Chapter 2

Domestic and External Financial Flows

External and tax revenue resources available for development in Africa have tripled over the past decade and have never been so high. In 2011, external finances recovered to pre-crisis levels with foreign investment (FDI), official development assistance (ODA) and remittances estimated at USD 152.2 billion. As a share of Africa's gross domestic product, external flows doubled from 6.8% in 2000 to 12.3% in 2006, but were still down at an estimated 8.2% in 2011.

FDI and ODA remain the key sources of finance. But African governments and their partners must increasingly look at remittances and tax revenues and this chapter takes a closer look than previous years at these forms of finance.

The appetite of emerging economies for natural resources and a boom in international commodity prices underpinned an increase in resource investment in Africa. Sustained growth of over 5% and improved macroeconomic indicators — lower inflation, sustainable debt levels — attracted international and, increasingly, national investors.

Foreign investment remains the largest external financial flow to Africa and has great potential for stimulating long-term growth and employment. Yet, the increase in investment in recent decades did not produce more inclusive growth or sufficient jobs as most of the finance went on to the hunt for resources. Africa needs to attract more productive FDI to diversify its economy and benefit from technology transfers and spill over effects.

Official development assistance increased in 2011, but at a slower pace than previous years. The sovereign debt crisis and austerity measures in OECD countries dampened prospects for a significant increase in future assistance. This particularly threatens the functioning of the state for nearly half of African countries where ODA is still the largest external finance.

Remittances to Africa peaked in 2011 and are projected to continue to increase strongly in 2012. The importance of remittances varies across countries and regions. They play a significant role in smoothing consumption and hence contribute to poverty reduction and improving social conditions. Additionally, they can provide capital to small and microenterprises, aiding job creation.

Collected taxes in Africa increased from an unweighted average of 17.9% of gross domestic product (GDP) in 2000 to 20.3% in 2010. However, this increase was mainly driven by resource-related taxes in oil-exporting countries as oil prices surged after 2007. African countries need to improve the quality of their tax systems by deepening their tax bases. Tax revenues complement external financial flows by helping states to provide quality public services and pursue economic policies that are conducive to raising growth and attracting finances from abroad.

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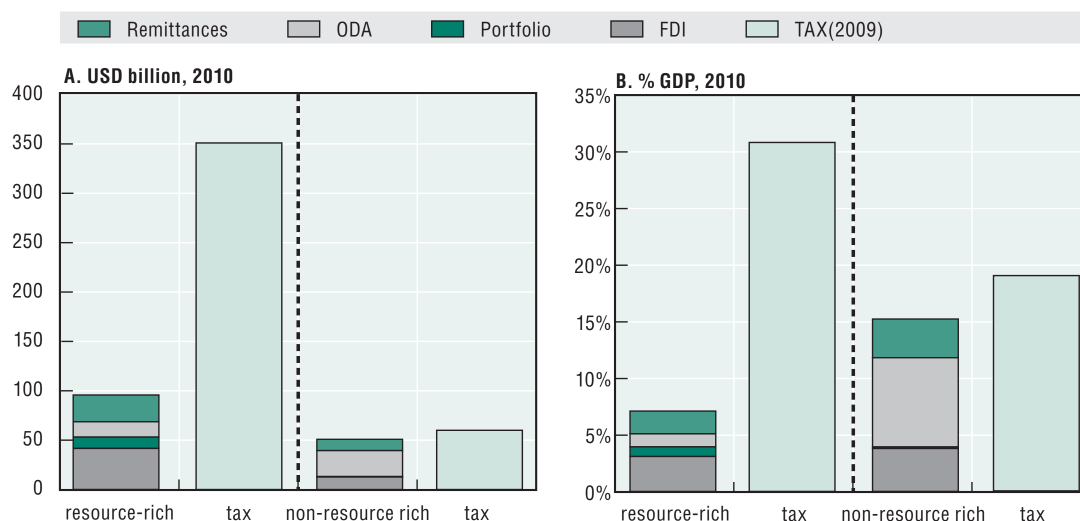
Table 2.1. **Summary of external financial flows and tax receipts in Africa (2000-12)**

Flows (real USD Billions)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011 (e)	2012 (p)
1. ODA, net total, all donors	15.5	16.8	21.4	27.4	30.0	35.8	44.6	39.6	45.2	47.8	47.9	48.4	48.9
2. Portfolio investments	1.9	-3.3	-0.1	-0.4	6.8	5.8	22.2	12.8	-27.0	-2.1	12.2	7.7	16.2
3. FDI inward	10.9	20.9	16.1	20.4	21.7	38.2	46.3	63.1	73.4	60.2	55.0	54.4	53.1
4. Remittances	11.5	12.6	13.2	15.8	19.8	22.7	26.8	37.0	41.5	37.7	39.3	41.6	45.0
5. Tax revenues	141.0	131.7	123.9	159.0	204.6	262.4	312.5	357	458.5	339.2	416.3	..	..
Total External flows (1+2+3+4)	39.7	47.1	50.6	63.3	78.3	102.5	139.8	152.5	133.1	143.5	154.4	152.2	163.2
North Africa	11.7	14.2	13.6	15.0	20.2	27.4	37.2	43.4	33.5	23.7	37.5	27.6	31.6
West Africa	7.5	8.0	9.6	10.7	13.9	23.6	34.0	32.2	33.6	37.6	37.7	42.4	45.2
Central Africa	1.7	2.8	4.0	8.8	5.1	6.0	6.0	8.0	4.6	7.0	9.5	8.4	8.6
East Africa	6.9	8.1	8.7	11.3	13.1	14.5	19.0	22.3	24.5	25.2	23.4	26.1	26.7
Southern Africa	10.6	12.5	13.0	14.9	23.3	28.2	40.5	42.5	31.9	44.2	41.2	39.1	45.9

Source: OECD/DAC, World Bank, IMF and African Economic Outlook Data. Author's estimates for 2011 ODA data, by using the forecasted rate of increase for Country Programmable Aid in the 2011 OECD Aid Predictability Report. Projections for 2012: FDI and portfolio: IMF, Remittances: World Bank, ODA: OECD/DAC (author's calculations). (This table excludes loans from commercial banks, official loans and trade credits).

The strong increase in Africa's financial resources over the past decade hides significant realities. Resource-rich countries captured most of the commodity-driven increase in external and especially domestic resources, largely through rising tax income from the exploitation of resources (Figure 2.1.a). In GDP terms, external flows are more important to non-resource rich countries (Figure 2.1.b.). Low-income countries, often poor in natural resources, attracted a higher share of FDI to GDP in 2010 and 2011. Green field investment to low-income countries showed more resilience to the economic crisis than the more cyclical resource-seeking FDI going to resource-rich middle-income countries.

