Chapter 2

External financial flows and tax revenues for Africa

This chapter analyses recent trends in external financial flows to Africa and tax revenue collection. It explores how the African finance landscape has changed in the past decade with a focus on the growing importance of private flows, such as foreign direct investment, portfolio investments and remittances, and the decline in official development assistance. Despite significant efforts to increase fiscal revenue these still fall short of needs.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

1. Note by Turkey:

The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".

2. Note by all the European Union Member States of the OECD and the European Union:

The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

In brief

The financial landscape has changed considerably in Africa since 2000. Private external flows in the form of investment and remittances now drive growth in external finance. Foreign investments are expected to reach USD 73.5 billion in 2015, underpinned by increasing greenfield investment from China, India and South Africa. Foreign direct investment (FDI) is diversifying away from mineral resources into consumer goods and services and is increasingly targeting large urban centres in response to the needs of a rising middle class. African sovereign borrowing is rocketing. Remittances have increased six-fold since 2000 and are projected to reach USD 64.6 billion in 2015 with Egypt and Nigeria receiving the bulk of flows. Conversely, official development assistance (ODA) will decline in 2015 to USD 54.9 billion and is projected to diminish further. More than two-thirds of states in sub-Saharan Africa, the majority of which are low-income countries, will receive less aid in 2017 than in 2014. Despite significant improvements in tax revenue collection over the last decade, domestic resource mobilisation remains low. Financing the post-2015 development goals will depend on the capacity of African policy makers and the international community to harness these diverse funding options and exploit their potential to leverage additional finance.

Private flows drive growth in external financial flows to Africa

This section reviews the evolution in external financial flows to Africa, highlighting the relative importance and trends of FDI, portfolio investments, remittances and ODA. It also examines ways to optimise these resources with a view to financing the Post-2015 Development Agenda.

External flows slowed in 2014

In 2014, total external flows to Africa were estimated at USD 181 billion, 6% lower than in 2013. This decrease resulted from a sharp drop in portfolio flows and a slight decline in FDI flows, reflecting subdued global demand and weaker commodity prices, especially for metals. This decline offset the slight increase in remittances (+2.1%) and ODA (+1.1%). Overall, estimates for total external flows averaged 7.3% of GDP in 2014, compared to 8.2% in 2013.

Over the last decade external financial flows have played a major role in financing Africa's development. However, they fall short of the financing needed to address Africa's key challenges. The third International Conference on Financing for Development, due to take place in Addis Ababa in July 2015, will provide an opportunity to take stock of progress towards financing the Millennium Development Goals (MDGs), which were set at the Monterrey conference in 2002. In the run up to the 2015 conference, the international community is designing a new development finance framework to fund the Sustainable Development Goals, which will replace the MDGs. African Union leaders representing the Common African Position on the Post-2015 Development Agenda have reiterated the need to mobilise significant resources from a variety of sources and to ensure the effective use of financing (African Union, 2014).

Private financial flows have grown in importance

Since the Monterrey conference financing options for the continent have increased substantially. Private financial flows have become more prominent, increasing from 63% of total external resources in 2002-06 to more than 70% in 2010-14 (Figure 2.1). Africa has attracted increasing foreign investment, notably from other emerging economies and within the continent. Foreign direct investment is diversifying away from mineral resources into consumer goods and services, as a response to the rapidly urbanising population and a rising middle class.

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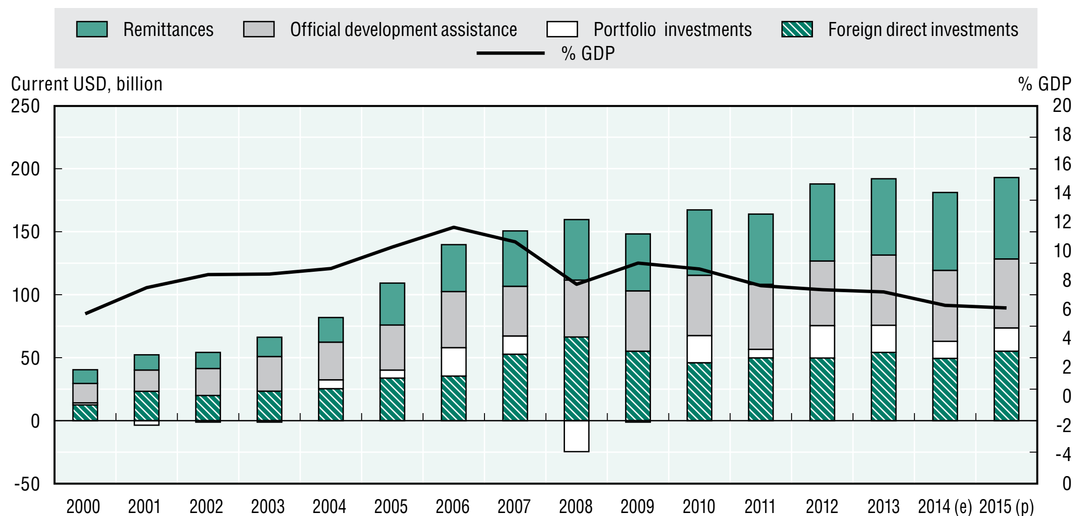
Figure 2.1. **External financial flows to Africa, 2000-15**



Note: ODA estimates (e) and projections (p) are based on the real increase in Country Programmable Aid (CPA) in OECD (2014b). The forecast for remittances is based on the projected rate of growth according to the World Bank. (This graph excludes loans from commercial banks, official loans and trade credits.)

Sources: Authors' calculations based on OECD/DAC, World Bank, IMF and *African Economic Outlook* data.

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Portfolio flows to the continent have also increased. Since 2011, more than a dozen countries, including Kenya, Nigeria and Uganda, have issued international sovereign bonds for the first time with the objective of financing large infrastructure projects.

Migrant remittances continue to grow and represent the single largest source of international financial flows to African countries. While private capital flows are volatile, remittances constitute a more stable source of foreign exchange and are therefore more suitable for longer-term purposes such as financial sector development (Ncube and Brixiova, 2013).

Public financial flows have decreased in importance

Conversely, the relative importance of international public flows, and especially bilateral aid from OECD countries, is diminishing. The share of ODA in total external flows declined from 37% in 2002-06 to 30% in 2010-14. This reveals a shift in regional aid allocation with a reduction of grants to low-income African countries and an increase of soft loans to middle-income countries in Asia. Nevertheless, South-South co-operation continues to grow rapidly, more than doubling between 2006 and 2011 (UN, 2014).

Countries are increasingly mobilising domestic resources to compensate for declining foreign aid. Tax revenues have grown thanks to major efforts to improve revenue collection and gains from the commodity price boom (Sy, 2015). However, in spite of considerable efforts and reform, tax mobilisation remains low (Table 2.1).

Table 2.1. **Financial flows and tax revenues to Africa (current USD, billion), 2005-15**

			2005	2006	2007	2008	2009	2010	2011	2012	2013	2014 (e)	2015(p)
Foreign	Private	Inward foreign direct investments	33.8	35.4	52.8	66.4	55.1	46.0	49.8	49.7	54.2	49.4	55.2
		Portfolio investments	6.3	22.5	14.4	-24.6	-0.3	21.5	6.8	25.7	21.5	13.5	18.4
		Remittances	33.3	37.3	44.0	48.0	45.2	51.9	55.7	61.2	60.6	61.8	64.6
	Public	Official development assistance (net total, all donors)	35.8	44.6	39.5	45.2	47.9	48.0	51.8	51.3	55.8	56.3	54.9
		Total foreign flows	*109.2*	*139.7*	*150.6*	*135.0*	*147.9*	*167.3*	*164.0*	*187.9*	*192.0*	*181.1*	*193.0*
Domestic		Tax revenues	258.1	305.9	343.4	442.4	330.6	408.3	462.9	515.1	507.4		
Total foreign flows		Low-income countries	21.8	22.8	29.5	36.5	36.9	39.5	47.5	47.9	49.7	52.3	54.2
		Lower-middle-income countries	61.7	78.4	84.1	81.8	69.4	94.7	84.9	109.1	111.9	96.3	105.2
		Upper-middle-income countries	23.2	35.6	33.2	11.9	35.9	28.1	26.5	25.6	26.0	26.9	26.6

Note: ODA estimates (e) and projections (p) are based on the real increase of Country Programmable Aid (CPA) in OECD (2014b). The forecast for remittances is based on the projected rate of growth according to the World Bank. (This table excludes loans from commercial banks, official loans and trade credits.)
Sources: Authors' calculations based on OECD/DAC, World Bank, IMF and *African Economic Outlook* data.

Private flows will play a major role in financing the Post-2015 Development Agenda

Private flows drive growth in external financial flows to the continent. Total external flows to Africa are projected to reach USD 193 billion in 2015, mainly due to a surge in portfolio inflows and a slight increase in remittances and FDI, the latter spurred by economic growth and an expanding consumer base. However, investor enthusiasm may diminish as a result of recent external and domestic risks, including declining commodity prices, the slowdown in emerging economies, and spillover effects from the Ebola outbreak and political instability in West Africa.

Mobilisation of domestic resources is crucial to counterbalance the decline in ODA

In terms of international public flows, the present decline in ODA to Africa from OECD countries is projected to continue. More than two-thirds of sub-Saharan African states, most of which are low-income countries, will receive less aid in 2017 than in 2014 (OECD, 2014b).

Improvements in the mobilisation of domestic resources will be key to counterbalancing aid declines. African governments will have to increase efforts to strengthen tax systems, expand domestic tax bases and enhance local financial markets to attract other private flows (UN, 2014). However, these domestic resources will not be sufficient to meet financing needs. More and better quality aid will remain an essential complement, especially in low-income countries.

Public and private flows supported by policies and incentives are necessary to fund the Post-2015 Development Agenda

Financing the Post-2015 Development Agenda will require an optimal mix of domestic and international, public, private and blended resources. There is also growing emphasis on using aid as a catalyst for private investment in the form of guarantees, loans or more traditional public-private partnerships.

Private flows will play an increasingly important role. In this respect, governments will need to develop policies and incentives that better match investor preferences with investment needs, so as to ensure that long-term sustainable development needs, for example, are not financed through short-term funds (UN, 2014). Governments must also continue efforts to attract sovereign wealth funds, private companies and development finance institutions, as they provide more stable and long-term sources of financing and help to mitigate the volatility inherent in financial markets (Sy, 2015).

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Private capital flows can help promote local development

Fostering economic linkages between multinational companies and the domestic private sector will also help to maximise business contributions to development goals. For example, large agribusiness companies work in partnership with donors to integrate African small-scale farmers into their value chains. These inclusive business ventures provide inputs and transfer knowledge and skills, but remain limited in outreach and scale.

