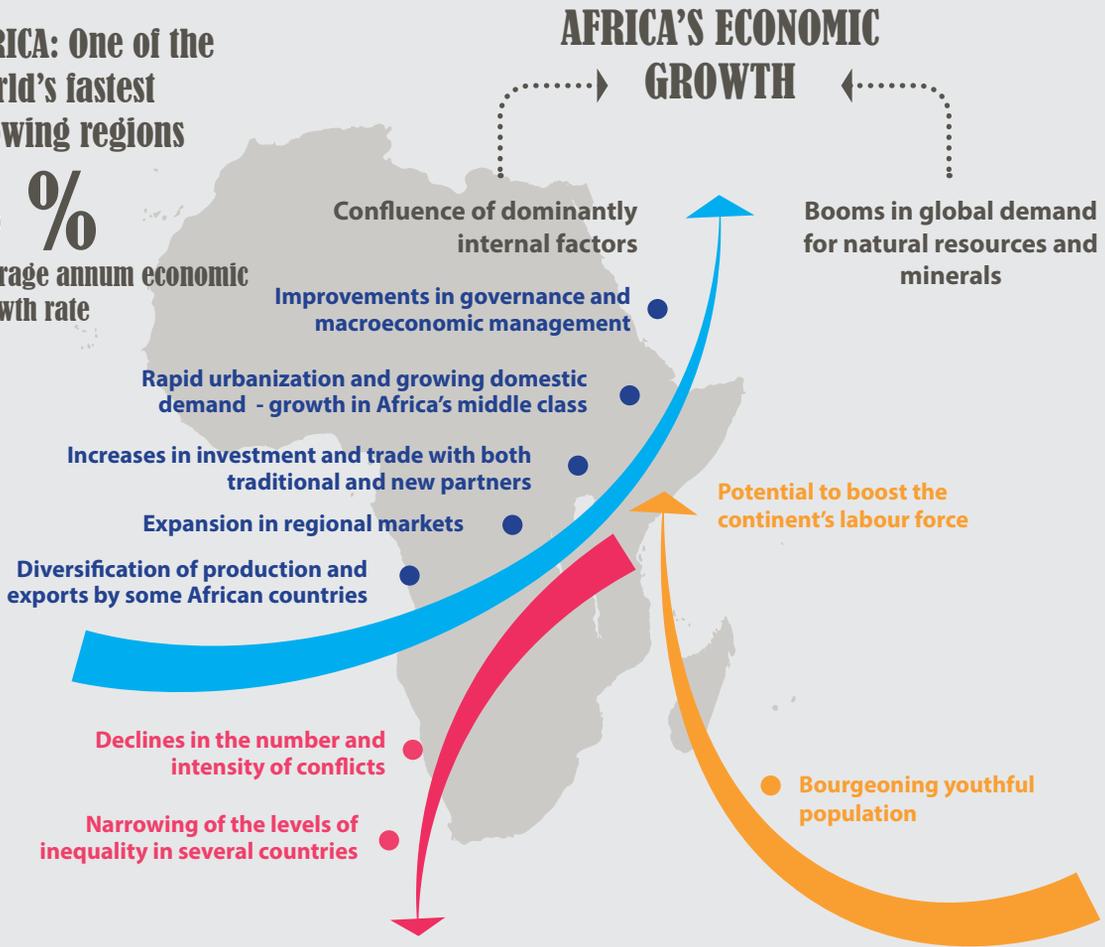
countries. Foreign direct investment to Africa has been growing in the past decade, however the pace of growth has remained slow. Overall, Africa is yet to emerge as the most popular destination for this investment, despite offering high returns on investment (ECA and AUC, 2014). Not even growing investment in Africa by emerging economies such as China, India and Brazil has been able to meet the financial-resources needs for economic transformation. These trends, coupled with Africa's increasing domestic investment and funding needs (including an annual funding deficit of \$31 billion for electrical power generation alone), call for greater focus on the strategic importance of financing Africa's development and the roles to be played by different stakeholders. In particular, it underscores the urgent need to explore alternative and innovative sources of finance for transformation and development, particularly in the context of the evolving Africa 2063 development agenda and the post-2015 global development framework.

The Economic Commission for Africa is one of the leading pan-African institutions involved in producing knowledge and articulating policy options on different aspects of Africa's development. During recent years the Commission has prioritized issues relating to development finance and domestic resource mobilization in its work programme and in its engagement with other pan-African

# Figure 1.1 Africa's economic performance since the turn of the twenty-first century

**AFRICA: One of the world's fastest growing regions**

**5 %**  
average annum economic growth rate



Source: Illustration by authors.

institutions. For example, in 2013-2014, the Commission partnered with the New Partnership for Africa's Development Planning and Coordinating Agency (NEPAD Agency) to produce the document titled: "Mobilizing domestic financial resources for implementing NEPAD national and regional programmes and projects: Africa looks within" (NEPAD and ECA, 2014). In June 2014, the Economic Commission for Africa with the NEPAD Agency, the African Union Commission, the African Development Bank and other partners actively supported President Macky Sall of the Republic of Senegal and a member of the NEPAD Heads of State and Government Orientation Committee in convening the Dakar Financing Summit for Africa's Infrastructure. The main goal of the summit was to elicit the active participation of the private sector (particularly Africa's private sector) in the financing and development of Africa's regional infrastructure within the framework of the Programme for Infrastructure Development in Africa (PIDA). The Economic Commission for Africa has also actively supported the African Union in its efforts to devise strategies to finance African-owned and African-driven development initiatives as alternatives to current models, which have tended to place premium on raising finance from external sources.

The Economic Commission for Africa, in consultation with its strategic partners, decided that the theme of the Ninth African Development Forum, held in Marrakech, Morocco, in October 2014, should be: "Innovative Financing for Africa's Transformation." This was part of its efforts to accompany Africa in its quest for alternative and innovative sources of finance for its structural transformation and development and also in anticipation of the Third International Conference on Financing for Development, which is scheduled to be held in Addis Ababa in July 2015. The choice of the theme was also informed by a new wave of thinking towards the development agenda of the United Nations beyond 2015. It builds on the outcomes of a number of regional and international efforts, such as the high-level panel of eminent persons on the development agenda beyond 2015, the twenty-sixth meeting of the NEPAD Heads of State and Government Orientation Committee, which was held in January 2012 in Addis Ababa, and the Seventh Joint Annual Meetings of the Economic Commission for Africa Conference of African Ministers of Finance, Planning and Economic Development and the African Union Conference of Ministers of Economy and Finance, which were held in March 2014 in Abuja.

The African Development Forum is a flagship biennial event of the Economic Commission

for Africa that offers a multi-stakeholder platform for debating, discussing and initiating concrete strategies for Africa's development. The forum is convened in collaboration with the African Union Commission, the African Development Bank and other key partners to establish an African-driven development agenda that reflects consensus and leads to specific programmes for implementation. It also provides a platform to present fresh research findings on key development issues to major development stakeholders to enable them to devise shared goals, priorities and programmes, and to determine the environment in which they will be implemented. The forum brings together a large number of participants, including Heads of State and Government, policymakers of African member States, development partners, specialized agencies of the United Nations system, intergovernmental and non-governmental organizations, academia, civil-society organizations, the private sector and eminent policy and opinion leaders.

The Ninth African Development Forum, on the theme "Innovative financing for Africa's transformation" afforded prominent African stakeholders the opportunity to share key information and engage in focused, in-depth discussions on issues relating to innovative financing mechanisms in five major thematic areas, guided by five issues papers prepared for the forum: domestic resource

mobilization, illicit financial flows, private equity, new forms of partnership, and climate financing. The forum was further guided by evidence-based knowledge and information on the range and scope of options for leveraging opportunities for financing the sustainable development of Africa. It tackled the issue of leveraging innovative sources of finance for Africa's transformation, undergirded by industrialization and inclusive growth and capable of generating jobs, improving socioeconomic conditions and providing resources to fund climate-change adaptation initiatives on the continent.

This book is a compilation of reworked versions of the well-researched and evidence-led papers that were presented at the forum and a synthesis of the very rich and insightful interactive discussions that took place during the Marrakech meeting. Its production has been inspired by the desire to package all this rich material and evidence in a more structured, accessible and user-friendly format to meet the needs of various stakeholders who have, since the conclusion of the forum, continued to express the desire to see a book emerge out of the material from the forum. Following the introductory chapter (chapter I), the rest of the book consists of five main chapters, structured around the five themes of the conference: Domestic resources mobilization (chapter II); Illicit

financial flows (Chapter III); Private equity (chapter IV); Climate financing (chapter V); New forms of partnerships (chapter VI); and Conclusions and recommendations (chapter VII). It also has a number of annexes.

Chapter II, on domestic resource mobilization, sets the tone for the book. It examines the multi-dimensional challenges that Africa faces in increasing domestic resource mobilization. It identifies and analyzes the root causes of the continent's low levels of domestic resource mobilization, premised largely on a number of characteristic features such as: low public and private savings rates; poor interest-rate management; narrow tax pools; complex administrative requirements; predisposition to grant unnecessary and disproportionate concessions to foreign companies; tax evasion; corruption; deficiencies in the growth and development of financial systems; the tendency of banks to discriminate against individuals and small businesses in favour of big corporations and specific sectors; and the fact that Africa's capital markets have not matured sufficiently to aid the mobilization of idle domestic and external resources towards productive investments. The chapter also points out that the rates of gross domestic savings in Africa have been consistently lower than the gross domestic investment rates since 2008, restricting the independent

allocation of domestic resources to investment in key sectors.

The analyses in the chapter also reveal that tax revenues are the largest source of domestic resources but tax collection increased its share of gross domestic product (GDP) only marginally, from 26.6 per cent in 2009 to 27 per cent in 2011, and many countries recorded tax ratios below 10 per cent. Current estimates of the financing gap suggests it stands at approximately 6 per cent and it is clear that mobilizing sufficient, stable and predictable resources is still a source for concern<sup>1</sup>. African countries should increasingly leverage domestic resources to bridge their financing needs. They should adopt policies that will broaden the existing narrow tax base, raise the level of savings and develop capital markets to attract foreign investment and utilize excess liquidity in the financial markets, among other results. High levels of external financing (including overseas development assistance) serve as a disincentive to domestic resource mobilization and must be tackled by embarking on wide-reaching reforms to capture currently unexplored or poorly managed resources better. This

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<sup>1</sup> The 2001 New Partnership for Africa's Development (NEPAD) Framework Document called for Africa to strengthen domestic resource mobilization. This was reaffirmed by the Monterrey Consensus of 2002, which emphasized the need to establish the internal conditions needed for mobilizing domestic savings and sustaining adequate levels of productive investment.

includes curtailing illicit financial flows and establishing institutional capacity to tap into more innovative sources of financing, such as public-private partnerships, sovereign wealth funds and diaspora bonds.

The chapter proposes a number of strategies for mobilizing domestic resources including:

- » Tax-based expansion strategies, including the potential contribution by the informal sector, reducing tax exemptions or tax holidays for foreign investors, and tackling constraints to implementing policy
- » Designing and implementing appropriate national policies to encourage the development of innovative financial services for low-income populations, reduce excess liquidity in the intermediary sector and improve access and cost of credit, particularly for small and medium enterprises
- » Addressing the challenges inherent in establishing well-functioning capital markets
- » Taking steps to establish the regulatory and legal framework for using capital markets as a means of mobilizing resources for productive investments
- » Adopting strategies that would assist African countries to overcome potential implementation issues and enable them to utilize innovative domestic sources of finance better, such as public-private

partnerships, sovereign wealth funds and diaspora bonds.

Building on the analysis in chapter II, the chapter on illicit financial flows (chapter III) argues that the curtailment of illicit financial flows (IFF) constitutes an important unexplored source for mobilizing domestic resources for Africa's development. It analyzes various dimensions, sources and impacts of these flows from the continent and proposes some strategies that could be used in halting and redirecting these resources towards its economic transformation and development. The chapter focuses especially on: the complex implications of curbing illicit financial flows, as an innovative means of financing development in Africa; relevant policy options, from an African perspective, on the problem of illicit financial flows and the main challenges that confront these policies; the policy measures that have been undertaken to mitigate illicit outflows from Africa and their development impacts; appropriate policy modalities, such as mobilizing support at the national, regional and global levels to tackle illicit financial outflows from Africa; and the role of state and non-state stakeholders in curbing illicit financial flows from the continent.

It also discusses the scale of the illegal financial flows and points out that the annual illicit flows from Africa during the

past decade could amount to \$50 billion, exceeding official development assistance. This estimate may fall short of the true situation as there are no accurate data for all transactions and for all African countries. The chapter highlights various initiatives that are part of the growing focus on reversing the tide of illicit financial flows from Africa, including initiatives by African Governments who in 2011 established the High-Level Panel on Illicit Financial Flows from Africa, with a mandate to examine the nature of such flows and their impact on the continent's development. There is emerging consensus that no post-2015 agenda can afford to ignore the issue of illicit financial flows and their impact on domestic resource mobilization and this partly explains why the need to curtail and redirect these flows as an innovative source of financing for Africa's transformation has been included in the common African position on the post-2015 development goals.

The chapter includes the strong argument that Africa's relatively high growth since the turn of the century would have been a lot higher if potential investment resources were not leaving the continent illicitly. It argues further that because illicit financial flows are hidden from African tax authorities they undermine Africa's fiscal policy space and deny the continent additional tax revenues, which could be used to fund government

programmes and enhance productivity. This, in turn, would increase the tax base to raise more revenue and fund development requirements. Furthermore, as Africa seeks to mobilize more domestic resources to fund its development, illicit financial flows deny its financial systems and Governments the opportunity to use these resources through domestic resource mobilization schemes. In addition, illicit financial flows severely impact the continent's savings ratios and deny local investors access to financial resources for investments, job creation, enhanced productivity and economic growth. The chapter posits that illicit financial flows are a serious threat to Africa, and they require a global and political solution.

The fourth chapter on private equity begins with the observation that, although foreign direct investment inflows to Africa have been rising, the continent still attracts only a small share of global equity funds, which are concentrated in a few countries and sectors such as business services and information and communications technologies. It makes a strong case for African countries to develop appropriate policies to attract private-equity investment, particularly in sectors identified as key growth areas. The analysis in this chapter focus on four broad dimensions of the private equity industry in Africa: means and ways of improving the availability of funds for the private-equity industry;

design of enabling, yet prudent policies by governments geared towards encouraging the use of contractual savings and public-private partnerships (including the private-equity sector and development-finance institutions) for private-equity investments; encouraging more impact investments, including through facilitating the extension of the investment portfolios of private-equity firms in areas such as agriculture and small and medium enterprises; and enhancing the role of Governments, especially with regard to the enactment of policies to encourage local investors, foreign direct investors and the private-equity industry to support national development efforts.

The chapter includes the argument that private equity can be an alternative to banks and equities listed for public trading on the stock exchanges (or bonds and debt markets), which have been the traditional sources of funding for the growth of companies and business ventures. It explains that a growth-oriented company requiring funding can approach private-equity players who, after convincing themselves of the risk-return potential, will provide a combination of debt (sourced from a bank) and equity (raised from institutional investors) to that company. The private equity investment horizon ranges between 5 and 10 years and fund managers usually “exit” by selling their equity at the end of that period. Private

equity in Africa, alongside the broader global investment community, is responding to the continent’s attractive investment climate, particularly the very competitive rates of return on investments. The chapter analyzes the performance and evolution of private equity on the continent, pointing to data from the past three years that shows significant investments made in the private-equity industry.

Despite the potentials of private equity in Africa, the sector continues to face a number of challenges. There is a positive narrative around Africa as the next frontier for investments but investor perceptions of the cost of doing business in Africa remain a concern. The continent’s sheer physical size, geopolitical fragmentation and weak infrastructure continue to make it an expensive location for doing business. Fundraising in the private-equity industry is also a major challenge, owing to a lack of local investors in the private-equity ecosystem. Another major constraint is the restrictions on capital flows between African countries and the rest of the world. Many countries are reluctant to open up their financial systems, which are often underdeveloped, making it difficult for capital to flow. Private equity is further constrained by delays in paperwork and lengthy processes for reserve or central bank approval for fund transfers, high borrowing costs, high taxation rates, the

lack of experienced and proven African fund managers, and the absence of institutional platforms that enable private-equity players and Governments to engage in discussions on issues affecting the industry. In many countries policymakers are not conversant with the private-equity industry and the scope of its operations in their country. Against this background, there is a strong case for African Governments to play a more active role in facilitating the promotion of private equity as an important potential source of investment for growth and development. In particular, government intervention will be required to raise awareness and understanding of issues affecting the industry. An enabling environment should be created for attracting and retaining skilled managers with operational experience to foster growth in industry and availability of funds should be improved. Lastly, impact assessments should be improved, particularly for projects with potentially positive socioeconomic outcomes.

Chapter V on climate finance begins with a reaffirmation of the strong linkages between Africa's transformative agenda and climate change and that climate finance and development finance are inseparable. The analysis centres on four sets of realities around the issue of climate change and climate financing, namely: growth opportunities for low-carbon development; enhancing Africa's capacity to gain access to

global climate finance; innovative domestic climate-finance opportunities; and climate-finance opportunities in the new global climate-change framework.

The chapter supports the prevailing scientific consensus that Africa is the region most vulnerable to the impacts of climate change and least able to cope with them owing, in part, to its low levels of economic development. It points to concordant predictions that the continent will experience increased episodes of drought and flood and frequent extreme events such as hurricanes, cyclones and rise in sea level, and all of these will have serious adverse consequences for many development sectors in Africa and threaten economies and livelihoods in many African countries. Africa's current dynamic growth is partly attributable to increased use of natural resources and to climate-sensitive rain-fed agriculture, which is vulnerable to seasonal variability and climate change. This means that urgent responses are needed to the numerous risks posed by climate change to this growth (Intergovernmental Panel on Climate Change, 2014). Climate change has potentially devastating implications on the lives and livelihoods of people and, conscious of this, adaptation measures are being implemented throughout Africa at all levels. However, they are limited in scope because of costs, low technical know-how, lack of technology and low levels of

economic development. It explains that adaptation costs for East, West, Central and Southern Africa are projected at between \$14 billion and \$15 billion a year and predicted to reach \$70 billion by 2045, if no additional mitigation action is taken (United Nations Environment Programme, 2013 and 2014). Significant financial resources are required to meet adaptation costs and there is growing concern that these costs will become unmanageable unless a significant reduction in greenhouse-gas emissions is achieved to prevent temperatures from reaching the threshold of 2 degrees increase. Meanwhile, negotiations for a new climate-change framework have stalled, while the climate continues to change unabated.

The analysis in the chapter reveals that, in addition to slow negotiations, pledges made at Copenhagen by developed countries to provide the \$100 million needed by 2020 to support the adaptation and shift of developing countries towards a low-carbon development path have not been honoured. Adaptation funding has also plunged to an all-time low in recent times, in part owing to the reliance on a share of proceeds from the Clean Development Mechanism, the low price of carbon credits and the small proportion of public climate-finance dedicated to adaptation. Africa has not benefited much from existing global mitigation-financing mechanisms as only 2 per cent of clean-

development mechanism projects have been carried out. Yet, all predictions show that climate impacts will adversely affect key economic sectors, such as agriculture, water, energy and health, even though the continent has contributed the least to global warming, with less than 4 per cent of greenhouse-gas emissions. The chapter therefore includes a strong argument for developed countries to continue to support the building of resilience to the impacts of climate change in Africa. More importantly, it urges African governments to adopt innovative domestic financing mechanisms, from both the public and private sectors, to supplement international financing for climate change, particularly as external sources remain cumbersome and fraught with complex procedures that make fund access for most African countries very difficult.

The chapter also discusses a major milestone in the African response to climate change and climate financing, as embodied especially in the Climate for Development in Africa Programme (ClimDev) established by the African Union Commission, the Economic Commission for Africa and the African Development Bank. The programme was endorsed by African Heads of State, with the main objective of building climate-resilient economies on the continent. The consortium launched the ClimDev Special Fund, which is managed by the African Development

Bank and offers low transaction costs and simplified funding procedures. The fund, which provides financial resources and grant incentives to countries, national agencies, regional bodies and other stakeholders, will greatly contribute to reducing the climate finance deficit on the continent. The fund is an innovative funding framework for fast-tracking access to the funding needed to build resilience to climate change. In addition, this type of funding targets payment for ecosystem services to ensure ecosystem integrity, which plays an essential supportive role in agriculture, energy, water and tourism in addition to its mitigation credentials. The chapter concludes with the submission that there is a positive side to climate change in that it brings about opportunities for Africa to leapfrog the old technologies that had brought about global warming and opt for clean technologies for developing along low-carbon pathways toward sustainable development of inclusive green economies.

The analysis in chapter VI on new forms of partnership is based on the well-known imperative for a paradigm shift in Africa's partnerships with various global actors, including in the area of development finance, which remains a crucial challenge for the continent. The infrastructural and technological chasm, coupled with continued reliance on foreign investment for financial assistance and the widening resource gap

of approximately \$40 billion for mainly non-oil-exporting African economies, calls for a renewed approach to development finance, underpinned by innovative forms of international partnerships. The chapter exposes the shortcomings in the current donor-recipient relationship, such as the inability to promote mutual accountability, the failure to redress the imbalances of existing multilateral trade and financial systems, and the inability of current partnerships to deal with global challenges, such as climate change and financial instability. These shortcomings further reinforce the need to forge new forms of partnership, which would lead to innovative sources of financing. Although Africa has benefited from favourable economic growth since the late 1990s, facilitated by improved macroeconomic fundamentals and expansion of all the main components of foreign financing (export revenues, foreign direct investments, remittances and official flows), investment has climbed only marginally as a share of gross domestic product (GDP) from 17 per cent in 2000 to 21 per cent in 2012.

Against this backdrop, the chapter proposes that a new approach to development finance should be sought through innovative forms of international partnerships, ensuring that the mistakes of the past are not repeated. These include:

- » The inability of the traditional donor-recipient logic to promote mutual accountability, enable authentic ownership of the development agenda, and deliver on the promises set out in Goal 8 of the Millennium Development Goals, especially with regard to the official development assistance target of 0.7 per cent of donors' gross national income
- » The failure to redress the imbalances of existing multilateral trade and financial systems, with no end in sight for the Doha Development Round and only a limited number of successful initiatives, such as debt relief in the financial sphere
- » The limitations of the existing partnership in dealing with global challenges, such as climate change or financial stability, which intrinsically call for the application of the principle of common but differentiated responsibilities.

The analysis is placed within the context of the evolving post-2015 development architecture, which dictates that the new forms of partnership capture the nuances of the evolved global economy. First and foremost, they should be consistent with the ongoing rebalancing of geopolitical and economic weight in favour of emerging and developing countries such as Brazil, China and India. Secondly, they should pay greater attention to advancing regional integration for Africa's own transformation prospects. Thirdly, the new partnerships should

cater for the complexity of the evolving development-finance landscape, which witnessed the emergence of new actors such as the development partners of the South and private philanthropic foundations and includes innovative aid modalities, such as debt-conversion mechanisms. Overall, the analysis makes a strong case for crafting new forms of partnerships around four main areas: boosting intra-African trade and Africa's transformation; South-South cooperation and the scope for industrialization; regional and South-South initiatives to enhance resource mobilization: stymying illicit financial flows, cutting remittance costs and harnessing official flows; and South-South coalitions to reform the multilateral trade and financial system.

The concluding chapter VII sums up the major arguments and findings presented in the earlier chapters. In line with the general tone of the book, the chapter underscores the centrality of domestic resource mobilization in the creation of inclusive and sustainable economic growth for Africa's transformation. It discusses the range of opportunities and policy options that are available to African countries to leverage the huge potential to strengthen domestic resource mobilization, including through deepening financial markets and diversification of financial products. It also discusses the importance and potential of regional integration in

fostering investor confidence, lowering costs and improving efficiency of raising capital across jurisdictions. Other key areas touched upon include: a summary of the various dimensions, sources and impacts of illicit financial flows from Africa; the potential of private equity to contribute to Africa's

economic growth and transformation; the strong linkage between climate change and Africa's transformation agenda and the inseparability of climate finance and development finance; and the imperative for the continent to evolve new forms of partnerships that place Africa first.





# CHAPTER 2

# DOMESTIC FINANCIAL RESOURCE MOBILIZATION FOR AFRICA'S DEVELOPMENT

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*Adam Elhiraika, Gamal Ibrahim, Derrese Degefa and  
Uzumma Erume*

## Overview

**A**frica is the fastest growing region globally<sup>2</sup> and is on the threshold of the sustained transformation required to move its economies from their current status to middle-income level. To achieve this goal, three factors must come into play. These are: quality and effectiveness of governance and institutions, effectiveness of development policies, and availability of technical and financial resources to implement development programmes and projects. Remarkable success has been achieved in improved governance, institutions and development policies over the past decade. However, the availability of resources remains a significant constraint.

The paradox is that Africa is resource-rich and has a huge base of potential financial resources, which if harnessed are sufficient to meet a significant portion of the continent's development needs. In spite of the beneficial impact over the years, official development assistance (ODA) is not only insufficient to meet Africa's development needs, but also it will not be the route to Africa's transformation. Therefore, the continent must break with the past and look within. It must rely on its own domestic financial

resources for sustainable solutions to its development finance needs.

This chapter presents the current status and potential of domestic financial resources in Africa and identifies instruments, policy measures and financial intermediaries that will significantly step up the mobilization of domestic resources in Africa for the financing of national and regional development programmes and projects.

## Fundamentals and overall status of domestic resource mobilization in Africa

### Fundamentals

Africa's development environment has the key elements or fundamentals to support a robust drive to mobilize domestic resources. The ability of a country or region to mobilize domestic resources to implement development programmes and projects is determined by the size of economic activities that it generates, its economic growth performance, capacity to raise and manage tax revenues and the efficiency of its financial system. Economic activities are driven by public and private investments, which rely on savings mobilized by the financial system, and the size of the fiscal space created by the

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<sup>2</sup> This chapter is closely based upon a study report by NEPAD and ECA (2014).

public sector, which is also determined by the economic growth performance.

## Economic growth

Growth is a pre-requisite for generating financial resources from the domestic economy as it creates the wealth from which revenue can be mobilized. Six African countries were among the world's fastest-growing ten economies over the decade, 2001-2011<sup>3</sup>, as measured by growth in gross domestic product (GDP). Forecasts by the International Monetary Fund also indicate that seven Africa countries are likely to occupy the top ten places over the half decade from 2011-2015<sup>4</sup>. If Africa can sustain at least 5 per cent annual GDP growth for the next two decades, step up investment in economic and social infrastructure and human-resource development, and harness the emerging demographic dividend, it will become a global growth pole before 2034 (ECA and AUC 2012a).

Africa's economies are responding to effective development policies, as evidenced by the rebound from recent global recession. Growth

prospects remain strong and very promising. The rebound of African economies has been driven largely by prudent economic policies prior to the crisis. Despite the promising development, a number of countries in the region still face structural problems to growth. Nonetheless, on balance African countries have the potential to generate significant domestic financial resources (see figure 2.1) from the encouraging economic growth performances.

## Domestic savings

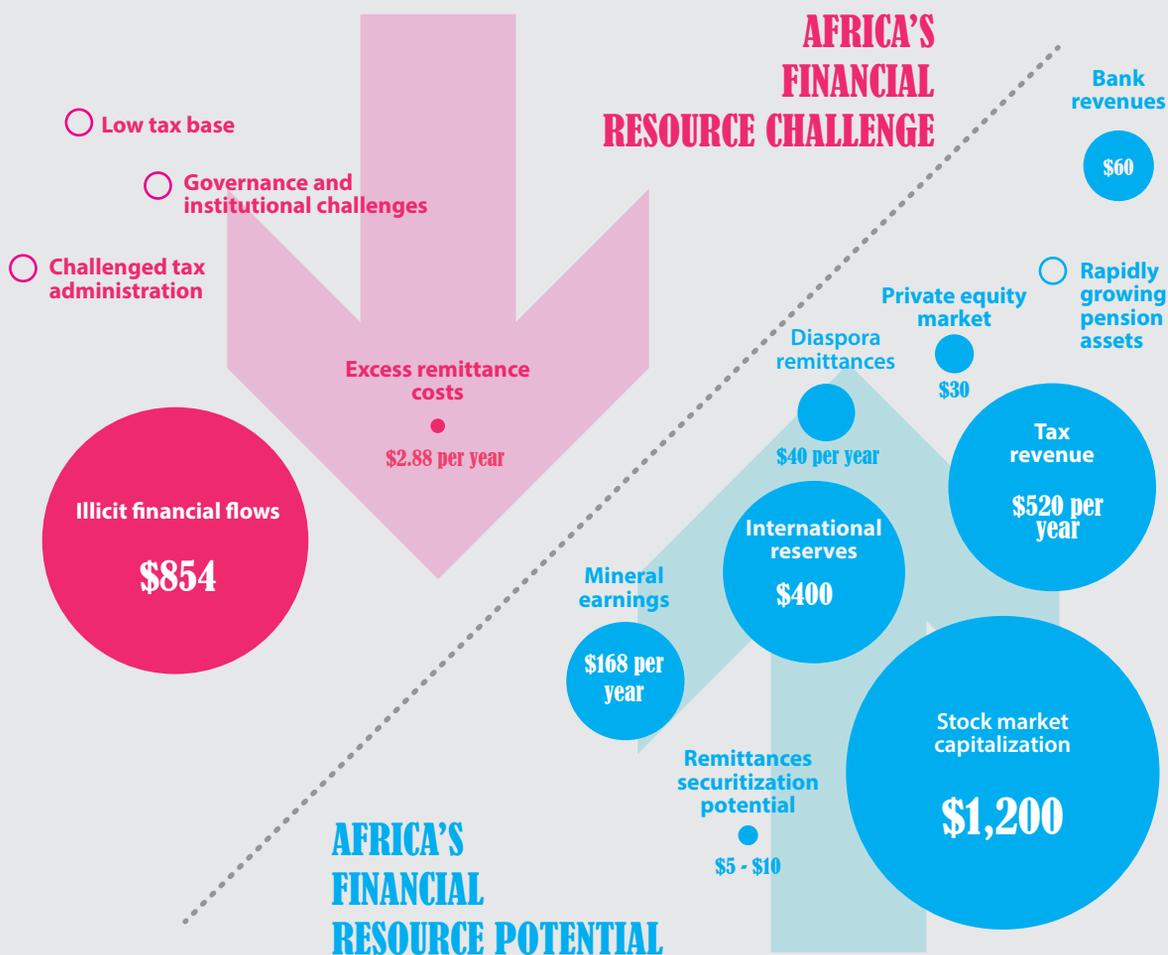
Compared to other developing regions, private domestic savings in Africa are low and the continent is under-banked<sup>5</sup>. This is partly because of: a large informal sector, where transactions do not pass through the formal banking system; low incomes due to the high levels of poverty; and inadequate incentives for people earning low incomes to use formal banking services as well as entry barriers due to high minimum deposits and balance requirements and the costs of maintaining an account. A low interest rate is paid on savings account relative to the cost of borrowing from the banks and the resulting interest-rate spread discourages savings and does not encourage borrowing for investment, especially by small and medium

3 These economies include Angola (11.1 per cent), Nigeria (8.9 per cent), Ethiopia (8.4 per cent), Chad (7.9 per cent), Mozambique (7.9 per cent) and Rwanda (7.6 per cent)

4 These countries include Ethiopia (8.1 per cent), Mozambique (7.7 per cent), Tanzania (7.2 per cent), Republic of Congo (7.0 per cent), Ghana (7.0 per cent), Zambia (6.9 per cent) and Nigeria (6.8 per cent)

5 Domestic savings to GDP was about 22 per cent in Africa over the period 2005-2010 compared to 46 per cent in East Asia and the Pacific, and 30 per cent for middle-income countries.

**Figure 2.1** Africa's financial resources potential and challenges (USD billions)



Source: NEPAD & ECA (2014)

enterprises (SMEs)<sup>6</sup>. The banks therefore have high liquidity but no customers to lend to. While the nature of banks' deposits limits the extent to which they can finance projects, a better working relationship between the financial sector and the public sector is very important. Unlike the banks, private-sector entities are investing in African government debt instruments<sup>7</sup>. Thus, while there are prospects for rapid growth in bond markets, incentives will be needed to promote savings mobilization through the banking sector.

## Tax revenue and tax administration

Africa has a good potential to raise more domestic resources from efficient tax administration systems. The average tax revenue to GDP ratio in Africa has been higher than that in other regions.<sup>8</sup> Yet, Africa's seemingly higher average tax revenue masks important differences at the country level, as several countries are still below the 15 per cent threshold considered necessary for low-income countries (ECA and OECD, 2012)<sup>9</sup>.

<sup>6</sup> The average deposit rate stands at 6 per cent, whereas the average lending rate is about 20 per cent across Africa.

<sup>7</sup> In total 39 African countries are issuing treasury bills, while 27 offer treasury bonds.

<sup>8</sup> Over the period 2005-2010, the average tax to GDP ratio for Africa was 20 per cent compared to 15 per cent in high-income countries, 13 per cent in middle-income countries and 11 per cent for East Asia and the Pacific. Africa's high tax ratio has been driven, amongst other factors, by wide-ranging tax reforms centring on indirect taxation and Value Added Tax (VAT).

<sup>9</sup> Tax ratios are even below 10 per cent for countries such as the Central African Republic, the Republic of the Congo, Ethiopia,

If African countries want to increase tax revenue further they should not rely on increasing the tax rate. Rather they should focus on expanding the tax base, improving tax administration and tapping relatively underutilized sources of taxation. The establishment of independent tax agencies to address issues of capacity in tax administration has been successful in a number of countries, including Malawi, Rwanda, Tanzania, Uganda, South Africa and Zambia.

Although tax revenue as a percentage of GDP is relatively high, the low absolute levels of government revenue are due to the low levels of GDP relative to the developing regions used in the comparison. Africa's total tax revenue reached \$527.3 billion in 2012 (see Figure 2.2) after increasing fast compared to official development assistance and remittances. This means that even with high taxation as a percentage of GDP, African Governments are left with fewer funds to apply towards development programmes. There is also a wide gap between tax capacity and actual tax revenues raised, due to tax-administration challenges.

