# United Nations
# Economic Commission for Africa (UNECA)

## Regional Outreach of the Intergovernmental Committee of Experts on Sustainable Development Financing to the Africa Region

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## Background Notes for the sessions

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## Topic 1: Overview of Financing for Sustainable Development for the Africa region: Issues, Challenges and Opportunities

While there is no certain or comprehensive estimate of the resource needed to achieve an ambitious development agenda that leaves no one behind, the financial cost of achieving development in Africa amounts to hundreds of billions of dollars annually. Estimates for costs of climate change adaptation for sub-Saharan Africa from a recent World Bank study are in the range of $14bn-$17bn annually. Foster et al. 2010 estimate that, even when taking into account potential efficiency gains, Africa would still face an infrastructure funding gap of $31 billion per year, mainly in power. Around $25 billion a year would be needed to achieve universal access to modern energy services by 2030. Adding to this figure the cost of providing universal access to basic services, social protection, fulfilling human rights and peace and security as well as the cost of arresting desertification, species depletion, water resource depletion and pollution, it is clear that financing needs are important.

Though Africa has benefited from the resumption of economic growth since the adoption of the Monterrey Consensus in 2002, the scale of its needs – from infrastructures to productive capacities – is such that accessing adequate finance for development remains a critical challenge.

Regional discussions on the post-2015 development framework have identified the need for Africa to focus on developmental transformation. The first task of structural transformation in the African context is the transformation of the system of "production" from one dominated by primary extraction and low value-added agriculture and services, to one in which high value is added through the application of technology, innovation, beneficiation, better linkages between sectors in the wider economy and a fairer share of natural resource rents. This also encompasses the structural transformation of Africa's political economy, including developmental governance, environmental sustainability and equitable development- as the building blocks for sustainable human development. Structural transformation is particularly crucial if Africa were to adequately manage the impacts of its vulnerabilities and those imposed by the international political economy. Structural transformation is both a goal and a necessity to adequately finance, achieve and sustain developmental goals in the African context.

Analysis of the mixed results of the region during past decades highlights key elements that should inform the discussion about financing for sustainable development in Africa post 2015.

1. Taxation is the biggest source of public finance in developing countries. African governments raise on average over ten times more revenue through taxation than through aid. There are signs that economic dynamism, coupled with improved macroeconomic fundamentals, is broadening the scope for domestic resource mobilization in the region, mainly by expanding the tax base potentially resulting in significantly more public resources. If the African countries that have a tax to GDP ratio of below 15 per cent increased their revenue levels to this threshold, the continent's governments would have an additional US$200 billion at their disposal annually.[1] Of increasing importance is international taxation. As trade has become more global and service-based and international tax rules haven't always been able to keep up with growing amounts of cross-border trade, income from these activities often goes untaxed or is taxed unduly low. Multinational enterprises often make use of aggressive tax planning that exploits loopholes and secrecy as well as transfer mis-pricing (see below).

[1] UN Millennium Campaign, 2014, Structural transformation and the challenge of financing Africa's post-2015 development agenda, p. 16 see: http://www.endpoverty2015.org/wp-content/uploads/2014/02/africapost2015.pdf,.

It is widely acknowledged that the region, as a major exporter of natural resources including oil and minerals, has not been able to capture a share of taxes that is consistent with the value of the natural resources and that progress on this front could generate additional public resources.

2. Illicit financial flows in all their forms have been a recurrent concern in the region, due to their magnitude in relation to foreign aid and domestic budgets, their adverse impact on countries' governance systems and the critical role that action on this front could play to finance developmental policies and actions. According to Global Financial Integrity (GFI), the bulk of illicit financial flows are commercial transactions such as transfer mis-pricing and trade mis-pricing. [2]

Conservative estimates suggest that illicit outflows from Africa totaled about US$854 billion between 1970 and 2008. Less conservative estimates put the cumulative amount closer to US$1.8 trillion. If that money had stayed in the respective African country, most countries would have been able to pay off their outstanding external debts and still held surpluses for economic development. Curbing illicit financial flows should be central to plans for resource mobilization to finance the post-2015 agenda.

3. Over the last decade, the region witnessed a significant increase in the volume of aid recorded, at least up to 2010. According to OECD-DAC data, between 2000 and 2010 net ODA disbursements to Africa doubled in real terms, while globally they increased by a factor of 1.7. However, the efforts of the international community are falling short of the targets set in MDG 8, and most donors have been incapable to deliver on the 0.7% aid target, on the 0.15%-0.20% target for LDCs, or for the Gleaneagles G8 commitments towards Africa.

Moreover, a similar argument holds with reference to uneven progress in untying aid, reducing its volatility and unpredictability, and in failing to address the lack of adequate aid strategies and aid management systems on the part of recipient countries. Looking ahead, aid budgets are likely to come under increasing pressure over the medium term. In addition, the donor-recipient logic underpinning several MDG 8 targets has raised concerns for the aid dependency of many African countries, and the international discourse has recognized the need for greater ownership of the development agenda.

4. The region has benefitted from the expansion of all the main components of foreign financing (FDI, remittances, as well as official flows), partly on account of the intensification of South-South economic linkages. Yet, the bulk of international financial flows are concentrated on a relatively small number of countries, typically including a few sub-regional growth poles and some natural-resource-rich economies. There have also been concerns that FDI flows and corresponding investment have been insufficiently linked to the broader national economies and have thus not contributed to their potential to national economic development. At the same time, there has been concern with "race to the bottom" policies adopted across the continent, in which extensive tax and other concessions are provided to attract foreign capital, with dire impact on government revenues.

5. The value of financial remittances from African migrants abroad has grown and now exceeds official development assistance. The recorded flows may well be far less than real inflows if one factors in cash carried in pockets across borders or transfers made in the form of goods rather than cash. Although most of these transfers are directed to fulfilling household consumption and housing needs, there is some evidence of increased investments financed by remittance. The potential to manage remittances

[2] Transfer mis-pricing refers to the deliberate mispricing of cross-border intra-group transactions, and thus the shifting of profits to low-tax or no-tax jurisdictions and losses and deductions to high-tax jurisdictions. Trade mis-pricing is the deliberate mis-invoicing of international trade transactions, i.e. understating the export revenue or overstating import expenditures with the goal to transfer money abroad and thus hide it from domestic tax administrations.

for structural transformation is important. For example, Ethiopia's diaspora bond has succeeded in attracting millions of dollars for the construction of the Millennium Dam project. The cost of remittances to Africa is however quite high, reflecting various charges and taxes as well as limitations in the banking infrastructure and capital management policies and infrastructure.