Private capital flows can also contribute significantly to development by spurring innovation in local capital markets and encouraging expansion in the scope and scale of financial services. The exponential growth of branchless banking and mobile banking technologies are a good move in this direction.

Tapping remittances and curbing illicit financial flows could free up resources

Remittances also have huge untapped potential in terms of resource mobilisation. Policy makers and the development community are exploring ways to exploit this potential to leverage savings and investment in productive assets. However, more effort is needed to maximise their development impact, including by reducing their transmission costs and channelling remittances through national commercial banks to access additional finance.

In addition, illicit financial flows from Africa, which are estimated to exceed FDI and ODA over the last decade, are a potential source of domestic resource mobilisation for the continent. If curbed, they could free up resources to invest in public goods.

Africa remains the frontier for foreign investment

This section explores recent positive trends in FDI,[1] outward African investment and portfolio investment. It points to the emergence of new sectors, investors and destinations, and highlights the top recipients as well as sources of foreign investment. The outlook for FDI and portfolio investments in 2015 looks favourable, although external and domestic risks may undermine investor confidence.

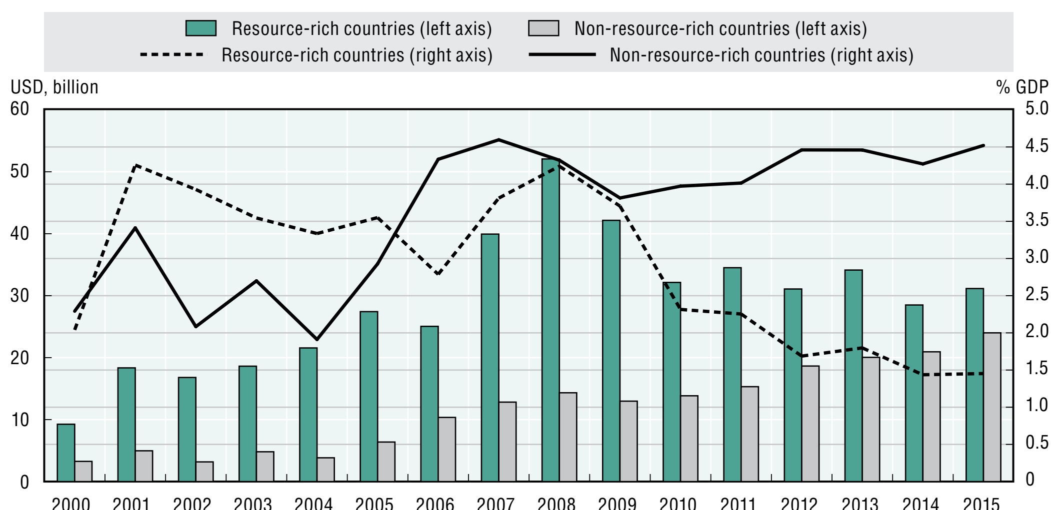
Africa continues to attract FDI inflows, but at a slower pace

In 2013, Africa's share of global FDI projects reached 5.7%, its highest level in a decade. FDI inflows increased to USD 54.2 billion, up 9% from 2012, driven by international and regional investment in the extractive sector, infrastructure and consumer-oriented industries. Estimates for 2014 show a slight decrease to USD 49.4 billion; however, inflows are projected to reach USD 55 billion in 2015, alongside continuous growth in the emerging middle class, which will boost FDI in consumer-oriented sectors (IMF, 2014b). Indeed, since the 1980s Africa's middle class has increased threefold, reaching 355 million in 2010 (34.3% of the population) and is projected to reach 1.1 billion (42%) in 2060 (AfDB, 2011).

Consumer-oriented sectors in Africa are increasingly attracting FDI

Although mineral resource-rich countries[2] remain the principal destination for investment flows, non-resource-rich countries increasingly account for a larger share of FDI. According to the IMF, non-resource-rich countries received an estimated 42% of the share of FDI in 2014, compared to 19% in 2008 (Figure 2.2). In 2014, the FDI-to-GDP ratio for non-resource-rich countries stood at 4%, twice the level of 2002. Conversely, the ratio for resource-rich countries shrunk from 4% to 1.5% over the same period.

Figure 2.2. **Foreign direct investment to Africa: Resource-rich vs. non-resource-rich countries, 2000-15**



Source: Authors' calculations based on IMF (2014b).

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In 2013, the Herfindahl index for sectoral concentration reached its lowest level in a decade, averaging 0.1 compared to 0.43 in 2003. This trend is also confirmed by data on announced greenfield projects. In 2013-14, manufacturing and services accounted for about 85% of the total value of projects in Africa (fDi Markets, 2014). In particular, FDI flows are starting to diversify into consumer-market oriented industries, including information and communication technology (ICT), retail, food and financial services. In 2013, investment in ICT and retail increased from 14% and 12% of total FDI in 2007 to 20% and 17%, respectively. Over the same period, the share of business services doubled, reaching 12% of total FDI (Ernst & Young, 2014).

Investments are targeting large African urban centres

Table 2.2 shows the main location-based motives for FDI in Africa over the last decade. Company investments in the continent are primarily market seeking, with more than 50% of projects motivated by access to domestic markets and one-third of FDI driven by proximity to regional markets and consumers.

Table 2.2. **Determinants for foreign direct investment in Africa, 2003-14**

Motive	Projects	% of FDI projects
Domestic market growth potential	554	52.2
Proximity to markets or customers	321	30.3
Regulations or business climate	250	23.6
Skilled workforce availability	67	6.3
Natural resources	61	5.7
Infrastructure and logistics	55	5.2
Lower costs	53	5.0
Industry cluster/critical mass	34	3.2
Government support	33	3.1
Attractiveness/quality of life	23	2.2
Other motive	88	8.3

Source: Authors' calculations based on fDi Markets (2014).

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African cities represent a growing and untapped consumer market, and are increasingly targeted by investors. Disposable income in Africa's major cities is expected to grow at an average of 5.6% per year up to 2030, while aggregate spending power is set to more than double from USD 420 billion in 2013 to USD 1 trillion in 2030 (Oxford Economics, 2013). The most appealing sub-Saharan cities for investors are Johannesburg, Cape Town, Nairobi and Lagos (in this order). Casablanca, Cairo and Tunis are considered to be the top three cities to invest in North Africa (Ernst & Young, 2014). This ranking reflects the current quality of business climate, infrastructure and availability of a skilled workforce.

The recent surge in infrastructure projects indicates that investors are also injecting resources into transport corridors aimed at connecting cities and transforming them into large urban clusters with a large consumer base. Examples include the Greater Ibadan-Lagos-Accra urban corridor, the Maputo Development Corridor, and the Northern Corridor between East and Central Africa.

New destinations are receiving attention from investors

In 2014, the leading investment destinations in Africa were Egypt, Mozambique, Morocco, South Africa, the Republic of the Congo (Congo) and Ghana (Table 2.3).

Table 2.3. **Top foreign direct investment destinations in Africa by value of investment, 2014**

Country	Value (USD billions)	Main sectors
Egypt	5.5	Oil, gas, automotive
Mozambique	4.9	Infrastructure, gas
Morocco	4.7	Manufacturing, real estate, food processing
South Africa	4.2	Infrastructure
Congo	2.8	Oil
Ghana	2.7	ICT, retail

Source: Authors' calculations based on IMF (2014b).

Several other countries are assuming a more prominent position on investors' radar, including Kenya, the Republic of Tanzania, Uganda and Zambia, reflecting the shift towards consumer goods. In Kenya, investment flows more than doubled in one year, reaching USD 1.2 billion in 2014. The country is becoming a favoured business hub, not only for oil and gas exploration, but also for manufacturing, transport and ICT. Kenya has also become a world leader in payment by mobile phone (see Box 2.2). In addition, the country is building a USD 14.5 billion information technology hub called Konza Technology City outside Nairobi, with a view to attracting investment in business process outsourcing, software development and data centres. Konza Technology City should lead to the creation of 16 000 direct jobs by 2018-19 and 200 000 by 2030.

FDI inflows vary significantly by region

In terms of regional performance, East Africa recorded the highest increase in FDI inflows, with overall investment growing by 9% to USD 9.5 billion in 2014. Southern Africa saw inflows resume normal levels, declining by 20% to USD 9.7 billion after record-high flows to South African infrastructure in 2013.

West Africa also experienced a 20% decrease in inflows with investment sliding to USD 8.3 billion, mainly as a result of continued political and security uncertainties in Nigeria. The Ebola outbreak, which disrupted economic activities across several sectors in Guinea, Liberia and Sierra Leone and isolated them from international markets, has also dented investor confidence. The service sector (hospitality, construction,

transportation and business services) has suffered the most, but investment flows have also declined in the primary sector. Large foreign investors such as Vale and Rio Tinto in Guinea have evacuated many foreign workers. In Liberia's mining sector, planned investments to expand capacity at the country's largest mining company (ArcelorMittal) to 15 million tonnes per year have been put on hold, and one major mining company (China Union) ceased operations in August 2014 (World Bank, 2014b). Evacuation of managerial and supervisory personnel has also slowed down investment in palm oil planting. Construction of a USD 10 million modern oil palm mill for Sime Darby began in July 2014 with completion expected in 2015, but has since been put on hold (World Bank, 2014b).

FDI flows to North Africa and Central Africa also decreased, but only marginally. Political uncertainties in North Africa seem to have had a negative impact on non-oil manufacturing activities while, with the exception of Libya, oil and gas remained unaffected. The resurgence of investor interest in the region is particularly evident in Egypt, where the United Arab Emirates (UAE) are establishing a firm foothold, investing across several sectors including oil and gas, banks, automobiles, tourism, food industries and education.

Investment in agribusiness is becoming more inclusive

The investment landscape of the agrifood market is changing. Uncertainty about the future supply of many agricultural products, land pressure and declining yields – Africa has the lowest level of agricultural productivity in the world – are leading many companies to work more closely with small-scale farmers to ensure stable supplies. In some sectors, such as horticulture and to a lesser extent in cocoa and coffee, companies are actively assisting in the production process. Notable examples include "inclusive" agribusiness business ventures, which align the profit incentive with a social mission to involve low-income farmers and provide them with inputs, training and other forms of support (Box 2.1).

Box 2.1. **Inclusive investment in agribusiness**

A range of business models for inclusive market development in the agribusiness sector build on the complementarities between smallholders and large-scale investors. These include diverse types of contract farming schemes (out-grower schemes), joint ventures and management contracts. In the case of out-grower schemes the commercial farmer facilitates access to inputs (e.g. bank loans, seed and advisory services) for smallholder farmers, in return for the right to market their output. These arrangements should reduce the risk to both parties. However, several key factors determine the outcome, including the negotiating power of large-scale investors and farmers, the professionalisation of farmer organisations and the terms of the contract.

