Financial Flows

Conclusion

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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.[1] 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.[2]

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.[3]

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.[4] 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.[5] 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,[6] 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.[7] 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.[8]

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.[9]

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.'[10] Domestic mining companies are associated with growing local wealth, whereas multinational firms are linked to increased regional unemployment.[11]

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.[12]

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.[13] 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.

Endnotes

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