6. An identified challenge relates to a dichotomous approach to the relationship between public and private finance. First, in many African countries development banks, which are well placed to fill the credit gap where risks in the productive sectors may be too high for commercial banks, have not been used to their potential. Second, opportunities for private and public sources of capital to leverage each other have not always been exploited. Third, the channeling of international public finance in a manner so as to complement national public and private finance has sometimes been problematic.

7. The "development finance landscape" has evolved markedly since the Millennium Declaration, and this has been marked in Africa. New actors, such as southern development partners and private philanthropic foundations, have entered the arena, bringing in additional resources, as well as approaches to development cooperation which differ from those of traditional donors. Innovative aid modalities are also emerging, which provide interesting examples of how to better engage the private sector and improve the overall effectiveness of aid. Development challenges are themselves evolving, thereby forcing the whole development architecture to adapt to the changing reality; for instance, the international community is paying increasing attention (and devoting growing resources) to issues such as climate change and disaster prevention, which did not feature as prominently ten years ago in the development agenda.

Given the above, Africa's key challenges going forward in the post-2015 era include:

i) Improving the mobilisation of domestic resources especially through taxation;
ii) tackling illicit outflows of capital;
iii) taking steps not only to harness foreign resources to complement domestic resources, but also to manage foreign inflows in order to maximise their positive impacts and minimise their negatives;
iv) taking steps to ensure that domestic capital markets thrive in support of the transformation agenda;
v) ensuring a fairer share of natural resource rents and increasing the benefits of natural resources;
vi) harnessing the complementarities between private financial flows and development banking; and
vii) advocating for the reform of the global systemic issues that constrain Africa from harnessing adequate resources for its development.

Given the scale of Africa's sustainable development financing needs, it is not realistic to expect such financing to be met by international development assistance, philanthropy or even private commercial capital by itself. This calls first and foremost for enhanced domestic resource mobilisation based on growing and diversified economies delivering decent incomes, higher aggregate savings and larger tax revenues. Functioning economies and larger domestic savings will also create the space to leverage foreign capital on terms that are development and environment friendly. There is also a real need for more creative models of financing in which public finance (domestic and foreign) leverages private finance for productive, value-adding, investments.

Proposals for financing and development partnerships should be assessed from three perspectives: first, from the point of view of evidence discernible from recent trends for the different financing modalities; second, from a political economy perspective as regards state-citizen relations and accountability; and,

third, from the point of view of their contribution to economic, social and environmental development-related transformational agendas for the continent.

## Topic 2: Financing Regional Infrastructure & Industrial development

According to a recent World Bank report[1], infrastructure has been responsible for more than half of Africa's recent improved growth performance and has the potential to contribute even more in the future. Nonetheless, Africa's infrastructure networks increasingly lag behind those of other developing countries and are characterized by missing regional links and stagnant household access. Africa's geography presents a particular challenge for the region's infrastructure development. Africa's infrastructure services are twice as expensive as elsewhere, reflecting both diseconomies of scale in production and high profit margins caused by lack of competition. Power is a major infrastructure challenge for the region, with 30 countries facing regular power shortages and many paying high premium for emergency power. The infrastructure challenge varies greatly by country type.

The infrastructure finance gap in Africa is significant. Generally, it really difficult to accurately determine the investment need (e.g. universal access or relative needs) and on what is currently spent, because of lack of reliable data. A 2010 World Bank study estimated the cost of addressing Africa's infrastructure needs at around $93 billion a year, about one-third of which was for maintenance. This is consistent with the Programme of Infrastructure Development in Africa (PIDA) estimates. Even if major potential efficiency gains were captured, Africa would still face an infrastructure funding gap of $31 billion a year, mainly in the energy sector. However, new estimates for the year 2012 put total infrastructure spending in Africa to about US$ 90 bn per year (Table 1).

**Table 1: Annual investments in infrastructure in developing countries by source**

| | Africa, 2012 | | Sub-Saharan Africa, 2001-2006 | | | |
|---|---|---|---|---|---|---|
| | | | capital only | | capital + O&M | |
| | US$ bn | % | US$ bn | % | US$ bn | % |
| National governments | 42.2 | 47 | 9.4 | 38 | 29.8 | 66 |
| Developed countries | 18.3 | 20 | 3.6 | 14 | 3.6 | 8 |
| Emerging economies | 21.4 | 24 | 2.5 | 10 | 2.5 | 6 |
| Private sector | 7.9 | 9 | 9.4 | 38 | 9.4 | 21 |
| Total | 89.3 | 100 | 24.9 | | 45.3 | 100 |

Source: World Bank, in UNTT, 2013.

Notes: O&M = operation and maintenance spending, capital = capital expenditure.

