Financing Africa’s Development in the 21st Century

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As you will have heard before, this is a unique moment in Africa’s economic trajectory. I do not wish to enter the rather sterile debate as to whether Africa is rising or not, a debate I follow sometimes with amusement. Each side across the divide can find evidence for whatever it is looking for. This is rather like the current debate about whether it is all over for the Emerging Markets.

It was Klaus Schwab who once observed that when it comes to Africa the pendulum seems to have gone from a moment of high hopes and optimism to despair and back to ebullience. A term was even coined in the 1990s: they called it "Afropessimism". All in one generation!

No I am not here for that debate. I am here for something different. I am here to talk about sustainability – the sustainability of African countries’ current performance. I am here to share with you my thoughts on what it takes to get to the next critical level – the stage that matters for every country, economic transformation – and what will be the role for an institution such as the AfDB. I am here to try and provide an answer on what it takes for Africa to participate meaningfully in the global value chains, where opportunities and jobs are created; and what it will take to turn Africa’s demographic advantage into a demographic dividend. Africa – a complex mosaic.

It has taken some time for the lexicon that classifies countries into two distinct groups of developed and developing to give way to a more meaningful classification which recognizes a much more complex multipolar economic structure. Ideally, the same ought to happen vis-a-vis Africa. African countries do indeed share a lot and their destiny is linked because of balkanisation and fragmentation.

However, for analytical purposes it would be more objective to move away from seeing Africa as a monolith and instead to see the continent as a complex mosaic consisting of large middle income countries, frontier markets, fragile states, small island states, landlocked ones, states rich in natural resources…I could go on. I believe this kind of taxonomy would help shape a more scientific assessment of the changes going on in each of the 54 countries and the five regions of Africa.

**Megatrends**

That said, I would like to begin by picking up four trends, or megatrends, which are shaping each and every one of the 54 countries in Africa. They do so in different ways, but they do so everywhere.
First, the emergence of the multipolar economic world and the opportunities this is generating as a source of investment, technology and as an export destination.

Second, the demographic dynamics with which you will be familiar: a young continent of one billion increasingly urban people and a growing number of people with a disposable income that drives domestic demand. I am aware of a rather interesting debate about the classification of who is and who is not middle class. Are they a real middle class or just strugglers – to use Nancy Birdsall’s term – or the floating poor, a term the AfDB prefers to describe the same phenomenon? But that is for another day.

Third, the discovery of large amounts of hitherto unknown natural wealth. The continent as a whole is said now to have 122 billion barrels of proven oil reserves, 500 trillion cubic feet of gas reserves and 85% of the world’s platinum.

Fourth, opportunities to leapfrog in some technologies, such as the mobile phone, which is having a deep and lasting impact on service delivery and the cost of doing business.

These megatrends are shaping and influencing the countries of the continent of Africa in a way which will influence the future trajectory of many countries. They do so at a time when two decades of economic and political reforms and increased economic integration have built a stronger shock-absorbing capacity, but also exposed new vulnerabilities. They do so also at a time when the global landscape is in flux and so many uncertainties exist for every part of the globe.

**Post-2015 agenda financing**

Before I come back to my theme of sustainability, let me make two quick observations. Last week in the UN there was a coming together of minds on what the post-2015 development landscape could look like. In the context of that post-2015 agenda debate, much work has been done on issues around financing. The heads of IFIs have made a submission on how our organizations see things and the roles of our institutions. Naturally I endorse and concur with all the recommendations and conclusions, from greater domestic resources mobilization, to issues around smart aid, to leveraging the private sector, to getting a fair deal from natural resources, to curbing capital flight, and more.

I know that Brookings itself has done extensive work on these issues, so I will avoid the temptation of carrying coals to Newcastle, as they say. I do recall that at the last Brooking event I attended at Aspen the discussion centred on the new or
emerging international aid architecture, from traditional sources to emerging ones, and from the BRICs to philanthropy.

The second quick observation I want to make is that if I am emphasizing finance, this is not a suggestion that capital alone is the most important determinant of development. All of us in this room will agree that until institutions are sound, finance’s usefulness will be limited.

**Sustainability**

Let me now come back to the issues around sustainability. Many people do regularly ask whether the current momentum in Africa can be kept, given international uncertainties and domestic challenges. I do agree that there is a whole range of internal and external factors which have the potential to reverse the progress of recent years. No doubt about that. They vary from country to country; they are old and they are new – not least among them are the current security problems in the larger Sahel from the Indian Ocean to the Atlantic.

**Infrastructure**

However there is one binding constraint which is common to all the countries which, if not adequately resolved, has the potential to create stagnation: infrastructure. Africa cannot transform by growing at 5%. It needs a minimum of 7% and it is poor infrastructure that is shaving off 2% each year that stands between us and that target. We all know that sustainability of Africa’s achievements is only possible if opportunities are widespread and jobs created. We know that to create jobs, to anchor into the global value chains, a number of things are key:

- A skilled labour force;
- A minimum of sound infrastructure, especially for power;
- Logistics, which is soft infrastructure; and
- Clusters.

The proposition is that the immense gap in African infrastructure is such that even in the best of times it cannot be closed by public means alone, whether internal or external.

**Private capital?**

So what is the alternative? While it is true that, financially speaking, Africa’s needs are large that is only true in relation to public means, not in relation to private capital. But we also know that private capital does not easily flow to infrastructure. This type of project financing is not easy because transaction costs are too high,
there are too many political unknowns and there are not that many projects ready to go.

