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Financial Flows

Introduction

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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]

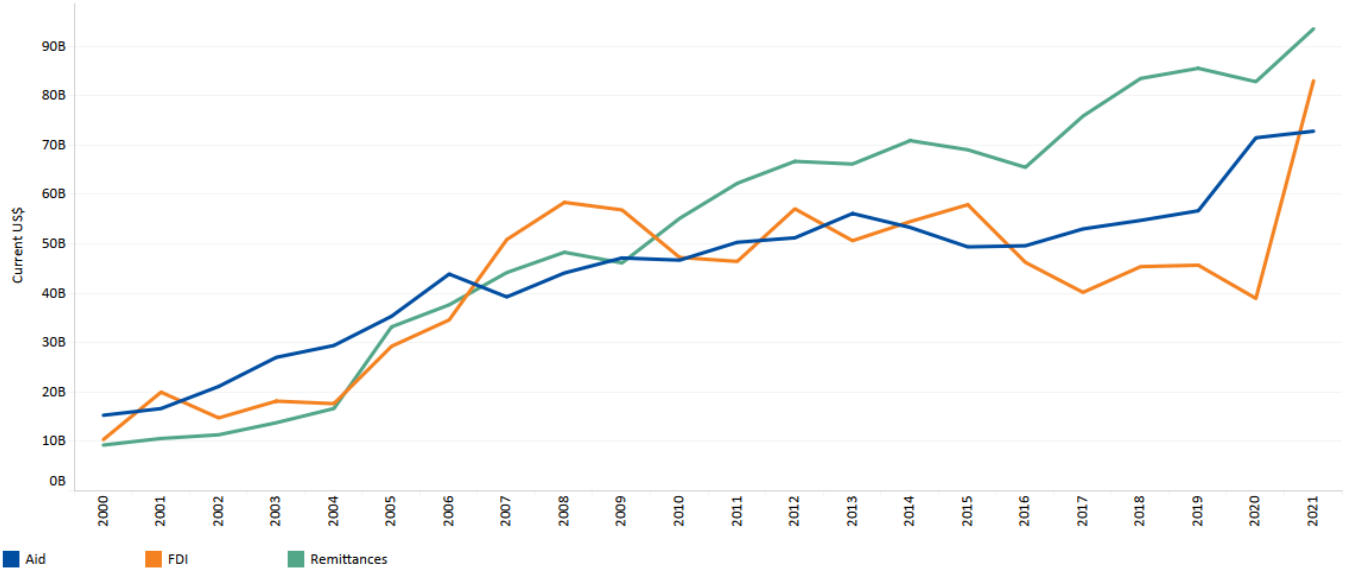
This theme responds to the following questions: What are the recent trends in financial flows to Africa? What could be the impact of increased financial flows on the development prospects of Africa?

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.

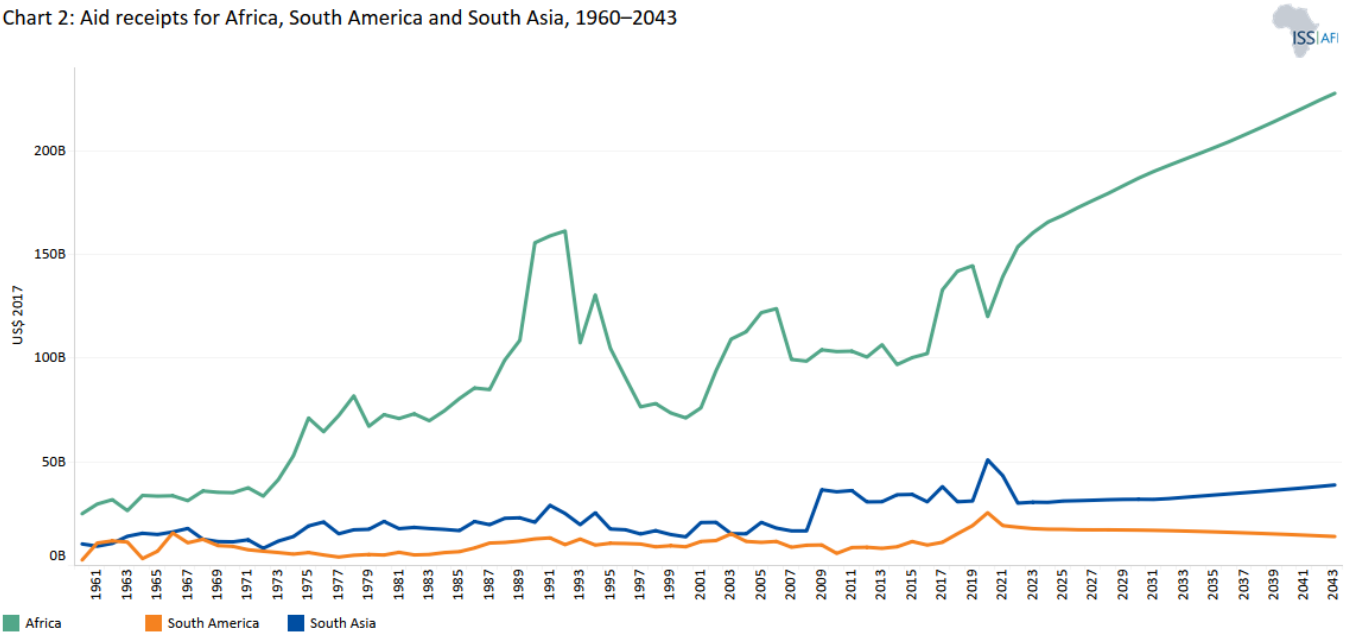
Chart 1: Financial flows to Africa, 2000–2021



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.

