STUDY

The G20 »Compact with Africa«

Unsuitable for African Low-Income Countries

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June 2017

- The »Compact with Africa« (CWA) – an initiative within the G20's finance track – is a key pillar of the G20 Africa Partnership. In its resolution – adopted by G20 finance ministers and central bank governors in Baden-Baden on March 17-18, 2017 – the G20 has acknowledged its special responsibility to join forces in tackling the challenges facing the world's poorest countries, especially in Africa. Notwithstanding that declaration, the CWA gives little attention to the specificities of the many low-income countries on the African continent.

- The CWA's macroeconomic framework has an orthodox agenda, with a set of well-known (neoliberal) recommendations: fiscal discipline, redirection of public expenditure, tax reform, financial liberalization, elimination of barriers to foreign direct investment, privatization of state-owned enterprises, deregulation of market entry and competition, and secure property rights. However, this agenda does not adequately reflect major African challenges: lack of jobs, poverty, insufficiently integrated economies, and low levels of industrialization.

- The CWA's business framework primarily addresses regulatory uncertainties. Its agenda sets priorities regarding institutional and judicial bottlenecks, which include enactment of business rules, lack of access to information, and discretionary treatment by government officials. Although it is absolutely necessary to resolve these basic problems, the CWA falls short of proactive strategies to support African enterprises.

- The CWA's financing framework is centered on de-risking (blending) instruments to stimulate infrastructure investment by pension funds and life insurance companies. Public investment, rural credit organizations, and bank intermediation – funding vehicles of successful development in Asia and Europe – are ignored. The commitments proposed to African partner countries are unlikely to be effective in stimulating sustainable infrastructure, because institutional, banking, and liquidity prerequisites for blended finance do not yet exist in most of sub-Saharan Africa.

Content

The G20 »Compact with Africa«

The G20 Africa Partnership is a central project of Germany's G20 presidency 2016/2017. Its aim is to improve conditions for sustainable private sector investment, investment in infrastructure, economic participation, and employment in African countries. Apparently, Germany envisions that increased investment on the African continent will foster conditions that will incentivize Africans to remain at home, thereby mitigating the migration crisis in Europe.

A key pillar of the G20 Africa Partnership is the »Compact with Africa« (CWA), an initiative within the G20's finance track, which is coordinated by the German Federal Ministry of Finance. In its resolution – adopted by G20 finance ministers and central bank governors in Baden-Baden on March 17-18, 2017 – the G20 has acknowledged »its special responsibility to join forces in tackling the challenges facing the poorest countries, especially in Africa«.[1] The CWA initiative aims to boost private investment and investment in infrastructure in Africa. To this end, the World Bank, the International Monetary Fund (IMF), and the African Development Bank (AfDB) have produced a joint report (The G-20 Compact with Africa: A Joint AfDB, IMF, and WBG Report), which proposes a catalogue of instruments and measures designed to improve macroeconomic, business, and financing frameworks as a way to boost investment.[2] The document is a dense, well-argued, and documented text, albeit written in fairly technocratic language.

From an African perspective, a complementary approach to the existing frameworks that African governments have already endorsed would have been preferable (Mabera and Monkam 2017). Africa has well-thought initiatives aimed at bolstering its diverse economies; however, these often fall short of implementation, which remains a crucial question of concern on the continent. In particular, the African Union's Agenda 2063 is the continent's blueprint for socioeconomic development and integration, with a set of priorities that will drive Africa's transformation over a period of five decades.

The CWA has suggested a great number of »policy commitments« for African partner countries that are deemed necessary to facilitate private infrastructure and corporate foreign direct investment (FDI). These commitments have to face reality tests for the difficult political and institutional environment in Africa's low-income countries (LICs). As past experience with policy reforms in developing countries suggests, the CWA risks being proved ineffective, because it assumes that all developing countries suffer from the same problems, and that all of the problems were equally important (Rodrik 2011). Yet an unweighted checklist of selected governance elements has often led to an undifferentiated reform program that fails to target an economy's most severe bottlenecks under the constraint of scarce political and administrative capital.

This discussion paper will focus on critically discussing the CWA's macroeconomic (section two), business (section three), and financing (section four) frameworks. Special attention will be given to the suggested »policy commitments« and their realism for the context of the poorest African countries, reflecting the G20 claim »to join forces in tackling the challenges facing the poorest countries«.[3] The aim of our paper is to produce policy conclusions (section five) with respect to the required sequencing of policy reforms in the context of the business and financing frameworks, and to define institutional prerequisites to realize the foreign private sector contribution envisioned by the G20 for the hard reality of low-income Africa. Despite the official narrative of »Rising Africa«, the number of extreme poor has grown at least by 50 million Africans to 330 million as a result of strong population growth. Poverty reduction has been slowest in fragile countries, and rural areas remain much poorer with substantial chronic poverty (Beegle et al.).

Macroeconomic Framework

The CWA's macroeconomic framework is about promoting private investment, economic growth, investment in infrastructure, and management capacity building. It provides an agenda for the G20, and focuses on the activities of African governments, G20 countries, and

1. http://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/Featured/G20/2017-03-30-g20-compact-with-africa.html

2. The report benefited from contributions by Professor Paul Collier (Oxford University), Richard Manning (Oxford University), and Ulrich Bartsch (German Ministry of Finance).

