Financial Flows

Thematic Futures

Kouassi Yeboua and Jakkie Cilliers

Last updated 19 April 2024 using IFs v7.84

Table of contents

This theme deals with the most important financial flows to and from Africa. It provides an overview of the role of overseas development assistance (aid), foreign direct investment (FDI), and remittances in development, as well as an estimation of the burden of illicit financial flows. We consider the size and impact of these flows at the regional and country level, focusing on the growing footprint of China in Africa, particularly concerning FDI. We then model the impact of an ambitious scenario that significantly increases aid, FDI, remittances and portfolio investment flows to Africa.

Summary

- Remittance has become Africa's largest source of external financial flows, followed by foreign direct investment.
- From a peak of 6.6% of GDP in 1990, aid flows to Africa now represent about 2.5% of Africa's GDP. Moreover,

the share of such flows in the form of budget support has significantly declined. The United States and Europe are the most notable donors to Africa.

- Africa is a marginal investment destination and gets about 5% of global foreign direct investment flows. Its stock of foreign direct investment represents less than 3% of the global total.

- China has a growing footprint on the continent, although the conditions associated with loans and contracts for infrastructure projects have previously been noted as a concern. With Africa's future infrastructure prospects tied closely to China's, changes to its approach could have a massive impact on Africa.

- Countries with large diaspora populations can tap into the funds within that community to invest locally by benefiting from a patriotic dividend, as Ethiopia and Kenya have shown.

- Illegal capital flows from Africa pose a central challenge to development as they remove domestic resources which could be crucial for the continent's economic development.

- The Financial Flows scenario shows that interventions to increase aid, foreign direct investment, remittances and portfolio flows and to reduce illicit outflows can promote growth and reduce poverty in Africa. Foreign direct investment has the most significant impact on growth and GDP per capita and also has the most significant impact on poverty reduction in lower-middle- and upper-middle-income groups. Aid has the most significant impact on poverty in the low-income group.

Introduction

Briefly

To reach sustainable growth and eradicate the current high level of poverty, substantial inflows of resources are needed to complement Africa's revenue shortfall.

At 16.5% of gross domestic product (GDP), Africa's average tax-to-GDP ratio is lower than other regions such as Asia and the Pacific (19.1%), Latin America and the Caribbean (21.9%), and Organisation for Cooperation and Development (OECD) countries (33.5%).[1] In tandem with efforts to augment domestic revenues, more inward financial flows from the rest of the world will promote African economic growth and reduce poverty. Developmental infrastructural projects, such as roads, airports, harbours, pipelines and railways, are usually funded by foreign capital. Foreign capital inflows enable a country to spend more than it produces, invest more than it saves and import more than it exports.

Financial flows to developing countries have increased substantially since the end of the 1990s, in line with accelerated financial globalisation.[2] The United Nations Conference on Trade and Development (UNCTAD)[3] notes that in recent decades, financial globalisation has accelerated faster than trade globalisation. However, Africa is marginalised in the current financial globalisation and has limited integration in global value chains. For instance, Africa receives barely 5% of global foreign direct investment (FDI) flows and only a handful of countries on the continent receive international portfolio investment.

Although the business climate in many African countries can now be equated to that of most developing countries elsewhere in the world, the continent continues to suffer from a bad image as an investment destination. As UNCTAD outlines:

> too often, many people outside the continent refer to Africa as a place of civil unrest, war, poverty, and mounting problems. This has given many investors a negative image of the continent. While this image reflects the reality in some countries, it is not true for all African countries.[4]

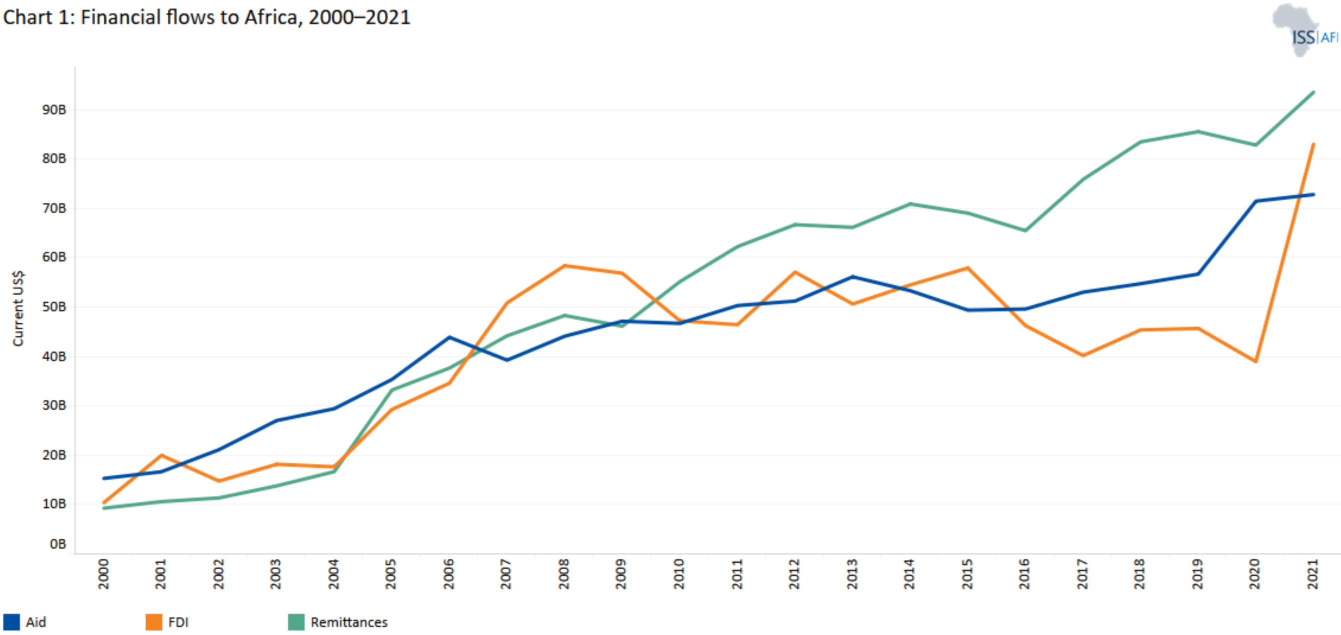
This theme responds to the following questions: What are the recent trends in financial flows to Africa? What could be the impact of increased financial flows on the development prospects of Africa?

Trends in external financial flows to Africa

There are many types of financial flows. This theme focuses mainly on official development assistance (ODA), remittances, and FDI (stock and flows). Two developing regions (South Asia and South America) are used to gauge Africa's historical and future progress in attracting external financial inflows from a comparative perspective.

While in the 1980s, aid accounted for the largest share of capital inflows into Africa, Chart 1 shows that the structural composition of financial flows to Africa has, over time, shifted towards a greater role for private flows. Remittance has become Africa's largest source of external financial flows, followed by FDI.

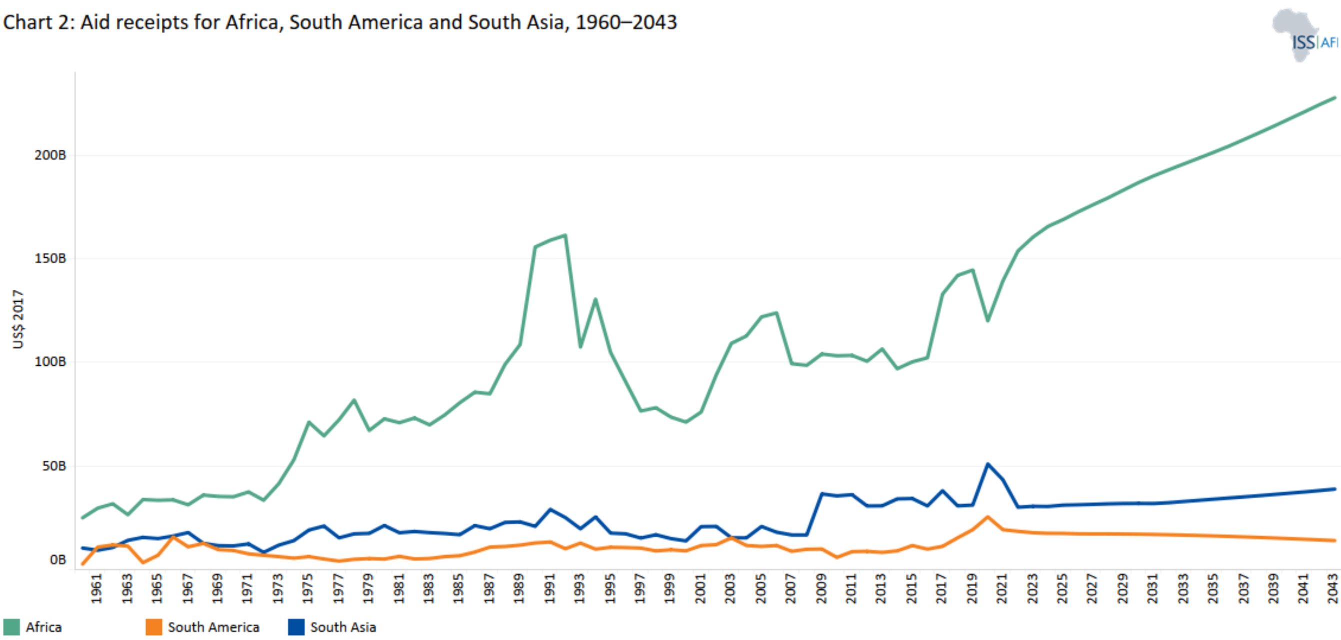
Chart 1: Financial flows to Africa, 2000–2021



Source: World Bank, UNCTAD

Chart 2 shows net aid receipts for Africa compared to South America and South Asia, the two most comparable regions, from 1960 to 2019 (historical data) and includes a forecast to 2043. Aid flows to Africa in absolute amounts, percentage of GDP and per capita basis are above South America and South Asia. On the Current Path, aid inflows into Africa are forecast to increase in absolute numbers by 2043, after a drop in 2020 due to the COVID-19 pandemic and its associated economic shocks. However, as a per cent of GDP or share of government revenues, the aid contribution will decline.

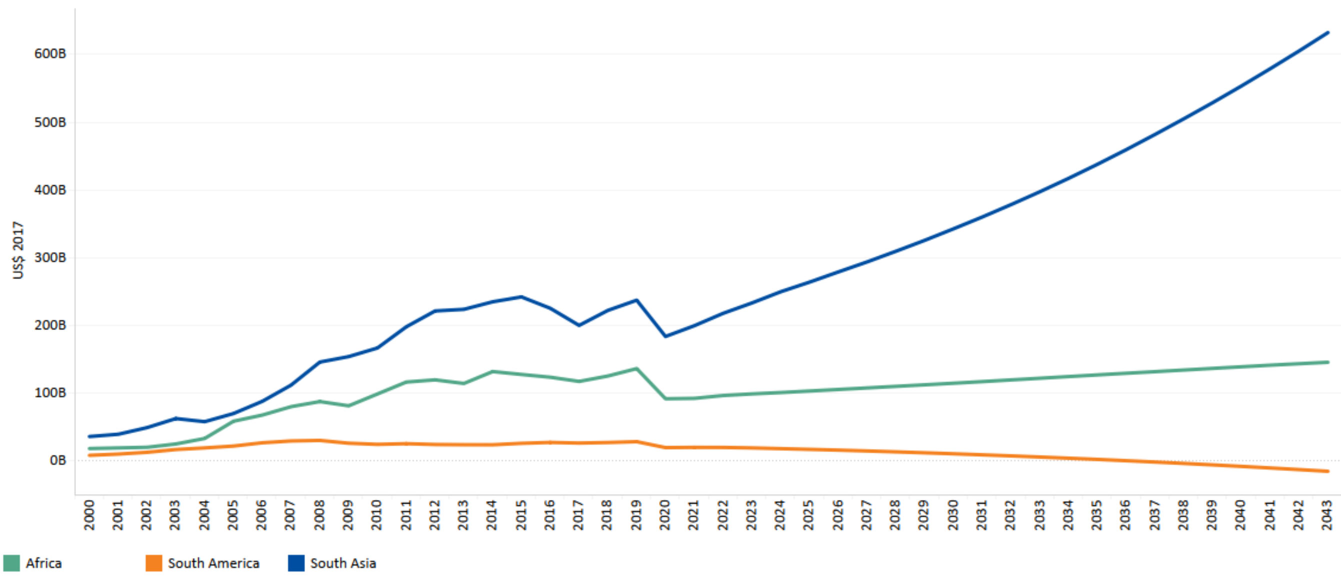
Chart 2: Aid receipts for Africa, South America and South Asia, 1960–2043



Source: IFs 7.84 initialising from IMF and World Bank data

The net remittance flows to Africa, South America and South Asia from 2000 to 2019 and International Futures (IFs) forecast to 2043 is shown in Chart 3. South Asia received the largest amount of remittance, followed by Africa and South America, and this trend is forecast to continue in the Current Path forecast.

Chart 3: Worker remittance for Africa, South America and South Asia, 2000-2043



Source: IFs 7.84 initialising from World Bank data

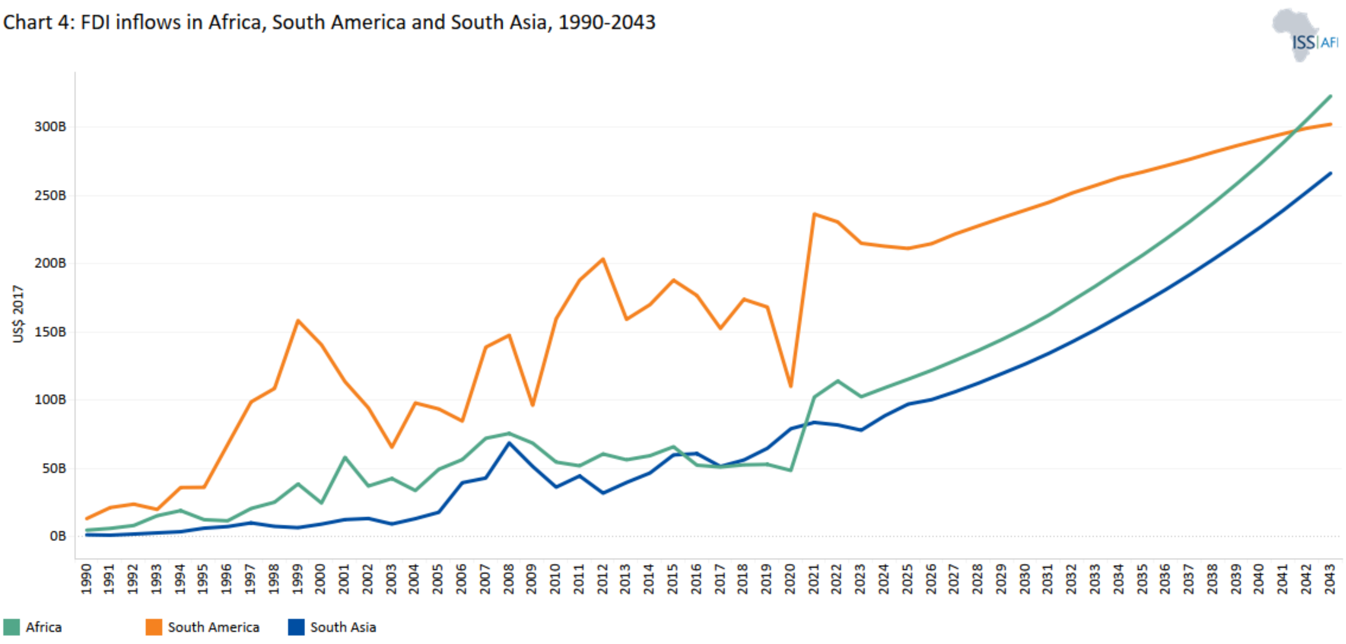
Like Africa, remittance flows are a major source of income for all countries in South Asia—larger than all other capital inflows combined. In 2019, India received more remittance than any other country in dollar terms; Nepal ranked third in the world in terms of remittances to GDP at 27%.

The cumulative remittances received by South Asia between 1970 and 2019 amounted to US$1.6 trillion—US$678 billion more than that of Africa at US$947 billion. South Asia received the lowest amount at about US$236 billion over the same period. As shown in Chart 3, remittance flows to all three regions declined in 2020 compared to their pre-COVID-19 pandemic levels in 2019. Many studies[5] have shown that remittances tend to increase when receiving countries experience disasters or recessions. However, since the COVID-19 shock was global in nature, both recipient and sender countries were impacted.

Africans living in Africa do not only receive remittances from the diaspora outside the continent but also send remittances to their families and support extended families in other African countries. However, Africa has remained a net remittance recipient. In 2019, the net remittance flows to Africa amounted to US$83.3 billion, equivalent to 2.9% of the continent's GDP, and about US$50 billion less than South Asia's. It is possible, however, that these official statistics may be misleading, as a significant share of remittances to Africa occurs via informal channels. On the Current Path, Africa will remain a net remittance recipient until 2043. While the absolute amount of remittance flows to Africa will continue to increase, remittance as a share of GDP is forecast to decline from 2.9% of GDP in 2019 to about 1% by 2043.

Trends in FDI inflows into Africa compared to South America and South Asia are shown in Chart 4. While FDI flows to Africa have been consistently below South America, they remain slightly above South Asia. In 2019, FDI inflows into Africa were equivalent to US$45.7 billion (1.8% of GDP), while outward FDI represented US$4.9 billion (0.22% of GDP). South America received US$110.8 billion (3.1% of GDP), while South Asia got US$59.1 billion (1.4% of GDP). As shown in Chart 4, FDI flows to all three regions declined in 2020 compared to their pre-COVID-19 pandemic levels in 2019. In the Current Path forecast, FDI inflows into Africa will increase across the forecast horizon to overtake South America by 2043.

Chart 4: FDI inflows in Africa, South America and South Asia, 1990-2043



Source: IFs 7.84 initialising from UNCTAD data

Analysing inward FDI into Africa in terms of the percentage of gross fixed capital formation helps to shed light on the importance of FDI in capital accumulation in the continent. The share of FDI in Africa's total gross fixed capital formation stood at 7.8% in 2019. It reached its highest level in 2007 at 14.7%.[6] This general perspective masks the case of some countries such as Angola, the Republic of the Congo, Mozambique and Somalia, among others, where FDI inflows as a percentage of gross fixed capital formation are significantly higher.

