Financing for Development in the Era of COVID-19: The Primacy of Domestic Resource Mobilization

United Nations

This flagship report draws on the report of the Secretary-General on the New Partnership for Africa's Development: nineteenth consolidated progress report on implementation and international support. The flagship report has been prepared by Mr. Liwaaddine Fliss, Ms. Rui Xu and Mr. Utku Teksoz, under the coordination of Mr. Kavazeua Katjomuise and the overall supervision of the Under-Secretary-General and Special Adviser on Africa.

This publication has been developed as part of OSAA's mandate to undertake analytical work that contributes to improving coherence and coordination of the UN System support to Africa and to facilitate intergovernmental deliberations on the linkages between peace and development in Africa

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EXECUTIVE SUMMARY

While the pandemic has reshaped the financing for development landscape in Africa and exacerbated existing vulnerabilities, it also provides an opportunity for African countries to strengthen domestic resource mobilization to underpin sustainable development financing. Effective domestic resource mobilization is essential in order to obtain the financing required to effectively drive the continent's economic growth and development in an inclusive and sustainable manner. Increased domestic resource mobilization would also be fundamental to Africa reclaiming its policy space over its development, channelling resources towards productive capacity development and structural transformation and industrialization. However, for domestic resource mobilization to play an effective role in the continent's sustainable development agenda, fundamental changes in both policy and institutions will be required, including through improving efficiency in public expenditures, strengthening revenue collection, harnessing private savings and the private financial sector for development and stemming illicit financial flows.

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INTRODUCTION

Lack of financing has been a major constraint to Africa's development over the years. This has constrained African countries' capacity to provide resources at scale for investment in social and productive sectors. A confluence of factors has contributed to this. Africa's financial sector remains shallow and thus is unable to play an effective role in savings mobilization. Many African countries suffer from the serious problem of weak institutions and capacity – hampering their ability to tackle tax evasion and avoidance, particularly by multinational enterprises. As a result, the continent has had to borrow externally to fill the financing gap. Furthermore, the substantial institutional savings (pension, assurance, and sovereign wealth funds) generated are not harnessed towards financing the region's development.

In addition, the nature of African economies, which are externally oriented and rely heavily on the import of foodstuffs and capital goods while exporting raw materials, also presents challenges for domestic resource mobilization. The heavy import bill drains African countries of vital foreign reserves, putting pressure on the exchange rate – leading to balance of payment problems. To fill the large financing gap, African countries have come to rely increasingly on external debt financing, which ends up diverting additional resources away from productive investment towards debt-servicing.

The lopsided and extractive relationship between Africa and its traditional partners is also a enormous challenge to Africa's long-term growth and sustainable development. While the continent is able to generate substantial private savings in the form of pension and insurance funds, as well as sovereign wealth funds, these are not harnessed towards financing the region's growth and development. If fully harnessed, these resources could go a long way towards reducing the financing gap for infrastructure and broader sustainable development.

When the coronavirus disease (COVID-19) pandemic struck in 2020, the region's economy was already relatively weak, with limited production and diversification, heavy import dependence, mounting debt and a narrow domestic revenue base, and thus was unable to provide resilience to the multidimensional impact of the pandemic. Measures to contain the spread of the pandemic, including national lockdowns and border closures, combined with increased spending to support businesses and the most vulnerable, put significant strains on national budgets, aggravating the impact of the pandemic on the continent. As a result, the pandemic has dramatically rolled back the development gains of the past two decades.

These problems, however, were not caused by COVID-19 alone, but had built up over decades[1]. However, the pandemic has served to magnify these and other existing fault lines in the multilateral governance system. This is being compounded by the ongoing war in Ukraine, the impact of which on Africa is being felt through rising food, fuel and fertilizer prices. Therefore, international solidarity at scale will be required to help Africa build forward better from COVID-19.

1 Owing to misguided policies, weak capacities and institutions, unfavorable external conditions and asymmetric power relations in the multilateral systems.

As the experiences of countries that have undergone successful growth and structural transformation have shown, sustained and lasting change can only come from within. Therefore, Africa must break with the past and look within, relying on its domestic financial and natural resources for sustainable solutions to its development finance needs.[2] Part of that shift must include prioritizing domestic and regional production and value chains and their integration into global value chains. The adoption of the African Continental Free Trade Area provides an opportunity to promote national and regional value chains and diversify economies.

While disruptions related to COVID-19 pose a significant challenge to the continent's development, they also present an opportunity for Africa to promote a new approach to development, including through structural transformation and industrialization to strengthen resilience to external shocks. Strong domestic resource mobilization systems are key in this regard. The report of the High-level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (the FACTI Panel) lays out a bold vision for a fairer international tax system anchored on the values of integrity and legitimacy and underpinned by a strengthened policy and institutional framework.[3]

Domestic resources, including tax revenue and savings, make up the bulk of Africa's development financing, accounting for over two thirds of total financial resources. Though official development assistance (ODA) remains an important source of budget support for some African countries, especially least developed countries, its relative importance in overall financing has declined over the years.

Effective domestic resource mobilization is essential in order to obtain the financing required to effectively drive the continent's economic growth and development in an inclusive and sustainable manner. Increased domestic resource mobilization would also be fundamental to Africa reclaiming its policy space over its development – increasing its ownership and exercising effective leadership with regard to its development, channelling resources towards productive capacity development and structural transformation and industrialization, as well as investing in national and regional value chains to exploit the benefits of the African Continental Free Trade Area.

Most of the available literature on domestic resource mobilization analyses the revenue side but not the expenditure side. However, the present report argues that any domestic resource mobilization process should start by setting up efficient public expenditure treasury management systems. Therefore, to ensure the efficiency and effectiveness of domestic resource mobilization systems, African countries need to address both the revenue and expenditure sides of the equation. The present report takes a holistic approach to domestic resource mobilization, including budget and non-budget components: (a) public expenditures; (b) budget/tax revenues; (c) domestic savings; and (d) capital markets.

The report is organized as follows: chapter 1 presents an overview of the financing landscape in Africa that shows the importance of the continent's own financial resources in development financing as a way to demonstrate the potential of domestic resource mobilization to fill the financing gap. Chapter 2 discusses mobilizing domestic resources through increased tax revenue and improved expenditure, underscoring the

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2 *Economic Report on Africa 2019: Fiscal Policy for Financing Sustainable Development in Africa* (United Nations publication, Sales No. E.19.II.K.2).
3 United Nations, *Financial Integrity for Sustainable Development: Report of the High-Level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda* (2021).

importance of tackling both the revenue and expenditure sides of the fiscal budget. Chapter 3 focuses on leveraging private financial resources and mobilizing savings, demonstrating the potential of private savings in development financing. Chapter 4, on stemming illicit financial flows, shows that addressing the inequities in international taxation is at the heart of ensuring a fairer globalization and securing a better future for Africa in the post-pandemic world. Chapter 5, on partnerships, underscores the need to align global partnerships with Africa's development aspirations. Finally, the report provides a conclusion and a proposed road map. The report builds on work undertaken by several United Nations entities in recent years, including the report of the Secretary-General entitled *Our Common Agenda*,[4] while adding value to the discussion by bringing a uniquely African perspective to the issues and debunking some of the myths on financing for development in Africa.

The methodology used for the preparation of the report includes an in-depth review of relevant documents and an analysis of relevant data sets. Other stakeholders consulted include the members of the Africa Knowledge Network. A Sound Board was also set up, comprising continental organizations and United Nations system entities working on financing for development issues, including the New Partnership for Africa's Development (NEPAD), the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Programme (UNDP) and the African Development Bank (AfDB). In addition, selected members of the United Nations interdepartmental task force on African affairs, including the Department of Economic and Social Affairs and UNCTAD, have also contributed to the report.

4 *Our Common Agenda – Report of the Secretary-General* (United Nations publication, 2021).

CHAPTER 1.

Overview of the financing for development landscape in Africa and the impact of COVID-19

The African continent experienced adverse socioeconomic repercussions from the COVID-19 pandemic, with real gross domestic product (GDP) growth declining by 2.2 % in 2020. Regional growth recovered to 3.8 % in 2021 and is projected to reach 4.0 % in 2022 and 3.6 % in 2023, underpinned by a rebound in commodity prices, improvement in investments and the easing of pandemic-related restrictions. However, this is below the required 6 % for the region to return to its pre-pandemic growth trajectory, thus representing a significant setback to development gains achieved before the pandemic.[5]

As a result of the social and economic toll of the pandemic, analysis by the International Monetary Fund (IMF) has shown that African countries would require additional financing of around $285 billion from 2021–2025 to meet the spending needs in response to COVID-19, about $135 billion of which would be required for low-income countries in the region. To get African countries back on their previous path of income convergence with advanced economies would require double the amount of additional financing. Table 1 (next page) below presents the lower and upper bounds of the estimated financing gaps during this five-year period.

The pandemic has reshaped the financing for development landscape in Africa, as it not only exacerbated existing challenges and vulnerabilities, including inequalities, but also created new opportunities. Domestic financing, including revenue and private savings, has been negatively affected but remains the largest source of finance. External financing such as foreign direct investment (FDI) and ODA, which were already on a slow decline prior to the pandemic, suffered a further setback. Meanwhile, remittances have proven to be a resilient source of development financing in the face of economic downturn.[6]

5 *World Economic Situation and Prospects 2022* (United Nations publication, Sales No. E.22.II.C.1).
6 World Bank and Global Knowledge Partnership on Migration and Development (KNOMAD), "Recovery: COVID-19 crisis through a migration lens", Migration and Development Brief 35 (November 2021), p. 58. Available at www.knomad.org/sites/default/files/2021-11/Migration_Brief%2035_1.pdf

TABLE 1 **AFRICA'S ADDITIONAL FINANCING NEEDS, 2021–2025 (BILLIONS OF UNITED STATES DOLLARS)**		
	Scenario A	**Scenario B**
	Additional financing needs to increase spending to counter the effects of COVID-19-related shocks, including procuring and administrating vaccinations, to prevent permanent scarring of the economy, and to ensure adequate buffers	Additional financing needed in addition to scenario A to increase investment spending (for both physical and human capital) enough to return African countries to the pre- COVID-19 income convergence path with advanced economies by 2025
Africa	284.6–485.9	518.1–719.4
Low-income countries	137.0–205.3	267.1–335.4
Emerging market economies	147.6–280.6	251.0–384.0

Source: IMF, background note for the high-level event on international financing summit for Africa, 2021.

The geopolitical ramifications arising from the ongoing war in Ukraine could trigger a food crisis as a result of the disruption of global trade supply chains.

When comparing various financing sources, it is evident that Africa's development is already financed to a large extent with its domestic resources, contrary to the common misconception that the region's development financing relies heavily on foreign aid. Table 2 summarizes the magnitude of different financing streams in recent years. In 2018, the sum of public revenues and private savings was $911.4 billion, around 20 times that of inward FDI and 16.5 times of net ODA.[7] Banks made available $566.5 million in domestic credit to the private sector. This supports the new narrative of Africa, which places the continent in the driver's seat of its development, without downplaying the complementary and catalytic role of external financing.

TABLE 2

SOURCES OF FINANCING FOR AFRICA'S DEVELOPMENT, 2014–2018 (BILLIONS OF UNITED STATES DOLLARS)

	2014	2015	2016	2017	2018
Public revenues excluding grants	**524.7**	**438.2**	**394.2**	**425.9**	**483.6**
Private savings	**507.0**	**419.6**	**408.2**	**415.6**	**427.8**
Total, foreign inflows	**210.1**	**200.5**	**170.5**	**229.8**	**221.8**
Inward foreign direct investment	53.9	56.9	46.5	41.4	45.9
Portfolio investments	30.4	22.2	6.2	57.1	36.5
Remittances	71.8	71.4	57.6	77.6	84.2
Official development assistance (net total)	54.1	50.1	50.4	53.8	55.3

Source: African Union Commission and Organisation for Economic Co-operation and Development (OECD), *Africa's Development Dynamics 2021: Digital Transformation for Quality Jobs* (Paris, 2021), table 8.1.

7 African Union Commission and Organisation for Economic Co-operation and Development (OECD), *Africa's Development Dynamics 2021: Digital Transformation for Quality Jobs* (Paris, 2021). Available at https://doi.org/10.1787/0a5c9314-en

Africa still has a long way to go to fully maximize domestic revenue mobilization. Tax revenue as a share of GDP rose steadily in the past decade, reaching 16.6 % in 2019, yet Africa consistently lags behind other developing regions (figure 1, next page). There is a large variation across African countries in tax collection, ranging from 34.3 % of GDP in Tunisia and Seychelles to 6.0 % in Nigeria (figure 2, next page). Countries in Northern Africa have the highest average tax-to-GDP ratio (22.7 %) while Central Africa recorded the lowest (10.1 %). The low tax-to-GDP ratio means that African countries have few financial resources to spend on improving infrastructure, health and education, which are key to the long-term prospects of the continent's economy and its citizens.

A large portion of Africa's development financing needs are supported by domestic savings, which remained steady in 2020, with sub-Saharan Africa reporting total gross domestic savings of $353 billion (20.1 % of GDP), lower than $918 billion for Latin America and the Caribbean and $866 billion for South Asia (25.7 %). The size of domestic savings remained steady in 2020 despite the disruptions and adverse economic impacts caused by COVID-19, while other regions experienced a sharper decline (figure 3, next page).

Assets managed by pension funds represent another important source of domestic financing. This amounted to $676 billion in 2017 and was estimated to reach $1.1 trillion by 2020.[8] However, many countries invest a substantial portion of their pension funds abroad; if such funds were invested domestically, that could help reduce the financing gap significantly.

FDI as a vital source of financing for African countries' development was severely affected by the COVID-19 pandemic. According to UNCTAD data,[9] in the past decade, FDI inflows to Africa fluctuated from $47.2 billion in 2010 to $47.1 billion in 2019, peaking in 2015 at $57.9 billion (at current prices). In 2020, global FDI flows fell by 35 % to $1 trillion from $1.53 trillion in 2019 due to the emergence of the COVID-19 pandemic. In Africa alone, the pandemic led to a decline in FDI to $39.8 billion in 2020, which was a 16 % year-on-year decrease (figure 4, next page). Per capita, FDI to Africa decreased by 18 % from $36.3 in 2019 to $29.9 in 2020. This amount is small compared to the region's gross capital formation, at $461.4 and $416.1, in those two years.[10]

Moreover, the share of Africa in global FDI remains marginal, averaging 4 % in 2020, considerably below the level for Latin America and the Caribbean (9 %) and Asia (58 %),[11] highlighting the challenges faced by African countries in attracting foreign investment to finance their development needs.[12] The decline caused by the pandemic is experienced in all subregions with the exception of Central Africa, mostly thanks to increased inflows to the Congo. Countries in Southern Africa received the highest FDI per capita in 2019 but also experienced the greatest decline in 2020, by 39 %, while the Northern, Eastern and Western Africa regions also reported decreases of 28 %, 21 %, and 20 %, respectively.

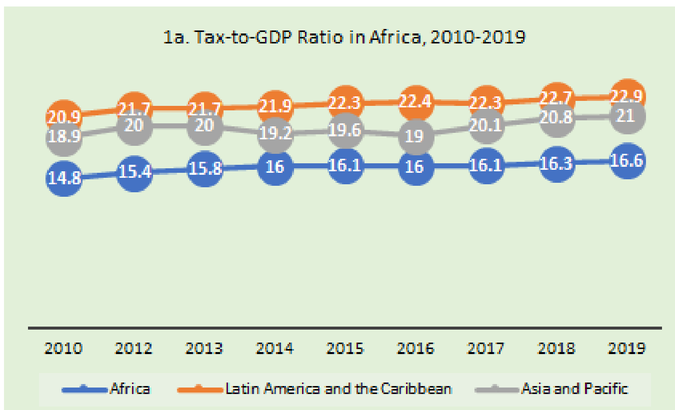
FDI in Africa directed towards sectors related to the Sustainable Development Goals fell considerably in 2020, according to the UNCTAD World Investment Report 2021. The drop had the most

8 Katja Juvonen and others, *Unleashing the potential of institutional investors in Africa*, African Development Bank Working Paper Series No. 325, 2019.
9 UNCTAD bilateral FDI database on flows and stocks. Available at https://unctad.org/topic/investment/investment-statistics-and-trends
10 United Nations calculations based on the AfDB African Economic Outlook (March 2021) data portal and *World Population Prospects 2019*.
11 UNCTAD bilateral FDI database on flows and stocks. Available at https://unctad.org/topic/investment/investment-statistics-and-trends
12 Ibid.

severe impacts on resource-dependent countries owing to declining commodity prices and lower demand. UNCTAD predicted that the recovery of foreign investment in Africa would rebound only marginally in 2021 and pick up greater pace in 2022 as a result of expected growth in demand for commodities and the pending finalization of the protocol on sustainable investment with regard to the African Continental Free Trade Area.[13]

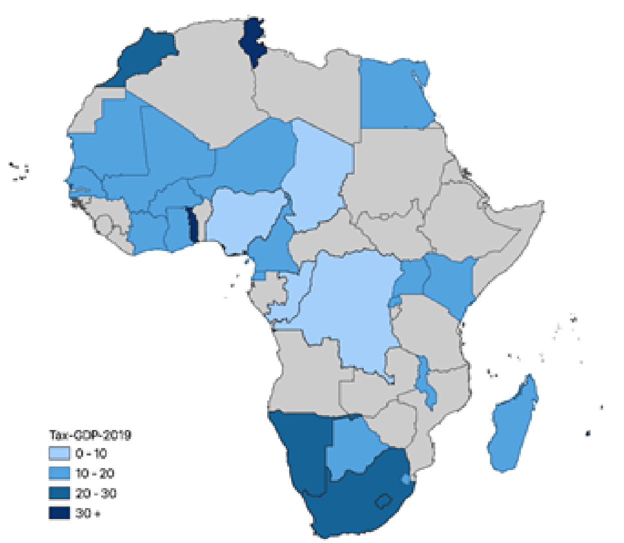
Increasing investment to support a sustainable and inclusive recovery is a priority for the African region. FDI should be channelled towards sectors with high growth potential that support the region's industrialization and structural transformation, including infrastructure, energy and human capital development, in order to "build back better" in the post- COVID-19 era.

FIGURE 1: TAX-TO-GDP RATIO IN AFRICA, 2010-2019



Source: OECD/AUC/ATAF (2021), Revenue Statistics in Africa 2021.

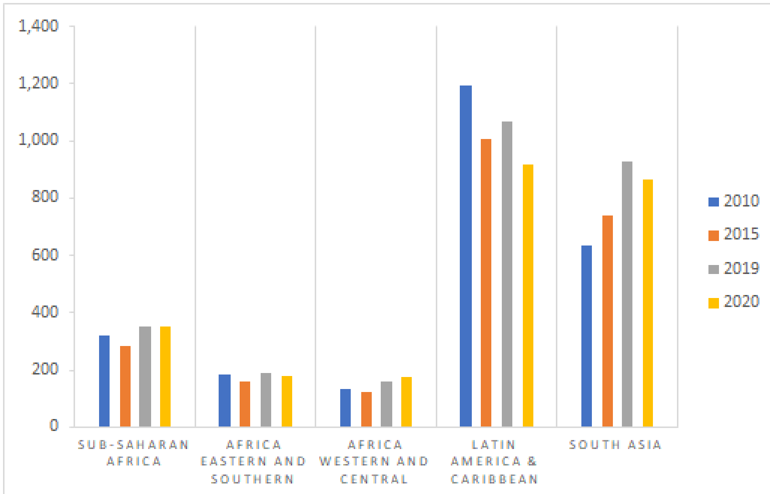
FIGURE 2: AFRICA'S TAX-TO-GDP RATIOS IN 2019



Source: OECD/AUC/ATAF, Revenue Statistics in Africa 2021. Data is available for 30 African countries.

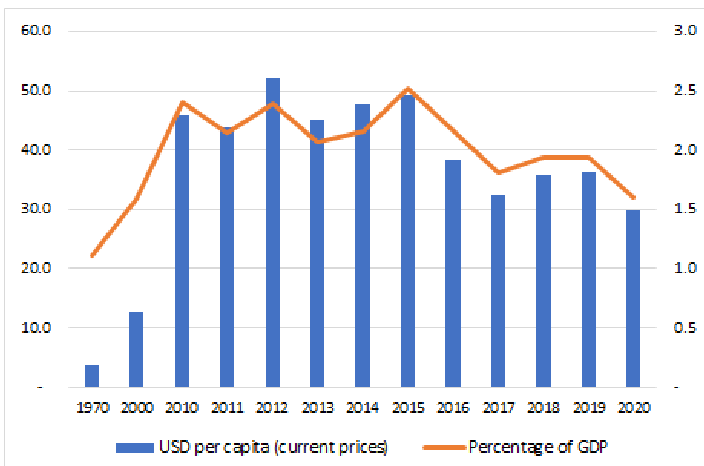
13 *World Investment Report 2021: Investing in Sustainable Recovery* (United Nations publication, Sales No. E.21.II.D.13).

FIGURE 3: AFRICA'S GROSS DOMESTIC SAVINGS ARE LOWER THAN OTHER DEVELOPING REGIONS (CURRENT USD BILLIONS)



Source: World Bank Group. World Development Indicators 2021.

FIGURE 4: TREND OF FDI FLOWS TO AFRICA



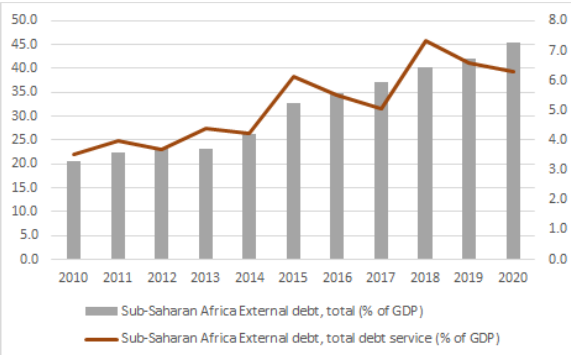
Source: UNCTAD bilateral FDI database on flows and stocks.