3. The five countries reported by the BMF to have expressed particular interest in joining the CWA – Cote d'Ivoire, Morocco, Rwanda, Senegal, and Tunisia – belies that G20 claim, because they do not belong to the poorest African countries.

international organizations. Moreover, the report states that commitments will be tailored to the specific economic conditions and development of the African country, and that individual African countries are free to set their own priorities. It identifies key reforms and makes it clear that macroeconomic stability is a precondition for attracting private investment in noncommercial public infrastructure – such as road networks, basic education, and health infrastructure (CWA 2017: 7).

The macroeconomic framework outlines four modules for governments to increase financing for infrastructure: ensure macroeconomic stability and debt sustainability; boost domestic revenue mobilization to provide priority infrastructure measures avoiding undue reliance on borrowing; strengthen institutions; and privatize public utilities and transform public utilities into entities that are potentially commercial and financially autonomous.

At the beginning of the chapter on the macroeconomic framework, the report mainly deals with average figures of sub-Saharan economic growth. The CWA mentions the »less supportive« global environment and states that »the diversity of economic conditions calls for differentiated policy response« (ibid.). The report argues that a set of adjustment policies are needed in countries hit hard – countries that have been affected by export price volatilities, by environmental crises, and political unrest. However, the report fails to comprehensively differentiate between growth and growth accelerations in countries and groups of countries, which would make it clear that »one size fits all« policies will not adequately cope with the challenges of different African countries – which are primarily high and rising unemployment, poverty, and social inequality.

Economic points of departure vary drastically from country to country – for example, between coastal and landlocked countries, middle-income countries (MICs), and LICs, and between resource-rich and resource-poor countries. African countries are affected differently by the external environment, which is characterized by vulnerabilities of commodity prices and demand. For instance, growth among non-renewable commodity exporters has dropped to a median growth of 3.2 percent (2015), whereas non-resource-intensive countries – such as Kenya, Cote d'Ivoire, and Ethiopia – have continued their strong growth momentum. Using the growth acceleration criteria laid out by Hausmann, Pritchett, and Rodrik (2005),[4] accelerated growth can be established for some countries; only about half of African countries are experiencing long-term growth. Many African countries had high growth rates of 6 to 8 percent, but others face very low and sometimes even negative growth. African LICs failed to realize accelerated growth, and most of them have specialized in a narrow range of exports. Commodity exporters not only lag behind diversified exporters in terms of diversity of export products, but also in terms of diversity of export partners.[5] Budget deficits have risen across all LIC groups. In oil exporting countries, the average fiscal deficit increased from 1.9 percent of gross domestic product (GDP) in 2014 to 5.1 percent of GDP in 2015. Among non-fuel commodity exporters, deficits increased moderately – from 2.3 percent in 2014 to a 3.5 percent in 2016 (IMF 2016).

The CWA's macroeconomic measures have an orthodox agenda, with a set of well-known (neoliberal) recommendations: fiscal discipline, redirecting public expenditure, tax reform, financial liberalization, elimination of barriers to foreign direct investment, privatization of state-owned enterprises, deregulation of market entry and competition, and secure property rights. However, this agenda does not adequately reflect major African challenges – lack of jobs, poverty, insufficiently integrated economies, and low levels of industrialization. Focusing the macroeconomic agenda on »making the institutions work« misses a significant aspect of the economic problems in Africa – especially in the LICs. On the one hand, the CWA strategy proposes measures that are somewhat in line with well-known big push strategies and macroeconomic structural adjustment concepts (Lopes 2012); on the other hand, the CWA emphasizes the role of domestic revenues and better institutions. Of course, it is essential to manage public investment and debt and

4. Hausmann, Pritchett, and Rodrik define a »growth acceleration« as »an increase in per capita growth of 2 percentage points or more.(…) To qualify as an acceleration, the increase in growth has to be sustained for at least eight years and the post-acceleration growth rate has to be at least 3.5 percent per year« (2005: 304). The growth criteria formulated by the authors do not treat sustainability in the sense of sustainable development, which includes the four interconnected domains: environment, economics, politics, and culture.

5. The slow progress in export diversification points to the need for reform policies. Key measures include upgrading institutional quality to support private investment; industrial policy support measures for small and medium enterprises, fostering integration in global and regional value chains, industrial zones, and clusters; education/training to improve the skills of the labor force; trade and agricultural reforms to reduce trade costs; financial inclusion; investment in research, technology, and innovation to improve product quality; and avoiding exchange rate overvaluation to support export competitiveness. For more information, see Kappel, Pfeiffer, and Reisen (2017).

to improve the efficiency of administration. Nevertheless, it is quite clear that stimulating sustainable and inclusive growth – jobs for the poor and environmental sustainability – requires proactive structural policies that are dedicated to different industrialization strategies, modernizing agriculture, raising competitiveness, and creating jobs for million of unemployed jobseekers.[6]

The CWA advocates prior initiatives on large-scale industrialization programs for African countries, in order to take advantage of economies of scale and scope and to escape the low-level-equilibrium trap.[7] According to this kind of »big push« concept of economic development, publicly coordinated investment can break the underdevelopment trap by helping economies overcome deficiencies in private incentives that prevent firms from investing and adopting modern production techniques and achieving scale economies. These scale economies in turn would create demand spillovers, increase market size, and could generate self-sustaining growth that allows the economy to move forward through large-scale infrastructure projects and FDI. The infusion of public capital – roads, schools, waterworks, power plants, access to the Internet, dams, airfields, and hospitals, among other infrastructural improvements – is planned to reshape African economies, expand and integrate markets, generate significant external economies, increase rates of return to large-scale manufacturing, and encourage subsequent investments.