Over the past few years the two major players have been international financial institutions (IFIs) and China and, lately, sovereign forays into capital markets. The African Development Bank itself commits 60% of all its lending to infrastructure. Chinese deals, though seemingly easy to mount, have taken place mostly in resource-rich countries, although in a limited way elsewhere as well. IFIs on the whole have stepped up lending, even while being criticized regularly by governments for delays and onerous transaction costs.

**Mitigating risk**

But if private sector interest in infrastructure has been limited so far, how do we explain the telecom and IT-related infrastructure sector, which has attracted significant capital since the 1990s? What is it that made it possible? It is true that costs of entry and risks are not the same. But what are the lessons?

Increasingly, energy companies are looking for opportunities, especially where the policy and regulatory arena are attractive, where there are sound public-private partnership frameworks, independent regulators, well-crafted smart subsidies and so forth.

But let me recast the broader issues here. At an immediate financial structuring level, risk mitigation instruments can be put in place. The Bank itself has had instruments of this type for quite some time. We are deploying more to comfort investors, to increase access to capital markets, to make it possible to do projects in high-risk, low-income countries. With a total value of one billion dollars, we estimate leveraging capacity of one to six. This money was raised from donors in the context of replenishing our concessionary window last month. I refer to the African Development Fund – the equivalent of the IDA. This is a very smart way for donors to use their money. This is what I call smart aid. It is still in its early stages, but we must encourage that direction of travel.

**Capital markets**

Confronted with large infrastructure deficits, many countries have taken advantage of the current international market conditions to borrow for infrastructure at attractive conditions. Access to capital markets has picked up pace over the past few years as more countries have received ratings: Ghana, Kenya, Tanzania, Senegal, Rwanda and several others.
The exceptional market conditions have been helpful, as has been a reassessment of risk in Africa, which investors now know is no better or no worse than other region of the world. It is a direction we need to encourage on two conditions: managing debt carefully and investing well. Done well, this can complement domestic resources where, again, more countries are trying hard to mobilize effectively those resources and eliminate leakages.

**Africa50 – a new business model for IFIs**

But even with all these traditional channels effectively utilized, African countries will still not be able to close the remaining gap. Two lines of thinking seem to me the low-hanging fruit.

First, many well-managed African countries can now go to capital markets and borrow competitively. The same countries are, however, not eligible at this stage to borrow from the IBRD or the AfDB’s non-concessional window. This is a policy dating back over 25 years. At the time this was right. But conditions have since dramatically changed. Access to MDB’s non-concessional windows would have two distinct advantages. First, it is cheaper and, secondly, it comes with a supportive policy framework. I am aware that many Middle Income Countries disliked the "hassle factors" associated with borrowing from IFIs. It is time to take a county-by-country assessment and identify those who should now access IDA or IBRD.

The second line of thinking is one related to how African countries can mobilize and more optimally use their own pools of savings. The current commodity super-cycle has led to accumulation of vast amounts of surpluses. These are now invested outside Africa in instruments deemed safe, liquid and giving a good return, sometimes in quite significant amounts which should be financing Africa. Not every African country has such large surpluses, of course. But for those who do, an opportunity to invest in Africa through a credible vehicle is a win-win. The African Development Bank has proposed a special vehicle for African institutional investors. This is Africa50, of which I am happy to share further details.

This would be deployed to finance only transformational projects deemed a priority and that show a good return. The AfDB is the sponsor and a founding partner. Africa50 will be a company in which the AfDB will be a shareholder and a supporter through a service level agreement. We consider this an opportunity for African countries to take charge of their own development.

And now just imagine if donors agreed that part of the African Development Fund could be used as equity. We have just completed our fundraising for the ADF for
2014-2016. Donors tried hard, but they are struggling. An agreement that part of that money could be invested in a fund like Africa50 would be truly the smart way to support Africa’s own efforts in this regard while reducing the burden on their taxpayers. But using aid money to leverage private sector investment requires crossing an “ideological” bridge.

I recall hearing a European Minister compare the evolution in development aid to the evolution in musical reproduction technology. The way she tells the story is that when she was born music came from the gramophone, when she was a teenager it came from cassette tapes, when she was a young mother it came from CDs and now it comes from iTunes and the like. Her idea was that aid is still deployed as it was in the era of the gramophone. I thought the metaphor was a powerful one.

**Conclusion**

I started off today saying transformation that generates jobs, that enables our countries to join the global value chains begins with closing the gap in infrastructure. The turn of the Millennium and the strong economic performance has put infrastructure everywhere in Africa under pressure.

If we are truly to move to the next level – which is transformation – there is no “business as usual” solution. When colonial powers were taking over Africa they put considerable resources into building infrastructure to service the colonial enclave economies. In East Africa they constructed something called the "Lunatic Express" – a 1700 km line from Mombasa to Uganda at a cost of £3.5 million in 1894, which would be £600 million today. As for the social infrastructure, they left that to the missionaries. That was the way things stood until independence, after which in came the IFIs, which at some point also disengaged. Large emerging market countries have filled the gap since 2001.

It is time now for a different value proposition based on African countries taking charge of their own development. That must begin with the continent taking advantage of the current commodity cycle to invest wisely. It is a chance in a generation: to invest in African instruments for African Development and for an attractive return.

Thank you for listening.