Debt levels and debt service costs, which increased during the pandemic, continue to pose a considerable burden for sub-Saharan African countries. External debt rose from 21 % of GDP in 2010 to 45 % in 2020, while total external debt service increased from 3.5 % to 6.3 %, diverting vital resources from development and Sustainable Development Goal financing (figure 5 (a), next page). The growing debt mirrors the shrinking fiscal space, which has worsened as a result of the pandemic (figure 5 (b), next page).

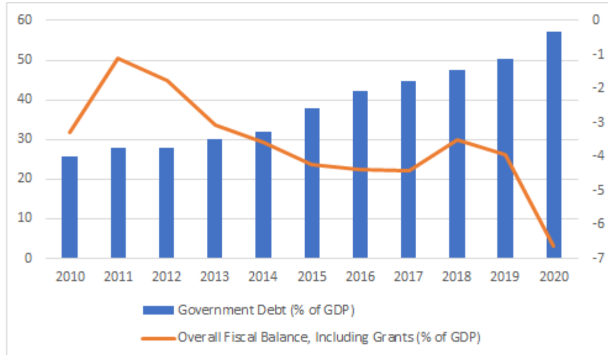
With the increasing need for African countries to improve their public health system, few countries have the fiscal space to finance this effort on their own. Because many governments have had to borrow, failure to meet debt service obligations may have devastating impacts on African economies, including sovereign credit downgrades, heightened pressure on foreign exchange reserves and currency depreciation, potentially reducing the continent's access to international financial markets.

FIGURE 5: SUB-SAHARAN AFRICA'S GROWING DEBT PROBLEM AND SHRINKING FISCAL SPACE

a) Growing debt in Africa



b) Debt and Fiscal deficit in Africa



Source: IMF, World Economic Outlook database, October 2021.

Remittances have become an important source of financing for development in Africa thanks to the links between the continent and its diaspora, yet it is a relatively untapped source when compared with other developing regions. In 2020, remittances decreased by 4 % as a result of the pandemic, but were estimated to have recovered in 2021 to grow again by 9 %, reaching an estimated $91 billion.[14] This represents a crucial loss for the poorest and the most vulnerable households. The top recipients of remittances in 2020 were Egypt ($24.4 billion), Nigeria ($21 billion), Ghana (3.2 billion), Kenya ($2.9 billion) and Senegal ($2.3 billion); total recipients by share of GDP were South Sudan (35.4 %), Lesotho (20.6 %), the Gambia (14.9 %), Cabo Verde (12 %), the Comoros and Zimbabwe (10.8 %).[15]

One of the key challenges to harnessing the potential of remittances to finance Africa's development is the high cost of sending remittances. In the first quarter of 2021, costs averaged around 8 % in sub-Saharan Africa, far above the 3 % threshold set in Sustainable Development Goal 10.c, a major commitment by the international community to cut down the transaction costs of remittances. At the subregional level, the most expensive remittance corridors are in Eastern Africa (United Republic of Tanzania to Uganda) and Southern Africa (South Africa to Angola) where the cost exceeds 20 %; while West Africa is the least expensive at less than 4 %.[16] Reducing the cost of sending remittances is fundamental to increasing their flows and maximizing their impact on development and poverty reduction. Apart from the challenge of high costs, the transformative impact of remittances is hindered by the lack of adequate financial services and of financial inclusion. A large portion of people who receive remittances have no access to banks or other financial services, thus limiting the impact of remittances on development.

ODA to Africa has registered a small increase in nominal terms since 2010; however, the share of Africa among developing countries has declined from 37 % in 2010 to 34 % in 2020 (figure 6). ODA disbursements from all official donors to Africa increased from $44.1 billion in 2018 to $46.0 billion in 2019, then rose further to $52.7 billion in 2020 (all measured in constant 2020 United States dollars),

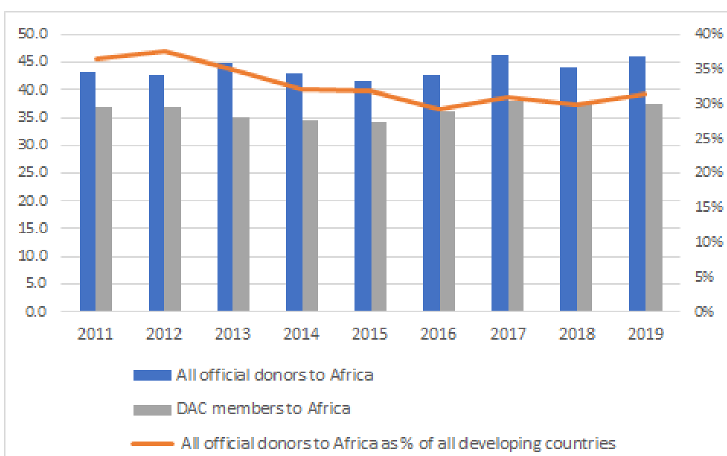
14 World Bank; KNOMAD database.
15 World Bank and KNOMAD, *Phase II: COVID-19 crisis through a migration lens*, Migration and Development Brief 33 (October 2020).
16 World Bank and KNOMAD, *Recovery: COVID-19 crisis through a migration lens*, Migration and Development Brief 35 (November 2021).

which represents a 14.7 % year-on-year increase. In 2020, the ODA disbursements to Africa accounted for about 34.4 % of all developing countries, compared with 8.4 % to South and Central Asia and 2.2 % to the Caribbean and Central America.[17]

ODA disbursements to Africa from members of the Development Assistance Committee, which includes 29 countries and the European Union, reached $42.9 billion in 2020, out of a total amount of $135.7 billion to developing countries (all measured in constant 2020 United States dollars), a 14.6 % increase from 2019. Although Africa is still the largest recipient of all developing regions, the amount of aid disbursed still falls below the level of the commitment made by donor countries (0.7 % of gross national income as ODA) and is insufficient to support the continent's huge development needs. Moreover, bilateral ODA flows to Africa from Development Assistance Committee countries in 2020 show that social infrastructure and services received the greatest share (40 % of total ODA), followed by economic infrastructure and services at 17 % and humanitarian aid at 12 %. Only 1 % of aid was allocated towards actions relating to debt. Aid needs to be more effectively allocated to fully unlock the potential of ODA in promoting Africa's potential for growth, regional integration and industrialization. ODA needs to be channelled to support domestic resource mobilization with capacity-building, strengthen local governance and stem corruption, and improve local and regional productive capacities to build back better.

Despite the myriad resources that can be harnessed for Africa's recovery and longer-term growth and sustainable development, African economies will not secure sustainable and inclusive development financing without tackling the problem of illicit financial flows. Illicit financial flows continue to drain large amounts of financial resources from the continent, estimated at $88.6 billion annually, equivalent to 3.7 % of GDP. This is driven primarily by commercial practices related to trade and tax abuse, followed by criminal activities and corruption. By reducing illicit outflows, the continent can increase the stock of capital available to local businesses, provide additional fiscal space for investment in infrastructure, health and education in the post-pandemic era, and feed the development of local and regional capital markets.

FIGURE 6: TREND OF NET ODA DISBURSEMENTS TO AFRICA (USD BILLIONS)



Source: Author's calculations based on OECD Statistics.

17 OECD.Stat, Aid (ODA) disbursements to countries and regions [DAC2a], as at 22 June 2022.

The pandemic has led to severe economic disruptions, decreased tax revenue, increased indebtedness and heightened fiscal constraints in Africa. Unlike advanced economies, African countries lacked the fiscal space to provide substantial financial support to struggling households and firms, which, coupled with a slow vaccination rate, led to a slower recovery. Although international cooperation has mitigated some of the harms caused by the pandemic, the response also exposed serious gaps in the effectiveness of multilateral action when it was needed the most.[18] Africa has received financial assistance and debt relief to cope with the emergency; however, this is insufficient to meet the region's development financing gap. It is clear that Africa's recovery and ability to build forward from the pandemic, as well as its long-term sustainable growth and development, will require a break with the past and the need to look within, and will increasingly rely on domestic sources of finance.

18 *Our Common Agenda – Report of the Secretary-General*, p. 48.

CHAPTER 2.

Mobilizing domestic public resources through increased tax revenue and improved expenditure

2.1. INTRODUCTION

Over the past several decades, African countries have made considerable efforts to mobilize increased domestic resources. Much of the effort, however, has focused on the revenue side. However, strengthening domestic resource mobilization is not just about raising taxes; it also entails ensuring progressive tax systems and bringing efficiency to revenue collection, combined with improving expenditure management. Therefore, a comprehensive approach that underpins domestic resource mobilization strategies in the context of Africa should be aimed at ensuring the quality of public expenditure by reducing inefficiency, eliminating waste, flagging potential areas of savings, rationalizing fiscal incentives and taking measures to increase public revenue by identifying underutilized tax resources, including by taxing the digital economy.

This must be complemented by measures to leverage the potential role of sovereign wealth funds and tackle illicit financial flows and tax evasion and avoidance (chap. 4).

2.2. ENHANCING THE QUALITY OF PUBLIC EXPENDITURE AS A PRO-DEVELOPMENT SOURCE

On top of the narrow tax-to-GDP ratio, the quality of public expenditure diverts much-needed resources away from the budget. The quality of public expenditure is not only important from the domestic resource mobilization standpoint but also for long-term growth and sustainable development. Analysis by IMF shows that African countries are relatively inefficient compared with other developing countries. For example, African countries' overall efficiency score in public spending, as proxied by average efficiency, shows that African countries are more inefficient than other developing countries, with an average efficiency score of 0.585, compared with 0.825. This means that African countries could have achieved the same level of output using 42 %[19] to 48 % fewer resources.[20] The public spending efficiency scores presented in the present report are estimates of the spending amounts that would have been saved by a country in order to reach the same level of output in comparison with its peers, based on the data envelopment analysis methodology.[21]

Similarly, at the sectoral level, spending inefficiency for education, health and infrastructure is also high compared with other regions (figure 7). Public spending inefficiency in infrastructure and education reached almost 52 % and 49 %, respectively. The spending inefficiency in health averaged only 13 %. These high inefficiency levels are mainly a result of countries' weak governance in public investment and social spending and weak institutional and administrative capacity, which results in the poor and/or inadequate allocation of resources across sectors and the prevalence of inequality.[22] African countries have set quantitative budgetary targets for priority sectors, including agriculture, education, health and other sectors. However, given the evidence of the high level of inefficiency in public expenditure, increased budgetary resources may not achieve desired outcomes.

In absolute terms, the inefficiency of public spending amounted to roughly $12 billion for education, $30 billion for infrastructure and $28 billion for health, representing a combined annual loss of 2.87 % of Africa's GDP.[23] These are substantial losses which, if addressed, could be harnessed towards sustainable development financing. According to IMF, sub-Saharan Africa loses more than 10 years of life expectancy as a result of inefficiencies in health.[24]

Given the leakages, increasing budgetary allocations to sectors might not be the most effective way to increase output; rather, the most sensible approach for optimizing value for money is to eliminate waste and improve efficiency in government spending, which could free up additional resources within the budget to finance priority expenditures, as well as respond to emerging challenges such as the COVID-19 pandemic.

Based on the above, the starting point for any domestic resource mobilization strategy in the context of Africa should be to identify potential areas to optimize spending and savings. On the expenditure side of the budget, savings could also be found in the cost of the public sector wage bill, which alone consumes one third of all government expenditures of sub-Saharan African countries.[25]

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19 Djedje Hermann Yohou, In *search of fiscal space in Africa: the role of the quality of government spending*, Études et Documents, No. 27 (2015). Available at: https://halshs.archives-ouvertes.fr/halshs-01222812/document

20 D. O. Wandeda, W. Masai and S. M. Nyandemo, *The efficiency of public spending in sub-Saharan Africa*, European Scientific Journal, ESJ, vol. 17, No. 19 (June 2021). Available at https ://eujournal.org/index.php/esj/article/view/14439/14405

21 Yohou, *In search of fiscal space in Africa*.

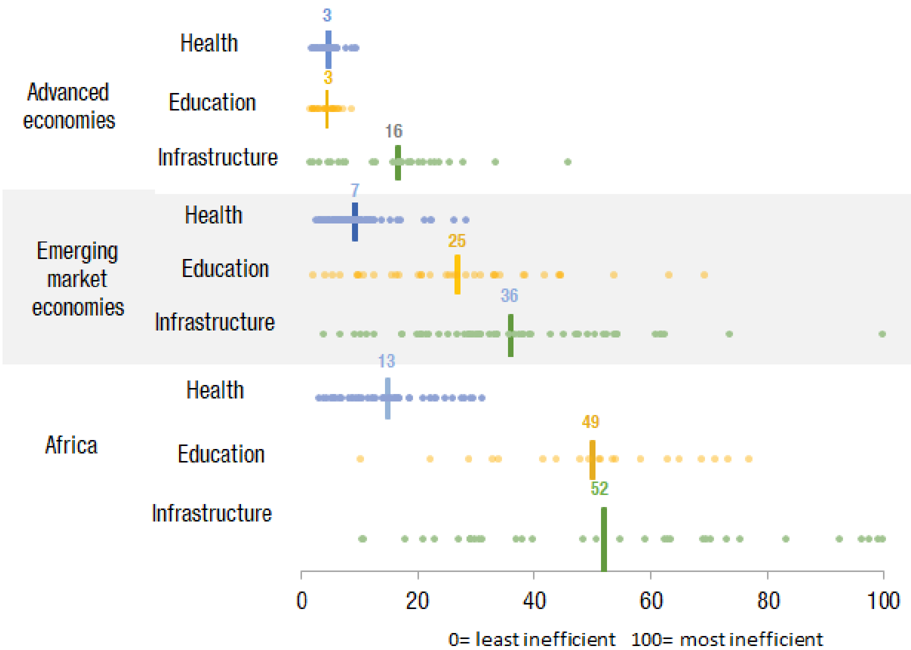
22 Schwartz and others, eds., *Well Spent: How Strong Infrastructure Governance Can End Waste in Public Investment* (Washington, D.C., IMF, 2020).

23 Calculation by staff of the Office of the Special Adviser on Africa.

24 Mercedes Garcia-Escribano, Pedro Juarros and Tewodaj Mogues, "Patterns and drivers of health spending efficiency", IMF Working Paper 22/48 (Washington, D.C., 2022). Available at www.imf.org/en/Publications/WP/Issues/2022/03/04/Patterns-and-Drivers-of-Health-Spending-Efficiency-513694

25 World Bank, *Governance COVID-19 response: managing the public sector wage bill during COVID-19*, Washington D.C., 2020.

FIGURE 7: SECTORAL SPENDING INEFFICIENCIES



Sources: International Monetary Fund (IMF). 2021. Fiscal Monitor: A Fair Shot. Washington, April and OSAA's staff calculation
Notes: All estimations are based on Data Envelopment Analysis; for health, output is life expectancy and input is total per capita health expenditure. For education, outputs are test scores, and net enrolment rates and input is public education spending per student. For infrastructure, output is the volume and quality of infrastructure and input is public capital stock and GDP per capita.
Country data points used in measuring inefficiency:

- *Africa: health (49), education (20) and infrastructure (17)*
- *Advanced economies: health (34), education (26) and infrastructure (27)*
- *Emerging market economies: health (84), education (36) and infrastructure (60)*

Box 1. The role of e-procurement in reducing inefficiency in public spending

Public procurement is a major category of government expenditure. However, the lack of transparency and accountability in public procurement makes it one of the areas most susceptible to corruption. For example, globally, roughly \$500 billion (equivalent to 7 %) of global health-care expenditure is lost to corruption annually. *a* **In Africa, an estimated \$9.5 billion in the health-care sector is lost to corruption per annum. This is substantial given the already meagre budget for health-care (5 % of GDP) spent by African countries, which is roughly half the global average. Considering the above, e-procurement could be an effective tool for curbing corruption by enhancing transparency and promoting competition through open and competitive bidding, thereby leading to better management of public expenditure. It could also contribute to lowering costs and time along the various stages of public procurement. In addition, e-procurement services could be used to reduce individual discretion related to spending and inform future decision-making processes and avoid rogue spending. Since inefficiency in public spending is a major challenge for African countries, diverting critical resources away from development, African countries need to fast-track the adoption of e-procurement services and e-government in general as ways to promote transparency and accountability and improve efficiency.**

a Transparency International, *The Ignored Pandemic: How Corruption in Healthcare Service Delivery Threatens* Universal Health Coverage, 2019.

The large public sector wage bill increases the rigidities of expenditure, leaving little wiggle-room for governments, and thus limited policy space. In addition, reducing non-productive and costly spending, such as generalized subsidies, including energy subsidies, and introducing progressive taxation and targeted transfers to the poor and vulnerable, including through expanded social protection systems, could free up additional resources for development while laying the groundwork for future returns on investment. Limiting the fiscal risk emanating from inefficient and unprofitable State-owned enterprises could also help. Improving efficiency in public spending and investment will depend on African countries' efforts in strengthening their public financial management and governance frameworks.[26] This could be achieved by, among other measures, embracing e-procurement services and e-government, which would ultimately increase government accountability, transparency and delivery (box 1 on page 21).

2.3. PUBLIC EXPENDITURE AND DEBT SUSTAINABILITY

Owing to the low revenue base and relatively underdeveloped debt markets, African countries have had to borrow to finance the large financing gap. This has led to an increase in external debt – currently accounting for an average of 60 % of Africa's public debt and 15.5 % of Africa's exports in 2020, with debt servicing absorbing on average more than 20 % of government revenues.[27] For example, between 2018 and 2020, some African countries, such as Egypt, Ghana and Zambia, dedicated 44 %, 42 % and 35 % of their respective government revenues to debt servicing. In addition, national and subregional African capital markets are not developed enough to enable countries to borrow in their local currencies. Increasingly, African countries are borrowing in private credit markets, including commercial banks. The share of commercial borrowing in Africa's public external debt has increased over the years from 27 % in 2011 to 52 % in 2020, with much of it in the form of Eurobonds. This is expected to grow as a result of added stress from both the pandemic and the war in Ukraine on fiscal budgets, with significant implications for indebtedness, debt-servicing capacity and debt sustainability more broadly.

The appetite of many African countries for issuing Eurobonds was motivated by the fact that these instruments can quickly mobilize resources and provide liquidity for larger fiscal space and investment choices to countries, without any of the intrusive policy conditions attached to multilateral and bilateral borrowing. Although issuing Eurobonds has its own advantages (providing access to long-term funding; increasing access by the local private sector to international finance; lowering debt-servicing costs by refinancing old bond debt with lower rates; strengthening macroeconomic discipline and transparency; and pushing for structural reforms), it also poses risks and challenges.[28]

Opting for excessive issuing of Eurobonds could increase the risk of fiscal indiscipline and irresponsible borrowing as a result of lack of governance and accountability. Starting from 2014, there has been a considerable increase in bonds issuance, and many countries returned to the market and became frequent participants. By February 2022, the total stock of outstanding Eurobonds reached $136.2 billion, with 57 % of the stock held by only four countries: Egypt,

26 Gerd Schwartz and others, eds., *Well Spent: How Strong Infrastructure Governance Can End Waste in Public Investment*.
27 World Bank, *International Debt Statistics 2022* (Washington, D.C., 2021).
28 M. Mecagni and others, *Issuing International Sovereign Bonds: Opportunities and Challenges for Sub-Saharan Africa* (Washington, D.C., IMF, 2014).

South Africa, Morocco and Nigeria. The massive borrowing illustrated by the spike in Eurobond issuance with 10-year maturities, which started in 2013, is now resulting in a massive number of sovereign debt repayments due in 2024 and 2025.

With the expiration of the Debt Service Suspension Initiative at the end of 2021, and the limited take-up of the Group of 20 Common Framework for Debt Treatments, many African countries will need to service existing debt. With little ability to increase borrowing, this will further increase their indebtedness and reduce their ability to invest in sustainable development and social services to ensure a robust recovery.

While many African countries have invested the proceeds from debt in infrastructure development, those countries that have failed to do so face major problems related to the governance of their public spending. Lack of efficiency in planning, allocation and the implementation of public investment in infrastructure in Africa results in poor management of public expenditure, especially expenditure financed by sovereign external debt (figure 8, next page). This could further aggravate the debt situation, since investment choices of poorly selected and executed projects may lead to recurring borrowing with longer maturities.[29]

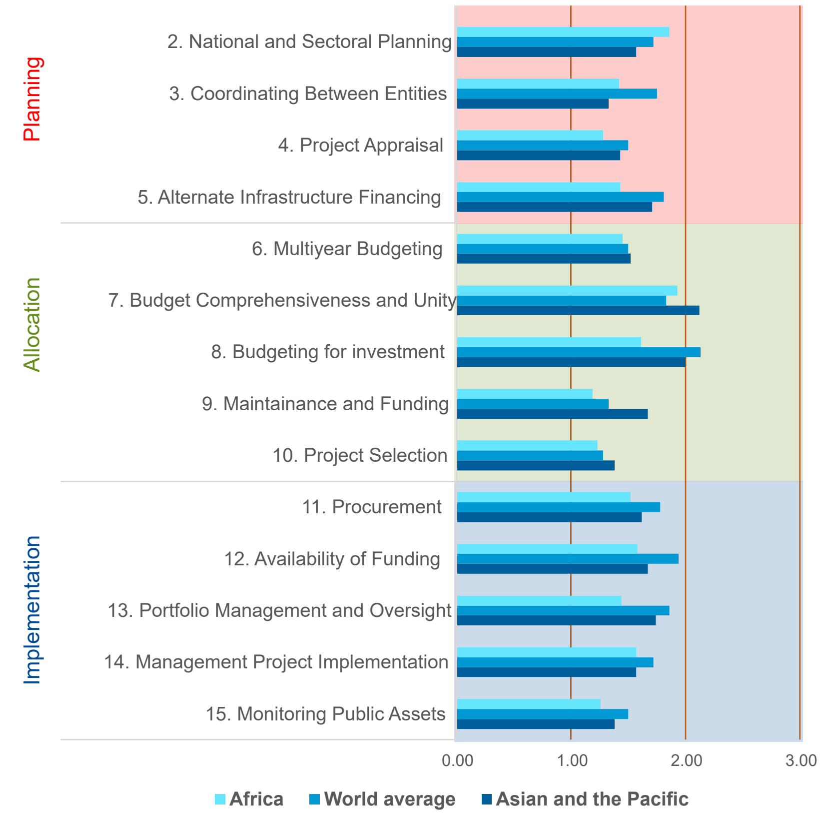
Therefore, African countries need to improve efficiency in public spending to avoid being trapped in a vicious debt cycle, especially given the limited fiscal space and elevated public debt occasioned by the COVID-19 pandemic. At the international level, efforts are also needed to extend debt relief and undertake systemic reforms of the global debt architecture to bolster resilience to future shocks, particularly given the added complications posed by the war in Ukraine on Africa's economy.