The macroeconomic framework primarily deals with improving the performance of public utilities. According to the CWA, widespread theft and a dilapidated infrastructure show how weak the operational performance of utilities is. In order to restore a financial equilibrium, the CWA emphasizes the reduction of costs and the increase of revenue of public utilities. Therefore, the report proposes better utility performance – which requires better governance, management reforms, and higher quality of infrastructure. The CWA focuses on sound public investment management, which contributes to reduced losses of committed resources, improving public practice, collusion and corruption, which adversely affect costs, timeliness, and quality of public investment. In order to meet the respective requirements, the CWA provides a set of largely technical measures.

Missing is a comprehensive strategy that tackles the low-level performance of public utilities. In many countries, public utilities are not always adequately managed and may struggle with resources, including human resources and sufficient state revenues. Excessive bureaucracy and corruption do not benefit all enterprises equally, but primarily large and/or foreign companies.

The CWA's macroeconomic framework identifies concepts for maintaining macroeconomic stability, while providing for adequate investment infrastructure. The CWA's macroeconomic modules are related to measures for avoiding debt problems in Africa. Rising inflows of long-term finance for infrastructure investment can lead to the risk of a new debt overhang in some countries. In particular, countries that try to stimulate growth by investing in infrastructure may not create more competitive industries and more jobs – thus growing gross domestic product and rising state revenues – in order to serve annual debt service. While some countries have low debt levels, 36 countries in Africa had debt-to-GDP ratios above 40 percent in 2015. There were large increases in public debt levels in many LICs, including Malawi and Mozambique. Rising public borrowing levels have been the key driver of debt accumulation in most cases, including Republic of the Congo, Zambia, and Mozambique, which undertook large external commercial borrowings through state-owned companies. LICs' debt servicing costs have also been rising, due to rising debt stocks and increased recourse to higher-cost commercial loans. According to the IMF (2016), »debt sustainability assessments have deteriorated in a number of Africa's countries; the sources of debt increases vary, but public infrastructure investments appear to be a common denominator«. Because this applies primarily to African LICs, the CWA emphasizes increasing savings through domestic revenue mobilization and expenditure cuts, including the reduction of subsidies. Further, the CWA advocates an investment-friendly tax system, sound public management, and expenditure reforms of civil service and pensions.

6. The CWA does not address the problem of poverty and unemployment and those sectors, which might not benefit from more FDI and infrastructure investment. The CWA fails to adequately address problems of social insecurity, rising number of poor people, unemployed youth (especially young women), those who have not been sufficiently trained, etc.

7. The theory states that as per capita income remains below a critical level, a population growth rate that exceeds the income growth rate will always bring the economy back to a »Low-level Equilibrium Trap«. Escape from the low-level equilibrium trap is possible either by increasing the rate of growth of income, or by lowering the rate of growth of population, or by both.

The debate on African infrastructure should focus more on these financing issues. There is evidence that inefficiency is often the barrier to investment. For example, the IMF (2015) estimates that about 40 percent of the potential value of public investment in LICs is lost to inefficiencies in the investment process due to time delays, cost overruns, and inadequate maintenance. Those inefficiencies are often the result of undertrained officials, inadequate processes for assessing needs and preparing for and evaluating bids, corruption, as well as short-term political interests. Reducing inefficiencies could substantially increase the economic dividends from public investment. The CWA focuses on these major bottlenecks, but fails to adequately address the different conditions, funding requirements and debt issues of African countries in general and the LICs in particular.

In addition, the report stresses the role of an »investment-friendly tax system« (CWA 2017: 11), which boosts private investment. The tax system is closely related to the overall investment climate, which is one of the most important determinants of FDI and local investment.[8]

The following risks, which are linked to the CWA's macroeconomic concept and focus on a privately (co-) financed strategy, should be carefully considered:

1. There are inadequate resources. The CWA fails to recognize that resources in African countries are limited and that there are many other scarce factors – such as low investment in human capital, inadequate institutions, and constraints to entrepreneurship.

2. There is a risk of inflation caused by higher public investment on infrastructure. Inflation has steadily eased in African countries with pegged exchange rate regimes, but the inflation rate among countries with flexible exchange rate regimes has risen since 2014 and most strongly in some African LICs, including Malawi, Ghana, Mozambique, Nigeria, and Sudan.

3. It is very difficult to coordinate the activities of the involved actors and institutions. This is a problem for small LICs in particular. Their governments face the difficulty not only in the initial drawing of the infrastructural activities, but also in the execution of various development projects according to a planned timetable. Thus, coordination can be regarded as one of the weakest points in the CWA. It should be noted, however, that the CWA does emphasize some interesting technical tool kits, such as Medium-Term Debt Management Strategy (MTDS), PPP Fiscal Risk Assessment Models (PFRAM), and Public Management Assessments (PIMA).

4. The CWA big push strategy puts more stress on heavy public investment in infrastructure, which is not related to the development of competitive industries in African countries. The CWA ignores the different speeds of countries, some of which produce capital and consumer goods, while many others – in particular, the LICs – supply raw materials or agricultural products.

5. Many least or less developed African countries are not able to invest in infrastructure, because they do not have the available resources and cannot raise taxes, improve the bureaucracies, and avoid rising debts. These countries lack appropriate human resources and institutional capacities.