Figure 2.1. **Domestic and external financial resources**



Source: OECD/DAC, World Bank, IMF and African Economic Outlook Data.
StatLink http://dx.doi.org/10.1787/888932600051

Total external flows to Africa in 2011 decreased slightly from USD 154.4 billion in 2010 to USD 152.2 billion. The gradual recovery of investment from the global economic crisis was halted by the revolutions in Tunisia, Egypt and Libya. In contrast to the modest recovery in

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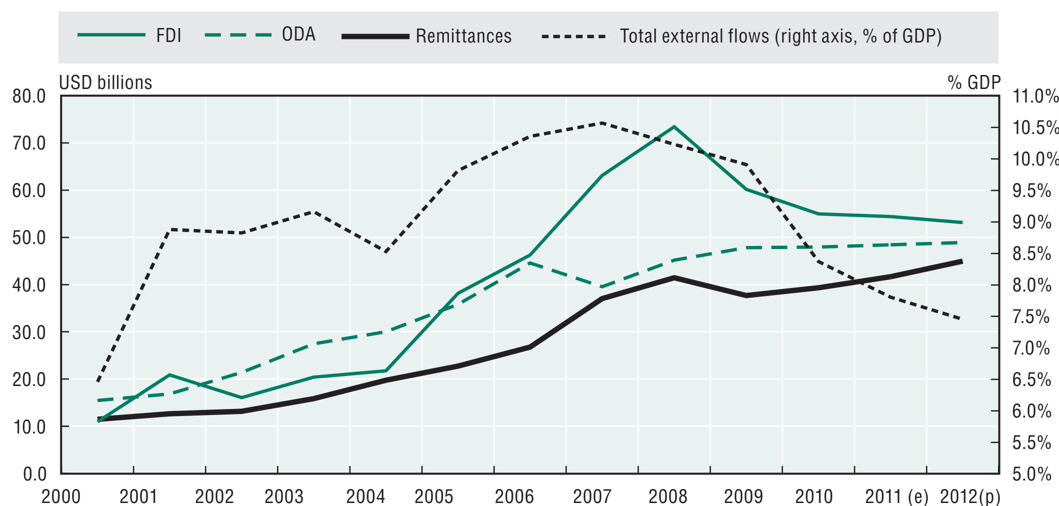
other developing countries, FDI flows to Africa decreased slightly in 2011 to an estimated USD 54.4 billion, compared to USD 55 billion in 2010 (UNCTAD, 2011). In comparison, total tax revenue increased by 22% to USD 416.3 billion in 2010. Total tax revenues in African countries were more than double the total external financial flows to the continent in 2010.

Africa's share of FDI to developing countries decreased from 9.4% in 2010 to 8.2% in 2011 as more money went to emerging economies outside the continent, particularly China. Africa received 3.6% of global FDI in 2011, down from 4.2% in 2010. This remains four times higher than the 0.8% in 2000, but significantly lower than its peak of 5.2% in 2009, indicating Africa's potential for attracting investment has not fully recovered.

FDI overtook official assistance as the largest external source for Africa in 2005 (Figure2. 2.). However, for 20 out of 28 low income countries which account for 52% of Africa's population, ODA remained the main external resource in 2010. The number of countries where investment exceeds other flows — all resource-rich countries — increased from nine in 2000 to 16 in 2010. Six lower middle-income countries (Cameroon, Cape Verde, Côte d'Ivoire, Djibouti, São Tomé and Principe, Sudan) had ODA as the largest external inflow in 2010. In all upper middle-income countries FDI represented over 50% of total external flows, with the exception of South Africa w ere portfolio inflows in 2010 represented 80% of total external flows. Some countries, such as Nigeria, Tunisia, Morocco, Senegal, Kenya, Swaziland and Lesotho, however, rely on remittances as the largest external inflow.

Figure 2.2. **FDI overtook ODA in 2005, but is below its 2008 peak**



Source: UNCTAD, OECD/DAC and World Bank. GDP forecast for 2012 from IMF.
(This graph excludes loans from commercial banks, official loans and trade credits).
StatLink http://dx.doi.org/10.1787/888932600070

To get back to the trend of increasing external financial resources, Africa needs foreign investment to recover to pre-crisis levels, particularly in Northern Africa, and remittances to continue progressing. The UN Conference on Trade and Development (UNCTAD) estimates that FDI to Africa should recover by 2014 to its average prior to the global crisis. The trend of emerging powers' increasing share in foreign investment should continue, in line with their needs for natural resources. Portfolio flows remain relatively marginal to Africa, but with the growing financial sector in countries like Morocco, South Africa or Egypt, a relative increase may be expected in the near term. In the current fiscal austerity and growing budgetary pressures in donor countries, official assistance will, at best, remain at its current nominal value in years to come.

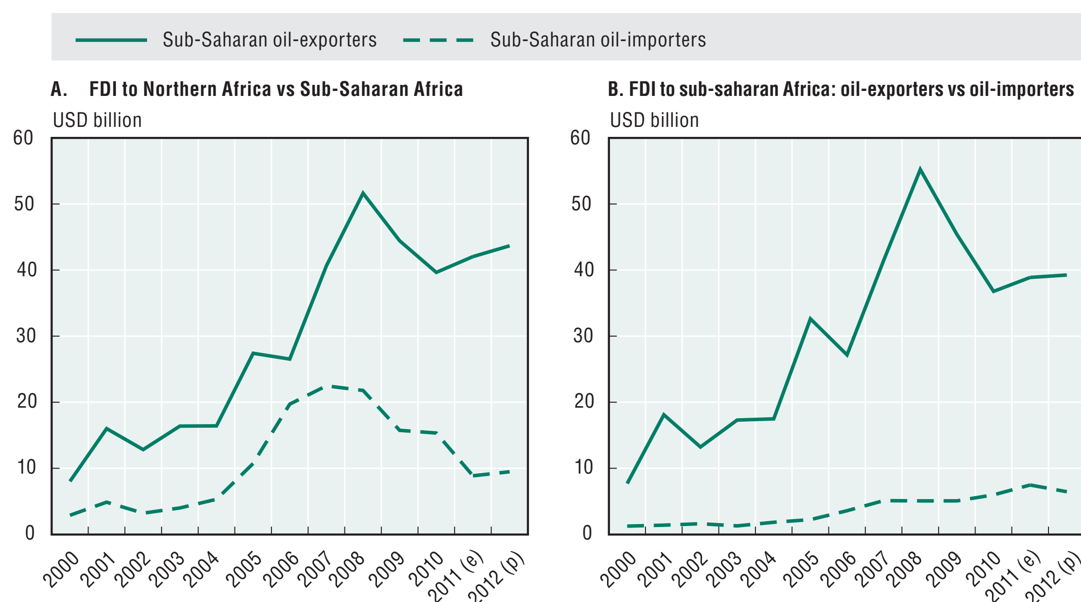
Risks are mainly related to global economic growth prospects and the evolution of commodity prices. A deeper crisis in Europe and a pronounced weakening of the global economy would hit financial flows to Africa (see chapter 1). The outlook for North Africa, in particular, depends on a return to normalcy in Libya, Tunisia and Egypt. Libya, one of the continent's largest foreign investment recipients, saw FDI drop from USD 6.3 billion in 2010 to an estimated USD 2.35 billion in 2011.

Investment Flows

Foreign Direct Investment to Africa

According to UNCTAD data, total foreign investment to Africa in 2011 decreased for the third consecutive year to an estimated USD 54.4 billion. This is in stark contrast to the general recovery of global FDI and resulted in a further decrease of Africa's share of the world total from 4.2 per cent in 2010 to 3.6% in 2011, still above the past decade's average of 3.3%. This near stagnation is the result of events in Egypt, Libya and Tunisia as economic and political uncertainty after the Arab Spring led international investors to adopt a 'wait-and-see' attitude. As a result investment to North Africa decreased by an estimated 42% in 2011, in addition to the 32% cumulative decrease in the previous three years.

Figure 2.3. **FDI to Sub-Saharan Africa recovered, while North Africa suffered**



Source: UNCTAD WIR, IMF WEO for 2011 estimates and forecasts.

StatLink http://dx.doi.org/10.1787/888932600089

Sub-Saharan Africa witnessed an estimated 25% increase in foreign investment in 2011 (Figure 2.3.a). Eastern and Western Africa led this recovery with a 53% and 17% increase respectively in receipts. This rebound signals that the fundamentals for attracting investment before the crisis remain in place: improved macroeconomic policies, a more conducive regulatory environment and – despite the fall from the earlier peak – favourable international commodity prices for exporters. In particular, metals, oil and agricultural raw materials saw average price levels in 2011 beat their 2008 peak levels.