2.4. STRENGTHENING DOMESTIC PUBLIC REVENUE MOBILIZATION

Over the past several decades, African countries have undertaken measures to mobilize increased tax revenues. This, however, has come at a high cost, as illustrated by the decreasing level of efficiency in resource mobilization (a decrease of 14 % between 2011 and 2020).[30] Evidence shows that tax collection in Africa tends to be expensive. For example, the cost of tax collection in Africa was 60 % higher than that of Asia and 32 % than that of Latin America and the Caribbean.[31] An IMF paper found that tax collection performance and cost are positively and strongly associated with the operational strength of tax administrations. In addition, the cost of tax administration operation is affected by economies of scale, where smaller tax administrations[32] are likely to have a higher cost of collection ratio compared with larger ones.[33] The share of trade taxes in GDP has been declining over time from 3.9 % in 2008 to 2.7 % in 2018.[34] This is due to trade liberalization, a trend that is likely to continue with the implementation of African Continental Free Trade Area.

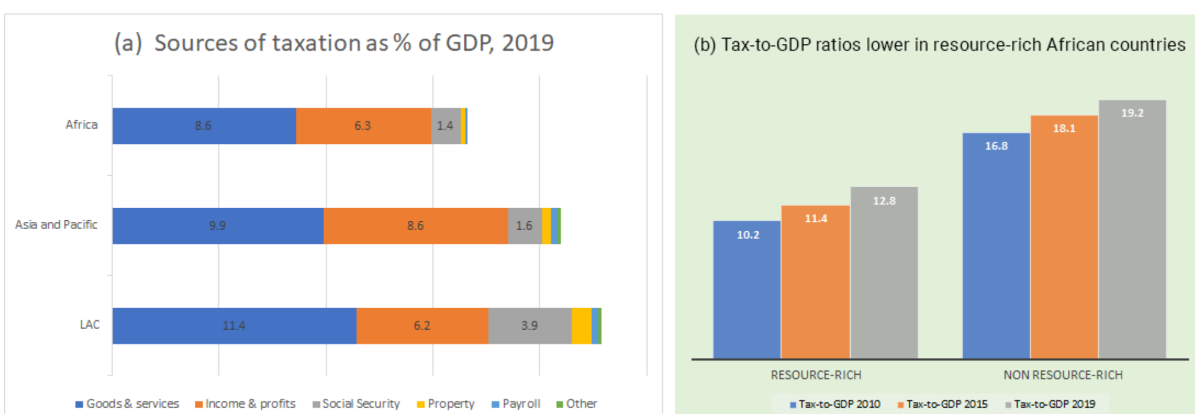
29 Ibid.
30 Country Policy and Institutional Assessment efficiency of revenue mobilization rating.
31 International Survey on Revenue Administration. Available at https://data.rafit.org/?sk=5a3bd47d-bec2-41a9-8f37-e5dbb98e3dcf&sId=1637191240032.
32 Eui Soon Chang and others, *Raising tax revenue: how to get more from tax administrations?* IMF Working Paper 20/142 (Washington, D.C., 2020).
33 International Survey on Revenue Administration.
34 OECD, African Union Commission and African Tax Administration Forum, *Revenue Statistics in Africa 2021* (Paris, 2021).

FIGURE 8: PUBLIC INVESTMENT MANAGEMENT ASSESSMENT (PIMA): EFFECTIVENESS OF INFRASTRUCTURE GOVERNANCE



Source : IMF (https://infrastructuregovern.imf.org/)

FIGURE 9A: MAIN SOURCES OF REVENUE AS A PERCENTAGE OF GDP, 2019
FIGURE 9B: AFRICAN RESOURCE-RICH COUNTRIES HAVE LOWER TAX REVENUES



Source: OECD/AUC/ATAF (2021), Revenue Statistics in Africa 2021

Therefore, countries need to put measures in place to compensate for the potential loss in revenues stemming from the implementation of the Free Trade Area. The two largest categories of revenue income are goods and services, and income and profits, consistent with other developing regions, yet the size of revenue income as a share of GDP still trails behind other regions, notably Latin America and the Caribbean and the Asia-Pacific region. Figure 9(a) illustrates the main sources of revenue as a share of GDP across 30 African countries in 2019. The structure of tax revenues varies across countries. As can be seen from figure 9(b), resource-rich countries in Africa have consistently registered lower tax revenue as a percentage of GDP compared with non-resource-rich countries. However, the share of non-tax revenues (bonuses, royalties and production-sharing revenue) is higher in oil-exporting States (more than 50 %) compared with oil-importing States (less than 20 %). The latter have managed to mobilize more resources through indirect taxes (more than 35 %), especially value added tax (VAT). These resources are more stable and predictable. Nevertheless, African countries are increasingly relying on VAT because of its relative ease of collection and broad base. However, this indirect tax has a heavy impact on the budgets of poor people.

Total revenues of oil exporters tend to be more volatile since they depend on oil prices and any shock could severely affect revenue collection. Small island developing States are also highly vulnerable to economic and natural shocks owing to the small and remote nature of their economies. Many suffer from low economic diversification, high dependence on remittances, debt stress, limited borrowing opportunities and small and unstable domestic revenues (box 2, next page).[35]

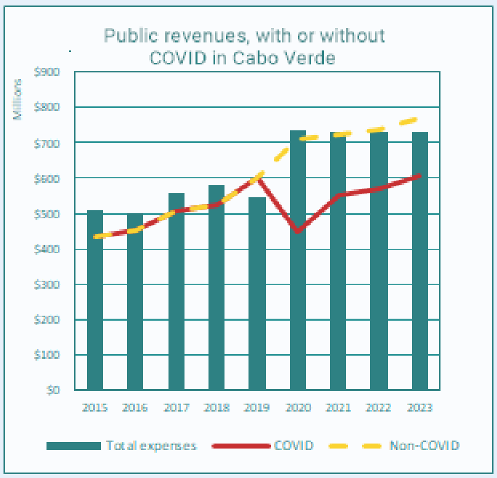
Excise tax is one of the categories of taxes that is underexploited in most African countries, averaging only 1.6 % of GDP between 2008 and 2018, compared with 2.4 % of GDP in Organisation for Economic Co-operation and Development (OECD) countries in 2018. Tapping into this type of taxation could raise additional revenues to fund government activities and also influence consumer behaviour, reduce related health expenditure and increase productive capacity. Where applicable, environmental taxes could also contribute to revenue mobilization while helping to curb pollution, which affects social groups differently and increases inequality. Property taxes in Africa average only 0.38 % of GDP, among the lowest rates compared with other developing regions.[36] This category of taxes is among the few that have a positive correlation between tax collection and spending at local levels. If public spending translates into enhancing the quality of infrastructure and public services offered, property values tend to appreciate, resulting in an increase in property tax and the accountability of local governments, and promoting democratic representation. African countries will need to invest in developing solid databases that allow for the identification and location of individuals, firms or real estate properties on which to levy taxes.

Most African countries have a narrow tax base, which most of the time results in the overtaxation of private sector actors, especially small and medium-sized enterprises, such as in Kenya, where such enterprises pay 51 % of their total profit in taxes, while in Ghana and Nigeria they are required to pay 33 % and 30 %, respectively.[37] High tax rates applied to small and medium-sized enterprises are barriers to their growth and could encourage informality and tax evasion.

35 OECD database. Available at www.oecd.org/dac/financing-sustainable-development/development-finance-topics/small-island-developing-states.htm
36 IMF, World Revenue Longitudinal Data (WoRLD).
37 Samuel Muiruri Muriithi, *African small and medium enterprises (SMEs): contributions, challenges and solutions*, European Journal of Research and Reflection in Management Sciences, vol. 5, No. 1 (2017).

Box 2. Domestic resource mobilization in small island developing States: Cabo Verde

Cabo Verde is an African small island developing State with a strong institutional framework, well-functioning checks and balances and good education and health systems. Domestic public finance and FDI partially took over ODA to ensure high growth and the continuous reduction of poverty and inequality, with the country achieving most of the Millennium Development Goals.[a] However, the socioeconomic impact of the COVID-19 pandemic in Cabo Verde was among the hardest worldwide. Government debt rose to 155 % of GDP, and the debt service ratio (debt service/export earnings) more than doubled from 2019 to 2022 (from 14.7 % to 29.6 %). Although remittances provided an important cushion against the crisis for many households, all other financing flows, both public and private, have been dramatically affected. In this context, the only alternative to more debt is the enhanced mobilization of domestic resources. Pre-pandemic, Cabo Verde had demonstrated tax administration efficiency, with a tax-to-GDP ratio of 21.6 % in 2019.[b] The onset of COVID-19, however, meant a reduction of 25 % in public revenues, calling for innovative domestic resource mobilization strategies.



Accelerating the transition to formality and streamlining tax expenditures will be critical. Informal employment accounts for 51.6 % of total employment, and tax exemptions cost $120 million per year. Another priority will be to ensure the quality of expenditure, through the classification of the State budget by programme in the national development plans, the installation of an integrated financial and budget management system and the recent adoption of the International Public Sector Accounting Standards, all embedded in well-functioning governance institutions. Digitization, such as the adoption of electronic invoicing, now applied to major importing companies and soon to be extended to all businesses, including informal businesses, will also be important. The high-level inter-institutional coordination mechanism for sustainable development, which is soon to be installed, will improve integrated policy coherence and budget efficiency and should be mirrored at the local level.

Moreover, the Government is striving to eradicate extreme poverty by 2026 through better access to basic and social services within a human rights-based approach and by providing the most vulnerable populations, especially youth and women, with the skills to embrace new economic opportunities and decent jobs. This will lead to extended tax bases and reduced social protection expenditures, creating fiscal space to invest in climate resilience, social inclusion and economic transformation.

Source: United Nations Resident Coordinator for Cabo Verde

[a] *Cabo Verde, 2021 voluntary national review. Between 2015 and 2020, despite the COVID-19 pandemic, extreme poverty decreased from 23.7 to 13.1 % and the share of the population living on less than 50 % of the median income decreased from 15 to 5 %.*

[b] *Cabo Verde, State budget for 2022.*

According to the World Bank, a reduction by 10 % in the number of payments and the time to comply with tax requirements could lower tax-related corruption by 9.64 %.[38]

Carbon finance can also be an important piece in Africa's climate finance, but the continent still has a long way to go to fully harness its potential (box 3, next page). Between 2016 and 2019, only $20 billion was invested in Africa's low carbon development projects and programmes through multilateral funds and bilateral sources.[39]

These investments have supported a range of climate solutions in the energy, transport, water and infrastructure sectors. In addition to financing projects that contribute towards reducing greenhouse gas emissions, carbon finance can improve transparency, good governance and accountability. These benefits can make it easier for countries to access other financial resources, such as concessional loans or grants.

2.5. STRENGTHENING GOVERNANCE AND INSTITUTIONS FOR ENHANCED EFFICIENCY IN REVENUE COLLECTION AND SPENDING

The quality of public institutions significantly influences the efficiency of both public spending and resource mobilization. In addition, institutional governance of public spending has a significant impact on a country's infrastructure development. For example, an analysis by IMF shows that by strengthening institutions for infrastructure governance, African countries could reduce inefficiency in public spending and cut their losses by half, which are estimated to be 53 % of the potential returns to their infrastructure investments.[40] In fact, the Secretary-General called for action on strengthening governance and revenue management in countries by enforcing clear regulatory frameworks, harmonizing national standards and enhancing coordination and cooperation by government agencies to ensure proper oversight of all companies and strengthening anti-corruption laws and law enforcement.[41]

38 Rajul Awasthi and Nihal Bayraktar, *Can tax simplification help lower tax corruption?* Policy Research Working Paper, No. 6988 (Washington, D.C., World Bank, 2014).

39 Amar Bhattacharya, "The criticality of climate finance for Africa", Brookings Institution, 8 February 2022. Available at www.brookings.edu/blog/africa-in-focus/2022/02/08/the-criticality-of-climate-finance-for-africa/

40 Gerd Schwartz and others, *How strong infrastructure governance can end waste in public investment*, IMF blog, 2020. Available at https://blogs.imf.org/2020/09/03/how-strong-infrastructure-governance-can-end-waste-in-public-investment/

41 United Nations, *Policy brief: transforming extractive industries for sustainable development*, May 2021. Available at www.un.org/sites/un2.un.org/files/sg_policy_brief_extractives.pdf

Box 3. Carbon finance in Africa

Climate finance is an essential resource for Africa's mitigation and adaptation efforts. Nonetheless, a number of challenges affect the availability of climate finance to African countries, including the limited capacity of African Governments to use international finance effectively, and constraints arising from complexity in rules at the international level, which hinder the pooling of funds by African countries to jointly access larger sums through a single-window mechanism.

The United Nations Climate Change Conference held in Glasgow in November 2021 adopted article 6 of the Paris Agreement. The article 6 framework, among other things, introduced a centralized governance system for trading emission reduction credits either through non-market-based international cooperation (article 6.8) or a market-based mechanism through the Sustainable Development Mechanisms programme. It also introduced a framework under the Sustainable Development Mechanisms, whereby some 5 % of the proceeds from carbon markets would go into a climate adaptation fund to help developing countries mitigate the impact of climate change. This financing for adaptation would be most welcomed by developing countries, especially with the shift that came at the Conference whereby these countries must now commit to developing less carbon-intensive economies that move away from fossil fuels. Countries could partly finance carbon projects by generating emission reduction credits that are tradable assets. here is hard work ahead for Africans if they are to reap the benefits from the potential for development financing afforded by carbon markets. This includes setting up regulations for a global market – one that has a centralized project authorization system, a central accounting framework and a central registry – as well as a database on article 6. African countries need support in assessing their carbon market opportunities and building their capacity to measure, account for and verify those opportunities based on the rules set out under the new international carbon markets.[a] This means that core financing for proposed projects must be in place before accessing the additional resources afforded by carbon markets, a fact that has made it difficult for many African countries to participate in complex carbon markets.

[a] *Charles E. Di Leva and Scott Vaughan, "The promise and challenge of carbon market and non-market approaches", International Institute for Sustainable Development. Available at* www.iisd.org/articles/paris-agreement-article-6-rules

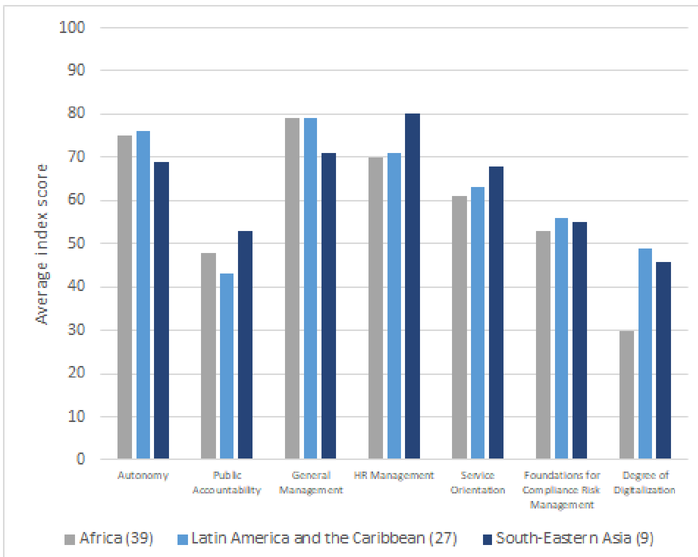
African countries suffer from a persistent problem of weak institutions and capacity, which undermines domestic resource mobilization and development more broadly. In addition, financial intelligence units and law enforcement agencies lack the capacity to conduct research and investigations and maintain the levels of transparency needed to ensure effective engagement with corporations to combat illicit financial flows. This is reflected in the poor performance of African countries on all indices related to tax administration performance, including the degree of digitization (figure 10 (a)). In addition, disparities exist within Africa, for example, tax administrations in Eastern and Southern Africa are more performant and efficient compared with the rest of the subregions (figure 10 (b)). This underscores the urgency of investing in the digitization of tax collection processes, combined with other initiatives such as digital identification, digital finance and electronic payment systems. Countries that have gone this route have reaped benefits. For example, the Ethiopian Revenue and Customs Authority saw an increase of 32 % in VAT collection owing to the introduction of electronic cash registers.[42] Further digitizing tax administration would facilitate and simplify processes and improve transparency, thereby reducing inefficiency and corruption.

42 See www.afdb.org/fr/news-and-events/ethiopia-reaps-rewards-of-tax-policy-reform-according-to-research-from-the-african-development-bank-19257

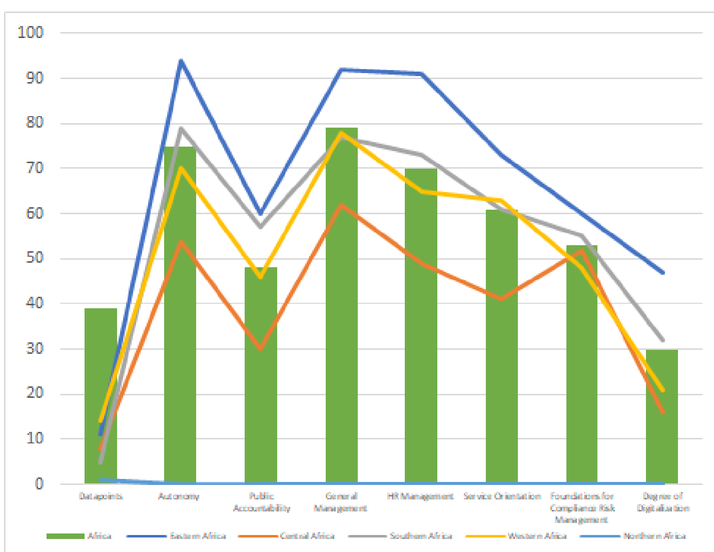
In order to minimize inefficiencies in revenue collection and spending with the objective of freeing up budget resources to strengthen resilience in responding to emergency challenges, such as the COVID-19 pandemic, focus must be on aligning national budgets, strategies and policies with the Sustainable Development Goals, including through the use of integrated national financing frameworks (box 4, next page), and enhancing integrated and interlinked analysis to enable coherent and mutually supportive policy choices to avoid negative spillover effects.

FIGURE 10: TAX ADMINISTRATION PERFORMANCE AND EFFICIENCY

a) Africa compared to other regions



b) Performance among African sub-regions



Source: ISORA 2018, Understanding revenue Administration, IMF

Notes: Average indices scores are related to practices and structural foundations for effective tax administrations. The composition of the indices may be found in ISORA 2018. Scores are between 0 and 100 (from least to most performant and efficient). The numbers in brackets are the number of countries (data points)

Box 4. Integrated national financing frameworks

Integrated national financing frameworks provide a framework for financing national sustainable development priorities and the Sustainable Development Goals at the country level. The frameworks were agreed upon in the Addis Ababa Action Agenda of the Third International Conference on Financing for Development in 2015. In 2019, the Inter-Agency Task Force on Financing for Development spelled out how the frameworks could be implemented, and 16 countries agreed to become pioneers. Since then, interest has steadily grown, and more than 80 countries are now pursuing integrated national financing frameworks, including more than 30 countries in Africa.

While a country's sustainable development strategy lays out what needs to be financed, integrated national financing frameworks spell out how the national strategy will be financed and implemented. The frameworks do so by considering all sources of financing and policy areas (i.e. public, private and macro-systemic issues) and related risks and constraints, and thus help policymakers identify and implement more sustainable and coherent financing policy reforms. The key building blocks to sound financing strategies include: (a) assessment and diagnostics, to identify financing gaps and constraints; (b) a holistic financing strategy; (c) monitoring and review processes to ensure continuous learning; and (d) inclusive governance and coordination mechanisms to bring together all stakeholders and enhance coherence.

Challenges to increasing domestic resource mobilization in a way that ensures economic growth, and a more equitable and environmentally sustainable system, are well known. Tax policy recommendations for addressing such challenges usually advocate for policy measures that balance economic efficiency and equity and are administratively feasible. However, the concrete policy responses for achieving those goals need to be context- and country-specific.

Integrated national financing frameworks were conceived precisely to assist countries in the design and implementation of financial policies specific to their contexts and needs. Given their integrated nature, such frameworks can help countries devise policy measures that allow them to increase their tax revenues, and at the same time strike a good balance between economic efficiency (i.e. by coming up with a mix of taxes that would not disincentivize economic activity) and equity (i.e. by setting more progressive tax rates), taking into account tax administration enforcement capabilities. An integrated national financing framework can, for instance, help a country to: (a) assess its revenue needs and its tax administration's constraints; (b) decide whether to engage in a comprehensive tax and/or fiscal reform or to provide for a sequence of incremental tax reforms; (c) quantify the impact of the domestic resource mobilization reform; and (d) increase public acceptance of the policy reforms by engaging all relevant stakeholders in the process and tying it to a country's overall development priorities.

Source: Department of Economic and Social Affairs.