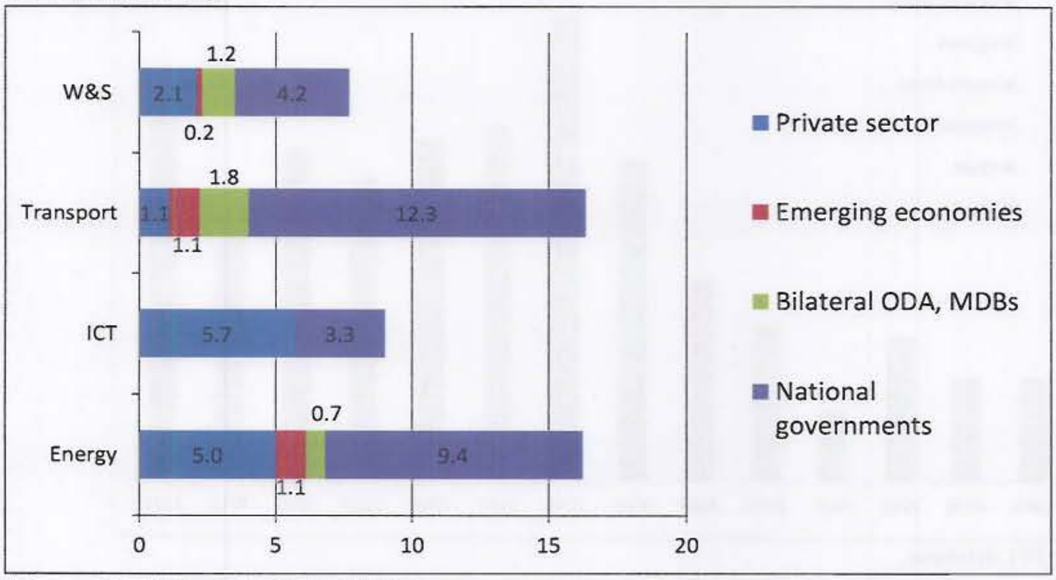
The largest share of this spending is from domestic public spending, followed by the private sector and official development assistance (ODA).The allocation of investments across sectors varies according to funding sources. Data from the Africa Infrastructure Country Diagnostics (AICD), World Bank, suggests that public investment is primarily focused on energy and transport, followed by water and sanitation and less on ICT (Figure 1). Traditionally, especially the energy sector, these are sectors that are firmly monopolised by government entities, and where private sector participation is very limited. In contrast, private sector finance primarily goes into ICT.

Although budget allocation by national governments to infrastructure is substantial and growing, the overall spending is rather modest. In 2001-2006 Governments in Sub-Saharan Africa invested 6-8%

[1] Foster et al., 2010, Africa's Infrastructure – A time for transformation, 2010, World Bank, See: http://elibrary.worldbank.org/doi/pdf/10.1596/978-0-8213-8041-3 .

of their national budgets in infrastructure. The total annual government spending for infrastructure amounted to about US$ 30 billion during the same period, or some 5% of GDP – if operation and maintenance are included (Table 1).

**Figure 1. Infrastructure spending by sector and funding source in Sub-Saharan Africa, 2001-2006 (in US$ bn)**




Source: World Bank, in UNTT (2013).

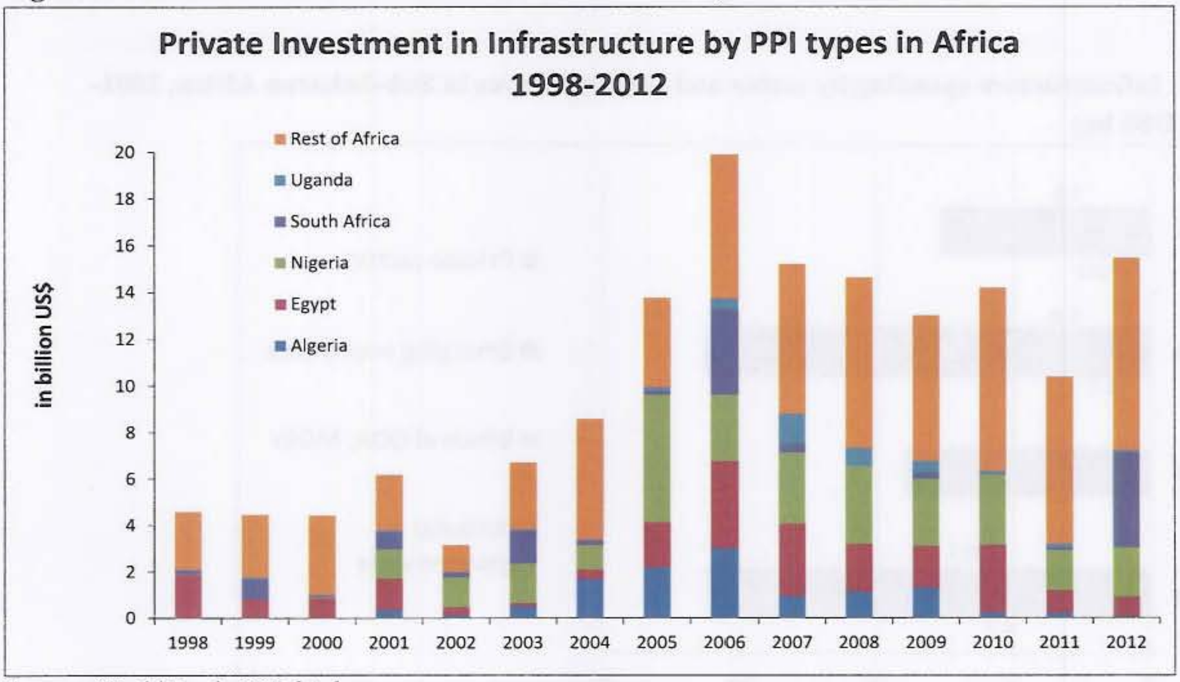
The majority of infrastructure investments are channelled through domestic budgets, bilateral ODA, and MDBs. However, infrastructure investment in Africa only accounts for about 10 percent of overall infrastructure finance at the global level of ODA. ODA is dominated by financing from MDBs, which has been growing steadily.MDB funding is mainly delivered through grants, loans (concessional and semi-concessional), incentives such as partial risk and partial credit guarantees and leverage mechanisms such as equity tranches covering first loss provisions, which intend to crowd-in capital from private sources.

New financiers from large middle-income countries are likely to invest on an increasing share of developing countries' infrastructure. This is particularly true in Africa, where they financed some 24% of infrastructure investments in 2012 (table 1). Out of all funding for Africa that came from non-national public sources, around 30% came from China (US$ 13.4 billion, mostly through official loans from the Export-Import Bank of China and the China-Africa Development Fund), 12% came from the Arab Coordination Group (US$5.2 billion, one-third from the Kuwait Arab Fund for Arab Economic Development), 1.6% from India (US$ 667mmainly through lines of credit extended by the Export-Import bank of India), and 1.1% from Brazil (US$530m in lines of credit issued by its national development bank BNDES).[2]

[2] UN Task Team Working Group on sustainable Development financing, 2013, Mapping of financial flows at the sector level: A UNTT WG contribution, http://sustainabledevelopment.un.org/content/documents/3352Sector%20mappings.pdf.