Aid to Africa

Briefly

Aid to Africa is contentious, with proponents and detractors in unyielding positions on either side of the policy divide. The aid sector is complex, and the environment in which it works is diverse, with the sweeping generalisations from the two camps shedding little light on the matter. Many analysts[7] have argued that aid has contributed to corruption and conflict and inhibited social capital formation, making African countries dependent on Western donors instead of deepening the social contract with their citizens and that African governments must wean themselves off this destructive addiction. However, some, like economist Jeffrey Sachs, call for increased aid.

The levels of aid to Africa shown in Chart 5 reflect an interesting geopolitical story. After an initial period of benign aid neglect following African independence, the Cold War sustained ever-higher levels of aid until the collapse of the Soviet Union in 1989, which effectively robbed Africa of its strategic relevance. The end of the Cold War eventually allowed the aid community (then largely consisting of OECD countries) to pay greater attention to aid effectiveness and value for money. Still, corruption, poor governance and high debt levels led to a significant degree of pessimism regarding Africa's development prospects in subsequent years.

Matters turned around with the United Nations Millennium Summit in New York in 2000, followed by the Report of the Commission for Africa released in 2005 and the European Consensus on Development (the EU policy declaration on aid) also issued that year. Collectively, these efforts paved the way for the 2005 World Summit in New York, which called for increased aid transfers to achieve the eight Millennium Development Goals (MDGs) set in 2000. The 2005 Paris Declaration on Aid Effectiveness subsequently outlined five fundamental principles (developing country ownership, alignment to developing country objectives, harmonisation among donors, results-based aid and mutual accountability) that established an important framework including donor and recipient countries.[8]

The 2011 Busan Partnership for Effective Development Cooperation[9] expanded the Paris Agreement by establishing, for the first time, an internationally agreed framework for development cooperation, which included traditional and new donors from the South, civil society organisations and private philanthropy. Donors agreed to allow aid recipients to use aid to procure from the cheapest suppliers rather than those prescribed by donors, an issue that ODA advocates had been lobbying for decades, as well as various other measures that harmonised aid modalities among donor countries.

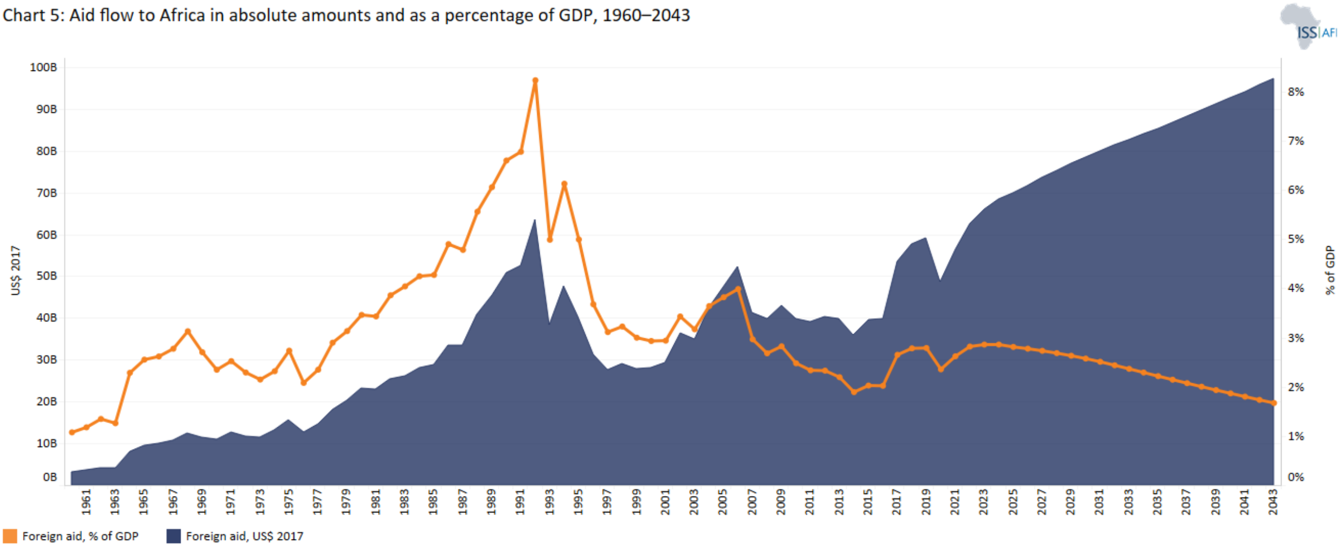
The reforms saw aid to Africa's 23 low-income countries increase to more than 8% of GDP in 2019, equating to more than 45% of government revenue. In contrast, aid has dropped to below 8% as a percentage of government revenue in low-middle-income African countries and below 2% in upper-middle-income countries, illustrating the progress made in shifting aid to the greatest need. By contrast, if aid were distributed equally among African countries, it would equate to an average of 2.4% of GDP.

The push to halve poverty by 2015 was met five years ahead of the deadline, largely due to rapid economic growth and pro-poor policies in China, which had little to do with the MDGs. The number of people living in extreme poverty in China fell from 1.9 billion in 1990 to 836 million in 2015, the final year of the MDGs. However, as were several other MDGs, the target to halve the portion of people suffering from hunger was narrowly missed.[10]

Although ratios differ, most aid is provided bilaterally, not through multilateral agencies. Given its sceptic views of multilateral organisations, the US provides most aid, approximately 89%, bilaterally.[11] The ratio for countries in the EU is lower at 78%. The average for the 30-member OECD Development Assistance Committee (or large aid providers) is 59%.

Chart 5 presents the trends in aid as a percentage of GDP from 1960 to 2019 (historical data) and forecast to 2043. Although the absolute amount of aid is forecast to increase (left-hand vertical axis) between 2019 and 2043, the relative importance of aid (as a proportion of GDP, right-hand axis) is forecast to decline from 2.3% of GDP in 2019 to 1.3% by 2043. Aid to Africa peaked at 6.6% of GDP at the end of the Cold War in 1990. Since North African countries have long since graduated to middle-income status, more than 90% of the aid to Africa now goes to sub-Saharan Africa (although a larger share of European aid has gone to its immediate neighbourhood in North Africa and the Sahel in recent years, in line with the concerns about stemming migration from there[12]).

Chart 5: Aid flow to Africa in absolute amounts and as a percentage of GDP, 1960–2043



Source: IFs 7.84 initialising from World Bank data

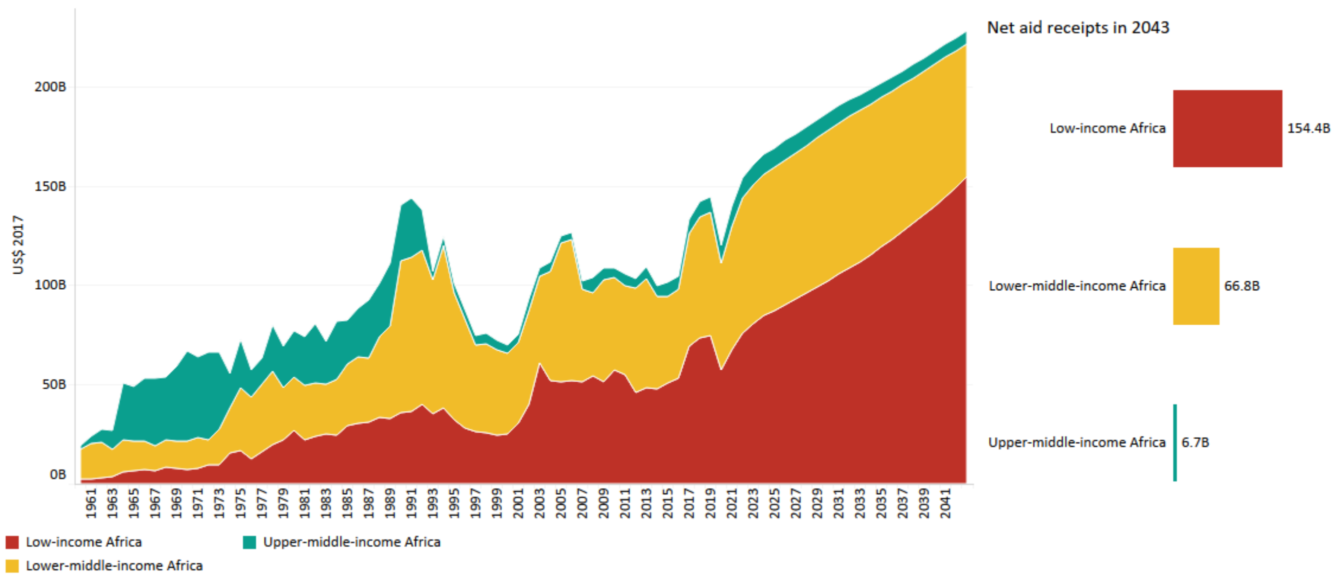
The absolute amount of aid flows to Africa would be significantly larger if developed countries met the 0.7% of gross national income (GNI) target for aid contributions as set out in the Sustainable Development Goal (SDG) ambition.[13] But that is unlikely: in fact, wealthy nations spent just 0.3% of their GNI on international aid in 2019, and only five countries—Luxembourg, Norway, Sweden, Denmark and the UK—met or exceeded the 0.7% target. In 2020, UK Prime Minister Boris Johnson indicated that his government would reduce aid levels to 0.5% as COVID-19 as Brexit hammered its economy.

Resources are also being shifted closer to home. In 2023, for example, 28% of the total UK aid budget was spent on hosting refugees and asylum seekers within its borders.

Slow growth globally is impacting on Africa. That, and the renewed great power competition between the West, China and Russia in Africa could, in time, modestly increase rather than decrease aid flows.

Chart 6 presents aid to Africa according to income grouping (as announced by the World Bank for 2021/22), including a forecast to 2043. It illustrates the extent to which aid is increasingly targeted at poorer, low- and lower-middle-income countries. It is important to acknowledge that several countries have graduated from the low-income category to lower middle-income status over the course of the period shown in the chart, resulting in an over-representation of aid to lower-middle-income- compared to low-income countries. While foreign aid remains the main source of external finance for low-income countries, the role of ODA is much smaller for low-middle- and upper-middle-income countries, which now receive more FDI and remittances.

Chart 6: Net aid receipts according to income grouping in Africa, 1960–2043



Source: IFs 7.84 initialising from WDI data

Contributions from the US

The US is the largest donor globally, providing almost a quarter of total aid. It is also Africa's largest bilateral donor.[14] In its financial year (FY) 2023 Department of State, Foreign Operations, and Related Programs (SFOPS) budget request, the administration proposed US$7.77 billion (current US$) in assistance for Africa, up from US$7.65 billion in FY2021 but significantly down from the US$10.7 billion provided for in 2018.[15]

Most of the aid (roughly 70%) from the US supports health programmes, particularly HIV/AIDS relief followed by efforts to combat malaria. US assistance has also sought to foster agricultural development and economic growth; strengthen peace and security; improve education access and social service delivery; and strengthen democracy, human rights and governance.[16] However, spending on aid as a portion of GNI amounts to only 0.17%, ranking the US as 24th among the OECD Development Assistance Committee donors, well below the United Nations target of 0.7% of GNI and providing significantly less aid on a per capita basis than the EU and its member states.[17]

In response to domestic and international affairs alike, the US's primary interests in Africa have changed and its future evolution is unclear. In 2004 President George W Bush authorised the creation of an agency eventually known as the Millennium Challenge Corporation (MCC) that rewarded low- and low-middle-income countries for practicising good governance, investing in their populations, and implementing sound economic policies. By 2024 the MCC has invested close to US$17 billion across 47 countries, many in Africa.

After 9/11, the US focus shifted to the war on terror, culminating in the disastrous Western interventions in Iraq and Libya, which destabilised the Middle East and North Africa and also spread terrorism into Africa. In addition, the shale energy revolution (see the theme on Leapfrogging) reduced the US's dependence on imported oil and hence its relationship with oil-producing countries such as Nigeria and Angola. As a result, US trade with Africa reduced sharply.

The US and other large donors continue to push for a larger role for the private sector, promoting the belief that Africa needs trade and investment, not aid. For example, after several years of inaction, the Better Utilisation of Investments

Leading to Development (BUILD) Act (passed in the US Senate in October 2018) supports private investment in Africa.[18] The US International Development Finance Corporation (US IDFC), which was subsequently established, can guarantee up to US$60 billion investment in Africa, focusing on small and medium-sized enterprises and supporting local companies.[19]

The BUILD Act was part of the 'Prosper Africa' initiative, aimed at supporting US investment across the continent.[20] Launched in December 2018, it was part of the Trump administration's counter to China's involvement in Africa and is meant to open markets for US businesses in Africa by leveraging mechanisms such as the President's Advisory Commission on Doing Business in Africa (PAC-DBIA).[21]

In 2019, USAID published its strategy on the 'Journey to Self-Reliance', which aimed to 'end the need' for foreign assistance in partner countries. Under the presidency of Donald Trump, the US strategy focused on countering China, but it did not provide a coherent view of the continent. Its transactional approach was also evident in the requirement for Sudan to recognise Israel in return for being removed from the US list of State Sponsors of Terrorism. In 2020, the Trump administration held progress on a free trade agreement with Kenya hostage to the same requirement while recognising Morocco's occupation of the Western Sahara in exchange for its recognition of Israel.

There have been important changes with the presidency of Joe Biden. Initially, policy development was overtaken by a series of crises, particularly the need to respond to COVID-19, the US withdrawal from Afghanistan, and, in 2022, the impact of Russia's invasion of Ukraine.

However, in contrast with the Trump administration, the Biden administration seeks to revitalise ties with Africa although it has maintained and sharpened the focus to counter both China and Russia's growing influence on the continent. In August 2022, it released its Strategy towards Sub-Saharan Africa[22] that sought to 'reframe Africa's importance to US national security interests.'[23] The strategy commits the US to the pursuit of (1) openness and open societies; (2) democracy and security; (3) pandemic recovery and economic opportunity; and (4) supports conservation, climate adaptation and a just energy transition. A flurry of official visits followed the US–Africa Leaders Summit in December 2022, where President Biden announced a U$55 billion commitment to the continent over the next three years, much of it coming from previously announced programmes and budgets, however.[24

Contributions from the EU

Europe remains connected with Africa through shared histories, languages and physical proximity, and its foreign and development policies are increasingly shaped by concerns around migration from Africa.

- Before Brexit, the various EU institutions provided about 13% of aid to Africa.
- Additional bilateral aid is also donated by individual countries such as Germany and France.
- At the end of 2020, before subsequent budget cuts, the UK provided about 7% of aid to Africa.[25]
- For the 2017 to 2020 External Investment Plan, the EU budgeted €32.5 billion in grants to Africa and, in its 2021 to 2027 budget, it made provision for €40 billion.
- The EU budgeted for a further €3.7 billion in grants for blending and guarantees.
- Note that these amounts exclude bilateral aid from individual EU member states.[26]

The EU has diligently nurtured a collaborative and consultative relationship with Africa. Whereas the US is cautious about engaging with regional organisations such as the African Union and Africa's various regional economic communities, the EU often sees them as its primary engagement point, reflecting its supranational economic and political architecture. After decades of European investment in building the capacity of the African Union as well as the legacy of colonialism, the relationships of aid and trade have created a network of friendship and collaboration that remains important for both parties although widespread anti-migrant sentiments across Europe are testing the strength of this relationship.

For example, without European assistance, the African Union's much-vaunted African Peace and Security Architecture (APSA) would not have been able to establish its three (out of an envisioned five) brigade-size capabilities for conflict prevention and management in Southern, West and East Africa.

The EU's intent to move beyond a donor–recipient relationship to achieve a more mature engagement was first captured in the Joint Africa–EU Strategy (JAES) of 2007, which was adopted by heads of state of the African Union and the EU at their second EU–Africa Summit in Lisbon.

In 2017, the EU launched its External Investment Plan, which includes a new guarantee mechanism that uses aid to be used to mobilise private capital flows through 'blended arrangements' and provides guarantees to mobilise additional resources for investment in Africa, generally aimed at addressing the socio-economic causes of migration.[27] Considerable attention is being given to efforts such as Aid for Trade and arrangements to mobilise additional financial support to the region through loans or equity.[28]

For its 2021–2027 Multiannual Financial Framework, the EU is merging several of its development instruments into a consolidated body, the Development and International Cooperation Instrument, which will receive €70.8 billion (US$83.6 billion). At least €26.0 billion (US$30.7 billion) will go to sub-Saharan Africa.[29]

The 2022 EU–AU Summit (Brussels, February 2022) subsequently approved partnerships in five key areas: green transition; digital transformation; sustainable growth and jobs; peace and governance; and migration and mobility.[30]

Although no longer a member of the EU, the UK has been an important partner to Africa, but its interest has waned in recent years following the decision by Prime Minister Boris Johnson, to dissolve the UK Department for International Development in the midst of the COVID-19 pandemic. There have been some efforts at reform, particularly the publication, in November 2023, of a new White Paper on International development in a contested world: ending extreme poverty and tackling climate change, but its effort appear half hearted amidst the ongoing program to repatriate illegal migrants from Africa to Rwanda.