Successful examples in the horticulture sector are found in **Ethiopia** and **Kenya**, where large investors and exporters have worked with local producers, through out-grower schemes, to provide them with the necessary capacity, market access and financing. This has allowed local producers to diversify their crops and their source of revenue.

Other smallholder-dominated export crops, such as cocoa and coffee, have not yet experienced these changes, but exhibit high potential, especially given the current surge in demand which is encouraging traders to work directly with farmers to ensure future supply. In so doing, traders also collaborate with international donors and local NGOs who possess greater knowledge of local realities and can also co-finance inputs and training for farmers.

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Box 2.1. **Inclusive investment in agribusiness** (cont.)

In East Africa, a large trading and processing company, ECOM, partnered with the NGO Hivos to train coffee producers. Between 2007 and 2012, they co-developed a training programme which has since helped over 85 000 coffee producers to improve the quantity and quality of yields and achieve greater transparency in production processes. As a result, farmers' income went up from 60% to 75%. Building on this success, ECOM and Hivos launched another partnership in 2013 to support 90 000 smallholder coffee producers (of which 50% are women) in **Kenya**, **Tanzania** and **Uganda**. The programme aims to build commercially viable models for the creation of effective farmer support systems, which can be widely replicated, allowing ECOM to expand its activities independently in the future.

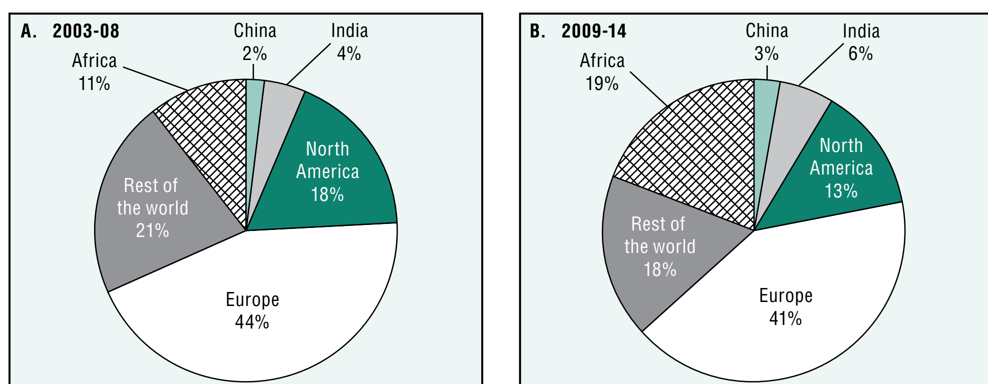
In **Côte d'Ivoire**, another agribusiness corporation, Cargill, collaborated with the NGO Solidaridad to provide cocoa farmers with access to inputs and training in good agricultural practices, with a view to increasing productivity and preserving the environment. Support activities include assisting co-operatives to obtain certification for their cocoa and improve the working and living conditions of member farmers. Women farmers also received training in other income-generation activities to help diversify their sources of income. A recent evaluation of Cargill and Solidaridad support activities during 2008-12 showed that the majority of the 60 000 Ivorian farmers benefited from the training they received. Productivity and quality of cocoa beans improved, which led to a rise in income, and farmers also increased their knowledge of labour and children's rights. While this initiative and others similar tend to target co-operatives (accounting for less than 15% of total farmers), they contribute to efforts to make the cocoa value chain more inclusive and sustainable.

Sources: Authors' elaborations based on Wageningen UR (2012, 2014), Wegner and Zwart (2011) and Hivos (n.d.).

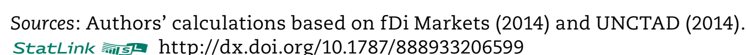
Greenfield projects in emerging African economies are increasing

Emerging economies are becoming an increasingly important source of greenfield projects in African countries (Figure 2.3). While investment by OECD countries is decreasing, the share of China and India in total announced greenfield investment projects grew from 2% and 4%, respectively, in 2003-08, to 3% and 6% in 2009-14 (fDi Markets, 2014).

Figure 2.3. **Sources of greenfield investment in Africa (by number of projects), 2003-08 and 2009-14**



Sources: Authors' calculations based on fDi Markets (2014) and UNCTAD (2014).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China, in particular, invested about USD 11.7 billion between 2009 and 2014 in 129 greenfield projects, creating approximately 48 000 jobs (fDi Markets, 2014). In 2013-14, a large proportion of this investment (USD 4.3 billion) concentrated in oil and gas-producing countries of the West African region, although Chinese capital is diversifying into transport, construction and clothing. In 2013, the Huanjin Group opened its first shoe production factory with a view to establishing a USD 2 billion special economic zone for light manufacturing in Ethiopia (UNCTAD, 2014). The factory could create employment for almost 100 000 Ethiopian workers. In Egypt, the Chinese electronic company Hisense partnered with local broadcaster Sun TV with the objective of producing 100 000 LCD televisions a year (Ernst & Young, 2014). These examples illustrate China's increasing use of specific African markets as manufacturing platforms to export products to global markets.

In 2013-14, the leading investors in terms of value of announced greenfield investment were the United Arab Emirates (USD 45.6 billion), France (USD 21 billion), the United States (USD 10.7 billion), Greece (USD 10 billion, concentrated in Egypt), the United Kingdom (USD 6.9 billion) and Belgium (USD 5.2 billion). European countries accounted for 41% of FDI to Africa and 37% of jobs created by greenfield FDI (308 000 jobs during 2009-14).

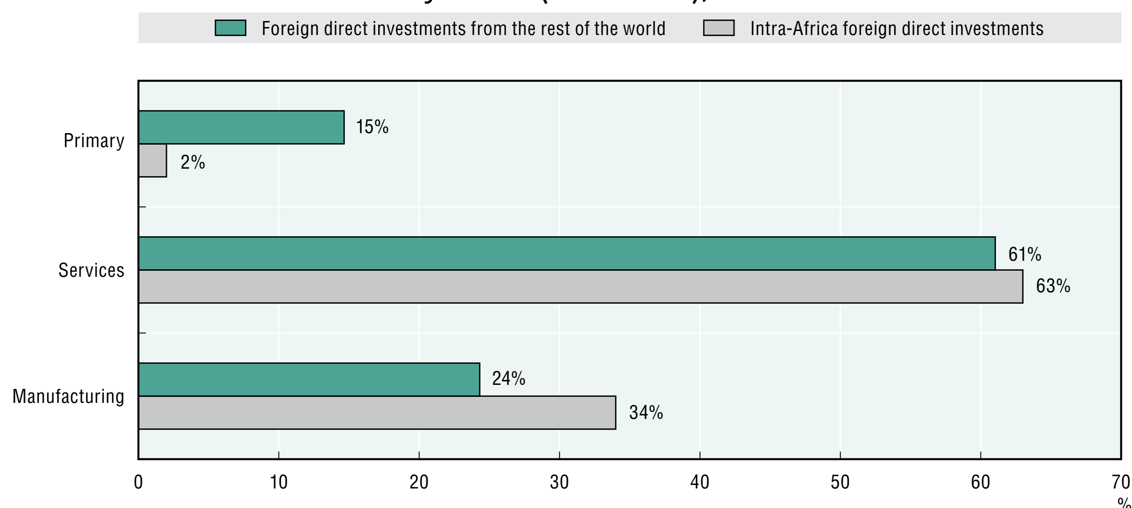
Intra-African FDI flows are increasing

Recent surveys on the attractiveness of Africa as an investment destination highlight the increasing confidence and optimism of African investors towards investment opportunities on the continent. The majority of respondents hold positive opinions concerning Africa's progress and its potential to attract investors. This growing optimism has translated into a surge in intra-African investment (Ernst & Young, 2014).

Intra-African greenfield investment is rising

The share of announced cross-border greenfield investment projects originating from within Africa rose from 11% of the total during 2003-08 to 19% during 2009-14. The share of jobs created by intra-African projects increased from 6% to 10%, reaching 86 000 in 2009-14 (fDi Markets, 2014).

Figure 2.4. **Sectoral distribution of announced value of greenfield projects by source (cumulative), 2013-14**



Sources: Authors' calculations based on fDi Markets (2014) and UNCTAD (2014).

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South African companies are the leading investors on the continent, accounting for about 50% of intra-regional greenfield projects. In 2009-14, South Africa invested in 312 greenfield projects for a total value of USD 25.6 billion (fDi Markets, 2014). Kenya, Nigeria and Mauritius follow as other important sources of intra-African investment, accounting for 134, 89 and 50 greenfield projects, respectively, between 2009-14. As indicated in Figure 2.4, about 99% of intra-African projects are concentrated in manufacturing and services, while extractive industries play a marginal role (fDi Markets, 2014).

Outward FDI flows from Africa are also growing

The last few years have also witnessed an increase in FDI flows from Africa to the rest of the world. In 2013-14, Africa's outward investment averaged USD 11.4 billion compared to USD 8.1 billion for 2011-12.

A number of emerging African multinationals are expanding their presence across the continent and worldwide, with some companies launching innovative products. FDI flows from African countries to the outside world increased by 30% from 2003-08 to 2009-14. The service sector is particularly dynamic, especially in retail, banking and ICT (Box 2.2).

Box 2.2. **Leading African companies investing in Africa and worldwide**

SABMiller, originally South African Breweries, has expanded from its original South African base to become a multinational brewing and beverage company. Currently the world's second largest brewer measured by revenues sales, SABMiller has brewing interests and distribution agreements across six continents. Its brewing operations in Africa encompass 31 countries and the company is now the second largest brewer in India. SABMiller also owns 49% of Snow, the biggest beer brand in China measured in terms of volume.

Another South African company to invest heavily in China is **Naspers**, Africa's largest media conglomerate. Naspers owns a 34% stake in China's largest Internet company, Tencent.

The **Shoprite Group of Companies** is a South African-based retail and fast food company. It operates over 1 200 corporate and 270 franchise outlets in 16 countries across the continent, in which it employs more than 11 000 people. It is also Africa's largest supermarket chain and ranks 93rd in the world list of food retailers. In 2014, Shoprite continued its expansion strategy with plans to open 47 new outlets across the continent, focusing on Angola and Nigeria. The group has also decided to increase the share of fresh products supplied by local smallholders. Smallholders supply about 80% of fresh products sold in Zambia, about 60% in Nigeria and 50% in Angola. Shoprite supermarkets have been instrumental in promoting the inclusion of smallholders in agribusiness value chains in a number of countries.

Safaricom is East Africa's largest mobile telecommunications provider and was ranked by Forbes as the most innovative company in sub-Saharan Africa in 2012. In 2007, Safaricom launched M-Pesa, Africa's first SMS-based money transfer service, which lets users deposit, transfer and withdraw funds via text message. M-Pesa has fundamentally altered the landscape of financial services in Kenya and Tanzania. By 2014, over 60% of the population of these two countries used mobile payments, with the service expanding to many other African countries and beyond. Competing services are also now emerging and spreading across the continent.