## Capital market

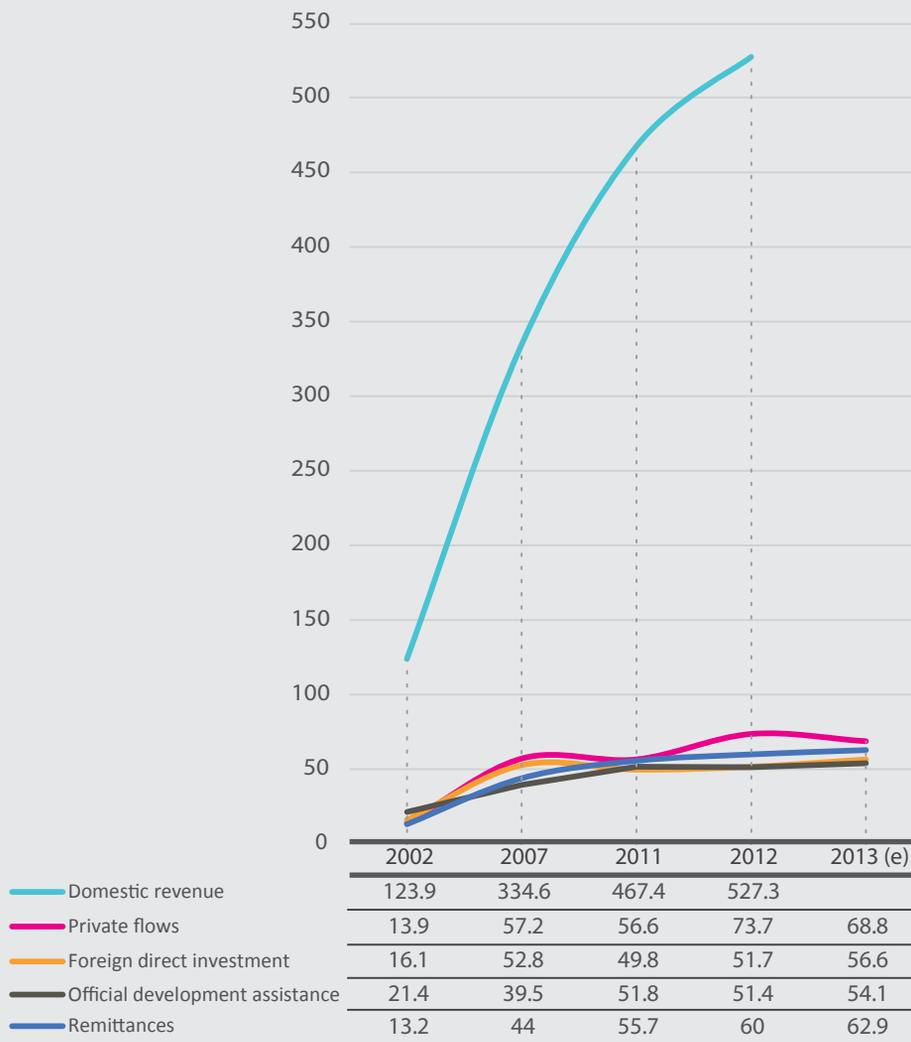
In addition to financial resources from the banking sector and revenues from taxation,

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Liberia, Nigeria and the Sudan.

# Figure 2.2

Development finance in Africa, 2002-2013 (USD billions)



Source: AfDB, ECA, OECD & UNDP (2012) and AfDB, OECD & UNDP (2014)

Note: e=estimated

other sources from which domestic resources can be mobilized include pension funds and national and regional stock exchanges. Some 20 national stock exchanges and at least one regional stock exchange are currently active on the continent.

Market capitalization is growing. Between 1996 and 2007, it rose from \$300 billion to \$1.2 trillion. Yet, the stock market is still at an early development stage in Africa, with the exception of the Johannesburg Stock Exchange, which is Africa's most advanced stock market and ranks as one of the top 20 globally. The availability of long-term development finance will benefit a great deal from the emergence of robust capital markets, including stock and bond markets. For this reason, measures are very much needed to promote capital-market development, including the emergence of regional stock exchanges. In the light of the recent experiences and the on-going financial crisis, the promotion of capital-market development at national and regional levels should be supported by strong and effective regulatory institutions as well as necessary policies to discourage unwholesome practices and speculative tendencies.

## Curtailment of illicit financial flows

Why have illicit financial flows (IFF) become an issue for Africa? The flows negatively affect domestic resource mobilization and

ultimately affect economic growth and opportunities for structural transformation through various channels. These channels include distortions in the resource allocation from high-yielding investments to investments that run a low risk of detection; distortion of prices, notably in the real-estate sector; distortion of consumption and impact on imports; distortion of exports and potential problems with investment and economic growth; unfair competition; risks of crowding out legal activities and negative impact on foreign direct investment; corruption; risk of volatility in the real sector; increasingly skewed distribution of income and wealth; distortion of economic statistics and thus potential errors in economic policy decision-making; and undermining the credibility of legal institutions (United Nations Office on Drugs and Crime, 2011). Illicit financial flows impact negatively on collection of tax revenues and so perpetuate Africa's economic dependence on external aid. Moreover, the amount of financial resources that illicitly leaves the continent is huge and continues to grow.

Africa's domestic resource mobilization efforts also will get a significant boost if illicit financial flows from the continent are curtailed. These constitute all money that is illegally earned, transferred, or utilized, including: proceeds of theft, bribery and other forms of corruption by government

officials; proceeds of criminal activities including drug trading, racketeering, counterfeiting, contraband and terrorist financing; and proceeds of tax evasion and laundered commercial transactions. It has been estimated that laundered commercial money through multinational companies constitutes the largest component of illicit financial flows, followed by proceeds from criminal activities and lastly corruption. Moreover, the trend has been increasing over time and especially over the past decade, with annual average illicit financial flows of \$50 billion between 2000 and 2008 against a yearly average of only \$9 billion for the period 1970-1999<sup>10</sup>. In terms of sectoral distribution, a high level of illicit financial flows from Africa is concentrated in the extractive industry. Moreover these are highly concentrated in very few countries.

## Governance and institutions

A country's governance and institutional setting provides the key elements of the enabling environment for investments, which promote growth and thus make domestic revenue mobilization possible. The governance and institutional frameworks are critical in the management of a country's economic and social resources for development in the same way as effective and responsive policies.

<sup>10</sup> All these estimates are considered to be conservative, as they exclude various forms of illicit financial flows such as proceeds from smuggling and mispricing of services.

Central to good governance are: the process of decision-making and implementation, capacity of governments to formulate and implement policies and programmes effectively, space and capacity for political participation, effective and efficient public institutions and systems, as well as peace and security.

Good governance and effective public institutions provide the foundation on which countries' growth and development rests. There is strong evidence of sustained progress in the pursuit of good governance and the emergence of effective institutions on the continent. The governance climate is conducive to sustainable growth and development. Africa is poised to address continuing challenges and constraints in its governance environment. Some of these require concerted efforts and need strengthening for results to be achieved in implementing the recommended strategies and instruments to support enhanced mobilization of domestic resources.

## Overall status

Africa's resource potential is enormous and strongly confirms that the continent has the means to finance its own development. Evidence documented (NEPAD and ECA, 2014 and from other sources) includes:

- » African countries raise more than \$527.3 billion annually from domestic

taxes, compared to \$73.7 billion received in private flows and \$51.4 billion in official development assistance<sup>11</sup>. This is an indication that there is a huge potential in tax revenue (see Figure 2.2).<sup>12</sup> The size of Africa's pension funds' assets is growing at an impressive pace. For instance, South Africa saw assets grow from \$166 billion in 2007 to \$277 billion in 2011; Nigeria from \$3 billion in 2008 to \$14 billion in 2010; and the assets of Namibia's pension funds are put at N\$16.3 billion (\$1.84 billion). Kenya's pension funds account for wealth estimated at K Sh397 billion (\$4.56 billion).

» Africa earns more than \$168 billion annually from minerals and mineral fuels and has more than \$400 billion in international reserves held by its central and reserve banks. Remittances by Africans living in diaspora climbed to \$60 billion in 2012. The World Bank estimated that in the next decade the amount remitted by Africa's diaspora could grow to \$200 billion. Africa has the potential to raise between \$5 billion and \$10 billion annually in the international capital market through

securitization of remittances from its diaspora communities.

» Stock-market capitalization in Africa rose from \$300 billion in 1996 to \$1.2 trillion in 2007. Some 39 African countries issue treasury bills and 27 offer treasury bonds. With more than 700 bonds worth \$206 billion issued by African countries as at December 2011, the emergence of respectable bonds markets is within reach

» Banking revenues are also estimated at about \$60 billion and there is high liquidity in the banking sector.

» No less than ten African countries have established sovereign wealth funds.

» Illicit financial flows from the continent reached \$854 billion over the period between 1970 and 2008, which amounts to a yearly average of about \$22 billion in lost financial resources. If curtailed, such flows are the financial resources that will be available for the implementation of national and regional development programmes and projects.

» The private-equity market in Africa is worth about \$30 billion. In 2011 private-equity firms raised \$1.5 billion for transactions in Africa.

All these, among others, indicate resources that could support Africa's development programmes and projects, if appropriate instruments were deployed. Given the resource potential of these sources of

<sup>11</sup> The data on domestic tax revenue, private flows and official development assistance are updated (as reported in figure 2.2) from what is reported in the NEPAD and ECA (2014) study report.

<sup>12</sup> There are a number of factors responsible for the inadequate generation of government revenues across Africa that must be addressed if taxation is to play a larger role in domestic resource mobilization. These include high levels of informal employment and business; low income levels even amongst formally registered firms and individuals; insufficient capacity for tax administration at national and local levels, limits and granting of excessive tax holidays and havens, particularly to multinational corporations in the extractive sector.

development finance and the encouraging performance of some of them to date, we are highly optimistic that Africa could robustly respond to a considerable portion of its infrastructure deficits within the next decade.

## Potential and key findings

After careful and extensive review of the issues surrounding the present state of Africa's financial-resource needs vis-à-vis the requirements for sustained implementation of national and regional development programmes and projects (as summarized in figure 2.3), the study by NEPAD and ECA (2014) has come up with the following major findings<sup>13</sup>:

» Development aid has helped, but will not deliver sustainable growth and development results in Africa. The continent must continue to explore innovative sources of domestic finance for its development programmes and projects. Africa's future lies in its ability to generate its own development finance. In any case, statistics show that Africa is indeed responsible for a significant proportion of its development finance as more than \$527.3 billion comes from domestic revenues compared to \$73.7 billion in private flows and \$51.4 billion in official development assistance. Yet, its development budget meets only a small

portion of the financing requirements and is inadequate to meet the needs of its development programmes.

» The continent has the resource base to support the development and implementation of viable domestic-finance instruments. Notable among these are pension funds, diaspora remittances, earnings from minerals and mineral fuels, international reserves held by the reserve and central banks, liquidity in the banking sector, the growing marketplace for private-equity funds and potential resource flow from securitization of remittances.

» In the implementation of Africa's development programmes, especially infrastructure, the private sector has so far played only a limited role. Given improvement in countries' enabling environments – governance reforms, improved policy and regulatory frameworks, emergence of functional and effective public institutions – there is a need for the private sector to step up its participation in infrastructure development on the continent. To this end, public-private partnerships need strengthening and new models of such partnerships need to evolve within the Africa context. Also required are high-level platforms for public-private sector consultations.

» Efforts on the part of Governments are required to enhance political stability, promote peace and security, strengthen public administration, raise confidence in

<sup>13</sup> Some figures have been updated since the study.

the legal and regulatory frameworks, gain more ground in the war against corruption and invest more in capacity development to ensure that bankable projects are properly prepared and effectively implemented.

» Infrastructure development in Africa has the potential to raise GDP by 2 per cent and develop the backbone for rapid industrialization, which in turn will boost the capacity to generate more domestic resources. Current infrastructure needs stand at about \$93 billion annually, out of which \$45 billion is mobilized, leaving an annual financing gap of \$50 billion. The need for additional resources for infrastructure development is undeniable.

» Carbon-finance mechanisms should be explored in greater depth to support implementation of some of the continent's projects. A number of African countries are considering carbon taxation as a form of mobilizing additional financial resources and tackling the challenges posed by climate change. Specifically, African countries should take greater advantage of external resources available in the Green Climate Fund, an entity of the United Nations Framework Convention on Climate Change mechanism designed to transfer funds from developed to developing countries, estimated at \$100 billion annually, and in the existing Clean Development Mechanism.

» African countries need to expand the fiscal space to support implementation

of national and regional development programmes by extending the catchment area for mobilization of savings, expansion of the tax base and improvement of the capital markets. Policies to improve savings rates need to focus on macroeconomic stability, financial deepening through institutional reforms and innovative saving instruments and interest-rate management policy. An expanded tax base relies on implementation of tax reforms (reducing exemptions and simplifying tax administration), enhancement of the productivity of public expenditure and management of booms related to terms of trade. A sub-regional approach to capital markets development should be vigorously promoted to boost local and foreign investment and reverse capital flight. Promoting domestic savings, growing the banking sector and reaching out to the large informal sector with appropriate financing instruments are all necessary.

» The potential to raise more domestic resources from tax is high. What is not required however are increases in tax rates, but better tax administration and expansion of the tax base. In this context, autonomous revenue agencies could generate remarkable results if they are properly managed and empowered. The need cannot be over-emphasized to revisit tax reforms continually at the level of each country, while drawing on good practices across the continent. Africa also needs to draw attention to the huge revenue loss

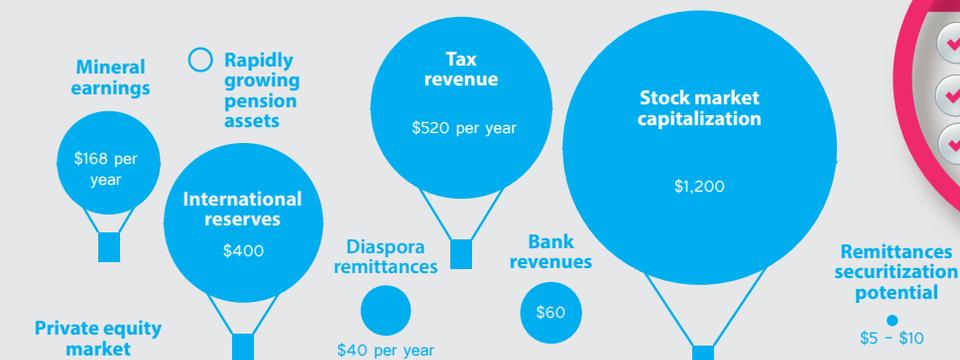
# Figure 2.3 Key elements of domestic resource mobilization proposal (USD billions)

**EXPECTED OUTCOME**



**70-80%**  
NEPAD PROGRAMMES AND PRO

## RESOURCE POTENTIAL



**IMPERATIVES FOR IMPLEMENTATION**

- ✓ Sustained Progress in Regional Integration
- ✓ Governance, Policy and Institutional Reforms
- ✓ Special Capacity Development Programme

## ENABLING ENVIRONMENT



## PROPOSED FINANCIAL INTERMEDIATION ARRANGEMENTS

- |  |  |
|--|--|
| <input type="checkbox"/> Africa Infrastructure Development Fund          | <input type="checkbox"/> Establishment of Strategic Development Sovereign Wealth Funds |
| <input type="checkbox"/> Africa Credit Guarantee Facility                | <input type="checkbox"/> Sovereign Pension Funds                                       |
| <input type="checkbox"/> Promotion of Africa-Owned Equity Funds          | <input type="checkbox"/> Establishment of Regional Stock Exchanges                     |
| <input type="checkbox"/> Deepening of Africa's Bond Markets              | <input type="checkbox"/> Promotion of New Models of Public-Private Partnerships        |
| <input type="checkbox"/> Securitization of Africa's Diaspora Remittances |  |

Source: Based on NEPAD and ECA (2014)

that arises from extensive tax exemptions, which a number of multinational corporations enjoy.

» A common framework is long overdue for reform of laws to allow public pension funds to invest directly in other parts of Africa. In a number of countries, current laws prohibit investment of public pension funds in other African countries and in development projects on the continent.

» Curtailing illicit financial flows remains a major challenge that must be vigorously pursued. Various estimates have been put forward on such outflows from Africa. The amount was as high as \$854 billion over the period between 1970 and 2008, and more than half of this occurred in the extractive industries sector.

» Instruments and measures that can support domestic resource mobilization include: establishment of an Africa50 infrastructure development fund; development of an Africa credit-guarantee facility; promotion of Africa-owned private equity funds; deepening of Africa's bonds markets including through existing initiatives such as the African Financial Markets Initiative and promotion of infrastructure and diaspora bonds; securitization of diaspora remittances; establishment of sovereign wealth funds to back strategic development; strengthening of the NEPAD Infrastructure Project Preparation Facility; deepening national stock exchanges and promoting emergence

of regional stock exchanges; encouraging syndicated bonds and loans; and improving the present public-private partnership models.

» Efforts should be made to develop specific financing instruments and other special instruments for Africa's development programmes and projects. These should provide targeted financial resources for National Agricultural and Food Security Investment Plans under the Comprehensive Africa Agriculture Development Programme (CAADP) and infrastructure projects under the Programme for Infrastructure Development in Africa (PIDA).

## Conclusion and recommendations

There is sufficient evidence that the fundamentals exist for the continent to raise substantially more financial resources domestically in order to implement its development programmes and projects.

A number of African countries depend heavily on aid, but this is not the dominant source of finance for the continent's development programmes and the perception is erroneous that Africa's development is driven by aid. On the contrary, the largest sources of finance are from domestic resources – savings

and taxes. Tax revenues are rising, but more needs to be done.

With strong and sustained commitment to good governance, effective institutions and a responsive policy framework, enhanced awareness and involvement of the continent's stakeholders, especially the private sector, and heightened consciousness of the need among Africans for Africa to own its development, the continent will define a new robust threshold for domestic resources that will enable at least 70-80 per cent of its development programmes and projects to be implemented using domestic resources. The resource potential exists and concrete results are within reach. The following main conclusions sum up the findings:

Africa is on the path to sustainable long-term growth. It is one of the world's fastest-growing regions. This growth has opened up a number of investment opportunities. To sustain this growth and successfully transform its economies, Africa must address its infrastructure constraints. This infrastructure deficit is one of the most constraining challenges that face investments, regional integration, intra-African trade and development of technology. To break through the infrastructure barrier that stands between Africa and its capacity to propel its economies to the level of middle-income countries within the shortest possible

time, the continent requires substantial financial resources. Development aid has helped, but the required resources will not come from aid. Africa must look within. It must generate financial resources from its own economies and own its development.

Africa has huge potential to raise substantially more domestic financial resources to implement its development programmes, especially regional development programmes and projects. Africa needs to devise new and innovative instruments for domestic-resource mobilization and to strengthen the effectiveness and efficiency of existing ones in order to tap these resources and generate substantially more development finance for the implementation of national and regional development programmes. It also needs to revisit issues which provide the overarching enabling environment for investment and efficacy of instruments for the mobilization of domestic resources. These include governance, institutional and macroeconomic policy reforms, and legal and regulatory frameworks. In addition, there should be heightened attention and immediate response to the need to accelerate regional integration, reform specific laws governing investment of public funds such as public pension funds and international reserves of central and reserve banks and build requisite capacity to design and implement reforms for an effective drive to mobilize domestic resources.

To take Africa's efforts to the next level in the mobilization of domestic resources, the following recommendations are drawn from the findings documented in the report (NEPAD and ECA, 2014):

## Impetus and instruments for mobilizing domestic financial resources

Africa should set itself a bold target to move away over the next two decades from development aid. The following instruments and financial intermediary arrangements are recommended to step up the mobilization of domestic resources on the continent:

- » Support initiatives to establish new specialized funds to finance the development of Africa's infrastructure, notably the proposed Africa infrastructure development fund
- » Develop an African credit-guarantee facility as a credit-enhancement mechanism to support financing of projects
- » Promote Africa-owned private equity funds
- » Deepen bond markets in Africa, promote infrastructure bonds and issue diaspora bonds
- » Promote regional stock exchanges
- » Securitize remittances
- » Establish strategic development sovereign wealth funds;

- » Strengthen the use of existing sovereign-backed pension funds for development projects

- » Explore new public-private partnership financing models.

The African infrastructure development fund and the African credit-guarantee facility should be set up as partner institutions and may be created and partly resourced by existing African financial institutions as proposed, with the Africa50 fund being set up by the African Development Bank with the endorsement of major regional and continental bodies, including the African Union, the Economic Commission for Africa and regional economic communities. To make these fund facilities fully functional, there is need to develop a new operational culture and system of innovations from the onset.

Continued support for the African Financial Markets Initiative, an initiative of the African Development Bank launched in 2008, is paramount to strengthening domestic resource mobilization efforts in the operational direction of private-equity funds and bond markets. The African Financial Markets Initiative is aimed at contributing to the development and deepening of domestic financial markets in Africa and so contributing to domestic resource mobilization by increasing the availability of financing options. The Initiative is

made up of the African Financial Markets Database and the African Domestic Bond Fund.

The National Agricultural and Food Security Investment Plans resulting from the Comprehensive Africa Agriculture Development Programme (CAADP) compact process should form one basis for mobilizing finance for the agricultural sector in African countries. Financing arrangements and facilities amenable to this are recommended, including specific funds such as the NEPAD Impact Investment Fund for SMEs in African Fisheries and Aquaculture.

The Programme for Infrastructure Development in Africa (PIDA) provides the framework for regional-level investment in infrastructure development on the continent, with the Presidential Infrastructure Champion Initiative as a key implementation model. The study puts forward appropriate financing mechanisms, which include specific facilities and the issuance of project bonds for PIDA projects. Moreover, African countries should explore new models of public-private partnerships and, where possible, they could consider the establishment of well-staffed and financed institutions to manage these projects.

## High-level policy initiatives promoting domestic resource mobilization in Africa

### Recommendations of the High-Level Panel on Illicit Financial Flows

Africa's domestic resource mobilization efforts will receive a significant boost, if illicit financial flows from the continent are curtailed. Several policy options have been suggested to stem these flows. First, there is need to raise awareness among African policymakers and other stakeholders on the magnitude and development impact of these activities. A key initiative by the African Union Ministers of Finance and Economic Planning is the establishment of the High Level Panel on Illicit Financial Flows from Africa. Several other regional initiatives, such as the African Regional Anti-Corruption Programme (2011-2016) and the African Tax Administrative Forum can also be useful conduits for creating awareness and sharing best practices for tackling illicit flows.

Second, there is need to develop and improve institutional frameworks that encourage greater levels of transparency and accountability in both the private and public sectors. At the regional level, this framework could be obtained through the establishment of an African convention on transparency or support to an existing

international transparency convention. At a global level, this could also entail requiring all multinational corporations, whether or not listed on a securities exchange, to file reports to some national authority on their operations, including staffing, sales, financing and tax obligations, on a country-by-country basis.

Lastly, and related to the second issue, African policymakers need to engage their international counterparts to cooperate and strengthen the global regulatory and institutional frameworks to combat illicit financial flows<sup>14</sup>.

### **Recommendations of the High Level Panel on Alternative Sources of Financing the African Union**

In recognition of the imperative to address the challenge of inadequate funding of African Union development programmes and projects, whereby about 90 per cent of funds for continental projects come from external development partners, the African Union Assembly established the high-level panel tasked to consider alternative sources for financing the African Union.

Key recommendations of the high-level panel are also part of the proposed instruments of domestic resource mobilization. Specifically,

<sup>14</sup> In this respect, several initiatives already exist, such as the United Nations Resolution 55/188 on the illegal transfer of assets and the World Bank Stolen Asset Recovery Initiative. These enjoy stronger political will and cooperation from advanced economies for effective implementation.

the panel proposed to the African Union the following five options to mobilize African-owned funds for the sector-priority programmes of the Union:

**Private sector and other contributions:** A certain percentage of the revenue derived from activities carried out by the private sector and non-governmental organizations under the guidance of the African Union could be allocated for financing specific social-welfare projects, such as combating pandemics, or allocated to some large-scale humanitarian actions within the framework of the African Union.

**Levy on insurance premiums:** Impose a minimum levy of 0.2 per cent on any insurance policy taken by an African citizen or enterprise operating in Africa, which is to be collected by insurance companies on behalf of the African Union.

**Levy on imports:** To impose a 0.2 per cent tax on consumable goods imported from outside the continent, excluding donations and exempted goods. The accruing amounts will be collected by Member States' Customs Services on behalf of the African Union.

**Levy on international travel:** Impose a tax of \$5 per ticket on flights to and from Africa. The accrued funds are to be collected with the help of the International Air Transport Association (IATA) from its affiliates. In the

case of companies not affiliated to IATA, the countries would have to collect the accruing funds and transfer them into the African Union's account.

**Tourism and hospitality:** Collect \$1 for each stay in African hotels. Accrued funds would be collected on behalf of the African Union by hotels, in collaboration with the revenue agencies of member States.

The high-level panel observed that implementing each proposal would have minimal impact on the economies of member states and that the proposed instruments are viable and sustainable as an alternative source of income for the African Union. The panel further demonstrated that implementing the last four options would generate revenues of \$1.4 billion. Furthermore, if the levy on air tickets were to be increased to \$10 per ticket and hospitality levy increased to \$2, additional revenue of \$775 million would be raised, without repercussions on the economies of member States.

## Improving taxation

Improvement of taxation for financial resource mobilization will need to tackle the constraints and challenges in order to maximize returns to government tax revenue. Innovative measures and incentives are required to attract the informal sector into the formal sector, where transactions are taxable. Providing business

support and information, particularly to small and medium enterprises, is one strategy for drawing firms to register formally as these supports can benefit their competitiveness, productivity and market access.

Poor tax-administration capacities can be strengthened with innovative tax-implementation schemes. Greater utilization of information and communications technology by tax authorities can lower the high transaction costs faced by many governments, amounting to as much as 5 per cent of revenue collected (ECA, 2012a). The outsourcing of tax collection to semi-autonomous institutions has been one means to improve efficiency in tax collection in many countries, including Malawi, Rwanda, Tanzania, Uganda, South Africa, and Zambia (NEPAD and ECA, 2014). However, the context in which tax collection is outsourced must be taken into account, with careful evaluation undertaken before autonomous agencies are created, as these have not proven to be a panacea in all cases (ECA, 2012a).

A key goal for tax reform is to increase the coverage of existing taxation by improving administration capabilities and broadening the tax base, rather than by increasing tax rates. Businesses across the continent highlight that high taxes already hinder their operations. Increasing rates even higher

may deter future investment and will lead contributors to view the system as unfair. Improving perceptions of the tax system, that it is fair and efficient, will in fact also serve to improve tax compliance. The ability to tax current business and income must be enhanced in the short-term, as formalization incentives will provide a larger tax base in the medium- and long-term, which tax authorities must be prepared for.

The excessive granting of tax exemptions, particularly for multinational corporations engaged in extractive activities, must also be revisited both to increase available tax revenues and to improve perceptions that tax systems are fair. In many cases, multinational corporations negotiated very advantageous tax exemptions but would continue operating even when faced with a marginally higher rate because of the high profits and returns they make doing business in Africa. Re-negotiations would require concerted political will and enhanced negotiation techniques on the part of African States. Exemptions should be maintained, however, for those firms re-investing in local production, employment and transfer of skills and technology.

Lastly, improved tax collection must be coupled with measures to ensure that new government revenue is used for the benefit of the citizens through social expenditures and

development projects. This shall be the means to cement a long-term relationship between the tax authorities and their tax base. These measures will facilitate enhanced revenue generation through currently existing channels of taxation, and bring in new ideas to improve taxation and raise availability of financial resources for NEPAD programmes and projects across the continent.

## Means of implementation and immediate follow-up actions

The NEPAD Heads of State and Government Orientation Committee is invited to consider the following:

- » Designate lead regional institutions to coordinate the process of implementing the proposed recommendations. To this effect, a NEPAD Cooperating Partners Committee, comprising the African Union Commission, the NEPAD Planning and Coordinating Agency (NEPAD Agency), the Economic Commission for Africa, the African Development Bank and other regional banks, is required.
- » Mandate consultation with stakeholders in order to subject the recommended arrangements and instruments, as well as the policy and institutional reforms, to regional consultations.
- » Establish a high-level African Union business council to raise the participation of

the private sector in the implementation of NEPAD regional projects.

» Authorize the development and implementation of a special capacity-

development programme to strengthen the human and institutional capacity of the Cooperating Partners Committee.





# CHAPTER 3

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# **ILLICIT FINANCIAL FLOWS:** WHY AFRICA NEEDS TO "TRACK IT, STOP IT AND GET IT"

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*Adeyemi Dipeolu; Gamal Ibrahim, William Davis and  
Oladipo Edmond Johnson*

## Introduction

Financing development in Africa has proven to be difficult in the past, compelling the continent to rely on external sources, including overseas development assistance. This type of assistance is often unevenly distributed, unsustainable and, in some cases, damaging to national economies in the long run. Lessons learned from Africa's development trajectory over the past three decades have prompted a fresh wave of thinking towards a post-2015 and Africa 2063 transformative developmental framework designed to ensure self-reliance for Africa. In the light of the recent global economic and financial crises and the approaching deadline for achieving the Millennium Development Goals, a structural transformation agenda will require an adequate, predictable, sustainable and integrated financing mechanism geared towards financing development goals (Abugre and Ndomo, 2014). The continent must embark on reforms to capture currently unexplored or poorly managed resources. This includes curtailing illicit financial flows and transforming those funds into a powerful tool for enhancing domestic resource mobilization as a way of furthering the continent's development.

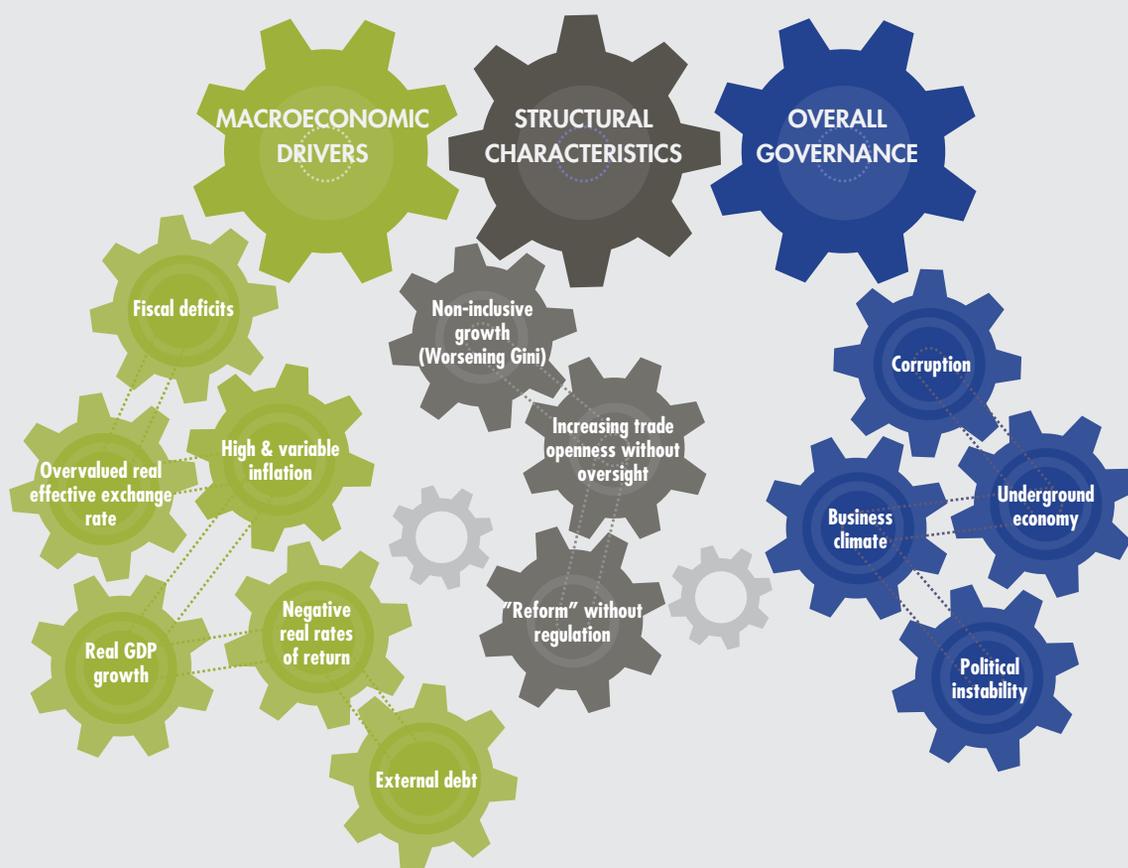
In response to the challenges set out above, the Economic Commission for Africa and the African Union Commission established the

High-level Panel on Illicit Financial Flows in 2012, at the request of participants at the Fourth Joint Annual Meetings of the Economic Commission for Africa Conference of African Ministers of Finance, Planning and Economic Development and African Union Conference of Ministers of Economy and Finance in March 2011. The panel was due to present its final report in January 2015 at the twenty-fourth ordinary session of the Assembly of the African Union. The report is based on rigorous research, country case-studies and regional consultations within and outside Africa.

Illicit financial flows are commonly referred to as “money that is illegally earned, transferred, or utilized” (ECA, 2014b). This represents a major break from the dominant work on capital flight, which emphasises macroeconomic instability, including the business environment, as the main driver of capital outflows and therefore places the burden of resolving the problem on developing countries instead of promoting shared responsibility. It also focuses attention on the structural and governance limitations that fuel such flows from Africa. The focus on hidden resources and their potential impact on development places the issue of illicit financial flows firmly in the broader realm of international political economy which emphasizes the role of governance at both the origin and the destination.

Figure 3.1 Drivers of illicit financial flows

## ILLICIT FINANCIAL FLOWS



Source: Kar (2011: 17).

These cross-border transfers of illicit money have a considerable detrimental impact on Africa's development and governance, especially in the transnational context. Among other things, illicit financial flows stifle Africa's socio-economic progress by draining scarce foreign-exchange resources, reducing government tax revenues, deepening corruption, aggravating foreign-debt problems and impeding private-sector development. The extractive sector is often particularly affected by these phenomena. In turn, this reduces the resources that Africa has for its development. The governance challenges posed by illicit financial flows include weakened public institutions and ultimately a reduced capacity of the State to provide public resources and welfare for the people.

All of the above has had a particularly adverse welfare and distributional effect on the poor, whose income and prospects for employment have dwindled (Kar and Cartwright-Smith, 2010).