2.6. FISCAL INCENTIVES: COUNTERPRODUCTIVE AND RACE TO THE BOTTOM

Another factor that undermines domestic resource mobilization is the use of fiscal incentives granted by African countries to foreign investors, ostensibly to encourage them to invest. The nature of fiscal incentives differs from one country group to another. While low-income countries tend to offer tax holidays and reduced tax rates, middle-income countries opt for establishing preferential tax zones, and high-income countries rely on investment tax credits and the favourable tax treatment of research and development.[43] The overuse of tax incentives by African countries might be due to the absence of overall favourable investment conditions, such as good infrastructure and logistics, political and macroeconomic stability, developed financial markets and good governance. Between 2009 and 2015, 65 % of countries in sub-Saharan Africa introduced new corporate tax incentives or increased the generosity of the existing arrangements.[44]

However, fiscal incentives extended to private investments, especially multinational enterprises, are the least effective at attracting FDI compared with a favourable business climate and macro-economic and political stability, especially in the African context. In addition, other factors are deemed to be more important by investors than incentive packages, including the transparency of national legal frameworks, the availability of affordable skilled labour, quality of life and the existence of bilateral agreements and treaties.[45] Evidence suggests that incentives were redundant, and 70 % of investment would have taken place anyway, regardless of the presence of such incentives. For example, in Rwanda, the redundancy ratio was at 98 %, and was over 90 % in the United Republic of Tanzania and Guinea.[46]

This confirms the ineffectiveness of tax incentives in attracting and generating initial private sector investment when those incentives are not backed by adequate policies.[47] However, with favourable preconditions, such as a good investment climate, it was found that tax incentives can be eight times more effective in attracting investment.[48]

Tax expenditures are costly and deprive governments of important financial resources. It is estimated that countries in sub-Saharan Africa experienced forgone revenues of roughly $46 billion (2.5 % of GDP[49]) (figure 11, next page) as a result of tax incentives in 2019 – surpassing total inflows of FDI into the region. By extending fiscal incentives, sub-Saharan African countries lose, in

43 IMF, OECD, United Nations and World Bank, *Options for low income countries' effective and efficient use of tax incentives for investment: a report to the G-20 Development Working Group*, 15 October 2015.

44 Maria Andersen, Benjamin Kett and Erik von Uexkull, "Corporate tax incentives and FDI in developing countries", in *Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications* (Washington, D.C., World Bank, 2017).

45 *Africa Investor Report 2011: Towards Evidence-based Investment Promotion Strategies* (United Nations publication, Sales No. E.12.II.B42); and Emmanuel Cleeve, "How effective are fiscal incentives to attract FDI to sub-Saharan Africa?" The Journal of Developing Areas, vol. 42, No. 1 (Fall, 2008).

46 Sebastian James, "Incentives and investments: evidence and policy implications", Working Paper (Washington, D.C., World Bank, 2013), p. 21; and Sebastian James and Stefan Van Parys, "The effectiveness of tax incentives in attracting investment: panel data evidence from the CFA Franc zone", *International Tax and Public Finance*, vol. 17, No. 4 (August 2010).

47 Agustin Redonda, Christian von Haldenwang and Flurim Aliu, "Tax expenditure reporting and domestic revenue mobilization in Africa", in *Taxation, International Cooperation and the 2030 Sustainable Development Agenda*, Irma Mosquera, Dries Lesage and Wouter Lips, eds. (Cham, Switzerland, Springer International Publishing, 2021); and IMF, OECD, United Nations and World Bank, "Options for low income countries' effective and efficient use of tax incentives for investment", p. 6

48 Sebastian James, "Effectiveness of tax and non-tax incentives and investments: evidence and policy implications", Working Paper (Washington, D.C., World Bank, 2013).

49 Jenny Rickard, Joe Kraus and Lauren Bredar, "Is there a place for tax incentives in post-COVID Africa?", 26 May 2021. Available at www.one.org/africa/blog/true-impact-tax-incentives-africa/

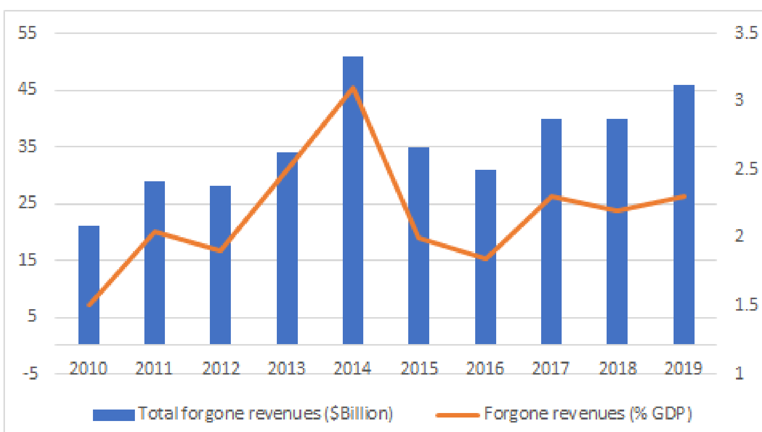
net terms, $14 billion per year. For example, the share of tax expenditure represented 5 % and 3 % of GDP for South Africa and Ethiopia, respectively, in 2019. They also represented 41 % of total tax revenues for Ethiopia.[50] Eliminating these tax expenditures would boost domestic resource mobilization considerably and increase health expenditure in sub-Saharan Africa by 47 %.

Countries also had to deal with managing the incentives and enforcing their compliance with the associated requirements, increasing administrative costs. The weak institutional governance structures and the lack of coordination at the national level between investment promotion objectives and resource mobilization strategies might have contributed to increasing the cost of tax incentives in Africa.[51]

When it comes to reporting on tax expenditure, data remains a challenge, with only 52 % of African countries having declared their tax expenditure during 2000–2020; among those, only 15 countries have reported their itemized tax expenditure. Mauritius, Morocco and South Africa are the only countries that publish tax expenditure reports on a regular basis. Because of the unavailability of data, the actual fiscal cost of tax expenditure may have been underestimated.[52]

In the context of reforming domestic resource mobilization, more transparency and capacity to produce and openly report on tax expenditure is required. Additional support to African countries is needed in order to enable them to close this loophole and make informed policy decisions, as is support to readjust and improve the effectiveness and efficiency of their incentive strategies at a time when Africa's financing needs are expanding.

FIGURE 11: SUB-SAHARAN AFRICA: TOTAL AND AVERAGE REVENUE FORGONE % GDP (2010-2019)



Source: Global Tax Expenditures Database

50 Global Tax Expenditures Database, accessed November 2021. Available at https://gted.net/
51 Economic Commission for Africa (ECA), *Strategies for Mobilizing Domestic Resources and Investments for Structural Transformation* (Addis Ababa, 2017).
52 Birahim Bouna Niang and Ahmadou Aly Mbaye, "Senegal: making domestic resource mobilization work to sustain growth and improve service delivery" CGD Policy Paper 165 (Washington, D.C., Center for Global Development, 2020), p. 4.

2.7. TAXING THE DIGITAL ECONOMY

In recent years, there has been an increasing trend towards digitization globally and in Africa. The pace has quickened considerably in response to COVID-19. The contribution of the digital economy to economic activities in Africa is increasing. It was estimated as having reached $115 billion in 2020 and could potentially reach $180 billion (5.2 % of GDP) by 2025.[53] The digital economy in Africa includes a variety of activities and sectors, ranging from e-commerce, financial technology (fintech), health technology, media and entertainment, transportation services, food delivery and business-to-business e-logistics. Owing to the intangible nature of this sector and the difficulty in measuring these assets for tax sectors, governments face challenges related to the taxation of the digital economy. In addition, the jurisdictions of digital platforms may differ from where those platforms conduct their business, increasing the possibility of shifting profits to low-tax jurisdictions.[54]

The pandemic accelerated the need to keep up with the change to a digital economy, thereby affecting consumption patterns. It pushed millions of people around the world, including in Africa, to become users of online platforms – buying digital products and services. African countries are starting to adapt their regulations on taxing digital businesses and platforms (table 3 on page 35).

In 2020, the African Union adopted its Digital Transformation Strategy for Africa 2020–2030 as part of the overall objective of building a digital single market in Africa by 2030. While the strategy tackles important issues related to digital governance, the enabling environment, infrastructure, innovation and entrepreneurship, as well as the critical sectors to drive digital transformation, it overlooks the fiscal aspects related to digital services and e-commerce. The regulatory aspect of the digital economy has yet to be properly addressed and African countries lack guidance on how to tax this sector. Since e-commerce was recently integrated into the African Continental Free Trade Area and is set to be a topic of discussion during the third phase of negotiations, this offers hope for a future agreement on a continental framework that will address the current regulatory challenges to further stimulate e-commerce in Africa.

In 2020, the African Tax Administration Forum released its proposal on a digital services tax of 1 to 3 % on gross annual digital services revenue (final withholding tax on gross turnover) earned by a company or multinational enterprise in any African country. The digital service tax would include the following: online advertising services; data services; services delivered through an online marketplace or intermediation platform; digital content services; online gaming services; and cloud computer services.[55]

53 Because of the blurred lines between traditional businesses using digital tools and new digital business models, measurement of the size of the digital economy is complex and difficult. Estimation was calculated by Google and International Finance Corporation, "e-Conomy Africa 2020: Africa's $180 billion Internet economy future", based on Accenture, "Africa iGDP Forecast, Africa", September 2020.

54 *Digital Economy Report 2019: Value Creation and Capture: Implications for Developing Countries* (United Nations publication, Sales No. E.19.II.D.17).

55 The African Tax Administration Forum proposed the "Suggested approach to drafting digital services tax legislation", available at https://events.ataftax.org/index.php?page=documents&func=view&document_id=79#

However, this proposal would be pre-empted if African countries opt to implement the two-pillar approach of the OECD/Group of 20 Inclusive Framework on Base Erosion and Profit Shifting,[56] which addresses the tax challenges arising from the digitization of the global economy. The first pillar establishes new taxing rights over a subset of large multinational enterprises, while the second pillar fixes the base rate and an approach for a new global minimum corporate tax (GloBE). Contention over issues related to the taxation of the digital economy have also complicated the full implementation of the Inclusive Framework. Of the 137 countries and jurisdictions set to implement the Framework, only 23 are African countries.[57] This raises concerns about the level of inclusivity of developing countries with regard to their participation and voice in the various working groups and the negotiation process in general.[58]

The Committee of Experts on International Cooperation in Tax Matters of the United Nations could serve as a more inclusive venue to discuss and negotiate taxation of the digital economy with full consideration of the impact on developing countries. In this respect, the Group of 77 has been vocal in stressing the need to upgrade the Committee into an intergovernmental body to play such a role.[59]

Going forward, African countries need to combine their efforts and act together to influence the international negotiations on taxing digital economy outcomes to take into consideration their developmental aspirations. They also need to keep up with change and adapt to the evolving regulations for taxing revenues from cryptocurrency, e-commerce and digital outputs, while avoiding the overtaxation of African start-ups and small and medium-sized enterprises operating in the digital economy.

2.8. HARNESSING AFRICAN SOVEREIGN WEALTH FUNDS FOR DEVELOPMENT

Although Africa's sovereign wealth funds remain small, they have grown considerably over the years and, based on favourable demographics, are likely to grow by leaps and bounds in the years ahead, generating much-needed resources for financing the continent's development. However, African countries face difficulties in harnessing these long-term savings. The total assets under management in 2020 of the 13 African sovereign wealth funds[60] was $24 billion,[61] which is very small compared with the world's largest fund, the sovereign fund of Norway, which is worth $1.3 trillion.[62]

56 OECD/G20 Base Erosion and Profit Shifting Project, "Statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy", 8 October 2021. Available at www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm

57 Julie McCarthy, "A bad deal for development: assessing the impacts of the new inclusive framework tax deal on low- and middle-income countries", Brookings Global Working Paper No. 174 (Washington, D.C., Brookings Institution, May 2022).

58 *Digital Economy Report 2021: Cross-border data flows and development: for whom the data flow* (United Nations publication, Sales No. E.21.II.D.18); and Irene Ovonji-Odida, Veronica Grondona and Samuel Victor Makwe, "Assessment of the two-pillar approach to address the tax challenges arising from the digitalization of the economy: an outline of positions favourable to developing countries", report of the South Centre Tax Initiative's Developing Country Expert Group.

59 Statement on behalf of the Group of 77 and China by Sameh Elkhishin, First Secretary of the Permanent Mission of Egypt to the United Nations, at the Economic and Social Council Special Meeting on International Cooperation in Tax Matters, New York, 18 May 2018. Available at www.g77.org/statement/getstatement.php?id=180518b

60 This figure excludes the Libyan Investment Authority, which has $65 billion in frozen assets under international sanctions; according to international standards, this is the only fund that has substantial assets under management in Africa. In addition, Namibia launched its Welwitschia Fund in May 2022.

61 International Forum of Sovereign Wealth Funds and Franklin Templeton, "Investing for growth and prosperity: in Africa, sovereign wealth funds focus on G, S and E", 2020. Available at: www.ifswf.org/publication/investing-growth-and-prosperity-africa-sovereign-wealth-funds-focus-g-s-and-e.

62 See www.swfinstitute.org/fund-rankings/sovereign-wealth-fund

TABLE 3

DIRECT AND INDIRECT TAXES ON THE DIGITAL ECONOMY IN SELECTED AFRICAN COUNTRIES

Indirect tax			Direct tax (corporate tax)	
Country	**VAT rate (percentage)**	**Base and threshold**	**Rate (percentage)**	**Base and threshold**
Algeria	9	Digital services consumed by Algeria-based customers	N/A	N/A
Angola	14	Threshold of $250,000 applies only to local companies	N/A	N/A
Cameroon	19.35	Digital services consumed	N/A	N/A
Ghana	12.5	Digital services consumed	1.75	Based on the value of electronic transactions, including mobile money payments, bank transfers, merchant payments and inward remittances
Kenya	16	Additional VAT rules taxing business-to-consumer sales by non-resident businesses through digital marketplaces and websites was set to begin in March 2021	1.5	Income accruing through a "digital marketplace", which is a platform that enables direct interaction between buyers and sellers of goods and services through electronic means
Nigeria	5	Digital services consumed	30	Taxable income where a foreign company transmits, emits or receives signals, sounds, messages, images or data of any kind by cable, radio, electromagnetic systems or any other electronic or wireless apparatus to Nigeria with respect to any activity, including electronic commerce, application stores, high-frequency trading, electronic data storage, online advertisements, participative network platforms, online payments and so on, to the extent that the company has a significant economic presence in Nigeria and profit can be attributable to such activity
South Africa	15	The threshold of R 1 million that triggers registration obligations for affected foreign companies		
Tunisia	N/A	Digital services consumed	3	Gross income from the sale of computer applications and digital services
Zambia	16	Digital services consumed		
Zimbabwe	14.5	Tax on the supply of digital services (online sales of e-books, games, software, videos) provided by non-residents to customers based in Zimbabwe	5	Gross income from satellite broadcasting services with respect to the provision or delivery of television or radio programmes, and e-commerce operators providing or delivering goods or services to persons resident in Zimbabwe

Source: Compiled based on Deloitte (https://www.taxathand.com/article/15137/Egypt/2020/Digital-services-tax-in-AfricaThe-journey-so-far) and Vertex (https://www.vertexinc.com/resources/resource-library/africa-taxing-digital-services-supplied-foreign-companies).
Abbreviations: N/A, not available; VAT, value added tax.

More than half of the assets under management in Africa's sovereign wealth funds are accounted for by the Sovereign Fund of Egypt ($12.7 billion), which is ranked forty-third in the world. The newest fund to be created in Africa is the Welwitschia Fund of Namibia (box 5).

The mandates of most African sovereign wealth funds are oriented towards national development rather than capital investment profits in global financial markets.[63] While small by global standards, African sovereign wealth funds could play an important role in supporting and stabilizing the national economies of the countries owning these funds – with spillover effects for the entire subregion, especially during the implementation of the African Continental Free Trade Area. The funds could also potentially help attract international capital to Africa, demystify the risk perception attached to investment in Africa and support the continent's development priorities.

Many African sovereign wealth funds supported local economies during the COVID-19 pandemic. The Sovereign Fund of Egypt chose to adapt its priorities to focus on areas that would help the country fight COVID-19 and build future resilience to similar shocks. During the COVID-19 pandemic, some governments drew large amounts from their sovereign funds – largely those with a stabilization and savings mandate – to support public spending, including Botswana ($300 million), Ghana ($200 million) and Nigeria ($400 million).[64]

African sovereign wealth funds can be instrumental in funding and attracting funding to long-term projects, such as infrastructure and clean energy. African institutional investors' assets under management, including African sovereign wealth funds, are not diversified and their appetite tends to be for government bonds and less risky assets. For example, between 2011 and 2017, African institutional investors accounted for less than 1 % of private placement in infrastructure in Africa. On the road to recovery, African sovereign wealth funds should continue to lead the way towards harnessing domestic and international capital for the development needs of local economies to stimulate growth.

2.9. RECOMMENDATIONS

Although African countries have made progress in mobilizing tax revenue over the years, average tax-to-GDP ratios remain low and there is considerable scope to increase domestic resource mobilization through further reforms. However, the focus of tax reform should not be on increasing the tax rate but rather on increasing the coverage of existing taxation. This could be done by improving the efficiency of tax administration through the digitization of tax collection processes, paired with other digitization initiatives such as digital identification, digital finance and electronic payment systems, as well as by broadening the tax base and eliminating inefficiency and wastage in government expenditure.

Inefficiency in public expenditure, including in health, education and infrastructure investment, means the continent loses 2.87 % of its GDP annually, which represents more than $12 billion in education, $30 billion in infrastructure and $28 billion in health, and diverts precious resources away from development. Therefore, the priority should be to eliminate waste and inefficiencies and thus identify potential savings that could increase government budgets. This must be complemented by measures to strengthen the institutional governance of public management and administrations.

63 International Forum of Sovereign Wealth Funds and Franklin Templeton, "Investing for growth and prosperity".
64 Andrew Bauer, "How have Governments of resource-rich countries used their sovereign wealth funds during the crisis?", Natural Reousrce Governance Institute, 21 August 2020.

Box 5. Namibia launches the Welwitschia Fund

Namibia is a small, open economy, making it vulnerable to external shocks owing to its high dependency on non-renewable minerals and agriculture exports. As a result, the country's public revenues are heavily dependent on contributions derived from volatile mining royalties and Southern African Customs Union receipts, which are susceptible to global trade disruptions – making it difficult for the country to accumulate and grow its foreign exchange reserve asset pool or buffers. Against this backdrop, Namibia launched the Welwitschia Fund on 12 May 2022.

The Fund is set to become one of Africa's newest sovereign wealth funds, geared towards enhancing national resilience by insulating the socioeconomic structure against cyclical shocks while promoting intergenerational prosperity for all Namibians through the distribution of benefits flowing from the present utilization of the country's natural resource endowments. The management and administration of the Fund will be delegated to the Bank of Namibia as the Fund's primary custodian. A total of N$ 300 million (estimated at $18.6 million) consisting of direct seed capital from the Government and a contribution from the dividends declared by the Bank has been injected into the Welwitschia Fund.

The objectives of the Fund are, inter alia, to enhance the country's resilience against cyclical and/or external shocks, promote intergenerational prosperity for all Namibians through the distribution of benefits from natural resources and the State asset base, and reduce dependency on non-renewable revenue sources. The primary investment objectives for the Welwitschia Fund are to achieve capital growth and enhance investment returns. As such, the funds will be invested in offshore assets and securities geared towards generating market-related returns over the medium to long term. The Fund will prioritize generating returns on national assets (over and above traditional foreign reserves) for fiscal and official reserves stabilization. More importantly, the Fund also has the mandate to invest a small portion of its assets (not more than 2.5 % of the intergenerational account) in domestic infrastructure to support economic growth and improve the quality of life for all Namibians.

The Welwitschia Fund will comprise two components. The first component is aimed at achieving short-term objectives dealing with fiscal stability and, in rare circumstances, foreign reserve stability. The second component will be geared towards the attainment of long-term intergenerational wealth transfer earned mainly from the country's natural resources. Accordingly, the Welwitschia Fund will comprise two independent investment accounts, each of which will have different risk and return characteristics commensurate with its investment objective and constraints. The two portfolios are the Stabilization Account and the Intergenerational Savings Account.

In terms of the institutional set-up of the Fund, the assets of the Welwitschia Fund are owned by the Government of Namibia; thus, the Fund will operate under the policy direction, coordination, and supervision of the Ministry of Finance. The Welwitschia Fund will be hosted as a pool of assets at the Bank of Namibia, and the governance structure of the Fund will be in line with the Bank of Namibia Act, and will consist mainly of the Bank of Namibia Board, the Investment Committee and the Financial Markets Department. The Bank of Namibia Board will be accountable to the Ministry of Finance. This will be the interim arrangement until a sovereign wealth fund bill is enacted.

Sources: Bank of Namibia; and United Nations Namibia, "Africa's sovereign wealth funds are a source of development finance". Available at https://namibia.un.org/sites/default/files/2020-09/Africa's%20Sovereign%20Wealth%20Funds%20are%20a%20Source%20of%20Development% 20Finance%20.pdf

By declaring war on inefficiency at all levels and sectors, governments could identify funds to be reallocated to priority expenditures as well as respond to emerging challenges such as the COVID-19 pandemic.

African countries continue to extend costly and inefficient tax incentives, which resulted in forgone revenues of roughly $46 billion in 2019 (2.5 % of GDP),[65] representing more than the total FDI inflows to the region. Eliminating these tax expenditures would boost domestic resource mobilization considerably. While the objective of attracting foreign investment is a noble one, there's little evidence that tax incentives are effective in this regard. In the context of tax reform, countries need to adopt a comprehensive approach that reconciles their investment promotion objectives and their resource mobilization strategies. There is a need to review existing tax incentives in order to eliminate them. However, complementary measures to improve the business environment, develop infrastructure, reduce red tape and ease the cost of doing business will be needed, as these are important determinants of foreign investment.

African countries need to promote the building of an enabling national ecosystem for digital economy and e-commerce by introducing the necessary regulatory, public policy and business practices while improving the quality of digital and trading infrastructure, payment systems and online security. African countries could adopt a progressive taxation system that would facilitate digital business and offer incentives to enterprises to enable them to eventually graduate to the formal sector.

African countries need to combine their efforts and act together to influence the international negotiations on taxing digital economy outcomes so that they take into consideration Africa's developmental aspirations. They also need to keep up with change and adapt to the evolving regulations for taxing revenues from cryptocurrency, e-commerce and digital outputs, while avoiding the overtaxation of African start-ups and small and medium-sized enterprises operating in the digital economy.