6. The CWA report does not offer a comprehensive approach that includes business, labor, education, and the environment. First, it does not even mention the role of investment in education – technical competences, vocational training, tertiary education – which many studies have identified as a main restraint to further development, including the development of local and national industries, small and medium enterprises (SMEs), and their integration into industrial clusters and global and regional value chains. The same applies to the development of agriculture, the link to urban centers, rural modernization, and the rise of productivity. Investment in education should be an integral complement to physical infrastructure and private investment of the CWA. Second, the CWA deals with investors' risks, but it does not consider the environmental and social risks associated with FDI and infrastructure investment. The CWA does not even mention the 2030 Agenda on Sustainable Development, which African countries and the G20 member

8. African countries generate more than 500 billion US dollars annually from domestic taxes and can mobilize more domestic revenue through improved tax administration and measures to broaden the tax base. The average tax-to-GDP ratio increased from 18 percent in 2000–02 to 21 percent in 2011–13. For more on this, see African Development Bank (2016), in particular chapter 2 on domestic and foreign resource flows (remittances, ODA, credits, FDI).

states have agreed upon. Ignoring the social and environmental costs of the CWA big push strategy means that the G20 turns against international solutions – like the climate agreement and the sustainable development goals of the 2030 agenda. The implementation of the CWA is in dire need of a strategy that includes growth, economic and sustainable development, which has been highlighted in many documents (UNCTAD 2015). Furthermore, the CWA completely ignores internationally agreed labor and social standards. Potentially adverse socioeconomic effects of private and public investment should be tackled by adhering to adequate international standards and by effectively implementing safeguards. Experience shows that economic growth should include measures to empower individuals through decent work and through social protection, thus achieving equitable and sustainable growth for all (see: ILO 2014). Third, the CWA fails to discuss the G20's responsibility in creating an uncertain trade and investment policy environment that harms investment in Africa. A predictable trade regime is needed between African countries and the main economic blocks – the United States (US), the European Union (EU), and China.

Business Framework

The CWA reflects the changing business environment in African countries. The report discusses the institutional framework and policies that support good governance and an enabling business climate, followed by a list of mutual commitments by G20 and African countries that could make Africa more attractive for investors. The CWA's business framework links four modules: promoting reliable regulations and institutions shifting toward rule-based, transparent and predictable processes of negotiated investments; dealing with dispute settlements; fostering bankable infrastructure projects; and standardizing contracts.

Since the mid-1990s, African countries have been experiencing a period of increased growth of GDP and real per capita income. FDI inflows into Africa have also increased due to increased demand for African natural resources and a growing African market led by the increased purchasing power of expanding middle classes in urban centers (Kappel et al. 2017). Performance[9] and competitiveness have also improved, although Africa continues to lag behind other continents. On average, landlocked and fragile LICs demonstrate worse rankings than coastal countries and MICs with natural resources. At the bottom of the rankings are primarily poor countries and landlocked countries. Most of these states are also characterized by civil war and fragile statehood.

Moreover, Africa is diversifying, the digital transformation is proceeding rapidly, and many African enterprises have started to integrate themselves into regional value chains (RVCs) and global value chains (GVCs). The CWA recognizes some positive developments, but makes it clear that most African countries – especially LICs – still have a long way to go. Many studies show that most LICs do not participate in value chains and thus are partly excluded from access to foreign markets, technological spillovers, and knowledge transfers.[10]

The most important part the of business framework chapter deals with reliable regulations and institutions. It states that African countries in general can do more to create a favorable business environment. Political risks are high and are a severe constraint to FDI; these risks include the danger of expropriation, transfer of convertibility restrictions, breach of contract, and the general absence of regulatory transparency. These widespread risks limit local and foreign investment. The CWA postulates that »making the international investment regime more ›rule-oriented‹ rather than ›power-oriented‹« (CWA 2017: 21) can help protect investors against risk. The CWA recommends the introduction multiple regulations and judicial procedures to protect investors – including the Systematic Investor Response Mechanism (SIRM), which enables countries to identify patterns in government-generated grievances affecting investment. Introducing these measures in Africa's MICs will already be an enormous challenge, but it seems unrealistic to consider such measures for fragile states, and for countries that are involved in political crises (for example, the Sahel states).

9. Economic performance covers fundamental aspects of the definition of competitiveness: economic development, level of financial development, infrastructure, institutional framework, level of education, and market openness.

10. See Bhorat, Haroon and Finn Tarp (2016); Kappel, Pfeiffer and Reisen (2017).

Regarding regulatory uncertainties, the CWA agenda sets priorities regarding measures that primarily address institutional and judicial bottlenecks, including the enactment of business rules; lack of access to information; and discretionary treatment by government officials.

Although it is absolutely necessary to resolve these basic problems, the CWA falls short of proactive strategies to support African enterprises. Governments and economic actors should develop strategies for SMEs in order to unlock their potential. Regulatory burdens disproportionately affect SMEs, thus they stagnate in many African countries. Again, the CWA does not differentiate. Research shows that the situations of SMEs differ widely: SMEs in LICs are mainly very small firms and micro enterprises, who are often informal actors just trying to survive; in MICs, there is a growing class of medium-sized enterprises (particularly in urban hubs), which are partly integrated in global or regional value chains.

The CWA intends to strengthen the investment climate and FDI, but omits investment policies that could deepen the complementarities between FDI and domestic investment. Yet, industrialization, the development of backward linkages, and local supply chains depend on a favorable investment climate for both local firms and foreign investors. There is a void here in the CWA argumentation.

Most striking, however, is the lack of a proactive policy to tackle broad-based problems of most African countries, which are caught in a primary commodity dependence and a trap of unlimited supply of labor. Due to growing world markets and improved institutions, numerous countries on the African continent were able to solidify their positions as suppliers of minerals, oil and gas, as well as agricultural products, but most African countries have been unable to industrialize further (Bhorat and Tarp 2016). Africa's share of exports of manufactured goods is especially low, having sunk from 1.6 percent in 1980 to 0.8 percent in 2015. Less than 4 percent of the population is employed in the African manufacturing industry. The share of manufacturing value added in gross domestic product decreased between 1991 (about 13 percent) and 2015 (about 10 percent in 2015).