## Illicit financial flows: a technical approach

Accurate measurement of illicit financial flows has proven difficult, due to the secretive nature of such transactions and data limitations. However, a number of

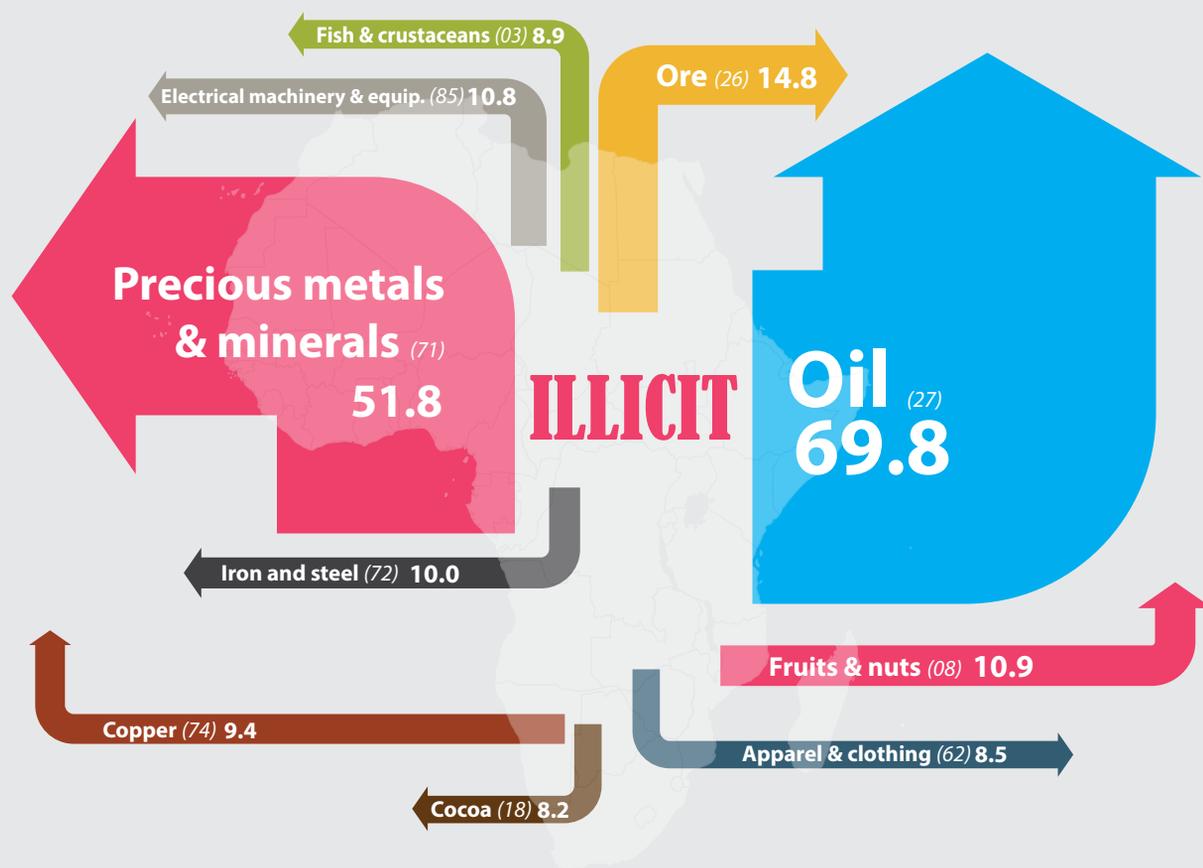
empirical methods have been used in an attempt to overcome these challenges and provide estimates of both the magnitude and development implications of illicit financial flows for developing countries in general and African countries in particular. These empirical models and their underpinning analysis deserve further scrutiny. These models conclude that Africa has been a net creditor to the rest of the world, owing

to the considerable illicit financial outflows from the continent. It is, however, important to note that these estimates are conservative given inadequate data and the multifarious channels through which illicit capital flows occur.

Estimates from various recent studies (including Kar and Cartwright-Smith, 2010) reveal that Africa lost between \$854 billion and \$1.8 trillion in illicit financial flows between 1970 and 2008. The latest progress report of the High-level Panel on Illicit Financial Flows from Africa revealed that the annual average was between \$50 billion and \$148 billion a year (ECA, 2013a and ECA, 2014b). Commercial illicit financial flows (including tax evasion, incorrect pricing of trade and services and transfer pricing abuses by multinational corporations) account for the largest proportion of illicit financial flows, followed by proceeds from criminal activities and corruption.

# Figure 3.2 Top 10 sectors by cumulative illicit financial flows from Africa, 2000-2009 (USD billions)

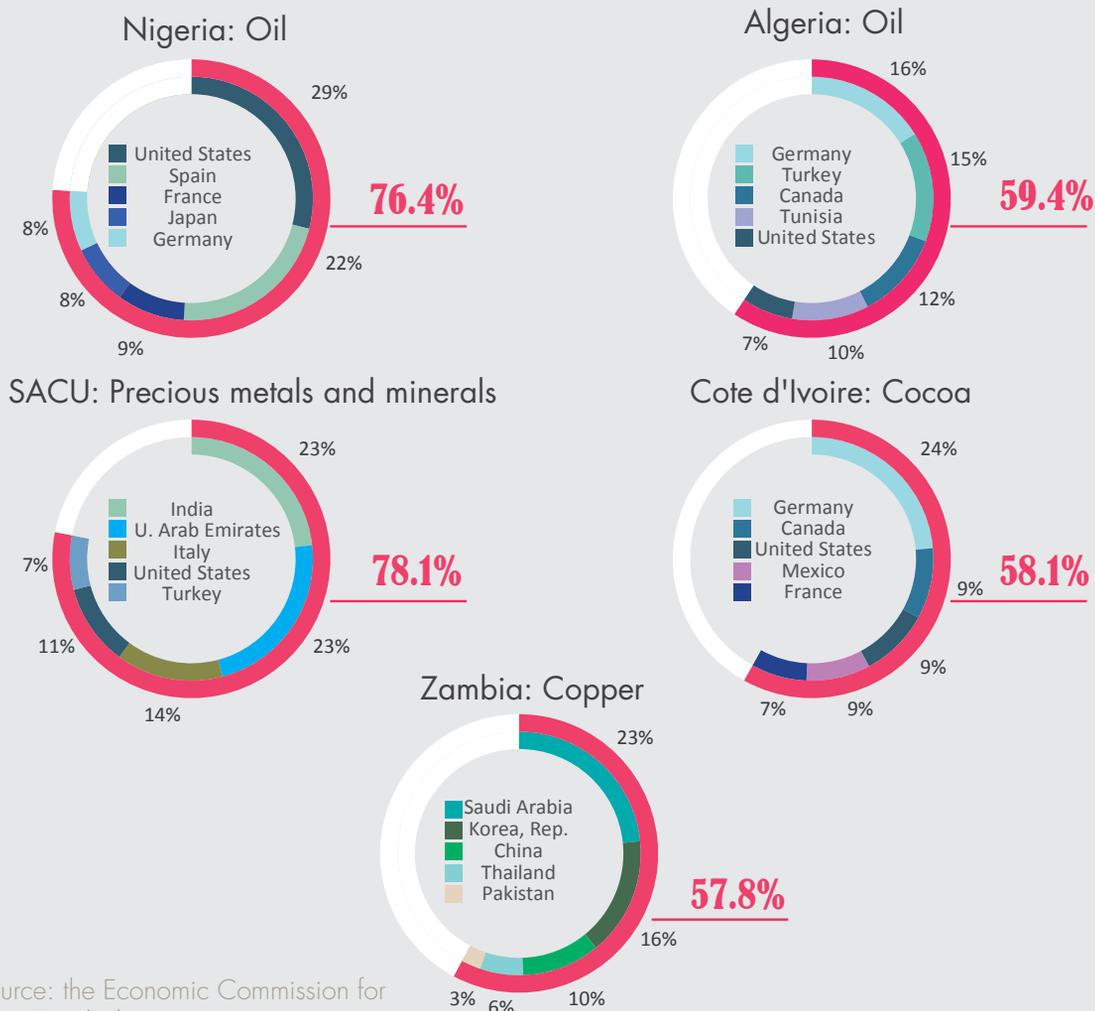
Only includes incorrect pricing of trade.



Source: Calculations by the Economic Commission for Africa.

# Figure 3.3 Top five destinations by share of total illicit financial flows, 2008

Share of total illicit financial flows (HS2 classification) for selected African countries and sectors where illicit financial flows are particularly large (only includes incorrect pricing of trade).



Source: the Economic Commission for Africa's calculations.

The Economic Commission for Africa has provided an empirical analysis by sector of the component of illicit financial flows in Africa linked to incorrect pricing of trade, an area which has not yet been well examined in the literature.

The methodology adopted in this model compares bilateral data for the same trade flow, comparing country *i*'s exports of product *a* to country *j* with country *j*'s imports of product *a* from country *i*. Interestingly, this two-way information is usually does not match each other for several reasons:

- » Exports are generally expressed free-on-board (FOB), while imports are normally reported including the cost of insurance and freight (CIF)
- » The same product may not necessarily be classified using the same nomenclature by each country
- » Mistakes in reporting the value of the flows are possible
- » Delays often occur in the export or import processes
- » Illicit financial flows can also be considered as a source of discrepancies.

Illicit financial flows from Africa measured through incorrect pricing of trade show high concentration in a few sectors, notably the extractive and mining industries. Over the

period 2000-2009 some 56 per cent of illicit financial flows from Africa came from the oil, precious metals, minerals, ores, iron, steel, and copper sectors (see figure 3.2).

Sectors such as fruits and nuts for human consumption, electrical machinery and equipment, fish and crustaceans, clothing and cocoa have also been targets for illicit financial flows, with each sector accounting for between 3 and 4 per cent of total illicit flows from Africa over the past decade.

Illicit financial flows also appear to flow overwhelmingly to a small number of destination countries. For example, in 2008<sup>15</sup>, some 76.4 per cent of illicit financial flows from the Nigerian oil sector ended up in just five countries, namely the United States, Spain, France, Japan and Germany<sup>16</sup>. More generally, it appears that the main receivers of such flows are primarily developed countries (in particular, the United States, Japan, the Republic of Korea and European countries) and emerging economies (China and India). Interestingly, these countries are also Africa's major trade partners.

<sup>15</sup> 2008 being the year over the period 2000-2009 when IFFs were the highest for Africa

<sup>16</sup> Swiss-based companies control much of the global trade in natural resources, notably copper and ore. However, it is interesting to note that the Government of Zambia, Africa's largest copper producer, reported a total of \$7.7 billion of copper exported to Switzerland for the period 2000–2009, which is not accounted for in the Swiss import data. This case mirrors that of some resource-rich African countries, which were not able to cash in on the price boom for commodities between 2004 and 2008.

## Broad issues

The issue of illicit financial flows is complex and technical in terms of factors such as the origin, destination, scale, modalities, drivers, actors and regulatory responses. The concept of illicit financial flows needs to be defined clearly, using the right terminology. Indeed, it has often been used interchangeably with capital flight, but the two concepts are distinct. “Capital flight” refers to capital leaving a country in response to what are seen as adverse economic conditions and can include a licit component as well as an illicit one. Illicit financial flows, by contrast, may or may not leave a country due to economic conditions, but involve illegality, either in how the funds were obtained (for example proceeds of crime), in the transfer (for example, tax evasion), or in what they will fund at the destination (for example financing of terrorism). A commonly used methodology to estimate illicit financial flows is to look for flows that have not been recorded in official statistics and therefore may have been deliberately concealed from the authorities. The reasoning behind this methodology is that such concealment likely indicates that the flows are illicit, because there would seem to be no other sensible reason to conceal such a flow.

Organized crime - including money laundering, drug trafficking, racketeering,

counterfeiting, dealing in contraband goods and terrorist financing - accounts for 35 per cent of illicit financial flows globally (ECA, 2014b). Money laundering was estimated at \$1.6 trillion, the illicit drug trade at \$320 billion and counterfeiting at \$250 billion. Commercial illicit financial flows - including transfer-pricing abuses by multinationals, tax evasion, laundered commercial transactions, aggressive tax avoidance (often through harmful tax holidays), duty waivers and incorrect invoicing - account for 60 per cent of the global total. The remaining 5 per cent comes from funds obtained through corruption (including theft of public assets and bribery), although this figure may be higher in Africa. However, corruption facilitates illicit financial flows from the other components and is therefore more important in the phenomenon of illicit financial flows than suggested by this 5 per cent figure. According to the Economic Commission for Africa and others, total annual illicit financial flows are estimated at some \$50 billion, and this may well fall short of the actual figure, as accurate data are not available for all transactions and for all African countries (ECA, 2012b). This figure exceeds the average annual official development assistance that Africa received from the period 2008-2012 (Organization for Economic Cooperation and Development. International Development Statistics online databases).

Illicit financial flows have considerable repercussions in Africa and pose multiple threats. First, they drain resources and tax revenues by eroding the much-needed tax base for public investment and social spending. They also curb domestic savings, which are needed to reduce the continent's annual \$31 billion gap in infrastructure financing and to tackle climate change and youth unemployment. Second, illicit financial flows lead to governance issues, for example by exacerbating inequality and by encouraging rent-seeking rather than maximization of productivity. This practice can damage countries as it undermines institutions such as banks, financial intelligence units and legal mechanisms for detecting and prosecuting perpetrators of illicit financial flows. Third, such flows perpetuate Africa's economic dependence on external aid. This is reflected by the proportion of official development assistance in the budgets of African Governments. Indeed, for some countries, official development assistance accounts for 70 per cent of total government revenue. Lastly, a lack of political will and leadership have helped illicit financial flows to thrive in Africa. Ultimately, the greatest victims are the poor and the vulnerable, because resources are diverted elsewhere that could have been used on poverty reduction and measures to boost economic growth.

## Specific issues

### Natural resources

In the area of natural resources, illicit financial flows occur mainly through corruption, illegal resource exploitation and tax evasion. Acts of corruption include bribes paid by companies and money embezzled from tax collection and budgetary allocations. Illegal resource exploitation results in illicit financial flows when companies transfer out revenues from unauthorised resource extraction. Lastly, tax evasion fuels illicit financial flows in the natural-resource sector through smuggling, incorrect pricing of transfers and other methods. These forms of illicit financial flows have dire consequences for revenues from the extractive industry. Royalties are affected by volume underreporting, value underestimation, price discounting, benchmarking or indexation, extortion and avoidance of fee payment. In addition, corporate income taxes are declining because of incorrect pricing of transfers or over-invoicing, undue tax exemptions or rebates, companies reporting volume or quality incorrectly, inflated operational costs and embezzlement. This situation affects development, as most countries are unable to maximize their gains from natural-resource wealth, with corrupt government officials and companies benefiting at the expense of the wider population (Le Billon, 2011).

## Governance

Illicit financial flows and governance are strongly interrelated, with linkages at the domestic and international levels. For instance, governance challenges caused by kleptocratic regimes, political instability, weak tax administration, unfavourable exchange rates and the absence of the rule of law are opportunities for illicit financial flows to thrive (Abugre and Ndomo, 2014). These outflows are facilitated by the establishment of shadow financial systems such as tax havens, secrecy jurisdictions, disguised corporations, anonymous trust accounts and fake foundations, as well as incorrect pricing of trade and money-laundering techniques, which enrich certain individuals at the expense of the great majority. At the national level, illicit financial flows are undermining the dynamics of macroeconomic components such as domestic savings, hard-currency reserves and tax collection in African countries. This has adversely affected Africa's structural transformation and led to a cycle of external borrowing and debt-service payments. It has also perpetuated the continent's dependence on external aid. In 2011, for instance, total official development assistance inflows to Africa amounted to \$50 billion, compared to \$17.4 billion in 2002. Indeed, illicit financial flows are a catalyst for increased external borrowing, creating

more scope for further debt, thereby limiting public expenditure (NEPAD, 2014).

## Private sector

Illicit financial flows affect the private sector in two ways. First, 60 per cent of such flows occur through incorrect pricing or invoice manipulation by multinational and private companies, with a view to channelling money abroad or laundering money by bribing regulators or inspectors. These companies have a strong global presence and influence and are therefore able to transfer pricing and evade tax through corrupt practices such as buying off national authorities. They even go as far as lobbying for the introduction of low taxes or laxer regulations during contract negotiations. The inability of African Governments to check and control such illicit acts has given free rein to certain companies to engage in incorrect pricing of exports and imports, under-declaration of the quantities of natural resources extracted, and generous tax holidays for footloose companies, sold out just before the expiry period of the concessions, with the companies then re-emerging as entirely different firms. Second, illicit financial flows undermine the private sector by stifling business and entrepreneurship and significantly reducing structural transformation and economic diversification (ECA, 2012b).

## Conflict

According to the Inter-Governmental Action Group against Money Laundering in West Africa, extremists in the Sahel and insurgency in some African countries are obstacles to tackling the problem of illicit flows being used to fund terrorism (Sahadath, 2014).

Many of the violent conflicts in the forest regions of Africa are tied to commodities, such as precious metals and rough diamonds, which can be looted and can also be used to finance conflict (Centre for International Forestry Research, 2010). Revenue from forestry is also used by belligerents to purchase arms and other materials, while logging operators participate by trafficking weapons and trading timber for arms.

It is clear that illicit financial flows pose a threat to the stability and security of African countries, undermine institutions and democracy, and jeopardize sustainable development and the rule of law. As a result, to deal with the problems of conflict in Africa, it is essential to understand the nature and patterns of illicit financial flows.

## Cross-cutting issues

### Corruption

While corruption cuts across all categories of illicit financial flows, it is clear that the

term is mostly associated with public-sector corruption such as bribery and abuse of office (ECA, 2014b). Corruption has the potential to facilitate criminal activities including trading drugs, racketeering, counterfeiting, financing terrorism, tax evasion, trade in contraband goods and laundered commercial transactions. Private-sector businesses also perpetuate these problems by bribing public officials and using their personal connections to influence administrative processes (ECA, 2013a).

### Tax havens and financial-secrecy jurisdictions

Tax havens and financial-secrecy jurisdictions serve as destination points for illicit financial flows through tax evasion and money laundering. Their nature allows for secrecy and ease of registration, which is often taken advantage of by business owners who use fake corporations as fronts. By serving as a destination point for funds, these tax havens undermine efforts to stem illicit financial flows from Africa and may encourage some African countries to also become havens and financial-secrecy jurisdictions (ECA, 2013a).

### Capacity issues

Capacity constraints have made it difficult to tackle the issue of illicit financial flows. One clear example is customs and revenue services, which are unable to deal with the

issue of incorrect pricing in the trade of goods, services and intangibles. Another area is the extractive sector, which lacks the capacity to negotiate contracts or ensure that Africa's views are reflected in the emerging global architecture to stem illicit financial flows. In addition, there is a capacity imbalance between prosecuting authorities and multinationals, which are always able to hire the best legal and accounting experts to fight their case (ECA, 2014b).

## Emerging findings

### High and increasing illicit financial flows from Africa

Academic literature on this subject agrees that illicit financial flows from Africa are high, in the range of many tens of billions of dollars annually. This demands an urgent effort to stem these flows.

### Does Africa have sufficient capacity and the right regulations to stop illicit financial flows?

Developing countries often lack sufficient capacity in public administration and regulatory bodies and have loopholes in their regulations, often leading to weak regulations which allow illicit activities to take place (for example see International Narcotics

Control Board, 2014, chapter 3). Africa is no exception, as indicated for example, by the case studies on industrial-policy organizations in the Economic Report on Africa 2014 (ECA and AUC, 2014). Research should be undertaken into how far similar issues affect the institutions that should be stopping illicit financial flows from Africa.

This may particularly be the case with the rules and institutions that should be responsible for stopping illicit financial flows from the commercial sector, which account for at least 60 per cent of the flows, according to estimates by Global Financial Integrity (2010). It seems reasonable to infer that the regulations and institutions that should prevent illicit financial flows may not be functioning properly. As a result, there should be reviews of the regulations and institutions in Africa that should be responsible for stopping illicit financial flows from the commercial sector. Development partners may also have a role to play in building African capacity in this area through technical cooperation and financing.

Tax incentives are one area where African countries may need to overhaul legal frameworks to stop the flows. Examples from literature indicate that some companies are abusing the incentives (such as tax holidays)

designed to attract them to Africa. This can result in Governments receiving little or no tax revenue from these companies. Corruption also undermines the efficiency and effectiveness of public administration in Africa and this needs to be tackled as part of efforts to stem illicit financial flows.

## Role of international agreements and cooperation in stopping illicit financial flows

The majority of illicit financial flows from African countries leave the continent entirely and go to other countries around the world. In addition, several organizations and government bodies (including the Organization for Economic Co-operation and Development, the Government of Norway, the Tax Justice Network and the Government of the United States<sup>17</sup>) have highlighted the role of tax havens and financial-secrecy jurisdictions in facilitating illicit finance. External measures from partners outside Africa, such as the Patriot Act in the United States, the United Nations Convention against Corruption and the recommendations of the Financial Action Task Force, have been welcomed as helping to curb illicit financial flows. Africa nevertheless continues to haemorrhage increasing amounts of illicit finance to countries outside the continent.

This suggests both that cooperation with countries outside Africa may be necessary to stem illicit financial flows and that the current global architecture for regulating financial transactions and in other areas of law enforcement may be incomplete. There should be further investigation on the extent of cooperation required and problems with global architecture, exactly what forms of cooperation with countries outside Africa are required, and on how global regulations and agreements need to be amended to stop illicit financial flows from Africa. This may include a change in the way the United Nations approaches illicit financial flows, since the Organization currently has no coordinated, system-wide response to the issue.

For example, the international regulations and agreements that govern the recovery of stolen assets would seem important for counteracting illicit financial flows. The institutions active in this area currently include the World Bank and the United Nations Office on Drugs and Crime (Stolen Asset Recovery Initiative), the Arab Forum on Asset Recovery and the Asset Recovery Inter-Agency Network of Southern Africa. The Convention against Corruption also includes rules for the recovery of stolen assets. These should be reviewed to see if they are sufficient.

<sup>17</sup> For example, the United States Government has put pressure on Switzerland regarding tax evasion there by United States citizens.

It is likely that development partners will need to play an active role in repatriating assets that are stolen from Africa. This has already worked well with the repatriation from Switzerland and the United States of America of funds stolen from Nigeria by Sani Abacha.

## Increased transparency may play a key role in curbing illicit financial flows

One area where both national and global regulations need to be reviewed is transparency requirements for the commercial sector. As mentioned above, the commercial sector appears to be the source of most illicit financial flows. If companies were to share more information about their transactions and accounts, this would make it easier to identify where illicit financial flows are coming from. This could include country-by-country and project-by-project reporting and the publication of information on beneficial ownership. It may also be the case that more transparency in the public sector could reduce corruption and illicit financial flows in public procurement, natural-resource contracts and government budgeting. However, although it appears that in theory improved transparency could help to curb illicit financial flows, it remains to be determined how successful this would be in practice.

In this regard, it may be particularly important to take action on financial-secrecy jurisdictions. These jurisdictions, as their name suggests, allow companies to operate while giving minimal information about their finances. This would appear to be ideal for perpetrators of illicit financial flows and ripe for abuse. What is more, because capital is often mobile, because companies can choose to be domiciled in a financial-secrecy jurisdiction and operate elsewhere, and because criminals and corrupt officials can transfer their funds to financial-secrecy jurisdictions, the existence of financial secrecy in one jurisdiction may facilitate illicit financial flows from across the globe. This seems to be a key issue to tackle.

Development partners may have an important role to play in the area of improved transparency. First, they may be able to put political pressure on such jurisdictions, perhaps to a greater extent than African countries. Second, they could ensure transparency in their own jurisdictions to stop their own companies from perpetrating illicit financial flows.

## Relationship between natural resources and illicit financial flows

The opacity of the extractive sector, its potential for outsized returns and incomplete global regulation may mean that this sector

is a leading source of illicit financial flows. Indeed, some empirical research on the level of illicit financial flows from various sectors has already indicated that this is the case (for example ECA, 2012b).

## Extent to which criminals are using new and innovative methods of perpetrating illicit financial flows

Throughout history, criminals have come up with new and innovative techniques to perpetrate their crimes without detection and to increase the proceeds of crime that they are able to amass. These often make use of the latest technology. The emergence of cybercrime in recent years is one example; another is the use of the Internet to conduct drug trafficking through illegal online pharmacies and anonymous marketplaces. Illicit financial flows may also be subject to this phenomenon. It is important to identify what new techniques criminals are using to perpetrate such flows, so that efforts to curb them are not based on an outdated understanding of how they operate. Advanced techniques for perpetrating illicit financial flows could include the incorrect pricing of services and the abuse of e-commerce.

This challenge may, for example, affect global anti-money-laundering efforts. In recent years, anti-money-laundering controls have grown in number and sophistication. The

question remains, however, as to whether they are sufficient to stop this aspect of illicit finance or whether further action is required, especially since the tactics of those involved in money laundering may be constantly evolving.

## Conclusion

It is imperative to curtail illicit financial flows and to fight corruption and the institution of tax havens, so as to ensure the efficient and effective use of resources and domestic long-term financing. Illicit financial flows need to be retained on the continent, where they can be invested, saved or consumed. Such flows could also be appropriately taxed to provide additional tax revenue to fund government budgets, which are often in deficit. This would also help boost domestic resource mobilization efforts. In line with this, Africa needs mechanisms and strategies to tackle these flows. Indeed, curtailing them could become a key delivery mechanism for sustainable development.

Tackling the issue of illicit financial flows requires concerted efforts by countries of origin and destination countries alike. The legal and financial approach must be transparent and the international asset-recovery regime integrated in an effort to curb these outflows and unlock the much-needed resources.

# CHAPTER 4

# PRIVATE EQUITY AND AFRICA'S ECONOMIC GROWTH: DEMYSTIFYING THE ASSET CLASS FOR POLICYMAKERS

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## Introduction

Africa's achievements over the last decade are noteworthy. They include average growth rates of about 5 per cent; inflation in single digits; and the fact that six of the world's fastest growing economies are in Africa. Increasingly, the stable and predictable economic and political environment in Africa is mitigating the risks for business investments, thereby providing more confidence for companies to exploit profitable investment opportunities. The rate of return on investment in Africa today is higher than in any other developing region (see for example Leke and others, 2010), even with adjustments for real and perceived business risks. The continent is richly endowed with natural resources, which provide opportunities for high rates of return on investments. The continent is rapidly evolving and the regional integration process is also gaining momentum and broadening the market space, especially for investors motivated by economies of scale.

Africa should not be seen mainly as a natural-resource story. Other leverage points need to be highlighted. The continent's population is nearly 1 billion, representing a burgeoning consumer market with increasing demands. Its combined consumer spending power is projected to increase from \$860 billion in

2008 to over \$1.3 trillion by 2020, with 128 million households having discretionary income. There is a growing middle-income group and a high rate of urbanization in many countries. The number of middle-class households is estimated to increase by almost 50 per cent from 2010 to 2020. There is also an increasing pool of well-educated and enterprising workers in most countries across the continent. These demographic dynamics provide the potential for market-seeking and efficiency-seeking investments in areas other than natural resources. Private-equity investors can easily tap into this market for consumer goods and services. Africa is therefore very much in the spotlight, and poised to provide private-equity investors with high returns on their investments.

However, the continent has not enjoyed the development of its capital markets as much as continents such as Asia. Only 25 of the continent's 54 countries have stock exchanges and the regional stock exchanges Bourse Régionale des Valeurs Mobilières and Bourse Régionale des Valeurs Mobilières d'Afrique Centrale cover another eight and five countries, respectively. However, not all of these exchanges are operational and some suffer from low capitalization and low numbers of listed shares. Only five African stock exchanges are members of the World Federation of Exchanges. Therefore, investors face difficulties in directing

their funds to the public stock markets.<sup>18</sup> Raising capital for investments is one of the biggest challenges facing many African entrepreneurs and economic operators because commercial banks often ask for high lending rates and collateral requirements. There is an urgent need for capital infusion to finance crucial infrastructure projects such as road and rail transport, energy, water, mineral-resource exploitation, agro-business and industrial development. Investing in these areas could be a lucrative venture for private equity and other potential investors. It will also create needed jobs for Africa's burgeoning population and help lift people out of poverty. Private equity also helps to fill the financial gaps in many local African companies. There should also be a strong political agenda to deal with the challenges of finding firms that can grow and nurture infrastructure. This would also entail finding the right management teams to transition businesses into successful regional ventures.

What does this African story mean for private-equity investors in terms of opportunities and challenges? Private equity

was not well known in Africa some 8 to 10 years ago. Now more capital is coming into Africa. The fact that private equity is being discussed in many forums also shows that it is getting more traction in Africa. Over \$200 billion has been raised by private-equity firms, with Kenya, Nigeria and South Africa being the major beneficiaries. Private-equity investment deals in Africa increased from \$890 million in 2010 to \$3 billion in 2011 (Ncube, 2012) – an increase of about 297 per cent. According to Emerging Markets Private Equity Association (EMPEA) database of private equity activity, in 2012 private-equity funds raised US\$1.4 billion for Africa, about 8% more than in 2011, when US\$1.3 billion was raised. The second largest deal in 2013 was the Delonex Energy deal in Kenya, to the tune of \$600 million. Recently, investors from China and India have also shown great interest in private-equity investment in Africa, particularly in the natural-resource, infrastructure and renewable-energy sectors.

Against this backdrop, private equity and its potential role in Africa's transformation should be an area of interest to policymakers. This chapter gives a synoptic overview of the asset class and its challenges, and what African Governments can do to help boost private-equity investments by existing players and new entrants alike. Research for the chapter was solely desk-based, using secondary sources. This chapter is not intended as advice

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<sup>18</sup> Unfortunately, apart from the Johannesburg Stock Exchange, Africa's financial markets are highly underdeveloped. As a result, as the Omidyar Network noted (2013), there is a "pervasive informal sector." This means that many of the "perks" traditionally associated with investing in public markets do not apply when it comes to the African financial landscape and this will not change until the markets are more regulated and formalized. For instance, the number of listed companies is limited, thus reducing an investor's choice of exposure – as an example the Ghana Stock Exchange had 36 listings as of July 2013.

for seasoned private-equity practitioners on “where” and “how” to invest or how to enter the asset class in Africa. Rather, it is meant to be an educational bridge and awareness tool for government agencies and policymakers. It attempts to explain the dynamics of the asset class in simple terms and solicits contributions and ideas from seasoned sector players for dialogue with Governments. While the chapter is intended for policymakers, Governments and development agencies, it is nonetheless also meant to raise the awareness of private-equity players about enhancing their engagement with Governments. Specifically, the chapter is aimed at:

- » Establishing a common and deeper understanding of the asset class among political decision makers and of what drives the behaviour of private-equity industry participants, to allow for open engagement and constructive dialogue
- » Indicating possible levers and initiatives to confirm the viability of these levers for policymakers, in order to maximize the benefits for all role players involved, when using this asset class as a conduit to grow foreign direct investments (FDI), which is a driver for economic growth, social enhancement and prosperity.

The chapter is structured as follows: I - Introduction; II - Understanding the asset class; III - Basic facts about the private equity industry in Africa; IV -

Challenges of the private equity industry; V - Role of Governments; and VI - Policy recommendations.

## Understanding the asset class

Private equity funds, hedge funds and venture capital are commonly referred to as “alternative asset classes”, making them different from more traditional asset classes such as cash, property and equities. The main difference is that these assets are less liquid (buying and selling is not as easy as, for example, buying and selling shares held in a share portfolio of public equities) and hence are more difficult to value, leading to a longer-term investment period with a different risk-return profile.

## Private equity - an alternative source of financing

In the traditional model, companies and business ventures usually source funding to finance their growth from banks and public equity markets (or bonds/debt markets) on stock exchanges. The funders remain far from the business and can only provide capital and monitor the company’s performance from the outside, with very limited or no direct involvement. Daily share prices are tracked by public shareholders who have invested in the company and have the choice to exit

## Box 4.1 Related asset classes besides private equity

"Private" equity: Private funding into investments, bypassing the public markets and the classic institutional model of general partners (fund managers managing the investments) and limited partners (private equity investors into the funds). This type of investment is associated with higher perceived risks, where institutional players are limited by sanctions or other reasons, and private financiers do direct investments, often using money raised deal-by-deal from family investment houses. "Private" private equity existed before private equity was institutionalized.

Venture Capital and other early-stage investors: A subset of private equity. Venture capital is equity co-invested with an entrepreneur to fund a venture when it is the early stage (known as "seed" and "start-up" capital) or expansion stage. The investor expects a higher-than-average return on the investment in order to offset the higher risk. In the African context, venture capital is still small compared to the overall private equity asset class.

"Environmental, social and corporate governance" (ESG) is the general term for the criteria used in what has come to be known as "socially responsible investing" or "responsible investing". Socially responsible investing, including issues related to the environmental, social and corporate governance aspects and impact of an investment, is one of several related concepts and approaches that influence and, in some cases, govern how asset managers invest portfolios. It refers to the three main areas of concern that have developed as central factors in measuring the sustainability and ethical impact of any investment in a company or business. They are used in private equity and more widely. Within those areas are a broad set of concerns, increasingly included in the non-financial factors that feature in the valuation of equity, real estate, corporations and fixed-income investments. The ESG impact is often difficult to measure.

their investments at any time by offering the shares for sale on the stock exchange.

Private equity does operate a little differently from the traditional model<sup>19</sup> in the sense that it typically involves investments in companies or enterprises with a view to making them more profitable and marketable in the future. Companies requiring funding may approach private-equity players for both debt (sourced from the bank) and equity (raised from institutional investors). These private-equity players provide the funds after considering the potential risks and returns. Private-equity players are more involved than public shareholders who invest via the stock exchange. The private equity investors may appoint representatives to the company's Board of Directors to oversee the implementation of the growth plans. Not only do the directors provide the capital, they also provide networks and expertise. The private-equity investment horizon ranges between 5 and 10 years and the fund managers have to exit by selling or trading their equity shares at the end of that period. In developed markets, they often do so by listing the company on a public exchange through an initial public offering. Variants of private equity are shown in Box 4.1.

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<sup>19</sup> The traditional model typically consists of a closed-end fund which has a fixed life of up to 10 years or more.