Africa's debt has risen further owing to measures taken to respond to the COVID-19 pandemic. If not addressed, increasing government debt and debt service costs could further constrain the already limited policy space and lead to cuts in public spending, leaving gaps in the delivery of essential public services such as education, health care and infrastructure. A sustainable solution to the crisis could be implemented if African policymakers and the international community act in tandem. While African policymakers can strive towards aligning their policy frameworks to enhance debt sustainability, the international community could support Africa with systemic and orderly, yet ambitious, debt resolution practices. International financial assistance should also be bolstered in the short term to support African countries dealing with the socioeconomic shocks created by the COVID-19 pandemic, the impact of the war in Ukraine on food, energy and finance, and the evolving climate crisis, with the aim of ensuring these resources can contribute to domestic resource mobilization and be replaced by domestic resource mobilization progressively over time.

The cornerstone of effective public spending and revenue mobilization systems is adequate governance architecture and mechanisms that enable countries to fight corruption and reduce inefficiency. African countries need to strengthen the institutional governance and capacity of their public administrations and adopt e-procurement and e-governance services that promote transparency and accountability.

65 Jenny Rickard, Joe Kraus and Lauren Bredar, "Is there a place for tax incentives in post-COVID Africa?"

Furthermore, countries need to strengthen their anti-corruption laws and law enforcement, enhance coordination and cooperation of oversight agencies, harmonize national standards and further enforce clear regulatory frameworks as part of implementing the principles of environmental sustainability, transparency, accountability, access to information, human rights and independent monitoring.[66] More broadly, building the capacity of countries for domestic resource mobilization also encompasses, in addition to good governance, the promotion of inclusiveness and social justice and the creation of conditions and incentives for productive investments.

Effective domestic resource mobilization requires a solid database that allows for the identification and location of individuals, firms and/or real estate properties on which to levy taxes. Countries must therefore invest in well-managed civil, business and land registries while also building efficient address systems. In addition, data are important in order to better assess financial needs, financial flows and risks to improve the functioning of financial systems. Data also play a critical role in the digital economy.

Sovereign wealth funds play an important role in stabilizing the economy and ensuring intergenerational prosperity by making sure that the blessings of natural resources are properly invested and do not become a curse. In this respect, countries need to further encourage African sovereign wealth funds to play a countercyclical role and participate in supporting long-term investment in infrastructure projects and other strategic sectors that would ultimately attract international capital to Africa, and promote public-private partnerships by demystifying the risk perception attached to investment in Africa.

66 United Nations, "Policy brief: transforming extractive industries for sustainable development".

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CHAPTER 3.
Leveraging private financial resources

3.1. INTRODUCTION

The domestic financial sector plays a central role in economic development by allocating resources and creating liquidity for businesses and avenues for managing risk. However, in Africa, the shallow nature of the financial sector, including capital markets, militates against it playing an effective role in mobilizing savings and channelling them into productive uses. Though Africa's pension and insurance funds are growing, they tend to be invested largely abroad. From a domestic resource mobilization perspective, necessary conditions need to be created to enable the domestic private sector to move along the national, regional and global value chains by facilitating access to finance and strengthening the mobilization of capital. Development banks and institutional investors should lead the way in mobilizing long-term capital for Africa's structural transformation.

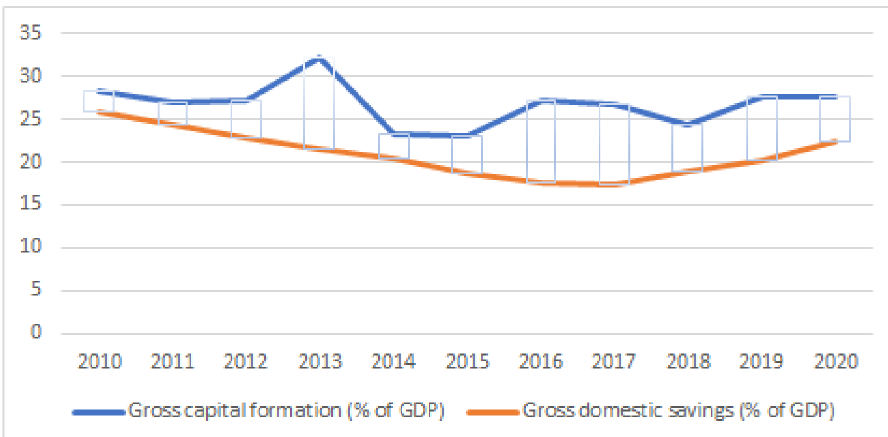
3.2. INCREASING DOMESTIC SAVINGS

Africa has among the lowest savings rates in the developing world, with the domestic savings rate averaging around 20 % from 2010–2020, considerably below 35 % and 28 % for East Asia and the Pacific and South Asia, respectively. However, this rate varies considerably across countries. Oil-exporting countries recorded the highest savings rate, 24.6 %, compared with 13.5 % for low-income countries. For example, countries with the highest domestic saving rates as a percentage of GDP in 2020 were Gabon (45 %), followed by the United Republic of Tanzania (34 %) and the Sudan (32 %), whereas others, including Somalia and the Comoros, recorded negative rates of 53 % and 9.6 %, respectively. In the African context, there are multiple factors that explain the low level of savings, including low and volatile incomes, the young demographic structure of African populations, high illiteracy rates, low life expectancy[67] and underdeveloped and shallow banking systems, as well as the high level of informality in the economy.

67 Thorsten Beck and others, *Financing Africa: Through the Crisis and Beyond* (Washington D.C., World Bank, 2011).

However, the low level of savings does not reflect the true picture of savings generated in Africa, owing to the high level of informality, illicit financial flows and savings that finance illegal and criminal activities. Between 2010 and 2020, the average investment rate in Africa was around 26 % of GDP, which resulted in an investment-savings gap of 6 % of GDP (fluctuating between 2 and 10 points (figure 12). The highest investment-savings gap registered was around 11 points in 2013. Owing to the large financing gap (table 1), which has been heightened by COVID-19, additional efforts to increase domestic savings are needed. Countries need to strengthen and develop their banking and financial systems, reduce informality, attract investments and adopt policies that encourage doing business. Reducing the financing gap would allow African countries to take full ownership of their development agenda – relying on their own resources for development, while external resources would play a complementary role.

FIGURE 12: INVESTMENT – SAVINGS GAP IN AFRICA (% OF GDP), 2010-2020



Source: World Bank, World Development Indicators

3.3. DEVELOPING FINANCIAL AND CAPITAL MARKETS

Despite a series of financial sector reforms undertaken by African countries in the late 1990s and in the 2000s, the financial sector remains shallow. This is reflected in the low financial development index[68] of 0.16 in 2019 compared with an average of 0.33 for Asia and the Pacific, underscoring the critical importance of financial deepening for domestic resource mobilization[69] (figure 13, next page). Although the depth and efficiency of African financial institutions have improved throughout the years, they remain relatively underdeveloped, which hinders the channelling of savings to productive investment and social development.

With respect to financial development, there are variations across countries, with Mauritius, Morocco, Tunisia and South Africa having the most developed financial markets in Africa, whereas Sierra Leone and South Sudan have among the least developed financial markets. In countries

68 The index measures a country's financial institutions (banks, insurance, mutual funds, pension funds) and financial markets, including stock and bond markets.
69 IMF, Financial Development Index Database.

that have experienced rapid financial development, such as Botswana and Namibia, this has been manifested in the growth of financial institutions and financial markets, with the combined assets of pension and insurance funds exceeding the share of commercial banks in total financial assets in the latter.[70]

However, in most countries, financial markets and institutions are less developed. Several factors contributing to this situation include low levels of income, low savings rates and governance challenges (corruption and political interference).[71] However, there is considerable scope for deepening financial sector development. Evidence shows that bringing Africa's financial sector development to the same level as other developing regions would add 1.5 percentage points to GDP per annum. This would contribute to increased growth by relaxing the credit constraint.

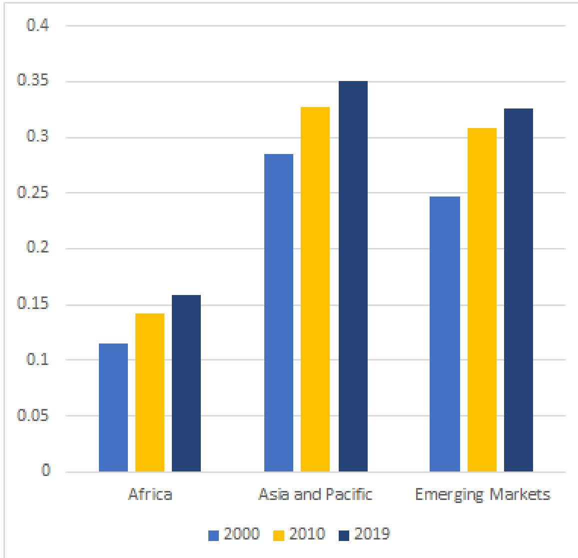
Another indicator of financial depth, the ratio of domestic credit to the economy by banks, remained low, at 30 % of GDP, compared with 54 % and 42 % for Latin America and the Caribbean and East Asia and the Pacific, respectively. Africa's ratio has stagnated in the past 10 years, whereas the world average continued to increase substantially to reach almost 100 % in 2020 (figure 14, next page). The banking sector is growing fast and is profitable, with the profits reaching twice the global average in 2018. Africa's financial sector is dominated by commercial banks that typically tend to provide short- to medium-term loans.[72] Despite increased competition, the cost of lending remains high – mainly due to market imperfections. Banks hold excess liquidity, and most of their assets are government securities with high returns at the expense of providing credit to the private sector and productive sectors.

The COVID-19 pandemic is having a negative impact on the banking system, with balance sheets coming under severe pressure owing to an increase in the level of non-performing loans, as many borrowers have lost their sources of income and are unable to repay their loans. For example, the average non-performing loan ratio for sub-Saharan Africa could increase by one third in the medium term once all the exceptional support measures provided to the sector by governments expire. This could result in further reducing the availability of credit to the economy, especially to small and medium-sized enterprises, potentially further curtailing growth and therefore reducing governments' tax revenues.

In recent years, the financial landscape has been changing with the expansion of pan-African banks, filling the void created by the retrenchment of European and American banks following the 2008 global financial crisis. These banks have broad geographical coverage in Africa: seven pan-African banks have a presence in at least 10 countries, while others are present in more than 36 countries.[73] Most of the pan-African banks go beyond traditional commercial banking activities, including capital markets, insurance, pensions, money transfers, microfinance and leasing. They also cater to small and medium-sized enterprises, which are largely underserved by other banks. Owing to the growth of pan-African banks, there has been increased competition for loans and deposits, and efficiency and product innovation has increased as well.[74]

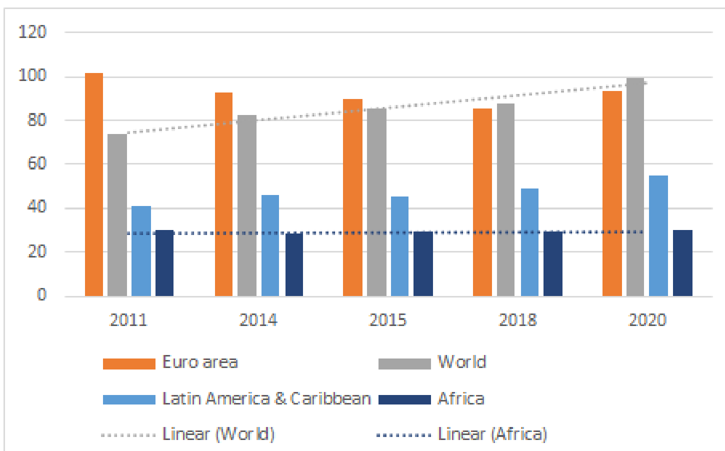
70 D. Marchettini, *Namibia: macro-financial risks associated with housing boom*, Selected Issues Paper (Washington, D.C., IMF, October 2015).
71 Thorsten Beck and others, *Financing Africa: Through the Crisis and Beyond*.
72 *Economic Report on Africa 2020: Innovative Finance for Private Sector Development in Africa* (United Nations publication, Sales No. E.20.II.K.2).
73 IMF, *Financial Development in Sub-Saharan Africa – Promoting Inclusive and Sustainable Growth* (Washington, D.C., 2016).
74 *Economic Report on Africa 2020*.

FIGURE 13: FINANCIAL DEVELOPMENT INDEX, 2000-2019



Source: IMF, Global Financial development Index

FIGURE 14: DOMESTIC CREDIT TO THE PRIVATE SECTOR BY BANKS (% OF GDP) 2011-2020



Source: World Bank, World Development Indicators

To overcome the constraints of financial infrastructure, African countries have sought to leverage the power of mobile technology to expand financial services to a large number of people. The development of mobile banking has contributed to increased financial inclusion. The region has been on the frontiers of mobile banking technology with the introduction of M-Pesa, M-Shwari and M-Kopa in Kenya, which has helped reduce transaction costs and facilitate personal transactions. This, combined with the growth of microfinance, has provided financial services to customers at the lower end of the income bracket – contributing to financial inclusion. However, there is a large section of the population that remains unbanked across Africa.

The inability of commercial banks to provide medium- and long-term financing to businesses, especially small and medium-sized enterprises in

Africa, is mainly due to the nature of the banks' asset-liability mismatch, as their liquidity is largely financed by short-term deposits, but is also due to the underdeveloped domestic debt market, such as corporate and government bonds.[75] Hence the need for establishing and strengthening national, subregional and regional development banks to provide the long-term financing needed for structural transformation and productive capacity development.

Public development banks have played an important role in the industrialization of other developing countries, such as the Republic of Korea and Brazil, by directing credit to targeted sectors that were critical to the countries' transformation and industrialization. However, this has not been the case in Africa, which has actually experienced a de-industrialization process. Though development banks have the potential to contribute to bridging the finance gap, their assets and financing capacities are small considering the sizeable financing needs[76] of the continent (Africa's annual infrastructure financing gap is between $68 billion and $108 billion).

For example, AfDB committed $5.85 billion in 2020, 43 % less than its commitment for 2019. The Bank's disbursements increased from $5.3 billion in 2019 to $7.2 billion in 2020 to support African countries in fighting the COVID-19 pandemic. Given the need for long-term financing, development banks should focus on promoting productive development and structural transformation. They could also play a countercyclical role during economic downturns by sustaining investment levels and protecting the countries' productive structure.

The African continental financial institutions, envisaged by the African Union Constitutive Act, aim at accelerating regional integration and socioeconomic development in Africa. These institutions are the African Central Bank, the African Investment Bank, the African Monetary Fund and the Pan-African Stock Exchange. The establishment of such financial institutions could play a critical role in the mobilization of long-term resources for investment in infrastructure and productive sectors, ensuring efficient and effective management of the African financial sector and promoting macroeconomic stability. However, progress in their establishment and operationalization has been slow.[77]

The stock markets in Africa have contributed to the financing of the private sector. They have grown over the years, with the market capitalization for the current 30 stock markets estimated at $1.43 trillion in 2021.[78] Although the number of listed shares and the traded volume continue to increase, they remain low compared with other regions. Five stock exchanges[79] account for about 90 % of the total capitalization, with the Johannesburg Stock Exchange in South Africa accounting for 80 % of total capitalization. However, African exchanges (except that of South Africa and to some extent Egypt) are illiquid, highly fragmented and operate under weak regulatory envi¬ronments. In addition, they offer a limited number of instruments for trading (equity shares and bonds) and a few listed stocks, which attract a limited number of investors. This is due mainly to the limited size of the domestic economies, unconducive business environments, weak supporting institutions and financial infrastructures, lengthy listing administrative procedures, high transaction costs and the lack of training and knowledge about

75 Thorsten Beck and others, *Financing Africa: Through the Crisis and Beyond*.
76 For example, AfDB estimates the annual infrastructure financing gap at $130 billion to $170 billion per annum.
77 African Union Commission and African Union Development Agency-NEPAD, *Second Continental Report on the implementation of Agenda 2063* (Johannesburg, South Africa, 2022).
78 See www.world-exchanges.org/our-work/statistics (accessed in February 2022).
79 South Africa, Egypt, Nigeria, Morocco and Kenya.

capital markets, as well as the lack of transparency in some of the financial markets, among other reasons. Capital market integration, technology and improved regulations and governance could help overcome the challenges to the development of capital markets. Further development of capital markets, including stock and bond markets, as well as regional stock exchanges, will be necessary to provide long-term development finance.

3.4. PROMOTING PUBLIC-PRIVATE PARTNERSHIPS

African countries have always faced difficulties attracting private sector investment in infrastructure. A handful of countries (South Africa, Morocco, Nigeria, Egypt and Ghana) accounted for more than half of all successful public-private partnerships from 2008 to 2018.[80] In terms of the sectoral distribution of public-private partnerships, most were in the energy sector (57 %), followed by transport (24 %) and information and communications technology (16 %) during the period 1999–2019. A major barrier to attracting private capital into infrastructure is the high perceived riskiness of African countries. While financial de-risking instruments are important, there is a need to adopt a more comprehensive approach that tackles policy, governance, institutional and regulatory constraints.

Although the share of domestic and external private financing in Africa's infrastructure has been increasing throughout the years, their contributions remain very small compared with the rest of the regions. This confirms the great potential of promoting public-private partnerships in Africa as part of the solution towards building forward better, and alleviating some of the fiscal burdens on governments brought by the pandemic. De-risking domestic private sector investment is critical, and institutional investors can play a critical role in this regard. However, African institutional investors' assets accounted for less than 1 % of private placement in infrastructure in Africa between 2011 and 2017.[81] It is critical to build internal capacity with regard to designing, preparing and financing projects that are attractive to private sector participation, while also keeping the right balance in risk allocation in public-private partnerships and eventually and gradually moving to projects that have higher risks.

3.5. HARNESSING PENSION FUNDS FOR DEVELOPMENT

Africa's pension funds have grown substantially over the years, and if fully harnessed could provide vital resources for financing development. For example, assets under management by pension funds stood at $676 billion in 2017 and were estimated to reach $1.1 trillion by 2020.[82] Pension assets have also grown strongly in some countries, such as Namibia, where they exceed the country's GDP (102 %). However, there are variations across countries. In South Africa, pension assets represent 92 % of GDP, but the proportion is very low in other countries, such as Nigeria (8 %), Zambia (3 %), Egypt (1.5 %) and Mozambique (1 %). Because of the high level of informality, unstable income levels and financial illiteracy, participation rates in pension fund systems in Africa remain relatively low.[83]

80 World Bank, PPI Database, 2019.
81 World Bank, "Contribution of institutional investors: private investment in infrastructure 2011–H1 2017". Available at https://ppi.worldbank.org/content/dam/PPI/documents/PPI_InstitutionalInvestors_Update_2017.pdf
82 Association of the Luxembourg Fund Industry and PricewaterhouseCoopers, " Beyond their borders: evolution of foreign investment by pension funds", 2015. See www.alfi.lu
83 Jacqueline Irving, "How the COVID-19 crisis is impacting African pension fund approaches to portfolio management", International Finance Corporation, 2020.

Diversification of pension portfolios minimizes risk, reduces potential loss and may also enhance overall system resilience. With respect to the investment of pension funds, countries' approaches vary. For example, Nigeria allocates most of the shares to bonds (88 %), while Botswana invests two thirds in equity (figure 15, next page). Pension investment strategies in Africa are not balanced enough and some do not benefit local economies, nor do they contribute to growth and development.

The proportion of pension assets invested abroad increased in many countries. For example, in Botswana, 62 % of assets were invested abroad in 2020 compared with 30 % in 2010. A similar trend is also observed in Namibia (figure 16, next page). Some African countries, including Egypt, Nigeria and Zimbabwe, prohibit the investment of pension assets abroad.[84]

Few African countries have statutory requirements for pension investment in infrastructure. If African countries were able to invest an allocation of 2.8 % of their pension fund assets into infrastructure, similar to South Africa, this would generate an additional $20.9 billion per year for infrastructure development, reducing the infrastructure financing gap by 30 %.[85] However, the high upfront costs, the lack of liquidity and the long horizon for infrastructure investments continue to discourage institutional investors, since many of them, especially in Africa, lack the resources and knowledge to manage the risks associated with such investments. In addition, the investment of pension funds in infrastructure and other assets requires the existence of a fair, transparent, clear and predictable policy framework, which is unfortunately still lacking.[86]

Taking advantage of favourable demographic trends, including the rising middle class and increased subscription to pension funds, African pension fund assets are expected to grow substantially in the coming years. African countries could take advantage of this favourable trend to amend their regulations by loosening pension fund investment limits to allow them to expand their exposure to infrastructure.

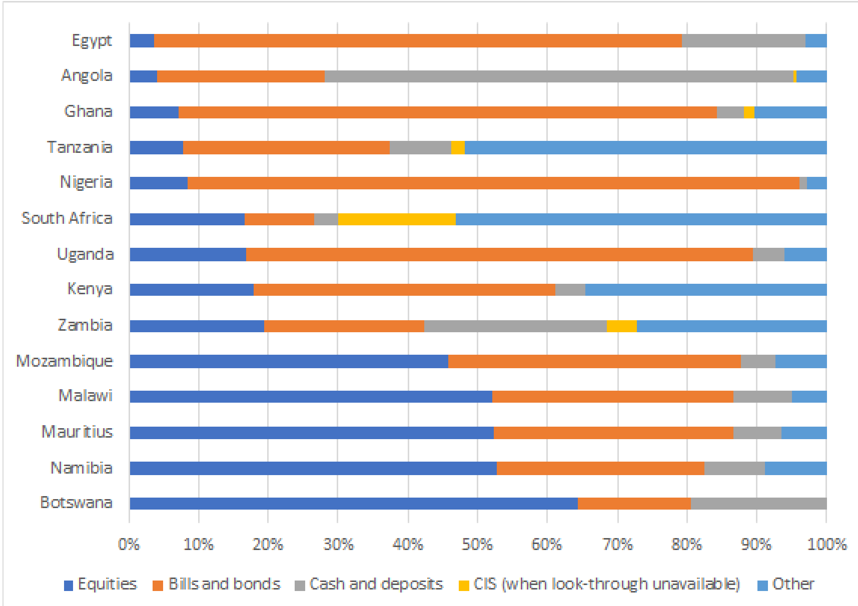
3.6. ATTRACTING THE DIASPORA FINANCE

The African diaspora, which constitutes 14 % of global migrants, has been growing, and doubled in size from 20.6 million in 1990 to 40.5 million in 2020.[87] Most migrants (85 %) originate from Eastern Africa (31 %), North Africa (28 %), and Western Africa (26 %). The contribution of the African diaspora, recognized by the African Union as "the Sixth Region", to Africa's development should be considered beyond sending remittances. The contributions of the diaspora to their countries of origin take different forms, such as financial (remittances, bonds, equity, trade, etc.) and non-financial (knowledge transfer, advocacy, political, etc.).