Africa is experiencing a big increase in e-commerce. The most popular online shopping site is **Jumia**, founded in Nigeria in 2012, which offers a wide range of electronics, fashions, home appliances and items for children. As of 2014, Jumia had warehouses in seven other African countries, including Cameroon, Côte d'Ivoire, Egypt, Ghana, Kenya, Morocco and Uganda. One year after its launch in Kenya, Jumia was the country's number one retailer, offering over 50 000 products and employing over 100 workers.

Sources: Based on reports of selected companies and media articles (Fast Company, 2014; Forbes, 2012).

FDI should rise in 2015, but slowing commodity prices, domestic political risks and the Ebola outbreak may undermine investor confidence

FDI flows to Africa are expected to grow by 12% in 2015, reaching USD 55 billion. The largest recipients of FDI are projected to remain almost the same as 2014, namely: Egypt (USD 6.5 billion), Morocco (USD 5.2 billion), Mozambique (USD 5 billion), South Africa (USD 4.2 billion) and Congo (USD 2.8 billion) (IMF, 2014b).

Despite political uncertainties in Egypt, Emirati Dana Gas and Italian Eni SpA have recently announced major investments in the oil and gas sector. North Africa is therefore expected to be the largest recipient region of FDI in 2015, topping USD 18 billion. Projections indicate that East Africa will rank second as result of increased FDI flows to ICT and infrastructure, followed by West Africa due to a small increase in investment in the extractive industries of Guinea and sustained, albeit slightly decreasing, investment in Côte d'Ivoire, Ghana and Nigeria.

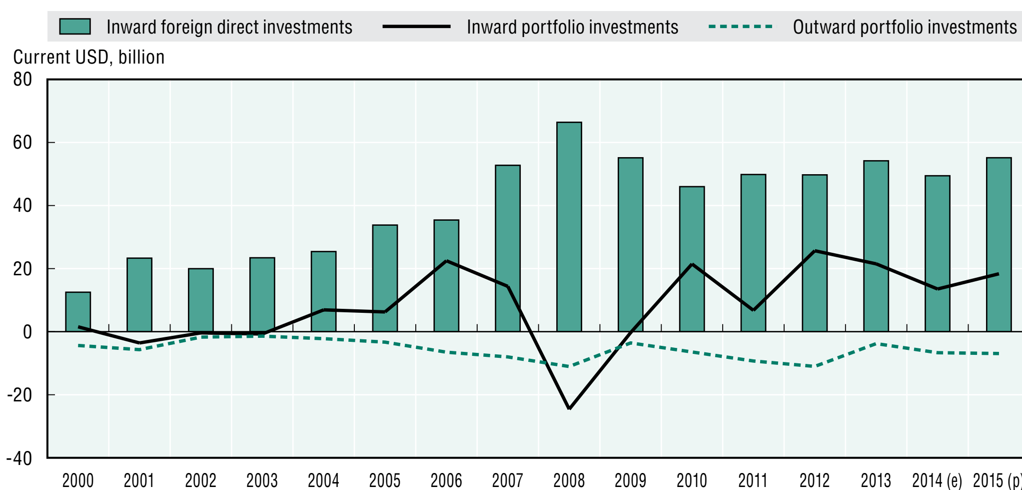
However, a series of external and domestic factors threaten this outlook. On the international front, a continuous decline in metals and oil prices could lead to a significant reduction in exports and cause foreign investors to scale down operations in resource-rich countries (World Bank, 2014a). At the same time, investors may be discouraged by economic slowdowns in emerging economies, especially China, and sluggish recovery in the euro area. On the domestic front, downside risks are emanating from the conflict in South Sudan, the deterioration in security in northern Nigeria, which is also negatively affecting neighbouring countries, and the precarious situations in northern Mali and the Kenyan coast.

The recent Ebola outbreak also constitutes a major risk to investor confidence in Guinea, Liberia and Sierra Leone, and may impact the economies of the West African region if intervention to stop the spread of the disease does not scale up effectively. No major Ebola-related disruptions are expected in the Nigerian oil sector, due to high regional concentration and significant offshore activity. However, should the crisis persist, economic reactions driven by fear may heighten, leading to deferral or cancellation of FDI to the West African region, which would affect large-scale mines, the cash crops sector (e.g. palm oil, cocoa), tourism and hospitality (World Bank, 2014b).

Portfolio inflows and outflows exhibit growing volatility

Portfolio investment inflows, including international investments in both equity and debt securities issued by non-resident entities, dropped in 2014. Conversely, portfolio outflows, comprising international equity and debt investment by residents, have increased. In general, both inflows and outflows remain highly volatile (Figure 2.5).

Figure 2.5. **Foreign direct investments and portfolio investments to Africa, 2000-15**



Note: (e) refers to estimates and (p) refers to projections.

Source: Authors' calculations based on IMF (2014b).

StatLink http://dx.doi.org/10.1787/888933206610

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Projections for portfolio inflows expect recovery but highlight potential risks

Over the last decade, portfolio inflows have gradually increased their share of total investment to Africa. However, they have experienced persistent volatility since their initial peak at USD 22.5 billion in 2006. From a record high of USD 25 billion in 2012 portfolio inflows declined in 2013 and almost halved in 2014, to an estimated 13.4 USD billion. Nigeria recorded the sharpest drop in inflows from USD 13 billion in 2013 to an estimated USD 0.6 billion in 2014. Ghana also recorded a decline from USD 0.7 billion in 2013 to negative inflows in 2014 (-USD 0.2 billion). Egypt experienced a more moderate decrease from USD 1.4 billion to an estimated USD 1.2 billion inflow in 2014. South Africa was the largest recipient of portfolio investments, with inflows rising from USD 7.5 billion in 2013 to USD 9 billion in 2014 (IMF, 2014b). The IMF expects portfolio investment in Africa to rise in 2015, as a result of the projected recovery in portfolio inflows to Nigeria (expected at USD 6.4 billion). However, this positive outlook contains risks.

The tapering of quantitative easing in the United States, oil market uncertainty and political risks may alter investor sentiment toward the continent. African countries projected to receive the largest portfolio investment, such as Egypt, Nigeria and South Africa, may in fact experience a sharp drop in inflows. This in turn could result in pressure on countries with large external financing needs (IMF, 2014a).

Portfolio outflows are expected to increase slightly, led by South Africa

Portfolio outflows from Africa have also been quite volatile, declining sharply from USD 11 billion in 2012 to USD 3.8 billion in 2013, and then rising to USD 6.7 billion in 2014. South Africa accounts for 77% of total outflows at USD 5.1 billion, followed by Angola at USD 1.2 billion. Other African countries recorded minor portfolio outflows, including Namibia (USD 0.5 billion), Botswana (USD 0.2 billion), Cameroon, Kenya and Mali (all less than USD 0.1 billion) (IMF, 2014b). In 2015, portfolio outflows are expected to increase slightly to USD 6.9 billion, mainly as a result of increased outflows from South Africa (projected at USD 5.6 billion).

African sovereign borrowing is rising sharply

Sovereign bond issuance is rising across Africa. Since 2011, more than a dozen countries, including Kenya, Nigeria and Uganda, have issued international sovereign bonds for the first time with the objective of financing large infrastructure projects. This trend continued in 2014 with African governments taking advantage of low interest rates and investor demand for higher yielding debt. Total issuance for sub-Saharan African countries, including South Africa, amounted to nearly USD 7 billion between January and October 2014, above the record USD 6.5 billion issued in 2013 (IMF, 2014a). This is equivalent to more than 25% of ODA and 14% of FDI to the region in 2014.

Bond issuance is increasing among African countries and local corporations

In the first half of 2014, Côte d'Ivoire and Kenya issued dollar-denominated bonds for the first time. Many issuances were oversubscribed, with orders reaching USD 5 billion and USD 8 billion in the case of Côte d'Ivoire and Kenya, respectively (World Bank, 2014a). Zambia issued a USD 1 billion ten-year dollar denominated government bond in April 2014 and was followed by Senegal (USD 500 million), South Africa (USD 1.7 billion) and Ghana (USD 1 billion). In December 2014, Ethiopia debuted its first USD 1 billion bond. In general, sovereign spreads went down with the exception of Ghana and Zambia, where budget deficits are widening and the pace of reform is slow.

The shift in consumer growth patterns is also translating into a significant broadening of corporate issuance, as companies in consumer-driven industries such as telecoms, energy, real estate and banking turn to capital markets to finance their growth.

The growing issuance trend is expected to continue well into 2015 (Standard Bank, 2014), given the need to finance infrastructure projects across the continent. Rwanda announced that it may sell up to USD 1 billion in dollar-denominated bonds in 2015, following its successful USD 400 million international bond sale in 2013.

In general, African countries' debt as a share of GDP is low. If the proceeds are spent on capital investment, this will produce greater returns and improve the ability of these countries to repay. However, excessive growth in international debt poses a series of risks, including delays in the implementation of projects, debt sustainability risks and currency risks (ODI, 2014). According to a recent ODI study, the currency depreciation experienced by sub-Saharan African countries in 2014 might threaten their capacity to repay their bonds to investors (ODI, 2015).

Remittances have a huge unexploited potential to spur investment in Africa

This section reviews the recent trend in remittance flows to Africa, highlighting how aggregate data mask huge diversities among recipients, both geographically and by income group. Remittances can be leveraged to spur investment and growth, but efforts to maximise their development impact must overcome major obstacles to their transmission. The data illustrated here underreport the actual size of remittances to Africa, since a significant amount (up to 75% of recorded flows) is sent via informal channels (OECD, 2014a).

Remittances continued to grow in 2014, with Egypt and Nigeria receiving the bulk of flows

Official remittances remain the largest source of international financial flows to Africa, accounting for about 33% of total external financial inflows since 2010. Private cross-border transfers from individuals and households have increased substantially over the last 15 years, from USD 11.9 billion in 2000-02 to an estimated USD 61.2 billion in 2012-14 (Table 2.4).

Table 2.4. **Fifteen largest recipient countries in Africa (ranked by % of GDP), 2014**

Country	% GDP	USD per capita	Current USD, billion
Lesotho	22.2	285.6	0.55
Gambia	21.1	100.3	0.19
Liberia	18.6	92.0	0.39
Senegal	10.5	114.3	1.66
Cabo Verde	10.0	381.0	0.20
Comoros	9.7	97.1	0.07
Togo	7.2	49.7	0.35
Mali	6.8	46.9	0.81
Sao Tome and Principe	6.6	121.6	0.02
Egypt	6.3	210.8	18.00
Morocco	6.1	205.5	6.82
Tunisia	4.8	214.8	2.36
Guinea-Bissau	4.6	27.5	0.05
Uganda	3.8	26.3	1.00
Nigeria	3.6	122.4	21.29

Source: Authors' calculations based on World Bank Remittances data.