Africa is in need of a structural transformation process towards a modern economy, resulting in the creation of jobs in the industry and modern service sectors, and modernizing agriculture. Due to long-term developments in many African countries, migrating agricultural laborers are employed in low-productivity service sectors and the urban informal sector. In short, many African countries are characterized by three main features: resource dependence with a capital-intensive form of production and limited employment generation; small and often stagnant manufacturing sector; and huge informal sectors. This dynamic reveals a tendency not only towards large capital-intensive companies, but also towards micro enterprises in the low-productivity, traditional, labor-intensive informal sector and the existence of only a negligible medium-sized enterprise sector. Therefore in countries characterized by the abovementioned transformation process, unemployment and poverty are widespread. Countries that were able industrialize and modernize agriculture created more jobs and reduced poverty.

Most countries in Africa have been unable to successfully industrialize[11] and significantly increase their industrial employment levels, due to a different global economy and global competition, rapid technological change, and global shifts in demand towards services. This means that the development prospects of African firms are limited because most African enterprises are less productive than those from Asia and other emerging regions. Even their use of the latest technologies, which – in principle – could bring about an industrialization process, is limited.

Of importance is the changing dynamic of urbanization in African countries. The creation of more productive jobs for the rapidly growing population in Africa is central to achieving sustainable structural transformation (Kappel, Pfeiffer, and Reisen 2017). The slight shift away from resource-seeking FDI has had an effect on employment: the share of jobs created by FDI in consumer-oriented industries in urban hubs has increased considerably and now exceeds the share of jobs generated by FDI in the extractive industries.[12] Among all the jobs directly created by FDI in Africa, about 80 percent were located in cities and directly led to more than 600,000 jobs (2003–2014). FDI in

11. Rodrik (2016) characterized these developments as »premature deindustrialization«, since it means that most developing nations are becoming service economies without having had a proper experience of industrialization.

12. On FDI and employment trends see Kappel, Pfeiffer, and Reisen (2017); AfDB, OECD and UNEP (2016).

urban agglomerations is an important driver of Africa's structural transformation. However, most foreign investors hire low-skilled workers, and jobs for skilled workers are often limited. The services sector (e.g., financial services) is an increasingly important destination for foreign investors in Africa. Manufacturing sectors (e.g., electronics, motor vehicles) have also received large investments in recent years. The largest share of jobs directly created by FDI in Africa is located in cities, reflecting increasing urbanization rates in African countries.

FDI is widely considered to be fundamental for growth, employment, and structural change. FDI inflows produce heterogeneous effects that go beyond spillovers to domestic firms; they can contribute to structural change, including the gradual shift to more consumer-market-oriented industries. FDI are not necessarily correlated with a country's attractiveness – as evidenced by Angola, Algeria, Botswana, Mauritius, Mozambique, and Rwanda. Each of these countries is rated either »highly attractive« but have few FDI projects, or »not particularly attractive« but have secured a large number of FDI projects. In many African countries, natural resource wealth and geographic location are still the main drivers of FDI inflows (Republic of the Congo, Angola, Nigeria, Algeria, etc.), but FDI inflows into consumer sectors are on the rise. Apart from foreign investors from industrialized countries, enterprises from emerging markets have also started investing in labor-intensive industries in order to take advantage of the low minimum wages in some African countries. China and India – as well as middle powers Turkey, Qatar, Israel, and Russia – are the major players from emerging markets in Africa. Chinese and Indian investors typically target construction, chemical and pharmaceutical products, information and communication technology (ICT), as well as food and beverages.

The overall conclusion is that FDI in manufacturing, construction, trade services, transport, ICT, etc., has resulted in growing employment and positive labor productivity growth. This is mainly the case in urban hubs and in sectors that are integrated in GVCs and RVCs (car production, food production, ICT sector, horticulture, textiles, etc.). Productivity growth in these sectors is the sine qua non of long-term development. Generally, the stronger integration of African countries into GVCs may also foster the absorption of technology and skills from FDI. Overall, however, the transfers of technology and spillover effects have been limited, and a systematic trend cannot be identified. Based on the analysis of trends and the channels that are expected to drive structural transformation in Africa, the following policy measures are key.[13]

1. Policies that deepen the complementarities between infrastructure development, FDI, and domestic investment should be promoted to ensure sustainable growth. The CWA does not sufficiently examine these links – in particular, how to create linkages in LICs. The development of backward linkages and local supply chains depends on creating a favorable investment climate for both local firms and foreign investors. Strong FDI linkages with the domestic economy can result in a greater diffusion of knowledge, technology, and know-how.

2. The CWA underestimates the developmental role of SMEs. Dismantling market entry barriers for SMEs can stimulate economic growth and, hence, boost employment and raise incomes. Although the overall environment for enterprise development has improved, the World Bank's Doing Business Indicators show the situation remains critical for SMEs. In many LICs, the costs of starting a business have decreased, but they are still much higher than in Asian countries. This is why many countries' competitiveness ranks below many other LICs in Asia or Latin America on infrastructure endowment, human development, technological readiness, and market efficiency. Solely focusing activities on the development of infrastructure and the regulatory framework »making the market better work« will not improve the competitiveness of SMEs and will not help the industrialization and upgrading of entrepreneurs. In order to promote African small and medium entrepreneurs, a proactive industrialization process is necessary and it should include the modernization of agriculture, intraregional trade in Africa, and integration in global and regional value chains.