According to World Bank data, total private investment in infrastructure in Africa reached $15 billion in 2012, in the range of $10-20 billion observed since 2005 (Figure 2). Private investment remains concentrated in few countries (Figure 2). At the global level, 70% of all investments in the last 15 years were in only 10 countries – most in Brazil and India. Nigeria was the only African country in the top ten recipients. Only a small percentage of global private investments, 2.7% in 2012, were in low income countries.

**Figure 2. Private Investment in Infrastructure in Africa, 1998-2012**




Source: World Bank, PPI database.

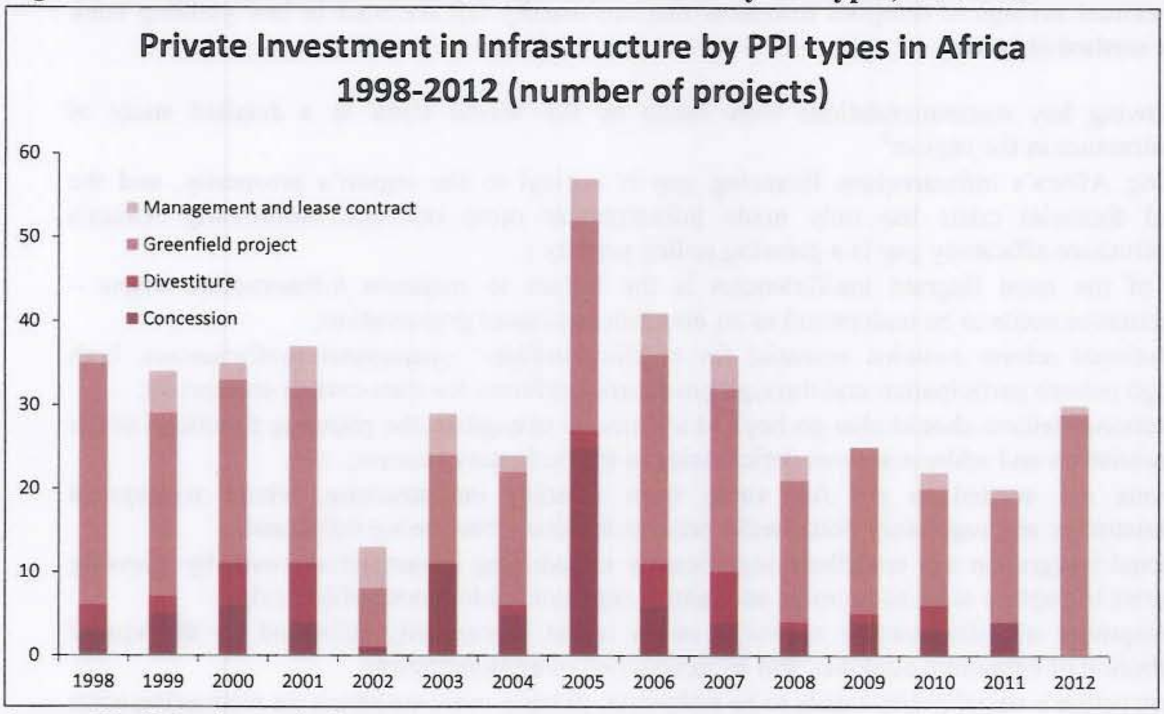
Over the last 5 years, local-currency bond markets that can capture domestic savings have been among the best performing assets classes in emerging and developing countries despite international market instability. Diaspora capital is another source of funding for infrastructure projects which has become increasingly available for projects in Africa. For instance, the Africa50 Fund aims to mobilize domestic capital in the form of pension funds and central bank reserves with diaspora backing.

Traditionally, private bank lending had been the dominant form of financing long term investments in infrastructure, particularly in the early, higher-risk construction stage, but suffered from the financial crisis, reaching a historic low in 2012. Commercial banks have tended to pulled back from project finance transactions and prefer to provide balance-sheet financing. Moreover, commercial banks typically do not offer financing with the long tenors required for infrastructure, and they are even less likely to finance projects in developing countries.[3]

[3]UN Task Team Working Group on Sustainable Development Financing, 2013, Mapping of financial flows at the sector level: A UNTT WG contribution, http://sustainabledevelopment.un.org/content/documents/3352Sector%20mappings.pdf.

Public Private Partnerships (PPP) have become a common financing instrument, with private participation taking various forms, ranging from full equity ownership to contractual forms without any equity involvement. Data from the PPI database for Africa for the years 1998-2012 shows that greenfield projects (i.e. a private entity firm or a public-private joint venture builds and operates a new facility for the period specified in the project contract) are the most prominent participation type, followed by concessions (i.e. a private firm takes over management of a state-owned enterprise for a given period) and management and lease contracts. Divestiture (i.e. a private firm buys an equity stake in a state-owned enterprise through an asset sale, public offering, or mass privatization program) has been the least common form of PPI over the last 15 years.

**Figure 3. Private Investment in Infrastructure in Africa by PPI types, 1998-2012**




Source: World Bank, PPI database.

Sovereign wealth funds, pension funds, and insurance funds could potentially become an important new channel to mobilize non-bank capital for infrastructure financing – if good projects with the desired risk-return profile could be developed. Yet currently a negligible percentage (about 1%) of Sovereign wealth funds, pension and insurance funds are allocated to infrastructure - mostly in middle income countries (World Bank, 2013)[4].

These non-bank private infrastructure investment modes have traditionally favored loan financing but bond financing is increasingly drawing a larger share of infrastructure investment. With policy-induced low interest rates and quantitative easing in higher income countries constraining the market, global investors have been drawn by higher yield and long term return benefits in developing countries and further encouraged by improvements in the credit quality of emerging markets to invest.

[4] World Bank, 2013, Financing for Development Post-2015. Washington, DC.