After growing steeply during 2010-12, on average by more than 10%, official remittances declined by about 1% in 2013. In 2014, however, they recovered by 2.1% in nominal terms, reaching an estimated USD 61.8 billion.

Per capita remittances for the continent were estimated at USD 56 per person in 2013-14, compared to USD 20 in 2003-04, with some countries including Cabo Verde, Egypt, Lesotho and Tunisia receiving over USD 200 remittances per person in 2014.

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Remittances represent a key source of capital for African countries

Cabo Verde, Gambia, Lesotho, Liberia and Senegal, for example, receive a large share of GDP in the form of remittance flows (Table 2.4). Remittances account for a relatively smaller share of GDP in large countries, but still outpace other sources of external financing. In Egypt, for example, private cross-border transfers are three times higher than foreign exchange revenue from the Suez Canal or tourism (World Bank, 2014c) and almost four times higher than FDI. In addition, remittances represent a more stable source of flows compared to other international private flows, largely because of their resilience to downturns in the receiving economy. They may even behave countercyclically, while FDI tends to be procyclical (OECD, 2014a).

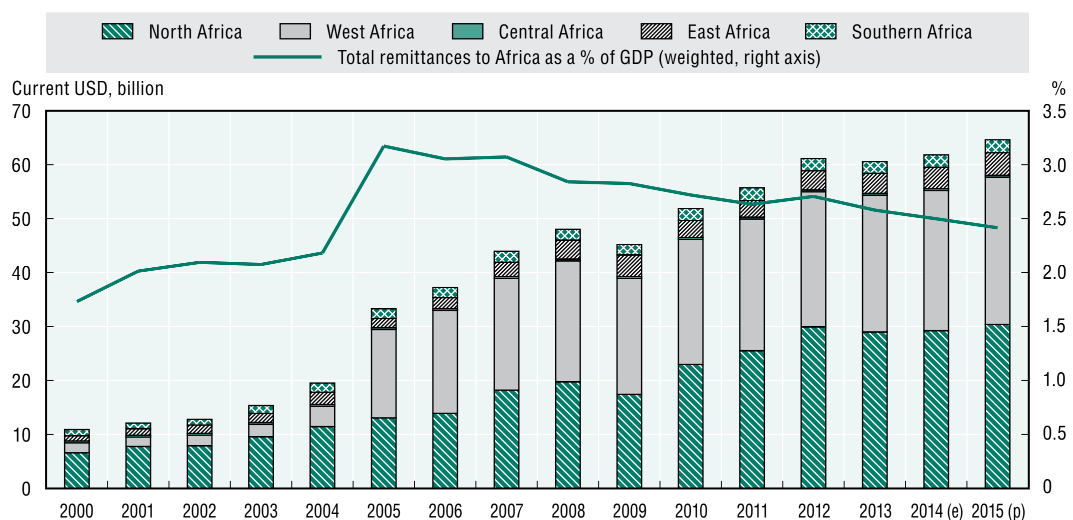
Remittances are often invested productively and can help ease debt sustainability pressures

Remittances behave in a countercyclical manner because they represent a private transaction and are often based on family and social ties. Traditional perceptions of remittances link them to spending on consumption rather than productive investment. However, evidence from Burkina Faso, Kenya, Nigeria, Senegal and Uganda shows that African households receiving international remittances from OECD countries have invested in buying agricultural equipment, building houses, starting businesses, purchasing land and improving farms (Plaza and Ratha, 2011). At the macroeconomic level, empirical studies show that remittances can help ease debt sustainability pressures by expanding the tax base, as has been the case in Egypt (Ncube and Brixiova, 2013).

Regional distribution of remittances is uneven

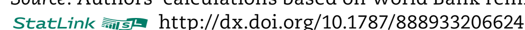
Official remittances to African countries are unevenly distributed with North and West African countries receiving the bulk of flows in 2014 at 47% and 42%, respectively (Figure 2.6). The largest recipients of remittances in 2014 were Nigeria (USD 21.3 billion), Egypt (USD 18.0 billion), Morocco (USD 6.8 billion), Tunisia (USD 2.4 billion), Algeria (USD 2.0 billion) and Senegal (USD 1.6 billion). Kenya and Uganda were the only two East African countries to receive slightly more than USD 1 billion in remittances. In Southern Africa, only South Africa surpassed the USD 1 billion threshold, receiving USD 1.4 billion in remittance flows in 2014.

Figure 2.6. **Remittance flows per African subregion, 2000-15**



Note: (e) refers to estimates and (p) refers to projections.

Source: Authors' calculations based on World Bank remittances data.

 http://dx.doi.org/10.1787/888933206624

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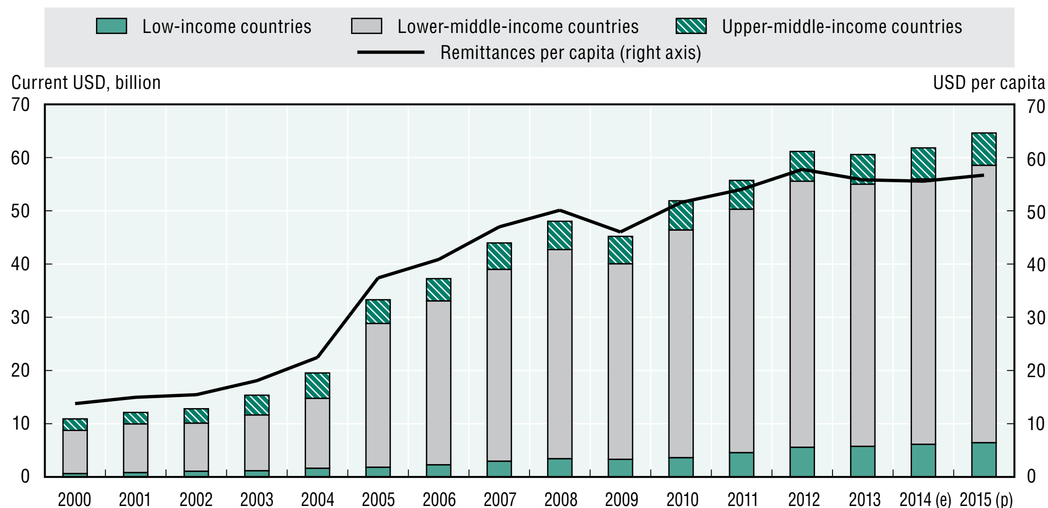
Remittances to North Africa increased by only 0.8% in 2014, compared to the 20% growth rates registered during 2010-12. After a sharp decline of 7% in 2013, remittances to Egypt increased by a modest 0.9% in 2014, attracted in part by the issuance of investment certificates for the planned expansion of the Suez Canal. Remittances to Morocco decreased slightly in 2014, due to continuing high unemployment rates in Europe, where 80% of Moroccan migrants reside (World Bank, 2014c). Remittances to sub-Saharan Africa grew by 3% due to a 2% increase in flows to Nigeria in 2014, although the largest nominal increases were recorded in Botswana (+63%), Comoros (+19%), Sierra Leone (+16%) and Kenya (+11%).

In terms of income grouping, this uneven distribution results in lower-middle-income countries receiving the largest share of remittances – 80.7% in 2014 – mainly due to the weight of Egypt and Nigeria, compared to 9.9% for low-income countries and 9.4% for high-income countries (Figure 2.7). Despite their low share, remittances exceed private investment flows for many low-income African countries and represent a lifeline for the poor (Mohapatra and Ratha, 2011).

Figure 2.7. **Remittance flows to Africa per income group, 2000-15**



Note: (e) refers to estimates and (p) refers to projections.

Source: Authors' calculations based on World Bank remittances data.

StatLink http://dx.doi.org/10.1787/888933206639

More should be done to maximise the development impact of remittances

According to World Bank projections, official remittances are expected to increase further in 2015, reaching USD 64.6 billion. In particular, remittances to North African countries will increase by 4% in nominal terms, while those to sub-Saharan Africa will increase by 5%.

Diaspora remittance flows could spur growth, but greater transparency is needed

Countries with a large population of migrants possess an opportunity to harness the potential of remittance flows, using them as a catalyst to develop the financial sector and spur investment and growth.

Amid the current debate over financing of the Post-2015 Development Agenda, policy makers are designing incentives to leverage diaspora remittances and savings to increase financial resources, including through issuance of diaspora bonds (World Bank, 2014c).

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The African diaspora living in high-income countries saves more than USD 53 billion annually (Plaza and Ratha, 2011), and several African countries are in the process of tapping into this pool of funds by issuing bonds for investments in their homeland. The money raised through diaspora issuances could be used to finance projects of interest to overseas migrants, such as housing, schools, hospitals and infrastructure, that have a concrete benefit to their families or community back home (Plaza and Ratha, 2011). However, diaspora bonds are not a new concept and Kenya and Ethiopia, for example, have already issued diaspora bonds with limited success. This is due partly to lack of awareness of the product within the targeted diaspora community, as well as fears of misuse of funds. Transparency and engagement of diaspora members in investment decisions may help to incentivise funds from migrants who want to make a contribution to their home countries.

Another possible way to raise finance for infrastructure and development projects might be to channel remittances though the local banking system, thereby allowing banks to use these flows as collateral to "securitise" future remittance receipts (OECD, 2014a). According to the African Development Bank, Africa could potentially raise an additional USD 17 billion annually by using future remittance flows as collateral (Shimeles, 2010).

A number of obstacles prevent African countries from deriving the full benefit of remittances

While the average global cost of sending remittances has decreased from 8.9% in 2013 to 7.9% in 2014 (World Bank, 2014c), remitting money to sub-Saharan Africa remains costly at around 12% of the value sent. As a result, a substantial proportion of flows occur through informal channels. In addition, South-South remittances are either not permitted or are costly due to lack of competition in the remittance market, high foreign exchange commissions and outward capital controls in many developing countries (Ratha and Shaw, 2007; World Bank, 2014c). One worrying trend is the imposition of additional fees on beneficiaries by international banks, some of which are now reducing their involvement in this sector following closer monitoring precipitated by money laundering and terrorism financing concerns (World Bank, 2013a). This is the case especially in Somalia and other African fragile states, which are highly dependent on remittances.

The G20 has taken steps to reduce the transaction costs and barriers for remittances by fostering co-operation between remitting and receiving countries (UN, 2014). Greater competition and diffusion of mobile phone and Internet-based technologies could also contribute significantly to driving down fees.

Official development assistance to low-income African countries is declining

The section analyses trends in official development assistance to Africa, drawing on the OECD Development Assistance Committee (DAC) Survey on Donors' Forward Spending Plans (OECD, 2014b). Foreign aid to the continent is estimated to decline from 2015 onwards. Against this backdrop, the development community is proposing a series of options designed to use aid as a catalyst for private investment. However, core aid will remain important, especially grants to low-income countries.