13. See Kappel, Pfeiffer, and Reisen (2017) to compare for additional concepts, strategies and measures stimulating FDI, supporting local businesses and related institutions. Also see: AfDB et al. (2016); African Development Bank, Organisation for Economic Co-operation and Development, United Nations Environment Programme and United Nations Economic Commission for Africa (2012); and United Nations Economic Commission for Africa and African Union (2014).

3. The CWA ignores agglomeration benefits that can be utilized in cities and industrial clusters. Innovative and competitive clusters can be drivers for more FDI. In growing cities – where the conditions for growth and the development of SMEs are evidently better – there is a greater likelihood of innovative and creative SMEs emerging. Supporting clusters through business development services, better transport systems, qualified labor, and access to electricity – which are daunting tasks in LICs – would help to enable connectivity and improve the competitiveness and innovative capacities of SMEs. These developments can help to attract FDI and foster investment in value chains and subcontracting with domestic medium-sized enterprises.

4. The CWA is fairly silent on how investment in the infrastructure of intraregional corridors can reduce trade costs and spur development. But they have the potential to boost regional exchange and growth. Regional economic integration is essential for Africa to utilize its full growth potential, to participate in the global economy, and to enjoy the benefits of an increasingly connected global market. In our view, particular significance should be placed on promoting economic development (industrial cluster promotion, integration into value chains, technology transfer) in reform countries (the good performers), because they are attractive, draw investment, and increase the exchange potential of neighboring countries, including land-locked and low-income countries. These countries can create contagion effects and also intensify regional integration.

Financing Framework

The CWA's financing framework aims at increasing the availability of financing at reduced costs and risks, with a focus on infrastructure projects with long gestation periods. In particular, it targets pension funds and life insurers. These institutional investors are characterized by the long-term nature of their balance-sheet liabilities, which enables them to invest in infrastructure projects with long gestation periods. Kappel, Pfeiffer, and Reisen (2017) project their asset base, to conclude that they would indeed make a very good fit for funding Africa's infrastructure. Projected to reach 100 trillion US dollars by 2020, institutional investors – pension, funds, life insurers and sovereign wealth funds – would need to invest 1 percent of their annual new inflows to fund Africa's infrastructure gap, estimated at 50 billion US dollars per year (see: IMF 2014).

The CWA makes some important ideological presumptions. First, it is solely driven by the Anglo-Saxon financing model with a focus on direct securities (equity and bond) markets, rather than bank-based financial intermediation, which has underpinned (Continental) European and East Asian economic and social development. Second, the CWA's financing framework is silent on the important role that the public and semipublic sectors may have played in early stages of development via mandatory public pension plans (East Asia) or not-for-profit financial cooperatives (such as agricultural credit unions). Third, it is silent on the »financing gap« (also known as the MacMillan gap), which has come to indicate that a sizeable proportion of economically significant SMEs cannot obtain financing from banks, capital markets, or other suppliers of finance (OECD 2006). The MacMillan gap requires an important role for public development institutions and public policies in tackling underlying market imperfections (OECD 2013). Lastly, it seems the German Ministry of Finance, which commissioned the CWA report in the first place, is missing a unique chance to bring in the specific German history of bank-based intermediation, of rural credit unions, and of public infrastructure push in the context of late industrialization. This would indeed be relevant for the African context.

Instead, the CWA's financing framework consists of three linked components to tap the global pool of private finance. The first peddles blending instruments and facilities – the use of public or philanthropic funds to attract additional investments from private sector actors into development projects – to lower African country risk to private investors (the new Private Sector Window under the IDA18 replenishment is mentioned explicitly); the second aims at support of domestic debt markets and at a more supportive global regulatory environment; and the third aims to promote new public infrastructure investment funds, such as the Managed Co-Lending Portfolio Program (MCPP)[14]

14. The Managed Co-Lending Portfolio Program is new lending platform created by the World Bank's private sector arm to mobilize institutional investments for infrastructure projects in developing countries. IFC has structured MCPP loans to have a low investment grade rating and yields 4 to 4.5 percentage points above the London Interbank Offered Rate. Meanwhile, the IFC and the Swedish International Development Cooperation Agency will absorb the first losses in any project.

Table 1. Eligibility to Access AfDF Funding (Number of Countries [out of 54 total])

Creditworthiness to Sustain AfDB Financing			
		No	**Yes**
Per Capita Income above the AfDF/ IDAOperational Cutoff	**No**	30 AfDF-only	3 blend-eligible
	Yes	4 AfDF-Gap	3 AfDB-only

Source: http://www.afdb.org/en/about-us/corporate-information/african-development-fund-adf/adf-recipient-countries/

initiated by The International Finance Corporation (IFC), part of the World Bank Group.

Growth diagnostics for developing countries – pioneered by Hausmann, Rodrik, and Velasco (2004) – has emphasized that an unweighted checklist of selected governance elements leads to an undifferentiated diagnosis that fails to target the most severe bottlenecks. The ex ante selection of areas of policy intervention most likely to remove obstacles to investment would need two components: one for symptoms of constraints within the economic and financial system in general and the second for project-specific issues.

Because most African countries remain poor, they are not considered creditworthy. Even though the African Development Bank (AfDB) has 54 member countries – of which only 17 are not eligible to African Development Fund (AfDF) funding – most countries have a per capita income below an operational cutoff (fiscal year 2015–2016: 1,215 US dollars). Recent forecasts (Kharas and Fengler 2017) project that the number of people living in extreme poverty (the headcount of those falling below 1.90 US dollars) will rise in 19 African countries by 2030.