Going forward, traditional public sources of infrastructure finance are strained so that they are unlikely to be able to cover the financing gap. Few governments have the room to increase infrastructure spending given their debt burden, low tax bases and limited access to international capital markets. While an increase in funding from emerging economies is likely, funding from developed countries through ODA and MDBs is unlikely to increase. Where capacity to raise tax revenues and access to capital markets is limited, mechanisms such as Resources for Infrastructure (RfI) arrangements, which allow governments to exchange oil or mineral extraction rights for turnkey infrastructure, can be a source of infrastructure financing in resource-rich countries in Africa. However, lack of transparency of RfI agreements have been a concern in the region.

More finance from private sources will be needed, but will not substitute for public financing. Private and public capital plays a complementary role in infrastructure financing. Public funds can be targeted so as to catalyze greater private finance for more and greener infrastructure through improving project design and implementation, mitigating investment risk and expanding available financing instruments. Innovative mechanisms can help to channel savings in developing countries into financing for infrastructure capital requirements. Diaspora bonds could be exploited to absorb a portion of annual savings of diaspora resources that are usually left dormant in low yielding bank accounts or stashed at home.

The following key recommendations were made by the World Bank in a detailed study of infrastructure in the region:[5]

- Closing Africa's infrastructure financing gap is critical to the region's prosperity, and the global financial crisis has only made infrastructure more relevant. Addressing Africa's infrastructure efficiency gap is a pressing policy priority ;
- One of the most flagrant inefficiencies is the failure to maintain infrastructure assets – maintenance needs to be understood as an investment in asset preservation;
- Institutional reform remains essential for tackling utilities' operational inefficiencies, both through private participation and through governance reforms for state-owned enterprises;
- Institutional reform should also go beyond utilities to strengthen the planning functions of the line ministries and address serious deficiencies in the budgetary process;
- Reforms are needed to get full value from existing infrastructure, where widespread administrative and regulatory bottlenecks prevent facilities from being fully used;
- Regional integration can contribute significantly to reducing infrastructure costs, by allowing countries to capture scale economies and mange regional public goods effectively;
- Development of infrastructure networks needs to be strategically informed by the spatial distribution of economic activities and by economies of agglomeration;
- Infrastructure's social policy needs to be rethought, placing more emphasis on recovering costs from those who can afford it and on recasting subsidies to accelerate access;
- Achieving universal access will call for greater attention to removing barriers that prevent the uptake of services and offering practical and attractive second-best solutions.

[5] World Bank, 2010, Africa's Infrastructure – A Time for Transformation, Vivien Foster and Cecilia Briceño-Garmendia, eds.

## Topic 3: Financing for Climate Change and Green Growth in Africa

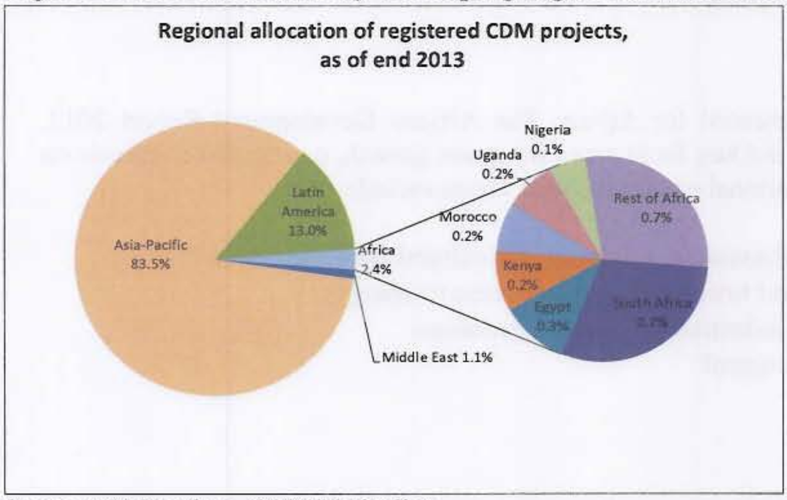
*Climate finance*

Climate finance is going to be essential for Africa's development in coming decades. Adaptation to climate change is a pressing issue for the region, as in other developing countries and LDCs. Estimates of the costs of climate change adaptation for Sub-Saharan Africa from a recent World Bank study are in the range of $14bn-$17bn annually, covering infrastructure, coastal zones, water supply and flood protection, agriculture, forestry, fisheries, human health, and extreme weather events[1]. Agriculture, which represents a significant part of Africa's labor demand and GDP, is a priority for climate change adaptation. Cities are another area where the impacts of climate change are going to necessitate significant adaptation finance in the region, as sea level rise is expected to affect some African countries and cities significantly. Other areas such as freshwater resources and health also necessitate substantial financing for adaptation in the region.

Africa, with massive tracks of equatorial forest, could stand to directly benefit from climate mitigation finance targeted at forests, such as public and private REDD-related finance. A number of challenges have been identified in this area, including lack of a full-scale international public mechanism; governance issues in relation to forest management and the distribution of the revenues from forest carbon finance; and capacity issues.

So far, Africa has been lagging behind other developing regions in terms of its access to international public climate finance. For example, Africa has been largely bypassed by CDM, with a very low proportion of registered CDM projects going to Africa, and projects in the region being concentrated in a few countries (Figure 1).

**Figure 1. CDM allocation by developing region and within Africa, 2004-2013**




Source: UNEP-Risoe, CDM/JI pipeline.

The funds specifically set up to assist LDCs in their efforts to respond to the climate change challenge include the UNFCCC GEF-administered Least Developed Country Fund (LDCF). Specifically, the

[1] World Bank, 2012, The Economics of Adaptation to Climate change, synthesis report, see: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2012/06/27/000425970_20120627163039/Rendered/PDF/702670ESW0P10800EACCSynthesisReport.pdf.

LDCF was tasked with financing the preparation and implementation of National Adaptation Programs of Action (NAPAs), which use existing information to identify a country's priorities for adaptation actions. Currently, 51 least developed countries (LDCs) have accessed funding in support of the preparation of their NAPAs. Of the 50 countries that had completed their NAPAs, 48 have accessed a total of $726 million for 138 country projects that address urgent and immediate adaptation needs. 69% of LDCF financing has been directed towards LDCs in Africa.[2]

The Green Climate Fund, which is expected to be operational in 2014, is expected to allocate minimum amounts to countries particularly vulnerable to climate change, such as LDCs and SIDS. However, it is not clear whether the contributions to these funds will be in addition to ODA. Fast start finance has mostly not been additional to traditional ODA – 80 per cent of these flows were also counted as ODA, and were paid out with similar modalities, largely through bilateral channels. Based on information submitted to the UNFCCC between 2010 and 2012, only 18 per cent of fast start finance, or $ 5.6 billion, went to Africa. Furthermore, as for other sources, the allocation of fast start finance has been unbalanced in favor of mitigation.