Contributions from China

Sources differ widely in their calculations of the amount of Chinese money that qualifies as aid instead of loans. The China Africa Research Initiative at the Johns Hopkins University School of Advanced International Studies[31] estimates that China provided US$3.3 billion in aid globally in 2018, up from US$2.99 billion in 2015. The bigger portion of this amount likely went to Africa, but it is unclear how much of this would technically qualify as aid.[32] A more detailed estimate from the JICA Ogata Sadako Research Institute for Peace and Development estimates that China's foreign aid on a net disbursement basis increased from US$5.1 billion in 2015 to US$5.9 billion in 2018. Estimates for 2019 were the same as for 2018, with a decrease to US$5.4 billion in aid in 2020.[33]

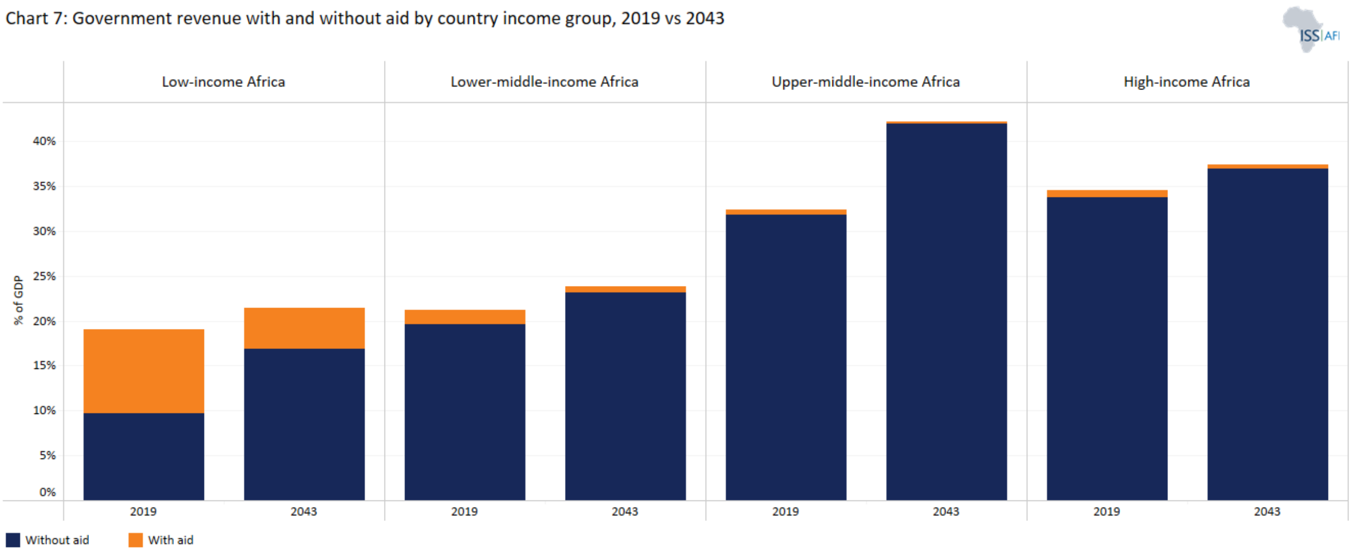
A recent dataset compiled by AidData elucidates China's overseas finance programme further. Although much of its lending and grant-making is shrouded in secrecy, China has established itself as a notable financier in many low- and middle-income countries. Finance is predominantly in the form of debt provided at commercial and non-concessional rates. In fact, since 2014, the Chinese ratio of loans to grants is at 31:1 and against significant collateral. Nearly 70% of

China's overseas lending is now directed to state-owned companies, state-owned banks, special purpose vehicles, joint ventures and private sector institutions in recipient countries rather than to central government institutions, giving rise to the notion of vast amounts of so-called 'hidden debt'. The data shows that, for the most part, these debts 'do not appear on their government balance sheets. However, most of them benefit from explicit or implicit forms of host government liability protection, which has blurred the distinction between private and public debt and created major public financial management challenges for developing countries.'[34]

The importance of aid to Africa

Chart 7 presents the average for government revenues as a percentage of GDP with and without aid in 2019 and 2043 for low-, lower-middle- and upper-middle-income countries in Africa. The largest difference is forecast to occur in low-income countries, where most aid goes to.

Chart 7: Government revenue with and without aid by country income group, 2019 vs 2043



Source: IFs 7.84 initialising from IMF data

Despite the criticisms often directed amongst some circles, aid in Africa remains essential for low-income, small and fragile countries on the continent. Cutting off aid could worsen the lives of millions of Africans, as aid accounts for a big chunk of the national budget in many poor countries. For example, without aid, total government revenues in Africa's 23 low-income countries would be 10% of GDP instead of 19%. The potential positive effect of aid is acknowledged in the SDGs, with SDG 17 calling on states to 'strengthen domestic resource mobilisation, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection.'[35] Aid, including humanitarian support, can alleviate the worst effects of war, hunger, poverty, poor governance and the lack of provision of services.

Aid cannot compensate for the lack of domestic revenue collection or poor policy, and bad governance. Hence, most aid can be considered palliative unless it can kickstart and sustain inclusive economic growth or serve a specific purpose contributing to that goal. That was the outcome of the Marshall Plan in Europe after the Second World War and the vast amounts of aid and technology transfer provided to countries such as South Korea and Japan. In these cases, recipient governments used aid as a force multiplier while working hard to regain financial independence. For instance, a large percentage of aid received by South Korea was used to bolster its manufacturing and transport sectors. Generally, that has not been the case in Africa.

Eventually, the combined impact of a range of policies could reduce the need for aid, including fair access to markets for African goods and encouraging foreign direct investment in infrastructure, agriculture, manufacturing, service and tech industries to stimulate inclusive sustained growth.

Leveraging foreign direct investment for Africa

Briefly

According to the World Bank, FDI is an investment made with the ultimate objective of possessing a lasting management interest (usually a minimum threshold of 10% of voting stock) in a firm operating in a country different from that of the investor.

The emerging conclusion from the recent FDI-growth literature is that attracting FDI is insufficient to generate economic growth and development. Domestic factors, generally discussed as the absorptive capacity of recipient countries, are often a determining factor in translating FDI inflows into growth and development. Generally, it seems that productivity spillovers of FDI can be materialised only in an environment that promotes quality education (human capital), sound and credible institutions, good infrastructure, and active local financial markets. Weaknesses in these areas undermine the ability of local firms to adopt advanced technologies and reduce their capacity to respond to the challenges associated with FDI inflows, such as intense competition, which can have a crowd-out effect on domestic investment.[36]

With appropriate domestic conditions and policies, Asian countries such as China, South Korea, Singapore, Malaysia and Taiwan were successful in orienting FDI into strategic sectors that were in line with their development objectives. For example, in South Korea, priority was given to export-oriented FDI with the most potential for generating jobs and foreign exchange. Some sectors were closed to FDI and in the sectors that were opened to FDI, joint ventures with domestically owned firms were encouraged to maximise technology and managerial skills transfer. Thus, in the mid-1980s for example, only 5% of transnational corporations' subsidiaries in South Korea were wholly under foreign ownership while it was 50% in Mexico and 60% in Brazil.[37]

Domestic conditions were improved to maximise technology spillovers and transnational corporations that were ready to transfer technology were selected against those that were not. Screening policies were used to ensure that FDI does not hurt domestic investments or firms. China also successfully uses FDI to stimulate domestic investments due to appropriate domestic policies. A study by Agosin and Mayer[38] reports that there is strong 'crowding in' of domestic investments by FDI in Asia, while 'crowding out' of domestic investments by FDI is the norm in Latin America and many African countries. The potential of FDI to unlock growth and development in Africa is, therefore, not straightforward—domestic conditions and policies matter.

In contrast to short-term financial flows such as international portfolio investments, which are generally motivated by profitable hit-and-run strategies or the real boom-and-bust cycles of economies, FDI is more stable, with several benefits for the recipient economies. It brings superior technology, new production processes, managerial know-how, etc. to domestic firms, thereby generating productivity gains.

The potential benefits from FDI are summarised in the Monterrey Consensus, agreed in 2002 at the United Nations International Conference on Financing for Development, as follows:

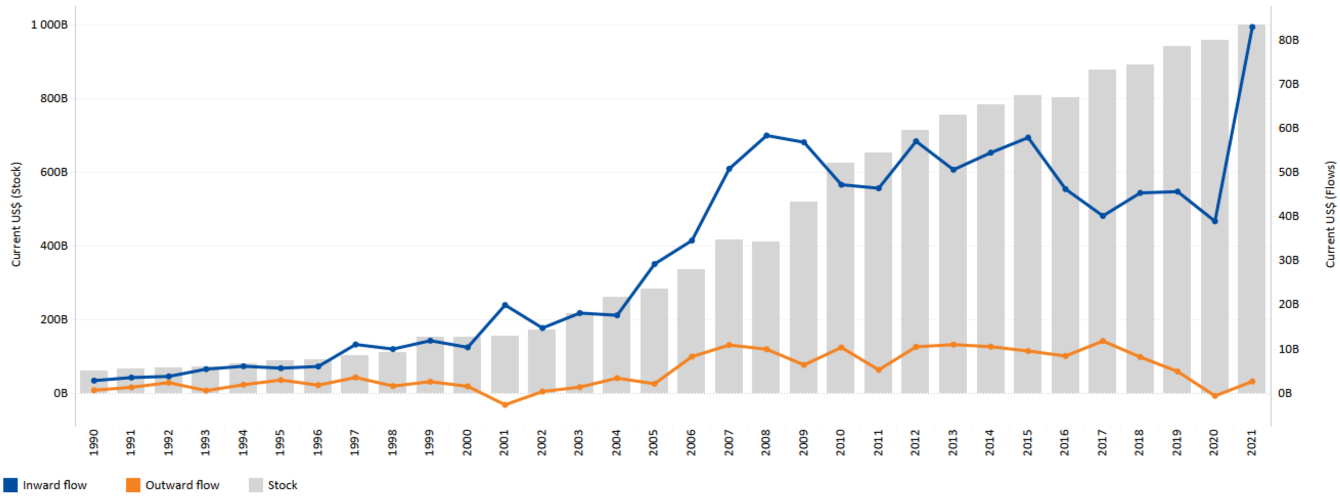
Foreign direct investment is especially important for its potential to transfer knowledge and technology, create jobs, boost overall productivity, enhance competitiveness and entrepreneurship, and ultimately eradicate poverty through economic growth and development.[39]

FDI can help recipient developing countries to enhance the development of more sophisticated industries, such as electronics (Costa Rica) and automotive manufacturing (South Africa and Morocco).

Historically, Africa has received less FDI than other developing regions such as South America and South Asia despite the high rate of return on investment it offers. For instance, from 2006 to 2011, the global average rate of return on FDI was 7%, 5.1% for developed economies, and 11.4% for Africa.[40] According to UNCTAD's World Investment Report 2022, FDI flows to Africa accounted for only 5.2% of global FDI in 2021, up from 4.1% in 2020,[41] with the continent's share of global FDI stock less than 3%.

Ayodele Odusola maintains that the explanation for this paradox can be found in poor infrastructure, low levels of human capital and low institutional capital, which serve as an effective tax on returns on investment.[42] Chart 8 shows the trends in FDI flows and stocks for Africa from 1990 to 2019. Most African countries received significant amounts of FDI only from the 1990s following the waves of liberalisation and privatisation brought about by the Washington Consensus.

Chart 8: FDI flows and stocks for Africa, 1990-2021



Source: UNCTAD online data

In 2021, annual FDI inflows amounted to US$82.9 billion (3.2% of GDP)—a significant jump after dropping to US$38.9 billion in 2020 due to the effects of the COVID-19 pandemic. The pandemic reduced FDI flows to Africa by about 15% in 2020, compared to its pre-pandemic level in 2019. As shown in Chart 8, Africa recorded a rapid increase in investment inflows during the global commodities boom, which reached a peak of US$58.4 billion (3.3% of GDP) in 2008 at the start of the global financial crisis. Unlike FDI flows, which might be marked by strong year-to-year volatility, FDI stocks reflect the long-term trends of FDI attractiveness in the considered economy, providing evidence of stable links with foreign investors. According to UNCTAD,[43] in 2021, Africa had an FDI stock of about US$1 trillion, equivalent to 38.7% of GDP, up from US$942 billion in 2019 (37.6% of GDP) compared to less than US$60 billion in 1990.

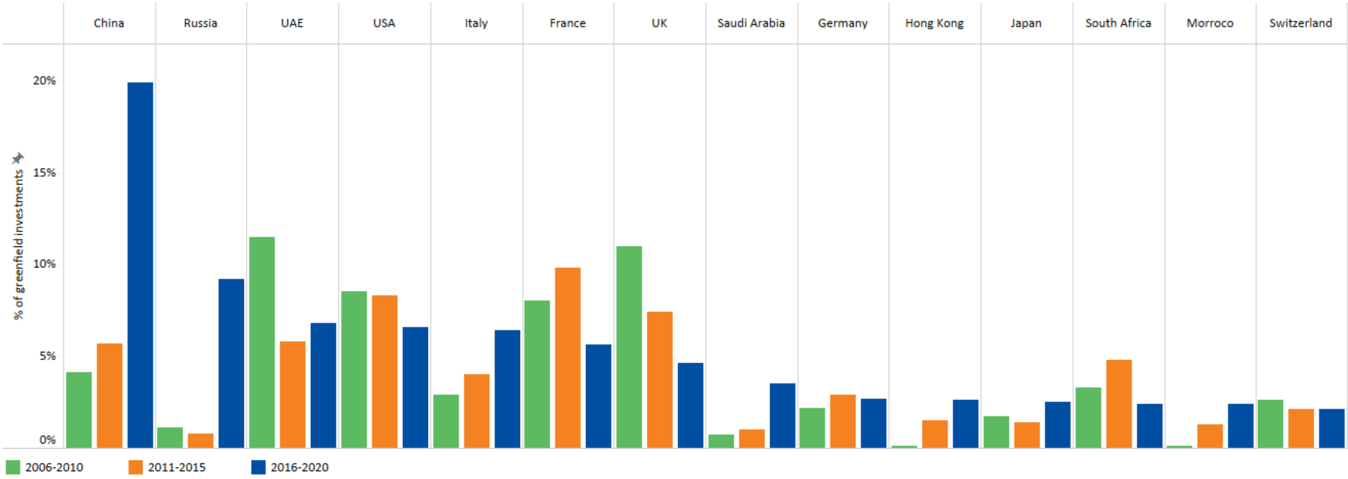
When FDI consists of the establishment or construction of a new firm, it is called greenfield investment, which is different to mergers and acquisitions (brownfield investments) that consist of the acquisition of an existing company in a foreign country. Greenfield FDI is particularly important for African countries where unemployment is rampant because it generates additional production capacity, promotes job creation, and increases the level of capital accumulation in the host country while the recipient economy also benefits from the associated knowledge transfer.

As shown in Chart 9, China has become a leading source of greenfield FDI in Africa, investing more than US$71 billion from

2016 to 2020, and accounting for about 20% of total greenfield FDI on the continent over the same period.[44] From 2016 to 2020, US greenfield FDI amounted to US$23 billion, which was 6.6% of total greenfield FDI in Africa. Russian greenfield investment was also high from 2016 to 2020 due to a one-time announced US$30 billion investment in 2017 for nuclear power generation in Egypt.

Chart 9: Trends in China's share (%) in total greenfield FDI in Africa, 2006-2020

*Grouping of rest of investors under 'Other' has been excluded



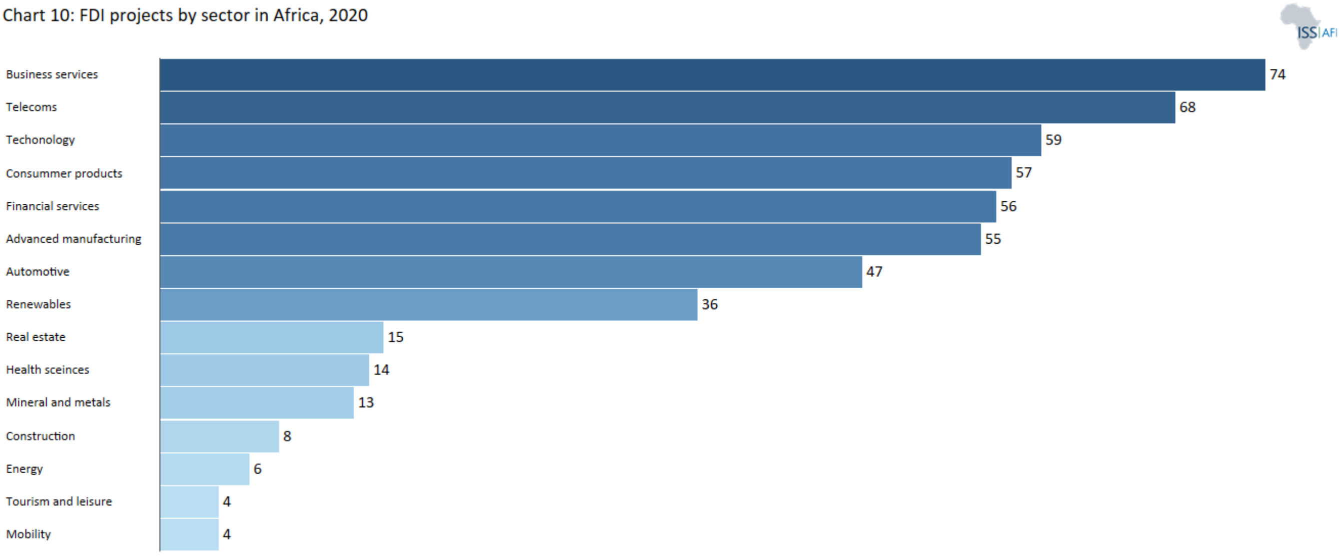
Source: Authors elaboration using data from Morgan et al.(2022). Foreign Direct investment in Africa. Recent Trends leading up to the AfCFTA. https://www.ers.usda.gov/webdocs/publications/104996/eib-242.pdf?v=333

The IFs Current Path forecast suggests that FDI stocks in Africa will likely reach 42.3% of GDP by 2043. The full implementation of the African Continental Free Trade Area (AfCFTA) agreement will attract FDI as a larger market can increase profit margins for external investors. By establishing a subsidiary on the continent rather than exporting from outside Africa, the unified African market can be accessed more easily and at lower costs.

Historically, a large share of FDI flows to Africa has been directed at the extractive sectors (known as resources-seeking FDI). For example, in June 2019, US energy firm Anadarko Petroleum Corporation[45] agreed to the construction of a US$20 billion gas liquefaction and export terminal in Mozambique—the single largest liquid natural gas project in Africa and an amount equivalent to almost half of total FDI to Africa in 2018. By the end of 2019, total investments in Mozambique for the next decade were estimated at US$128 billion—more than the entire amount of aid and FDI to all of Africa in 2018.[46] But an Islamic insurgency in the Cabo Delgado province that started the previous year brought the investments to a shuddering halt in April 2021. After first opting to use mercenary companies to respond to the threat, the government of Mozambique eventually turned to Rwanda and the Southern African Development Community to provide military support.[47] Work on the project is scheduled to resume in July 2023.

FDI in Africa is now diversifying into sectors such as manufacturing, technology and services, which is very promising in terms of technology transfer, sustainable growth and job creation in Africa (see Chart 10).