Foreign aid to developing countries rebounded in 2013

Foreign aid to developing countries fell in 2012, mainly due to bilateral aid budget cuts in DAC[3] countries, but rebounded in 2013 rising by 12.4% in real terms. Donors provided a total of USD 150 billion in net ODA.

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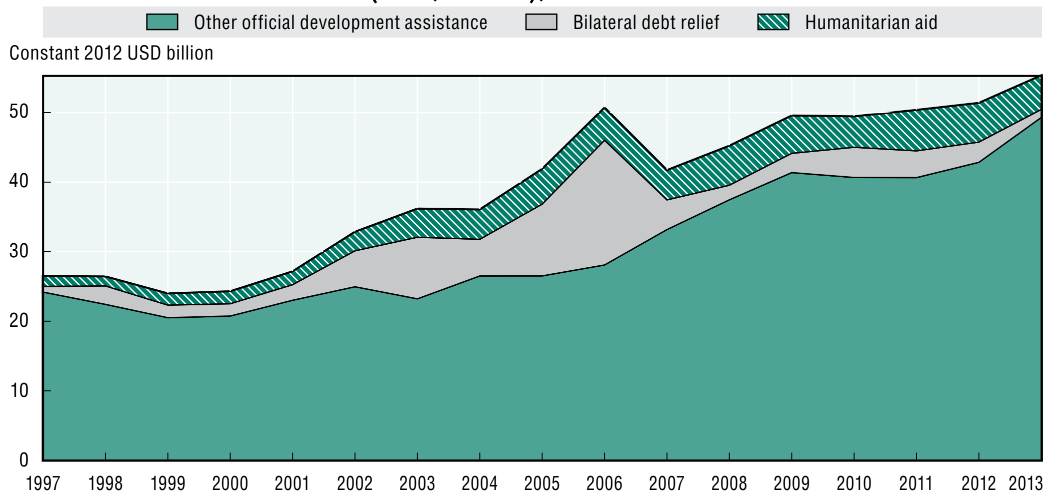
Bilateral aid from DAC member countries accounts for over 62% of total ODA, and increased by 5.9% in real terms from 2012, reaching USD 93.7 billion. In turn, net ODA from DAC countries stood at 0.3% of gross national income (GNI)[4] from 0.29% in 2012 (OECD, 2014a). Multilateral aid reached USD 41.5 billion, recording an increase of 3.9% in real terms. Non-DAC donor support recorded the highest increase of about 187% in real terms, reaching USD 15 billion in 2013.

Non-DAC donor aid to Africa boomed in 2013

Official development assistance to Africa also increased in 2013 by 7.7% in real terms (Figure 2.8). Net ODA disbursements amounted to USD 55.8 billion compared to USD 51.3 billion in 2012. Multilateral aid increased slightly by 3% in real terms, and reached USD 20.6 billion in 2013; however, the increase in aid allocations to Africa mainly reflects higher disbursements from non-DAC[5] donors.

Figure 2.8. **Net official development assistance disbursements to Africa (USD, billion), 1997-2013**



Source: OECD (2015).
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In particular, net ODA from non-DAC donors amounted to USD 5.8 billion compared to USD 1.1 billion in 2012, representing an increase of 413% in real terms. This increase was the result of support provided by the United Arab Emirates to Egypt, which increased dramatically from USD 11 million in 2012 to USD 4.6 billion in 2013. Indeed, the United Arab Emirates posted the highest ODA/GNI ratio of 1.34%.

Although data on concessional flows by non-DAC donors, and in particular on aid from emerging countries, are incomplete, estimates show a substantial increase in recent years (UN, 2014). For example, China's financing commitments to Africa increased from USD 5 billion in 2006 to USD 10 billion in 2009 and to USD 20 billion in 2012. In 2014, China increased this credit line by another USD 10 billion (Sun, 2014). The majority of this concessional support is channelled to infrastructure development.

OECD/DAC country aid to some of the neediest countries in Africa is falling

Conversely, DAC member aid to Africa declined by 4.2% in real terms from 2012 to 2013, down to USD 29.4 billion. In particular, the United States, the largest contributors of ODA to the continent, reduced disbursements to sub-Saharan Africa by 3.6% in real terms to USD 8.6 billion in 2013. France also lowered its ODA net disbursements to sub-

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Saharan Africa by 33%, averaging USD 2 billion in 2013, due to lower levels of debt relief compared to 2012. This reduction in DAC bilateral aid to Africa highlights a reduction in grants, which declined by 1.9% in real terms.

Regional disbursements are uneven, with North and East African countries benefiting most

Much of the 2013 increase in ODA to Africa was allocated to North Africa. Egypt was the largest recipient receiving about USD 5.5 billion, more than three quarters of which were allocated to infrastructure projects. Other major recipients included Ethiopia (USD 3.8 billion), Tanzania (USD 3.4 billion), Kenya (USD 3.2 billion), the Democratic Republic of the Congo (USD 2.6 billion) and Nigeria (USD 2.5 billion). These six recipients accounted for 38% of total ODA to Africa. East African countries, in particular, experienced an increase in aid allocations compared to 2012. However, the same period saw a decline in ODA disbursements to several other low-income countries, mainly in West and Central Africa.

The ODA share of GDP for low-income African countries declined to 8.2% in 2012-13 compared to 11.5% in 2010-11 (Figure 2.9). This trend is expected to continue in coming years (OECD, 2014b). This is a cause for concern, as many African low-income countries are heavily dependent on foreign aid.

Figure 2.9. **Net official development assistance disbursements to African countries by income group (% GDP weighted), 2000-15**

Note: ODA (e) estimates and (p) projections are based on the real increase of Country Programmable Aid (CPA) in OECD (2014b).
Source: Authors' calculations based on OECD (2015) and IMF data.
StatLink http://dx.doi.org/10.1787/888933206659

In December 2014, the OECD-DAC committed to reversing the declining trend of ODA to least developed countries (LDCs) and allocate more of total ODA to countries most in need, including LDCs, low-income countries (LICs), small island developing states, landlocked developing countries and fragile states. It also decided to revise the methodology for measuring ODA loans to reflect the current interest rates environment and incentivise more concessional financing to LDCs and other LICs. These actions are meant to encourage additional concessional resources for countries most in need, including low-income African countries, and support their implementation of the post-2015 development framework.

Aid to Africa is projected to decline from 2015 onwards, reflecting shifts from grants to soft loans

According to the 2014 DAC Survey on Donors' Forward Spending Plans, there has been a gradual shift in overall regional allocation priorities towards middle-income countries in Asia, while donor aid to Africa has stagnated and is likely to decrease from 2015 onwards. More than two-thirds of countries in sub-Saharan Africa are projected to receive less aid in 2017 than in 2014 (OECD, 2014b).

Survey estimates predict a decline in Country Programmable Aid to Africa

The survey provides estimates of future aid allocations for all DAC members and major non-DAC and multilateral donors, from 2014 up to 2017, based on the gross receipts of Country Programmable Aid (CPA) of developing countries.[6]

In 2013, CPA to Africa grew by more than 13%, at a faster rate than in other regions, allowing the continent to maintain its position as the largest recipient of CPA. However, estimates for 2014 show that CPA volume increased by only 1.1% to USD 47.6 billion from USD 47.1 billion in 2013. North African countries, including Morocco and Tunisia and large recipients in sub-Saharan Africa (Ghana, Mozambique and Nigeria), accounted for most of the increase. The largest CPA recipients in 2014 were Ethiopia, Kenya, Nigeria and Tanzania, as was the case in 2013.

Projections indicate that CPA for the region will decline by 2.6% in 2015 to USD 46.4 billion, by a further 3.0% in 2016 to USD 45.0 billion and by 0.3% in 2017 to USD 44.8 billion. In 2015, about half of African countries are expected to receive less CPA. In 2017, only Libya, Morocco and Tunisia in North Africa and Côte d'Ivoire, South Sudan and Zambia in sub-Saharan Africa are projected to receive noticeable increases in aid compared to 2014. For 35 sub-Saharan African countries the level of CPA aid will be lower in 2017 than in 2014.

Given Africa's growing population, aid per capita is expected to decline at a faster pace. Indeed, CPA per capita in sub-Saharan Africa will decrease from its peak of USD 41.5 per capita in 2013 to USD 37 per capita in 2017.

Low-income countries will be most affected by the decline in CPA

Country Programmable Aid to the 27 low-income African countries, which are home to about 520 million people, is likely to decrease by 4% in 2015, by a further 4% in 2016 and by 1% in 2017. Low-income countries' share of total CPA will therefore decline from 59.3% in 2014 to 58.5% in 2015 and 58.0% in 2017. This trend reflects reduced access to grant resources on which these countries are highly dependent (OECD, 2014b). In turn, lower-middle-income countries and upper-middle-income countries will see their share of total CPA increase in 2017 to 34.5% and 7.5% respectively, from 33.7% and 7% in 2014. It is likely that much of this support to upper-middle-income countries will be in the form of soft loans (OECD, 2014b).

As highlighted earlier, this declining trend in CPA to low-income countries is particularly worrying as aid flows for most of them still account for a large share of external financial flows (53% in 2013-14). Although some of these countries have undertaken significant efforts to improve domestic resource mobilisation and attract other private flows, these are insufficient to meet their large financing needs.

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Blended loans will help finance the Development Agenda, but core aid will remain important

To finance the Post-2015 Development Agenda, the development community is proposing a new financing framework, which brings together domestic and international, public, private and blended resources. Blended finance encompasses traditional public-private partnerships, as well as instruments provided by development finance institutions, to leverage private investment (e.g. blended loans, equity investments, guarantees). For example, from 2007 to 2014, the European Union blended EUR 2 billion in grants with loans and equity from public and private finance institutions, generating investment with an estimated value of about EUR 40 billion (OECD, 2014a). These risk-sharing mechanisms are well suited to funding infrastructure projects, which by nature are long, costly and risky, and can deter private investment. In addition, blended loans allow financing costs for borrowers to be lowered and have the benefit of improving access to financing for local businesses.

Although these approaches are promising, core aid – and mainly grants to low-income countries – will remain an important source of finance. Greater efforts are also needed to improve the quality of foreign aid, making it more predictable and aligning it with the specific needs of recipient countries (OECD, 2014b). Timely and predictable aid is one of the core pillars of the "New Deal for Engagement in Fragile States", endorsed in 2011 by the G7+ group, fragile and conflict-affected countries and international organisations. Under the "New Deal", development partners commit to enhancing transparency in the use of aid, implementing risk management measures, strengthening national capacities and timeliness of aid, and improving the speed and predictability of funding with a view to achieving better results.