National capacity issues have been mentioned as a key bottleneck hindering the region's capacity to access international public sources of finance for climate change. The imbalance between international funds for mitigation and adaptation, which has been mentioned for many existing instruments, has affected Africa as well as other developing regions whose most pressing needs are for adaptation finance. The complexity and fragmentation of the climate finance architecture has also been mentioned as a key impediment.[3]

More generally, for Africa it is critical that climate finance become better integrated and coherent with traditional development finance, as some of the areas where climate finance would be needed are core development concerns of Africa, for example agriculture and land management, or forest management or urban development. For example, climate change will affect freshwater resources, and the impact of these changes is going to be a critical parameter in arid or semi-arid countries in the region, implying the need for integrated strategies for agriculture and food production, energy, and drinking water supply. The current fragmentation of the international financing architecture plays against the mobilization of resource for integrated strategies in these critical areas.

*Financing for Green Growth in Africa*

Green growth represents a significant potential for Africa. The African Development Report 2012, Towards Green Growth in Africa,[4] identified key focal areas for green growth, noting that emphasis on specific areas will need to be tailored to national circumstances. Those include:

- sustainable management of natural assets, e.g. forests, agricultural land and water
- investment in renewable energy and towards universal access to energy
- energy and resource efficiency in industrial production processes
- waste management and pollution control

[2] GEF Website.

[3] UN Task Team Working Group on Sustainable Development financing, 2013, chapter 4: public support to private finance for development, http://sustainabledevelopment.un.org/content/documents/2111Chapter%204-public%20support%20to%20private%20investment.pdf

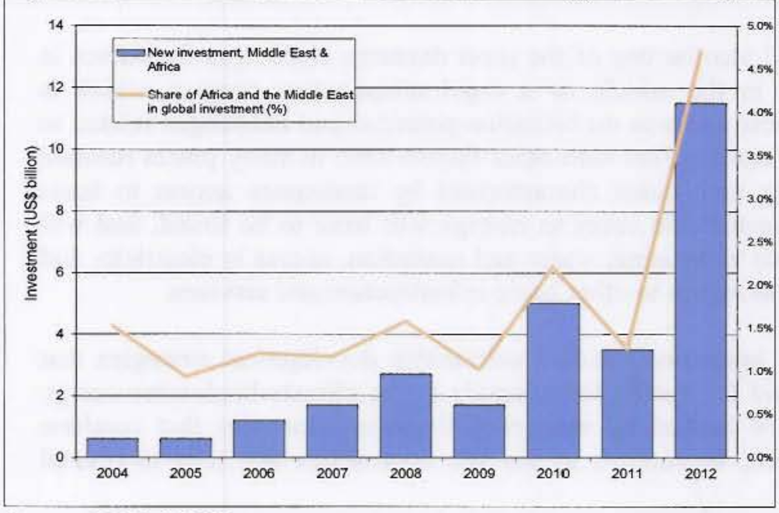
[4] See: http://www.afdb-org.jp/file/news-and-pressrelease/ADR_2012_Full_Report_English.pdf

- resilience building, including sustainable transport and cities, flood control and climate adaptation in agriculture, and social sectors.

Financing in these areas follows a wide variety of models, with differences in sources of finance, actors and instruments, with some areas witnessing an important role of private finance and others relying mostly on public finance, domestic and external.

In many of these sectors, Africa faces financing challenges. Taking the example of renewable energy, during the last decade, investment in Africa has taken off rapidly. However, Africa has so far received a small portion of it, as illustrated by Figure 2. Among the countries having registered the most investment in asset finance for renewable energy in 2012, South Africa came in 4th position, behind India but before Brazil. However, investment has been concentrated in a few countries of the region.[5]

**Figure 2: New investment in renewable energy in Africa, 2004-2012**



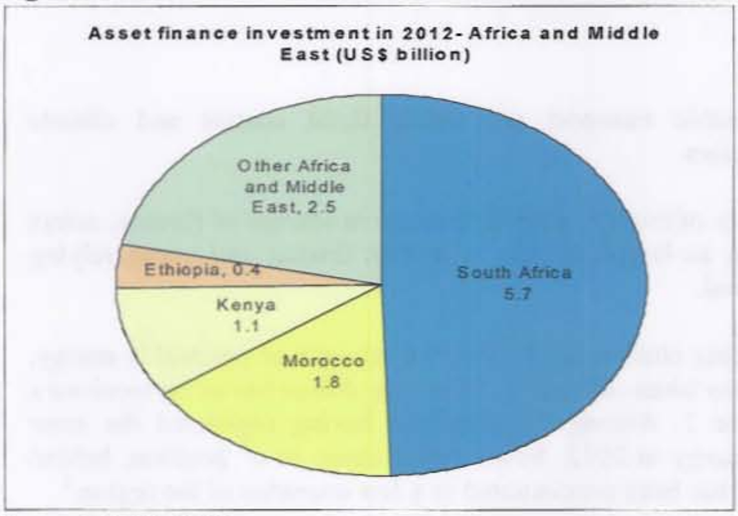

Source: BNEF, 2013.

The rise in private and blended finance for renewable energy has only started to impact Africa. Given the projected needs, private finance would clearly need to expand its reach further. Doing this will likely continue to involve work on national policy frameworks in order to mitigate both technology-specific and broader policy environment risks.

Financing for forest management, which in many countries of the region relies on government budget resources, has also been a challenge in the region, with domestic public resources often inadequate and limited; increasing ODA for the sector, but suffering from high variability from year to year; and lack of integration across financing sources, in particular those for climate and "traditional" forest management.