Chart 10: FDI projects by sector in Africa, 2020

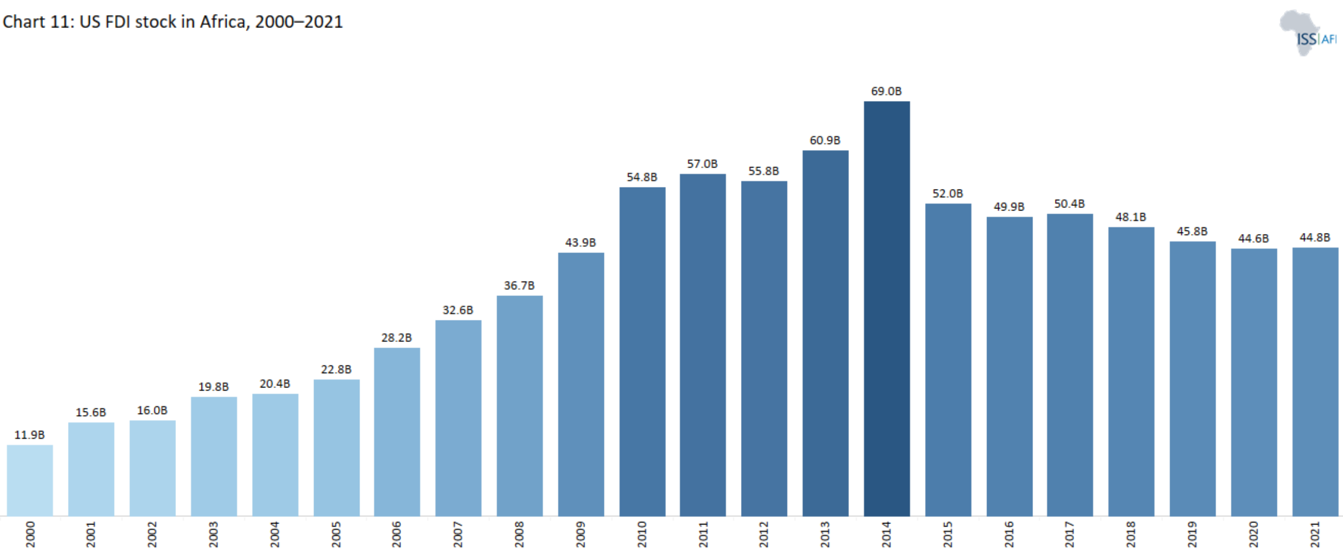


Source: Authors elaboration using data from Ernst & Young (2021). Africa Attractiveness Report 2021

Trends in US FDI to Africa

In addition to the US being the largest aid donor to Africa, it also leads in the stock of FDI it has built up in Africa, although it has declined since 2014 (Chart 11). However, FDI to Africa only breached 1% of the total US FDI between 2010 and 2014, pointing to the huge potential. At the end of 2017, the Trump administration introduced tax reforms that allowed the large-scale repatriation of accumulated foreign earnings by US multinationals. Companies rushed to shift monies back to the US, with the effect that US FDI stock in Africa amounted to only US$48.1 billion in 2018—significantly below the 2014 peak of US$69 billion. As a result of this and other changes such as declining requirements for fossil fuels, US FDI stock in Africa stood at US$44.8 billion in 2021—still below the peak in 2014.

Chart 11: US FDI stock in Africa, 2000–2021



Source: US Bureau of Economic Analysis

The composition of US investments in Africa has changed over time. While the share of mining FDI accounted for more than 50% from 2000 to 2014, it declined to 32% in 2020 and manufacturing FDI in the food sector rose from less than 3% in 2014 to more than 9% in 2020.[48]

The large stock of FDI in Africa from the US is followed by the UK and France. Europe is by far Africa's most important investor, accounting for 40% of FDI stocks, followed by the US at 7% and China at 5%.[49] Intra-Africa investment is also gaining momentum: the value of FDI stocks originating from other African countries increased significantly from an average of US$18 billion from 2004 to 2008 to US$80 billion over the period 2014 to 2018.[50] South Africa, Morocco, Kenya, Nigeria and Mauritius have become important sources of FDI to the rest of Africa. However, observers argue that investment funds from Mauritius may be channelled from third parties due to the country's favourable taxation policies.[51]

Although stocks tell one story, flows are changing. China pumped more than US$72 billion worth of FDI into Africa between 2014 and 2018, followed by France (US$34.17 billion), the US (US$30.85 billion), the United Arab Emirates (US$25.27 billion) and the UK (US$17.68 billion). Coming off a low base, the flow of FDI from China to Africa steadily increases its stock of FDI in Africa, although the most recent trend is sharly downward. Chinese FDI flows to Africa have exceeded those from the US since 2013.

China's growing footprint in Africa

Briefly

The victory of the Chinese Communist Party over the Western-backed Kuomintang (Nationalist Party) in 1949 meant that China's foreign policy was inevitably shaped by its efforts to deter and eject French colonial and US military forces from Asia and to oppose and weaken its opponents where possible. This has also been felt in Africa, from as early as 1964.[52]

In addition to the political and military support that China provided to various liberation parties in Africa during their struggles for independence, its best known early infrastructure project is probably the TAZARA railway line, built to reduce landlocked Zambia's economic dependence on export infrastructure linkages through Rhodesia (now Zimbabwe) and South Africa. The single-track line of approximately 1 860 km connected Zambia to the port of Dar es Salaam in Tanzania and was completed in 1975 at a cost of about US$406 million (US$2.67 billion today)—provided as an interest-free loan to Zambia and Tanzania.[53] The expenditures of TAZARA and other solidarity projects placed a huge burden on the Chinese economy, with foreign aid amounting to 5.9% of total government spending from 1971 to 1975, peaking at 6.9% in 1973.[54]

Subsequent years saw China transform from a poverty-stricken developing country to a global power, today challenging the influence and dominance of the US. Reform of the institutions involved in FDI and aid followed. The process commenced in 1994, with China reforming the institutions tasked with administering its outward investment and aid by establishing two new policy banks, the Export–Import Bank of China and the China Development Bank, which provide most of China's overseas development loans. Some years later, in 2018, China established the China International Development Cooperation Agency (CIDCA) to coordinate aid and, early in 2021, published a White Paper on development cooperation that sets out its belief in support of endogenous growth. However, unlike most Western countries, Chinese development assistance is managed by several different government departments, with the bulk handled by the Ministry of Commerce.[55]

Since 1995, China has run a year-on-year positive trade balance that from 2004 to 2009 increased tenfold. Between 2008 and 2019, the Export–Import Bank of China and the China Development Bank lent US$462 billion, just short of the

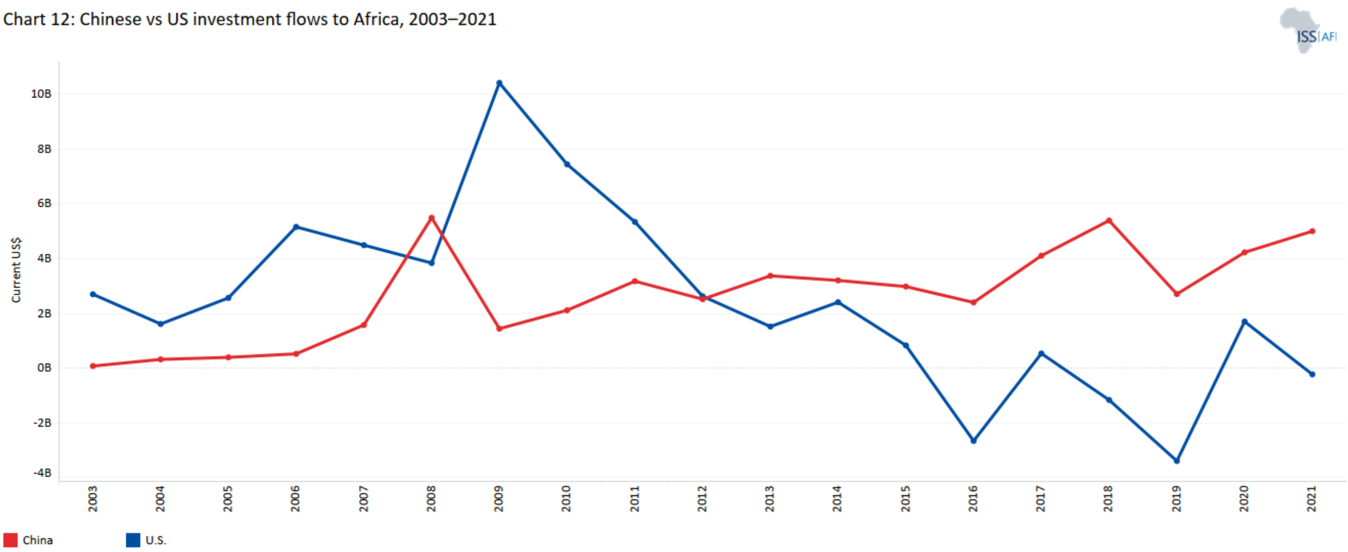
US$467 billion extended by the World Bank, according to data from Boston University, although only a modest portion of this went to Africa.[56]

Data on the extent of FDI and aid from China is opaque (not unlike those of Western institutions in the case of the former category), though there are signs of recent improvement in the quality of data. China is not a member of the Paris Club (an informal group of creditor nations) or the OECD, which collects data on lending by official creditors. For example, half of China's loans to developing countries are apparently unreported.[57] Recent research shows that the Chinese state and its subsidiaries have provided about US$1.5 trillion in loans and trade credits to 150 countries, making China the world's largest official creditor.[58] Africa is the third largest destination for Chinese investment after Asia and Europe although recent trends are sharply downward. From 2005 to mid-2022, the combined value of China's global investment and construction exceeded US$2.25 trillion, with US$311.9 billion in sub-Saharan Africa.[59] However, its lending practices and collaboration with these institutions have steadily intensified.

The partnership between China and Africa has progressively deepened since the establishment of the Forum on China–Africa Cooperation in 2000. Today, the forum serves as a vehicle for strategic collaboration in trade, investment and finance, as well as being a basis for diplomatic and political collaboration. With the ongoing privatisation of the Chinese economy, the number of Chinese firms active on the continent increases yearly. In 2017, McKinsey estimated that more than 10 000 privately owned small Chinese companies operate in Africa indicating that Chinese investment in Africa is more market-driven than commonly understood. The official data from China's Ministry of Commerce is about a third of that.[60]

Chart 12 presents the divergent trends in investment flows to Africa from China and the US. Chinese FDI flows to Africa have exceeded those from the US since 2013, as US FDI flows have generally declined since 2010.

Chart 12: Chinese vs US investment flows to Africa, 2003–2021



Source: China Africa Research Initiative data, School of Advanced International Studies, John Hopkins School of Advanced International Studies

China's demand for commodities, its positive balance of payments and ability to extend credit, and its coordinated effort to export its surplus construction capacity (which eventually culminated in the Belt and Road Initiative) have benefited Africa greatly, despite the continent not originally being included in the scheme:

- China has since become the biggest single-country financer and builder of infrastructure projects in Africa, having spent about US$11.5 billion per year from 2012 to 2018.[61] The country, therefore, fulfilled an important role in helping to close Africa's gap in infrastructure, which the African Development Bank estimates at between US$130 billion and US$170 billion annually.[62] Recent indications are that investments are shifting from physical infrastructure to smaller, more profitable projects with private financing, such as toll roads. That is in contrast to its previous investment in large, fully state-financed infrastructure projects, which in some cases have contributed significantly to African countries' national debt. China's current lending level to African countries has also declined sharply, now only at 10% of its 2016 peak.

- Chinese firms have also contributed to establishing complete industrial chains in some African countries. To this end, 'China has created 25 economic and trade cooperation zones in 16 African countries. The zones, registered with China's Ministry of Commerce, had attracted 623 businesses with a total investment of $7.35bn at the end of 2020'.[63]

- In 2020, the Chinese ambassador to South Africa estimated the stock of Chinese FDI in Africa at US$110 billion (much larger than most other estimates).

- According to the China–Africa Business Council,[64] the total investment flows to Africa peaked at US$53.9 billion in 2018 and stood at US$29.6 billion in 2020.

Chinese lending to Africa

Accessing data from the Chinese Loans to Africa database, Jason Mitchell[65] writes that Chinese financiers signed 1 188 loan commitments valued at US$160 billion with African governments and their state-owned enterprises between 2000 and 2020, predominately in transportation, power generation, mining and telecommunications. The top loan recipient countries over that 20-year period were Angola, Cameroon, Ethiopia, Kenya, Nigeria and Zambia. The largest recent recipients included Ghana, South Africa and Côte d'Ivoire. The biggest African debtors to China include Angola (which owes $42.6 billion), Ethiopia ($13.7 billion), Zambia ($9.8 billion) and Kenya ($9.2 billion), all of whom are now in debt distress.

Since COVID-19 there are clear signs that the pace of Chinese loans to Africa has declined sharply, largely due to the restructuring of the Chinese economy, slower growth, its reduced demand for some commodities and concerns about the ability of many African countries to service their obligations. China has worked hard to secure access to strategic resources such as cobalt, lithium and rare earths that is needed for the production of batteries and computer chips and its investments are now smaller and careful under the slogan "small is beautiful". According to the China Africa Research Initiative at Johns Hopkins University, Chinese lending to Africa slowed from about US$9 billion in 2018 to less than US$5 billion in 2021.[66] By 2020, China accounted for 12% of Africa's US$696 billion of external debt, with 22 African countries heading towards debt distress.[67]

Chinese overseas lending differs from capital outflows from the US and Europe in three important respects:

- The majority comes from the government and various state-owned entities.

- Its lending generally occurs at market rates and the conditions are opaque. In contrast, the World Bank typically lends to Africa at concessional (i.e. below-market interest) rates and provides longer maturities.

- Chinese loans are often backed by collateral and barter-trade type of arrangements, meaning that debt repayments are secured by revenues, such as those coming from commodity exports and by providing in-kind services of Chinese companies instead of payment.[68]

Chinese flexibility in accepting unconventional collateral, airports, harbours and mines as security has raised alarm bells in conservative circles in the US, who see this as a ploy through which China can lay its hands on strategic infrastructure with potential security implications. But this is seldom a concern in Africa and not borne out by deeper analysis. However, there have been some cases in which African governments have entered into expensive prestige projects (such as the airport in Lusaka) and overpriced projects (such as the 472 km Mombasa–Nairobi standard gauge line), with subsequent negative consequences.

A concern that has often been repeated in mainstream media is that many of the large Chinese construction (and other) projects provide little work for locals. That may have been the situation several years ago, but field research in Ethiopia and Angola indicates that: national labour participation is substantially higher than generally assumed in Western media; wages in Chinese firms abroad are largely similar to other firms in the same sector; and Chinese firms contribute as much to training and skills development as other companies in the same sector.[69] It is estimated that every US$1 billion investment in infrastructure made by Chinese firms has created roughly 110 000 jobs in Egypt, Morocco and Tunisia.[70]

Then there is the issue of the quality of infrastructure, and the extent to which China is 'exporting corruption' in the manner in which it uses development assistance to buy influence (and contracts) from African leaders. The obvious challenge here, compared to the situation in the US and Europe, is that Chinese public-sector companies and financial institutions cannot be held to account domestically in China through shareholder activism or public disclosure.

These concerns are accentuated by Chinese contracts typically containing stringent confidentiality clauses that bar borrowers from revealing the terms or even the existence of the debt. The cancellation, acceleration and stabilisation clauses potentially allow China to influence the debtors' domestic and foreign policies, including commentary from government officials and in government-controlled media, particularly concerning mentions or dealings with Taiwan and Tibet and human rights issues such as voting in the Human Rights Committee in Geneva.[71]

Large Chinese loans do not come with a requirement to discuss matters around the rule of law, good governance or human rights, as expected by the IMF and the World Bank. China does not share the views and approaches of the West in terms of rule of law and transparency, or of competitive tendering as an antidote to corruption and what has generally become known as 'standards of good governance'. It, therefore, has no qualms about offering inducements to ensure favourable consideration of contracts.[72] As one example, the decision by Uganda's President Yoweri Museveni to intervene in a bidding process for a contract to surface the highway linking Kampala to Jinja in favour of his preferred Chinese contractor, therefore, came as no surprise.[73]

A study of 100 debt contracts with foreign governments thus finds that China uses 'creative design to manage credit risks and overcome enforcement hurdles, presenting China as a muscular and commercially savvy lender to the developing world.'[74]

Today, Africa's dependence on China is such that its future prospects are closely tied to that country's prospects. If China stumbles, it will have a massive impact on Africa. This dependence on China makes many African governments essentially powerless when it comes to issues such as responding to Chinese involvement in illegal mining and fishing in Africa. For example, the Ghanaian government has been the subject of much criticism by the population and opposition leaders for its inability to end illegal Chinese gold mining in the country or the extent to which it is exploiting Ghana's fish resources.[75]

Remittances to Africa

Whereas aid is typically a transfer of public and private philanthropic money between countries, remittance consists of private money or goods that migrants send to families and friends in their countries of origin. Most aid and FDI go to government coffers and are often directed at large expenditure items. Over 50% of remittance is sent to households in rural areas, where 75% of the world's poor and food-insecure people live. Rural households rely on these flows for improving their livelihoods while also increasing their resilience. Globally, the accumulated remittance flows to rural areas are expected to reach US$3 trillion by 2027.[76]

Unlike aid and FDI, remittance flows do not directly affect government revenues as they generally consist of money sent home by migrants and serve to support the livelihoods of families in recipient countries. However, it may indirectly affect government revenue through value-added taxes (VAT) as remittances are spent mostly on household consumption and housing investment. About 75% of remittances are used to put food on the table and cover medical expenses, school fees or housing expenses, most of it going to rural areas.[77]

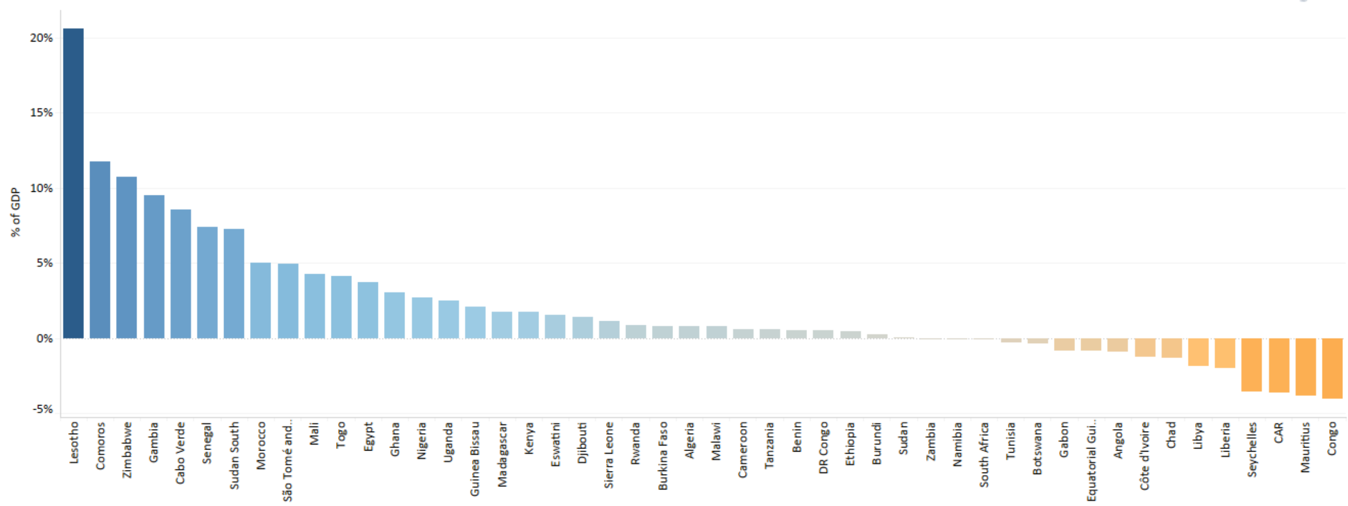
In times of crisis, migrant workers may send more money home to cover crop losses or for family emergencies. According to the International Fund for Agricultural Development (IFAD), more than 70 countries rely on remittance for at least 4% of their GDP. Within IFs, 15 African countries, including Nigeria, get remittance inflows equivalent to 3% or more of GDP.