Apart from general investment barriers, common project risks for infrastructure investments need to be considered in the African context. These include completion risks (failure to complete the project on time and on budget); performance risks (the risk that the project fails to perform as expected on completion, maybe due to poor design or adoption of inadequate technology); operation and maintenance risks (which relates to costs, management and technical components and obligation to provide a specific level of service); financing risk (which may arise from an increase in inflation, interest rate changes, etc.); and revenue risks (which relates to the possibility of the project not earning sufficient revenues to service its operating costs and debt and leave adequate return for investors).

Legal, regulatory, and institutional challenges of private-public partnerships (PPPs) should not be underestimated in the context of Africa's LICs. Long-term commitments in the infrastructure sector depend on a set of legal, regulatory, and institutional frameworks. From the time of project preparation, to bidding and finally operation, the regulation of PPPs requires an independent regulator and the handling of disputes by an independent judiciary. Other institutional prerequisites are property and collateral registries, reliable accounting and reporting procedures, and tested and reliable foreclosure mechanisms. The longer the term of contracts and the larger the funding commitments, the more important such »basic« institutional and legal infrastructure becomes.

Moreover, fiscal contingencies of PPPs could burden weak public finances in countries where debt tolerance has proven low. In particular, when privately financing large infrastructure projects in immature markets, there is a risk that private returns come at the expense of long-term fiscal costs (contingent liabilities).

To a large extent, long-term funding of infrastructure in Africa is provided circumventing the intermediation process altogether, including via FDI. Most countries are at the first two steps of the Infrastructure Funding Escalator outlined in Della Croce, Fuchs, and Witte (2016). Table two provides a simplified model. It shows that a prominent role of institutional investors can only be envisaged toward the end of the Infrastructure Funding Escalator. As for low-income Africa, the CWA's focus on an important role for private institutional investors to fund the infrastructure gap is unrealistic: most African countries

Table 2. The Infrastructure Funding Escalator

Steps	Step 1	Step 2	Step 3	Step 4	Step 5
Major Funding Source	Government	Step 1 + Aid Grants + Concessionary	Step 2 + Banks Loans + Leveraged Private Funds	Step 3 + Private Equity + Project Bonds	Growing Role Institutional Investors

Source: based on Della Croce, Fuchs, & Witte (2016).

are at the first two steps of the Infrastructure Funding Escalator, where public investment and concessionary aid remain the major funding sources.

The first component of the CWA's financing framework pins high hopes on blended finance and leveraged finance via development finance institutions (DFIs). Table three, however, shows that private funds mobilized by DFIs seem to have shied away from the »Bottom Billion« (to paraphrase Paul Collier). Within the group of countries attracting blended finance investments, LICs generally (not just in Africa) receive much less on a per country basis compared with other developing countries (Tew and Caio 2016). On average, LICs obtained 60 million US dollars of private investment per country between 2012 and 2014; the equivalent figures for other developing countries were six times higher – 352 million US dollars for LMICs and 404 million US dollars for UMICs. Little of blended finance and of foreign direct investment (FDI) goes to low-income countries compared to official development assistance (ODA), as both categories of private sector flows seem to favor middle-income countries. Despite policy efforts to mobilize private finance through official DFIs, so far they have represented a small fraction of the flows directed to low-income Africa.

Three commitments addressed to partner countries are derived from the first component: support ongoing de-risking initiatives; support various de-risking instruments (IDA18 Private Sector Window, AfDB's PSF[15]); support the further refinement of a commonly accepted set of principles for blended finance. This is more of a self-promotion of the World Bank and the AfDB than a helpful commitment for low-income Africa. In reality, new AfDB initiatives have had a low uptake, especially in low-income Africa. A study finds that the growing complexity and fragmentation of private sector mobilization initiatives created by multilateral development banks seems confronted with »little awareness or understanding of these private sector mechanisms and initiatives« on the ground (Bertelsmann-Scott et al. 2016).

The second component of the CWA's financing framework calls for domestic debt market development, as already found in Egypt, Nigeria, and South Africa. The CWA document is well aware – in some paragraphs, at least – of capacity constraints that impede Africa's securities market development. To be sure, there has been limited progress in developing markets for long-term finance on the continent (Croce et al. 2016). Except for South Africa, the depth of equity and bond markets falls far short of the capitalization and liquidity of financial markets in other developing regions, despite recent

15. Private Sector Credit Enhancement Facility (PSF).

Table 3. Allocation of FDI, ODA and DFI Mobilized Funds per Income Group in Africa

Income Group	**FDI**	**ODA**	**DFI mobilized**
Low Income	4	30	5
Lower MIC	22	43	51
Upper MIC	70	74	19
Mean Percentage Shares during 2012–2014			

Data for country-allocable investments only.
Source: Development Initiatives based on OECD and UNCTAD data.

issuance of Eurobonds and local currency bonds in some places. The largest and most important segment across financial sectors in Africa is the banking system, not an ideal source of intermediation for long-term finance, given the maturity transformation of banks' short-term liabilities and consequent risks.

To avoid currency mismatches in private and public balance sheets, local currency bond market development is primordial. Most poor countries do not borrow in their own currency, which has time and again triggered debt crises as a result of strong currency depreciation, as currently observed in African commodity exporting countries. Substituting external, foreign currency debt with domestic, local currency debt may increase rollover and interest rate risks because of shorter maturities of the latter; this implies it will have to be refinanced more frequently and possibly at a higher rate. Dafe, Essers, and Volz (2017) cite Ghana as an example of the risks involvedsince 2007, Ghana had issued three Eurobonds with tenors between 10 and 12 years, whereas the average tenor of its local currency bonds at issuance was about two years only; moreover, their yields stood at no less than 23 percent in 2014.