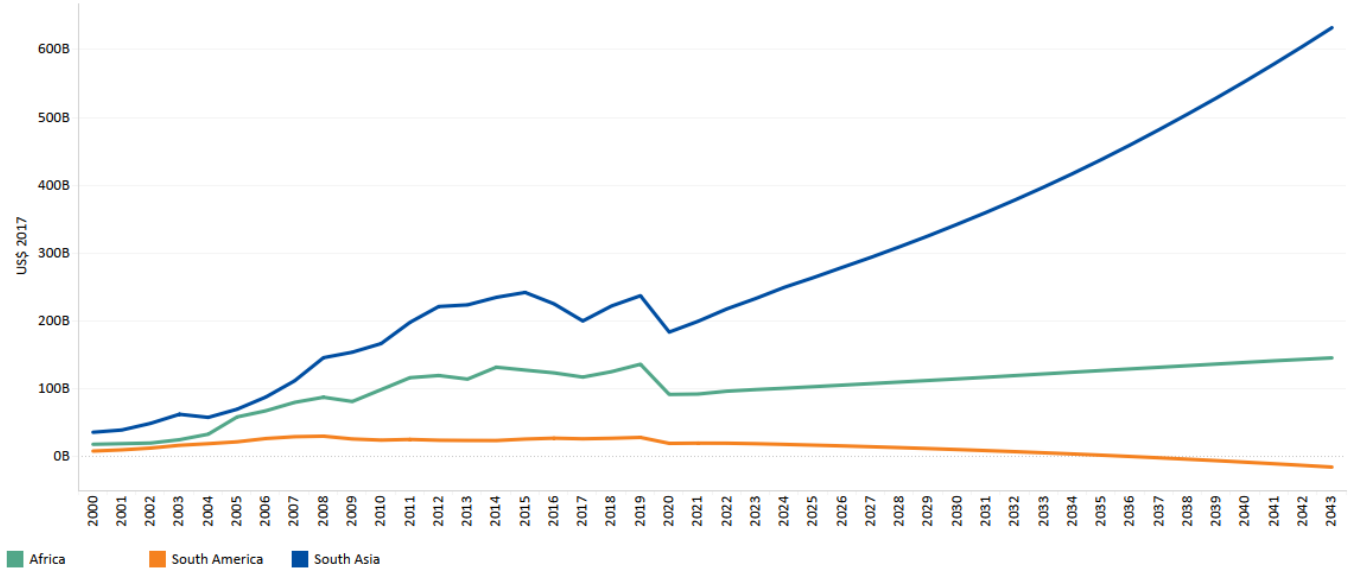
Chart 2: Aid receipts for Africa, South America and South Asia, 1960–2043



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

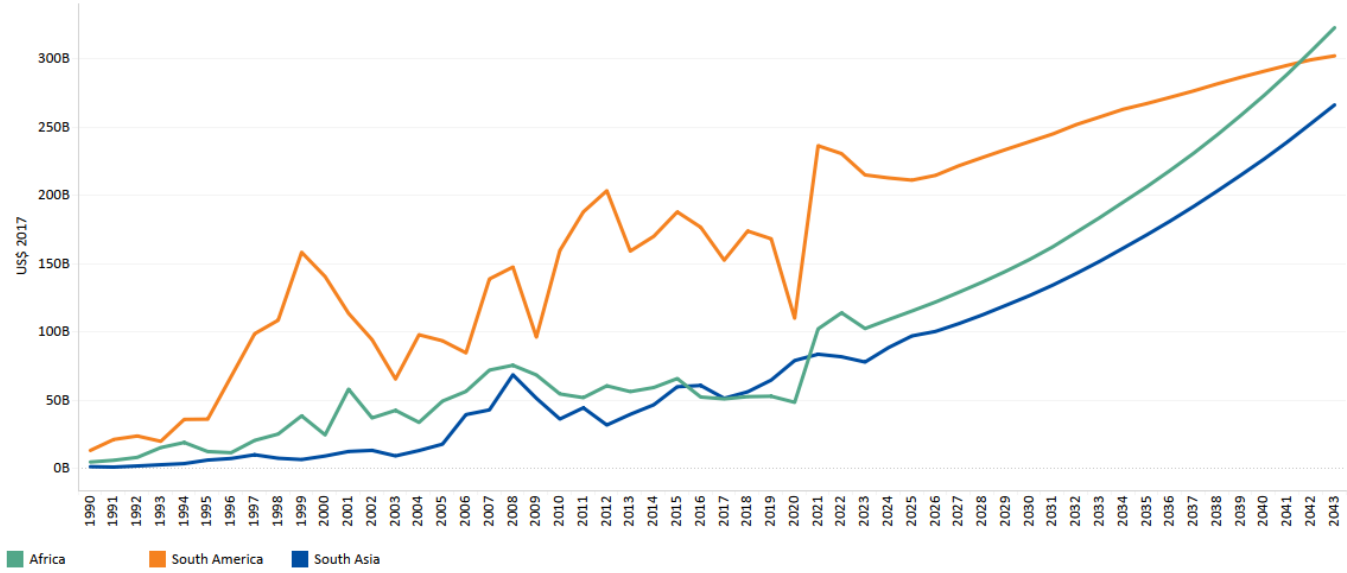
Like Africa, remittance flows are a major source of income for all countries in South Asia—larger than all other capital inflows combined. In 2019, India received more remittance than any other country in dollar terms; Nepal ranked third in the world in terms of remittances to GDP at 27%.

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.

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.

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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.

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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.