Capturing data on remittance flows is challenging,[78] as they mostly occur through informal channels via diaspora networks and are driven by the size of the migrant population, for which data is often also unreliable. According to the United Nations,[79] the size of the African diaspora worldwide is around 150 million people, with the majority residing in the Americas (North, Central, and South America and the Caribbean). Other significant diaspora populations are in Europe and Asia. However, while this large group is historically from Africa, the size of the community responsible for remittances is much smaller, coming from recent migrants. According to the World Migration Report 2022,[80] in 2020 around 21 million Africans were living in another African country—a significant increase from around 18 million in 2015. The number of Africans living in different regions outside the continent also grew during the same period, from around 17 million in 2015 to over 19.5 million in 2020. In 2020, most African-born migrants living outside the region were residing in Europe (11 million), Asia (nearly 5 million) and Northern America (around 3 million).

According to the World Bank, the amount of remittance sent to Africa from the diaspora was US$84 billion in 2020. This represents a decrease of about 2.6% from the previous year, likely due to the economic impact of the COVID-19 pandemic. The top countries receiving remittance in Africa include Nigeria, Egypt, Ghana and Kenya. Nigeria accounts for about 40% of remittance flows to sub-Saharan Africa.

Viewed as a percentage of GDP (Chart 13), the leading remittance recipient countries—all around 10% of GDP—are Lesotho, Comoros, Zimbabwe, The Gambia and Cabo Verde. Countries such as South Africa, Tunisia, Botswana, Gabon, Equatorial Guinea, Côte d'Ivoire, Libya, Seychelles and Mauritius are net remittance senders. Most of these countries are home to a significant number of African migrants. Due to its comparatively strong economy, Côte d'Ivoire, for instance, is home to many immigrants from neighbouring countries such as Burkina Faso, Mali and Guinea.

Chart 13: Net remittances received in 2019, as a % of GDP



Source: World Development Indicators data

Countries with large diaspora populations (such as Nigeria and Ethiopia) can tap into the funds within that community to invest locally by benefiting from a patriotic dividend but then need to maintain a strong and positive relationship with the diaspora community. Israel is often held as the global success story in this regard, having raised US$46 billion since 1951.

India has raised more than US$11.3 billion through diaspora bonds, mostly for infrastructure projects, which also helped the country avert a balance of payments crisis in 1998 following sanctions after it ran a series of surprise nuclear tests.[81] Ethiopia crossed an important hurdle when, in 2011, it floated a diaspora bond to help fund the Grand Ethiopian Renaissance Dam.[82] The Kenyan diaspora sent an estimated US$3 billion in remittances back home in 2019 and, in 2020, Kenya followed up on its successful 2009 diaspora bond by introducing a licensed investment fund for citizens living overseas to invest in development projects. Nigeria issued its first successful bond in 2017.[83]

Remittances can have important political economy side effects. Large inflows allow governments to be less responsive to the needs of society. The reasoning is that families that receive remittances are better insulated from economic shocks and are less motivated to demand change from their governments; the government in turn feels less obligated to be accountable to its citizens.[84]

In addition to their contribution to poverty reduction and human development, remittances tend to be less volatile to economic downturns than FDI and portfolio investment. Hence, they may help reduce foreign exchange reserve shortages in some African countries. Remittance is a critical economic stabiliser and should thus be encouraged and facilitated. Remittance flows benefit from new technologies, which have lowered the costs of sending small amounts of money privately from one country to another, but the concerns about money flows to groups and individuals associated with terrorists have created numerous obstacles for Africans to send money home. It still costs more to remit money to sub-Saharan Africa than any other region globally, and moving money legally between neighbouring African countries is even more expensive.[85]

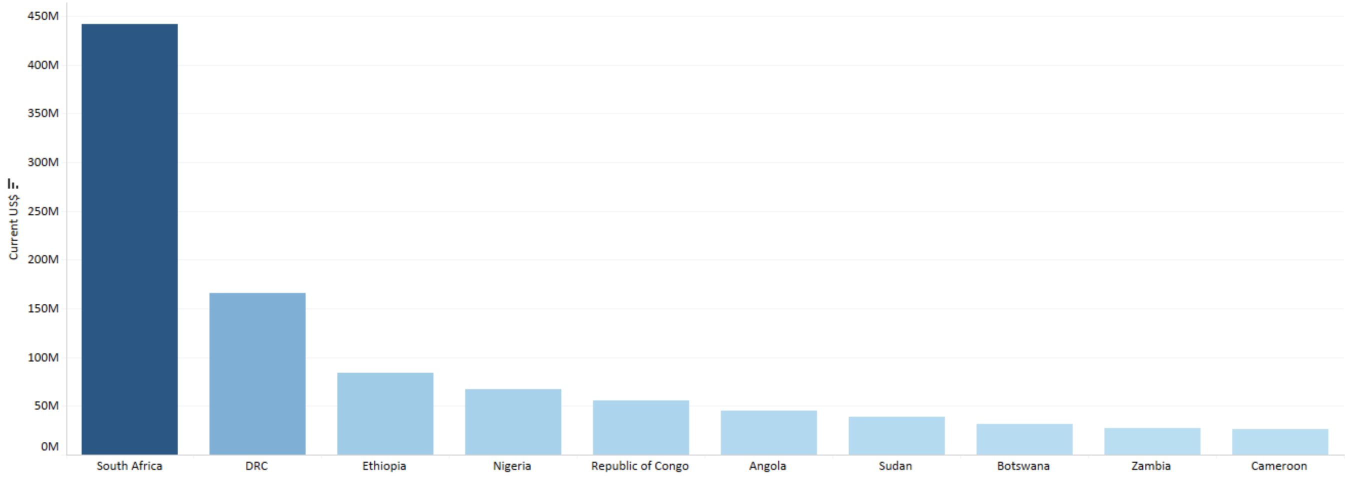
Illicit financial flows

There are several definitions of which specific forms of capital movement constitute illicit financial flows. For instance, Global Financial Integrity defines illicit financial flows as 'the illegal movement of money or capital from one country to another.' This definition of illicit financial flows covers activities including hiding the proceeds of crime, channelling funds to criminal destinations, and evading tariffs and taxes through misreporting of transactions. Other definitions generally focus on actions that are not strictly illegal but are undesirable because they result in reduced tax revenues, including tax avoidance actions such as strategic transfer pricing.[86]

The 2015 Report of the High Level Panel on Illicit Financial Flows from Africa estimated that 65% of illicit flows from the continent originate from commercial activities of multinational companies through transfer mispricing, trade misinvoicing, misinvoicing of services and intangibles, tax treaty shopping and unequal contracts. The remaining 35% is linked to criminals and funds stolen by government officials.[87] Using the Global Financial Integrity methodology, a recent estimate by the Brookings Institute is that US$1.3 trillion left sub-Saharan Africa in the form of illicit money flows between 1980 and 2018.[88] The outflows are concentrated in a few countries (South Africa, DR Congo, Ethiopia and Nigeria) and in a few sectors, notably the extractive and mining industries (oil in particular), which present lucrative opportunities for misinvoicing. Chart 14 shows the top 10 emitters of illicit financial flows from Africa.

According to the 2020 UNCTAD Africa Report, an estimated US$88.6 billion leaves the continent as illicit capital flight every year, equivalent to 3.7% of Africa's GDP, and nearly as much as the combined annual inflows of aid and FDI.[89] The bulk of the money goes to China and the US. In the case of China, the increase in illicit financial flows has followed rapid increases in trade between most African countries and China. In response, Chinese President Xi Jinping launched an anti-corruption campaign in 2012, which appears to have contributed to a decline in illegal outflows from the peak in 2014.[90]

Chart 14: Top 10 African emitters of illicit flows, average (1980-2018)



Source: Authors elaboration using data from Signé et al.(2020)

In the case of the US, the problem is its status as a 'secrecy jurisdiction', which facilitates private offshore tax evasion. The US Foreign Account Tax Compliance Act requires foreign financial institutions and signatory governments to disclose information about US citizens' assets in their jurisdiction to the US government. But the US government is not providing reciprocal information to the 113 participating governments on the assets that are held in the US and has resisted joining the OECD Common Reporting Standard for the automatic exchange of information on foreigners' financial accounts with their home country governments. It is not surprising that, in 2020, the US ranked second only to the Cayman Islands on the Tax Justice Network's Financial Secrecy Index, surpassing Switzerland, Hong Kong and Singapore.[91]

Illegal capital flows from Africa pose a central challenge to development as they remove domestic resources which could have been crucial for the continent's economic development. A study[92] by Janvier D. Nkurunziza reports that illicit financial outflows have a strong and negative effect on investment rates, notably private investment. Studies have found several drivers of illicit financial outflows such as higher taxes and higher inflation, suggesting that firms seek out relatively more stable or favourable fiscal environments for their funds. Goal 16 of the SDGs specifically includes a target to reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organised crime by 2030.

For example, African countries are estimated to lose about US$450 million to US$730 million in corporate income tax revenue every year from multinational mining enterprise tax avoidance,[93] with total tax losses, not just from mining, being estimated at US$17 118 million.[94]

Although several important agreements already underpin efforts to curb tax losses,[95] more is required. Support from the Biden administration for a global minimum tax on large multinational companies, based on sales regardless of the physical presence in a country, was an important step in this regard. Eventually, in October 2021, the G20 formally endorsed a global deal to impose a minimum corporate tax rate of 15% for companies with annual revenue over €750 million (US$865 million). It requires those with an annual turnover of €20 billion (US$23 billion) and profit margins above 10% to pay taxes in countries where they sell their products or services.[96] To date, the tax deal is lacking in implementation, however, as it is being blocked by Hungary in the EU and by the Congress in the US. Meanwhile, the amount of money lost to tax havens keeps growing. A recent WIDER Working Paper indicates that corporations shifted nearly US$1 trillion in profits earned outside of their home countries to tax havens in 2019, up from US$616 billion in 2015.[97] A more stable and equitable international tax system will contribute to national digital taxes and constrain tax avoidance and profit shifting.

In response, the African Development Bank and the Coalition for Dialogue on Africa has initiated a US$5.9 million project (the African Financial Integrity and Accountability Support Project) to stem illicit financial flows from Africa.[98] The project, launched in March 2023, aims to improve regional coordination of combating illicit financial flows from Africa. This will reduce illicit financial flows and improve domestic revenue mobilisation in African countries.

The Financial Flows scenario

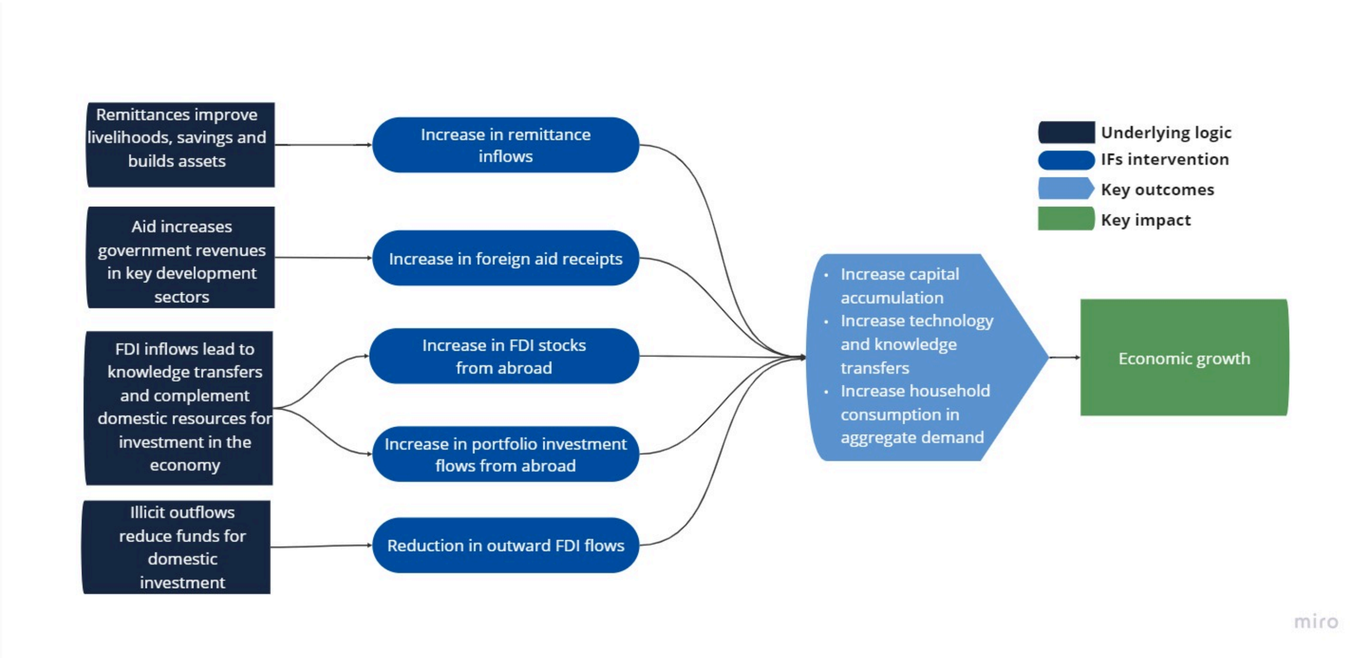
Briefly

The impact of external financial flows on recipient countries has been a subject of extensive debate in the literature. Proponents of capital inflows assert that they promote economic growth, especially in developing countries, because they complement domestic resources, supplement domestic savings, close the foreign exchange gap and guarantee modern technology and the availability of managerial skills. Others argue that foreign capital inflows, aid in particular, are detrimental to economic growth because they often become a substitute rather than a complement to domestic resources and because it is generally consumption oriented rather than investment oriented. Furthermore, foreign inflows support the importation of inappropriate technology, alter domestic income distribution and embolden a bigger, inefficient and corrupt government in developing countries.[99]

In this section, we model the impact of a Financial Flows scenario on Africa's long-term development trajectory using the IFs modelling platform. It includes ambitious but reasonable increases in aid, FDI and remittances, and illicit financial flows from Africa. IFs does not model illicit financial flows as there is no global dataset or substantive methodology to estimate its extent, although UNCTAD and the UN Office on Drugs and Crime (UNODC) recently finalised a conceptual framework to measure illicit financial flows that will eventually contribute to producing global data estimates.[100] For the purpose of this scenario, we reduce outward FDI as a proxy for illicit financial flows. In 2019, outward FDI flows from Africa amounted to US$4.9 billion, with outflows from Libya being the largest (US$1.7 billion).[101]

The logic underpinning our Financial Flows scenario is presented in Chart 15.

Chart 15: Financial Flows scenario



Impact of the Financial Flows scenario

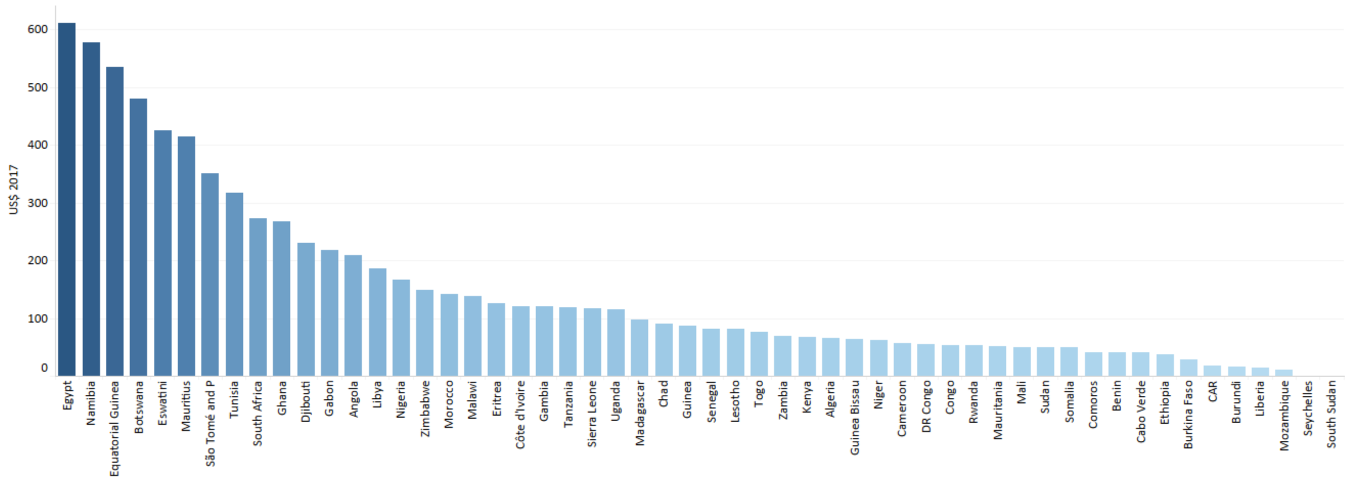
In 2019, FDI inflow in Africa was equivalent to 1.7% of GDP and is set to increase to 3.8% of GDP by 2043 in the Current Path forecast. In the Financial Flows scenario, inward FDI is forecast to increase to 4.9% of GDP—1.2 percentage points larger than the Current Path forecast. The result is that the stock of FDI is projected to be about US$4.3 trillion in 2043 compared to the Current Path forecast of US$3.3 trillion in the same year. The increase is large, yet Africa would still only have 4.9% of the global stock of FDI by 2043. An increase of such magnitude would, however, require more stability in Africa, improvement in the business environment, and likely the full implementation of the AfCFTA.