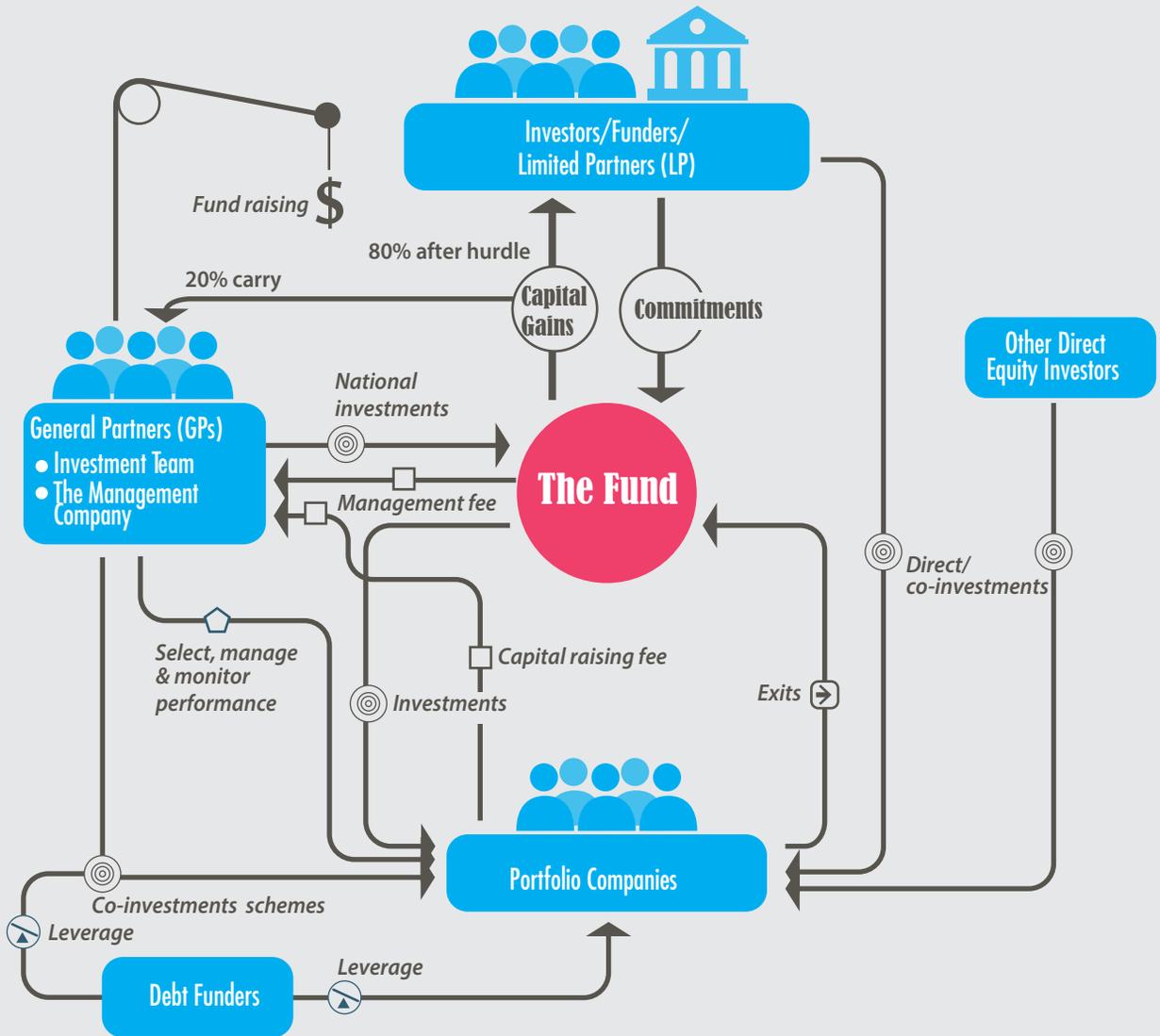
## Role of players in the private-equity model

There are three main players in the private equity industry:

- » General partners (GPs): These are a group of experienced transactors (often a small team with banking and accounting skills), who market their previous experience and track record in order to raise money from institutions. In many cases they would offer to be the fund manager and manage the investments using a fund structure.
- » Limited partners (LPs) are usually the institutional investors who provide the money but are not usually closely involved in investing it. Typically they include large pension funds and, in the African context, development finance institutions.
- » Investee companies, often referred to as “assets” or “portfolio companies”.

The general partners raise money committed by the limited partners for a period of about 10 years and then they manage the funds raised with a view to earning a return. The key part of managing the fund is buying, growing and then successfully selling shares in the ownership of companies. For that work and skill, the general partners earn a combination of fees and a share of the returns generated, called “carry” or “carried interest”. In order to add value strategically

**Figure 4.1** Typical structure of a private equity fund: funds are variations of a similar theme of LPs, GPs and portfolio companies



Source: Illustration by authors.

and operationally to the companies acquired, the general partners need skills in executing transactions (such as negotiating and buying the shares) and experience in managing their investment post-transaction. Advance funds are given to them in the form of a management fee that allows them to pay their small complement of highly-skilled staff and the myriad of ad hoc advisors and experts they use to execute their deals.

The return, however, actually depends on the third role player in the model, which is the investee company (or the recipient of the funds). The model only really works if the portfolio of investee companies actually grows fast enough in value during the period of investment. That only happens if the general partner carefully chooses the markets, sectors and companies, and the management teams of those investee companies have the skill to scale up and grow the assets (businesses) they are responsible for. Interestingly, in the private equity model, the most prominent player of the industry (the general partners' fund manager) is caught in the middle between the limited partners, who are exerting pressure for returns and the investee companies, which are looking for growth.

## Value creation and sharing

It is crucial to understand the dynamics of the private equity industry. The general

partners do not own the funds to be invested (although sometimes they co-invest into the fund). While the limited partners are the ultimate investors in the model, they entrust the capital to the general partners, who put it into the "blind-pool"<sup>20</sup>. The general partners are responsible for returning the capital received at the outset. A typical agreement on carry would mean they also return 80 per cent of the value created over and above that to the limited partners and distribute the remaining 20 per cent among the general partners<sup>21</sup>. The general partner spends two to three years raising funds, another two to three years investing it, about five to seven years adding value to the investments and another two to three years to exit. It takes about 10 years, on average, to get to the general partner's portion of the carry. Timing is also critical in the value-generation equation as overall market sentiment determines a large portion of the assets' entry and exit prices.

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20 Money committed to the general partners by the limited partners based on trust that the general partners will invest well and generate the desired returns for the limited partners.

21 A simple example of private equity value creation mechanics: if the limited partner commits \$100m to a general partner and the general partner grows that \$100m to \$300m over the investment period through smart investment choices (and through hard work with the investee company management teams), the \$200m of value created is split 80-20 in favour of the limited partner. This means that the limited partner gets back his initial \$100m+\$160m and the general partner team for their efforts, get to keep \$40m, generally referred to as "carry". This is a very simplified version of the mechanics. In reality, there are hurdle rates, management fees and other details to be considered. The hurdle rate (see Figure 4.2) usually refers to an agreed initial return before the carry can be considered.

Figure 4.2 illustrates a simple example of private equity returns and value shared. The simple model started with \$500 funds and, at the end of 10 years, the value of the fund was \$2,000. The agreement is that any capital gains greater than 8 per cent compounded each year (the hurdle rate) would be shared 80 per cent to the limited partners and 20 per cent to the general partners. Therefore, the limited partners get their initial capital (\$500) plus the \$580 amount to cover the hurdle. The carry amount is then shared out, with the limited partners getting another \$736 and the general partners (fund managers) getting \$184 for their role.

Figure 4.3 shows the processes or stages of the private equity industry from beginning to end. The first stage is fund strategy and fund-raising, which happen periodically. Deal sourcing and origination are probably the most frequent activities, while deal execution is the busiest period in the fund's life-cycle. Once the fund is fully invested, the workload shifts towards growth nurturing and value extraction in the portfolio. Exit grooming entails preparing the assets in the portfolio for marketing and sale to the next owner. Exit is the selling off of the portfolio assets in order to realize the value for the fund and return the capital to the limited partners.

## Challenges of the private-equity model

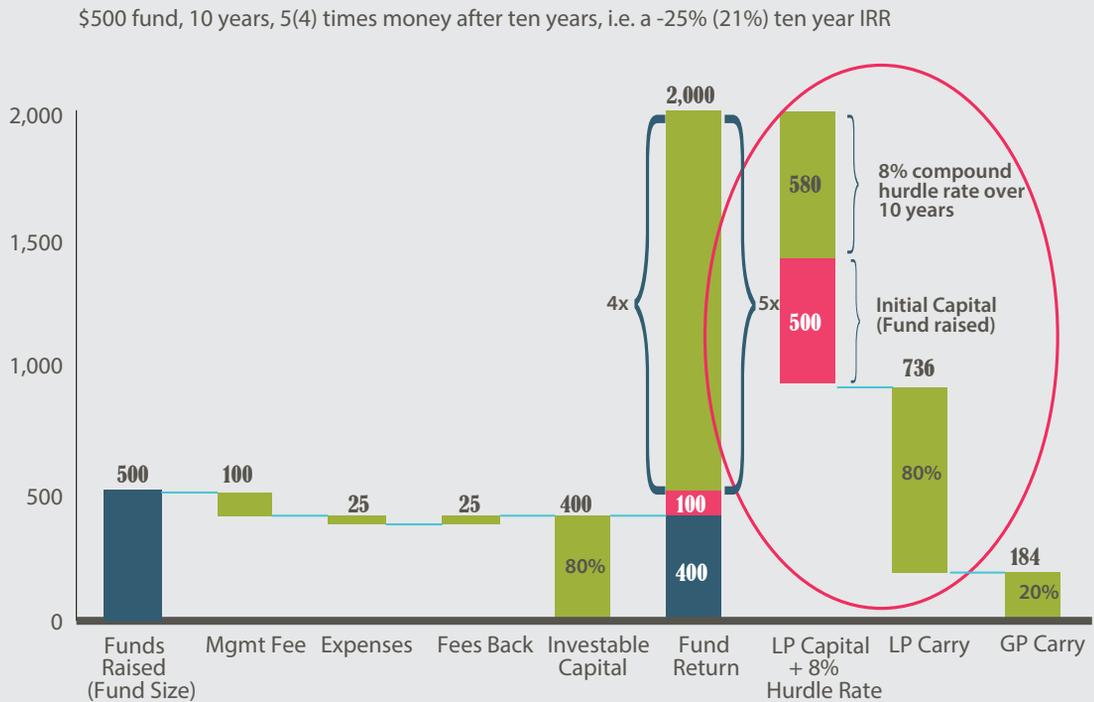
The most important issue in the private equity model is the timing of the market (buy low – sell high) and the need for growth in the assets, often linked to growth in their markets. However, factors affecting the returns of the general partners and limited partners are common to most businesses.

These include:

- » **Currencies:** Limited partners are primarily based overseas and need their returns in foreign currency, while investee companies operate in-country in local currencies. This creates an exchange-rate risk challenge, as buying the asset is done in the initial year of investment at a given rate, and converting the proceeds at another exchange rate five to seven years later.
- » **Interest rates:** As described above, general partners like to use leverage (in the form of debt), where possible and investee companies may have debt on their balance sheets. In terms of returns, fluctuations of the interest rate obviously affect general partners and investee companies alike. Inflation rates can also affect the risk and returns.
- » **Political and market risks:** Experienced private equity operators in Africa have not often recorded asset losses due to political risk. However, private

# Figure 4.2

An example of returns and value shared in the private-equity model



Source: Illustration by authors.

Note: Fund returns are either express gross or net of management fees.

equity players do admit loss of value from production losses during periods of shutdown following political unrests.

## Basic facts about the private-equity industry in Africa

Africa's private equity industry is currently in the spotlight. Not a day passes by without there being at least a tweet, an article or even a full-blown report or research piece published on the topic. The story was different in very recent years, when private equity could be dismissed as "hype" by some skeptics. The impact of private equity is tracked through measurable indicators such as private equity penetration<sup>22</sup>, values of deals closed and returns generated. For private equity tracking, Africa has been lumped together with Latin America and Eastern Europe. Private equity in Africa, however, has grown measurably off its small base, along several key metrics. The most commonly used metrics or variables to assess reliably the industry's health at a macro level include:

- » **Fundraising:** How much money was the asset class able to attract (i.e. the success of fundraising activities)?

- » **Deal flow (invested funds):** How much of that was deployed/invested (an indication of deal-flow)?

- » **Returns generated:** What returns did that yield (how successfully did they create value)?

**Fundraising:** In absolute and relative terms, Africa is still the smallest private equity market, yielding only 0.5 per cent of the cumulative global total of private equity funds raised over the last 11 years and only slightly more than that (0.7 per cent) in 2012. The share of all emerging markets private equity funds of the world total for private equity almost doubled relative to the cumulative average (from 12 per cent to 20 per cent), which is almost the same magnitude as the share lost by Western Europe (from 25 per cent to 14 per cent). While Africa's share may seem small, it is not surprising in view of the sum of its economies, which account for only 4 per cent of global gross domestic product (GDP).

The growth over time paints a slightly different picture. In the pre-crisis years, for eight years running, funds raised to invest into East, West, Central and Southern Africa grew at almost 5 per cent per annum and was only outperformed by the funds for the Middle East and North Africa. The sub-continent thereafter managed to bounce back at a respectable 11 per cent per annum,

<sup>22</sup> Private equity investments as a percentage of gross domestic product.

## Figure 4.3 Private equity value chain and its markets



Source: Illustration by authors.

slightly behind the 16 per cent average for the emerging markets, but still slower than funds raised for Asia, Eastern Europe and Latin America and beating only shrinking Middle East and North Africa in the emerging market group. Looking at the entire 11-year reporting period, however, private equity fund-raising for East, West, Central and Southern Africa grew at an annual growth rate of 26 per cent,<sup>23</sup> the clear winner and beating all other markets.

**Performance:** Returns generated, multiples, environmental, social and corporate governance issues, impact on gross domestic product and returns: The African Venture Capital Association and Cambridge Associates, a global investment advisor which maintains databases and tracks private equity investment performance data around the world, recently concluded a benchmarking

study, which covered 40 institutional-quality African funds in 25 countries.

The study revealed an 11.2 per cent annualized return for the 10 years ending 30 September 2012. Relevant highlights of the study are shown in Box 4.2.

Another study conducted by the Development Bank of Southern Africa and the South African Venture Capital Association aimed at monitoring the performance of selected companies, which had received private-equity funding revealed that over the three-year period from 2005/6 to 2008/9, private equity-backed companies in South Africa achieved the following results:

### Private-equity opportunities in Africa

Several opportunities in Africa have been attracting more foreign investments. Despite the negative perceptions by some private equity players about developing countries, huge investments have been flowing into Africa.

<sup>23</sup> Knowing the 'magic' of Compound Annual Growth Rate (CAGR) calculations, this stems from the low base in 2001

## Box 4.2 Related of benchmark study tracking performance of private-equity investments

African private equity funds outperformed United States venture capital and are roughly in line with the Broad Cambridge Associates Emerging Markets Private Equity and Venture Capital index for the most recent 10-year period.

For earlier 10-year periods – for instance, those ending in 2008 to 2010 – African private equity outperformed the 10-year emerging market benchmark.

Except for the most recent periods, African private equity has performed in line with or ahead of Asian and Latin American private equity.

Over 40 per cent of the funds in the African Private Equity and Venture Capital Index beat the broad emerging markets median fund for their vintage year.

The strongest performing sectors within the private-equity funds in the African index were information technology, industry and manufacturing, and the consumer sector.

African private equity funds from the 2005 to 2007 vintages are trailing African and emerging markets stocks to date, but are slightly ahead of developed market stocks on a public-market equivalent basis. Many of the funds in the African benchmark remain early in their life cycle and are largely unrealized, making comparisons to public markets less meaningful for now for more recent vintages.

## Box 4.3 Performance of selected African companies for the period of 2005 to 2008

Annual world-wide employment growth rates of 9 per cent, compared to 4 per cent for companies listed on the Johannesburg Stock Exchange and 8 per cent for private-equity backed businesses in the United Kingdom and Northern Ireland.

Employment of 5 per cent of South African formal-sector employees, which equates to around 427,000 jobs.

Average domestic employment growth rates of 10 per cent per annum, compared to 1 per cent across all businesses in South Africa.

Average turnover growth of 20 per cent, compared to 18 per cent for business listed on the Johannesburg Stock Exchange and 8 per cent for private equity-backed businesses in the United Kingdom.

Pre-tax profit growth of 16 per cent per annum compared to 14 per cent for Johannesburg Stock Exchange businesses and 11 per cent for United Kingdom private equity-backed businesses.

Growth in exports of 31 per cent per annum, on average, compared to 24 per cent nationally and 10 per cent for United Kingdom private equity-backed businesses.

Private equity, however, has not benefited all 54 African States equally. The future for private equity in Africa cannot be predicted simply by extrapolating past performance as an indicator for future outcomes. Indeed, opinion-based research by global industry bodies, such as the Emerging Markets Private Equity Association, has revealed that Africa will become the next frontier for investment. According to Economic Report on Africa 2013 (ECA and AUC, 2013), Africa's economic growth generally stems from factors such as: strengthening domestic demand which is associated with rising incomes and urbanization; increasing public spending, especially on infrastructure; bumper harvests in some regions; tightening trade and investment ties with emerging economies; and post-conflict economic recovery in several countries. Over the last decade, the average inflation rate has halved and public debt, including external debt, has decreased sharply.

Investment opportunities are boosted by factors including: a fast-growing population, making Africa one of continents with the highest potential for growth in consumption; an average growth rate in gross domestic product of around 5 per cent a year for the past decades; abundant natural resources such as oil and minerals; only a few private-equity players on the ground, making it attractive for investment by new entrants;

and the growing efforts by African leaders to push the regional integration agenda forward.

Historically, private-equity deals have taken place within a subset of the continent, concentrating in Southern Africa (dominated by South Africa with 65 per cent of deals done and 42 per cent of exits), and more recently, Eastern and Western Africa<sup>24</sup>. Indeed, according to Sheel Gill, Head of Transaction and Restructuring at KPMG in East Africa: "Private equity inflows are expected to rise in East Africa over the next five years riding on macroeconomic stability, the improved investment climate and increased consumer spending and consumption in the region. Private equity inflows will account for half of foreign direct investments in the region." (Mulupi, 2013)

Figure 4.4 shows how private equity deals are distributed in Africa. In recent years, Southern Africa has dominated the share, accounting for about 65 per cent of the private-equity deals, followed by North Africa (14 per cent) and West Africa (13 per

<sup>24</sup> In West Africa 13 per cent of deals done and 25 per cent of the exits were driven by Nigeria and Ghana in particular. Eastern Africa accounted for 4 per cent of deals and 11 per cent of exits and is catching up, recently scoring the second largest transaction in emerging markets globally. While the francophone parts of North Africa are well developed, countries such as Egypt, which suffered during the "Arab Spring", accounted for 14 per cent of the deals and 11 per cent of the exits.

cent). Central Africa remains at the bottom with about 1 per cent of the deals.

Not all sectors have attracted huge private equity investments in Africa. Investors have been very careful in identifying sectors that would easily grow and bring returns. In the past years, private equity had been concentrated in the sectors shown in figure 4.4.

Figure 4.4 also shows the number of private equity deals, by sector, in Africa, from 2006 to 2012. The consumer discretionary sector<sup>25</sup> tops the list with 28 per cent of the deal, followed by industrials with 26 per cent. The energy sector is also promising with 12 per cent. Many African countries would stand to gain by ensuring that their energy sector attracts more private-equity investments, as this is a key sector for the continent's transformation. The healthcare sector has received less attention from private-equity investors.

## Challenges of the private-equity industry

Despite the positive trends in the private equity industry in Africa, it is important to highlight some of the challenges it faces:

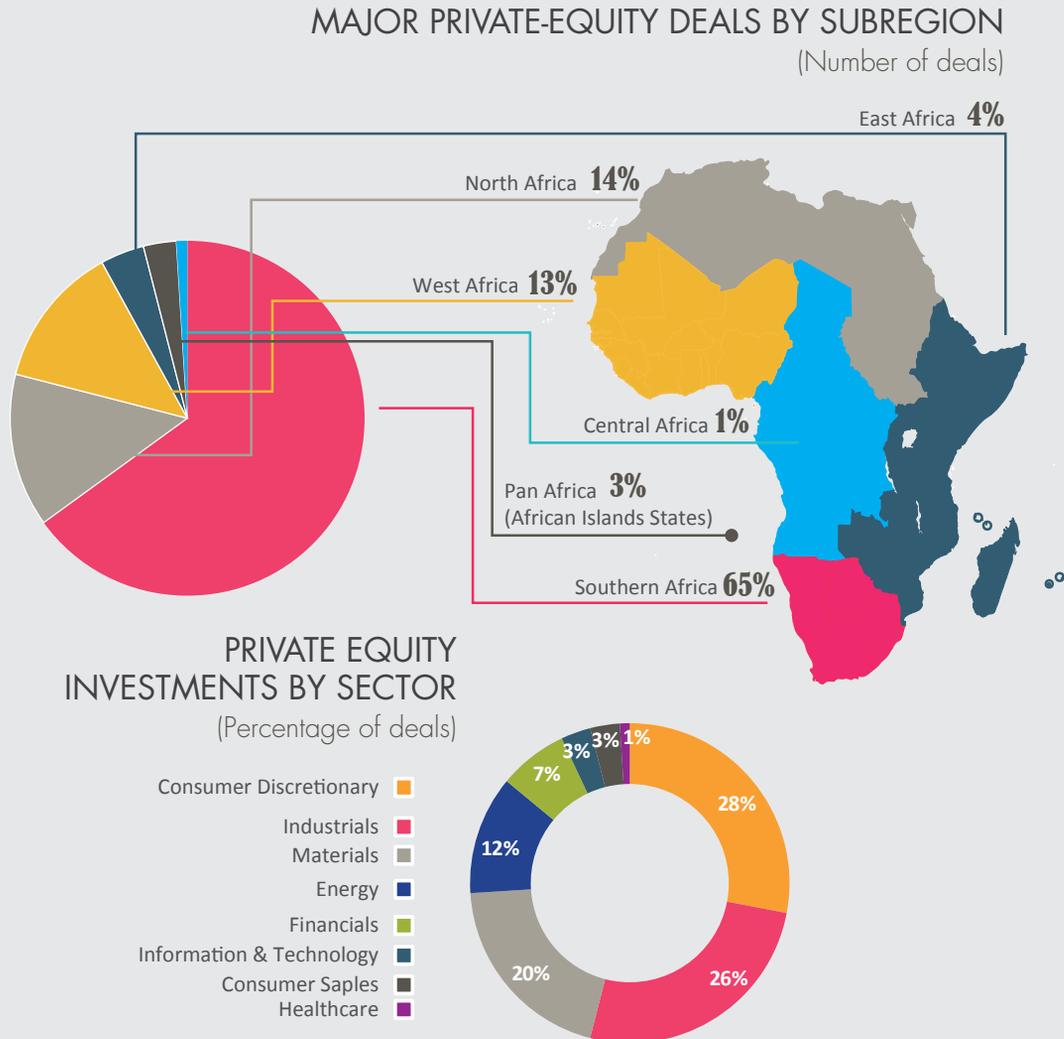
- » **Negative perceptions of some investors** abroad despite the positive narrative around Africa as the next frontier for investments
- » **Cost to serve:** the sheer physical size, the geopolitical fragmentation and the weak infrastructure in Africa continue to impact on the cost of doing business
- » **Fundraising:** Africa depends heavily on development finance institutions for investing in Africa-focused private-equity funds. There are 51 such institutions that are actively investing in Africa-focused funds, accounting for 9 per cent of the limited partners investing in the region. These institutions provided well over half the value of investment by limited partners. There is therefore more dependence on development finance institutions than on commercial funders.

Recently however, there has been an increase in the sources of new capital for general partners from the African diaspora, whose remittances play an important role in capital flows to the region. Also, in South Africa, a change in the Pension Fund Act in 2011 has allowed local pension funds to quadruple their private equity allocation to 10 per cent, bringing the allocation in line with more experienced public pension funds, such as those of the United States and Canada.

In addition to the limited sources of funding, private equity in Africa suffers from

<sup>25</sup> A sector of the economy comprising businesses selling non-essential goods and services.

**Figure 4.4** Private-equity deals in the Africa region



Source: RisCura (an authorized financial-services provider).

challenges related to reliable transparency and accountability by fund managers. It is crucial that development finance institutions and government development agencies should monitor the invested funds. In attracting investors, African general partners need to demonstrate credible measures through which the private equity industry can be monitored to build better accountability and transparency. Fund managers must demonstrate their vast experience, skills and consistency in portfolio returns. Another challenge is the lack of local investors in the private equity ecosystem. Foreign funders are always more comfortable when a fund management team is capable of attracting local money before raising funds from abroad. Outside South Africa, this is difficult, given the lack of a vibrant private equity ecosystem.

Deal flow in Africa is mainly proprietary and generated by the personal networks of the fund managers, given the lack of intermediaries. Nearly half of the deals are sourced through networks or relationships, while a third are identified through company and sector tracking. Just 14 per cent of deals are opportunities brought to the private equity firm<sup>26</sup>. About 80 per cent of the deals have a deal value below \$50 million and roughly 40 per cent of them currently are

done below \$5 million<sup>27</sup>. A major challenge is that most businesses are run by family entrepreneurs, who often still need to be educated about the benefits of private-equity funding as part of the pre-transaction courting process. That process also forms the mutual trust base for the relationship. On balance however, generating deal flow is not the biggest challenge faced by private equity houses in Africa.

Besides, not only is deal execution in Africa difficult because of geographic distances and lack of physical infrastructure, the weak and underdeveloped private equity ecosystem and existing legal and regulatory systems in most parts of the continent complicate matters. At the smaller end of the market, there are few value-adding intermediaries and other service providers, such as local investors and legal, accounting, banking and consulting institutions. The major effect of the lack of a professional ecosystem is that the cost of doing due diligence is high.

One of the less documented challenges faced by private equity in Africa is the issue of capital flow restrictions between African countries and the rest of the world. A number of countries are reluctant to open their financial systems for fear of abuse. To some extent, most of the financial systems are underdeveloped, making it difficult for

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<sup>26</sup> Once South African deals are removed from the figures, this falls to 11 per cent.

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<sup>27</sup> AVCA Africa Fund Manager Database as of July 2013.

the capital to flow. In some cases, private equity faces a big challenge from delays in paperwork and lengthy approval processes at the reserve banks before they can to move funds in and out.

Other challenges include high borrowing costs<sup>28</sup>, high taxation rates and insufficient numbers of experienced and proven African fund managers. There is also the lack of institutional platforms that enable private-equity players and Governments to engage in discussions on issues affecting the industry. Many countries and governments are generally not conversant with the private-equity industry and the scope of its operations in the country.

## Role of Governments

African Governments have a key role to play in promoting private equity as one of the major potential sources of investments for enhancing growth and development in their countries. Policymakers have a multitude of levers available to make Africa a preferred destination for private-equity capital (as opposed to the funds flowing to competing regions such as Asia and Latin America). Many of the levers are general housekeeping tasks aimed at enhancing the investment attractiveness of Africa. Some countries

have progressed better than others. Those that have progressed happen to be the ones that have attracted a greater share of private equity capital already. Areas for government intervention include the following:

### **Understanding private equity and its contribution to growth and development:**

Private equity by itself is not a driver of economic growth or enhancement, but can be a catalyst and accelerator for growth, provided there is significant positive momentum in an economy. The actual quantum of an additional positive impact on economic growth by private equity in Africa has not yet been quantitatively proven. The link is not certain between private equity and Governments' ultimate goal of sustainable growth and poverty reduction in Africa, as opposed to just increased private investment. The determining factors or framework under which this link would be certain have not yet been researched. It is thus too early to make factual statements on the impact and role of private equity in financing economic growth and prosperity on the continent. However, private equity in Africa could accelerate the desired economic growth and enhancement if it provides growth capital (not replacement capital) and adheres to the principles of responsible investing and to rigorous implementation of environmental, social and governance agendas.

<sup>28</sup> In some countries the cost of borrowing is as high as 40 per cent, which is not conducive for investment.

**Improving the legal and regulatory environment:** The private-equity industry needs policies and regulatory frameworks that foster its growth. Policymakers need to have deeper understanding of the industry in order to develop these policies. Most private-equity funds on the continent are registered in countries with good regulations, and flexibility in the free flow of funds. No player wants to set up a holding company in a country with fund transfer restrictions.

The regulatory environment in Africa has, in recent years, posed challenges to private-equity firms in raising capital in the region. Investment laws should be improved, making it easier for private-equity players to meet requirements. Furthermore, African investors cannot move around as easily as foreign investors, further deterring investment. Governments should enact policies that encourage local investors as much as foreign investors. In this regard, implementing protocols on the free movement of people and capital across the continent will be helpful for the private-equity industry.

**Building the talent pool:** Private equity is effective only when managers are prudent in using capital to grow businesses in a sustainable manner. In Africa, however, the industry is still new and the continent lacks adequate skilled and experienced fund managers. Governments should create the

enabling environment for Africa to attract and retain more talent in the form of skilled and experienced managers, specifically with operational experience, in order to make the industry grow.

**Creating awareness among key private-equity players:** There is limited knowledge about the industry in a number of countries, as well as very little or no engagement between private-equity industry players and regulators, resulting in communication gaps between them. Policymakers need to understand the issues affecting the industry, including political risk. There is, therefore, a need for greater engagement between policymakers and private-equity actors.

**Improving availability of funds for the private equity industry:** Finding adequate financial resources for the private-equity industry remains one of the major challenges in many African countries. This calls for an urgent need to explore how Governments could facilitate the flow of capital into private equity. Normally pension funds are restricted in what they can invest in for reasons of prudence, including even restrictions in investing in companies that are listed on stock markets. African Governments should find a way to ensure that these pension funds are invested in private equity, albeit wisely and responsibly. They are also encouraged to explore co-financing and co-sharing opportunities with

other private-equity investors, in sectors such as infrastructure financing (for example energy, telecommunications and water). The Ghana Venture Capital Trust Fund is a good example of such a public-private partnership initiative, partly financed by the Ministry of Finance and Economic Planning.

**Encouraging investment of local African capital into private equity:** Building up private equity in Africa entails accelerating development of the ecosystem and sourcing investments from local capital markets and funds. There is a need to improve the knowledge of local African investors through education, better understanding of the asset class, incentives and the regulatory framework. Significant sources of local capital (pension funds, family offices, sovereign funds, high net worth individuals, diaspora) can be tapped both for investing and exiting private equity assets.

**Encouraging more impact investments:** It is not easy to assess the impact of private equity on the welfare of people. Nevertheless a number of private-equity industries are, in one way or another, investing in projects that have an impact on people's lives. Adequate consideration should be given to investing in sectors that could positively change the lives of many people, while making decent returns for the investors. In this regard, Governments should provide special incentives for private-

equity firms to put their money into sectors such as agriculture, where the majority of the poor are actively involved.

## Recommendations

Africa's private equity industry has been gaining ground in recent years. By bringing cash rather than debt, private equity can help to deliver development capital. The following key policy recommendations are put forward as a synthesis of what Governments can do to support the industry. Many of these recommendations are also applicable to the private equity industry itself. The following policy recommendations are based on the analysis in this chapter:

### Improving availability of funds for the private equity industry

» As Africa continues to face the challenge of funding, governments must seek ways and means to facilitate the flow of capital into private equity. In many African countries, pension funds cannot be invested in companies that are not listed on a public securities exchange, and in some cases they are restricted in their listed investments. Governments should encourage the use of pension funds for private-equity investments in a responsible manner. Governments are also encouraged to explore co-financing and co-sharing opportunities with private-equity

investors, in areas such as infrastructure financing (energy, telecommunications and water).

- » Development finance institutions should be more involved in developing projects that are attractive to private-equity investors.

## Encouraging more impact investments

Impact investments, which have both direct and indirect effects on human enhancement (such as education, health, environment and jobs), are a necessary form of private equity. Investment in such sectors needs to be further encouraged, as this is one of the main priorities of many African Governments. To this end, Governments are urged to provide regulatory and other incentives to encourage more private equity investments in such areas.

- » Governments should also promote private equity to support national development efforts, while making decent returns on investments.

» Private-equity firms should be encouraged to put money into the agricultural sector, where the majority of the poor are actively involved, with emphasis on investments that help improve livelihoods sustainably for poor farmers. Investing in sectors such as agriculture can change the lives of many people. Furthermore, private-equity investments in small and medium enterprises, where most employments are created, can be very beneficial and should be strongly encouraged.

## Other enabling measures to enhance the role of Governments

» Enabling measures need to be specific to each country. Private equity is not exclusively driven by the size of an economy or opportunity. Some countries have policies that are friendlier to private equity-friendly than other countries. Governments need to maintain policies that allow them to foster growth. The macro, political and socioeconomic situations are the driver for an enabling environment.



Governments should therefore make the effort to implement and sustain strong macroeconomic reforms.

» There should be zero tolerance for anything that is improper. Governments must therefore address corruption and integrity issues to inspire investor confidence, as transparency and integrity are the foundation of any capital market.

» Governments should strengthen the bond and equity markets by introducing securities-lending, encouraging new listing requirements and supporting companies for listing and post-listing, especially as there are not many companies listed in sectors such as agriculture and oil and gas. Governments are also urged to open sectors such as telecommunications, banking and insurance services for investment, as these provide key opportunities for private-equity investors.

» African investors cannot move around as easily as foreign investors. This deters local investment. Governments should enact policies that encourage local

investors and foreign investors alike. In this regard, implementing protocols on the free movement of people and capital across the continent will be very beneficial.

» Furthermore, efforts to accelerate the achievement of the objectives of Africa's regional integration in areas such as trade facilitation and infrastructure networks can greatly boost the ecosystem for private equity and for investments in general.

## Fostering greater interaction between policymakers and private equity industry players

» There is very little engagement between private-equity industry players and regulators, resulting in communication gaps between them. There should be greater engagement between policymakers and private-equity actors. To this end, the private-equity industry should use its networks to engage more with Governments and regulators.



# CHAPTER 5

# **CLIMATE FINANCING:** IMPLICATIONS FOR AFRICA'S TRANSFORMATION

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## Introduction and background

To date, all global assessments have concurred that Africa is disproportionately affected by the impacts of climate change, despite its miniscule contribution (a mere 3.6 per cent of global emissions). The severity of Africa's vulnerability to climate change was further confirmed by the fifth Assessment Report of the Intergovernmental Panel on Climate Change. Indeed, the effects of climate change are already becoming evident in several subregions of Africa.