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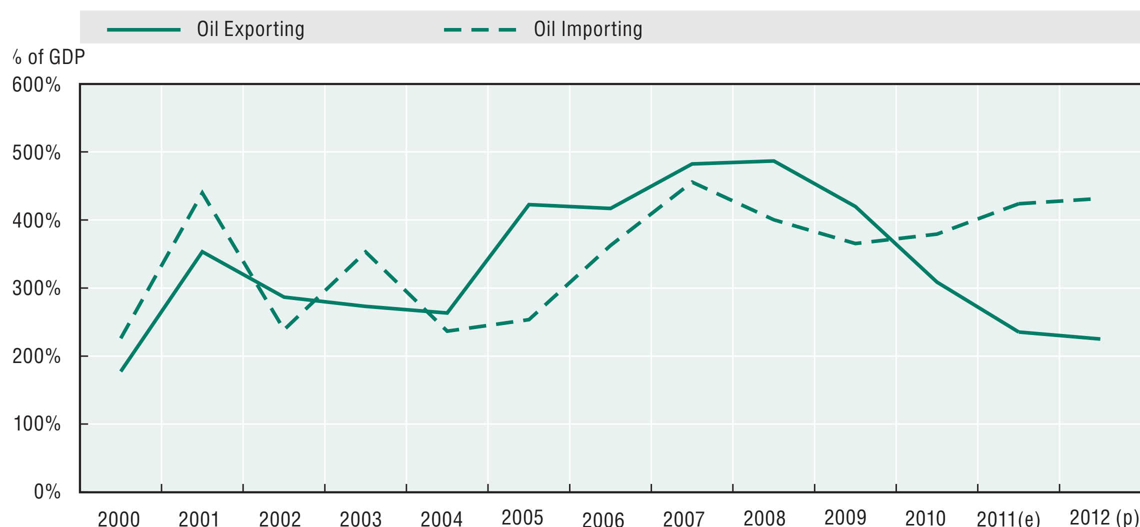
Figure 2.3.b shows how oil-exporting countries drew foreign investment to sub-Saharan Africa, resulting in a further concentration of FDI in extractive industries, especially oil. Non-oil economies are typically much smaller than oil exporters, hence they attract less investment volume. Figure 2.4., however, shows that oil-importing countries have been able to attract an equal amount of FDI as a share of GDP compared to oil exporters. The share of FDI to GDP for oil-importing countries has shown more resilience through the international crisis than oil-exporting countries.

Figure 2.4. **Oil-importing countries attracted more FDI as a share of GDP than oil-exporting countries**



Source: UNCTAD WIR, IMF WEO for 2011 estimates and 2012 forecasts.

StatLink http://dx.doi.org/10.1787/888932600108

FDI is an important source for productive investment —finance for fixed assets and inventories— in Africa (UNCTAD, 2010). The average share of FDI in gross fixed capital was 19.2% over the past decade, nearly twice the global average and well above other developing countries at 12.4%. Reisen and Rieländer (2011) indicated that foreign investment can enhance growth through capital accumulation as well as through total factor productivity. Resource-seeking investment remains the main FDI in Africa; however McKenzie & Co. (2010)[1] estimated that Africa's productivity increased by 2.7% annually from 2000 to 2007 indicating that African countries are gradually improving conditions to attract more productivity-enhancing investment.

The World Bank *Doing Business* Report 2012 indicated that a record 78% of African economies pursued regulatory reforms. Over the past six years the average had stood at 56%. In 2011, five African countries were in the "top reformers" list: Morocco, Cape Verde, São Tomé and Principe, Burundi and Sierra Leone. These countries should reap the benefits of past reforms in coming years.

In 2010, OECD countries still accounted for about 40% of total FDI to Africa, but their share will probably diminish in coming years. Emerging partners are expected to further increase their investment in Africa to find additional natural resources, competitively priced skills and growing markets. According to the 2011 Ernst and Young "Africa Attractiveness Survey" annual investment from emerging partners grew on average 13% annually over the past decade.

Investment from the emerging powers mainly sought natural resources, but is now increasingly diversifying into agriculture, manufacturing, and service industries (e.g., telecommunications). This enhances the potential for technology transfers and increasing productivity, playing an important role for economic growth in non-resource-rich countries (Mlachila and Takebe, 2011).

The short term investment outlook for Africa remains cautiously optimistic, in line with the sustained recovery of global FDI flows. This positive outlook is based on the sustained strong economic growth in Africa and the improvement of the business climate and competitiveness. Strong headwinds might come from a worsening of the recession in Europe in 2012 and the projected slowdown in global economic activity. This scenario would most likely temper the FDI recovery through lower demand for natural resources and decreasing oil prices. Investment recovery in North Africa will depend on stability in Tunisia, Egypt and Libya in particular. The following section highlights regional FDI trends.

Foreign direct investment trends differ significantly across regions. Southern Africa has been the continent's largest investment recipient since 2008. But according to International Monetary Fund figures, Western Africa should reach the same level in 2012, largely driven by new oil and other resource extraction in Ghana and Nigeria. The Arab Spring scared away investors from North Africa and they are not expected to return before 2013. Although Eastern Africa receives the continent's lowest FDI levels, it attracts more diversified investment which has helped increase productivity.

Southern and Western Africa attracted 55% of Africa's total investment in 2011. The top five recipients were Nigeria, South Africa, Morocco, Angola and the Congo Republic, by themselves attracting 48% of the 2011 total. Nigeria's oil industry and large consumer market made it the continent's top investment recipient, taking over from Angola, with a total of USD 7.36 billion. South Africa and Morocco followed with respectively USD 7.17 billion and USD 3.44 billion. Those same countries are expected to remain the top five FDI recipients for 2012. Morocco is the newcomer in the top 5, following a decade of specific policies that are starting to bear fruit.

The uprisings in North Africa had a strong impact on investment, which fell by 42% in 2011 to USD 9.48 billion. This represented 17% of total FDI to Africa, compared to 28% in 2010. With the exception of Morocco all countries attracted less investment. Egypt was the worst hit with a 60% drop in 2011. Egypt's long term economic fundamentals remain strong, boding well for investment prospects once the region stabilises. Investment in Morocco is expected to continue to pick up as the country has positioned itself as a haven of stability in the region, culminating in the Financial Times nomination of "Top Investment Destination for 2012".

East Africa is a less resource-rich region, with the exception of South Sudan and Sudan. Its share of African FDI diminished from 13% in 2004 to 7% in 2010, with total flows dropping to USD 4 billion in 2010. Investment picked up again in 2011 to USD 6 billion, led by Sudan with USD 2.63 billion, Ethiopia (USD 1.03 billion) and Uganda (USD 0.82 billion). Uganda wants to attract an oil refinery for its nascent oil industry, just as it did with a gold refinery built by Russians for its gold reserves. East Africa already has larger numbers of green field investment compared to other regions, indicating a higher diversity of projects and investment interest. This bodes well for diversifying the economy. East Africa's geographical position links it with the Middle East, India and China. A sustained increase in GDP per capita for 2011 and 2012 combined with its growing educated workforce should attract more investment in services and develop the local consumer market.

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FDI to Southern Africa halved from USD 30 billion in 2008 to USD 15 billion in 2011, reflecting decreased investment in Angola, from USD 16.58 billion in 2008 to an estimated USD 3.27 billion in 2011. Uncertainty ahead of Angola's presidential election might further dampen prospects in 2012, but its booming oil industry should bring strong inflows in years to come. South Africa reversed its recent downward trend attracting over USD 7 billion in 2011 from a 5-year low of USD 1.55 billion in 2010. Mauritius is continuing to move up the value chain by diversifying away from textiles and tourism into offshore banking, business outsourcing and luxury real estate.