[5] UN Task Team Working Group on Sustainable Development Financing, 2013, Mapping of financial flows at the sector level: A UNTT WG contribution,
http://sustainabledevelopment.un.org/content/documents/3352Sector%20mappings.pdf

**Figure 3: Net new asset finance in Africa and the Middle East: Breakdown by countries, 2012**




Source: UNTT, 2013.

Securing adequate financing for cities will also be one of the most daunting challenges for Africa in decades to come. The continent is still in the middle of a rapid urbanization process, which is happening in a context of often limited local resource mobilization potential and challenges related to the functioning of land markets, which in combination with other factors have in many places resulted in the multiplication of informal housing and slums characterized by inadequate access to basic services. Financing models to allow for sustainable cities to emerge will have to be found, and will need to be encompassing critical areas such as housing, water and sanitation, access to electricity and modern cooking energy, transport, as well as access to other basic infrastructure and services.

Going forward, there is a clear need for integrated national sustainable development strategies that better consider cross-sectoral synergies and trade-offs, for example in the climate-land-water-energy cluster. In turn, those strategies should be backed by integrated financing strategies that combine multiple financing sources and instruments, in contrast to the silo approaches that tend to prevail currently.

*Key questions for discussion:*

- How to enable easier access to international public finance channels and instruments for climate change, biodiversity, desertification, and other best critical areas for Africa?
- How can climate finance and in particular adaptation finance be better linked to development finance in critical areas such as agriculture and urban development?
- How can national green growth strategies be financed, and what types of sources and instruments should be used?

## Topic 4: Improving Domestic Resource Mobilization

Domestic resource mobilization, including improving taxation, combatting illicit financial flows, effective public financial management, and strengthening private financial intermediation is crucial to financing sustainable development.

In 2011, **tax revenue** was an average of 26.8 per cent of GDP in Africa,[1] compared to 34.1 per cent in OECD countries.[2] While significantly below OECD levels, the average tax to GDP ratio is high by global standards. Nonetheless, this relatively high average tax revenue masks important differences at the country level, with the average highly skewed by a few oil-producing outliers with tax to GDP ratios of more than 40 per cent. In the majority of African countries, tax ratios lie below ten percent.

Given low levels of GDP, even comparatively high tax to GDP ratios leave African governments with fewer funds to invest in development activities. In lieu of raising tax rates, in most countries, increased tax collection efforts can focus on expanding the tax base, including efforts to tax the informal sector and those considered hard to tax, such as the self-employed and wealthy individuals with ample opportunities to conceal their income. In addition, as the international tax system has not kept up with an increasingly global and service-based economy, multinational enterprises are often able to artificially segregate taxable income from the economic activities that generate it, thus evading and avoiding taxes.

Improving the capacity of tax administrations, especially in the area of international taxation, will be necessary. Likewise the establishment of semi-autonomous revenue agencies has been shown to improve revenue mobilization and stabilize state-taxpayer relations. Tax holidays and incentives should be scrutinized closely, as they do not necessarily lead to long-term investment that benefits sustainable and equitable development and job creation.

Given the potential impact that revenues arising from the extraction and/or sale of **natural resources** could have on achieving development goals, special attention should be paid to ensure that countries receive tax proceeds consistent with the value of their resources. More precisely, governments should choose a fiscal regime that is appropriate to the country's specific needs including providing adequate income streams for whole life cycle of planned projects, securing early revenue, attracting investments, ensuring a "fair" share of the proceeds in case of rising prices, and minimizing administrative burden and risks.

Developing countries face special challenges when dealing with private companies from the extractive industries or when entering into joint ventures. Often, natural resources are extracted by foreign companies as local capital is scarce. These companies usually have substantive market power and are better informed than many governments on the process of discovery and appraisal, as it is often driven by these same companies. It is also likely that they have more expertise and special knowledge, including on taxation issues, than under-resourced tax administrations, which may not have the same expertise and information readily available.[3] The proper negotiation of contracts with companies from the extractive industries is crucial in ensuring that countries are able to capture a fair share of profits. Other issues to improve resource mobilization in this area include the proper administration of transfer pricing, exacerbated by the fragmentation of the supply chain, as well as domestic tax issues such as a capital gains tax and general and specific anti-avoidance rules.

[1] AfDB, OECD, UNDP, UNECA, 2013, African Economic Outlook 2013.
[2] OECD Revenue Statistics.
[3] Daniel, P., Keen, M. and McPherson, C. 2010, The Taxation of Petroleum and Minerals. Principles, problems and practice. London and Washington: IMF.

The concept of **illicit financial flows** (IFFs) is characterized by a lack of terminological clarity, but it is generally used to convey three different sources of IFFs: the proceeds of commercial tax evasion, revenues from criminal activities, and public corruption. IFFs out of Africa have become a matter of major concern because of the scale and systematic adverse impact of such flows on the continent's development and governance agenda. Global Financial Integrity, a Washington-based think tank, estimates that IFFs from Africa could be as much as US $50 billion per annum since 2000. While this estimate is disputed, it is certain that IFFs present a major threat to Africa's development stifling various efforts on the continent to improve public finances and enable governments to better plan and finance their own development agendas.

Commercial tax evasion typically occurs in two ways, firstly where profits are shifted across borders to be hidden from tax administrations. Multinational enterprises (MNEs) often engage in aggressive tax planning, thereby making use of a mis-match in different countries' tax systems to evade taxation. Secondly, through engaging in transfer mis-pricing, which refers to the deliberate mispricing of cross-border intra-group transactions, and thus the shifting of profits to low-tax or no-tax jurisdictions and losses and deductions to high-tax jurisdictions.

The level of complexity and knowledge required in administering transfer pricing legislation can put a tremendous strain on tax authorities, especially in countries where tax administrations tend to lack human and other resources. Additionally, given the increased levels of cross-border economic activity, national tax administrations are confronted with information asymmetry vis-à-vis multinational enterprises. In order to circumvent this, the exchange of information between tax administrations needs to be promoted and supported. In addition, while exchange of information is an important factor in the fight against tax evasion, rules of such an exchange need to ensure that they adequately reflect the reality of African countries in terms of the capacity that is needed to administer such rules.