Currently, the continent is on a steady growth path, with a view to both structurally transforming its economies and enabling climate-resilient development. Climate financing offers Africa the opportunity to address climate change impacts directly, to expand the engagement of multiple actors, and to implement multiple actions. For example, it can help with the deployment and leveraging of new technologies for climate change adaptation and mitigation, as well as the opening up of new niche markets, including the carbon market. Climate finance has the ability to fast track the transition towards low-carbon and climate-resilient development, just as it can trigger the shift to renewable sources of energy in support of the transformation agenda towards a green and blue economy. Climate finance can catalyse such a transition and propel Africa

towards a new development trajectory. This would inevitably require a new business model that would engender mitigation and adaptation projects, and galvanize the private sector, drawing on the inherent corporate social responsibility, and on the business opportunities that can be reaped through such engagements. This chapter explores the benefits of climate finance for Africa's transformation agenda. It also seeks to unmask some of the vexing governance implications that are associated with climate finance. It discusses the Green Climate Fund and underlines both the opportunities and the constraints that are associated to its governance architecture. Lastly, it makes specific recommendations on how African countries can use current financial flows to catalyse and leverage new sources of finance in climate change adaptation and mitigation.

## Climate change implications for Africa: why Africa needs climate finance

Climate change is already having significant impacts on the continent and this is only going to get worse; it is essential that these impacts are managed. For instance, the Sahara and semi-arid parts of Southern Africa will likely

experience a temperature rise of as much as 1.6 degrees Celsius by 2050. This temperature increase is likely to lead to an increase in evapotranspiration of 5–10 per cent. Over the same period, precipitation in Southern Africa and parts of the Horn of Africa is projected to decline by about 10 per cent, although parts of Equatorial Africa and the Sahel could experience rainfall increases of 5 and 15 per cent respectively.

By 2050, sea levels are projected to rise by about 25 cm in coastal areas of Africa. Incidentally, most of the major and most densely populated cities in Africa, with the highest levels of economic activity, are along the coastline. Rising sea levels could have adverse consequences on crucial development sectors in Africa, including agriculture, transportation, water, tourism and energy infrastructure. Boko and others showed that agricultural production, food security and water resources in the continent would likely be severely compromised by climate change and variability. For example, about 75–250 million and 350–600 million people respectively will experience increased water stress and water scarcity by 2020 and 2050, which in turn will reduce water quality, increase water-borne diseases and, in some cases, create new conflicts and exacerbate existing ones, resulting in displacement and migration of communities. Climate change is acutely linked to food production and stable

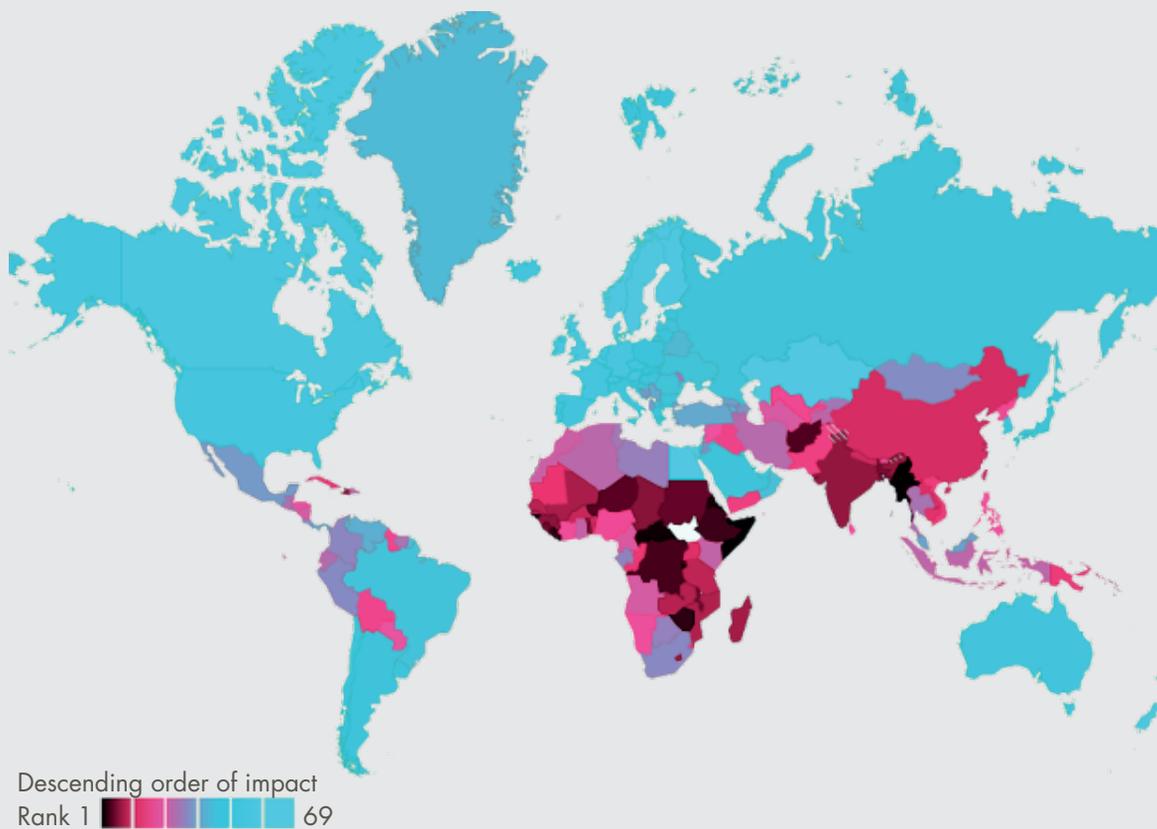
food systems. Climate-related perturbations will cause further disruptions to Africa's already weak food systems and cause further stress in both rural and urban areas. This makes climate finance a central component of Africa's future adaptation process, and it also reveals the fact that the current sources of finance are disproportionate to the amounts needed to address climate change impacts in East, West, Central and Southern Africa. Africa's most vulnerable people have been afforded little opportunity in the debate to offer insights on how climate finance will address their problems.

Climate change is no longer a problem of the future, but an issue of the present day as it exposes the current economic gains made in the continent and heightens current vulnerabilities in key productive sectors. Hence addressing climate change impacts is crucial in climate proofing national investments and aligning future development towards low-carbon and climate-resilient pathways. These require adaptation and mitigation measures, both of which entail new financial investments in sectors that are currently outside the scope of national budgeting priorities such as food security, health and education in most African countries.

Therefore, climate finance will be vital for the continent as it strives to manage the impacts

## Figure 5.1 Mapping the impacts of climate change

Overall Vulnerability: Physical Impacts Adjusted For Coping Ability (Extreme Weather, Sea Level Rise and Agricultural Productivity Loss)



Source: Center for Global Development. Available from [www.cgdev.org/page/mapping-impacts-climate-change](http://www.cgdev.org/page/mapping-impacts-climate-change).

of climate change. Figure 5.1 shows that Africa's vulnerability to climate change is ranked higher than any other region mainly because its coping capacity is much lower.

## Sources of climate finance

There are different types of climate finance flows, from both domestic and international sources (see figure 5.2). However, the focus here is on international climate finance flows and their role in safeguarding Africa's transformation.

### International and multilateral sources of finance

Dedicated global funds for climate intervention under the United Nations Framework Convention on Climate Change target both mitigation and adaptation. Examples of these include:

#### **Global Environment Facility, Least Developed Countries Fund and Special Climate Change Fund**

The Least Developed Countries Fund and the Special Climate Change Fund, which are operated by the Global Environment Facility, were established at the seventh session of the Conference of the Parties, in 2001, with a view to providing financial support to least developed countries to help them to tackle the effects of climate change. Out of the 49

least economically developed countries in the world, 35 (about 70 per cent) are in Africa.

#### **Adaptation Fund**

The Adaptation Fund was established in 2007 under the Kyoto Protocol by the parties to the United Nations Framework Convention on Climate Change. It is largely financed through a 2 per cent levy on revenue from the sale of certified emission reduction credits, and operates on a project-based approach, with project proposals being submitted by implementing entities to a central board.

#### **Green Climate Fund**

The Green Climate Fund is of great interest to Africa, as direct access arrangements might apply to countries eligible to receive Green Climate Fund funds. The Fund was established in 2010 to provide a significant proportion of the medium-term financing goal of \$100 billion a year by 2020, a target set by developed countries in 2009. As the Fund is mandated to spend 50 per cent of all its resources to help developing countries to adapt to climate change, and with half of this money reserved for the most vulnerable States, it will represent an important avenue for African States. The uniqueness of the Fund is that it will ensure the allocation of an equal share of climate funding to adaptation (50 per cent) as well as catalyse the paradigm shift towards low-carbon and climate-resilient development in recipient countries. The

Fund is intended to promote the principles of national ownership; however, there is still a great deal of ongoing debate on what modalities will apply and also the absence of mandatory assigned contributions for those countries with financing obligations under the Framework Convention.

While there have been recent pledges to revitalize the Fund as a demonstration of commitment by Annex 1 Parties, measures of continuous replenishment to ensure the sustainability of funding flows have yet to be put in place. Furthermore, there seems to be a shift in focus away from other funding mechanisms following the slow and low replenishment as attention builds on the Fund. If such a trend continues, it risks narrowing the base and options for climate finance mechanisms.

## Africa's climate finance needs

The current climate change finance architecture is tailored towards adaptation and mitigation, and grossly underestimates the cost of a comprehensive response to climate change impacts in Africa. The complexity of adapting to the current impacts and the dire need to make the transition towards low-carbon development while building resilience to the future impacts of climate change are highly underrepresented in current climate finance estimates. The

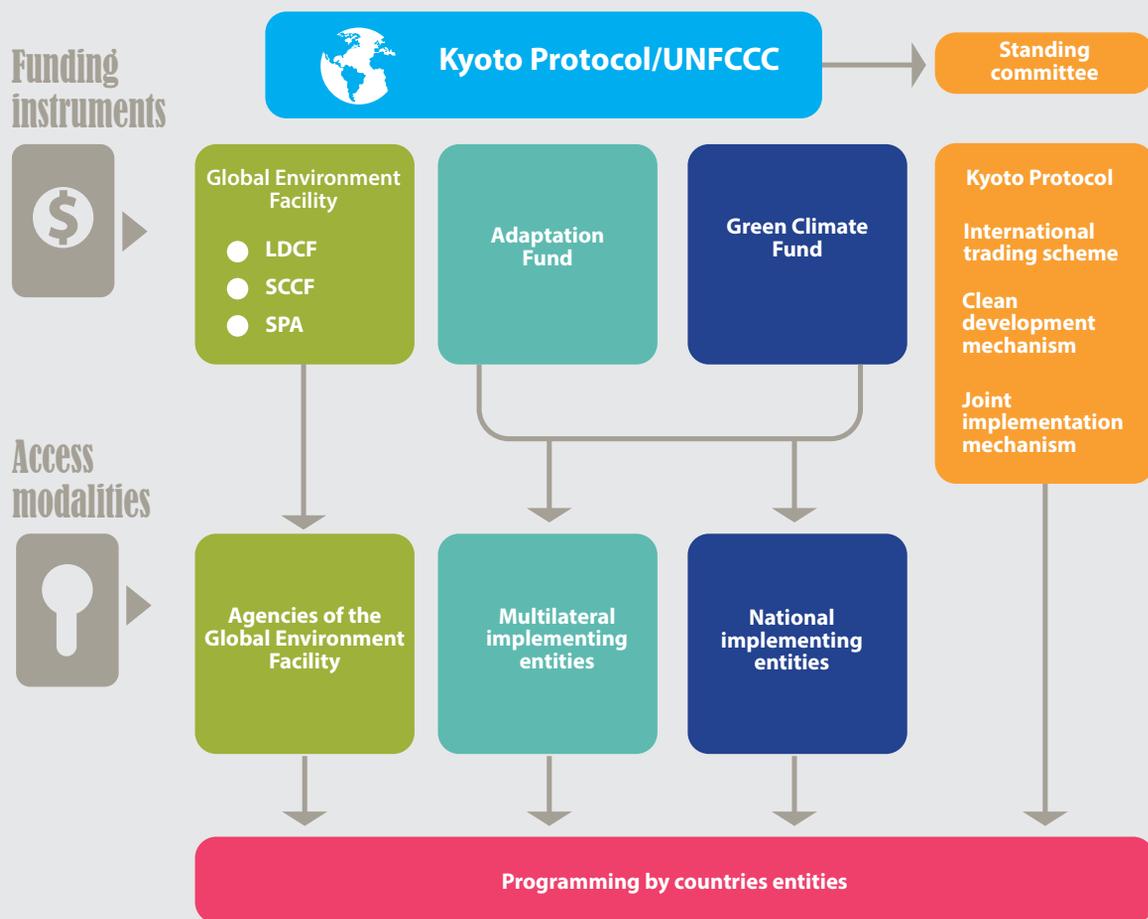
demand for climate financing for developing countries substantially exceeds existing financial flows from multilateral and bilateral financial sources. For instance, the African Development Bank has concluded that adaptation costs in Africa will be in the region of \$20–\$30 billion over the next 10–20 years, while the World Bank puts that figure at \$18 billion per year from 2010 to 2050. These funds are used to finance various activities such as forest conservation (REDD+), adaptation to climate change, technology transfer, reduction of greenhouse gas emissions and capacity development, without necessarily targeting the transitions required toward low-carbon intensive development. Furthermore, mobilizing funds will be a massive challenge because of the size of the amount, the complexity and the evolving nature of the current climate finance architecture (see figure 5.2).

## Climate financial flows and bottlenecks

At the moment there are different types of climate finance flows, from both domestic and international sources, that African countries can access (see figure 5.2). However, all these funds remain elusive for various reasons including insufficient institutional arrangements and lack of information, transparency and predictability on the part

# Figure 5.2

Multilateral sources of climate finance

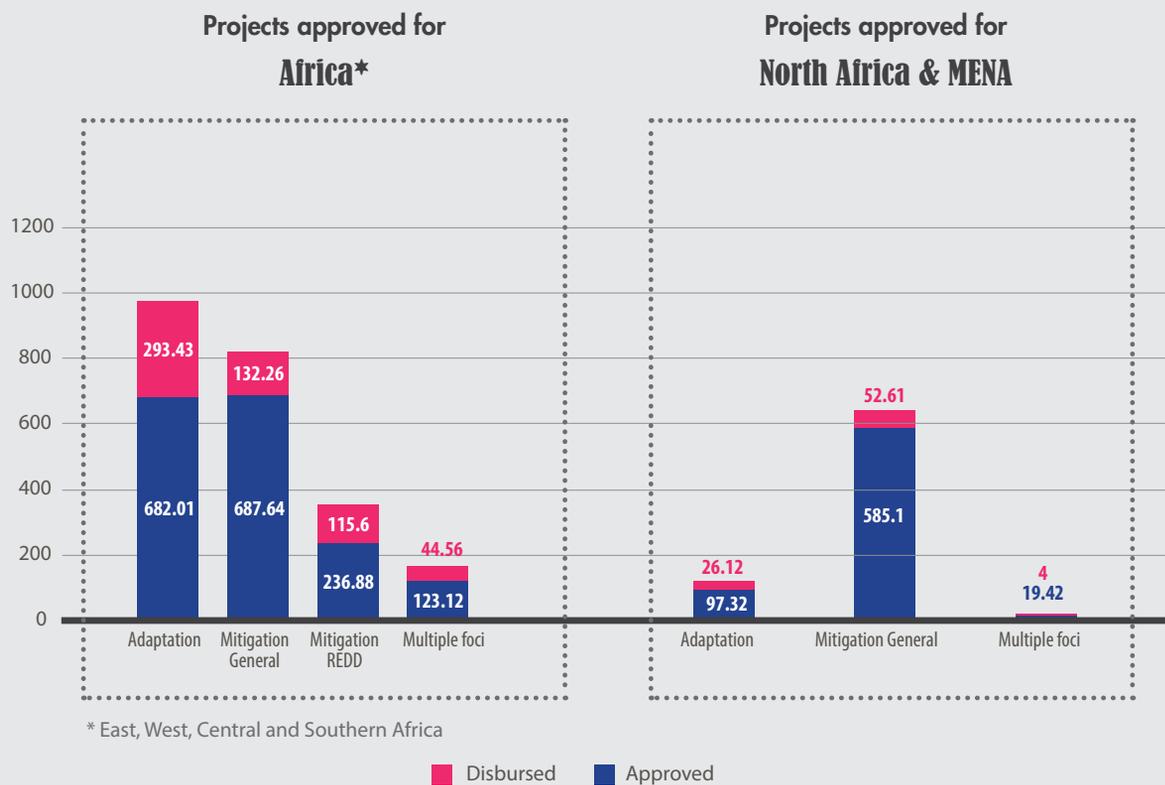


Source: ECA, 2014.

of development partners contributing to climate finance. Furthermore, the complexity in access modalities of some these funds constitutes a major bottleneck that requires special preparedness by countries for access. For instance, only two countries in Africa (Rwanda and Senegal) have successfully applied for non-programmer funding from the Adaptation Fund. They represent two National Implementing Entities (NIE) out of over ten countries that have NIE status in the region. Even with approved funds, disbursement modalities and the cycle of disbursement constitute major constraints to project implementation.

At present global climate funds from both multilateral and bilateral sources overwhelmingly lean towards emissions reductions, which benefit just a handful of large emerging economies with increasing greenhouse gas emissions such as China, South Africa, India and Brazil. According to the Climate Funds Update, since 2003, only about 17 per cent of all funds approved have been allocated for adaptation measures, which is a greater climate change response priority for Africa.

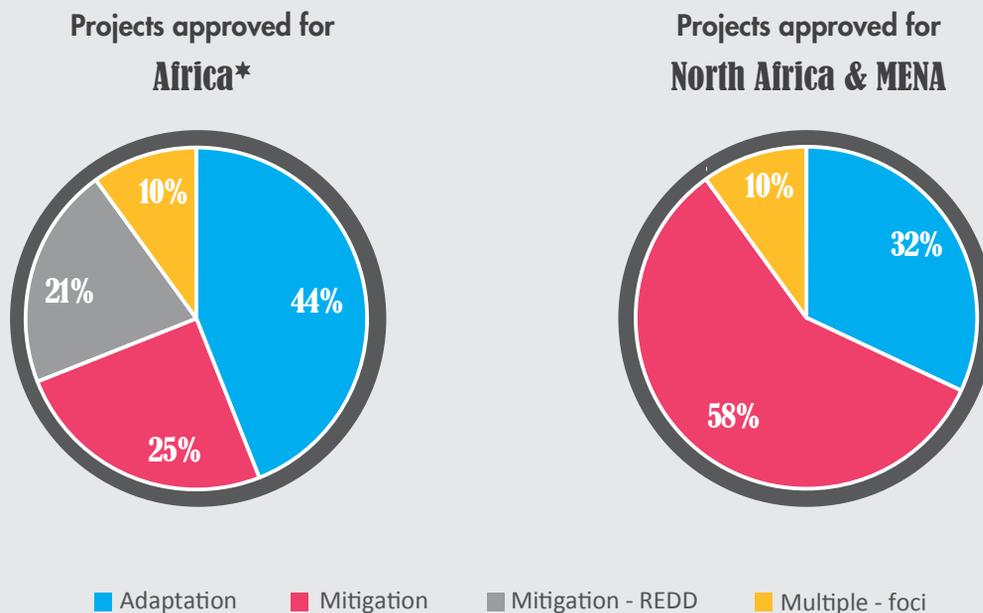
**Figure 5.3** Approved and disbursed funding for Africa and the Middle East, 2013 (USD millions)



Source: Climate Funds Update, November 2013.

# Figure 5.4

Projects approved for Africa and the Middle East 2013 (Percentage)



\* East, West, Central and Southern Africa

Source: Climate Funds Update, November 2013.

## Present distribution of disbursed funds in Africa

In terms of actual investment, of all the funding disbursed so far from all sources (including the Least Developed Countries Fund, the Pilot Programme for Climate Resilience, the Global Climate Change Alliance and the Special Climate Change Fund), which amounts to \$395 million, 44 per cent has gone to East, West, Central and Southern Africa. More specifically, of all the funds allocated for the implementation of national adaptation programmes of action, 56 per cent of approved funding from the Least Developed Countries Fund (\$222 million) and 26 per cent of funding from the Special Climate Change Fund (\$50 million) have gone to East, West, Central and Southern Africa.

According to the World Bank's 2013 findings, less than one third of adaptation and mitigation funding approved for spending in Africa was disbursed (see figure 5.3). Climate Funds Update, an independent website that provides information on international climate finance initiatives, states that a significant percentage of climate finance in East, West, Central and Southern Africa is directed towards mitigation activities, despite the fact that adaptation should be given funding priority because of the high vulnerability of

many countries in East, West, Central and Southern Africa (see figure 5.4).

Another challenging aspect of climate finance for Africa is the current unevenness in disbursement and allocation of climate funds. For example, South Africa ranks the highest in terms of approved funds, with about \$500 million (see figure 5.5), followed by the Democratic Republic of the Congo, with just below \$200 million, even though these two countries rank ninetieth and tenth respectively in terms of their overall vulnerability, according to the Center for Global Development (see figure 5.1). This shows a clear inverse relationship between the top two recipients in East, West, Central and Southern Africa in terms of their vulnerability profile. This challenge should not be underestimated as it demonstrates that disbursements of funds are not based on a country's risk profile or coping ability, but instead depend on each country's ability to mobilize resources.

Between 2003 and 2014 an average of \$5millionperyearperprojectwasapproved(see figure 2.2) This is a far cry from the estimated annual requirement for climate change response and adaptation in Africa as proposed by the African Development Bank and the World Bank (\$18 million per year from 2010 to 2050).

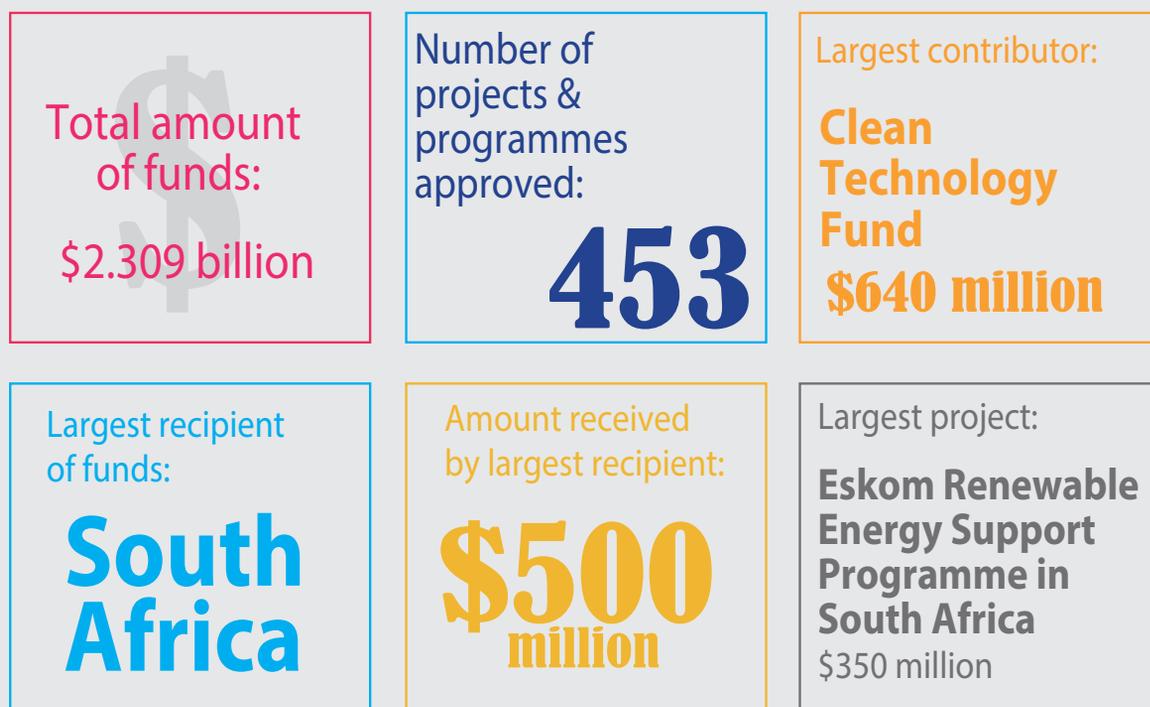
Africa must be able to develop cross-cutting measures to provide new and better financial flows as well as set out an agenda that is relevant to its development. However, at the moment African countries are facing insurmountable obstacles in accessing these funds. Some of the key challenges for all the funds are:

- » The current design of climate funds fails to target the most critical groups, especially in Africa, and address their adaptation needs. Some of the conditions and modalities of international climate funds tend to limit access to funds that are necessary to fully address climate change impacts.
- » There is a serious problem of adequacy and predictability. The funding available is not commensurate with the huge needs for adaptation or mitigation in Africa. In addition to the gap between availability of funds and current needs on the ground, there is the issue of predictability. It remains unclear where new funds will come from and how frequently these new sources will replenish as current sources of funds dry up.
- » Capacity. One of the difficulties is that access is related to accreditation of national institutions as national implementing entities that can demonstrate strong capabilities in generating bankable proposals. Such capacity is generally lacking on the continent.
- » Governance of climate funds. The management of climate funds will imply reconciling different needs, interests, and stakes in a way that does not compromise both intra-generational and intergenerational equity. The issue of scale and scope of investment spatially and temporally becomes the crux of the challenge. Without a sustainable and predictable flow of climate finance over time, countries will be incapable of achieving an optimal level of climate change response across sectors and sections of the population.
- » Another governance constraint relates to functioning and effectiveness of the global climate institutional mechanisms. Different agreements during various Conferences of the Parties to the Framework Convention have demonstrated the weaknesses of the negotiations process and shown it to be painfully slow. There is a clear need to expedite the pace of negotiations and reduce associated transaction costs.

## Innovative financing mechanisms to scale up climate change actions in Africa

Following the current impasse regarding the fulfillment of the climate finance pledges made by developed countries, it is important for Africa to develop more

**Figure 5.5** Monetary disbursement trends in East, West, Central and Southern Africa for the period 2003 to 2014 (USD)



Source: Climate Funds Update, December 2014.

creative and innovative ways of generating funds from both domestic and external sources, at a scale and pace sufficient to match the impacts of climate change and the consequent adaptation needs. The Overseas Development Institute reported that pledges for climate funds were 71 per cent lower in 2013 than 2012. Therefore, innovative financing mechanisms could be used to ramp up climate change activities and investment in Africa.

However, sustained innovation will require strategic planning and enhanced climate finance readiness. Remodelling the current climate financing landscape in Africa will be critical, especially with the emergence of new donors on the South-South axis, including the BRICS countries. Therefore, as “owners of the burden and owners of the solutions”, it is important for Africa to actively contribute to new and innovative financial mechanisms and to seek ways to overcome inefficiencies and other constraints of existing financing systems. Such mechanisms will include innovations in domestic public financing, international sources, the private sector, grants and concessionary loans, adaptation levy and bond systems, and leveraging African and diaspora philanthropy.

## Domestic sources

Climate change is of national significance to all African countries. As a result, domestic sources of financing should also be in the mix of mechanisms driving climate finance. In response, countries have started channelling domestic revenue to support climate related expenditure – a trend that is likely to increase due to efforts targeted at tax reform across Africa. For instance, in Ethiopia, in the budget year 2011/12 an estimated 9.970 million birr (1.8 per cent of GDP) was allocated to cover climate relevant expenditure. Some areas to consider for domestic sources include:

### National budgetary processes

Following the elaboration of climate public expenditure and institutional reviews by some African countries, it is possible to view national spending on climate-related activities. Building on this, it is important for countries to fully integrate climate change into their national budgetary processes, whereby a portion of the budget is directly allocated to climate change actions. Having budgetary provisions for climate change is crucial to scaling up actions and ensuring their sustainability, and results in better returns on investment. This approach also ensures that climate investment is aligned with national development priorities and strategic goals.

## Budgetary support

Development assistance (regional and bilateral) received by many African countries includes top-ups and budgetary support for both investment and recurrent expenditures. Such financial assistance constitutes a large percentage of national budgets for some countries. Integrating climate change considerations to climate-proof ODA will constitute a compelling case in structuring climate funding support towards investments that build resilience. This is particularly crucial with investments in infrastructure, agriculture and water systems. Addressing climate change in such sectors, where development assistance is growing rapidly, could be beneficial to countries. By using these approaches, it will be possible to increase climate-dedicated funds for key sectors as well as top-up funds for climate actions.

## International sources

Some of the decisions emanating from the Conferences of the Parties to the Framework Convention have the potential to encourage the development of innovative sources of financing for addressing climate change, and Africa should review and capitalize on some of these, including nationally appropriate mitigation actions and non-market-based mechanisms. Africa must also seek ways of increasing its share of clean development

mechanism activities and entering the carbon-trading marketplace.

## Private sector

The private sector is already an important source of climate finance through capital markets. At present the focus is on mitigation, but there are also emerging opportunities with regard to adaptation. These include debt and equity through direct project lending, and credit lines to local financial institutions. Microfinance and micro-insurance products aimed at poor communities are already being piloted in various African countries.

## Grants and concessionary loans

Many multilateral banks such as climate investment funds are beginning to provide concessionary loans as part of grant packages for climate-resilient investments. While it could be argued that African developing countries should not be addressing climate change using loans, this is nevertheless an important funding stream that needs to be reviewed and explored.

## Adopting synergistic approaches in targeting multilateral funds

The disproportionate allocation of climate finance in favour of mitigation efforts, as opposed to adaptation measures, is unlikely to change since they have different drivers. Africa therefore needs to institutionalize

a synergistic approach to mobilizing climate finance for joint implementation of adaptation and mitigation, especially for REDD+. For instance, safeguard mechanisms currently under discussion as an integral part of REDD+ should include adaptation measures.

## Adaptation levy and bond systems

Extractive industries, which drive economic growth in Africa, offer opportunities for innovative climate financing through corporate social responsibility schemes. Like the Caribbean region, Africa should consider establishing a bond system to shield its economic growth from climate change disasters. It should also consider instituting adaptation levies on the huge volume of extractive resources that leave the continent for markets overseas – not in the form of royalties, but as part of a collective responsibility to address climate change on the continent.

The European Union's airline carbon tax might not be appealing to developing countries, but it is considered vital for addressing climate change in Europe. The United States has also put in place a pollution tax, and many other regions are also going in that direction. If Africa were to push for an adaptation levy on its natural resources (e.g. for every tree felled for timber in the Congo basin or for every barrel of crude oil

exported), it would easily gain international support in the light of the global recognition of the continent's extreme vulnerability and its need for adequate resources to respond to the challenge.

## Capitalizing on the African diaspora and philanthropists

Awareness of climate change should be raised among African philanthropists and the diaspora. This is critical for bridging external funding and building sustainability. The current lack of capacity and appropriately trained human resources in certain African countries could be easily overcome by establishing viable and functional connections with the African Diaspora, the importance of which has already been demonstrated by the volume of remittances which constitute a significant share of foreign exchange earnings for African countries.

## Way forward: optimization of climate finance effectiveness in Africa

Climate finance is a critical component not only to combat climate change impacts, but also to ensure that Africa remains on its current economic and transformational growth trajectory. Climate change puts to test Africa's coping capacity for which,

climate finance consequently plays a critical role. As such, the following considerations and actions are recommended:

» Demystifying climate change finance is crucial to allow for business opportunities to flourish and enable different stakeholders to own the responsibility for burden sharing. As 'owners of the burden and owner of the solutions', it is important to identify where Africa can actively contribute to the solution instead of being just a passive recipient of climate funds.

» The current Africa rising narrative can trigger greater confidence that will generate the capabilities of the people, their vision and plentiful human and natural resources in managing the risks.

» Increasingly, there is a mindset and an urge to wean the continent out of the current dependence on international sources of climate funds such as ODA, FDI etc. and replacing these with creative management of African natural resources. For instance, in Nigeria crude oil transporters are promoting green investment in offsetting their carbon footprint, while legislation banning tree cutting has triggered the expansion of REDD+ activities in Rivers State. Both the significance and actual contributions of these types of initiatives should be deliberately promoted for scale out in other African countries.

» The channelling of climate funds to end-user groups such as smallholder farmers

is critically important to achieving the desirable impact of reducing vulnerability in the agricultural sector which employs a majority of Africa's labour force (~70 per cent), and contributes about 30 per cent to the GDP of most African countries.

» Young people need to be in the solution space for climate change in Africa. Capitalizing on the current youth demographic dividend that Africa enjoys opens multiple windows of opportunities for tapping into this important clientele group in the interest of intergenerational equity. Young people have an important role to play in scaling up the climate change response as an important clientele group for climate finance.

» Re-branding the agricultural sector to make it more attractive to African youths can incentivize them to take up career opportunities in the sector, and thus, contribute toward addressing youth unemployment which currently stands at about 40 per cent in the region. Climate finance investment in the agricultural commodity value chain can innovatively open up the base for youth workforce absorption with the potential of curbing rural-urban migration, and even the brain drain to industrialized countries.

» Research has an important role to play in informing and shaping climate change responses. It is important to ensure that research is at the heart of the solution. Using a nexus approach, especially for

agriculture, has the potential to expand the response needed to address climate change across different systems and certainly would yield multiple benefits.

» The private sector cannot be a passive onlooker of the process of climate finance. Hence, there is crucial need to rethink all the possibilities inherent in the development of public – private partnerships for the optimal engagement of the private sector in the mobilizing climate finance.

» Re-designing the business model for climate change response is crucial for

Africa. This will enable synergies between adaptation and mitigation response actions. From a climate financing perspective, the long term adaptation solutions for Africa might well be in mitigation efforts in the continent. Mitigation offers great opportunities for the transition towards a green economy as Africa turns towards renewable energy sources, smart agriculture and other forms of low-carbon development.

» Building the capacity of people and institutions is fundamental to expanding



Africa's climate finance mobilization potential. Partnering with researchers and academics can significantly enhance the development of competitive grant proposals. Financing literacy of the public is important in determining how risks could be managed using climate finance.

» Information is critical for the enhancement of public understanding about different sources of climate financing, modalities of access and training to write bankable proposals.

» There is a strong resonance for home-grown climate financing, such as pension funds, national budgetary processes, bonds and levies, in taking ownership of the African climate response as international funds increasingly become unstable, unpredictable and incoherent with Africa's development agenda.

» Corporate social responsibility represents another window for domestic funding as well as developing the social entrepreneurial capacity of young people.