Investment in West Africa increased in 2011, reaching an estimated USD 13.25 billion, compared to USD 11.31 billion in 2010. Over the past five years, West African FDI has been driven strongly by commodity related investments. Nigeria accounted for 79% of total FDI to the region in 2005. However, Nigeria's share of regional investment has fallen to about 54% as Ghana's new oil industry is attracting an increasing share – rising from USD 860 million in 2007 to USD 1.67 billion in 2011. Nigeria's 'Petroleum Industry Bill' should enhance transparency and governance of the country's oil industry. Nigeria's Ministry of Trade and Investment announced expected investments from three major Oil companies in 2012 of over USD 4.5 billion. Around 70% of investment in the region goes into oil and gas, while most of the remaining sum is captured by the real estate and telecommunication sectors.

FDI to Central Africa decreased from USD 7.9 billion to USD 7.64 billion, yet this represents an increase of around 50% compared to 2009. This increase was driven solely by Democratic Republic of Congo (DRC), where investment increased by 343% in 2010. This was led by telecommunications, though the country typically attracts resource-seeking finance. The Congo Republic, DRC and Equatorial Guinea represented 81% of the region's investment, most of which went into resources. Resource extractive industries are capital intensive and require high-skilled labour, thus not benefiting the local population through more inclusive growth and low-skilled employment creation.

Outward and intra-African investment

According to UNCTAD, total direct investment outflows from African countries increased by 18% in 2010 to USD 6.7 billion, compared to the USD 5.6 billion in 2009. They have not yet fully recovered to their peak level of USD 10.7 billion in 2007. North and Southern Africa provide the bulk of these outflows, nearing 80% of the total (Figure 2.5.). African investment directed at OECD countries represented 62% of total African outflows over the past decade, equal to USD 26 billion (UNCTAD and OECD data, 2012). Luxemburg attracted USD 5 billion, followed by the UK and France (USD 4 billion each), Germany (USD 2.4 billion) and Austria (USD 1.8 billion).

Africa's investment outflows doubled to 0.5% of the world share in 2010, compared to its average of 0.26% during the past decade (UNCTAD, 2012). North Africa provided USD 3.3 billion, roughly 50% of the continent's total. In 2010 Libya remained the highest outside investor, laying out USD 1.3 billion, with Egypt and Angola both close to USD 1.2 billion each. This will change radically for 2011 and 2012 because of the upheavals in Libya and Egypt. Nigeria (USD 0.9 billion), Morocco (USD 0.5 billion), South Africa (USD 0.45 billion) and Algeria (USD 0.2 billion) are the remaining four top investors. South Africa's outward FDI in 2010 was significantly lower than its pre-crisis performance of USD 3 billion and USD 6 billion in 2007 and 2006 respectively.

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Figure 2.5. **African FDI outflows mainly go from resource-rich countries to OECD nations**

North Africa — West Africa — Central Africa — East Africa — Southern Africa

% of GDP

A. FDI outflows per region

Total FDI outflows (left axis) — Share of Total outflows (right axis)

USD billion — % of Total African FDI outflows

B. African FDI outflows to OECD countries

Source: Author's calculations and UNCTAD WIR 2012.

StatLink http://dx.doi.org/10.1787/888932600127

According to Ernst and Young (2011) intra-African investment (included in FDI inflows and outflows above) increased 21% between 2003 and 2010, but the amount of capital involved and the number of projects remain smaller than for other emerging actors. This low activity can be explained by the region's dependence on external financial flows. The traditional pattern of North Africa and Southern Africa absorbing most intra-regional investment is slowly changing. Nigeria invested an estimated USD 1 billion in Ghana's service sector in recent years, especially banking and insurance. Leading Moroccan banks are investing heavily in the development of the West African financial system and banking sector. For Africa to fully realise its intra-regional trade and investment potential, further harmonisation of Africa's regional trade agreements and the inclusion of investment regimes would be required.

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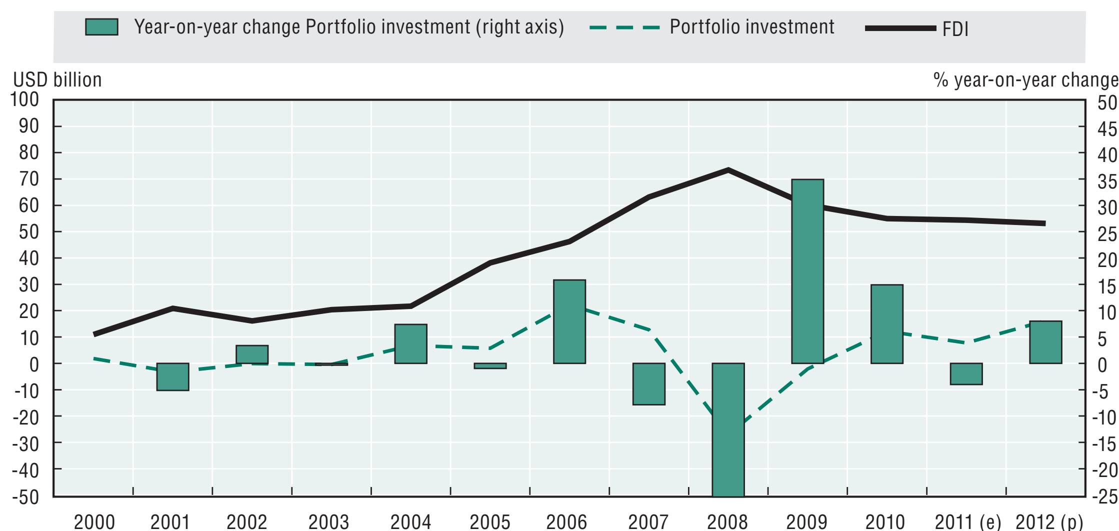
Figure 2.6. **Portfolio investments compared to FDI in Africa (2000-11)**



Source: UNCTAD WIR 2012 and IMF WEO 2012.

StatLink http://dx.doi.org/10.1787/888932600146

Mergers and acquisitions and portfolio flows

Portfolio flows to Africa recovered less swiftly than FDI and, although gradually becoming more important over the last decade, they remain marginal compared to foreign investment. According to the IMF, net portfolio flows to 23 African countries in 2000 amounted to USD 1.9 billion, representing 17% of total investment in Africa. In 2011, 32 African countries registered an estimated USD 7.7 billion, representing only 15% of total FDI to Africa. Figure 2.6. shows the volatility of these flows, peaking at USD 22.2 billion in 2006, dropping later to USD -27.2 billion in 2008, following the financial crisis. Such sudden capital movements bring the risk of an exchange rate crisis as experienced by South Africa in 2008, when the rand depreciated following the impact of the international financial crisis on portfolio flows.

Through the decade, South Africa remained the largest portfolio inflow receiver, amounting to an estimated USD 13.5 billion in 2011 —79% of entire portfolio flows to Africa. Nigeria came second, attracting USD 2.4 billion in 2011, representing its highest inflows ever. Political uncertainty impacted portfolio flows to Egypt in 2011, dropping to USD 3.1 billion from USD 8 billion in 2010.

Mergers and acquisitions (M&A) took off in Africa in 2006-10, with a total worth of USD 120 billion recorded compared to USD 42.5 billion for 2000-05. M&A from the world to Africa in 2010 was valued at USD 29.6 billion, more than double the 2009 figure of USD 11.1 billion, but below its 2008 peak of USD 36 billion, according to Dealogic data. The average size of deals doubled from USD 329 million (2000-05) to USD 664 million (2006-10).

This rebound was, for the first time, driven by the emerging economies, with India, China and Brazil representing three out of the five top merger and acquisition deals in 2010. Standard Bank estimated that M&A activity between Africa and China rose 90% in 2011 to USD 5 billion. It is expected to grow further this year despite the economic slowdown. The 2010 rebound was not confirmed in 2011 however. UNCTAD (2012) estimated the net value of cross-border M&A deals in Africa to have decreased by 17.1% from USD 7.6 billion in 2010 to USD 6.3 billion in 2011.