Remittances to Africa rose from $67 billion in 2016 to $87 billion in 2019. In 2020, they decreased by 4 % due to the pandemic, but were estimated to have recovered in 2021, reaching an estimated $91 billion.[88] Remittances tend to be countercyclical during economic downturns, pandemics and natural disasters and could act as a stabilizing factor that ensures the continuous flow of funding.

84 Ibid.
85 Calculation by staff of the Office of the Special Adviser on Africa based on its own methodology; and Amadou Sy, "Leveraging African pension funds for financing infrastructure development", Brookings Institution, March 2017.
86 Amadou Sy, "Leveraging African pension funds for financing infrastructure development".
87 Department of Economic and Social Affairs, population database. Available at www.un.org/development/desa/pd/content/international-migrant-stock
88 World Bank; KNOMAD database.

FIGURE 15: ALLOCATION OF PENSION SAVINGS IN SELECTED ASSET CLASSES AND INVESTMENT VEHICLES (2020 OR THE LATEST YEAR AVAILABLE)



Source: OECD, 2021, Pension Markets in Focus 2021

FIGURE 16: SHARE OF PENSION ASSESTS INVESTED ABROAD, 2010 AND 2020

Source: OECD, 2021, Pension Markets in Focus 2021

Remittances to Africa are projected to grow by 5.5 % in 2022, the highest growth compared with the rest of the regions.[89] These are encouraging signs that will help countries' efforts towards recovering better from the pandemic.[90] Since the above-mentioned data captures only money

89 World Bank, "Remittances to reach $630 billion in 2022 with record flows into Ukraine", 11 May 2022. Available at www.worldbank.org/en/news/press-release/2022/05/11/remittances-to-reach-630-billion-in-2022-with-record-flows-into-ukraine
90 World Bank, "Remittance flows register robust 7.3 percent growth in 2021", 17 November 2021. Available at www.worldbank.org/en/news/press-release/2021/11/17/remittance-flows-register-robust-7-3-percent-growth-in-2021

sent through formal channels, it is estimated that, if informal funds and in-kind remittances were factored in, annual remittances could reach $200 billion annually.[91]

In most regions, remittances registered strong growth in 2021 after the decrease in 2020 due to COVID-19. Latin America and the Caribbean recorded a 22 % growth rate, followed by 8 % in South Asia and 5 % in Europe and Central Asia. At the country level, Egypt was among the top five remittance recipients in the world and, together with Nigeria and Morocco, accounted for 65 % of the total remittances to Africa in 2021. The economies of South Sudan, the Gambia and Somalia are the most reliant on remittances – with inflows representing an average of almost 35 % of their GDP. These countries and their people are dependent on these resources, which play an important role in supporting vulnerable people's basic needs, including food, shelter, education and health.

Despite the increasing growth of remittance flows, the cost of sending money to Africa continues to be the highest in the world, at an average of 7.9 % in the first three quarters of 2021, far above the global average of 6.4 %, as well as that of Latin America and the Caribbean (5.5 %) and East Asia and the Pacific (6.7 %). Several factors have an impact on the cost of remitting money, including the degree of competition in the remittance corridor, the availability of information to the sender on the different cost-service options, migrant stock, the stability of the exchange rate in the recipient country, the level of financial development in both the recipient and sending countries and the choice of the transfer instrument (cash, bank or mobile) and channel (formal versus informal).

Apart from the challenge of high costs, the transformative impact of remittances is hindered by the lack of adequate financial services and lack of financial inclusion. A large portion of recipients of remittances do not have access to banks or other financial services, thus their reliance on informal channels. Reducing the cost of sending remittances is fundamental to increasing the flows and maximizing their impact on development. Developing an ecosystem around and diversifying products related to remittances (including insurance premiums and scholarships) could increase the flow, enhance the impact of remittances, increase efficiency and encourage savings and capital accumulation.

African countries have failed to mobilize diaspora financing at considerable levels, and its potential remains largely unexploited. A few African countries[92] with a sizeable diaspora population have managed to issue diaspora bonds – with varying success. For example, the issuance of diaspora first-generation bonds in Nigeria was a success, while other attempts, such as diaspora-targeted bonds in Ethiopia, infrastructure bonds in Kenya and the Golden Jubilee Savings Bonds in Ghana, have been less successful. Among the major reasons cited for such failures is the lack of trust of the diaspora community in their government. In addition, since the diaspora has a lower risk perception of their countries compared with foreign investors, generally countries tend to offer lower interest rates on diaspora bonds compared with the rest of the bonds, which makes them less attractive to external investors. This has resulted in the segmentation of the market, which explains the failure of such bonds that exclusively target the savings of the diaspora. In contrast, widening the range of bonds for potential investors, including the diaspora, has proved more successful.

91 Dilip Ratha, "Remittances: funds for the folks back home", Finance and Development Magazine, 24 February 2020.
92 Egypt, Ethiopia, Ghana, Kenya, Nigeria and Rwanda.

There are opportunities for countries to tap into this financing source by putting in place the right strategies and policies. By strengthening the transparency and governance of the regulatory system of these bonds, and coupling that with the presence in host countries of national financial institutions, African countries could better promote such bonds and make them more attractive to the diaspora.

While mobilizing remittances could be achieved in the short term by, among other things, reducing the costs of transfers, tapping diaspora savings is only possible in the medium to long term. Factors such as political, economic and financial instability are major risks to diaspora finance. Remittances are countercyclical and might not be affected by the above-mentioned risks, but members of the diaspora, like foreign investors, require the necessary enabling environment and governance structures to invest their hard-earned savings in their home countries.

3.7. RECOMMENDATIONS

Africa's financial sector continues to be dominated by commercial banks that have limited options for non-bank financing, such as insurance firms and housing finance institutions, in addition to nascent capital markets that lack the ability to provide the full mix of equity, company and government bonds.[93] African countries need to encourage financial institutions to structure and offer innovative financial products tailored to the changing needs of businesses throughout their growth cycle. In this respect, there is a need to promote and leverage the potential of the different sources of short- to medium-term financing such as commercial banks, fintech and financial markets, and long-term sources such as capital markets and development banks. In addition, African countries need to foster competition, promote a transparent and effective financial regulatory environment in order to minimize risk (i.e. non-performing loans) and ensure effective regulatory oversight over financial operations and institutions.

Africa's large development financing needs, including for financing transboundary infrastructure projects, require the establishment and operationalization of the continental pan-African financial institutions, including the African Central Bank, the African Investment Bank, the African Monetary Fund and the Pan-African Stock Exchange. These institutions could be instrumental in supporting countries' efforts to mobilize resources at the regional level for Africa's transformation, hence the urgency for African countries to accelerate the establishment of such institutions.

The large and growing pension fund market represents an important untapped source for financing development that could be leveraged for the continent's structural transformation, including infrastructure development and de-risking long-term investment in the Sustainable Development Goals. For example, if African countries were able to invest an allocation of 2.8 % of their pension fund assets into infrastructure, similar to that of South African pension funds, this would generate an additional $20.9 billion per year, reducing the infrastructure financing gap by 30 %. In this respect, countries need to take advantage of the positive outlook in the African pension funds market brought about by favourable demographic trends, including the rising middle class and the increased subscription to pension funds, by strengthening the governance structures and amending existing regulations that limit investment in infrastructure.

93 *Economic Report on Africa 2020.*

African countries need to be supported in building their internal capacity to design, prepare and finance projects that are attractive to private sector participation. While the involvement of institutional investors is critical in financial de-risking and encouraging public-private partnerships, African countries need to adopt comprehensive approaches that tackle policy, governance, institutional and regulatory constraints that hinder the investment of private capital in infrastructure.

If properly mobilized and leveraged, remittances have enormous potential from a domestic resource mobilization standpoint. African countries need to continue engaging the international community to deliver on the Sustainable Development Goal commitment to reducing the cost of sending money to 3 % – a level that has been found to be critical in influencing the flow and volumes of remittances. This could be achieved by promoting financial inclusion (mobile banking for money transfers) and strengthening competition in the remittance industry and underserved corridors through facilitating the entry of new players, reducing bond and capital requirements and harmonizing regulations governing money transfer. The effects of remittances on poverty and inequality reduction should be harnessed and strengthened by bridging the diaspora savings-investment gap through facilitating access by the diaspora to savings, loans and products linked to remittances, such as health insurance premiums and scholarships, and strengthening the transparency and governance of the regulatory system of diaspora finance, coupled with the presence of national financial institutions in host countries.

Institutional investors play an important role in mobilizing and channelling long-term financing to productive sectors. In this respect, countries need to encourage such investors to participate in raising the capital of national development banks to reach a critical size that will enable the banks to increase their lending capacity to the local economy, support long-term investment in infrastructure projects and other strategic sectors and promote public-private partnerships. Developing and deepening domestic financial and capital markets is a must to increase domestic resource mobilization and to reduce currency exchange risks.

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CHAPTER 4.

Stemming illicit financial flows for Africa's sustainable development

4.1. INTRODUCTION

Illicit financial flows[94] out of Africa remain a serious impediment to Africa's sustainable development. This poses a significant challenge to domestic resource mobilization because such flows deprive African countries of vital financial resources for financing investment in Sustainable Development Goals. Since illicit financial flows move from Africa to developed countries, they perpetuate existing global inequalities. Therefore, tackling illicit financial flows is key to ensuring fairer and more equitable globalization. If the problem of illicit financial flows is not addressed as a matter of urgent priority, African countries will fall further behind in social and human development, with a large number of people languishing in grinding poverty.

This has become even more urgent considering the devastating impact of the COVID-19 pandemic on Africa. As fiscal space is threatened by declining tax revenue, African countries will need to harness all the available resources to fill the widening financing gap. A major challenge to addressing illicit financial flows identified by the 2015 High-level Panel on Illicit Financial Flows from Africa (the Mbeki Panel) is the lack of a global framework.[95] Although there are several initiatives and instruments to address various aspects of illicit financial flows developed under the United Nations, the African Union, the Group of 20, OECD and IMF, they are disparate and do not amount to a coherent and overarching institutional system. Therefore, the adoption of a comprehensive global framework will be indispensable to addressing illicit financial flows out of Africa.

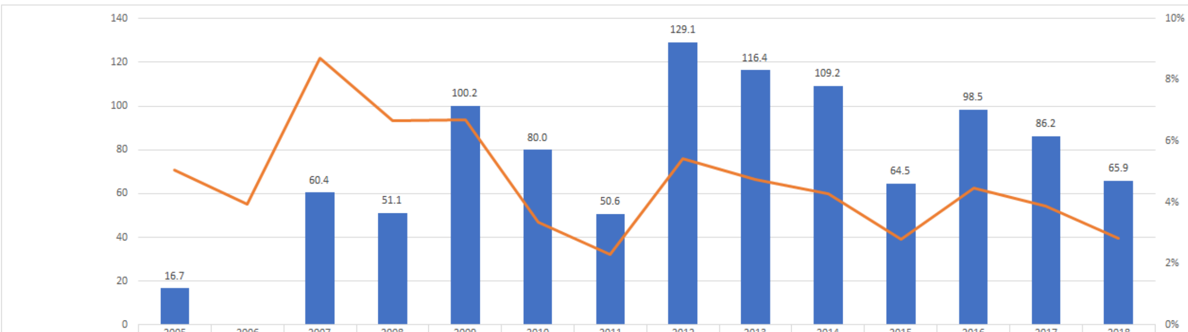
94 UNCTAD defines illicit financial flows as cross-border exchanges of value, monetary or otherwise, which are illegally earned, transferred or used. This is broadly in line with the definition adopted by the African Union's High-level Panel on Illicit Financial Flows from Africa.

95 African Union Commission and ECA, "Illicit financial flows: report of the High-level Panel on Illicit Financial Flows from Africa" (Addis Ababa, 2015). Available at https://repository.uneca.org/ds2/stream/?#/documents/0ca955c2-2e56-5120-a605-9e8a7566c7d3/page/3

4.2. TRENDS IN ILLICIT FINANCIAL FLOWS

Illicit financial flows out of Africa are large and growing. Capital flight from the continent, which serves as a good proxy for illicit financial flows, grew substantially over the period 2008–2018, peaking in 2012 at $129.1 billion (figure 17). This is comparable to the figure reported by UNCTAD in its report entitled *Economic Development Report 2020: Tackling Illicit Financial Flows for Sustainable Development in Africa*. Africa has lost a combined $2.0 trillion through illicit financial flows during the period 1970–2018.[96]

FIGURE 17: AGGREGATE CAPITAL FLIGHT FROM AFRICA (2008-2018)



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Capital flight (in billion)	16.72886865	-19.26186722	60.44039121	51.08802673	100.1555803	79.99594961	50.64030765	129.1069509	116.3646854	109.2068542	64.51848297	98.47010125	86.22856449	65.93453488
Capital flight (% of GDP)	0.050581481	0.039383606	0.086920338	0.06669415	0.067091916	0.033467346	0.02291454	0.054398202	0.047373894	0.042896012	0.027802489	0.04479752	0.038775201	0.028261174

Source: Capital flight – Political Economy Research Institute, University of Massachusetts Amherst.
GDP – African Development Bank, African Statistical Yearbook.

As discussed in chapter 1 of the present report, illicit financial flows from Africa far outstrip the annual inflows of ODA ($48 billion) and FDI ($54 billion).

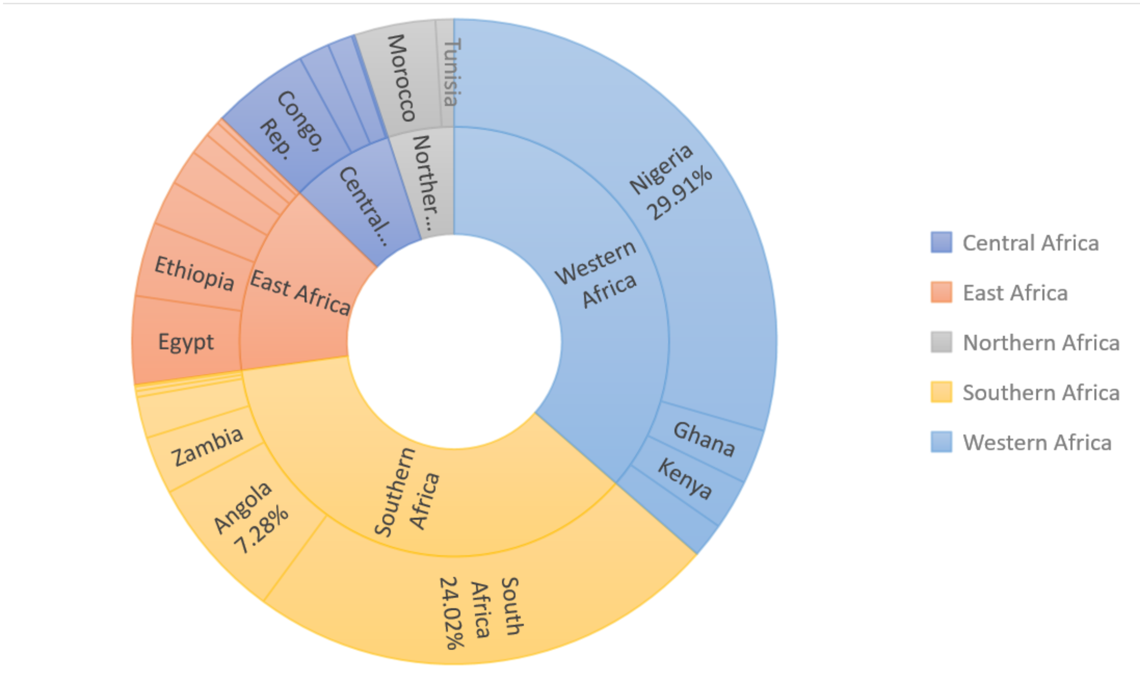
Illicit financial flows tend to be large for resource-rich African countries. The six largest illicit financial flow-remitting countries during the period 1970–2018 were Nigeria, South Africa, Mozambique, Algeria, Angola, Egypt and the Democratic Republic of the Congo. For example, during that period, Nigeria lost a total of $466 billion in illicit financial flows, followed by South Africa and Mozambique, with $330 billion and $135 billion in illicit financial flows, respectively.

There is considerable subregional variation in illicit financial flows (figure 18). West Africa and Southern Africa account for the largest shares of such flows, at 29.6 % and 28.5 %, respectively, followed by North Africa (19.8 %) and Eastern Africa (12.7 %). Central Africa has the lowest share at 9.4 %. The revenue loss associated with capital flight alone ranges from about 2 % of GDP in Southern Africa to 2.3 % in West Africa.[97]

96 This is based on the Capital Flight Database of the Political Economy and Research Institute of the University of Massachusetts Amherst, which calculates capital flight as trade misinvoicing plus balance of payments residual. See Léonce Ndikumana and James K. Boyce, "Capital flight from Africa 1970–2018: new estimates with updated trade misinvoicing methodology", PERI Research Report (May 2021).

97 Economic Development Report 2020: Tackling Illicit Financial Flows for Sustainable Development in Africa (Sales No. E.20.II.D.21). Data are median by subregion.

FIGURE 18: AGGREGATE CAPITAL FLIGHT (IN BILLION) FROM AFRICA, 2005-2018



Source: UNCTAD

4.3. TAXATION AND COMMERCIAL-RELATED ACTIVITIES

The Mbeki Panel identified commercial practices related to trade and tax abuse as the largest driver of illicit financial flows from Africa, accounting for 65 % (followed by criminal activities (30 %) and corruption (5 %)).[98] Given its sheer size, targeting this source of illicit financial flowswill be critical to strengthening domestic resource mobilization in Africa.[99] Furthermore, commercial activities contribute the most to employment, the production of critical goods and services and the payment of taxes. Therefore, addressing this is crucial to stemming the haemorrhaging effect of illicit financial flows on Africa. However, determining the illegal/illicit nature of commercial activities is a challenge.

In the context of Africa, the Mbeki Panel provided guidance on which tax and commercial practices/activities may be categorized as forms of illicit financial flows. They include "abusive transfer pricing, trade mispricing, misinvoicing of services and intangibles and using unequal contracts, all for purposes of tax evasion, aggressive tax avoidance and illegal export of foreign exchange".[100]

In 2014, the taxation of multinational enterprises amounted to 88 % of the tax base of Nigeria. Rwanda similarly reported that up to 70 % of its tax revenue was realized from the taxation

98 African Union Commission and ECA, "Illicit financial flows: report of the High-level Panel on Illicit Financial Flows from Africa".
99 Office of the Special Adviser on Africa, Tackling Illicit Financial Flows Arising from Taxation and Illegal Commercial Practices in Africa (forthcoming).
100 African Union Commission and ECA, "Illicit financial flows: report of the High-level Panel on Illicit Financial Flows from Africa".

of multinational enterprises. In Burundi, one multinational enterprise alone is responsible for close to 20 % of the country's tax revenue. All this shows the significance of corporate taxes for African countries.

4.4. CAUSES AND DRIVERS OF ILLICIT FINANCIAL FLOWS OUT OF AFRICA

Illicit financial flows are generally influenced by a wide range of factors. In terms of the drivers of such flows, the literature shows that, in the context of Africa, illicit financial flows are influenced by structural factors as well as domestic policies. Capital account convertibility, debt, exchange rate regimes, interest rate differentials, corruption and political instability are key factors in driving illicit financial flows out of Africa. The report of the Mbeki Panel identifies corruption as a cross-cutting factor that drives illicit financial flows at every stage. While corruption is a worldwide problem, weak institutions and governance deficits make Africa vulnerable to corruption and abuse of power, which can fuel illicit financial flows.

The dependence of African countries on natural resource extraction, particularly fossil fuels, makes them particularly susceptible to illicit financial flows, and has also historically locked many African countries into patterns of primary product export specialization, leading to the so called "paradox of plenty", in which countries rich in resources do not actually benefit from their own natural wealth. Illicit financial flows are also enabled by several actors both in Africa and out, including financial institutions and professional service providers, such as accounting, auditing and legal service providers. In addition, illicit financial flows are facilitated by a global shadow financial system that includes tax havens, secrecy jurisdictions, disguised corporations, anonymous trust accounts and fake foundations, and uses trade mispricing and money-laundering techniques.

A study by the Brookings Institution grouped the drivers of illicit financial flows into categories: macroeconomic drivers and governance drivers.[101] Based on the correlation analysis conducted for the study, the findings revealed a positive and significant relationship between illicit financial flows and real GDP (aggregate) and inflation. These findings suggest that macroeconomic instability encourages people to send their capital abroad. The study also showed a positive and significant correlation between illicit financial flows and tax revenue as a share of GDP. Additional correlation analysis (figure 19) makes it clear that higher levels of corruption and conflict both contribute to capital flight. As is evident in the subsequent chapter of the present report, residents of countries where corruption is very high are unwilling to pay taxes because of the perception that such collected resources would be misused.