# CHAPTER 6

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# NEW FORMS OF PARTNERSHIPS AND INNOVATIVE SOURCES OF FINANCING AFRICA'S TRANSFORMATION

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David Luke*

## Introduction

Since the late 1990s Africa has benefited from a fairly long-lived period of economic boom and a significant number of countries in the region witnessed growth accelerations. Such trend has been so pronounced that the continent's gross domestic product has doubled in real terms between 1995 and 2012, from \$656 billion (in 2005 dollars) to \$1,369 billion. Gross domestic product per capita conversely increased by 40 per cent over the same period, from \$917 to \$1,265 at 2005 prices and exchange rates<sup>29</sup>. Despite this remarkable performance, Africa's transformation continues to remain rather elusive. Growth has been largely underpinned by the sustained expansion of extractive industries and the services sector. With few exceptions it has almost by-passed agriculture and even more so manufacturing (AUC and ECA, 2013). Over the period 1995-2012 as many as 38 African countries have witnessed premature de-industrialization, as evidenced by a decline in the manufacturing share of value added. Simultaneously, the notable expansion of export revenues has mainly stemmed from price effects and has been accompanied by an increase in the already heightened concentration on primary products ('Ofa and others, 2012).

This pattern of structural change, in turn, made it harder for the large number of people seeking jobs outside the agricultural sector to find adequate productive employment as a way to exit extreme poverty. For this reason, structural transformation and inclusive growth lie at the core of the Common African Position on the post-2015 Development Agenda<sup>30</sup>.

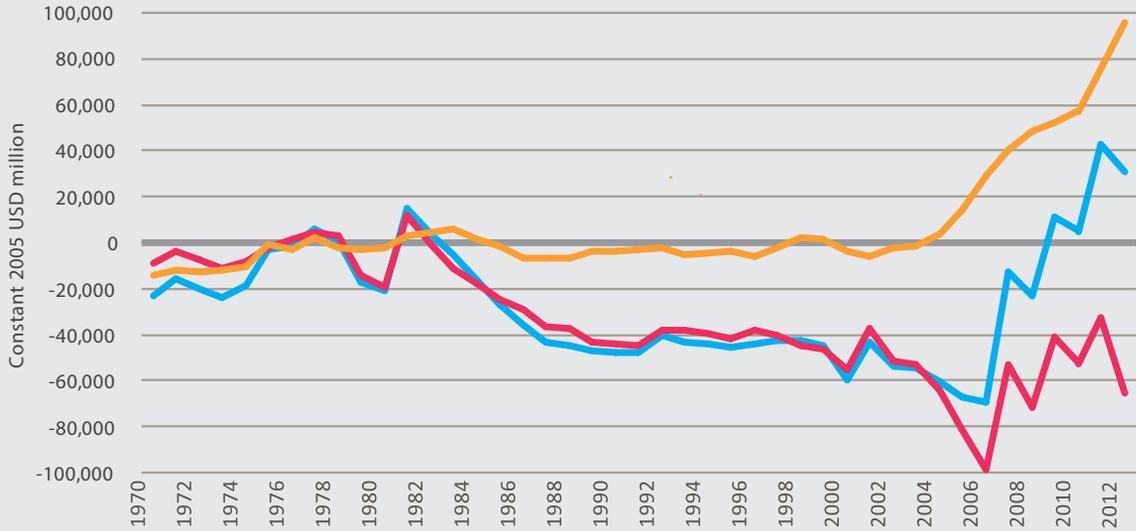
The financing implications of this state of affairs are clear, even though in principle resumed growth and improved fundamentals should strengthen domestic resource mobilization. Investment has climbed up only gently as a share of gross domestic product (from 17 per cent in the year 2000, to 21 per cent in 2012), but the quest for development finance remains a crucial challenge over the medium term, particularly in view of the region's infrastructural and technological gap<sup>31</sup>. National accounting data show that Africa's growth acceleration has been accompanied by a heightened reliance on foreign savings to finance investments, with the resource

<sup>29</sup> Data drawn from UNCTADstat database, consulted on 18 June 2014.

<sup>30</sup> In the same vein, Valensisi and Gauci (2013) show, based on historical employment elasticities of growth, that even if the 7 per cent growth target of the Istanbul Programme of Action were achieved, "a number of least developed countries may not be in a position to productively employ all the new entrants in the labour market, unless their pattern of growth shifts towards more diversified employment-intensive sectors."

<sup>31</sup> For instance, Foster and others (2010) estimate that, even when taking into account potential efficiency gains, Africa would still face an infrastructure funding gap of \$31 billion per year, mainly in power.

**Figure 6.1** Resource gap in Africa, 1970-2012 (USD millions)



Top 5 oil exporters (in decreasing order): Nigeria, Algeria, Angola, Libya, Equatorial Guinea

— All Africa    — Top 5 oil exporters    — Rest of Africa

Source: UNCTADstat.

gap accounting nowadays for approximately \$40 billion<sup>32</sup>. External financing proved to be even more critical for non-oil-exporters, to the extent that their resource gap totalled as much as \$100 billion, as evident from Figure 6.1.

Against this backdrop, financing Africa's transformation will require huge efforts to improve the performance of existing sources of development finance, while simultaneously exploring innovative mechanisms for financing development (UNDESA, 2012). This in turn will necessitate "the consolidation of existing partnerships and the forging of new ones", as explicitly recognized in the Common African Position on the post-2015 Development Agenda (AUC, 2014). The ensuing sections elaborate on this point, highlighting some key elements of these renewed development partnerships.

## Lessons from the global partnership for development (Millennium Development Goal 8)

Innovative forms of international partnerships should build upon past lessons, including notably that, although the Millennium Development Goals have successfully mobilized the international community around measurable and time-bound development objectives, given current trends the global partnership for development is set to be a largely "unfinished business" by 2015. Three patent limitations of the current international development architecture should shape the re-thinking of the development partnerships:

The inability of the traditional donor-recipient logic to promote mutual accountability, to enable an authentic ownership of the development agenda and to deliver on the promises of Millennium Development Goal 8, especially regarding the target of raising official development assistance to 0.7 per cent of gross national income.<sup>33</sup>

32 The resource gap is defined as the difference between gross fixed capital formation and gross domestic savings.

33 Despite a significant increase in the volume of aid over the last decade, most donors have not been capable of delivering on the 0.7 per cent aid target, on the 0.15 per cent-0.20 per cent target for least-developed countries, or on the Gleanegles G8 commitments towards Africa. As a matter of fact, in 2011 aid

The failure to redress the imbalances of the existing multilateral trade and financial systems, with no end in sight for the trade negotiations of the Doha Development Round, and only a limited number of successful initiatives in the financial sphere (notably debt relief)

The limitations of the existing partnership in dealing with global challenges, such as climate change or financial stability, which intrinsically call for the application of the principle of common but differentiated responsibilities.

## Adapting to the evolving reality

In addition to addressing the above concerns, looking ahead at the post-2015 development architecture, it is crucial that the new forms of partnerships be able to capture the emerging nuances of the global economy.

First and foremost, new partnerships should be consistent with the ongoing rebalancing of geopolitical and economic weight in favour of developing countries. In this sense,

a fair and development-oriented reform of the multilateral trade and financial architecture can only warrant a greater attention to the development dimension, and a stronger voice for the developing world in key for a (for instance the long-standing issue of International Monetary Fund's voting and quota system). At the same time, accounting for the systemic relevance of South-South economic relations is critical not only at a multilateral level, but also to harness the new opportunities strategically, and avoid the challenges that can result from the above trends. In the case of Africa, for instance, developing countries now account for as much as 43 per cent of the continent's exports and 50 per cent of its imports, up from 26 per cent and 33 per cent respectively only 15 years earlier.<sup>34</sup> Brazil, China and India represent the most notable cases in point, but are not the only examples. Africa's trade and investment relations with countries such as Turkey, South Korea, Saudi Arabia, Malaysia, and Indonesia have also intensified at a rapid pace over the last decade.

The implications of intensifying South-South trade on Africa's structural-transformation agenda have so far been mixed (ECA, 2013, and UNCTAD, 2010 and 2011, amongst others). African economies have benefited

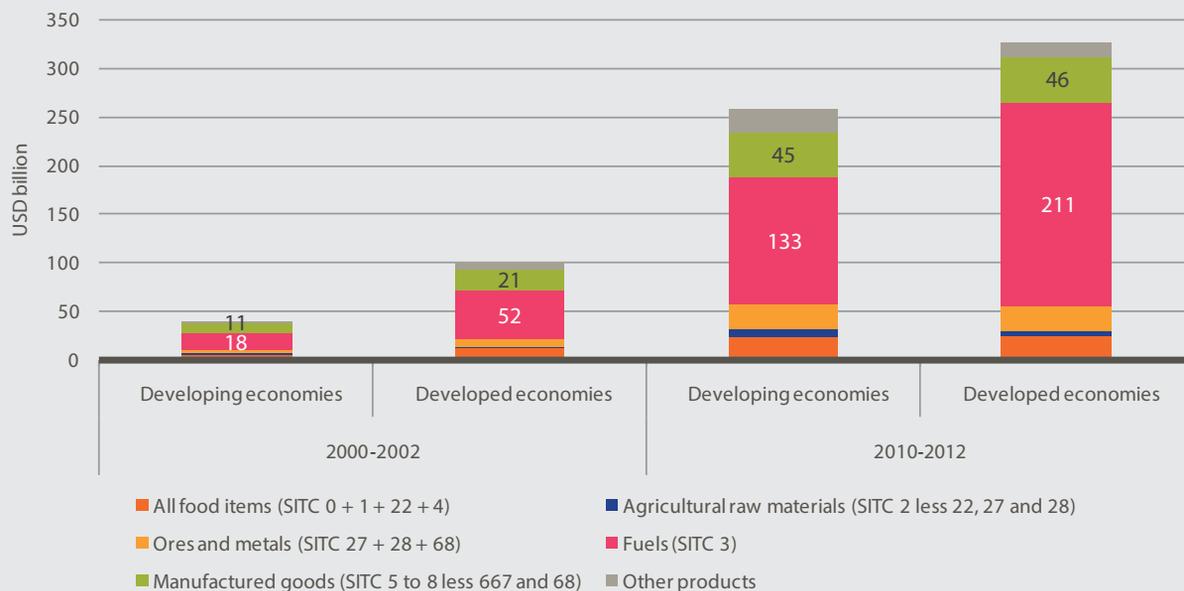
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commitments by Development Assistance Committee (DAC) donors accounted for 0.31 per cent of their gross national incomes, and only 5 committee members had already met the 0.7 per cent target: Denmark, Luxembourg, Netherlands, Norway and Sweden. Similarly, in the same year official development assistance provided by DAC donors to least-developed countries reached 0.11 per cent of their own gross domestic product, and only Belgium, Denmark, Finland, Ireland, Luxembourg, Netherlands, Norway, Sweden, and UK met the 0.15 per cent/0.20 per cent target (UN, 2012).

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34 Estimates are based on data extracted from UNCTADstat database, consulted on 20 June 2014, and refer to the 3-year averages for 1995-1997 and 2010-2012.

**Figure 6.2** Africa's exports to developed and developing countries, by main product, 2000-2002 and 2010-2012 (USD billions)



Source: UNCTADstat

from the boost in international demand for exports and from greater availability of cheap manufactured imports. Moreover, the dynamism of many Southern economies, especially vis-à-vis the “secular stagnation” of developed countries, could to some extent serve as a springboard for Africa to foster structural transformation. However, many African countries also face heightened competition in labour-intensive manufacturing and risk that their commodity dependence will be locked in by the emerging international division of labour. In this respect, for instance, it is sobering to note that fuels accounted for half of Africa's exports to developing economies (\$133 billion out of total exports of \$259 billion) in 2010-2012. Conversely, even though manufacturing exports to southern markets have increased remarkably, from an average of \$11 billion in 2000-2002 to \$45 billion ten years later, in relative terms their weight in Africa's total exports to developing countries has fallen by 10 per cent (see figure 6.2). These figures reveal that the boom of Africa's trade with Southern partners has so far only weakly stimulated economic diversification and, in terms of specialization pattern, is only slightly more diversified than Africa's trade with developed economies. Yet, it could be argued that there is still a large untapped scope for Africa to engage Southern trade partners strategically in a way that is more conducive to structural transformation,

eschewing the so-called “primary commodity trap”, and avoiding a “race-to-the-bottom” to attract foreign investment.

Secondly, the renewed partnership for development should pay greater attention to the regional dimension, and in particular to the enormous relevance that regional integration plays for Africa's own transformation prospects, as long recognized by Pan-African thinking. Though still limited to roughly 10-12 per cent of total (officially recorded) exports, intra-African trade is considerably more diversified than Africa's exports to the rest of the world. Manufactured goods, specifically, accounted for 40 per cent of total intra-African goods trade in 2010-2012, but only 13 per cent of that with the rest of the world<sup>35</sup> (see figure 6.3). Despite this, the share of intra-industry trade and trade in intermediate products in the regional market is still limited, implying that regional production networks are only incipient and still shallow. Notably, African economies source as much as 88 per cent of their imported intermediates from outside the continent, in striking contrast to East Asian economies, where a vibrant intra-regional trade in intermediates has risen.

Beyond intra-African trade, the scope for regional-transformative initiatives is equally

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<sup>35</sup> Put differently, one third of Africa's exports of manufactures is sold within the continent.

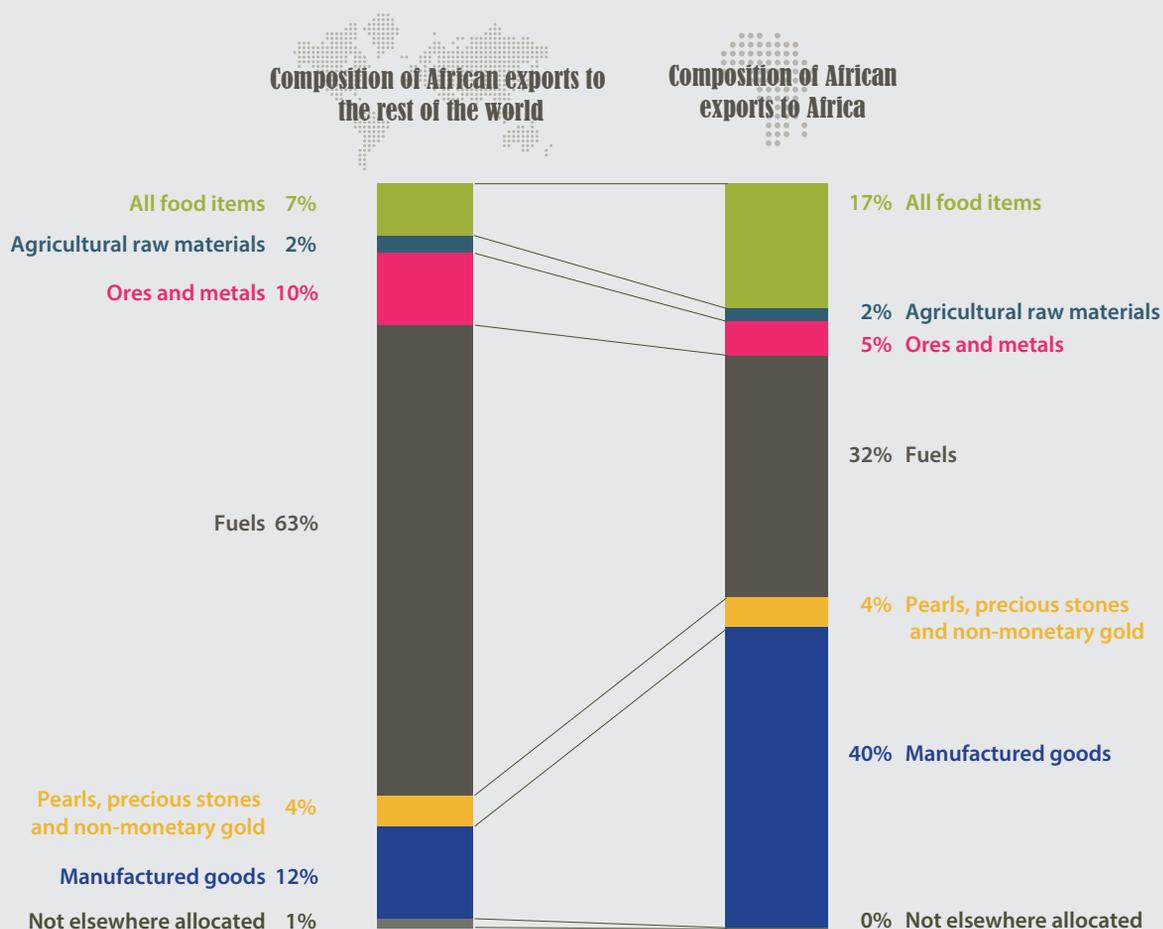
evident with regards to a range of other issues, from infrastructural investments and development of corridors, to cross-border cooperation towards mobilizing development finance. Regional strategies and close policy coordination may also play a promising role in forging strategic partnerships with large developing countries, which typically have a continental strategy towards Africa.

Thirdly, the new partnerships should account for the increasing complexity of the evolving development-finance landscape, which witnessed the emergence of new actors, such as southern development partners and private philanthropic foundations, and of innovative aid modalities (for instance debt-conversion mechanisms) alongside the traditional donors. This evolution could contribute to partly cushioning the ongoing decline in traditional official development assistance (UN, 2013), with traditional donor countries coming under increased pressure to cut aid budgets and ensure “value for money”. Beyond the mere availability of official flows, the new features of the development-finance landscape open the opportunity to leverage the synergies and complementarities across partners. Partnerships among countries from the global South tend to be characterized by distinct features and modalities compared to traditional partnerships with developed countries. This opens a wide scope for strategically harnessing the

complementarities between South-South and North-South cooperation, a scope which is still largely untapped. For example, it has been noted that traditional donors still tend to allocate the bulk of their aid budget to social sectors but southern development partners focus rather on infrastructural provision and productive sectors.

Fourthly, in the spirit of the Rio principle of “common but differentiated responsibilities”, new partnerships should be conducive to the sustainable management of global commons, including: environment, land and maritime ecosystems; global health; peace and security; and fair, predictable, non-discriminatory and rule-based multilateral trading and financial systems (compare this to AUC, 2014). Looking ahead at the post-2015 development agenda, new partnerships should also be capable of addressing emerging development challenges, which did not feature as prominently 15 years ago when the millennium development goals framework was conceived. Notable examples of emerging development challenges are issues such as climate-change adaptation and mitigation, prevention of natural disasters, and financial markets increasingly driving commodity prices and bringing related volatility.

**Figure 6.3** Composition of Africa's exports by destination, 2010-2012 (Percentage)



Source: ECA and AUC (2014)

## New partnerships and Africa's priorities

This final section highlights some of the key area of interest for Africa, indicating where renewed partnerships offer promising scope for supporting Africa's transformative agenda. For the sake of clarity, priority areas are grouped into three main topics: trade, South-South cooperation and new partnerships for development finance.

Starting with trade, regional integration certainly deserves a pivotal place in Africa's transformative agenda, and this recognition should also shape Africa's strategic positioning vis-à-vis bilateral and multilateral negotiations outside the continent. The establishment of the Continental Free Trade Area, in line with the decisions taken by the African Union in January 2012, could double the share of intra-African trade, and stimulate the emergence of a more sophisticated trade pattern (Mevel and Karingi, 2012). As such, it should represent the key policy priority over the medium term. This implies addressing a number of diverse policy and institutional issues, ranging from the reduction in tariff to the reduction of technical and administrative barriers to trade. Work must be done not only at the level of each regional economic community, but also – and perhaps more

importantly – across them (Valensisi, Lisinge and Karingi, 2014).

Beyond the regional market, the sustained increase of labour costs in some of the world's manufacturing power-houses (notably China) could create the opportunity for Africa's expanding labour force to engage in more sophisticated activities, thereby supporting industrialization and diversifying the continent's specialization pattern. Simultaneously, unless properly managed, the continuous appetite of emerging economies for Africa's natural resources could reinforce the dependence on exports of primary commodities, especially if developed economies do not provide a vibrant vent for other African products. This provides the conceptual basis for engaging southern partners in a more strategic way to make sure that South-South trade relations support greater value addition and foster the emergence of regional value chains.

Moving to South-South cooperation, the emergence of new donors and innovative modalities offers the scope to go beyond the traditional donor-recipient dichotomy and focus instead on harnessing the potential synergies and complementarities across different partners at global, regional and domestic levels. One area where this could be extremely promising is the improvement of Africa's infrastructural provisions,

particularly because of the size of the underlying investments. This requires African countries to assume full ownership of the agenda for infrastructural development (as articulated, for instance, in the Programme for Infrastructure Development in Africa) and to coordinate at regional level and with the donor community. They should strategically exploit the donors' complementarities and distinct comparative advantages. South-South cooperation also offers a promising platform to identify common interests and coordinate positions in relation to the management of global commons and the reform of the multilateral trade and financial architecture. It became evident at the Ninth World Trade Organization Ministerial Conference in Bali, with India's "success" on the issue of public stockholding for food-security purposes, that the emergence of a multipolar world widens the scope for effective South-South coalitions including in the forging of a fairer multilateral trading and financial system.

With regard to new partnerships for development finance, three areas of particular significance are mentioned, but the list is not exhaustive. First, recent analyses have highlighted how the disproportionately high costs of formal remittance services deprive Africa of much-needed funds to finance not only consumption, but also physical investments and investments in human

capital. The World Bank estimated that, had the costs of remitting funds to countries in East, West, Central and Southern Africa in 2010 matched the average fees worldwide, remittances receipts in East, West, Central and Southern Africa would have been \$6 billion higher (Ratha and others, 2011). Given the relevance of South-South migration and remittance flows in Africa, there is a clear case for cooperation, which aims to enhance the use of formal remittance channels (it is estimated that currently over 50 per cent of remittances to the region are sent through informal channels) and cut the associated costs. Similarly, African countries may benefit from cooperation initiatives aimed at mobilizing remittances for investment purposes, by means of innovative instruments such as diaspora bonds.

Secondly, compared to the limited size of most African financial markets and the fixed costs associated with setting up adequate regulation and surveillance mechanisms, there is a scope for joining efforts at regional or sub-regional levels to create viable financial hubs. The main rationale behind these initiatives would be to contribute to the development of vibrant and appropriately regulated financial markets and possibly also to the creation of debt markets denominated in local currencies. In this vein, for example, the African Development Bank has already supported the sale of

bonds denominated in local currency in the Uganda Securities Exchange and is planning to do the same in Kenya, Tanzania and Ghana (Mugwe, 2012).

Thirdly, recent studies have revealed the sheer size of illicit financial flows which are depriving Africa of its much-needed financial resources, as well as a number of loopholes and inefficiencies that hinder effective revenue collection. The Economic Commission for Africa estimates that illicit financial flows could have been as high as \$50 billion per year over the last decade, with a large share of this accounted for by incorrect pricing of trade. International cooperation at regional and global levels on issues such as incorrect invoicing of trade, smuggling and illicit financial flows could bring substantial improvements in term of domestic-resource mobilization.

## Conclusions

As part of the discussions on the post-2015 development agenda, the debates at the Ninth African Development Forum indicated the widespread agreement in the region on the need to renew the global partnership for development. Despite some encouraging successes, the Millennium Development Goals remain largely unfinished business.

The current global partnership for development has failed to redress the patent imbalances in the international trade and financial system. This was lamented as proof that the partnerships concluded by African countries too often pivoted around someone else's interests. Moreover, Africa has enjoyed encouraging growth performance over the past decade but this has largely failed to generate sufficient employment and trigger much-needed structural transformation. In many ways it represents the continuation of a core-periphery dynamic reminiscent of the old colonial days. This in turn has resulted in a pattern of growth that was insufficiently inclusive and failed to deliver results in terms of Africa's interests and strategic development priorities.

Against this background, the call for an African renaissance, capable of fostering the creation of a prosperous and integrated continent, is a reflection of the urgency to insert Africa strategically into the global economic and geopolitical reconfiguration triggered by the rise of the South. This will require identifying those partnerships that authentically empower Africans and decolonize their mentalities. African leaders and policymakers are called upon to capitalize on this historic opportunity and lead the continent onto the path of

sustainable development. Three main directions of policy imperatives have emerged in order to foster Africa's structural transformation:

First, taking advantage of the prolonged period of rapid economic growth, African countries should step up their domestic resource mobilization efforts, eliminating fiscal loopholes, stymying illicit financial flows, broadening the tax base and enhancing the effectiveness of the tax-collection system. The recognition that domestic resource mobilization should play a pivotal role in the quest for development finance is not only a reaction to the emerging aid fatigue of traditional partners. It is also a key step to promote accountability, end aid-dependency and reclaim full ownership of Africa's development agenda. The transition from reliance on aid to mobilization of domestic resources may require some time, but there are already some opportunities for policymakers to play a more proactive role in coordinating donors and harnessing new sources of development finance (including diaspora bonds, private equity and impact investment).

Secondly, African policymakers should renew their efforts to advance the regional integration agenda, eliminating those

tariff- and non-tariff- barriers that keep the regional market fragmented and providing adequate infrastructure to make this integration viable. The experience of East Asian countries has shown that tapping into the regional market to harness economies of scale and learning by doing should be regarded as a strategic priority, which supports structural transformation and could foster the emergence of regional value chains. Moreover, achieving a greater degree of regional integration would also result in a stronger negotiating position vis-à-vis other partners and potential investors.

Third, African countries should clearly articulate their interest and strategically engage southern partners with a view to foster structural transformation, whilst avoiding the so-called "primary commodity trap" and the "race-to-the-bottom" to attract foreign investment. In addition, the distinct features and operating modalities of southern partners open the scope for strategically harnessing the synergies and complementarities between South-South and North-South cooperation, as well as across the wide array of potential partners within the South.

# CHAPTER 7

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# CONCLUSION

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*Abdalla Hamdok and Francis Ikome*

**T**here is growing consensus that domestic resource mobilization is key to creating and sustaining inclusive and sustainable economic growth on the African continent. The analyses in this book have demonstrated that, although tax collection on the continent has improved tremendously over the past decade, major challenges remain in a number of areas, such as:

- » The establishment of strong and effective public institutions, which are key ingredients to unlocking the potential for domestic resource mobilization and the attainment of structural transformation
- » The imperative of expanding the tax base, strengthening tax administration and sustainability, and promoting legitimacy by linking taxation to effective service delivery
- » The urgent need to rethink Africa's reliance on exports of natural resources, which are often undervalued and under-taxed, as evidenced in the fact that only about 3-5 per cent of actual royalties are received by countries
- » Addressing the ever-growing volumes of illicit financial flows, which continue to deprive African countries of much-needed resources for socioeconomic development and structural transformation

» Paying attention to issues related to African countries' limited capacity in negotiating contracts with large foreign companies, in the extractive industries or otherwise, so that the latter can cement unfavourable terms for countries, preventing them from harnessing revenues from their economic activities and exacerbating tax evasion.

The chapters in this book have presented the range of opportunities and policy approaches available to African countries to leverage the huge potential to strengthen domestic resource mobilization. It has examined how the deepening of financial markets could improve access and diversification of financial products, including the use of innovative modalities such as private equity, impact investment, microfinance and climate financing, which have the ability to boost access to financing for a variety of stakeholders whilst being underpinned by ethical values. It has also discussed ways in which advances in technology could assist countries to widen the reach of financial services, including overcoming geographical challenges as well as reducing costs and improving access, particularly for the people who do not currently have access to bank accounts. Another aspect that has been critically analyzed is the potential of tax cooperation and harmonization at the regional level to strengthen negotiation positions at global

platforms and also reduce the cost of obtaining information relevant to tracking and enforcing tax payments, particularly for multinational corporations who operate across borders. There has also been an analysis of the potential dividends to be gained from improvements in domestic capacity, particularly with regard to enabling identifying and enforcing a diversified national tax base, stronger linkages between the formal and informal economies, ensuring fiscal sustainability, and visible and tangible linkages between taxation and public-service delivery. The role of regional integration has been underscored as a priority conduit for ensuring better governance, reforms of domestic governments, putting laws in place that foster confidence for investors, and its potential to contribute to lowering costs and improving efficiency in raising capital, including through regional stock markets or licences to trade across jurisdictions.

Other opportunities to augment domestic resource mobilization that have been discussed in the book include:

- » Exploring innovative forms of banking, including microfinance
- » Information and communications technology including mobile applications to increase investment levels and access

to financial products and services for low-income consumers

- » Considering the size of remittances to the continent, African countries are fast exploring how these funds can be harnessed and directed towards productive investments. One method that has been implemented is diaspora bonds, which are promising but must be treated with caution due to issues of credibility, expected investment returns, lack of awareness and financial literacy of diaspora investors. Starting small may be the way to replicate the use of diaspora bonds at a scale that is manageable, especially for first-time issuers. In addition, the private sector should be encouraged to also use this tool. Increased competition can help lower the cost of transfers

- » The curtailment of illicit financial flows constitutes another unexplored source of mobilizing domestic resources for Africa's development.

This book has analysed various dimensions, sources and impacts of illicit financial flows from Africa and strategies for halting and redirecting these important amounts of resources towards the economic transformation and development of the continent. The huge amount of resources that leave the continent through illicit financial flows, averaging about \$50 billion in the last decade alone, have had the impact of stifling domestic savings and investment,

draining hard-currency reserves, reducing tax collection and consequently undermining Africa's structural-transformation efforts. The book has made a case for greater transparency in revenue declaration and improvements in payments from multinational corporations, tightening tax-haven regulations and secrecy jurisdictions and strengthening efforts to curb money laundering, as ways of retrieving diverted money and spending it on poverty reduction and economic-growth activities.

The issues of illicit financial flows, including the dynamics that drive them, are very technical and complex and tackling them requires broad and deep technical expertise. The book calls for building and strengthening African expertise in areas such as tax codes (in order to be able to better negotiate with companies on concessions), lawyers, forecasters (for example to forecast the value of natural resources) and insurance experts. It has urged African countries to be more careful in signing bilateral investment treaties and double taxation treaties, which could sometimes be harmful. It suggests that African countries should always employ relevant and competent experts in important international negotiations, including pooling expertise with other African countries.

It makes a number of important revelations and proposes a range of policy actions that could help reverse the tide of illicit financial flows, which include:

» Illicit financial flows have political impacts, including undermining state structures and governance. They can also be a source of financing for terrorism and therefore have the potential to contribute to undermining security. Strengthening the State and state institutions and entrenching good governance and anti-corruption measures are important to tackle these flows. It is recommended, for example, that financial intelligence units should be independent of the rest of Government to help them to stay free of corruption and allow them to work without interference.

» It is important to improve institutional coherence, promote policy dialogue and establish professional networks of practitioners to share operational experiences. In particular, international cooperation with partners both inside and outside Africa is essential to tackle illicit financial flows. The ongoing economic difficulties/fiscal pressures being faced by many developed countries offer a historic opportunity for greater international collaboration in efforts to crack down on illicit financial flows. Related to this, Africa also needs to ensure that its voice is heard in global processes on illicit financial flows such as the Base erosion and profit shifting (BEPS) initiative of the Organization for

Economic Cooperation and Development. The United Nations Committee on Tax and Trade can be one way to do this. Regional cooperation is critical to avoid the race to the bottom and strike a balance between attracting foreign investment and exercising effective control over multinational corporations.

» Many illicit financial flows happen when companies exploit legal loopholes rather than actually breaking the law. This is one of the reasons why it is important to develop a strong, clear and transparent legal framework. It is also important to learn from best practices, review evidence on what has worked in Africa in the past and draw on this in order to produce a solution appropriate to Africa. Debarring companies found to have been involved in corruption in public procurement and other areas and the establishment of a national register of perpetrators of illicit financial flows that should be available to public officials working in relevant institutions may be solutions to corruption. Moreover, illicit financial flows needs to be communicated to the general public in a way that is clear and simple, maybe in indigenous languages. Sanctions for illicit financial flows should also be publicized to sensitize people and deter the flows and it is important to change culture to dissuade people from taking part.

» Natural resources are strategic to Africa's growth and structural

transformation but the extractive industry has been particularly vulnerable to illicit financial flows. This makes understanding the political economy of the extractive sector and its complexities critical to transformative policies attempting to capitalize on the value of natural resource endowments for sustainable development. This calls for effective policies at both national and subregional levels to address structural issues of ownership and control and the external orientation of the sector. The Africa Mining Vision is an ambitious continental framework, which needs to be domesticated into national laws and policies supported by strong political will, accountability, policy space and a broad-based social compact.

» There are a number of other sectors that are particularly vulnerable to serving as channels through which illicit financial flows are transmitted, including: trade in fake medicines; tax havens and financial-secrecy jurisdictions; public procurement; and luxury goods, which are usually used in hiding transactions and laundering monies.

» Transparency is very important for tackling illicit financial flows. The establishment of a single register of companies and their affiliates would help, as would companies reporting country-by-country and project-by-project. Detailed research on the illegal flows in Africa, their effects and methods, and development of an analytical framework for identifying

illicit financial flows and various actors are both important. Institutions dealing with the flows must have teeth and the perceived fragility of African countries should not be used as an excuse for not tackling the flows. Currently, Africa's rate of prosecution in cases of illicit financial flows and of corruption compares very poorly with some other continents. It is important to improve on this. Successful prosecutions could lead to asset recovery, which is an important strategy in the fight against illicit financial flows in that it not only permits the recovery of funds that had been illicitly acquired but also serves as deterrent to perpetrators. Unfortunately however, asset-recovery performance in Africa remains poor.

» In some countries in Africa, the central bank is in charge of banking supervision both in terms of financial stability and in terms of investigating where banks may have broken the law. Combining these two functions under the same roof may have synergies because information for one type of supervision can be used for the other. Exchange controls are also part of the response to illicit financial flows. The central bank can work with customs, police, trade and tax officials (the latter notably to tackle under-invoicing), the Government, the judiciary and the ministry of justice. In general, government departments need to work together to tackle the phenomenon. African countries can force institutions and individuals to declare transaction amounts

above a certain threshold. Some African countries already use internal and external controls to prevent illicit financial flows and all transactions go through multiple checks.

Private equity and its potential to contribute to economic growth and transformation in Africa have also been analyzed in this book. Africa has become a key destination for private capital mainly because of the sustained economic growth rates that the continent has registered over the past five years. There are tremendous opportunities for private-equity investments with respect to tourism, infrastructure, agribusiness, the consumer market and the mining sector. These opportunities are not limited to the public sector but are also open to small and medium enterprises. There are already a number of success stories, such as Equity Bank in Kenya, upon which investors could build. Despite the opportunities for private-equity capital in Africa, there are a number of challenges that need to be overcome, to make the sector a real vector for economic transformation, including:

» Firstly, there is need to address the concerns of institutional investors over the acute shortage of established fund managers in Africa who can absorb the amount of capital that limited partners from developed and emerging markets want to deploy.