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Box 2.1. **A glimpse at African investment policy developments**

In 2011 a record 78% of economies in sub-Saharan Africa implemented regulatory reforms to improve the business environment (World Bank *Doing Business Report*, 2012). Such reforms are the focus of the *NEPAD-OECD Africa Investment Initiative*, which is conducting Investment Policy Reviews in partner countries in Africa.

This year heralds a breakthrough for this regional work: the Initiative will co-operate with the Southern African Development Community (SADC) in developing the SADC Regional Investment Policy Framework. SADC has identified the OECD Policy Framework for Investment (PFI) as the reference for this regional framework. In this way the country-level work provides building blocks for regional co-operation. We draw from this accumulated experience in national and regional investment policy reform to highlight the following emerging trends in Africa:

- Investment policies increasingly include **private sector involvement** through public-private partnerships (PPP) and the facilitation of **employment generation** and **investment by small businesses** through linkages with larger investors.
- Several governments have established **national task forces or regulatory committees** – often at the highest levels of government – to co-ordinate and oversee investment policy and business climate reform.
- There is increasing momentum for **co-ordinating investment policy reform at regional level**. This is a crucial development for allowing countries to tap scale economies, expand market size, and facilitate investment in projects that by nature span national borders (such as large-scale water, energy or transport infrastructure).

Tax policy reforms to facilitate SME growth, revenue sharing, and employment:

Mauritius has lightened its tax system to facilitate business development, by abolishing a solidarity tax on dividends and interest, a capital gains tax on immovable property, a land transfer tax, and a municipal tenant's tax (effective 1st January 2012).

Mozambique has engaged in cross-cutting fiscal reform since 2009, including revising its land usage fees and land taxes and providing a simplified regime for smaller enterprises.

Botswana made amendments to VAT to favour small scale agriculture, effective from 2012.

South Africa renewed tax incentives for manufacturing investment, with a special focus on job-creation and the facilitation of small industry development. In 2012 consideration will also be given to expanding incentives for labour-intensive projects in Industrial Development Zones.

Co-ordinating investment policy reform through national task forces:

Mauritius set up a Joint Public-Private Sector Business Facilitation Task Force in October 2011, which focuses on removing investment and export bottlenecks. The task force will prioritise tourism, international trade, public utility development, and facilitate land conversion and access to building and land use permits.

Tanzania's National Investment Steering Committee led the development of the 2009 Roadmap on 'Improving Tanzania's Performance in Doing Business', and plays a guiding role in the Roadmap's implementation.

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Regional co-ordination of investment policy reform

The *Southern African Development Community* (SADC) launched its Regional Action Plan for Investment (RAPI) in January 2012. A key component is the Regional Investment Policy Framework. This framework will seek to harmonise investment policy across SADC member states in co-operation with the *NEPAD-OECD Africa Investment Initiative*, using the OECD Policy Framework for Investment as its reference.

The *East African Community* (EAC) called on all Partner States to harmonise national laws according to the EAC Common Market Protocol by December 2012, which should facilitate free movement of labour and a further integration of regional financial markets. The *Economic Community of West African States* (ECOWAS) has been developing the ECOWAS Common Investment Market (ECIM) since 2008. In September 2010 ECOWAS officially launched the process of creating a region-wide investment code under the ECOWAS Common Investment Market, which has included reference to the OECD Policy Framework for Investment (PFI). FDI flows to Africa are growing fast – they reached USD 415 billion over 2001-10, over five times the amount of the previous decade. As FDI to Africa has outstripped official development assistance since 2005, it is vital that African countries design investment policies to ensure that FDI serves as a source of growth and development —particularly through spurring employment creation, technology and knowledge transfer, and export diversification. Channeling FDI towards manufacturing and services— and not only into extractive industries (which attracted 43% of FDI to Africa in 2010) —will be crucial. Indeed the social and economic dividends of FDI are not automatic. Governments will need to continue strengthening investment frameworks with these objectives in mind. The trends highlighted above are encouraging in this regard: beyond seeking to enhance FDI attraction, recent investment and tax reforms attempt to capitalise on investment spill-overs for job creation, diversification and small business development. These efforts still need much wider implementation. Regional platforms can boost this reform momentum, by co-ordinating investment policy reform across member countries.

Source: NEPAD-OECD Initiative for Investment in Africa.

Remittances

The World Bank estimates that remittance flows to developing countries recovered by 8% to USD 351 billion in 2011, compared to USD 129 billion global official development assistance in 2010. These flows are likely under-reported as a large amount is sent through informal channels or in-kind. Some estimate actual remittances to be twice the official figures (IMF 2005a; World Bank 2005a; Docquier and Rapoport 2004). Up to 75% of the total remittances sent to Africa go informally, a much higher figure than for other continents (Freund and Spatafora, 2005).

The nature of remittances is different and complementary to other external financial flows. The importance of remittances in consumption, thereby reducing poverty, is widely recognised (Ratha 2003). The wider impact is not so sure. Chami *et al.* (2003) found that remittances do not necessarily increase economic output as they typically are compensatory rather than channelled towards productive investment. They can help set up informal microenterprises which generate employment however (Gupta *et al*., 2007).

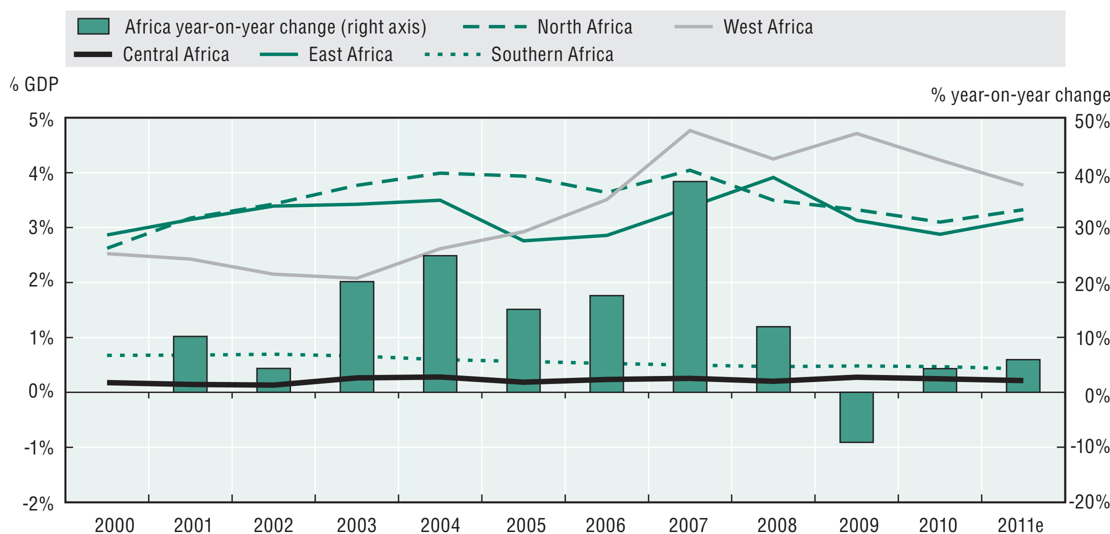
Total remittances to Africa in 2011 were estimated back at the pre-crisis level of about USD 41.6 billion, an increase of 5.9% over 2010. The GDP share of remittances for Africa

remained stable at 2.3% in 2011, though with significant regional differences. West Africa had the highest share of remittances to GDP, 3.8% in 2011. Remittances to Southern and Central Africa represented less than 0.5% of their GDP. Remittances as a share of GDP are highest for Lesotho at 28% in 2011, followed by Gambia (11%), Senegal (10%), Togo (9%) and Cape Verde (8%). After Tajikistan, Lesotho has largest share of remittances to GDP in the world, explained by their migrant workers in South Africa.