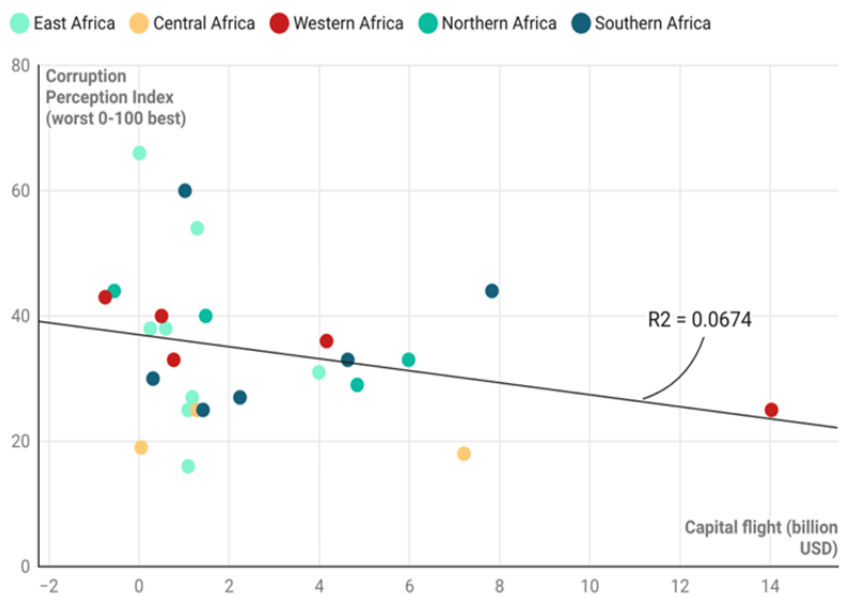
4.5. IMPACT OF ILLICIT FINANCIAL FLOWS ON AFRICA'S DEVELOPMENT

Illicit financial flows constitute a serious constraint to Africa's growth and sustainable development, as they deprive the region of vital resources for its development. Illicit financial flows also have a negative impact on domestic resource mobilization. This is manifested through reduced government funding for capital or development expenditure programmes such as education and health.[102] Indirectly, illicit financial flows affect development negatively through curtailing investment and saving.

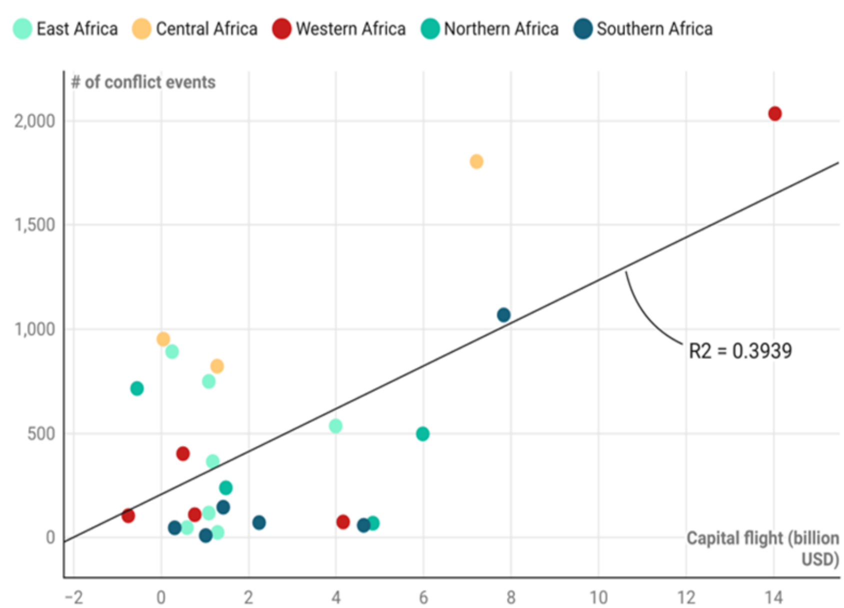
101 Landry Signé, Mariama Sow and Payce Madden, "Illicit financial flows in Africa: drivers, destinations, and policy options", Policy Brief (Washington D.C., Brookings Institution, March 2020).
102 J. D. Nkurunziza, "Illicit financial flows: a constraint on poverty reduction in Africa", Association of Concerned Africa Scholars, Bulletin No. 87 (Fall 2012).

FIGURE 19: CORRELATION ANALYSIS BETWEEN CAPITAL FLIGHTS AND CORRUPTION OR CONFLICT

a) Capital Flight (2018) and Corruption (measured by Corruption Perception Index in 2020)



b) Capital Flight (2018) and Conflict (measured by # of conflict related incidents in 2021)



Source: Capital flight – Political Economy Research Institute, University of Massachusetts Amherst.

4.6. IMPACT OF ILLICIT FINANCIAL FLOWS ON AFRICA'S DEVELOPMENT

Illicit financial flows constitute a serious constraint to Africa's growth and sustainable development, as they deprive the region of vital resources for its development. Illicit financial flows also have a negative impact on domestic resource mobilization. This is manifested through reduced government funding for capital or development expenditure programmes such as education and health.[103] Indirectly, illicit financial flows affect development negatively through curtailing investment and saving.

Illicit financial flows divert vital resources away from the continent's development, thereby widening the financing gap, which in turn has to be filled through the inflow of external resources, including foreign aid and debt, which often come with onerous conditions and terms. The annual financing gap for Africa to achieve the Sustainable Development Goals is around $210 billion.[104] UNCTAD estimates that curbing illicit financial flows across Africa, estimated at $78 per capita, could close the financing gap by 33 %.[105]

4.7. RECENT REGIONAL AND GLOBAL EFFORTS ADDRESSING ILLICIT FINANCIAL FLOWS

In recent years, efforts have been made at the regional and global levels to tackle illicit financial flows. At the regional level, the African Union established a High-level Panel on Illicit Financial Flows from Africa (the Mbeki Panel) to develop an assessment of the magnitude of such flows out of Africa, their drivers and sources, and their impacts on Africa, and provide specific actionable and practical recommendations to be undertaken by African countries and the rest of the world.

Recognizing the vital importance of strengthening integrity within the global financial system for achieving the transformative vision of the Sustainable Development Goals, the FACTI Panel was convened by the President of the General Assembly and the President of the Economic and Social Council on 2 March 2020. The FACTI Panel recommended the establishment of a global pact that would seek to strengthen and promote values of integrity and legitimacy and strengthen policy and institutional frameworks to foster financial integrity for sustainable development.

Other important initiatives worth highlighting include the Global Forum on Transparency and Exchange of Information for Tax Purposes, established in 2009, and the Inclusive Framework on Base Erosion and Profit Shifting, established in 2016. The Africa Initiative was launched in 2014 by the Global Forum to help African countries

103 J. D. Nkurunziza, "Illicit financial flows: a constraint on poverty reduction in Africa", Association of Concerned Africa Scholars, Bulletin No. 87 (Fall 2012).

104 *Economic Development in Africa Report 2016: Debt Dynamics and Development Finance in Africa* (United Nations publication, Sales No. E.16.II.D.3). $210 billion is the amount needed for basic infrastructure, food security, health, education and climate change mitigation.

105 *Economic Development Report 2020: Tackling Illicit Financial Flows for Sustainable Development in Africa*.

combat tax evasion[106] and illicit financial flows through transparency and the exchange of information. Despite all these efforts, a global architecture for tackling illicit financial flows is still lacking. Although there are several initiatives and instruments to address various aspects of illicit financial flows, they are disparate and dealt with in separate processes and forums – making their implementation difficult and ineffective.

4.8. INTERNATIONAL TAX COOPERATION

Several measures have been taken to limit tax avoidance and evasion through improved transparency and disclosure, including the adoption of instruments and frameworks to enable tax authorities to clamp down on cross-border tax evasion. For example, according to the Department of Economic and Social Affairs,[107] through voluntary disclosure and offshore tax investigation, €107 billion was recovered in 2018, with $29 billion going to developing countries. Despite the large potential revenue gains from the exchange of information, only 20 African countries participate in the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. For example, eight African countries were able to recover $189 million in additional tax revenues through the exchange of information during the period 2014–2019; two countries identified $378 million in voluntary disclosure programmes. Many African countries, including the least developed countries, face financial, human and institutional constraints.

Tax evasion and avoidance, particularly by multinational enterprises, remain a serious challenge to domestic resource mobilization in Africa. A report on aggregated country-by-country reporting on multinational enterprises released by OECD in 2020 showed a significant mismatch between the locations where their economic activities take place and where their profits are reported.

As of November 2021, 27 African countries (out of 141) are members of the OECD/Group of 20 Inclusive Framework on Base Erosion and Profit Shifting, a global initiative to reform international taxation rules, reduce tax avoidance and ensure that multinational enterprises pay their fair share of taxes.[108] In October 2021, the Inclusive Framework set out the "Statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy", which has been signed by 137 member jurisdictions as at 4 November 2021. They also agreed on a global minimum corporate tax rate of 15 % for multinational enterprises.

This is significantly below the global corporate minimum tax rate of 21 to 25 % proposed by developing countries. From a tax equity standpoint, it is feared that the agreement would worsen inequities in the multilateral tax system, which has cost Africa billions in lost tax revenue. It would have a potential negative impact on tax revenue mobilization in Africa. Unlike OECD countries, which can mobilize more payroll taxes, African governments lack the capacity to levy and collect such forms of taxes. Instead, they depend heavily on corporate tax revenues.

106 Twenty-nine African countries are members of the Forum: Benin, Botswana, Burkina Faso, Cameroon, Cabo Verde, Chad, Côte d'Ivoire, Djibouti, Egypt, Eswatini, Gabon, Ghana, Kenya, Lesotho, Liberia, Madagascar, Mauritania, Mauritius, Morocco, Niger, Nigeria, Rwanda, Senegal, Seychelles, South Africa, United Republic of Tanzania, Togo, Tunisia and Uganda.

107 *Financing for Sustainable Development Report 2020* (United Nations publication, Sales No. E.20.I.4).

108 Vladimir Starkov and Alexis Jin, "A tough call? comparing tax revenues to be raised by developing countries from the Amount A and the UN Model Treaty article 12B regimes", Research Paper No. 156 (Geneva, The South Centre, 2022). Available at www.southcentre.int/research-paper-156-1-june-2022/.

For example, in 2015 alone, the total corporate taxes collected by African governments was estimated at $67 billion.

So far, the two-pillar solution has been widely criticized by many developing countries, including in Africa. For example, Kenya and Nigeria highlighted the embedded inequities in the deal, and that the implementation of the deal could deprive them of vital tax revenues. Many African countries have unilaterally established digital services taxes to tax digital companies in their jurisdictions; by adhering to the Inclusive Framework they would have to remove those unilateral taxes, which would substantially reduce their resources. According to Oxfam, 52 countries in the global South would register net losses when implementing the Inclusive Framework as a result of phasing out their digital services taxes.[109]

This was confirmed by a recent study undertaken by the South Centre comparing the estimated revenue gains or losses from implementing Amount A of OECD and article 12B of the United Nations Model Double Taxation Convention between Developed and Developing Countries.[110] In Africa, it is estimated that countries would benefit more by adopting any of the three article 12B options of the United Nations Model Convention options (using the gross method based on 3 % and 4 % tax rates and the net method) compared with the OECD Amount A option. In fact, the majority of African countries could gain three to four times more revenue if the United Nations tax option, using a tax rate of 4 % under the gross method, was adopted and implemented.

One of the disconcerting elements of the agreement is the decision to grant the right to apply the minimum corporate tax rate to the countries in which multinational enterprises are headquartered. This will transfer tax revenue to developed countries at the expense of African countries, leaving small and medium-sized enterprises to shoulder the disproportionate share of the tax burden. In addition, the provision prohibiting countries from taxing digital multinational enterprises not covered by the agreement is likely to have an adverse impact on the ability of African countries to raise revenue through digital services taxes.

4.9. RECOMMENDATIONS

Several measures have been proposed to address corruption and money-laundering, including strengthening institutions and legal frameworks. Digital technology can also be an effective tool against corruption and money-laundering. There is a need to strengthen the regulation and supervision of professional service providers in line with the recommendations of the FACTI Panel. This calls for a strong and robust global framework to address illicit financial flows, and must be complemented by measures to enforce existing national, regional and international instruments, including anti-corruption and money-laundering measures to stem corruption-induced illicit financial flows.

Africa must deepen the extractive sector's contributions to tax revenues by closing all loopholes for base erosion and profit shifting by multinational enterprises. This calls for strengthening tax and regulatory frameworks, protecting base erosion of inbound investment, and stopping corrosive waivers and tax breaks to foreign investors that have better capacities to pay tax than do local companies. In this respect, a pragmatic approach to fighting tax evasion and tax avoidance with the United Nations, OECD, the

109 Oxfam, "The effect of the OECD's Pillar 1 proposal on developing countries – an impact assessment", Briefing Paper, October 2021.
110 Vladimir Starkov and Alexis Jin, "A tough call?"

World Bank, IMF and the African Development Bank partnership remains critical.

Building on the success of the High-level Panel on Illicit Financial Flows from Africa (the Mbeki Panel), African countries must continue to engage the international community to ensure that their priorities and concerns on international tax cooperation are effectively addressed.

Building on recent progress made, including through the FACTI Panel, as well as the adoption of global minimum corporate tax, the international community must work towards establishing a comprehensive global framework to tackle illicit financial flows.

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CHAPTER 5.
Strengthening partnerships for domestic resource mobilization

5.1. INTRODUCTION

Transformative change that will ensure a better future for Africa can only be achieved through African-led initiatives originating from within the continent and supported by novel and strengthened partnerships at the national, regional and global levels. In the face of one of the most cataclysmic exogenous shocks that the world has ever seen – the COVID-19 pandemic – the inability to achieve vaccine equity is emblematic of the failure of existing partnerships to respond to Africa's needs and aspirations. Chronic supply shortages, infrastructure bottlenecks, the inability to access finance and years of underinvestment have impeded on the provision, distribution and eventual manufacture of the requisite vaccines and medications on the continent.

This calls for a paradigm shift towards more sustained and impactful partnerships under the "new normal" parameters of the post-pandemic world, capitalizing on the renewed momentum being achieved through the decade of action for the Sustainable Development Goals.

According to a joint report by the University of Denver and UNDP, by 2030, 8 out of 10 people pushed into poverty by COVID-19 will be living in countries on the lower end of human development, with the heaviest burden falling on Africa.[111] The pandemic has already pushed an additional 10 million people below the poverty line in Africa. Presenting a number of different scenario analyses, the University of Denver and UNDP estimates that up to 58 million more people could be pushed into poverty in Africa by 2030, which would reverse decades of hard-fought development gains. Hence, nowhere else is this need to engage in a full-scale effort to strengthen partnerships towards domestic resource mobilization more urgent than in Africa. The scarce financial resources will have the highest-expected marginal utility and impact on the lives and livelihoods where the needs are the highest.

111 Pardee Center for International Futures at the University of Denver and UNDP, "Flagship publication 1: assessing impact of COVID-19 on the Sustainable Development Goals" (December 2020).

This rising trend of poverty, however, is not necessarily the destiny of Africa. On the contrary, the Sustainable Development Goals, as a comprehensive package, have transformative positive spillover effects on one another. The above-mentioned report by the University of Denver and UNDP also estimates that "SDG Push" investments, consisting of targeted policy interventions and integrated policy choices in governance, health, social protection, green economy and further digitization, can lift 68 million people out of poverty in Africa by 2030.

Furthermore, efforts to build forward better from the pandemic will also be crucial to achieving lasting results not only in health outcomes but also across a broad spectrum of other Sustainable Development Goals. For instance, UNDP estimates that every million people vaccinated brings in an additional $7.93 billion in global GDP.[112] It follows from these estimates that if every low- and middle-income country in Africa were to reach the African Union's goal of 40 % vaccine coverage by the end of 2021, this would boost global GDP by an additional $3.17 trillion, which could be invested back into financing for sustainable development.

For the better part of the past two decades, the United Nations system has been arguing that domestic resources will be the key to financing Africa's sustainable development. The argument follows that capital and investment flows into Africa, as well as ODA and concessional finance, would play a complementary role in further catalysing other resources. However, such a transformative change in financing Africa's development has been slow in coming.

With the adoption of the 2030 Agenda for Sustainable Development and Agenda 2063, African countries have strengthened ownership and leadership of their development. Africa is now in a much better position to control its development narrative based on strengthened national efforts, including domestic resource mobilization, supported by stronger and deeper partnerships, than ever before. The present chapter explores partnerships needed at the national, regional and global levels in order to strengthen domestic resource mobilization to finance Africa's sustainable development.

At the present juncture, partnerships are critical to revamping the approach towards Africa's development. The international community needs to move away from the mindset of pursuing a set of narrow objectives and targets, such as poverty reduction, towards managing transformative change that underpins sustainable development in all its dimensions. As expressed in the report of the Secretary-General entitled *Our Common Agenda*: "Now is the time to correct a glaring blind spot in how we measure economic prosperity and progress."[113] Among the key areas that must be urgently addressed are energy to power Africa, finance to overcome dependence on external resources, digital connectivity to ensure social inclusion and people-centered policies (e.g. investments in social protection floors and decent jobs, as well as in food and nutrition security, education and health systems). To that effect, partnerships at the national, regional and global levels will be the key to supporting the continent in harnessing its human capital, natural resource wealth and renewable energy potential, and leveraging the opportunities from intra-African trade through the African Continental Free Trade Area to move further upstream in the global value chains by investing in trade in higher value added goods.

112 See https://data.undp.org/vaccine-equity/impact-of-vaccine-inequity-on-economic-recovery/
113 *Our Common Agenda – Report of the Secretary-General*, p. 4.

5.2. DOMESTIC PARTNERSHIPS

Domestic partnerships targeting both the revenue and expenditure sides of government budgets are critical for domestic resource mobilization. This requires a broad coalition, akin to a social contract, between governments and their constituencies. As noted in *Our Common Agenda*: "Now is the time to renew the social contract between Governments and their people and within societies…People need to see results reflected in their daily lives. This must include the active and equal participation of women and girls, without whom no meaningful social contract is possible."[114] Equally important are the tearing down of silos and strengthening coordination among and within government ministries and departments as part of a holistic approach towards addressing Africa's sustainable development challenges.

Since Africa has long been suffering from weak institutions, efforts to improve the governance of public resources, as well as transparency and accountability, also fall within this category. It will take a combination of domestic political will as well as cooperation and technical support from Africa's development partners to channel at least part of ODA and other concessional financing towards capacity-building and the strengthening of domestic institutions in Africa. The most obvious starting point would be to leverage these sources of finance to invest in modernizing tax collection systems, simplifying customs and business registration procedures to improve the business environment, and strengthening property rights to boost domestic revenue mobilization.

Africa's long-term sustainable development hinges on strengthening productive systems, including by producing foodstuffs as well as manufacturing pharmaceutical products, to minimize disruptions in global supply chains. Strengthening productive capacity also requires transformative partnerships to accelerate technology transfer and knowledge-sharing, which is an area where progress has been uneven, as demonstrated by the setbacks regarding vaccine production in Africa, stemming, inter alia, from a reluctance to share the intellectual property rights and production technology of potentially life-saving vaccines.

Since manufactured goods dominate intra-African trade, the African Continental Free Trade Area holds great prospects for increasing manufacturing value added in Africa. Supporting African countries in terms of their integration into global value chains through a new generation of partnerships could help unlock the beneficial effect of the Free Trade Area for Africa's industrialization by facilitating the development of national, regional and continental value chains. Partnerships to support the implementation of the African Continental Free Trade Area are multifaceted: trade facilitation and market access measures to help African countries overcome supply-side bottlenecks, as well as the Aid for Trade initiative, with its emphasis on technical assistance, infrastructure and productive capacity, are critical elements to assist Africa in reaping the full benefits of the Free Trade Area's implementation.

5.3. REGIONAL PARTNERSHIPS

Agenda 2063 encompasses blueprints and frameworks (e.g. the free movement of people and goods, open skies agreements and African continental financial institutions) to further Africa's regional integration, which can be implemented through partnerships at the regional and

114 Ibid.

subregional levels. Given the scale needed to create a viable market, regional partnerships constitute a crucial backdrop for cross-border infrastructure investments as well as reforms to deepen regional financial markets. Regional harmonization of financial regulations and banking sectors across borders would be critical to facilitating cross-border capital flows, including through African sovereign wealth funds and pension funds investing their resources within the continent.

There is still a lot of room for improvement in building and fostering regional partnerships, in particular vis-à-vis the establishment of regional financial institutions and development banks, as well as sector-specific investment vehicles to help finance Africa's structural transformation. With regard to regional partnerships, the required blueprints and frameworks, including the open skies agreements, the free circulation of people and goods, the African passport and the African financial market institutions, are all encompassed within Agenda 2063. The flagship projects, as well as goal 9 of Agenda 2063, include a set of African continental financial institutions, including the African Central Bank, the African Investment Bank, the African Monetary Fund and the Pan-African Stock Exchange, which will collectively transform the African financial sector into a purpose-driven, efficient and pivotal sector for domestic resource mobilization in Africa. Nana Addo Dankwa Akufo-Addo, President of Ghana, was appointed in February 2020 as a champion for the establishment of the African Union financial institutions. Among these, the African Central Bank is a financial institution that envisions a common monetary policy and single currency as pillars of Africa's further economic integration.

Some progress has already been made in aligning the macroeconomic convergence criteria, and the statute and structure of a future African Central Bank is at the consultation stage within the Association of African Central Banks. The African Investment Bank and the African Monetary Fund are envisaged as twin institutions that will further economic and financial integration by eliminating restrictions and frictions with regard to the trade of goods and services, as well as provide seed capital and risk-sharing arrangements to make medium- to long-term investments more viable in Africa. Among the aforementioned African financial institutions, the most progress has been made in setting up the Pan-African Stock Exchange: the negotiations on the memorandum of understanding between the African Union and the African Securities Exchanges Association have been completed and the implementation stage has been reached.[115] It is now up to African policymakers and their development partners to redouble their efforts to effectively implement these regional blueprints to make this transformative vision a reality on the continent.

Through domestic political will and international partnerships, Africa can strengthen its institutions, enhance transparency and accountability, and improve the governance of its public resources. Africa's development partners may channel part of ODA and other concessional financing towards capacity-building and strengthening institutions in Africa, namely through investments in modernizing tax collection systems and simplifying customs and business registration procedures.

115 For further information on the status of implementation of Agenda 2063, please see African Union Commission and African Union Development Agency-NEPAD, Second Continental Report on the Implementation of Agenda 2063 (Johannesburg, South Africa, February 2022).