Despite important efforts, tax revenue collection still falls short of needs

This section analyses the performance of tax revenue in Africa from 2003 to 2013. It is based on the latest available data collected by the African Development Bank though annual country missions for the *African Economic Outlook*. Despite improvements in domestic resource mobilisation over the past decade, African countries still face enormous challenges in raising more and better taxes. A major hurdle is illicit financial outflows from Africa, which are estimated to outpace the flow of aid and investment.

Taxation is increasingly important for Africa

Enhanced domestic resource mobilisation in Africa is central to meeting the dual challenge of increasing productivity levels and making growth more inclusive in pursuit of the continent's integration and transformation agenda (AfDB et al., 2010). While governments need more resources to invest in physical and social infrastructure – which markets will eschew or underprovide – tax reforms are also an essential feature of successful governance reforms (Prichard, 2010). Domestic resource mobilisation reinforces a country's ownership of public policy and allows countries to move towards financial autonomy (UN, 2014). For this reason, African Union leaders reiterated the key messages of the 2002 Monterrey Consensus and the 2008 Doha Declaration in the context of the 2014 Common Africa Position on the Post-2015 Development Agenda, and declared that policies that increase and improve the quality of finance from domestic sources should remain a top priority for their governments (African Union, 2014).

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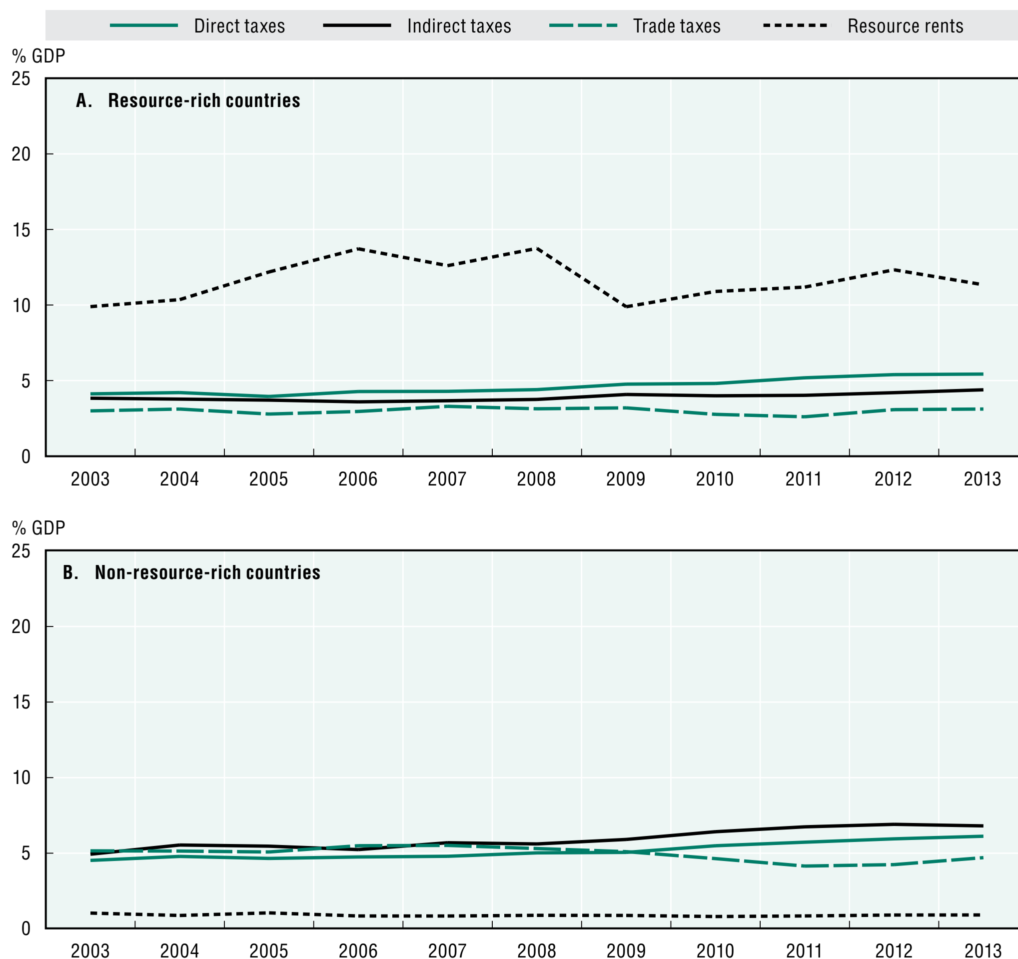
Tax revenues are increasing but remain vulnerable to shifts in energy prices

Public domestic finance in Africa has increased more than threefold in a decade from USD 157 billion in 2003 to USD 507 billion in 2013. Compared to 2012, total tax revenue in 2013 registered a slight decrease of about 1.5% mainly on account of lower resource rents.

Resource rents account for the majority of tax revenue, but are highly volatile

Resource rents are the main contributor to tax revenue in Africa, amounting to USD 215 billion in 2013. Their share of total tax revenues increased from an average of 39% in 2000-03 to an average of 43% in 2010-13. However, rents from natural resources are volatile by nature, as they depend on fluctuations in international commodity prices (Figure 2.10). Indeed, resource rents increased during the 2002-08 period and then contracted during the 2008-09 global recession, mirroring the boom and bust of commodity prices. After peaking at USD 235 billion in 2012 they decreased by 8% in 2013, following a broad-based decline in energy, metals and minerals prices. The continuous decline of commodity prices, illustrated in Chapter 1, and in particular collapsing oil prices, do not bode well for the collection of resource rents in 2014 and 2015.

Figure 2.10. **The tax mix in Africa: Resource-rich vs. non-resource-rich countries, 2003-13**



Source: Authors' calculation based on *African Economic Outlook* data.
StatLink http://dx.doi.org/10.1787/888933206660

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In 2013, 70% of tax collected in Africa originated from six countries: South Africa (USD 86.5 billion), Nigeria (USD 77.8 billion), Algeria (USD 71.8 billion), Angola (USD 48.7 billion), Libya (USD 42.8 billion) and Egypt (USD 38.9 billion).

The tax mix is more balanced in non-resource-rich countries

The tax mix – the relative composition of a country's tax revenue – differs widely between resource-rich and non-resource-rich countries in Africa (Figure 2.10). For example, resource rents in Algeria, Angola, Congo, Equatorial Guinea and Libya accounted for more than 80% of total tax collection and represented more than 20% of GDP in 2013. Over the last decade, these countries have made little progress in setting up a more balanced tax mix, remaining highly vulnerable to shifts in commodity prices.

Conversely, non-resource-rich countries have progressed in broadening their tax base, raising tax collection through direct and indirect taxes. Ethiopia and Kenya have a well-balanced mix of indirect, direct and trade taxes, which helps them to maintain a more stable and predictable flow of resources to finance public goods.

Domestic resource mobilisation is hampered by a range of obstacles

Despite significant improvements in tax revenue collection over the last decade, efforts still fall short of need in most economies. The infrastructure-financing gap remains wide as new challenges arise, such as mitigating and adapting to climate change. Moreover, tax systems have yet to play a significant role in tackling high levels of inequality, due to their relatively low redistributive effects.

Efforts to combat tax avoidance are hampered by lack of monitoring capacity

The combination of a huge informal sector, low levels of tax collection, high rates of tax evasion (low tax payer morale) and a weak tax administration all add to the challenge of fiscal reform for inclusive development. In addition, many resource-rich countries lack the capacity to negotiate contracts, which would promote greater transparency and improve public revenue from the extractive sector (OECD, 2014a).

Abusive transfer pricing – the artificial movement of taxable profits from high-tax to low-tax jurisdictions – occurs on a substantial scale in Africa. Moreover, only three African countries have transfer-pricing units in their internal revenue services (AU/ECA, 2015). Lack of official monitoring capacity leaves African countries highly vulnerable to these tax avoidance practices. The OECD and the G20 are working together to curb strategies defined as "base erosion and profit shifting" (BEPS), which exploit gaps and mismatches in tax rules to shift profits for tax purposes (Box 2.3).

Box 2.3. **African countries can benefit from global processes to address international tax issues**

The G20 has identified base erosion and profit shifting (BEPS) as a serious risk to tax revenues, sovereignty and fair tax systems, affecting both developed and developing countries worldwide. BEPS issues arise from deficiencies in current international tax rules and standards that enable multinational companies to shift profits across borders to take advantage of lower tax rates.

For low-income countries, which rely heavily on tax revenue from multinational companies, profit shifting has a particularly significant effect on vital tax revenues. If large and high profile taxpayers are seen to be avoiding their tax liabilities, confidence in the effectiveness of the tax system is undermined.

Box 2.3. **African countries can benefit from global processes to address international tax issues** (cont.)

The OECD and G20 economies are working together to address BEPS issues and provide consistency for both business and tax sovereignties. In 2013, the OECD launched a 15-point Action Plan to provide governments with domestic and international tools to combat profit shifting (OECD, 2013). The involvement of developing countries in the OECD/G20 BEPS project is crucial to ensure they receive appropriate support to address the specific challenges they face.

During the first year of the OECD/G20 BEPS project, more than 80 developing countries and other non-OECD/non-G20 economies provided input through four regional consultations and four thematic global forums. This process enabled the project to identify BEPS issues that are most relevant and pose specific challenges for developing countries. Priority areas include limiting base erosion via interest deductions and other financial payments, preventing tax treaty abuse and the artificial avoidance of Permanent Establishment status, transfer pricing (in particular base eroding payments), and transfer pricing documentation and country-by-country reporting. Political support and capacity building to address BEPS issues were identified as key cross-cutting challenges for developing countries.

Lack of comparable data on transfer pricing and the granting of wasteful tax incentives were also identified as areas of particular concern for developing countries (OECD, 2014). These issues are the subject of other specific mandates for further analysis by the G20 and ongoing work through the OECD Task Force on Tax and Development.

The involvement of developing countries in designing solutions to counter BEPS has now been scaled up to facilitate direct participation by developing economies in the project. Since 2015, 13 developing countries have been involved in the Committee on Fiscal Affairs and the relevant Working Parties on BEPS, including Morocco, Nigeria, Senegal and Tunisia – as well as the African Tax Administration Forum (ATAF) for Africa. The BEPS project organises network meetings in five regions (including Africa) to engage with a broader group of developing countries, particularly low-income countries that may lack the capacity to participate directly in the BEPS project. The meetings take place in partnership with ATAF and CREDAF (*Centre de rencontre des administrations fiscales*) for French-speaking countries.

Sources: OECD (2013, 2014e).

Increasing data accessibility and promoting the sharing of good practices among countries is critical to improving fiscal policies. Important efforts in this regard are presented in Box 2.4.

Box 2.4. **Making revenue statistics comparable in Africa**

Although consensus on the necessity to improve domestic resource mobilisation in Africa is a key feature of Agenda 2063, adopted by the African Union in January 2015, the lack of a solid information basis on government revenues hampers effective reform and policy making.