There has been a threefold increase of remittances per capita for Africa between 2000 and 2011. Countries have different levels of dependence of remittances. Cape Verde received USD 306 per capita in 2011, followed by Lesotho (USD 291), Morocco (USD 220), Mauritius (USD 193) and Tunisia (USD 175). A more detailed regional comparison is difficult given the lack of official data on remittance flows, in particular for Central African countries.

The share of remittances to GDP for Africa has remained stable across the decade, averaging 2.4%. Figure 2.7. shows that remittances for West Africa increased from 2.5% of GDP to 4.8% of GDP during the period. For oil-importing countries remittances were almost twice as important in terms of GDP, averaging 3.7% of GDP over the last 10 years, compared to 2.0% for oil-exporting countries. North Africa attracts the largest amount of remittances, amounting to USD 19 billion in 2011, followed by West Africa with USD 14 billion, respectively 117 USD per capita and 46 USD per capita. Both regions amount to 80% of total remittances to the continent, a proportion that has stayed roughly the same throughout the last decade, except that West Africa has nearly doubled its share of total remittances to the continent. The two regions most affected by the crisis were North and East Africa, which saw remittances drop 12% and 16%, respectively, in 2009.

Figure 2.7. **Remittance flows per African subregion**



Source: World Bank 2012.

StatLink http://dx.doi.org/10.1787/888932600165

The three top recipients absorbed over 60% of total remittances to Africa in 2011. With USD 10.7 billion, Nigeria attracted the most remittances, followed by Egypt and Morocco, with USD 8 billion and USD 7.1 billion, respectively. These countries have a large migrant population in more developed countries. Nigeria and Egypt are among the top 10 countries in the world for remittance inflows in 2011. Remittances to Egypt increased an estimated 30% in 2011, boosted by the impact of high oil prices for Gulf Co-operation Council (GCC) countries.

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The weak Kenyan shilling in 2011 resulted in a temporary surge in remittances inflows to Kenya in 2011 from USD 1.78 billion in 2010 to an estimated USD 2.24 billion. Depreciation of the local currency can have a strong impact on remittances by increasing the purchasing power of money sent home, creating an incentive to increase the sums.

The main sources of remittances are slightly different for each sub-region. The United States and Western Europe accounted for nearly 70% of remittance flows to sub-Saharan African countries in 2010 (28% and 41% respectively), followed by the GCC countries (9%). The Middle East and North Africa, in contrast, received nearly 40% of their remittances from the GCC in 2010.

Despite the recovery of global remittances, the World Bank estimates future growth of such transfers will remain at half of their pre-crisis average of 17.3% (2000-08), reaching USD 441 billion by 2014. The strongest downside risks are for those from Europe and the United States, because of their economies. According to World Bank calculations, remittance flows to Cape Verde, Senegal and Guinea-Bissau are most exposed to any worsening of the economy in Europe. The impact of the Arab Spring is yet unclear. Migrants from Egypt, Tunisia, Niger and Chad massively fled Libya because of the unrest, likely affecting remittances flows in 2012.

Official development assistance

According to OECD Development Assistance Committee (DAC) figures, global ODA volumes increased by 6.3% to USD 128.5 billion in 2010. This reversed the fall in ODA in 2009 because of the international financial crisis. It represented the highest level of ODA in history. When looking at development assistance as a share of gross national income (GNI), the upward trend of past years was confirmed in 2010, with total net official development assistance reaching 0.32% of GNI compared to 0.31% in 2009. In contrast, bilateral aid for core development programmes and projects (i.e. excluding debt relief grants and humanitarian aid) rose by just 4.6% over 2009, compared to 9.0% the previous year. This rise in global ODA reflects the international community's efforts to sustain the economies of developing nations through the financial crisis.

Although the period from 2004 to 2010 saw the largest ODA increase in history, donors still fell short of the 1970 target fixed by the UN General Assembly of providing 0.7% of their GNI in development assistance. In 2010, the largest donors by volume were the United States, followed by the United Kingdom, France, Germany and Japan. The United States contributed 0.21% of its GNI, compared to the average donor country effort of 0.49%. Only Denmark, Luxemburg, the Netherlands, Norway and Sweden continued to exceed the 0.7% target. Sub-Saharan Africa received 33% of total assistance disbursements in 2000-09, compared to 29% for 1990-99. In 2009-10 Belgium, Denmark, France, Ireland and Portugal gave over 50% of their ODA to Africa.

This increase in assistance financing followed the 2005 Group of Eight summit in Gleneagles, Scotland, where individual donors pledged to raise their assistance to a specific level. The OECD/DAC estimated these pledges increased overall assistance by 37% in real terms since 2004, or about USD 30 billion (in 2004 dollars). Yet the current 2010 ODA figures still represent a shortfall of about USD 19 billion on the 2005 pledges even though Africa received an additional USD 11 billion over the pledged USD 25 billion by the end of 2010. Some of these pledges were met, notably the US aim to double their 2004 aid levels to sub-Saharan Africa by 2010. In 2011, in order to enhance accountability and transparency, the DAC approved a 'Recommendation on Good Pledging Practice', which aims to keep aid targets

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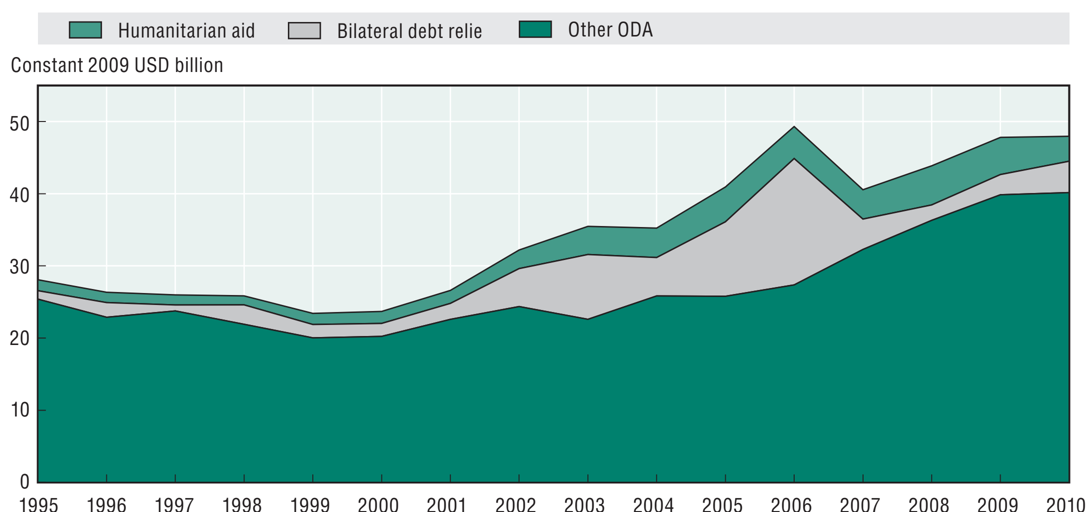
clear, realistic and attainable. Notwithstanding increased efforts to raise aid efficiency, prospects for increasing assistance in the near future remain bleak amid the greater fiscal austerity and sovereign debt problems in developed countries.

The OECD/DAC's fourth comprehensive survey of donors' future spending plans suggests slower aid growth ahead, with global Country Programmable Aid (CPA) planned to increase at a real rate of 2% per year from 2011 to 2013, compared to 8% per year on average over the past three years. Looking at donor countries' CPA to Africa only, the increase is projected to be even lower at 1.3% per year. This reflects concerns about the capacity of developed countries to maintain current aid volumes.