The Financial Flows scenario sees Africa receiving about US$8.7 billion more aid in 2030 than in the Current Path forecast. Instead of US$85.7 billion aid in 2030 in the Current Path, the final year of the SDGs, Africa is estimated to get US$94.5 billion in the Financial Flows scenario in the same year. Most of the additional funds would go to low-income countries, with Malawi, Ethiopia, Mozambique, the DR Congo and Somalia receiving the largest additional share. Remittances will increase to US$88.9 billion by 2043 in the Financial Flows scenario, compared to US$66.8 billion in the Current Path forecast.

Increased capital inflows into Africa will stimulate economic growth such that the size of the total African economy will be US$110.3 billion larger in 2033 than it would have been otherwise and US$371 billion larger in 2043. Large economies, such as Nigeria, Egypt and South Africa, benefit the most.

The average GDP per capita for Africa increases by approximately US$86 in 2033 and US$215 in 2043 compared to the Current Path forecast. This is a notable increase as the continent's total population will, by 2043, exceed 2.2 billion people. The improvement in GDP per capita for each African country is presented in Chart 16, with many upper-middle- and lower-middle-income countries doing particularly well in the Financial Flows scenario. This might be explained by their relatively better economic and institutional frameworks compared to low-income countries.

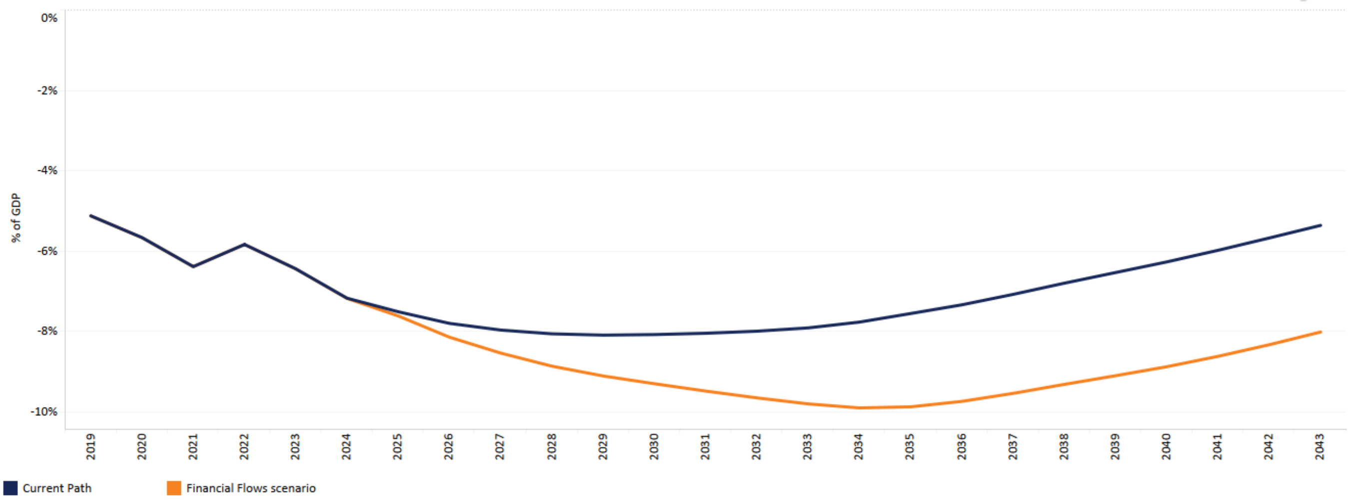
Chart 16: Increase in GDP per capita in the Financial Flows scenario relative to the Current Path in 2043



Source: IFs 7.84 initialising from IMF data

A large inflow of capital may appreciate the real exchange rate, which partially offsets the growth gains by reducing the aggregate demand through its effect on net exports (see Chart 17). A study by Combes et al[102] finds that in developing countries, a 1% increase in total financial flows appreciates the real exchange rate by 0.5%. Chart 17 shows the trends in net export (per cent of GDP) in the Current Path forecast and the Financial Flows scenario. The net export in the scenario remains below the Current Path over the forecast horizon. By 2043, the net export is estimated to be -8% of GDP (trade deficit) in the scenario compared to 5.4% on the Current Path in the same year. In addition to the real exchange rate appreciation, higher economic growth can also deteriorate the trade balance as it increases consumer spending resulting in more purchases of imports.

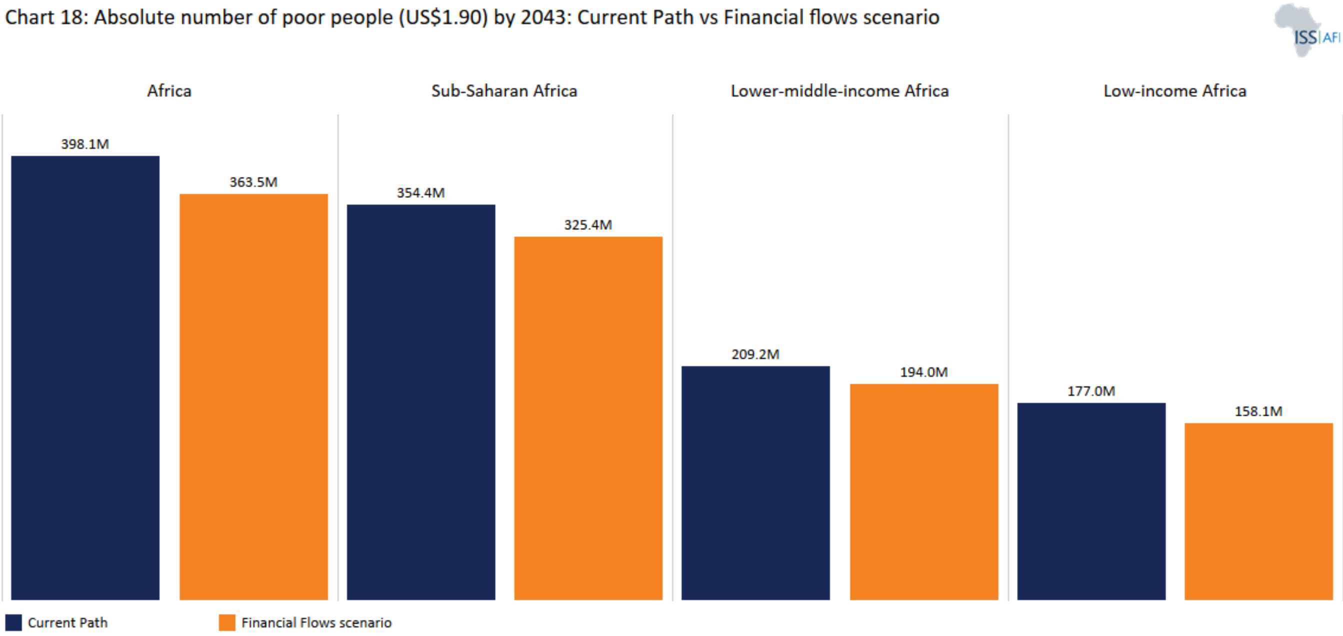
Chart 17: Net exports for Africa: Current Path vs. Financial flows scenario, 2019–2043



Source: IFs 7.84 initialising from IMF and WDI data

Compared to the Current Path forecast, the Financial Flows scenario reduces the number of Africans living in extreme poverty (using the US$1.90 benchmark) by 2033 by 16.6 million people and to 34.4 million in 2043. This translates to a poverty rate of 24.7% in 2033 and 16.2% in 2043 (Chart 18).

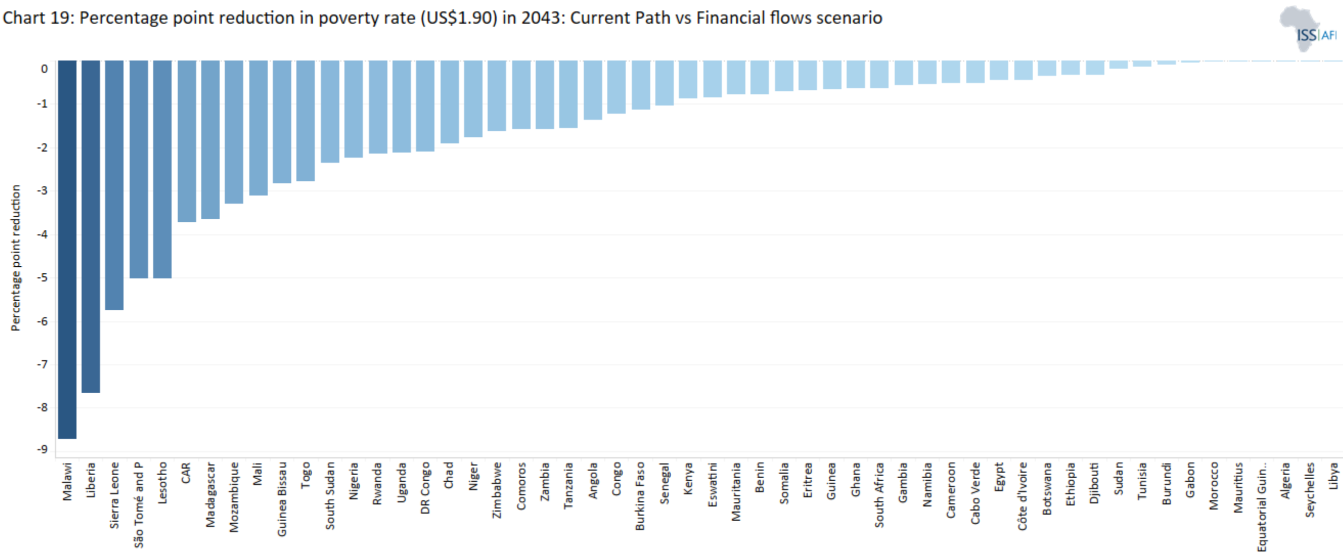
Chart 18: Absolute number of poor people (US$1.90) by 2043: Current Path vs Financial flows scenario



Source: IFs 7.84 initialising World Bank and PovcalNet data

As a percentage of the population, the largest poverty reduction is in Malawi (8.7 percentage points lower than the Current Path forecast in 2043), followed by Liberia and Sierra Leone. However, when considering the absolute number of poor people, Nigeria sees the biggest poverty reduction in the Financial Flows scenario by 2043 (8.7 million fewer poor people compared to the Current Path forecast), followed by DR Congo, Malawi and Mozambique. The extreme poverty rate at US$1.90 is already eliminated in countries such as Seychelles and Mauritius and in North Africa. As a result, the scenario has a marginal impact on extreme poverty reduction in these countries (Chart 19).

Chart 19: Percentage point reduction in poverty rate (US$1.90) in 2043: Current Path vs Financial flows scenario



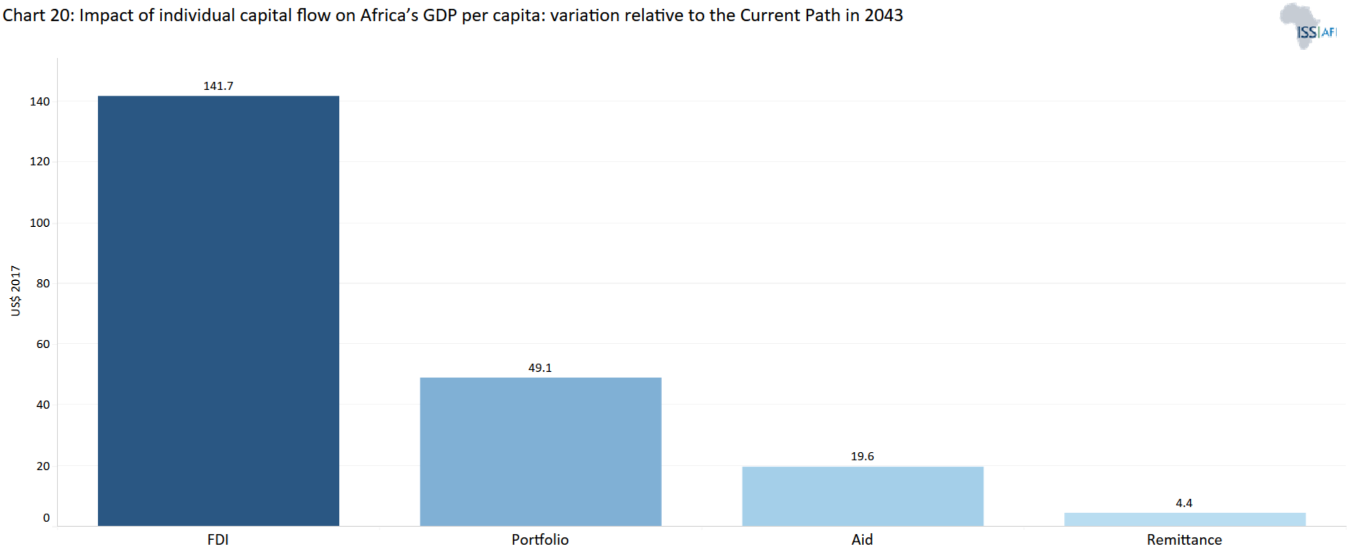
Source: IFs 7.84 initialising World Bank and PovcalNet data

Compared to the Current Path, the Financial Flows scenario slightly reduces income inequality in Africa. Income inequality, as measured by the Gini coefficient, marginally declines in all the countries relative to the Current Path forecast by 2043 except in Botswana, South Africa, Republic of the Congo, Equatorial Guinea and Seychelles, where inequality slightly increases above the Current Path.

Comparing the impact of different inflows

Thus far we have presented the combined effects of capital flows consisting of various components such as aid. However, different types of inward financial flows such as aid versus FDI are bound to affect economic growth and poverty differently. We extend our analysis by investigating the effects of each type of capital flow on Africa's socio-economic development prospects.

Chart 20: Impact of individual capital flow on Africa's GDP per capita: variation relative to the Current Path in 2043



Source: IFs 7.84 initialising from IMF data

Chart 20 shows that an increase in each type of financial flow (aid, remittances, portfolio investment and FDI) could improve Africa's GDP per capita above the Current Path forecast in 2043. The most significant improvement in GDP per capita would come from FDI, followed by portfolio investment flows, aid and remittance. The effect of aid, remittance and portfolio investment flows on growth and GDP per capita is much weaker than that of FDI.

By 2043, the increase in aid flows (to about US$100 in 2043) would improve Africa's GDP per capita by only US$20. The majority of the empirical studies provide no robust evidence of the aid–growth effect. Some studies have found that aid fosters growth in countries with good domestic policies but that it has no impact or a weaker impact in countries suffering from poor governance.[103] Poor governance in most African countries may explain the marginal impact of aid on growth and GDP per capita. In the presence of strong institutions that limit diversion and appropriation, aid can contribute to human capabilities and infrastructure development with a positive effect on growth. In their absence, aid may ameliorate their impact, essentially alleviating suffering, hunger and other effects of slow growth and poor governance.

An increase in remittance would improve Africa's GDP per capita by only about US$4 compared to the Current Path forecast in 2043. Several factors may explain this marginal effect. Remittances can boost growth by providing alternative resources to release financial constraints on domestic investments and consumption. However, the growth gain from remittances can be partially offset if it is spent on imported consumer goods rather than stimulating domestic investment or if they lead to an appreciation of the real exchange rate. Moreover, the 'brain drain' associated with a loss of productive capacity due to the migration of skilled workers can partially offset the positive effect of remittances on economic growth. Some argue that remittances may harm growth by reducing incentives for labour market participation.[104] Remittances may equally hurt growth in developing countries that are net remittance senders, such as South Africa, Côte d'Ivoire and Equatorial Guinea, among others, as they reduce the already low domestic resources available for investment. In this vein, a study by Konan and N'Zué[105] reveals that there is a certain minimum threshold beyond which each dollar remitted will harm economic performance in Côte d'Ivoire.

Increased international portfolio investment (debt and equity) would improve Africa's GDP per capita by US$49 above the

Current Path forecast in 2043. Foreign portfolio investments (FPI) are limited in Africa, especially in low-income African countries. Debt portfolio investments via corporate bonds, for instance, are typically invested productively in the real economy to increase productive capacities, which increase economic growth. However, the same benefits cannot necessarily be expected in the case of pure financial investment, such as equity portfolio investment. In contrast to FDI, FPIs are short-term financial flows and are more liquid, thereby offering investors a chance for quicker returns on their money—or a quicker exit. As such, they can have a destabilising effect on the host economy as they quickly depart the country of investment whenever there is uncertainty or negative news.

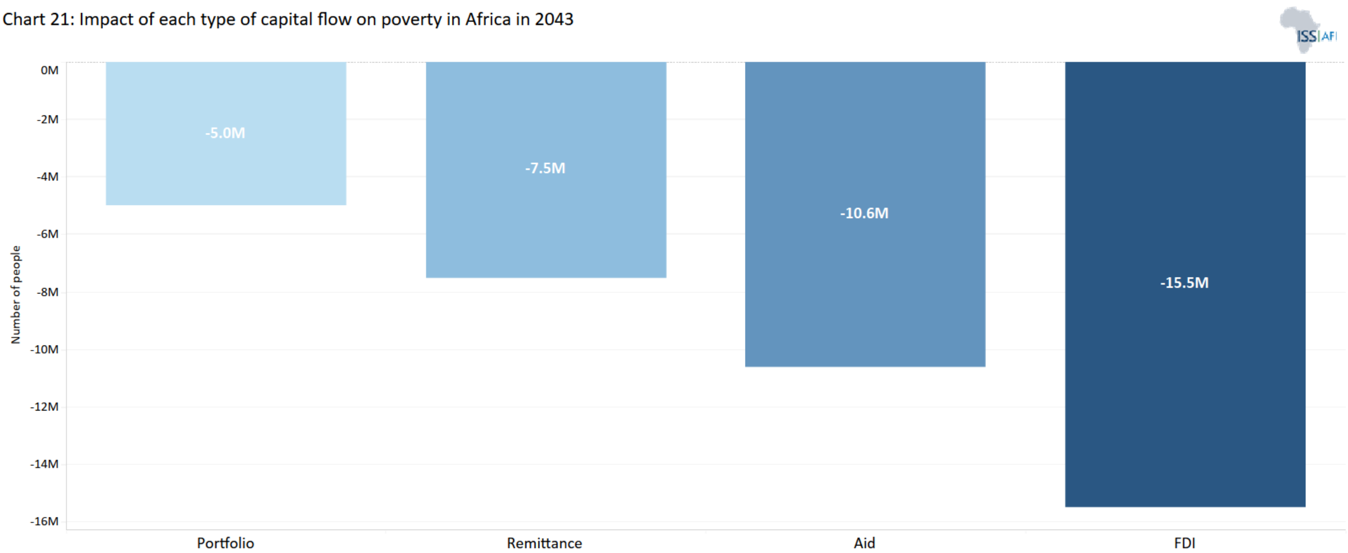
Compared to other types of capital flows, policies to attract more FDI will have the biggest impact on Africa's development prospects by far. An increase in FDI flows to Africa would increase the continent's GDP per capita by US$142 above the Current Path forecast. Transnational corporations, through their FDI activities, fuel economic growth and development because they contribute to capital accumulation, the transfer of superior technology and management skills in the host country.