Four commitments addressed to partner countries are derived from the second component: introduce an appropriate regulatory and supervisory framework; establish over-the-counter trading as well as custody and settlement mechanisms to minimize costs and risks for debt securities; support the development of pensions funds, life insurance companies, and mutual funds to develop a domestic institutional investor base; implement »sound« debt management policies. We seriously doubt whether scarce African government resources are really best employed by facilitating an Anglo-Saxon system of direct securities markets, and we question the risks in terms of fraud and gambling.

1. The CWA's financing framework is not well suited for low-income Africa. Focusing on de-risking instruments to stimulate infrastructure investment by pension funds and life insurance companies, it is oriented toward a type of investor that usually comes at the end of the funding process.

2. Public investment, rural credit organizations, and bank intermediation have often been the funding vehicles of a big infrastructure push in successful initial development phases. These are ignored in the CWA

3. The Anglo-Saxon finance model based on direct securities (bonds and equity) markets is based institutional, banking, and liquidity prerequisites that do not yet exist in sub-Saharan Africa. They may also lead to debt service problems in poor countries with low debt tolerance.

4. Consequently, the commitments proposed to African partner countries – heavily focused on blended finance – are unlikely to be effective in stimulating sustainable infrastructure where it is most urgently needed, such as schooling, health, and rural development.

Policy Recommendations for African LICs

The CWA chapter on the macroeconomic framework partly reflects the orthodox wisdom for reforms in Africa, by not differentiating between middle-income, low-income, and least developed countries. Most African countries experienced two major interventions: the first – structural adjustment programs – focused on macroeconomic stability; and the second included a focus on improving institutions, reducing corruption or dealing with infrastructure inefficiency. The CWA is a mix of both, but its mistake is not to link the agenda of macroeconomic stabilization, good governance, plus investment in infrastructure to conditions of growth and structural transformation. The CWA does not build on such a concept of structural transformation involving a shift from low to high productivity activities and industrial developments, economic diversification, employment creation.

The CWA business framework focuses on the institutional setting for African countries in general, but lacks an adequate approach for LICs. The CWA offers a concept that will help to improve African institutions, management systems, and the infrastructure, and to unleash entrepreneurial potentials. Nevertheless, the CWA falls short regarding a proactive structural policy – especially for LICs – that links infrastructure investment and fiscal stability with a coherent industrial policy, and integrates FDI and local investors. The CWA does not even mention human rights, labor, or environmental standards.

We propose an agenda that consists of three sequential elements.

- It is necessary to undertake a diagnostic analysis to figure out where the most important constraints on growth are in different African countries or group of countries. This is in line with the CWA concept mentioning the different speeds of African development. A successful growth strategy begins by identifying the most binding constraints. Otherwise, policymakers are condemned to a non-focused spray gun approach. The main challenge is to identify those infrastructure projects that will yield the greatest return. In low-income Africa, economic activity is constrained by at least one of the following factors: macro risk factors, including financial, monetary, and fiscal instability; and micro risk factors, including property rights, corruption, and taxes.

- Once the key problem(s) are identified, it is necessary to think about the appropriate policy responses. The key in this step is to focus on the distortions associated with the constraints mentioned above. The CWA identified constraints, but it did not tackle the links between economic stability, infrastructure development and the development of different industries and local and foreign enterprises. Moreover, it did not analyze the different stages of development and poverty and unemployment in LICs and MICs.

- The next sequence deals with institutionalizing reforms. The CWA strategy primarily deals with bureaucratic obstacles and focuses on institutional reforms. To avoid new crises in African countries, by deploying adjusted strategies for group of countries, the CWA should take a much more comprehensive approach instead of looking into well-known and not always adequate reform programs. The CWA seems to believe that the old-style concepts of structural adjustment will benefit African countries, but this is misleading. Selective and more targeted policy initiatives can have more powerful effects and will spur sustainable and inclusive growth.

The CWA's financing framework essentially puts the cart before the horse – particularly for LICs in Africa – by trying to appeal to institutional long-term financing. It ignores the financing model of successful development, which has largely been based on public infrastructure preceding industrial development, corporate savings via retained earning, rural credit associations, and bank-based finance. It also ignores the risk of debt sustainability linked to blended finance, especially as multilateral development banks are reducing the share of concessionary finance, including to African countries with a long history of default.

Long-term funding of infrastructure in Africa is often provided by circumventing the financial intermediation process altogether. Most countries are on the first two steps of the infrastructure funding escalator, outlined in Table 2. Realistically, a prominent role for institutional investors can only be envisioned towards the end of the infrastructure funding escalator. Strengthened public financing and grants augmented by concessionary credit remain the basic prerequisites for funding low-income Africa's infrastructure.

The dilemma is that low domestic savings levels, weak government finances, and a low debt tolerance militate against forcing foreign private debt and contingent fiscal liabilities upon countries where infrastructure deficits are most blatant. The risk of lasting current account deficits, which are typically financed privately, is that they tend to end with balance-of-payments crises. Many African countries have benefited from comprehensive debt restructuring and relief efforts in recent decades, but since 2010 countries have once again accumulated foreign debt as raw material prices weakened, growth slowed, and concessional debt was replaced. Both investors and Africa's governments should consult the Joint World Bank-IMF Debt Sustainability Framework for Low-Income Countries before raising the finance they need to meet the SDGs, including through grants when the ability to service debt is limited.

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Imprint

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ISBN 978-3-95861-850-3