Net official assistance disbursements to Africa remained stable at USD 48 billion in 2010, as shown in Figure 2.8.. Debt relief went from USD 2.8 billion in 2009 to USD 4.2 billion in 2010, whereas humanitarian aid dropped 32.9% from USD 5.2 billion to USD 3.5 billion. Ethiopia, Congo DRC, Tanzania, Nigeria and Sudan attracted the largest amounts of ODA, jointly representing 29% of total net spending on the continent in 2010.

Figure 2.8. **ODA levels to Africa have maintained levels through the international crisis**



Source: OECD/DAC 2012.

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As a share of GNI, Liberia is Africa's most aid dependent country, with ODA representing 177% of its GNI, followed by Burundi, DRC, Sierra Leone and São Tomé and Principe each with ODA representing over 20 % of GNI. Overall, aid dependency ratios have increased during the last decade. In 2000, 19 countries representing ODA/GNI over 10% compared to 25 countries in 2010. This is nearly half the number of countries on the continent. Aid dependency measured as a ratio of official assistance to GNI has increased for low income countries with the average being 13.5% in 2000 compared to 19.6% in 2010.

Total Country Programmable Aid to Africa is expected to decelerate relatively stronger at about 1% per year in real terms during the next three years, in contrast to the 12% real annual growth rate experienced between 2008 and 2010. In per capita terms, according to World Bank data, net ODA in Sub-Saharan Africa has remained stable at USD 19 per capita in 2008 and 2009. Over time however, this should decrease significantly as the United Nations

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predicts Africa's population will increase by 25% to 1.5 billion by 2020. In such a constrained environment, African governments need to tap alternative financial sources and put stronger emphasis on increasing the efficiency and the impact of donor resources. It is unlikely that this decelerating ODA will be reversed in coming years, so the donor governments who are worrying about fiscal austerity at home should emphasise raising aid efficiency and impact.

The emergence of new donors and alternative co-operation modalities, as reviewed in the 2011 AEO, provides opportunities for African countries to diversify financing sources. Zimmerman and Smith (2011) estimated that gross development flows from selected countries beyond the OECD/DAC stood at nearly USD 11 billion in 2009, representing roughly 8% of global gross ODA. Flows from emerging donors even exceeded the contributions made by some DAC members. This is notably the case of Saudi Arabia (USD 3.2 billion in gross ODA), China (USD 1.9 billion) and the United Arab Emirates (UAE) (more than USD 1 billion). According to the 2011 AEO, although emerging partners are not yet major players in foreign investment or official assistance, they outplay traditional partners in alternative finance, such as export credits or natural resource-backed lines of credit.

The four major providers of South-South co-operation —Brazil, China, India and South Africa— are increasingly reaching out to African countries. Brazil's total development co-operation reached 362.2 million USD in 2011 (IPEA and ABC 2011), most of which is channelled through multilateral co-operation. Brazil's assistance in Africa is expanding rapidly towards Portuguese-speaking countries and Ghana. China's total development co-operation of USD 1.9 billion in 2009 (China's Ministry of Finance 2010), which is almost four times the 2000 level. China's engagement in Africa is set to increase. At the last Forum for China-Africa Co-operation, the Chinese government pledged USD 10 billion in concessional loans to African countries and USD 1 billion in special loans for African small and medium-sized companies. India's co-operation with Africa is also rising, as seen in the USD 5.4 billion in loans and USD 500 million in grants pledged at the first India-Africa Forum Summit in 2008. South Africa announced in 2011 the establishment of the South African Development Partnership Agency, which will improve co-ordination of its different development activities (Ramachandran 2011). South Africa's development co-operation flows decreased from USD 112.6 million in 2009 to USD 108.7 million in 2010 and are essentially oriented towards countries in its region (Zimmerman and Smith 2011). On 6 April 2011, the OECD/DAC released an official statement formalising its efforts to expand partnerships with other key players in development co-operation.

According to the 2011 Survey on Aid Effectiveness, to monitor progress in implementing the 2005 Paris Declaration, only one out of the 13 targets for 2010 was met. This was on increased 'co-ordinated technical co-operation'. The direction and pace of progress since 2005 varies considerably. Several developing countries have made strong progress in the quality of planning and financial management tools. The proportion of developing countries with sound national development strategies has more than tripled since 2005. In contrast, little progress was made to lower aid fragmentation and to improve predictability of aid. Little progress has been made regarding particularly sensitive issues such as aid conditionality and donor co-ordination. The OECD/DAC estimates the cost of aid fragmentation, as measured by unnecessary transaction costs, duplicated efforts or missed opportunities for effective partnerships, at up to 30%-40% of the total resources expended.

Box 2.2. **Outcome of the Fourth High Level Forum on Aid Effectiveness**

The Busan Partnership for Effective Development Co-operation, agreed at the Fourth High Level Forum on Aid Effectiveness in Busan (Korea) in 2011, is the most inclusive agreement on global co-operation for development to date. Donors, South-South co-operation partners, developing countries, civil society organisations, private sector representatives and many others took part in formulating the agreement – under the auspices of the OECD/DAC-hosted Working Party on Aid Effectiveness – and lent their support to the final product. The Busan Partnership goes far beyond the traditional "donor-recipient" division: major South-South partners are promoting the document as a reference for their co-operation and the private sector has recognised that it could lead to innovative financing investment tools as well as new methods for reducing risk in developing countries. From an African perspective, the more relevant aspects of the Busan Partnership agreement are:

- A firm commitment to continue working on the implementation of the aid effectiveness principles as defined by the Paris Declaration (2005) and the Accra Agenda for Action (2008). The principles place special emphasis on country ownership; and call on donors to harmonise their support, aligning it with national priorities. Sustaining commitments for these principles was one of the main demands of African delegations during the negotiation process.
- The recognition that ODA is one of many sources of development finance, and as such must be integrated within a coherent framework for development. ODA can play an essential role in leveraging other financing and supporting domestic resource mobilisation.
- It has been endorsed by many of the most important providers of South-South co-operation, namely emerging economies, who had been reluctant to participate actively in international discussions on aid effectiveness. While insisting on their freedom to apply the principles on a voluntary basis, countries like China and Brazil are now engaged on collective efforts to optimise development co-operation.
- Through its focus on implementation at the country level, the Busan agreement calls for establishing national frameworks to track the effectiveness of co-operation. This implies participation of a broad range of actors. Parliaments, local governments, civil society organisations, and the private sector are all part of this accountability design.
- At the global level, it establishes the Global Partnership for Effective Development Co-operation to support commitments and ensure accountability for their implementation through a relevant set of global indicators and targets against which to measure advances.

The involvement of African countries was a crucial success factor in the negotiations leading to the Busan agreement and will remain vital for its implementation. Regional initiatives, such as the African Platform for Development Effectiveness co-ordinated by the African Union Commission and NEPAD, can play a major role in this process.

Source: Provided by the OECD Development Cooperation Directorate.