A broad partnership of international organisations* have therefore set up the Revenue Statistics in Africa project to improve the comparability, consistency, quality and accessibility of revenue indicators and data. These can then be used to analyse taxation and spending policies and their incidence on equity and economic efficiency, with a view to feeding policy dialogue networks, exchanging good practices and distilling policy recommendations on fiscal policy reform.

Tax officials from Cameroon, Senegal, South Africa and Tunisia gathered with partner organisations in November 2014 under the auspices of the African Union Commission to kick-off the project, and were joined in February 2015 by their peers from Cabo Verde, Côte d'Ivoire, Mauritius, Morocco and Rwanda. The first edition of Revenue Statistics in Africa is due for launch in early 2016 and will cover the nine participating countries. The aim is to gradually include

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Box 2.4. **Making revenue statistics comparable in Africa** (cont.)

other African countries on a voluntary basis in future annual editions. The published statistics will enable comparison among participating countries from Africa, as well as from Asia, Latin American and the OECD.

Note: *The African Development Bank, the African Tax Administration Forum (ATAF), the African Union Commission, the *Centre de rencontres et d'études des dirigeants des administrations fiscales* (CREDAF), the OECD Centre for Tax and Policy Administration, the OECD Development Centre and the World Customs Organisation (WCO). For more information see: www.oecd.org/dev/emea/harmonisingafricanrevenuestatistics.htm.

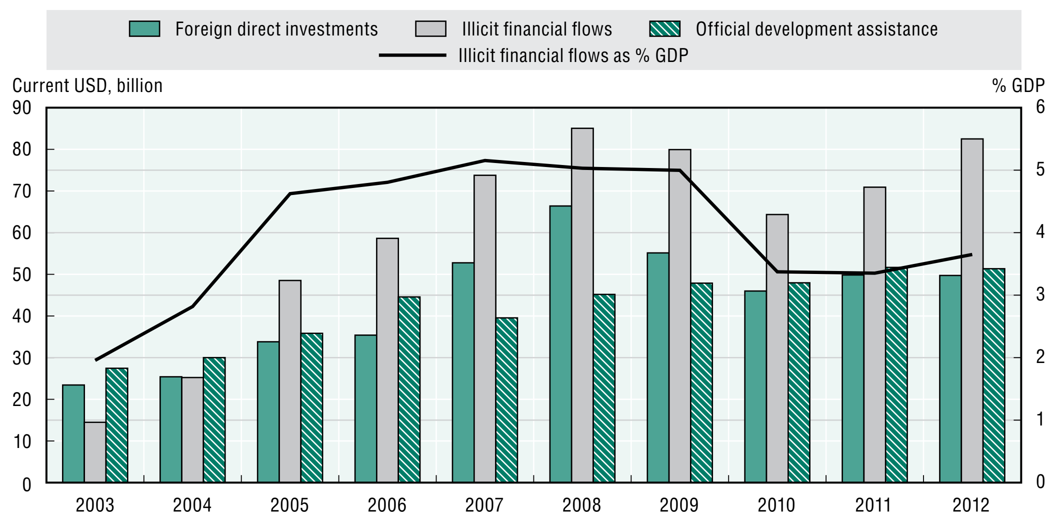
Illicit financial flows from Africa are greater than ODA and FDI

Illicit financial flows (IFFs) drastically undermine efforts to mobilise domestic resources. While definitions vary, IFFs generally involve funds that are illegally earned, utilised or transferred out of a country in contravention of national or international laws (AU/ECA, 2015; OECD, 2014c). Illicit financial flows exploit practices such as tax evasion (including trade misinvoicing and abusive transfer pricing), money laundering, bribery by international companies and abuse of office by public officials.

The impact of IFFs on African countries is especially negative and growing

These detrimental practices occur everywhere, however their economic and social impact on African countries is especially negative, given the smaller size of the resource base and markets (OECD, 2014c). Illicit financial flows remove money that could be invested to finance much-needed basic social and public services. They also weaken African financial systems and undermine state structures (OECD, 2014c). Ndikumana and Boyce (2012) estimate that Africa's capital stock would have increased by more than 60% if funds leaving Africa illicitly had remained within the continent, while GDP per capita would be 15% higher.

Figure 2.11. **Illicit financial flows from Africa compared to official development assistance and foreign direct investment, 2003-12**



Note: IFFs are computed according to the methodology developed by Kar and Spanjers (2014), which measures IFFs using two sources: (i) outflows due to deliberate trade misinvoicing, and (ii) outflows due to leakages in the balance of payments, also known as illicit hot money narrow outflows. The vast majority of measurable illicit financial flows from Africa (67.4 % on average from 2003 to 2012) are due to trade misinvoicing.

Sources: Authors' calculations based on Kar and Spanjers (2014), OECD (2015), and IMF and *African Economic Outlook* data.

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Recent estimates show that IFFs are a large and growing problem (Figure 2.11). Africa lost an annual average of USD 60.3 billion – about 4% of GDP – in illicit financial outflows during 2003-12 (Kar and Spanjers, 2014). These outflows exceed aid and investment flows in volume – ODA and FDI for the continent over the same period averaged USD 42.1 billion and USD 43.8 billion per year, respectively. Illicit financial flows for sub-Saharan Africa in 2012 (estimated at USD 68.6 billion) are slightly less than the combined total of ODA (USD 41.1 billion) and FDI (USD 35.4 billion). However, IFFs are clandestine transactions, and as such estimates wary widely and may well underestimate the actual size of flows.

The issue of IFFs is gaining increasing prominence in the international arena

The OECD, the G8 and G20, the European Parliament and the African Tax Administration Forum have all launched initiatives to tackle the phenomena. In 2015, the AU/ECA High Level Panel on Illicit Financial Flows from Africa recommended the adoption of a unified policy instrument to combat IFFs within the Post-2015 Development Agenda. Its aim is to ensure coherence among the different initiatives and to reinforce Africa’s limited capacities to cope with the problem.

According to the final report of the AU/ECA High Level Panel (2015), large commercial corporations account for the vast majority of IFFs (65%), followed by organised crime (30%) and corrupt practices (5%). The most widely documented method for transferring illegal money across international borders is trade misinvoicing – the deliberate over- and under-invoicing of trade transactions. This practice accounted for 67.4% of all illegal outflows from Africa between 2003 and 2012 (Kar and Spanjers, 2014).

Joint efforts and greater transparency are needed to tackle illicit flows

Given the detrimental effects of misinvoicing on the capacity of African countries to mobilise domestic resources, the AU/ECA High Level Panel recommends that African governments and the international community join efforts to ensure its curtailment. One option would be to equip customs authorities with the latest, comparable global pricing data, which would allow them to promptly detect and block misinvoiced transactions (AU/ECA, 2015).

Ultimately, putting a stop to IFFs depends on greater transparency. A key contribution to efforts in this area is the Africa Initiative launched by the Global Forum for Transparency and Exchange of Information for Tax Purposes (Box 2.5). For African countries to make the most of this and other global initiatives, they need to establish or strengthen the capacities of revenue authorities, transfer pricing units, customs services and anti-corruption agencies, and provide them with the necessary financial resources.

Box 2.5. **The Africa Initiative of the Global Forum on Transparency and Exchange of Information for Tax Purposes**

The Global Forum on Transparency and Exchange of Information for Tax Purposes is the largest international tax group in the world with 126 members. It is responsible for monitoring the implementation of internationally agreed standards of transparency and exchange of information (EOI) for tax purposes. African member countries include Botswana, Burkina Faso, Cameroon, Côte d’Ivoire, Gabon, Ghana, Kenya, Lesotho, Liberia, Mauritania, Mauritius, Morocco, Niger, Nigeria, Senegal, Seychelles, South Africa, Tanzania, Tunisia and Uganda. All members participate on an equal footing and have committed to adhere to the international standard on Exchange of Information on Request.

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Box 2.5. **The Africa Initiative of the Global Forum on Transparency and Exchange of Information for Tax Purposes** (cont.)

The Africa Initiative proposes approaches to combating the problem of illicit flows from Africa. These include strengthening the fight against tax evasion and supporting domestic revenue mobilisation through enhanced transparency and exchange of information throughout Africa, including by:

- building political momentum in Africa to make effective use of existing global EOI infrastructure
- providing African tax administrations with tools to request, process and use information
- increasing the number of African countries in the Global Forum
- building EOI capacity within African regional organisations such as the African Tax Administration Forum (ATAF)
- creating a sustainable legacy of transparency and EOI in Africa.

The Initiative is steered by a taskforce consisting of African members of the Global Forum and international and regional organisations, including ATAF, the *Centre de Rencontre et d'Etudes des Dirigeants des Administrations Fiscales* (CREDAF) and the World Bank Group.

Source: OECD (2014d).

Notes

1. The OECD defines foreign direct investment as "a category of cross-border investment made by a resident in one economy with the objective of establishing a lasting interest in an enterprise that is resident in an economy other than that of the direct investor. The motivation to significantly influence or control an enterprise is the underlying factor that differentiates direct investment from cross-border portfolio investments. Portfolio investors do not have as an objective any long-term relationship. Return on the assets is the main determinant for the purchase or sale of their securities" (OECD, 2008).
2. Resource-rich countries include: Algeria, Angola, Botswana, Cameroon, Chad, Congo, Côte d'Ivoire, Democratic Republic of the Congo, Egypt, Equatorial Guinea, Gabon, Ghana, Guinea, Liberia, Libya, Mauritania, Namibia, Nigeria, Sierra Leone, South Africa, South Sudan, Sudan and Zambia (IMF definition).
3. DAC members include: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, the European Union, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States.
4. Denmark, Luxembourg, Norway and Sweden continued to exceed the United Nations' ODA target of 0.7% of GNI, and the United Kingdom met it for the first time. However, the Netherlands fell below 0.7% for the first time since 1974.
5. Non-DAC donor ODA disbursements to Africa include data from: Croatia, Cyprus, Estonia, Hungary, Israel, Kuwait (KFAED), Latvia, Lithuania, Malta, Romania, Russian Federation, Saudi Arabia, Thailand, Turkey and UAE.
6. Country Programmable Aid (CPA), also known as "core" aid is a sub-set of gross bilateral official development assistance that measures actual transfers to partner countries. CPA represents the proportion of aid that is subject to country allocation decisions by the donor. CPA been proven in several studies to be a good proxy for aid recorded at country level. For more information on CPA, see www.oecd.org/dac/cpa.

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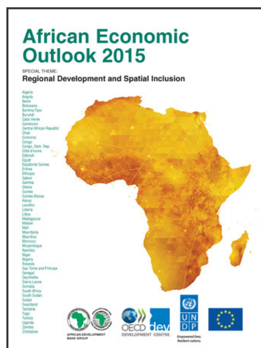

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