» Secondly, strategies need to be put in place to win the trust of policymakers as this is very important for the success of the private-equity model. Trust has to be built against a backdrop of generalized fear that prevails against private equity, which is regarded by some people as consisting essentially of investors who take over firms, generate short-term returns for their own pockets and leave nothing behind. The importance of educating Governments and promoting transparency about the asset class is therefore a critical first step in assuring policymakers that capital is used in ways that benefit the economies of their countries.

» Thirdly, Governments have a critical role to play, particularly with regard to the establishment of business-friendly regulatory environments. A good example is Tunisia, where the Government changed its approach to private equity by expressly recognizing its potential to contribute to investment. Tunisia's private-equity reform was buttressed by the establishment of a development bank for small and medium enterprises and promotion of industrial activities.

» Fourthly, African private equity firms are enjoying a positive trend towards exits, including through initial public offers (IPOs) and trade sales.

» Fifthly, our analysis highlighted the need for private equity to invest in women's businesses, with a view of leveraging

their entrepreneurial acumen while also addressing issues around the disparities that exist between men and women when it comes to setting up businesses in Africa.

Particular attention has been paid in this book to pension funds, which constitute a rapidly growing pool of capital and hold much potential that needs to be unlocked and leveraged for Africa's economic transformation. There is over \$29 billion of untapped capital, which represents an enormous opportunity for Africa's investment industry. But it also leads to a problem of absorbing this investment and taming irrational exuberance so that the funds invest sensibly, because rapid growth can lead to recklessness. This growing resource must be managed carefully and properly because people depend on it for their livelihoods in their old age. Governments are reluctant to take risks they do not understand and no-one should compel them to invest pension funds in things they do not properly understand. Nevertheless, there is need for countries to ease restrictive regulations that do not allow pension funds to invest in private equity, while remaining mindful of the imperative responsibility to invest wisely. In this regard, there is a need to promote financial literacy among citizens and transparency in terms of ensuring that all players disclose how their investments are deployed. Ultimately, proper dialogue and interaction between all the

different stakeholders must be encouraged with a view to gradually bridging the knowledge-gap and creating solutions to which all parties subscribe.

Attention has also been paid to issues surrounding impact investment, which is essentially at the intersection of financial return and philanthropy. Impact investment is unlike aid, which is money free of the profit motive, as it requires a financial return, albeit at lesser rate than the returns expected by private-equity investors. In principle, impact investment is about financial and economic inclusion such as supporting micro-enterprises. Our analysis points to the fact that for impact investing to have greater impact it should somehow be connected to the economic eco-system in which it operates. This means that impact investment needs to be beneficial to the community and to society at large. Environmental, social and governance issues need to be factored into an entrepreneur's investment thesis or plan. Looking after the environment, creating more jobs, protecting workers and adhering to principles of good governance have all demonstrated positive upside to financial return. After all, improving the community in which the business operates will ultimately benefit the entrepreneur in the long term.

The book also examined ways of enhancing the role of Governments in attracting greater private-equity investments in support of national-development efforts. In addition to improving the business environment, Governments could also actively participate in setting up limited-term funds whose impact could be measured over a period of time, with very specific criteria on how the fund is expected to influence the growth and development of the private sector. There is significant appetite for investing capital into growing and expanding business where Governments can contribute. Governments can also contribute through education and sensitization exercises, in reducing suspicions; improving the awareness among various stakeholders, including businesses, of their respective roles in building private equity; and encouraging the diaspora to invest in their countries of origin, as well as encouraging the regional integration of markets.

The book has brought out the strong nexus between Africa's transformative agenda and climate change. It has highlighted the inseparability of climate finance and development finance. Climate finance offers Africa great opportunities in addressing the impacts of climate change and in expanding the engagement of multiple actors for implementing multiple actions. It can help with the deployment and leveraging of new

technologies for climate-change adaptation and mitigation, as well as opening up new niche markets within the carbon market. Climate finance has the ability to fast-track the transition towards low-carbon and climate-resilient development and switching towards renewable sources of energy in support of Africa's agenda of transformation towards a green economy. Climate finance can catalyse new funds and propel Africa towards a new development trajectory. This would inevitably require a new business model that would engender mitigation and adaptation projects, and galvanize the private sector, drawing on inherent elements such as corporate social responsibility and the business opportunities that can be reaped through such engagement.

The analysis in the book demonstrates that, despite the great opportunities offered by climate finance to Africa, including in facilitating green economic growth and transformation, the continent continues to face a number of challenges in leveraging these opportunities.

» The first challenge relates to access to climate finance, which arises from the fact that the current designs of climate funds do not target the most critically affected groups, especially in Africa, or help them to address their adaptation needs. For example, agriculture is considered to be the most critical sector, as it employs

7 out of every 10 Africans. Yet, some of the conditions and modalities of the international climate funds tend to limit access to funds in order to address climate-change impacts on agriculture fully. Unfortunately, most of the people on the demand side lack the requisite collateral and prerequisites that would entitle them to access these funds.

» The second challenge revolves around issues of adequacy and predictability. The funding available is not commensurate with the huge needs for adaptation or mitigation in Africa. In addition to the gap between availability of funds and current needs on the ground, there is the issue of predictability. Where will new monies come from and how frequently will these new sources replenish current sources of funds?

» The third challenge revolves around capacity constraints. One of the difficulties is the fact that access to financing is related to accreditation of national institutions as national implementing entities (NIEs) that can demonstrate strong capabilities in generating bankable proposals.

» A fourth challenge borders on issues of governance of climate funds, which require reconciling different needs, interests and stakes in a way that does not compromise equity both intra-generational and intergenerational.

» The book contends that the issue of scale is the crux of the challenge.

Unfortunately, different accords made by different conferences of parties gatherings (COPs) under the United Nations Framework Convention on Climate Change have exposed the weaknesses of the negotiations process and shown it to be painfully slow. There is a clear need to hasten the pace of the negotiations and reduce the associated transaction costs.

The book has mapped out a way forward on climate finance and has strongly recommended the demystification of climate-change finance with a view of creating business opportunities and enabling different stakeholders to own responsibility for sharing the burden. It is important to identify where Africans can be “owners of the burden and owner of the solutions” and can actively contribute to the solution and not just be a recipient of climate funds. It has also argued that the current “Africa rising” narrative can trigger greater confidence and this, in turn, will boost the people’s capabilities and their vision and boost the plentiful human and natural resources for managing the risks. It has presented a range of interventions that would enhance Africa’s ability to leverage various opportunities for climate finance more effectively for its development and in a manner that would also reduce its dependence on external sources:

» There is an increasing mindset that Africa should be weaned off its current dependency on international sources of climate funds, official development assistance, foreign direct investment and other interventions, and should be made more forward-looking in the management of its natural resources. In Nigeria, for example, transporters of crude oil are promoting green investment in offsetting their carbon footprints. Similarly, the legislation banning tree-cutting has triggered the expansion of REDD+ activities in Rivers State of Nigeria.

» The channelling of climate funds to the end-user groups such as smallholder farmers is critically important in achieving the desirable impacts in reducing vulnerability in the agricultural sector that employs the majority of Africans (about 70 per cent), and contributes about 30 per cent to the gross domestic product of most countries.

» Young people need to be in the solution space for climate change in Africa. Capitalizing on the current youthful demographic dividend that Africa enjoys opens multiple windows of opportunity for tapping into this important clientele group in the interest of intergenerational equity. Young Africans have important roles to play in scaling up climate-change response as an important clientele group for climate finance.

- » Re-branding the agricultural sector can incentivize young Africans to take up career opportunities in agriculture and address youth unemployment, which currently stands at about 40 per cent in Africa. Climate-finance investment in the agricultural commodity value chain can innovatively open up the base for young people to be absorbed into the workforce with the potential of curbing rural-urban migration and even brain-drain to industrialized countries.
  - » Research has an important role to play in informing and shaping responses to climate change. It is important to ensure that research is at the heart of the solution. Using a nexus approach, especially for agriculture, has the potential to expand the response needed in addressing climate change across different systems and yielding multiple benefits.
  - » Forging public-private partnerships is critical as the private sector cannot afford to be a passive onlooker of the process of climate finance.
  - » Redesigning the business model for climate-change response is crucial for Africa. This will enable synergies between adaptation and mitigation response actions. From the perspective of climate financing, the long-term adaptation solutions for Africa might prove to be in mitigation efforts. Mitigation offers great opportunities for the transition towards the green economy as Africa turns towards renewable sources of energy, smart agriculture and other forms of low-carbon development.
  - » Building capacity of human and institutions is fundamental in expanding Africa's potential to mobilize climate finance. Partnering with researchers and academics can significantly enhance the development of competitive grant proposals. It is also important to finance public literacy as a means to manage risk using climate finance.
  - » Information is critical for the enhancement of public understanding about different sources of climate financing, modalities of access and training to write bankable proposals.
  - » There is a strong resonance for home-grown climate financing, such as pension funds, national budgetary processes, bonds and levies, in taking our destinies into our own hands as international funds increasingly become unstable, unpredictable and inconsistent with Africa's development agenda.
  - » Corporate social responsibility represents another window for domestic funding as well as developing young people's capacity to be social entrepreneurs.
- The continent has to evolve new forms of partnerships against the background of rapidly-changing global economic and geopolitical transformations. This book

contends that functioning partnership rests on a clear understanding and articulation of one's interests, as well as on the careful assessment of resource requirements. Proceeding from this premise, the power balance between the parties is crucial determinant of the terms of the partnership. Africa has rather a weak track record in negotiating partnerships to date, as evidenced by the fact that partnerships concluded by African countries often pander more to the interests of the partners rather than advance the interests of the African countries. Foreign strategic interests in Africa are essentially two dimensional: as a vast source of natural resources and as an expanding consumer market. In light of this, the analysis recommends that the whole continent should reposition itself with a view to upgrade production and transform its economy rather than continuing to be a dumping ground for other people's products. Africa is urged to leverage the possibilities offered by ongoing reconfigurations of the world to take full control of its development agenda by entering into new and more balanced strategic partnerships with the rest of the world. The analysis cautions that this requires concerted efforts, including in identifying those partnerships that authentically empower Africans and take their interests as central issues.

The current analysis has also pointed to the need for renewed partnerships for Africa's development to pay greater attention to the regional dimension and in particular to the enormous relevance that regional integration plays for Africa's own transformation prospects, as long recognized by Pan-African thinking. Regional integration in Africa, however, is still a largely unfinished business. Whilst being more diversified than Africa's trade with the rest of the world, intra-African trade remains very low and accounts for only 10-12 per cent of the continent's trade flows. Flows of goods and services, as well as movement of people, are greatly hampered not only by tariffs but also by administrative, technical and linguistic barriers. Towards this end, African policymakers are urged to demonstrate real leadership, develop a truly African vision and focus on implementing Africa's transformative agenda. It adds that the roles of civil society, media and the private sector should be strengthened to enhance the accountability of leaders to their peoples, creating effective and context-specific checks and balances. In addition, Africa should insert itself strategically into the global economic and geopolitical reconfiguration triggered by the rise of the South, in order to build partnerships amongst equals, which truly empower African people.

Africa's remarkable growth performance in the past decade and half and its effort to

rebalance its economic relationship gradually, particularly towards emerging economies in the global South have been analyzed. Growth and rebalancing have involved multiple dimensions ranging from trade to investment and knowledge flows, migration and remittances. Rebalancing is particularly pronounced in the trade sphere, where developing countries now account for roughly half of Africa's exports compared to a third in the early 2000s. The rising relevance of the "BRICS" countries (Brazil, Russia, India, China and South Africa) has been the focus of much of the debate on South-South links and synergies, but in reality the scope for South-South cooperation goes well beyond the BRICS and should be the foundation of Africa's partnerships in the context of the global South. Partnerships among countries from the global South tend to be characterized by distinct features and modalities compared to traditional partnerships with developed countries. This opens a wide scope for strategically harnessing the complementarities between South-South and North-South cooperation but this scope is still largely untapped. African countries are warned to coordinate their actions and to be strategic in their interaction with other southern partners in order to avoid the middle-income trap. In order to move up the value chain, they must, among others:

- » Move away from the traditional trade patterns inherited from the colonial period. African countries continue to rely excessively on exports of raw materials, but they should use the available technology to process their resources, rather than exporting them raw with very limited value addition.
- » Develop their services sectors, which are essential for the proper functioning of value chains and the flourishing of the economy.

Africa's trade flows have increased fourfold over the last 10 to 15 years. Developing countries account for 43 per cent of Africa's exports and 50 per cent of its imports. This is a significant increase compared to the early 2000s. Unfortunately less than 12 per cent of the Africa's total trade flows are within the region. However, when informal trade is included, intra-African trade almost doubles, accounting for up to 23 per cent of all African trade. Research shows that it is possible to at least double the level of intra-African trade in the next 10 years by simply removing tariff and non-tariff trade barriers. The analysis in the present book goes beyond specific trade issues and also discusses issues related to the Millennium Development Goals (MDGs). It argues that, although the goals successfully mobilised the international community around social-development outcomes, they lacked policy frameworks and failed

to recognize the importance of structural transformation. Therefore, they ultimately failed to deliver on the promises of the global partnership for development (Millennium Development Goal 8). As a consequence - and despite some encouraging progress - the goals remain for the most part unattained in Africa. The proposed sustainable development goals are more ambitious and their achievement would require even more resources. This is a colossal undertaking that requires innovative approaches to find adequate development finance. Traditional partnerships will still be

important but they can no longer be the only option. In particular, official development assistance can no longer be the centrepiece in financing Africa's development. Domestic resource mobilization and the involvement of the private sector are two critical pillars if a sustainable solution is to emerge. Specifically, countries should explore the option of strengthening the role of bond markets, pension funds and sovereign wealth funds to catalyse investment in Africa and provide adequate capital, especially to small and medium enterprises.



Overall, this book has analyzed five thematic issues areas of development financing: domestic resources mobilization, illicit financial flows, private equity, climate financing and new forms of partnerships. These five sources are unexplored or underdeveloped alternative and innovative sources of finance with huge potential to generate resources that could greatly reduce the continent's dependence on external resources to finance its development. If these sources are properly developed and leveraged, they would provide the requisite resources to finance Africa's development

and transformation agenda, as embodied in Agenda 2063, as well as facilitate meeting the ambitious goals being set out as part of the evolving post-2015 development agenda. Significantly therefore, the current analysis is relevant and pertinent for ongoing efforts to evolve a new global blueprint on development financing, including the forthcoming Third International Conference on Financing for Development.





## **ANNEX I**

# Marrakech Consensus Statement

## ***Preamble***

We, participants at the Ninth African Development Forum (ADF-IX), on the theme “**Innovative Financing for Africa’s Transformation**”,

***Representing*** stakeholders from across the African continent, including Governments, academia, the private sector, civil society, women and children, the United Nations family and development partners, met in Marrakech, Morocco, from 12 to 16 October 2014, at the invitation of the Kingdom of Morocco, the United Nations Economic Commission for Africa and its strategic pan-African partners,

***Noting*** the fact that African economies have been experiencing significant growth since the late 1990s, but that structural transformation continues to remain elusive, with as many as 38 African countries witnessing de-industrialization over the period 1995-2012,

***Recognizing*** that the quest for development finance remains a crucial challenge for Africa in the post-2015 development agenda, particularly for non-resource-rich countries,

***Conscious*** of the development opportunities, as well as the complexities, brought about by the growing significance of South-South economic linkages and alongside the rapidly evolving global economic and financial landscape,

***Cognizant*** of the important role that a well organized and properly integrated African diaspora can play in the continent’s development, including through remittances and the leveraging of the numerous investment opportunities on the continent,

***Aware*** of the central role that partnerships continue to play in Africa’s development and the need to renew and strengthen the continent’s existing partnerships, while also forging new and innovative ones, at both the global and regional levels,

**Reaffirming** our commitment to strategically engage traditional and emerging partners, with a view to supporting Africa's transformation, addressing global development challenges and contributing to the establishment of a fair, inclusive and sustainable trade and financial system,

**Conscious** of the challenges and opportunities of private equity investment in Africa,

**Recognizing** that various forms of illicit financial flows (IFFs) constitute a huge drain on Africa's financial resources and that this impacts negatively on the continent's aspirations for structural transformation,

**Determined** to reverse and ultimately eliminate IFFs from Africa and to channel these vital resources towards strengthening the continent's resource base and considerably reducing its dependence on external sources of finance,

**Noting** that African countries have been experiencing a major economic resurgence by virtually any measure of performance: average growth rates of 5 per cent and inflation in single digits coupled with an increasingly stable and predictable economic and political environment, and that the rate of return on investment in Africa today, even adjusting for the real and perceived business risks, is higher than in any other developing region,

**Recognizing** that many African countries are beginning to promote within national and regional economic transformation programmes, domestic policies that encourage private investments and initiatives,

**Conscious** of the need for greater levels of private investments, particularly from within Africa, to help create new jobs for the continent's growing population, develop a strong industrial sector, contribute to agriculture transformation, and participate in the exploration and development of its vast mineral and energy resources,

*Aware* of the significant role that private equity can play, including as an important source of investment for national growth and development, and Africa's transformation in general; as well as affirming our commitment to exploit various opportunities available to make Africa a preferred destination for private equity capital by enhancing the continent's investment attractiveness,

*Recognizing* that the current sources of funding are insufficient compared to the increased climate investment needs in Africa,

*Acknowledging* that climate finance should be derived from multiple sources of finance, including from domestic, public and private, as well as from bilateral and multilateral sources,

*Noting* that the scale up of climate finance provided by different funds and mechanisms is highly critical for enhanced adaptation and mitigation actions, and to support continuing development and the transition to low-carbon growth by African countries,

*Acknowledging* that the mobilization of climate funds is critical to support the Green Climate Fund towards a transition to a low emission and climate resilient development in Africa,

*Recognizing* that climate finance is currently not meeting Africa's expectations in the required scope to adequately address climate change in adaptation commensurate with the risks and vulnerability of the continent and particular stakeholder groups, such as women and young people,

Understanding the need for greater clarity, coordination and complementarities between existing climate finance mechanisms and significant improvement in access modalities of global funds,

*Noting* that innovative financing mechanisms, including from domestic sources, for climate change actions in Africa are required to expand the menu of options in climate finance, the Climate for Development in Africa (ClimDev–Africa) programme has established the Climate for Development Special Fund (CDSF) as a regional fund to improve access to climate funds,

**Recalling** all relevant declarations and programmes of the United Nations and major pan-African institutions, which have been endorsed by African countries, on the mobilization of financial resources for the continent’s economic transformation and development,

**Adopt the following consensus statement:**

**I. Unlocking domestic resource potential for Africa’s structural transformation**

1. Africa has significant challenges to overcome to close its financing gap and generate the necessary resources required to achieve sustainable and inclusive economic development on the continent. Endowed with abundant arable land, human capital and natural mineral wealth, Africa has the opportunity to raise significant resources domestically and attract foreign resources to finance its development agenda. Despite this, Africa has been unable to fully capitalize on its resource potential; taxation revenue is low, underpinned in several countries by weak administrations that do not fully exploit the existing domestic tax base and that grant ill thought-out tax concessions to high-value industries such as those in the extractive sectors and multinational corporations.

2. Despite reforms undertaken over the past decade, Africa’s financial systems are still largely underdeveloped in a majority of countries and unresponsive to the needs of individuals, households, and small and medium sized enterprises, constraining the domestic savings rate and the availability and access to credit for productive investments. Similarly, the majority of capital markets on the continent are still in their infancy, with low capitalization and liquidity levels, as well as poor human, technological and institutional capacity. All these factors combined with poor public financial management present significant barriers to sourcing, mobilizing and allocating resources in a socially and economically beneficial manner.

### **Recommendations:**

3. In order to address the current issues of domestic resource mobilization on the continent and improve the generation, sustainability and retention of these sources towards financing the development of the continent, **African countries should:**

- a. **Reaffirm the value of the principles embodied in the 2002 Monterrey Consensus and the Doha Declaration on Financing for Development** highlighting key actions to be taken to improve the mobilization of domestic resources for development; including emphasizing principles of national ownership in raising domestic resources by undertaking tax reforms that are fair, efficient and transparent, and that broaden the tax base based on equitable outcomes.
- b. **Exploit the potential of the continent's extractive industries** in a manner that ensures that current and future generations benefit from resource earnings. Mechanisms such as sovereign wealth funds need to be established and efficiently managed to reduce vulnerability to economic volatility and the allocation of proceeds to sustainable, inclusive development endeavours.
- c. **Commit to using fiscal policies to address issues of poverty** while strengthening the accountability, transparency and delivery of public financial management systems to improve the allocation of resources and provide the social and economic infrastructure necessary for sustainable, economic growth.
- d. **Improve the necessary internal conditions for increasing domestic savings** by adopting reforms that will remove or reduce barriers to savings and improve the national capacity and willingness to save. Providing incentives for financial institutions to improve access to saving products and services through innovative mechanisms will encourage saving on the continent.

- e. **Establish strong and efficient regulatory and enforcement frameworks** that will encourage the growth and utilization of contractual savings (e.g. pensions and insurance) that can be allocated towards long-term investment projects.
- f. **Develop innovative policies which will encourage partnerships** between the public and (domestic) private sector to address the existing infrastructure gaps, improve the allocation of private resources towards sustainable development goals and release capital for productive investments, particularly for small and medium enterprises; including improving access and diversification of financial products and services, which are more appropriate to their economies.
- g. **Explore ways to lower the cost of remittances and introduce diaspora bonds** to attract and channel foreign private finance towards productive investments in the economy; as well as urgently invest in improving human, institutional and technological capacity to address issues of taxation, increasing the level of savings, improving access to financial services and products.

## **II. Building global coalitions to combat illicit financial flows from Africa**

4. Africa faces significant challenges in improving its domestic resource mobilization and a key element of this challenge is curtailing the massive illicit financial flows (IFFs) that derive from the proceeds of tax evasion and laundered commercial transactions; proceeds of criminal activities; and proceeds of theft of public resources, bribery and other forms of corruption. IFFs are a huge drain on Africa's resources and tax revenues, and they constrain the level of savings needed to address key development issues.

5. Research has established that IFFs are also detrimental to sustainable economic development, and peace and security on the continent in a number of other ways. For instance, IFFs exacerbate weak (or serve to weaken) governance structures as they provide

an incentive for rent-seeking rather productivity maximization, undermining structures, institutions and legal mechanisms installed to detect and prosecute perpetrators of IFFs. They also reduce the effectiveness of governance efforts by encouraging the establishment of shadow financial systems such as tax havens, secrecy jurisdictions and trade mispricing, among others. This can work to undermine the progress made in improving macroeconomic management and, in fact, increase the debt burden. Further, IFFs also serve to increase Africa's dependence on external aid, reflected in many countries in the high proportion of Governments' budget provided by official development assistance, reducing ownership and autonomy of development plans and resources allocation. Overall, and perhaps the most damaging to growth and stability on the continent, IFFs facilitate and, in some cases, encourage armed conflict in the pursuit of "lootable" commodities. This serves to seriously undermine the stability and security of African countries, and jeopardizes sustainable development and rule of law.

6. It is clear that IFFs pose challenges for Africa; but these are not insurmountable. Tackling them will require political will and commitment at various levels to reform the structures, systems and practices which make IFFs so pervasive on the continent. More specifically, corruption, tax havens, financial secrecy jurisdictions and capacity constraints need to be tackled directly through dedicated investment, international cooperation and systems that provide deterrents and high penalties for perpetrators.

### **Recommendations:**

7. In the light of the challenges and threats posed by IFFs to the maintenance of good governance, the rule of law, stability and security, and the effective harnessing of Africa's natural resources to realize economic transformation and sustainable development, **African Governments should strive to:**

- a. **Strengthen institutional capacities to deal decisively and effectively with private sector practices** aimed at facilitating tax evasion, in particular transfer pricing and trade mispricing, including by reinforcing the capacities of national judicial systems and law enforcement agencies to aggressively pursue and punish transgressors; **as well**

as strengthen commitment to international measures against corruption and take anti-corruption and anti-criminal measures at the national, regional and global levels.

b. **Commit to developing appropriate and acceptable national and regional standards** to prevent harmful competition to attract foreign direct investment in the extractive industries.

c. **Pursue mutually beneficial cooperation between source and destination countries of IFFs** at the regional and international levels aimed at discouraging and curbing IFFs, and facilitating asset recovery and repatriation. This should include the adoption of further measures to improve access to tax information; as well as fully and freely making available, in a timely manner, data on trade pricing of goods and services in international transactions, in accordance with accepted coding system categories;

d. **Promote peer learning and research on the impact of IFFs** on different sectors of economic activity and engage and sensitize the public on the negative effects of IFFs from Africa.

### **III. Private equity as a source of investing in Africa's growth and transformation**

8. Africa is rapidly evolving and the regional story is also gaining more momentum, and broadening the market space especially for investors motivated by economies of scale. The continent's population is nearly 1 billion, representing a burgeoning consumer market with increasing demands. There is a growing middle income group and a high rate of urbanization in many countries. These demographic dynamics provide the potential for market-seeking and efficiency-seeking investments in areas other than natural resources.

9. Raising long-term capital for investments is one of the biggest challenges facing African entrepreneurs and economic operators due to, inter alia, often high and uncompetitive rates offered by commercial banks. Furthermore, there is an urgent need for a massive capital infusion to finance a number of crucial projects in Africa in areas

including infrastructure, with particular emphasis on the Programme for Infrastructure Development in Africa (PIDA), mineral resources exploitation, agro-business, industrial development and economic diversification in general. Investing in these opportunities can be a lucrative venture for potential private equity and other investors, while helping to create millions of much needed jobs for Africa's burgeoning population and lifting people out of poverty.

### **Recommendations:**

10. In seeking to promote private equity as a potential source of investment for Africa's development and transformation, **African countries should:**

- a. **Improve the regulatory environment** for the private equity industry to foster its growth through favorable tax policies, good regulations and flexibility in the free flow of funds. Governments should also enact policies that encourage local investors as much as foreign direct investment (FDI), including implementing protocols on the free movement of people and capital across the continent;
- b. **Build closer rapport with private equity players:** A number of African governments have little knowledge about the industry. Governments need to better understand what issues are affecting and impacting the industry, including political risk, by encouraging more engagement between private equity industry players and regulators;
- c. **Encourage the investment of local African capital into private equity:** Recent growth in long-term domestic savings, particularly pension funds, offers an opportunity to increase private equity investment across the continent. There is today approximately \$29 billion in pension fund assets that could be invested in private equity in Africa which remains untapped. Other sources of local capital (family offices, sovereign funds, high net worth individuals, the diaspora) can also be tapped both for investing and exiting private equity assets. Governments should explore co-financing

and co-sharing opportunities with private equity investors, such as infrastructure financing (energy, telecommunications, water, etc.), and encourage the development of new products to channel these long-term savings into productive investment;

d. Encourage more impact investments: Impact investments aim to deliver financial and social returns. Through investments in sectors as diverse as health care, education and agriculture, impact investment has the potential to address some of the key challenges of poverty reduction and improve people's lives. Governments should explore innovative partnerships with impact investors and the private sector in general, in order to harness this potential.

#### **IV. Leveraging climate finance for Africa's adaptation and mitigation needs**

11. Various international and regional assessments concur on the severity of Africa's vulnerability to climate change. Addressing the enormous climate-related challenges facing Africa requires both domestic and international sources of financing. One key concern in Africa is the allocation of funds between adaptation and mitigation actions. While in developed countries, the majority of climate finance is spent on mitigation, in most developing countries adaptation is a more pressing priority than mitigation. However, this is likely to change as some developing countries become middle-income countries and mitigation becomes an increasingly important priority for them. This is even more likely with growing private sector interest and an increasing share of mitigation funding, as nations develop their institutions and the enabling environment, with regulations and incentives that encourage private sector investments.

12. In the case of Africa, the role of the private sector in climate finance is still very minimal and uncertain, especially as no good lessons or practical experiences have been drawn from the clean development mechanism, as a result of low participation rates from regions such as Africa. Furthermore, the price of carbon credits has been very volatile and currently stands at just \$1 to \$2 per ton of carbon dioxide for clean development mechanism projects.

13. Furthermore, less than one third of adaptation and mitigation funding approved for spending in Africa has been disbursed. Moreover, a significant percentage of climate finance in East, West, Central and Southern Africa is directed towards mitigation activities, despite the fact that adaptation should be given funding priority because of the high vulnerability of many countries of East, West, Central and Southern Africa.

**Recommendations:**

14. In the light of the severity of Africa's vulnerability to climate change, arising in part from its limited ability and capability (financial and otherwise) to deal with climate events and future impacts of climate change, including on its economic transformation agenda, **African countries should strive to:**

- a. **Foster the establishment of enabling policy environments** that enhance resource mobilization and investments in climate change interventions for Africa's development and transformation;
- b. **Support human and institutional capacity building initiatives** towards better access and absorption of climate finance at regional and global levels;
- c. **Influence negotiation processes** to ensure that critical work streams are designed to stimulate the funding of Africa's adaptation and mitigation programmes in the overall negotiations;
- d. **Secure from the international community, the reduction of current barriers and funding asymmetries** to ensure that African countries are not exposed to the vagaries of climate change and further subjected to climate risks due to the lack of adequate resources to manage climate impacts and climate proof critical sectors.

## V. Harnessing new forms of partnership for Africa's transformation

15. Albeit still small-sized, Africa's regional market displays an encouraging dynamism (especially when compared to the current conjuncture afflicting many developed markets), while the composition of intra-African trade continues to be significantly more diversified than that of Africa's exports to the rest of the world. This provides the rationale to consider Africa's regional integration as the strategic springboard to diversify our economies, reach more efficient scales of production, leverage learning by doing, and ultimately improve the terms of our integration into the global market.

16. The sustained increase of labour costs in some of the world's manufacturing powerhouses, coupled with the growing significance of South-South investment and knowledge flows, could create the opportunity for Africa's expanding labour force to engage in more sophisticated activities, thereby supporting industrialization and diversifying the continent's specialization pattern. Simultaneously, unless properly managed, the continuous appetite for Africa's natural resources could reinforce the dependence on primary commodity exports. This provides the conceptual basis for engaging Southern partners in a more strategic way, making sure that South-South trade relations support greater value addition and foster the emergence of regional value chains.

### Recommendations:

17. In seeking to forge more balanced partnerships with old and emerging actors, with a view of fostering inclusive and sustainable growth and improving the terms of the continent's integration into the global economy, **African countries should:**

- a. Put regional integration at the core of their trade policy frameworks, by actively pursuing the subregional and continentally-agreed integration agenda (notably with the establishment of the Continental Free Trade Area), as well as ensuring that multilateral and bilateral trade and investment agreements are in line with Africa's transformation agenda.

- b. Harness strategically South-South trade and investment linkages, making sure that they support economic diversification, innovation and technology transfer, greater value addition, and foster the emergence of regional value chains.
- c. Leverage South-South Cooperation and innovative aid modalities, thereby moving beyond the traditional donor-recipient dichotomy, and adopting a more flexible framework that reflects the reality of a multipolar world. In this context, Governments will be called upon to harness the potential synergies and complementarities across different actors – whether private or public, traditional donors or emerging development partners – at the global, regional and domestic level.
- d. Enhance the use of formal remittance channels and reduce the associated costs, both along North-South and South-South channels, with the aim of freeing much-needed private resources for investment purposes, in both human and physical capital.
- e. Foster the emergence of viable regional and subregional financial hubs in Africa in an effort to overcome the constraints posed by the limited size of national financial sectors and the fixed costs associated with the setting up of adequate regulation and surveillance mechanisms.

## **VI. Call for action**

18. Within the context of an increasingly strong positive narrative about Africa's prospects for social and economic transformation, the issue of mobilizing requisite financial resources, both domestic and external, is paramount. Therefore, the Ninth African Development Forum, on the theme "Innovative financing for Africa's transformation", could not be more timely and pertinent. The participants are of the conviction that the rich deliberations during the Forum have produced very important actionable recommendations for uptake by various stakeholders in Africa's development. We therefore call upon African Governments and all stakeholders, supported by their development partners, to ensure the effective implementation of all global and sector-specific actions contained in this consensus statement.

19. We agree that this consensus statement should feed into relevant national, regional and international processes on sourcing for financial resources to address various dimensions of Africa's economic transformation and development, as well as inform efforts to forge partnerships to reverse the tide of illicit financial flows from the continent.

## **VII. Vote of thanks**

20. We are truly grateful to His Majesty King Mohammed VI of the Kingdom of Morocco for his high patronage and for the insightful Royal Message delivered on his behalf by H.E. Mr. Abdelillah Benkirane, Chief of the Moroccan Government.

21. In the same vein, we also wish to extend our sincere appreciation to His Excellency Mr. Alassane Ouattara, President of the Republic of Côte d'Ivoire; His Excellency President Macky Sall of the Republic of Senegal; and Prime Minister Jose Maria Pereira Neves of Cabo Verde for their presence at this Forum, and in particular for their inspiring contributions to the discussions.

22. We also wish to acknowledge the presence of many African ministers and other dignitaries, whose participation contributed in large measure to the success of the Forum.

We commend the United Nations Economic Commission for Africa, its strategic pan-African partners and the Government of the Kingdom of Morocco, alongside many other stakeholders, for successfully convening the Forum and for contributing to its resounding success. In particular, special thanks go to the many participants, from diverse backgrounds, from within the continent and beyond, who honoured the call to serve the continent in its quest for resources to facilitate the actualization of its economic and social transformation agenda.

Finally, we wish to express our profound gratitude to Government of Morocco, in particular the Ministry of Economy and Finance and the Ministry of Foreign Affairs and International Cooperation as well as the people of the Kingdom of Morocco, and especially the immensely hospitable people of our host city, Marrakech and its Wali.