The impact of each type of capital flow on GDP per capita also varies according to the income groups in Africa. For the upper-middle- an d lower-middle-income groups, FDI has the most significant impact on GDP per capita, followed by portfolio investment flows, while aid and remittance have the lowest impact compared to the Current Path forecast in 2043.

As for the low-income group, FDI has the most significant impact on GDP per capita, followed by aid, while remittance has the lowest impact in 2043, compared to the Current Path forecast in 2043.

As shown in Chart 21, an increase in all types of capital flows could reduce poverty in Africa, and FDI would probably have the most significant impact on the long-term well-being of African populations.

Chart 21: Impact of each type of capital flow on poverty in Africa in 2043



Source: IFs 7.84 initialising from PovcalNet and World Bank data

An increase in FDI flows to Africa could reduce the number of poor people on the continent to 383 million in 2043 instead of 398 million in the Current Path forecast—in other words, 15.5 million fewer poor people than on the Current Path in 2043. FDI reduces poverty through the direct channel by creating jobs in the private sector. Jobs created by FDI in host countries can be particularly good jobs and help in knowledge and technology transfer. These jobs directly reduce poverty, and the knowledge transferred can also enable indigenes to further create more jobs. However, for FDI to directly reduce poverty through job creation, labour-intensive manufacturing FDI is required. The effects of FDI on poverty reduction thus depend on the type of inflow. More labour-intensive manufacturing FDI, such as in the case of Asian countries, could significantly reduce poverty in Africa.

More recent studies suggest that for aid to reduce poverty, it should be targeted at the right programmes and objectives, including social expenditure on health and education.[106] Remittances directly augment the income of those households that receive them, and they are a crucial lifeline for many people, especially in low-income countries.

The impact of each type of capital flow on poverty varies according to the income groups in Africa:

- For the upper-middle-income group, FDI has the most significant impact on poverty, followed by portfolio investment flows, while aid and remittance have the lowest impact compared to the Current Path forecast in 2043.
- For the lower-middle-income group, FDI has the most significant impact on poverty reduction, followed by remittances, while aid has the lowest impact in 2043 compared to the Current Path.
- As for the low-income group, aid has the most significant impact on poverty reduction, followed closely by FDI, while portfolio flow has the lowest impact in 2043, compared to the Current Path forecast in 2043.

Overall, the Financial Flows scenario shows that increased external financial inflows into Africa could promote growth and reduce poverty with aid being particularly important to reduce poverty in low-income countries and FDI for others.

Conclusion

This theme provides an overview of trends in financial inflows (aid, FDI and remittances) in Africa. Despite the growing investment flows from China, Africa's share in global FDI inflows is still marginal at 5%. More than any other financial inflow, more significant FDI inflows can boost development in Africa but cannot replace domestic revenues to enhance development.

Aid is also not a panacea for Africa's development, but if creatively used, it can contribute to changing the future, especially for poor countries. Historically, much aid was not often given to African countries for development purposes but for strategic reasons and to keep influence alive. Instead of using aid to improve the circumstances of their populations, many African leaders saw aid as a resource to be plundered with little regard for good governance and development. Donors should make good governance a prerequisite for aid but allow for effective national prioritisation processes and then direct additional financial support to services that would otherwise not be covered by domestic funds.[107] This means that aid should top up the allocation of domestic finances to expand the affordable services that African governments commit to. In addition, aid should support institution-building and good governance to improve accountability and effective delivery of services.

Remittances have become significantly more important for some countries. Much can be done to improve remittance flows, given the role they play in reaching rural, poor people, particularly during tough times, but remittances contribute little to overall growth. Increased remittance flows could be facilitated by reduced fees paid by senders and recipients, removing taxes on remittances, increased market competition in the remittance industry, and digital technologies.[108]

Remittance flows are closely associated with migration patterns, which has become an important domestic political issue in the West. This is even though migrants have a positive economic impact in host countries, especially if they access the labour market. Many advanced countries are experiencing hiring shortages in fields including personal assistance and the hospitality and food industries. However, anti-migrant sentiments have become an important domestic policy issue in African countries such as South Africa.[109]

To attract more investment from the West, African countries need a sovereign credit rating by an international rating agency to reflect their creditworthiness. Before the COVID-19 pandemic, insurance companies, pension funds and sovereign wealth funds globally already had more than US$100 trillion in assets under management.[110] In mid-2020, the only African countries with a sovereign credit rating by all three dominant rating agencies (Standard & Poor's, Fitch and Moody's) were Angola, Egypt, South Africa, Mozambique and Morocco, and it is perhaps no surprise that most private sector FDI goes to these countries.[111] With all the essential Western rating agencies typically viewing Africa through a jaundiced lens, African countries often pay punitive interest rates. In contrast, China's investment decisions are essentially guaranteed by its government—a state-backed loan—although seldom offered at concessional rates, as with credit from the World Bank or the IMF.

The global geopolitical tensions exacerbated by the Russian–Ukraine war and recent events in Palestine could also affect FDI flows to Africa. A recent study by the IMF shows that over the last decade, the share of FDI flows among geopolitically aligned economies has kept rising, more than the share for countries that are closer geographically,[112] suggesting that geopolitical preferences increasingly drive the geographic footprint of FDI. If geopolitical tensions continue to rise and countries diverge along geopolitical fault lines, FDI may become even 'more concentrated within blocs of aligned countries.'

In this context, China will continue to play an important role. In 2020, China announced a five-year plan to establish a dual circulation economy, which aims to advance Chinese self-sufficiency that may impact the type of investment flows to Africa. There are also rising concerns in Beijing about the ability of key African governments to service their loans from China, and the debate within that country is steadily becoming more critical of Africa's mounting debt burden.[113] Projects need to be subject to cost–benefit analysis, and China has warned that it intends to pull back on vanity projects.

However, China is the world's largest energy importer and is not resource-rich. It will, therefore, remain important and perhaps increase its role in agriculture, energy and resource investments in Africa. Increasingly, Chinese investments extend to middle-class consumption, including healthcare, entertainment, real estate development and manufacturing. These sectors have all seen increasing levels of Chinese investment.[114]

In addition to traditional sources of FDI, new partners are coming to the fore. In November 2023, the Saudi Development Fund announced that it plans to sign deals worth US553 million with African countries, some of which would ease debt. The Saudi US$700 billion sovereign wealth fund could play an important role here by mentioning "game-changing" investments in Africa.[115]

Whatever the source—public or private—FDI is not a substitute for government efforts to maximise domestic revenues that will drive the development of large infrastructure such as water, sanitation, electricity and road systems. Also, ensuring that FDI benefits the recipient requires effective government regulation and oversight. For example, a recent analysis of control rights for gold, copper and diamond production in African states south of the Sahara showed that 'domestic mineral production stimulates local income more than internationally controlled extraction since national mining companies promote more backward economic linkages and have higher incentives to engage in local capacity building.'[116] Domestic mining companies are associated with growing local wealth, whereas multinational firms are linked to increased regional unemployment.[117]

Curbing illicit financial flows will require cooperation at the global level. The problem of tax evasion, for instance, can be addressed through collaboration with developed countries to help strengthen the capacity of local tax authorities by improving the sharing of tax information across countries, countering money laundering, creating international standards for tax transparency, and countering base erosion and profit shifting.[118]

Africa must work much harder to unlock investment from the pent-up dam of money, searching for returns in Europe, North America, China, the Middle East and eventually India. More FDI boosts economic growth and contributes to knowledge transfer and, hence, to Africa's economic transformation. The inadequate technical, governance and implementation capacity in African countries requires dedicated effort to strengthen domestic legislation, institutions and policies governing investment and its ability to negotiate and oversee the associated agreements.

If the international community wants to help Africa, it needs to incentivise private investment through tax benefits, de-risking foreign investment and building African capacity to negotiate, manage and evaluate projects. It needs to boost concessional loans and grants, raise concessional finance such as issuing special drawing rights, and reduce the resource and information asymmetry between borrowers and lenders to discourage predatory lending practices. The associated requirements may require the establishment of various additional financial institutions such as regional banks, and stock exchanges, as proposed by a group of African presidents and heads of African financial institutions on the margins of the 2024 summit of the African Union. The purpose is to improve Africa's access to capital, impartial debt management and fair credit and risk assessments. The track record of the implementation of AU decisions is poor, however.

The world desperately needs an international public credit rating agency to provide objective, expert-based ratings of the creditworthiness of sovereigns and companies instead of relying on a handful of Western companies. UNCTAD calls for precisely this in its 2020 Trade and Development Report, arguing that it would promote global public goods and help to promote competition in a highly concentrated private market.[119] Implementing a more equitable global taxation structure that grants African countries access to a fair share of profits and limits base erosion and profit shifting by international companies will also improve government revenues.

Looking to the future, Africa has significant scope to improve matters by investing in the capacity of its institutions to oversee and manage trade, FDI and aid and develop formal remittance processes. The source of assistance and investment support is eventually less important, except to ensure that African countries are not forced to choose particular alliances as happened during the Cold War; instead, collaboration and a mix-and-match approach should be encouraged. In this vein, the recent trend in funding large projects is positive, namely that the basket of funding includes multiple sources (e.g. the World Bank, the African Development Bank, the European Investment Bank and the Bank of China) and project implementation consisting of a collaborative approach (such as a German engineering company overseeing technical compliance, American project management and Chinese construction capacity that does the heavy lifting).

Eventually, there is little difference between Africa's old and new partners. Each inevitably puts their interests first, as should Africa. But Africa should work more diligently in setting the terms for how best it can benefit from aid, FDI and the flow of remittances. Africa needs to become a rule-maker and assume a more significant role in its destiny, particularly in the mode of development it pursues. Africans need to push that Western negotiation strategies on debt relief include China, not exclude it.

African countries should, therefore, improve domestic conditions such as political stability and provide a well-educated workforce, good infrastructure and an efficient legal system, which will enable them to set up conditions concerning FDI and push foreign investors into sectors that are aligned with their developmental goals. With better domestic conditions and a targeted approach, countries such as China and South Korea were able to maximise the economic gains from FDI.

Chart 22: Summary of recommendations

Recommendations

1. African governments must creatively use aid to stimulate growth and poverty reduction
2. Donors should make good governance a prerequisite for aid and refrain from pushing agendas not in the recipients' best interests
3. Remittances provide stable income for many poor households in African and must be encouraged and facilitated through better regulation and lower costs
4. Diaspora savings should be used to fund development projects through diaspora bonds
5. Africa's business climate needs to be improved by governments to encourage people to invest the money they receive from relatives overseas.
6. Governments should work to attract FDI by:
   a. improving institutional quality, political stability and infrastructure
   b. providing a well-educated labour force
7. Governments should channel FDI into sectors aligned with development goals
8. Africa must improve border collaboration, data collection and monitoring systems to reduce illicit financial flows from the continent
9. Governments should guard against risks associated with large inflows of foreign money, such as real exchange rate appreciation that weakens competitiveness of export sectors

Although Europe remains Africa's most important partner in trade, FDI stock and aid, China's footprint in Africa has grown enormously in recent years. The rise of China is certainly the most noteworthy feature of the 21st century and its demand for natural resources played a big part in the story of Africa's growth for several decades from the mid-1990s. This is also evident from how commodity exports from Africa increased more rapidly than the global average. As a result, Africa's broad pattern of increased dependence on commodity exports to earn foreign exchange and continued deindustrialisation from already low levels have continued unabated. Meanwhile, the Chinese economy is rebalancing to rely more on domestic consumption for future growth and its once-insatiable appetite for commodities has tempered. As the hubris around the Belt and Road Initiative tapers down, China will not maintain the breakneck speed of investment growth in Africa seen during the last two decades, and the impact of Russia's invasion of Ukraine has added additional volatility to global markets.

In sum, a large inflow of foreign cash can bring considerable economic benefits to African countries but, if not properly managed, can also cause real exchange rate appreciation, weakening the competitiveness of the export sectors. African governments should maximise the benefits from financial inflows while minimising the risks.

Annexure

This theme used IFs version 7.84. All interventions start in 2024, interpolate to 2033 and then are maintained at that level unless indicated otherwise.

Interventions and parameters	Adjustment in IFs	Benchmark/Justification/Notes

Increase remittance to Africa (xworkremitinm)	Interpolate from 1 to 1.1 and maintain for each African low-income country. Interpolate from 1 to 1.08 and maintain for each African low-middle-income country.	On average, low-income Africa receives more remittances than lower-middle-income countries. No intervention for upper-middle-income African countries. They are generally net remittance senders. This intervention keeps remittance flows to Africa above South America and below South Asia over the forecast horizon, in line with current and past trends. South Asia and South America are the two most comparable regions to Africa.
Increase Aid (foreign) receipts (aidrecm)	Interpolate from 1 to 1.15 and maintain for each African low-income country. Interpolate from 1 to 1.1 and maintain for each African lower-middle-income country.	On average, low-income countries in Africa receive more aid than lower-middle-income countries. Low-income countries in Africa rely more on aid. No intervention for upper-middle-income African countries. Aid flows to this group in Africa have significantly declined. Aid to Africa now goes mainly to low- and lower-middle-income countries. Upper-middle-income countries rely more on FDI. This intervention keeps aid flows to Africa above South Asia and South America over the forecast horizon, in line with current and past trends. Since 1960, aid flows to Africa have been consistently above those to South Asia and South America.
Increase aid donations from High-income OECD countries (aiddon)	Increase aid donations from OECD high-income countries from 0.24% to 0.26% of GDP, and maintain.	Aid from high-income countries accounts for a small fraction of their GNI. The UN target is 0.7% of GNI.
Increase foreign direct investment to	Interpolate from 1 to 1.08 and	On average, upper-middle-income

Africa (stocks) (xfdistockm)	maintain for each African low-income country. Interpolate from 1 to 1.1 and maintain for Africa lower-middle-income countries. Interpolate from 1 to 1.12 and maintain for African upper-middle-income countries and Seychelles (the only high-income country in Africa).	countries receive more FDI than low- and lower-middle-income countries. Upper-middle-income countries rely more on FDI. This intervention keeps FDI stocks in Africa above South Asia and below South America over the forecast horizon, in line with current and past trends.
Reduce outward Foreign direct investment (xfdistoutm)	Interpolate from 1 to 0.8 and maintain for Africa.	A proxy for a reduction in illicit financial flows.
Increase portfolio investment in Africa (xportfoliom)	Interpolate from 1 to 1.5 and maintain for low-income countries. Interpolate from 1 to 2 and hold for lower-middle- and upper-middle-income countries in Africa and Seychelles (the only high-income country in Africa).	Foreign portfolio investment in Africa is very low, so the improvement will come from a very low base. On average, lower-middle- and upper-middle-income countries receive more foreign portfolio investment than low-income countries in Africa.

Endnotes

1. Foresight Africa 2023, Africa Growth Initiative at Brookings
2. Financial globalisation is an aggregate concept that refers to increasing global linkages created through cross-border financial flow. ES Prasad, K Rogoff, S Wei and MA Kose, Effects of Financial Globalization on Developing Countries: Some Empirical Evidence, International Monetary Fund, September 2003
3. UNCTAD, Development and globalisation: Facts and figures 2021, New York and Geneva: UNCTAD, 2021
4. UNCTAD, Foreign direct investment in Africa: Performance and potential, New York and Geneva: UNCTAD, 1999
5. M Sanket and R Dilip, Impact of the global financial crisis on migration and remittances, Economic Premise No. 2, Washington, DC: World Bank, 2010.
6. M Sanket and R Dilip, Impact of the global financial crisis on migration and remittances, Economic Premise No. 2, Washington, DC: World Bank, 2010.
7. Examples include: J Sachs, Foreign aid works – it saves lives, *The Guardian*, 30 May 2012; D Moyo, *Dead aid: Why aid is not working and how there is another way for Africa*, London: Allan Lane, 2009; A Deaton, *The great escape: Health, wealth and the origins of inequality*, Princeton: Princeton University Press, 2013; G Mills, *Expensive poverty: Why aid fails and how it can work*, Johannesburg: Picador Africa, 2021.
8. R Bissio, The Paris Declaration on Aid Effectiveness, in United Nations, *Realizing the Right to Development*, OHCHR, 2013
9. OECD, The Busan Partnership for Effective Development Cooperation, July 2012
10. H Ritchie and M Roser, Now it is possible to take stock — did the world achieve the Millennium Development Goals?, 20 September 2018
11. Bilateral aid is provided directly from a national agency, such as the US Agency for International Development or the Swedish International Development Cooperation Agency, to the country or region concerned. Multilateral aid is provided through organisations such as the World Bank and the African Development Bank as grants and concessional loans (i.e. below market rates). See: SEEK Development, Donor Tracker United States; SEEK Development, Donor Tracker EU.
12. SEEK Development, Donor Tracker EU
13. United Nations, Sustainable Development Goals, Goal 17: Revitalize the global partnership for sustainable development
14. Congressional Research Service, U.S. Assistance to Sub-Saharan Africa: An Overview, R46368, 2020
15. In 2018, the United States Agency for International Development (USAID) provided US$10.7 billion in aid to sub-Saharan Africa, equivalent to 21% of total aid disbursements. The 2019 appropriation declined to US$7.1 billion. Congressional Research Service, U.S. Assistance to Sub-Saharan Africa: An Overview, R46368, 2022.
16. Congressional Research Service, U.S. Assistance to Sub-Saharan Africa: An Overview, R46368, 2022
17. Data for 2020: Compare your country.
18. The BUILD Act replaces the Overseas Private Investment Corporation, which was created in 1971.
19. The US IDFC will be able to take a minority equity stake or financial interests of its own in development projects. It will also provide insurance or reinsurance services and technical assistance, administer special projects, establish enterprise funds, issue obligations, and charge and collect service fees. 'Through these market-based fees, the US IDFC will operate at no net cost to [US] taxpayers.' See: DF Runde and R Bandura, The BUILD Act has passed: What's next?, 2018.
20. According to former US National Security Advisor John Bolton. See: J Airey, Bolton: New Africa strategy is tough on China, Russia, U.N., *The Daily Wire*, 14 December 2018.
21. DF Runde and R Bandura, U.S. economic engagement in Africa: Making Prosper Africa a reality, Washington, DC: Center for Strategic & International Studies, 2019.
22. White House, US Strategy toward Sub-Saharan Africa, August 2022.
23. White House, Fact Sheet: U.S. Strategy towards Sub-Saharan Africa, August 2022. Also see: Congressional Research Service, U.S. Assistance to Sub-Saharan Africa: An Overview, R46368, 2022. Its priorities for US engagement with Africa include advancing global health; enhancing peace and security; promoting mutually beneficial economic growth, trade and investment; strengthening democracy; and building resilience to address challenges related to health, climate change, food security, and other areas.
24. Reuters, Explainer: How the U.S. plans to commit $55 billion to Africa over three years, *Reuters*, 15 December 2022
25. European Union, Development aid at a glance: Statistics by region: Africa, 2019.
26. European Commission, Africa–Europe Alliance, 2018.
27. Its thematic objectives are (i) local private-sector development, (ii) social and economic infrastructure development, (iii) climate change mitigation, and

(iv) root causes of migration. In addition to financial support, it provides technical assistance and offers a policy dialogue. See: M Gavas and H Timmis, The EU's financial architecture for external investment: Progress, challenges, and options. Washington, DC: Center for Global Development; European Commission, Joint Africa–EU Strategy, 2019.