5.4. INTERNATIONAL PARTNERSHIPS

It will take strong international partnerships to improve international tax cooperation. Such partnerships will need to incorporate the exchange of information among jurisdictions to prevent the conditions that multinational enterprises exploit in order to shift profits and avoid taxes. International partnerships will also assist in stemming illicit financial flows out of the continent and help address ODA effectiveness by earmarking part of ODA flows for the strengthening of institutions in order to build a strong domestic resource mobilization system, thus underpinning the continent's efforts to sustainably finance its development.

Typically, ODA to Africa has been focused on social sectors and designated as humanitarian aid. While these areas are important, and may even prove critical, especially during conflicts and pandemics, their contribution to Africa's transformation and sustainable development has been limited so far. Goal 20 of Agenda 2063 called on African countries to take full responsibility for financing their development and reduce the percentage of national budgets financed by ODA.

According to the *Second Continental Report on the Implementation of Agenda 2063* published by the African Union and the African Union Development Agency-NEPAD, progress was varied: on the one hand, Africa moved in the right direction in reducing ODA dependence, with the proportion of ODA in national budgets decreasing slightly from 7.3 % in 2013 to 6.9 % in 2020. On the other hand, the contribution of total tax revenue as a percentage of GDP in 2020 reached only 31 %, well below the 2021 target of 63 %. The proportion of resources raised through innovative financing as a proportion of national budgets remained at 11 % over the same period, falling significantly short of the 2021 target of 62 %.[116] The conclusion to be drawn from this analysis is that the composition of ODA is at least as important as its sheer volume. There would be immense pay-off to using ODA in a more strategic way – for instance, as seed capital to initiate medium- to long-term institutional reforms in targeted fields, including those that would help overcome bottlenecks in domestic resource mobilization. This would strengthen synergies and have positive spillover effects in Africa's efforts to make the "Africa We Want" a reality, in this case by meeting and exceeding the criteria envisaged in goal 20 of Agenda 2063.

International partnerships to accelerate technology transfer and knowledge-sharing, in which progress has been uneven, as demonstrated by the setbacks regarding vaccine production in Africa, are the keys to strengthening productive capacity in Africa. They must also support African countries in addressing infrastructure bottlenecks that impede the provision, distribution and manufacturing of vaccines on the continent. The African Continental Free Trade Area holds great prospects for increasing manufacturing value added and contributing to Africa's industrialization through national, regional and continental value chains.

International partnerships have a key role in securing concessional financing for and ensuring debt sustainability in Africa. There was already a rapid buildup of debt in developing economies prior to the pandemic, considered a "fourth wave" of debt, which has grown exponentially and has become vulnerable to currency risk since then.[117] Recent studies also highlight that global debt resolution practices tilt the playing field in favour

116 African Union Commission and African Union Development Agency-NEPAD, *Second Continental Report on the Implementation of Agenda 2063*.

117 M. Ayhan Kose and others, "What has been the impact of COVID-19 on debt? turning a wave into a tsunami", Policy Research Working Paper No. 9871 (Washington, D.C., World Bank, 2021).

of creditors, which makes debt restructuring cumbersome and often unlikely. Consequently, this leads to an increase in private debt under more punitive conditions.[118]

While it searches for a lasting solution to the debt sustainability crisis, the international community has a role to play in alleviating the most immediate pain by providing temporary relief through measures such as debt moratoriums. This could provide the necessary breathing room in Africa to continue the most critical forms of spending while the international community comprehensively reviews measures to be implemented to achieve long-term debt sustainability. An excellent example of such emergency measures to help cushion the immediate liquidity crisis in Africa is the Debt Service Suspension Initiative. As of September 2021, 48 of the world's poorest countries benefited from over $5 billion in debt service relief from official bilateral creditors, complementing emergency financing provided by the World Bank and IMF. However, the Initiative, which expired in 2021, is only a temporary measure. Such stop-gap arrangements do not reduce debt levels; they only defer payments and negatively affect sovereign credit ratings, hence restricting access to market finance further down the line. For instance, the World Bank argues that only 48 of the 73 countries eligible for the Initiative requested assistance, owing to concerns that applying for the Initiative would affect their sovereign credit rating and restrict their access to new borrowing.[119]

There have been some attempts to go beyond the Debt Service Suspension Initiative, as in the case of the Group of 20 Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative, which was established in November 2020 to facilitate timely and orderly debt treatment for countries eligible for the Initiative.

Such mechanisms, however, have faced difficulties in ensuring the participation of private creditors and in implementing relatively fast debt restructuring, owing to the ever-growing complexity of the creditor base. The international community and its African countries should not miss this historical opportunity for debt restructuring.

Despite the effective rapid response to the liquidity crisis with short-term emergency measures, a historic opportunity was missed, as the much-needed medium- to long-term debt sustainability measures have still not been enacted. Forward-looking measures intended to reform the international financial and debt architecture and make it more resilient and fit-for-purpose, including through a global compact to provide concessional finance with a minimum 10-year maturity; efforts to lower the cost of borrowing, including through the full capitalization of the Liquidity and Sustainability Facility and increased resources for the Poverty Reduction and Growth Trust; the integration of Sustainable Development Goal- and climate-related objectives into debt contracts, including through State-contingent clauses designed to provide immediate debt standstills to countries in times of crisis; investments in renewable energy; and reforms to digitize revenue collection and expenditure in order to increase transparency and accountability, are needed. The international community has a fragmented creditor base and has put overconcentrated power in the hands of a few large credit rating agencies, creating frictions and obstacles for African countries in accessing finance. Therefore, African solutions could be the key to solving Africa's problems, since the above-mentioned bottlenecks can be avoided through an African home-grown credit rating system, giving countries fair and equitable access to international capital markets.

118 Lilas Demmou and others, "Insolvency and debt overhang following the COVID-19 outbreak: assessment of risks and policy responses", OECD Economics Department Working Paper, No. 1651 (Paris, 2021).
119 M. Ayhan Kose and others, "What has been the impact of COVID-19 on debt?"

The problems stemming from the shortcomings of global economic governance, in particular the historic underrepresentation of African States in multilateral organizations, have prevented the full impact of measures such as special drawing rights, resulting in special drawing rights being allocated in abundance to countries that need it the least. This is yet another reminder of the fact that lasting solutions for a more fair and equitable global economic governance architecture are far overdue.

Box 6. Special drawing rights – a solution or an illusion?

The IMF Board of Governors issued a general allocation of special drawing rights, effective 23 August 2021, equivalent to about $650 billion. The allocation was issued to benefit all members in order to shore up their reserves with a view to enhancing confidence in and the resilience and stability of the global economy and to helping countries cope with the impact of the COVID-19 crisis. The special drawing rights allocation was made to all 190 members of IMF in proportion to their existing quotas in IMF.

The issuance of special drawing rights increases liquidity without increasing debt. In the case of African member States, for instance, the special drawing rights would increase the availability of hard currency reserves for implementing emergency measures to contain the pandemic (i.e. purchasing vaccines, medicines and food, etc.), and for meeting their debt service obligations.

However, Africa has been historically underrepresented in the governance structure of IMF. For instance, the 48 countries in the sub-Saharan Africa region represent a cumulative 3.6 % of the IMF quota share and therefore received a cumulative special drawing rights allocation equivalent to only about $23.4 billion. Including the region of North Africa, Africa only received $33 billion in total. This falls short of the external financing gap of Africa (including North Africa), estimated by IMF at $1.2 trillion through 2023.[a] Expenditures needed to address COVID-19 in Africa are projected to reach $285 billion through 2025.[b] Furthermore, the newly issued special drawing rights were unevenly distributed within the region, with Angola, Nigeria, South Africa and Zambia – all Eurobond issuers – receiving the greater share, each more than $1 billion. While it is commendable that IMF issued its largest special drawing rights allocation to date, the distribution of these special drawing rights skewed towards those that needed it the least. For instance, the United States of America, which arguably needed such liquidity the least, nevertheless received $113 billion, equivalent to 17 % of the total special drawing rights allocation and almost four times as much as what Africa received.

To help correct this historic injustice, the international community has called on developed economies to lend some of their newly issued special drawing rights to the developing countries, which are in most need, including those in Africa. Notably, the Carbis Bay Group of Seven Summit Communiqué of June 2021 specifically mentioned African countries, calling for a systemic approach to redistribute the special drawing rights through the Poverty Reduction and Growth Trust, which lends at 0 % interest rates to low-income countries in need. The Communiqué proposed a global total of $100 billion for the voluntary redistribution of special drawing rights. Pledges received so far amount to $24 billion, including $15 billion from existing special drawing rights, to the Poverty Reduction and Growth Trust.

(cont'd)

The lack of a clear and transparent mechanism for the voluntary redistribution of special drawing rights may inhibit progress. Furthermore, the international community remains divided, with the Group of Seven and the Group of 20 favouring different approaches, as the redistribution of special drawing rights may have geopolitical implications. As the recent experiences with the Debt Service Suspension Initiative and the Group of 20 Common Framework for Debt Treatments have shown, ambitious and decisive action through the current multilateral governance architecture seems difficult to achieve. The pandemic and the economic crisis that followed could be leveraged as an opportunity to re-initiate a debate on global economic and financial governance to give more voice and representation to Africa, commensurate with the continent's aspirations and its ever-growing weight in the global economy.

[a] See www.imf.org/en/News/Articles/2020/10/09/sp100920-opening-remarks-at-mobilizing-with-africa-ii-high-level-virtual
[b] See www.imf.org/en/News/Articles/2021/05/18/sp051821-remarks-at-financing-african-economies-conference

5.5. RECOMMENDATIONS

At the national level, African policymakers may wish to build stronger partnerships and achieve societal consensus to initiate transformative reforms to address the challenge of weak institutions. While some institutional reforms may take a longer gestation period to benefit society as a whole, there are still low-hanging fruits, such as the digitization of public revenue collection and expenditure systems, that will promote transparency and accountability, resulting in a rapid improvement in the efficiency of tax collection as well as government spending. Investments in capacity-building and steps to break down silos within national Governments will reposition African countries to make the best use of physical and soft infrastructure that will accompany the regional, financial and economic integration that is already in place.

At the regional level, African policymakers may wish to allocate more political capital to fast-track the implementation of the blueprints for African financial institutions as well as the other flagship projects of the African Union, including the African Continental Free Trade Area on the free movement of people, goods and services; a common African passport; a single African air transport market and high speed rail network; regional infrastructure projects; and the establishment of pan-African institutions, such as the Pan-African e-Network university project. These measures will further strengthen Africa's financial and economic integration and significantly increase the continent's domestic resource mobilization capacity.

At the international level, partnerships should be formed with African counterparts on an equitable basis, taking into account the African ownership and leadership of the continent's sustainable development and domestic resource mobilization strategies, the main tenets of which are encapsulated in Agenda 2063. The international community can facilitate technology transfer and capacity-building for stronger African institutions, which will in turn enhance the continent's ability to finance its own development in a sustainable basis, in accordance with goal 20 of Agenda 2063, and unlock the productive potential of Africa in critical sectors, such as manufacturing and health-care. Putting into action the lessons learned from the COVID-19 pandemic, the international community can also be instrumental in reversing decades of underinvestment in Africa's health-care systems, for instance by rallying behind projects to produce vaccines and medicines locally on the continent.

Notwithstanding the discussion above, debt sustainability continues to be a major issue for many African countries. Recent estimates by the Economic Commission for Africa (ECA) suggest that 15 countries are at risk of external and public debt distress, and 6 are already facing debt distress. Concerted efforts are needed to address this problem. The international community has been prompt in addressing the most urgent cases, whereas longer-term measures to ensure debt sustainability have almost invariably been missing. Rather than focusing on extending stop-gap measures for limited periods of time, the international community, especially the private sector, should explore longer-term solutions that would address the root of the problem. Africa needs to expand the availability and predictability of financing for development by investing in economic activities to build resilience to exogenous shocks and create green and decent jobs for its youthful population. To that effect, the international community has a crucial role to play in facilitating this transformation, which will benefit not only Africa, but the entire world economy and financial system by rendering it more stable.

To conclude, table 4 (next page) presents a matrix displaying an overview of selected major challenges that Africa faces in mobilizing domestic resources, as well as recommendations on the type of partnerships required to address these challenges. The matrix supports the call of this chapter for a paradigm shift in partnerships to make the “Africa We Want” a reality and makes it clear that multifaceted partnerships at the national, regional and global levels will be needed to support African States in overcoming the constraints that prevent them from mobilizing more and more domestic resources sustainably to finance their development trajectories.

TABLE 4

PARTNERSHIPS REQUIRED FOR SUCCESSFUL DOMESTIC RESOURCE MOBILIZATION IN AFRICA

Challenges	Partnerships		
	National	Regional	Global
Low revenue collection due to weak institutional infrastructure	Partnerships with taxpayers and the private sector to increase the tax base by providing value-for-money infrastructure and public services in return for tax revenue	Partnerships at the regional and subregional level for sharing best practices and strengthening institutions and governance within tax jurisdictions	Partnerships with international organizations to provide capacity-building support and technical assistance to strengthen institutions
Low revenue collection due to the size of the informal economy	Partnerships among government agencies to cut red tape and provide incentives to formalize the informal economy	Partnerships at the regional level for the harmonization of regulations and incentives to formalize the informal economy	Partnerships with international organizations to provide capacity-building support, knowledge-sharing and technical assistance to formalize the informal economy
Low revenue collection due to tax evasion and profit shifting, particularly by multinational enterprises, as well as tax incentives that lead to a race to the bottom	Partnerships to strengthen tax, accountability and regulatory frameworks, in particular as they pertain to multinational enterprises	Partnerships at the regional and subregional level to harmonize tax regulations and tax collection practices to prevent tax arbitrage within the continent, as well as digital infrastructure and accountability frameworks to strengthen the exchange of information among jurisdictions	Partnerships to create a level playing field in international tax systems and to close loopholes benefiting multinational enterprises, including the OECD/Group of 20 Inclusive Framework on Base Erosion and Profit Shifting, the Addis Tax Initiative and the Group of Seven agreement on a global minimum corporate tax
Low rate of domestic savings and investments due to shallow financial markets	Partnerships among government agencies to: (a) boost savings and investment via national banking systems; and (b) leverage African sovereign wealth funds and pension funds towards Africa's development, including by fostering a business-friendly environment, good governance, regulation and risk management strategies	Partnerships to foster regional financial markets and integration by pooling resources to provide market depth, including through the establishment and/or strengthening of critical regional infrastructure, such as the African Monetary Fund, the African Investment Bank and the African Central Bank	N/A
Illicit financial flows drain domestic resources	Broad-based national partnerships to advocate for the outlawing of conditions conducive to illicit financial flows by establishing formal and effective processes to detect and prosecute financial crimes, such as money-laundering, corruption, tax avoidance, profit shifting and other related trade and tax-related illicit financial flows	Partnerships with regional organizations such as the African Union, ECA and AfDB to provide funding and technical assistance to improve physical and digital infrastructure and data systems, and foster knowledge-sharing and peer learning within the region	A global partnership to combat illicit financial flows, such as a global pact for financial integrity for sustainable development, in accordance with the recommendations of the FACTI Panel Partnerships to facilitate the exchange of information among jurisdictions, especially those from beyond the continent

Poor quality of expenditures, including leakages, losses, corruption and theft	Intragovernmental partnerships among ministries and departments to reform expenditure management systems for more transparency and accountability	Partnerships with regional organizations for capacity-building in expenditure management, transparency and accountability	Partnerships with developed economies and international organizations to establish benchmarks and share experiences and best practices in expenditure management
High perception of investment risk in Africa leads to low FDI and other capital inflows	Partnerships at the national level to implement reforms to secure property rights and a business environment conducive to investment; and partnerships with financial institutions to use blended finance and other risk-sharing solutions to de-risk private investments	Partnerships to establish and/or strengthen regional financial infrastructure to foster risk-sharing and the creation of larger cross-border projects	Partnerships with international financial organizations for equitable risk-sharing throughout the full life cycle of an investment
Debt sustainability/debt overhang issues worsened by the impact of the COVID-19 pandemic	Partnerships (social contracts) with the citizenry to implement structural reforms for economic diversification and to break overreliance on raw material exports/food and intermediate goods imports, which will in turn alleviate exchange rate and reserve pressures and help with domestic resource mobilization and debt sustainability in the medium to long term.	Partnerships at the regional level to articulate a common position among countries in similar situations in order to negotiate better deals for debt service, suspension or cancellation, as appropriate Partnerships at the regional level to foster African financial architecture, including through the establishment of African credit rating agencies to provide more realistic and fair assessments of bankability of projects and debt sustainability writ large	Partnerships with international organizations and informal groupings, such as the Group of Seven and the Group of 20, to secure debt service suspension and debt cancellation in order to ensure the domestic resources of Africa are channelled towards addressing the increased financing needs resulting from the pandemic and the pandemic-induced recession, which threatens to push tens of millions of Africans back into extreme poverty Partnerships with international financial institutions to increase the availability of concessional financing
Asymmetric power relations in the multilateral system/global governance	N/A	Partnerships at the regional level to find a common position advocating for the reform of the multilateral system to give Africa more voice and representation commensurate with its size and population	Partnerships at the global level to secure transformative reforms to the global economic governance and the multilateral system in order to increase the voice and representation of Africa, which is historically underrepresented in these institutions

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Conclusion and road map

African countries have made progress in mobilizing financial resources for their development. Resources from domestic sources already account for two thirds of the continent's total financial resources and have further potential to drive Africa's financing for development. Further reforms will be required to expand domestic resource mobilization, including by reducing inefficiency in public expenditure. Currently, such inefficiencies in public expenditure, including in health, education and infrastructure, cost Africa an equivalent of 2.87 % of its GDP. The priority for African countries should be to identify waste and potential savings in their domestic budgets and take steps to eliminate ineffective tax incentives.

The relative importance of ODA in Africa's financing has diminished over the years, as private external financial resources, including FDI, debt, bond flows and remittances, play an increasing role in financing Africa's sustainable development and closing the financing gap, which has widened as a result of the COVID-19 pandemic. Nevertheless, ODA remains an important source of budget support. In this regard, the recent decisions and proposals to markedly cut ODA in order to mitigate the impact of the war in Ukraine on refugees are concerning. This is the exact moment in which countries and the United Nations system must respond to surging humanitarian and development needs by bringing the additional resources needed to meet ODA pledges by Member States. These resources must also be bolstered in the short-term to support African countries dealing with the socioeconomic shocks created by the COVID-19 pandemic, the impact of the war in Ukraine on food, energy and finance, and the evolving climate crisis. These resources should also be strategically invested in the sectors most vital to strengthening resilience and enhancing countries' ability to cope with crises, while ensuring such resources can also contribute to long-term sustainable development outcomes and thus be progressively replaced by domestic resource mobilization, such as through investments in universal social protection, energy, digital connectivity, decent jobs, food and nutrition security, and education and health systems.

The pandemic has also laid bare the vulnerabilities of African economies to external shocks, including narrow production, limited diversification, heavy dependence on global trade and finance, a shallow financial sector and high levels of inequality and poverty. Weak domestic resource mobilization is the critical weakness of Africa's development. Therefore, Africa must break with the past and look within and rely on resources for its own sustainable development. This calls for addressing several long-standing issues that have hampered Africa's development, including mobilizing domestic public resources through increased tax revenue and improved expenditure; leveraging private financial resources and mobilizing savings; stemming illicit financial flows; and harnessing partnerships for Africa's sustainable development, including by ensuring that resource-rich countries in Africa can capitalize on their natural wealth while contributing to the green transition and sustainable development outcomes.

The following road map is proposed:

- **Improving inefficiency in public expenditure**

  - Efforts must be taken to strengthen domestic resource mobilization and improve the alignment of national budgets and strategies with the Sustainable Development Goals, including by prioritizing investments that remain vital to bolstering resilience and countries' ability to cope with crises, such as universal social protection, energy, digital connectivity, decent jobs, food and nutrition security, and education and health systems;

  - African countries should carry out a comprehensive audit/review of their government expenditure by 2025 to identify wastages and potential savings for their budgets along with potential expenditure reallocation gains within and across sectoral allocations. This must be complemented by measures to strengthen the institutional governance of public management and administrations. By addressing inefficiency at all levels and sectors, governments could identify funds to be reallocated to priority expenditures as well as respond to emerging challenges such as the COVID-19 pandemic, with the support of United Nations entities and relevant regional and international organizations, including AfDB, IMF, the African Union Commission, the African Union Development Agency-NEPAD, the World Bank and the regional economic commissions;

  - African countries should also fast-track the adoption of e-procurement services and e-government in general by 2026, to promote transparency and accountability and improve overall efficiency, with the support of United Nations entities and relevant regional and international organizations, including IMF, the World Bank, AfDB and the African Union Commission;

- **Improving tax revenue mobilization**

  - African countries must digitize their revenue collection system by 2024 to build strong domestic resource mobilization systems, with the support of United Nations entities and relevant regional and international organizations, including IMF, the World Bank, the African Union Commission, the African Tax Administration Forum and UNDP;

  - African countries must digitize their customs processes and systems by 2024, with the support of United Nations entities and relevant regional and international organizations, including UNCTAD, UNDP, the World Bank, IMF and the African regional economic commissions;

  - African countries, supported by the international community, should assess and review their tax incentives regimes by 2026 by adopting a comprehensive and balanced approach that rationalizes their usage and reconciles the country's investment promotion objectives and resource mobilization strategies. Additional measures to improve the business environment, develop infrastructure, reduce red tape and ease the cost of business will be needed, as these are important determinants of foreign investment, with the support of United Nations entities and relevant regional and international organizations, including IMF, the World Bank, AfDB, the African Union Commission, UNCTAD, ECA and the African Tax Administration Forum;

- **Leveraging the contribution of pension funds to financing for development**

  - African countries should amend their relevant regulations by 2025 by loosening pension fund investment limits to allow them to expand their exposure to infrastructure, with the support of United Nations entities and relevant regional and international organizations, including IMF, AfDB, the World Bank and the African Union Development Agency-NEPAD;

- **Stemming illicit financial flows out of Africa**

  - The international community must adopt a global framework for tackling international tax cooperation and illicit financial flows, with the support of United Nations entities and relevant regional and international organizations, including the African Union Commission, OECD and the African Tax Administration Forum.