Financial Flows.

Conclusion

Marvellous Ngundu

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Conclusion

Africa's external financing challenge is not simply a shortage of capital. It is also a challenge of converting external resources into productive investment, employment, public revenue and higher household incomes. Aid, remittances, FDI and portfolio investment play different roles and carry different risks. Still, all can contribute more effectively to development when they are supported by stronger domestic institutions, infrastructure, skills and productive linkages.

The scenario analysis illustrates this distinction. A more favourable external financing environment increases the resources available to African economies, but the development gains are considerably larger when stronger absorptive capacity accompanies those inflows. By 2043, the combined intervention, represented by the External Financial Inflows scenario, raises GDP by approximately US$210 billion above the Current Path, increases government revenue by about US$70 billion, raises average GDP per capita by around US$140, increases the inward FDI stock by approximately US$228 billion, and results in roughly 21 million fewer Africans living below the US$3.00-a-day poverty threshold. The effects differ across income groups, reinforcing the need for differentiated financing strategies rather than a single continental approach.

The central policy implication is that Africa should pursue more external finance, but place equal emphasis on improving the development return from every dollar, euro, yen or renminbi it attracts. The objective is not financing for its own sake, but financing that expands productive capacity, strengthens domestic linkages and supports structural transformation.

Policy recommendations:

- **Strengthen domestic absorptive capacity**: Prioritise reliable infrastructure, skills, institutional capability, project preparation, technology absorption and domestic supplier development so that additional external finance translates into productivity, employment and income rather than remaining disconnected from the domestic economy.

- **Improve the quality, not only the volume, of external finance**: Investment incentives and facilitation should favour finance that expands productive capacity, exports, employment, technology transfer and local value addition. Aid should protect essential public goods and capability-building, while remittance policy should reduce transfer costs without treating household resources as public finance.

- **Differentiate financing strategies by country conditions**: Low-income and fragile economies require continued access to grants and deeply concessional finance; lower-middle-income economies should increasingly use external finance to support industrialisation, infrastructure and regional value chains; and upper-middle-income economies should prioritise innovation, technological upgrading and deeper, more resilient capital markets.

- **Deepen domestic financial and fiscal systems**: Stronger tax administration, transparent investment incentives, deeper local-currency bond and equity markets and larger domestic institutional-investor bases can increase the domestic benefits of external finance while reducing vulnerability to sudden reversals.

- **Diversify finance and manage external vulnerability**: Diversify financing partners, curb illicit financial flows, strengthen debt transparency and macroeconomic management, and align external finance with national and regional development priorities. External finance should complement, not substitute for, stronger domestic resource mobilisation.

Recommendations

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About the authors

Dr Marvellous Ngundu is a Senior Research Consultant at AFI. He holds a Ph.D. in Economics from the University of Johannesburg in South Africa. He is the recipient of the 2024 Megatrends Afrika Research Fellowship at the Kiel Institute for the World Economy (ifw) in Germany, as well as the 2020/2021 fellowship program of the China Africa Research Initiative (CARI) at Johns Hopkins University's School of Advanced International Studies in the United States. His research interests lie in the fields of international, political, and development economics, with a particular emphasis on Africa-China economic relations.

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