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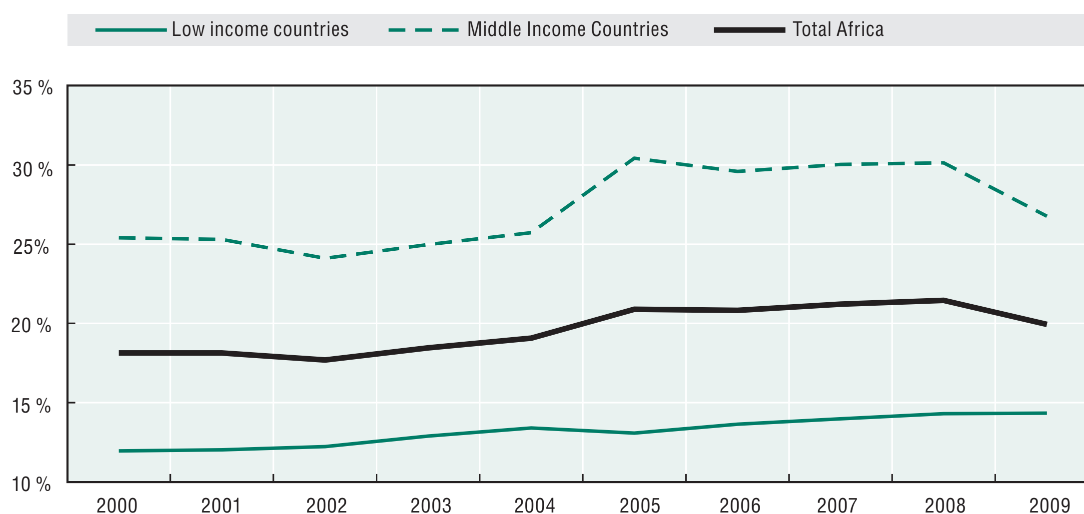
Increasing tax revenue for development

Taxes play an important role in a well-functioning state, but should not be an end in itself (Kaldor, 1980 and Toye, 1978). A healthy public finance system is needed for rapid, equitable, and sustainable growth: government revenue should adequately finance basic security, education, health services and public investment while avoiding inflationary financing (Di John 2009). Fair and efficient taxation forces the state to engage with its taxpayers and hence nurture the process towards a balanced and equitable social contract.

According to 2012 AEO data, total collected tax revenue went from USD 141 billion in 2000 to USD 416.3 billion in 2010, representing an unweighted average tax share of 20.3% of GDP. In 2010 total taxes came to more than eight times the amount of ODA received by Africa. There are significant differences in the capacity of countries to provide public services solely with tax money. Countries such as DRC, Burundi, Sierra Leone, Ethiopia or Guinea-Bissau perceive less than USD 35 in annual taxes per capita in comparison to countries like Equatorial Guinea (USD 3 806), Seychelles (USD 2 810), Botswana (USD 2 101) or Gabon (USD 1 755).

Figure 2.9. plots the evolution of unweighted average tax shares for Africa and their breakdown into different income categories. Classifying African countries according to their level of income shows two different trends in tax ratios. Middle-income countries in Africa have, on average, a tax share comparable to that in other countries for the same income category. In contrast, the tax share of low-income African countries represented 15.1% in 2010, up from 11.8% in 2000. In 2010 the tax ratio of middle-income countries reflected a drop in resource prices, whereas the average tax ratio for low-income countries continued to increase slowly as a result of significant fiscal reforms.

Figure 2.9. **Tax revenues in Africa represent an increasing share of GDP during the last decade**



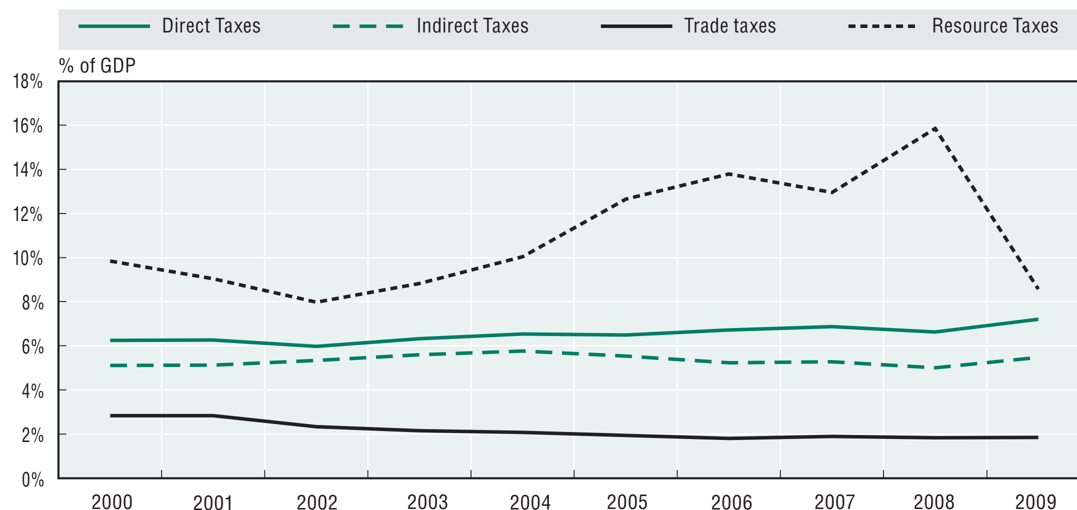
Source: Authors' calculations.

StatLink http://dx.doi.org/10.1787/888932600203

As highlighted in the 2010 AEO, the fiscal performance of middle-income African countries, often rich in natural resources, is highly linked to the international price of natural resources. The effect of fluctuating resource prices from 2008 through the global crisis can be seen in Figure 2.10.. Direct taxes, indirect taxes and trade taxes as a percentage of GDP remained nearly constant, whereas resource taxes accounted for nearly the entire increase

of the tax ratio. Tax revenues peaked to USD 458.5 billion in 2008 following an increase in commodity prices in 2008 before dropping by 26% over 2009. This USD 119 billion decrease in tax revenues was roughly the sum of ODA and FDI that year, highlighting the importance of a more transparent and fairer taxation of extractive industries for a more inclusive development in resource-rich countries.

Figure 2.10. **The increase in tax revenue is mainly driven by taxes on natural resources**



Source: Authors' calculations.

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The passing of the Dodd-Frank financial reform bill by the US Congress in July 2010 should lead to increased transparency on the amount and use of payments made by multinationals to national governments for natural resource extraction. The law requires extractive companies listed on the Securities and Exchange Commission to report payments to national governments on a country-by-country and project-by-project basis. This should allow African citizens and civil society to hold governments more accountable for the use of natural resource rents. Following this new law, in 2011, the European Commission started to develop its own version of the law, potentially requiring the disclosure of profits made by multinationals in Africa.

Many countries face severe challenges to raising their tax revenues. Most African nations have large informal sectors and so a shallow tax base. This tax base is further eroded by the excessive granting of tax preferences, inefficient taxation of extractive industries and the inability of tax administrations to fight abuses of transfer pricing by multinational enterprises. The capacity constraints of tax administrations, combined with the lack of fiscal legitimacy of the state, results in an unbalanced tax structure relying mostly on a narrow set of taxes to generate revenues. Resource-related tax revenues typically distract governments from generating revenue from more politically demanding forms of taxation such as corporate income taxes on other industries, personal income taxes, Value Added Taxes (VAT) and excise taxes.

The 2010 AEO signalled the importance of policy reform sequencing. The tax base needs to be deepened in the short run by limiting tax preferences and negotiating fairer taxation with multinationals. In the medium term the capacity of the tax administration

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should be raised. In the long run African countries will need to improve the balance between different taxes. The aim must be strengthening the fiscal legitimacy of the state, which must be accompanied by a public debate on better governance, transparency and the use of the increased public resources for the government.

The outlook for tax revenues in Africa is very specific to each country, but some general trends can be identified. Resource-rich countries tax revenue will remain highly dependent on the evolution of oil and commodities prices. Unless they manage to better tax multinationals operating in those sectors, tax revenues will remain volatile and below their potential. International commodity prices tend to be cyclical with other resource-related inflows such as FDI.

In contrast, tax revenue flows in low-income countries and non-resource rich countries are projected to increase more gradually, but in a more sustainable manner. The past decade of fiscal reforms in many non-resource-rich African countries, as highlighted in the 2010 African Economic Outlook should enable countries to strengthen tax revenues in line with their projected economic growth.

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From:

African Economic Outlook 2012

Promoting Youth Employment

Access the complete publication at:

https://doi.org/10.1787/aeo-2012-en

Please cite this chapter as:

African Development Bank*, et al.* (2012), "Domestic and External Financial Flows", in *African Economic Outlook 2012: Promoting Youth Employment*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/aeo-2012-4-en

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