28. The Aid for Trade Initiative was formally launched at the Sixth WTO Ministerial Conference in Hong Kong in 2005. See: World Trade Organization, Aid for Trade, 2019.
29. Additional funds could come from Germany, among others. See: SEEK Development, Donor Tracker EU.
30. European Commission, EU paves the way for a stronger, more ambitious partnership with Africa, 9 March 2020.
31. China Africa Research Initiative, Data: Chinese global foreign aid.
32. N Kitano, A note on estimating China's foreign aid using new data: 2015 preliminary figures, Tokyo: JICA Ogata Sadako Research Institute for Peace and Development, 2017. Also see: Organisation for Economic Co-operation and Development, Development Co-operation Report 2017: Data for development, Paris: OECD, 2017; China Africa Research Initiative, Data: Chinese global foreign aid.
33. N Kitano and Y Miyabayashi, Estimating China's foreign aid: 2019–2020 preliminary figures, JICA Ogata Sadako Research Institute for Peace and Development, 14 December 2020.
34. A Wooley, AidData's new dataset of 13 427 Chinese development projects worth $843 billion reveals major increase in 'hidden debt' and Belt and Road Initiative implementation problems, AidData, 29 September 2021.
35. United Nations, Sustainable Development Goals, Goal 17: Revitalise the global partnership for sustainable development.
36. K Yeboua, Foreign direct investment, financial development and economic growth in Africa: Evidence from threshold modelling, *Transnational Corporations Review*, 11:3, 2019, 179–89.
37. HJ Chang, Globalization, transnational corporations, and economic development: Can the developing countries pursue strategic industrial policy in a globalizing world economy?, In D Baker, G Epstein and R Pollin (eds.), *Globalization and progressive economic policy*, Cambridge: Cambridge University Press, 1998.
38. MR Agosin and R Mayer, Foreign Investment in Developing Countries, UNCTAD Discussion Papers, No. 146, 2000.
39. United Nations, Financing for development, Monterrey consensus of the international conference on financing for development, 2003.
40. JC Anyanwu and ND Yaméogom, Regional comparison of foreign direct investment to Africa: Empirical analysis, *African Development Review*, 27:4, 2015, 345–63.
41. UNCTAD, World Investment Report: International tax reforms and sustainable investment, New York and Geneva: UNCTAD, 2022.
42. A Odusola, Addressing the foreign direct investment paradox in Africa, *Africa Renewal*.
43. UNCTADStat, online data.
44. S Morgan, J Farris and ME Johnson, Foreign direct investment in Africa: Recent trends leading up to the AfCFTA, Economic Information Bulletin No. 242, October 2022.
45. S Zawadzki, Anadarko approves $20 billion LNG export project in Mozambique, *Reuters*, 18 June 2019.
46. S Planting, Gas in Mozambique – a $128bn opportunity, *Daily Maverick*, 24 September 2019.
47. By the end of 2021 more than 20 countries were helping Mozambique fight the insurgency. See: Institute for Security Studies, Will foreign intervention save Cabo Delgado?, 8 November 2021.
48. S Morgan, J Farris and ME Johnson, Foreign direct investment in Africa: Recent trends leading up to the AfCFTA, Economic Information Bulletin No. 242, October 2022.
49. See: European Commission, Africa–Europe Alliance. The data still includes the UK as a member of the EU.
50. European Commission, Africa–Europe Alliance
51. S Morgan, J Farris and ME Johnson, Foreign direct investment in Africa: Recent trends leading up to the AfCFTA, Economic Information Bulletin No. 242, October 2022.
52. C Cheng, The logic behind China's foreign aid agency, Carnegie Endowment for International Peace, 21 May 2019.
53. Staff writer, Tanzania–Zambia Railway: A bridge to China?, *The New York Times*, 29 January 1971.
54. Staff writer, Tanzania–Zambia Railway: A bridge to China?, *The New York Times*, 29 January 1971.
55. M Rudyak, The ins and outs of China's International Development Agency, Carnegie Endowment for International Peace, 2 September 2019.

56. I Neuweg, What types of energy does China finance with its development aid?, The London School of Economics and Political Science, 21 June 2018.

57. S Horn, CM Reinhart and C Trebesch, How much money does the world owe China?, *Harvard Business Review*, 26 February 2020.

58. S Morris, B Parks and A Gardner, Chinese and World Bank lending terms: A systematic comparison across 157 countries and 15 years, Washington, DC: Center for Global Development, 2 April 2020.

59. American Enterprise Institute, China Global Investment Tracker, July 2022.

60. *The Economist*, How Chinese firms have changed Africa, 20 May 2022.

61. R Partington, Fears grow in Africa that the flood of funds from China will start to ebb, *The Guardian*, 5 January 2019.

62. African Development Bank, African Economic Outlook 2018, Abidjan: AfDB, 2018, 63–93.

63. According to the China–Africa Economic and Trade Relationship Annual Report 2021, as quoted by J Mitchell, Africa's reliance on China is only likely to get worse, Investment Monitor, 26 January 2021.

64. E Olander, Even amid a pandemic, Chinese FDI in Africa jumped almost 10% last year, China Global South Project, 31 August 2021.

65. J Mitchell, Africa's reliance on China is only likely to get worse, Investment Monitor, 26 January 2023.

66. China Africa Research Initiative data, School of Advanced International Studies, John Hopkins School of Advanced International Studies.

67. A Vines, C Butler and Y Jie, The response to debt distress in Africa and the role of China, Chatham House Research Paper, 15 December 2022.

68. Examples are Angola and South Sudan. In 2020, Angola had a debt-to-GDP ratio of 91%, half of which was owed to China and much of that was provided by way of oil exports. See: Africa Center for Strategic Studies, The challenges of reform in Angola, 21 January 2020; Further Africa, Angola negotiates the end of oil-backed debt with China, 24 January 2020.

69. C Oya and F Wanda, Working conditions in Angola. Infrastructure construction and building materials factories, London: SOAS University of London, 2019; F Schaefer and C Oya, Employment patterns and conditions in construction and manufacturing in Ethiopia: A comparative analysis of the road building and light manufacturing sectors, London: SOAS University of London, 2019.

70. UN Habitat, The State of African Cities 2018 – The geography of African investment, 2018.

71. A Gelpern et al, How China lends: A rare look into 100 debt contracts with foreign governments, Washington, DC: Center for Global Development, 31 March 2021.

72. R Muhumuza, As China builds up Africa, some in Uganda warn of trouble, *AP News*, 24 October 2019.

73. R Muhumuza, As China builds up Africa, some in Uganda warn of trouble, *AP News*, 24 October 2019.

74. A Gelpern et al, How China lends: A rare look into 100 debt contracts with foreign governments, Washington, DC: Center for Global Development, 31 March 2021.

75. Coalition for Fair Fisheries Arrangements, China's capture of Ghana's fishing industry is threatening food security, 4 October 2022; J Nyabiage, The case of the reappearing Chinese gold miner gripping Ghana, 28 September 2022.

76. International Fund for Agricultural Development, 12 reasons why remittances are important, 15 June 2022.

77. International Fund for Agricultural Development, 12 reasons why remittances are important, 15 June 2022.

78. The International Monetary Fund and the World Bank, the main providers of international remittance statistics, base their estimates on broad definitions, such as the sum of income earned by migrants and the income of workers who are employed by embassies, international organisations and foreign companies, plus all transfers in cash of kind made or received by residents and non-resident individuals, meaning it includes payments to UN officials and various financial transactions. Migration Data Portal, Remittances, 6 January 2023.

79. Office of the High Commissioner of Human Rights, People of African Descent, Backgrounder.

80. International Organization for Migration, World Migration Report 2022, Geneva: United Nations Network on Migration, 60–61.

81. A Gevorkyan, Can Diaspora Bonds Supercharge Development Investment?, Migration Policy Institute, 24 June 2021.

82. M Famoroti, Debt by diaspora: Ties that bond, Brookings, 24 January 2018.

83. P Madden, Africa in the news: Zambia's debt, Kenya's parliament and trade, and politics in the Horn of Africa, Brookings, 26 September 2020; A Gevorkyan, Can diaspora bonds supercharge development investment?, Migration Policy Institute, 24 June 2021.

84. R Chami et al, Is there a remittance trap?, International Monetary Fund, 2018.

85. World Bank, COVID-19: Remittance flows to shrink 14% by 2021, 29 October 2020.

86. M Forstater, Illicit Financial Flows, Trade Misinvoicing, and Multinational Tax Avoidance: The Same or Different?, Center for Global Development Policy Paper 123, 26 March 2018.

87. UN Economic Commission for Africa, Illicit financial flows: Report of the High Level Panel on illicit financial flows from Africa, Addis Ababa: UNECA, 2015.

88. L Signé, M Sow and P Madden, Illicit financial flows in Africa: Drivers, destinations, and policy options, Brookings, 2 March 2020.

89. UN Conference on Trade and Development, Economic Development in Africa Report 2020: Tackling illicit financial flows for sustainable development in Africa, Geneva: UNCTAD, 2020, 182.

90. L Signé, M Sow and P Madden, Illicit financial flows in Africa: Drivers, destinations, and policy options, Brookings, 2 March 2020.

91. A Donker, U.S. tax policy can help Africa's fight against illicit financial flows, *Foreign Policy*, 17 May 2021; The 2020 Financial Secrecy Index results are available at: Tax Justice Network, Financial secrecy index.

92. JD Nkurunziza, Illicit financial flows: A constraint on poverty reduction in Africa, *Association of Concerned Africa Scholars Bulletin*, 2012, 87.

93. G Albertin et al, Tax avoidance in sub-Saharan Africa's mining sector, International Monetary Fund, 28 September 2021.

94. Tax Justice Network, The State of Tax Justice 2021, 16 November 2021.

95. Examples include the Financial Action Task Force, the Global Forum on Transparency and Exchange of Information for Tax Purposes, and the Inclusive Framework on Base Erosion and Profit Shifting including the Multilateral Convention to implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting. See: L Signé, M Sow and P Madden, Illicit financial flows in Africa: Drivers, destinations, and policy options, Brookings, 2 March 2020.

96. L Kim, G-20 leaders back 15% minimum corporate tax deal, *Forbes*, 30 October 2021.

97. L Wier and G Zucman, Global Profit Shifting, 1975–2019, WIDER Working Paper 121/2022.

98. African Development Bank, African Development Bank, Coalition for Dialogue on Africa, launch $5.9 million project to stem illicit financial flows from Africa, 9 March 2023.

99. S Adams et al. The effects of capital flows on economic growth in Senegal, *The Journal of Applied Economic Research*, 11:2, 2017, 121–42.

100. The framework identifies four main activities that can generate illegal outflows, namely: illicit tax and commercial activities; illegal markets; corruption; and exploitation-type activities and financing of crime and terrorism. Strangely, it does not include a high tax burden, rampant inflation and political instability as drivers, although it does include aggressive tax avoidance (since it is empirically challenging to separate some of these from illicit activities); illegal tax and commercial practices; trade misinvoicing and abusive transfer pricing; criminal activities including the drug trade, human trafficking, illegal arms dealing and smuggling of contraband; and bribery and theft by corrupt government officials and their collaborators. Pilot projects using the new framework are underway in Afghanistan, Colombia, Ecuador, Mexico, Nigeria, Panama and Peru, and will contribute to producing global data estimates. UNCTAD, UN agencies finalise a framework to measure illicit financial flows, 21 December 2020.

101. UNCTAD online data.

102. J-L Combes et al, Financial flows and economic growth in developing countries, *Economic Modelling*, 83, 2019, 195–209.

103. C Burnside and D Dollar, Aid, policies, and growth, *American Economic Review,* 90:4, 2000, 847–68.

104. R Chami et al, Macroeconomic consequences of remittances, IMF Occasional Paper No. 259, 2008.

105. SY Konan and FF N'Zué, Should countries' restrict remittances outflow? Evidence from Côte d'Ivoire, *Migration and Development*, 11:2, 2022, 233–51.

106. J Page and A Shimeles, Aid, employment and poverty reduction in Africa, *African Development Review*, 27:S1, 2015, 17–30.

107. T Drake, L Regan and P Baker, Reimagining Global Health Financing. How Refocusing Health Aid at the Margin Could Strengthen Health Systems and Futureproof Aid Financial Flows, Policy Paper 285, Centre for Global Development, 2023.

108. M Mohieldin and D Ratha, How to keep remittances flowing, Brookings, 11 June 2020.

109. With the right policies, migrants can be an opportunity for their economies by taking these jobs. When migrants are employed, they pay taxes, they spend and they grow the economy. According to the IMF, for every 1% increase in the share of migrants in the adult population of advanced economies, GDP per capita can increase by up to 2% in the long term. IMF, Migrants bring economic benefits for advanced economies, 24th October 2016.

110. A Rabah et al, From global savings glut to financing infrastructure, *Economic Policy*, 32, 2017, 221–61

111. Another 13 countries were rated by two of the agencies, namely Botswana, the Republic of the Congo, Cameroon, Cabo Verde, Ghana, Kenya, Namibia, Nigeria, Rwanda, Senegal, Tunisia, Uganda and Zambia. See: Countryeconomy.com, Sovereigns ratings list.

112. International Monetary Fund, Global Financial Stability Report 2023.

113. Pangea Risk, Africa lobbies for debt swap to avoid wave of sovereign defaults, Exx Africa Insight, 4 May 2020.

114. J Mitchell, Africa's reliance on China is only likely to get worse, Investment Monitor, 26 January 2023.

115. Reuters, Saudi Arabia to sign deals worth over $500 mln with African nations -minister, Reuters, 9 November 2023, https://www.reuters.com/world/saudi-arabia-sign-deals-worth-over-500-mln-with-african-nations-minister-2023-11-09/?utm_source=fmn.beehiiv.com&u

116. T Wegenast, AA Khanna and G Schneider, The micro-foundations of the resource curse: Mineral ownership and local economic well-being in sub-Saharan Africa, *International Studies Quarterly*, 64:3, 2020, 530–43.

117. T Wegenast, AA Khanna and G Schneider, The micro-foundations of the resource curse: Mineral ownership and local economic well-being in sub-Saharan Africa, *International Studies Quarterly*, 64:3, 2020, 530–43.

118. Profit shifting takes advantage of differences and gaps in tax legislation to shift profits from one tax jurisdiction to another to avoid paying taxes in certain jurisdictions.

119. UNCTAD, Bold public spending only way to recover better from COVID-19, 21 September 2020.

Donors and sponsors

Hanns Seidel Foundation

Sweden Sverige

AUDA-NEPAD
AFRICAN UNION DEVELOPMENT AGENCY

Cite this research

Kouassi Yeboua and Jakkie Cilliers (2024) Financial Flows . Published online at futures.issafrica.org. Retrieved from https://futures.issafrica.org/thematic/10-financial-flows/ [Online Resource] Updated 19 April 2024.

About the authors

Dr Kouassi Yeboua is a senior researcher in African Futures and Innovation programme in Pretoria. He recently served as lead author on ISS studies on the long-term development prospects of the DR Congo, the Horn of Africa, Nigeria and Malawi. Kouassi has published on various issues relating to foreign direct investment in Africa and is interested in development economics, macroeconomics, international economics, and economic modelling. He has a PhD in Economics.

Dr Jakkie Cilliers is the ISS's founder and former executive director of the ISS. He currently serves as chair of the ISS Board of Trustees and head of the African Futures and Innovation (AFI) programme at the Pretoria oce of the ISS. His 2017 best-seller Fate of the Nation addresses South Africa's futures from political, economic and social perspectives. His three most recent books, Africa First! Igniting a Growth Revolution (March 2020), The Future of Africa: Challenges and Opportunities (April 2021), and Africa Tomorrow: Pathways to Prosperity (June 2022) take a rigorous look at the continent as a whole.

About African Futures & Innovation

Scenarios and forecasting can help Africa identify and respond to opportunities and threats. The work of the African Futures & Innovation (AFI) program at the Institute for Security Studies aims to understand and address a widening gap between indices of wellbeing in Africa and elsewhere in the world. The AFI helps stakeholders understand likely future developments. Research findings and their policy implications are widely disseminated, often in collaboration with in-country partners. Forecasting tools inspire debate and provide insights into possible trajectories that inform planning, prioritisation and effective resource allocation. Africa's future depends on today's choices and actions by governments and their non-governmental and international partners. The AFI provides empirical data that informs short- and medium-term decisions with long-term implications. The AFI enhances Africa's capacity to prepare for and respond to future challenges. The program is headed by Dr Jakkie Cilliers.