## **ANNEX II**

*Royal message from His Majesty  
King Mohammed VI  
of the Kingdom of Morocco*

*\*Translated from French by the Publications Section of the Economic Commission for Africa*

*His Royal Highness King Mohammed VI addressed a message to the participants at the Ninth African Development Forum, which kicked off on Monday, 13 October 2014, in Marrakech. The following is the text of the royal message, which was delivered by Mr. Abdelilah Benkirane, Head of Government.*

*His Excellency Mr. Alassane Ouattara, President of the Republic of Côte d'Ivoire,*

*His Excellency Mr. Macky Sall, President of the Republic of Senegal,*

*His Excellency Mr. José Maria Pereira Neves, Prime Minister and Minister of State Reform of Cabo Verde,*

*His Excellency Mr. Carlos Lopes, Executive Secretary of the United Nations Economic Commission for Africa,*

*Excellencies, ladies and gentlemen,*

*It gives me great pleasure to address this message to the participants at this high-profile continental forum and to assure you of my highest consideration.*

*The Kingdom of Morocco is proud to host the Ninth African Development Forum and very much appreciates the initiative taken by the United Nations Economic Commission for Africa to hold this session outside its Addis Ababa headquarters for the first time.*

*By selecting the city of Marrakech to discuss the relevant and highly topical theme of innovative financing for Africa's transformation, you are acknowledging the measures taken by my country to promote Africa, and also celebrating the commitment by the Moroccan business community to contribute to the economic take-off and competitiveness of the continent at a time of globalization.*

*In this regard, I commend the United Nations Economic Commission for Africa for the efforts it continues to make to promote the human and economic development of our continent.*

*The Kingdom of Morocco will remain an ever-committed and ever-determined partner supporting the constructive initiatives and actions of the United Nations system to promote Africa.*

*I am convinced that agreement among us, African countries, on the conditions for the continent's development and economic take-off will engender strong synergies and tremendous complementarities that we should build upon as ambitiously as possible.*

*Our continent is determined and willing to set forth a new process for the emergence of a "new Africa"; an Africa that is proud of its identity; a modern Africa that is not shackled by ideologies and old ideas; an Africa that is bold and enterprising.*

*This determination represents, in and of itself, a call to the international community to adopt an objective approach to Africa's development.*

*To reiterate the message I delivered during the sixty-ninth session of the United Nations General Assembly, Africa's development problems are not attributable to the nature of the land or the climate on the continent, but to deeply rooted economic dependence, weak support, inadequate sources of financing, and the lack of a sustainable development model.*

*Excellencies, ladies and gentlemen,*

*My call to the international community to adopt an innovative and non-traditional stance vis-à-vis the African continent is only matched by the ongoing commitment of African countries to experiment and implement new partnership approaches and to engage in innovative, inclusive and mutually beneficial South-South cooperation.*

*The Kingdom of Morocco is constantly working to achieve this major goal. In its relations with its fellow African countries, it always advocates a comprehensive and integrated approach that can help to promote peace and stability, enhance sustainable human development for all Africans, ensure that the sovereignty and territorial integrity of States are respected, and safeguard the cultural and spiritual identity of our peoples.*

*We are working with the same resolve to ensure that Africa places its trust in Africa and that our continent can use all its assets to fully seize all opportunities engendered by globalization.*

*It is being acknowledged more and more that, following the political independence achieved in the 1960s, African countries are now forging their economic independence, and that Africa is the new frontier of world growth.*

*Our continent's trade with the rest of the world has bulged by 200 per cent since 2000. Africa will be home to two billion people by 2050, giving the appearance, and rightfully so, that Africans are the youth of the world. The poverty rate on the continent has been declining steadily, and regional trade among African countries is booming.*

*In this regard, it is important to note that, beyond the overall strategic vision that Africa as a whole must have, the subregional dimension should be considered as part of the operational mechanisms and instruments that we will need to develop together.*

*This will allow us to invest in regional economic communities as viable and competitive platforms. Such an approach will allow African countries not only to maintain their continental integration ambition, but also to establish regional groups and to develop geo-economic platforms that could help them to enhance their positioning and competitiveness in the global economy.*

*For the Kingdom of Morocco, this intra-African process is essential. Accordingly, in addition to its unwavering commitment to the renewal of the Arab Maghreb Union, Morocco is continuing to engage with several regional organizations, including the Economic Community of West African States (ECOWAS), the Economic and Monetary Union of West Africa (UEMOA), the Economic Community of Central African States (ECCAS) and the Economic and Monetary Union of Central Africa (CEMAC).*

*Morocco is determined to maintain mutually beneficial, balanced and fair relations with all these economic groups.*

*Excellencies, ladies and gentlemen,*

*Africa is emerging as a new global centre of growth, owing to its considerable resources and potential. Nonetheless, this process cannot be consolidated and strengthened without a structural transformation of African economies and a shift in focus to high-value-added activities with a strong technological content.*

*To succeed in this regard, the financial dimension is of vital importance.*

*The mobilization of domestic financial resources is of course an essential element for the long-term financing of large-scale investment projects, especially infrastructure projects, and for paving the way for the achievement of the post-2015 development goals.*

*It is equally important for the international community to show more imagination and creativity in devising innovative financing instruments that can best support the economic transformation and sustainable development of the continent.*

*In this connection, the launching by the Kingdom of Morocco of Casablanca Finance City will foster the integration of Africa into international financial markets, facilitate intra-African trade, and steer global savings towards investment on the continent. More and more international investors are seeing Casablanca Finance City as a platform for financial operations and a gateway into African markets.*

*I am particularly pleased that the Africa 50 Fund was established recently, with the support of the African Development Bank, at Casablanca Finance City. The Fund will provide our continent with an innovative mechanism that would enable it to enhance the mobilization of resources on a large scale and to attract private financing for development and financing for infrastructure projects in Africa.*

*Similarly, to foster the mobilization of financial resources for Africa, efforts should be made to promote public and private partnerships and to steer the private sector towards high-value-added segments, such as renewable energies, agriculture, technology and infrastructure.*

*Excellencies, ladies and gentlemen,*

*In the light of all these assets and potential, it has never been more relevant to recognize that modern-day Africa has a greater need for win-win partnerships than for conditional assistance. It needs partnerships that can act as a catalyst for the mobilization of financial resources, advance regional economic integration and improve Africa's position along the international value creation chain.*

*Similarly, the appeal to the international community to provide financial assistance to Africa should encompass other equally important dimensions and parameters, such as good governance, robust institutions, institutional capacity-building, spatial and intergenerational cohesion and consideration of the human element.*

*Our changing continent is sending a message of hope and renewal to the international community. It is by combining our efforts and mobilizing our respective assets that we will achieve the goal of a united, stable and prosperous Africa in the twenty-first century.*

*I wish you success in your deliberations.*



# ANNEX 3

*Statement by  
Alassane Ouattara,  
President of Côte d'Ivoire*

*\*Translated from French by the Publications Section of the Economic Commission for Africa*

*His Excellency Mr. Macky Sall, President of the Republic of Senegal,*

*Mr. Abdellah Benkiran, Prime Minister of the Kingdom of Morocco,*

*Mr. José Maria Pereira Neves, Prime Minister of Cabo Verde,*

*The Executive Secretary of the Economic Commission for Africa,*

*Ministers,*

*Central Bank Governors,*

*Honourable guests,*

*Ladies and gentlemen,*

*First, I wish to express my sincere gratitude to His Majesty King Mohamed VI for inviting me to take part in the Ninth African Development Forum.*

*I trust that the Prime Minister will help to convey our messages to His Majesty.*

*This invitation once again attests to the quality of the bond of history, friendship and fraternity between Côte d'Ivoire and the Kingdom of Morocco.*

*The two visits that His Majesty paid to Côte d'Ivoire, in March 2013 and February 2014, illustrate the exceptional relations between our two countries and our two peoples. These visits have helped to strengthen and reinvigorate our exemplary cooperation.*

*Honourable guests,*

*Ladies and gentlemen,*

*I am particularly happy to participate in this important Forum, which is being held under the theme "Innovative financing for Africa's transformation". This theme is quite topical, since it comes at a time when Africa is changing and is being transformed into the next emerging continent in the world.*

*The question that remains is how to support this profound transformation that is unfolding before our very eyes, through adequate and innovative financing. This is the challenge we must tackle.*

*The first option available to us is to speed up the development of our financial markets, in order to start transforming our economies.*

*In this connection, we must develop innovative financial products and establish effective regional and national financial institutions and infrastructure.*

*This entails developing small and medium-sized enterprises and encouraging them to move from the informal sector to the formal sector. This is one of the necessary conditions for their eligibility for this type of financing.*

*As input to the discussions that you will be having during this Forum, I wish to emphasize seven points that I find essential:*

*First, we should mobilize local savings. The proportion of persons with bank accounts in our region is obviously low, not exceeding 12 per cent in Côte d'Ivoire, for example. A considerable amount of financial transactions are still conducted outside the financial sector. This has negative consequences for our countries:*

- *This situation creates unfair competition between the burgeoning informal sector and the formal sector, for several reasons, including the fact that too many transactions are not captured in the tax system, generating a significant revenue shortfall for our tax authorities;*
- *Resources that are outside the banking system and that are not saved do not contribute to the economic development of our countries and prevent the mobilization of savings;*
- *The cost of issuing currency (bank notes) is high;*
- *The development of cash transactions exacerbates the risk of money-laundering, the proceeds of which could be used to finance illegal and even terrorist activities.*

*We must therefore make efforts to boost the proportion of persons with bank accounts in our countries. This is a topic that is of particular interest to me. This is why I have asked my Government to work with the Central Bank of West African States to develop new financial instruments for the mobilization of long-term saving, which is important for insurance companies and other institutions.*

*Second, we should enhance the role of securities mobilization.*

*A dynamic securities sector is a pivotal factor for the development of our countries. A case in point is the regional stock exchange that is being developed in Abidjan.*

*However, that exchange should mobilize more resources if it is to meet the financing needs for our development. This would require better information and education for our people, who must be encouraged to invest in the financial instruments proposed by the exchange. This policy will undoubtedly contribute to the development of financial instruments, with increased income for individuals or businesses investing their resources on the exchange. It will also provide the private sector and Governments with access to more long-term resources at more competitive prices.*

*Third, we should adopt measures that encourage the private sector to invest in our economies.*

*It is well known that private investment funds have contributed significantly to the economic development of regions such as Latin America and Asia. Africa must follow suit. In this connection, the liquidity of financial instruments available on the stock market will help to attract international investors. It would therefore be important to maintain transparency in investment procedures, promote the repatriation of invested capital, and improve the business climate.*

*Fourth, we should improve Africa's image. This point is vital. It would require our involvement, as African leaders, in order to make Africa better known and to change the world's perception of the continent, because, in reality, Africa is changing and is becoming more and more competitive.*

*Fifth, we should promote the mobilization of resources from countries of the South.*

*In the current context of growth of emerging countries, innovative financing goes hand in hand with South-South financing. Although the major emerging powers have significant needs in their own countries, they are devoting more and more resources to other countries of the South. As a result, they are creating new sources of financing for Africa. Nonetheless, this is not sufficient. Relations between countries of the South should be intensified.*

*In this regard, the example given by the Kingdom of Morocco in the area of South-South cooperation, thanks to the vision and far-sightedness of His Majesty, should be commended.*

*Sixth, we should increase financing from public-private partnerships. The financing requests and needs of our economies in future years will be such that public resources will no longer be sufficient, making it imperative to seek help from the private sector. The solution is to encourage the financing of major structuring and job-creating projects by public-private partnerships. This is why my Government has established a public-private partnership unit to make full use of this type of financing.*

*My final point concerns the structuring of financing around migrant remittances.*

*Remittances by African migrants may provide considerable leverage for the financing of Africa's development. They generate significant resources and call for a better organization of transactions.*

*Honourable guests,*

*Ladies and gentlemen,*

*In addition to these different sources of financing that I have just enumerated, financing could also be obtained from international capital markets through euro bond issuances.*

*From January to the end of September 2014, sub-Saharan Africa raised \$6.9 billion on these markets, compared with \$6.5 billion in 2013. Côte d'Ivoire was able to raise \$750 million last July, at a rate of 5.625 per cent; the subscription was much larger than the amount issued (approximately \$5 billion).*

*South Africa, Senegal and the Sudan also used non-traditional financing, such as sukuk bonds, to finance their investment projects, especially their infrastructure projects.*

*Meanwhile, the Bretton Woods institutions must take into account our financing needs and agree to increase the debt ceiling at reasonable proportions.*

*The excess liquidity held by African banks is also a cause for concern, because it shows that they are not yet participating in the financing of our economies, including in the development of small and medium-sized enterprises.*

*Honourable guests,*

*Ladies and gentlemen,*

*To conclude, allow me to say a few words about my country, Côte d'Ivoire, which has set a goal of becoming an emerging country by 2020.*

*This goal is within reach: since 2012, our economy has been growing steadily, at a rate of close to 10 per cent, owing to an improved business climate, a more attractive investment code and major sectoral and structural reforms, among other factors. According to the World Bank Business Report 2014, Côte d'Ivoire was among the 10 countries that had instituted the highest number of reforms in the world.*

*We have also invested heavily in such areas as infrastructure, energy, agriculture, health, education and information and communications technologies, through our National Development Plan 2012-2015. Private investments, including public-private partnerships, represent 60 per cent of the anticipated investment. Accordingly, investments as a percentage of GDP should increase from 9 per cent in 2012 to 16 per cent in 2014.*

*We held an investment forum in Abidjan, in January 2014, which was deemed a success based on the participation of investors from a large number of countries and on the investment intentions they expressed.*

*Our growth is also driven by consumption, thanks to an increase in peasant income of 20 per cent in three years, an increase in civil servants' salaries, and a hike in the guaranteed minimum wage.*

*Our country's goal is not just to maintain strong and long-lasting growth, but also to generate equitable, cooperative, gender-sensitive and environmentally friendly growth for the benefit of one and all. Honourable guests,*

*Ladies and gentlemen,*

*I have faith in Africa. This is a continent of the future; a continent full of promise; a continent that will surprise the world.*

*I am convinced that the discussions we will be having during this Forum will enable our countries to become more of an integral part of the global economy.*

*I am just as confident that the outcomes of this Forum will stand African countries in good stead to take on the challenges of an emerging Africa.*

*I thank you.*



# **ANNEX 4**

*Statement by*

*H.E. Mr. Macky Sall,*

*President of the Republic of Senegal*

*\*Translated from French by the Publications Section of the Economic Commission for Africa*

*His Highness Prime Minister Abdelilah Benkiran, host of the Forum,*

*His Excellency Mr. Alassane Ouattara, President of Côte d'Ivoire,*

*His Excellency Mr. José Maria Neves, Prime Minister of Cabo Verde,*

*Mr. Carlos Lopes, Executive Secretary of the United Nations Economic Commission for Africa,*

*Ladies and gentlemen,*

*It gives me great pleasure to take part in this Ninth African Development Forum, which is being held here in Marrakech, the centre for discussions and meetings, at the kind invitation of His Majesty King Mohammed VI.*

*I wish to express my gratitude to his Majesty for the brotherly hospitality to which we have become accustomed in Morocco.*

*The theme of the Forum, "Innovative financing for Africa's transformation", reflects the positive trend that has been the hallmark of African economies for more than a decade now.*

*Notwithstanding the challenges and adversities they face, African countries have maintained their growth and development trajectory by enhancing the mobilization of their own resources and diversifying their partnerships.*

*Nonetheless, although they open up new opportunities, these positive changes also show that the conventional solutions that have been devised so far for development financing are no longer aligned with the scope and urgency of our countries' needs.*

*Our ambition, the aspiration of our people, is not just to combat poverty. Our ambition, the aspiration of our people, is also, and above all, to use their own devices to generate long-lasting growth that creates jobs and prosperity and leads to inclusive development.*

*If we want to forge ahead on this upward trajectory, we must equip ourselves with the tools to change paradigms, because anything that is possible in all continents is also possible in Africa.*

*We must explore other complementary and even alternative sources of public financing and development assistance, the latter of which is, of course, limited and always shrinking.*

*We must consider private investment and the partnership with Africa as an integral part of a new world economic order that is more suited to the needs of our countries.*

*We must agree that a new order in which ideas, rules and mechanisms are etched in stone cannot provide a base for the performances called for by the pace of growth that is required for the continent's emergence.*

*This is why, in my capacity as Chairperson of the NEPAD Steering Committee, and in the spirit of the Dakar Summit of June 2014 on the financing of infrastructure in Africa, I invite the Economic Commission for Africa and all relevant authorities to join us in advocating the removal of certain roadblocks that are slowing down the development of our countries.*

*I call upon partner countries and institutions to work with us to take on these major challenges.*

*There is an urgent need to reform global financial and economic governance in order to improve the conditions of access to capital markets by developing countries.*

*There is an urgent need to reduce the time frames for the design, financing and realization of development projects by streamlining and simplifying the methods, formalities and procedures involved, in keeping with the rules of good governance, in order to encourage results-based management.*

*There is an urgent need to intensify international cooperation for transparency in our extractive industries, including in the drafting of mining contracts.*

*There is an urgent need to establish a more effective multilateral system for the prevention and suppression of illegal financial flows, including those derived from corruption, money-laundering, tax fraud and other illicit practices that cost Africa an estimated \$50 billion to \$148 billion annually, according to a 2013 report by the Economic Commission for Africa.*

*All these efforts should generate greater resources and efficiency for the financing and execution of projects.*

*Clearly, it is through action that we will eliminate the final traces of afro-pessimism.*

*In this connection, it is encouraging that a number of African countries are continuing to inspire confidence and to offer credible partnership opportunities, with stable institutional settings and transparent and secure business environments.*

*This is the experiment that we are conducting as part of our new social and economic development strategy known as the Emerging Senegal Plan (PSE). The seven major components of this Plan are agriculture, infrastructure, energy, mining, tourism, information and communications technology, and habitat.*

*With the new law on build, operate and transfer (BOT) contracts, we want to expand and improve cooperation with the national and foreign private sectors, by promoting public-private partnerships for the realization of public infrastructure projects.*

*Senegal already has a number of success stories with public-private partnerships, including a 45-km toll highway, which will soon be extended to 110 km.*

*In cooperation with the private sector, we are currently carrying out an urban development project with the new city of Diamniadio, which has a large international conference centre that has already been completed.*

*We also intend to soon launch a project for an express train connecting Dakar to the new Blaise Diagne (AIBD) international airport, covering a distance of almost 45 km.*

*This new airport, which will be operational in 2015, was financed through an innovative mechanism, the airport infrastructure development tax (RDIA). This tax is collected on airline tickets of passengers using Senegalese airports.*

*There are other sources of financing that also offer a promising outlook for our countries.*

*A case in point is that of Islamic finance, with Senegal having just completed its first sukuk transaction within the West African Economic and Monetary Union (WAEMU), for an amount of \$200 million.*

*Another example is that of migrant remittances, which are estimated at close to \$2 billion annually in Senegal, representing more than quadruple the amount of foreign direct investment and more than double the amount of official development assistance.*

*At a time when the sources of financing are dwindling, the potential of Islamic finance and migrant remittances should be given greater consideration in our discussions, strategies and development policies.*

*I hope that this Ninth African Development Forum will help to lay the groundwork for these new options.*

*I thank you for your attention.*



# **ANNEX 5**

*Statement by*

*Prime Minister Jose Maria Pereira Neves  
of Cabo Verde*

*\*Translated from French by the Publications Section of the Economic Commission for Africa*

*Ninth African Development Forum-ADF-IX  
Marrakech, Kingdom of Morocco  
Statement delivered by His Excellency Mr. José Maria Pereira Neves,  
Prime Minister of Cabo Verde at the opening ceremony  
13 October 2014*

*Your Excellencies, Heads of State and Government,*

*Honourable colleagues, Prime Ministers,*

*His Excellency Dr. Carlos Lopes, Executive Secretary of the Economic Commission for Africa,  
Ministers,*

*Experts,*

*Ladies and gentlemen,*

*Allow me, first of all, to express my sincere thanks to His Majesty King Mohammed VI of Morocco for inviting me to participate in this worthwhile initiative. This invitation is an honour to both my country and me personally.*

*It is both an honour and a privilege for me to address this august assembly. It is an honour because of the quality and relevance of the statements that are expected to be delivered during this Ninth African Development Forum. It is a privilege because it gives me the opportunity to express my opinion on the theme of the Forum, a theme that is highly appropriate for most African countries and vital for a country like Cabo Verde, one of the small island developing States. As you all recall, the theme of the Forum is “Innovative financing for Africa’s transformation”, a theme which could not have come at a better time for Africa as a whole, and for small island developing States in particular, which are at a crossroads in their development.*

*As you are aware, climate change hits small island developing States particularly hard, given the limited resources available to them for coping with its impacts.*

*In this connection, I am pleased to see that you have invited all these experts, policymakers, members of civil society and development partners to discuss other innovative means of mobilizing financial*

*resources for dealing with the impacts of climate change, with a view to transforming our economies at this critical juncture.*

*I therefore wish to congratulate the Executive Secretary of the Economic Commission for Africa and his staff for the quality and volume of the work carried out by his institution recently, and for the special attention paid by the institution to the opportunities created by the blue and green economies.*

*Small island developing States are particularly vulnerable to the effects of climate change, all the more so owing to their geographic remoteness, their small size, their population constraints and their weak human capital. It is therefore urgent to adopt programmes aimed at reducing the vulnerability of African small island developing States.*

*These African States also suffer from infrastructural damages caused by the impacts of climate variation, including storms and typhoons and, in the case of Cabo Verde, drought, desertification and water shortage. Infrastructural development is also essential for the economic and structural transformation of small island developing States.*

*The Governments and peoples of African small island developing States have gained strength from the support of the international community. However, we are well aware that foreign aid alone will never be sufficient to meet our ever-growing needs.*

*Accordingly, we have been holding internal discussions on the ways and means of mobilizing financial resources to help us align our development strategies with the requirements of the blue and green economies.*

*African small island developing States are endowed with unique biodiversity and natural and oceanic resources that can help to turn their challenges into opportunities that can lead to the type of development that will create jobs and prosperity for their people. To exploit this potential, these States will need resources to transform their economies into blue and green economies, rooted in renewable resources and carbon-friendly development.*

*The fishery sector is of vital importance for African small island developing States as a source of subsistence, employment, food security and currency, even though the importance of these various aspects of the fishery sector differ from one country to the next.*

*Income from fish exports is highest in Seychelles, Cabo Verde and Mauritius, accounting for 52 per cent, 43 per cent and 15 per cent, respectively, of total exports.*

*These countries rely most on fish exports (tuna in particular) as a source of income. Nonetheless, fish imports are also highly significant in Mauritius, where they account for 83 per cent of the total value of imports.*

*A sustainable coastal fishery will help to alleviate the pressure on fishery resources, which will in turn help to combat the depletion of wild fish stocks, the destruction of natural habitats and declining biodiversity.*

*The sector has everything necessary to support the economies of African small island developing States. These States just need to take a chance.*

*Small island developing States depend heavily on seaborne trade because the only other means of transport available to them is by air. However, imports and exports are essentials for economic development. They play a major role in international trade, create jobs and wealth, contribute to the national gross domestic product, facilitate the development of relations among industries in the same field, and bring cities closer to one another.*

*Any boost in activity relating to manufacturing, agriculture and trade services will therefore benefit not only ports but also countries and coastal communities.*

*Maritime transport handles 80 per cent of the volume of global trade and accounts for 70 per cent of its total value. The expansion of seaborne trade over the past 10 years has allowed certain countries to take advantage of good business opportunities.*

*Coastal tourism is the largest segment of the market, offering great opportunities to small island developing States, which are often endowed with pristine environments, unique ecosystems and cultural features that set them apart naturally from other tourist destinations.*

*Tourism contributes directly and indirectly to the economies of African small island developing States. In particular, Cabo Verde and Seychelles depend a great deal on the tourism industry, with an indirect contribution of 43 per cent in Cabo Verde and 57 per cent in Seychelles.*

*In Cabo Verde, the tourism industry is a very important economic sector. With 10 islands spread strategically between South America, West Africa and Europe, Cabo Verde offers a wide array of landscapes, natural endowments and beaches; it is, in a way, a tourism Mecca which I invite you all to visit!*

*The tourism industry has become an important driver of economic growth in Cabo Verde since 2005.*

*Apart from tourism, energy resources also provide an opportunity for African small island developing States. Small island developing States depend heavily on fuel and spend more than 30 per cent of their income on foreign currency annually. Paradoxically, the major renewable energy resources of small island developing States remain unexploited.*

*The development of a sustainable energy sector in small island developing States will help to enhance their energy security, promote their economic growth and reduce their greenhouse gas emissions. The extraction of non-renewable resources may also open up an avenue for reducing their dependence on imported fossil fuels.*

*Marine renewable energy may be obtained from a number of sources, including wind, solar and oceanic energy. It may strengthen the reliability of electricity generation in small island developing States, and also reduce overall costs for the consumer.*

*The wind energy potential of many African small island developing States is considerable. Compared with fossil fuel power, wind energy may now be profitable in many small island developing States.*

*These States should therefore have no concerns about energy, which is indispensable for their economic development.*

*The sedentary biological resources of the outer limits of the continental shelf, including marine genetic resources, may also be of significant value. Given their size, oceans offer considerable potential in marine biological resources, including marine genetic resources. Oceans are a rich source of biological molecules that may be used for research and development.*

*According to recent studies, oceans make up 95 per cent of the Earth's biosphere, although it appears that 95 per cent of that biosphere remains unexploited.*

*Any small island developing State that is alone, isolated from the rest, faces enormous challenges. It is therefore essential for small island developing States to develop partnerships among themselves, with the continent, and with the rest of the world.*

*Financial and technological support from the international community will be essential to offset the high cost of kick-starting the processes of transition and alignment in the development of African small island developing States. It is essential to adopt a regional approach and to establish a regional*

*framework that would enable African small island developing States to combine their efforts in order to attain the minimum and cost-effective thresholds for investment, trade and capitalization on the regional value chain.*

*The time has come for African small island developing States to be the masters of their own destiny. It is time for these small African States to become the locomotives of the continent's development in many sectors. We will succeed if the blue economy is mainstreamed into our development policies and into our daily practices.*

*The Economic Commission for Africa has set the ball rolling on innovative financing for transformation, as I said earlier, and the quality of the participants gathered here makes it abundantly clear that this Forum will be highly successful.*

*Nonetheless, I wish to emphasize the need to establish clear implementation mechanisms and timelines.*

*Every support in this regard would be welcomed.*

*Thank you very much for your kind attention.*





## **ANNEX 6**

*Statement by Carlos Lopes,  
United Nations Under-Secretary-General  
and Executive Secretary  
of the Economic Commission for Africa*

13 October 2014  
Marrakech, Morocco

*Excellency, Mr. Abdelilah Benkirane, representing our host country, the Kingdom of Morocco,  
Excellency, Mr. Alassane Ouattara, President of Côte d'Ivoire,  
Excellency, Mr. Macky Sall, President of Senegal,  
Excellency, Mr. José Maria Neves, Prime Minister of Cabo Verde,  
Honourable Ministers, Distinguished Guests, Participants, Ladies and Gentlemen,*

*Allow me to first of all thank all those who have been working tirelessly to make this Ninth African Development Forum, the first taking place outside our headquarters in Addis Ababa, a success. Our host country has been its usual efficient and gracious self. We are grateful. Prime Minister Benkirane, we are watching with admiration the economic strategy towards the rest of the continent being pursued under the authority of His Majesty King Mohammed VI, as illustrated by the enlightening speech he just delivered. The presence of President Macky Sall is particularly symbolic, given his role leading the NEPAD efforts and his passion for the transformation of the continent. We are proud to work with you and for you.*

*The theme of our Forum calls for the guidance of President Ouattara, known for his impeccable credentials in the area of financing. President Ouattara, thank you for accepting to be the sponsor of the study and initiative we are launching on private equity. Prime Minister Neves is a great example of the new narrative about Africa, being a young leader who contributed to his country's impeccable development record. Your presence is also significant during this year devoted to Small Island developing States. Excellencies, your combined presence is a testimony of a new trend in Africa where policy thinkers and policy doers are becoming one. We are witnessing a considerable sea change in attitudes and mentalities, with leaders that are reformers and practitioners that are dreamers.*

*Ladies and gentlemen,*

*A mythical figure of African history, the Moroccan Ibn Battuta, considered one of the greatest travelers of all time, arrived in Somalia in 1331. He was surprised with Mogadishu's prosperity. He described this port city as being full of rich merchants, particularly active on the exports to many countries of high quality local fabrics. Its Sultan, Abu Bakr Umar, had a well established Government with wazirs, legal experts, commanders and tax collectors. Today's Mogadishu, six centuries later, continues to be an amazingly active port, despite decades of a devastating civil war. It continues to be an exporter. The problem is that instead of high quality fabrics, it has shifted to cattle, sheep and goats, or lower value addition, in the jargon of economists. The cost of all the war fronts, from piracy*

*response to terrorism, exceeds its export value. Today's Government does not have a tax collection system as efficient as Abu Bakr Umar's.*

*How is it possible that one of the few countries with one language, religion and ethnic group could have been moving backwards for so long?*

*The reasons for such dramatic developments are complex. But some lessons should be learned from glorious Somalia, since most of Africa has moved out of violent conflict. In fact the continent has today less turmoil than Asia, and close to 90 per cent of its population is no longer exposed to war and complex emergencies. Despite the gains in the Africa narrative, the continent continues to be perceived by many as unstable and insecure, and prone to disease, yet again, as seen by the hysteria around the Ebola virus. Ebola affects three countries that together represent less than one per cent of Africa's gross domestic product, or three weeks of the Nigerian economy. The lessons I want this Forum to retain from Somalia, apart from the need for us to move towards a peaceful and attractive environment, are more related to the economy. Africans feel legitimately proud about their growth achievements over the past decade and a half, and how resilient to exogenous shocks their economies have been. The just-released IMF outlook says it all: Africa as a whole will be expected to grow above 5 per cent in 2014. However, many Africans are stunned when they learn that their manufacturing value addition has been going down during the same period, from an already very low base (it currently stands at 9 per cent of combined GDP). That is one of the reasons we call for structural transformation; and we say it has to be qualified in the form of higher agricultural productivity, modernizing and formalizing the large service sector, better use of Africa's natural resource richness and, of course, industrialization.*

*After two years debating structural transformation and its imperatives, such as regional integration, the demographic dividend, urbanization opportunities and climate change challenges, the time has come to address more squarely the key question of how are we going to finance Africa's transformation. The old way, begging for aid? Is there a new way?*

*How should Africa prepare for the large United Nations Conference it will host in Addis Ababa in 2015 on finance for development? Are we ready to lead in this discussion, more crucial for Africa than any other region?*

*Ladies and gentlemen,*

*Africa learned from the financial crash of 2008 the importance of building on strong foundations. This requires a paradigm shift in the mind of fund managers and capital market perception and thinking about Africa.*

*Private equity in Africa has demonstrated that benefits do not only accrue to limited partners, general partners and portfolio companies, but also to Africans through local and regional markets. Africa might have finally found a way to whet the appetite of private equity investors. Private equity is an alternative source of capital that spans across infrastructure, health services, agriculture and underserved but high return investment. Each success breeds new opportunities and a resounding narrative for the transformation of Africa.*

*Our ability to strengthen, build and preserve capital in Africa is in line with Africa's search for innovative financing mechanisms. In recent years, African Governments have taken an active role in changing the investment landscape. Aid is no longer the panacea. This shift is associated with evidence-based policies. Economic activity thrives at the confluence of multiple sources of capital. As we build Africa's reputation in the global capital market, each success story establishes Africa as a destination for global capital flows. Driving them to transformational projects is what is expected from Governments that are strategic and focused. Notwithstanding the backbone of the transformation agenda, infrastructure, Africa offers opportunities in road, rail transport, energy, water, mineral resources exploitation, agro-business and industrial development. The opportunity to diversify investors' portfolios is not negligible. However, it remains a challenge given the stark lack of liquidity and the scarce access to capital markets. African regulatory bodies need to engage meaningfully with private equity funds to understand the legal and regulatory requirement for a radiant African ecosystem. As I said, African Governments have responsibilities to fulfill in order to create an enabling environment. National, regional and continental ecosystems must be upgraded to better support large scale investments. Africa has come a long way. It now has an increasingly stable and predictable economic and political environment. The reduced political and economic risk provides more confidence for investors. Governments' efforts for structural transformation are supported by an increased pool of well-educated and enterprising workers. The real test is the confidence that capital will afford to Africa by resisting the temptation of a flitting experience. The reality is that Africa cannot rely on development aid for the transformation agenda, so its appetite is moving towards private investment and domestic resource mobilization.*

*Ladies and gentlemen,*

*In a changing world, Governments can no longer ignore the blurred lines between private and social sectors. Impact investing, with its focus on better outcomes, has the potential to transform social desires into successful outcomes. For instance, it is true that a key challenge facing Africans today continues to be food security, along with the development of a sustainable agricultural sector. In particular, the African agricultural sector is deficient in the capital needed to improve farm productivity, enhance crop yields and produce more food for local consumption. Studies show that*

*growth in the agricultural sector has a thrice greater impact on poverty reduction than growth in other sectors.*

*Climate finance offers unique windows to deal with both climate change and the repositioning of Africa as a cleaner producer, by leapfrogging technological platforms and tapping the exceptional renewable energy potential of the continent. This Forum will demonstrate that the potential of domestic resource mobilization is immense. From better contract negotiations of extractive and other natural resources, to improved tax systems or better use of sovereign funds and reserves, Africa has been short-changed by lack of appropriate policies. Illicit financial flows are another scandal that needs a closer look. If the continent finds itself at the bottom of the Transparency Index, it is as much because the current state of affairs serves the interests of those who rank it as it is because of the local beneficiaries of corruption. Denouncing illicit financial flows is not just a moral imperative. It is a good input for transformative policies too.*

*Africa's migrants are sending in excess of \$50 billion, paying the world's highest transfer fees on top of their human sacrifice. The use of this asset class is far from productive right now.*

*With a few exceptions, recipient countries have a long way to go to establish attractive vehicles for these funds. Global impact investments accounted for about \$8 billion in 2012, a third of it going to Africa. Impact investments are clearly an emerging and innovative source of finance that has the potential to become an important complement to traditional investments. Impact investments can have both direct and indirect positive effects on human development in areas such as education, health and the environment. All these innovative financing modalities show the importance and timeliness of our discussion.*

*Ladies and gentlemen,*

*My dream, and I hope your dream too, is that when African children enter a history class and read Ibn Battuta's descriptions, they will feel like all other children from a modern, inclusive and developed part of the world.*

*African children should feel amazed about how much Ibn traveled but, also, how much their own societies have traveled; because they will know their continent, Africa, is the new development frontier. This is in our hands. This is possible.*

*I thank you.*



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