Where national and international tax codes interact in a way that offers loopholes to companies engaged in cross-border trade, i.e. hybrid mismatch, African countries should focus on closing these. Ultimately, existing standards to prevent double taxation need to be complemented by new standards that address cases of no or low taxation. Just as important is that Africa presses for reform to the international tax system that actively supports developing countries as they counter tax evasion and avoidance. Such reform should give recognition to developing countries priorities such as source country taxing mechanisms and beneficial ownership rules without adding administrative complexity and cost.

There have been major achievements in **public financial management** systems in Africa, such as improved legal frameworks, and the use of risk-based internal audit and procurement reforms. A study by the African Development Bank finds that the budget process in Uganda is characterized by relative transparency and broad participation, and the quality of internal audit has improved significantly in Ghana since the establishment of the Internal Audit Agency.[4] Overall, while the budget formulation stage has improved significantly in the past years, challenges persist in budget execution and audit. To strengthen public financial management systems, further reforms could improve fiscal transparency and develop capacity in budget oversight and audit. The proper management of overseas development assistance and its relation to the budget is equally important. In going forward, reforms of African

[4] African Development Bank, 2012, African Governance Outlook. Public Financial Governance Reforms: The recent progress in Africa.

public financial management systems should strive to ensure political ownership of the process as well as transparent budget processes.[5]

Given the large need for investments associated with financing sustainable development, incentivizing **domestic private investment** is a crucial part of a financing strategy. Financial systems in Africa tend to be dominated by the banking system, whose financing is often short-term in nature. Development banks can play an important role in providing longer-term financing. In the long term, the development of private bond and equity markets could also increase the availability of long-term financing for sustainable development, and reforms are needed to further develop these markets. Currently, capital markets in Africa are constrained by limited market size, weak financial market infrastructure, a lack of regulatory frameworks and effective governance. Evidence of the effectiveness of stock markets in raising new capital in many developing (as well as developed) countries is limited. At the same time, volatility in capital markets has been shown to have an impact on the real economy if poorly managed. Thus it is critical that regulations ensure the stability of capital markets, and more broadly, macroeconomic fundamentals to reduce systemic risk and foster an environment conducive to increasing levels of domestic private investment. The ensuing regulatory and policy framework in the banking system and in capital market legislation should also be geared toward reducing systemic risks, while still ensuring access to credit, especially for much needed long-term investments in the interest of sustainable development.[6] In addition to providing long-term financing through private investment, there is still a need to improve access to banking services that can support the growth and innovation of small and medium-size enterprises especially as these make up the bulk of private sector in most African countries.

*Key questions for discussion:*

- Are the current international efforts aiding African countries in mobilizing domestic resources enough? If not, what is lacking – technical support, coalition building, exchange of information, or other issues? In which areas do you see a need for more international support, where is regional cooperation crucial?
- From your experience at the country-level, which were successful reforms in the area of tax policy design and tax administration? Are there lessons to be drawn from reform efforts that did not succeed?
- How can the region ensure that fiscal arrangements for extractive industries are effective in capturing a fair share of the company's profits for development purposes?
- From your experience at the country-level, which were successful reforms in the area of public financial management? Are there lessons to be drawn from reform efforts that did not succeed?
- Are the domestic regulatory and policy frameworks governing the banking system and capital markets in your country conducive to growth and sustainable development in all its dimensions? If not, what needs to change?

[5] CABRI, AFROSAI & ATAF, 2010, *A status report on good financial governance in Africa*. Pretoria: Collaborative Africa Budget Reform Initiative.
[6] UN, 2014, World Economic Situation and Prospects 2014.

## Topic 5: Management of External Financing

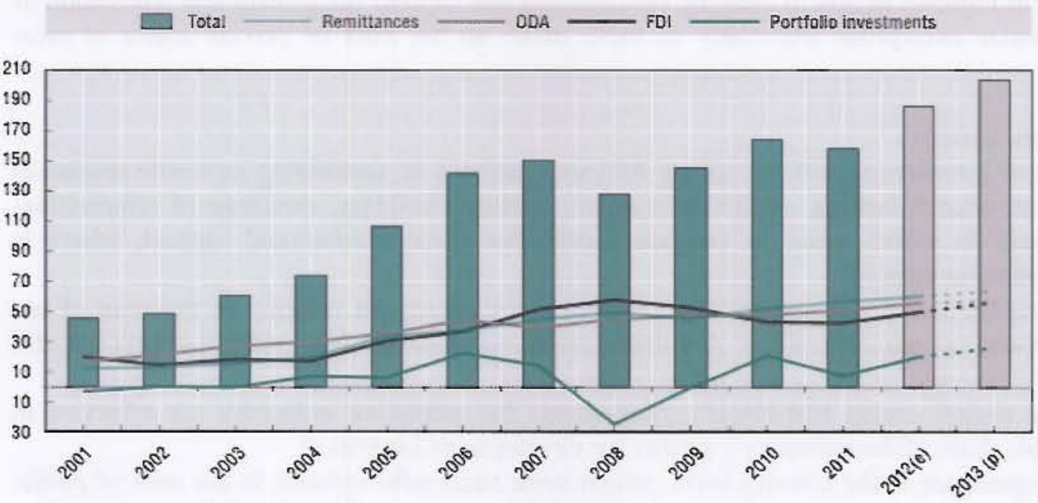
Apart from a short drop during the global financial and economic crisis in 2008 and 2009, external financial flows to Africa have increased steadily and significantly since 2000. Total flows, including foreign direct investment (FDI), portfolio investment, official development assistance (ODA) and remittances, amounted to USD 186.3 billion in 2012, or 9.2 per cent of Africa's GDP, a historic high.[1] These flows represent a critical source of financing for sustainable development in the region, complementing domestically mobilized resources.

Several challenges remain however: (i) access to financing is unequal between countries; (ii) external sources do not sufficiently contribute to financing priority areas and investments critical to achieving sustainable development in all three dimensions across the continent; and (iii) even where external financing is available, its sustainable development impact could often be further improved.

*International public finance for Africa – ODA, Innovative Development Finance (IDF), Climate Finance*

Public financing is indispensable for achieving sustainable development. Additional international public financing is needed in two areas: to reduce poverty and meet social needs, particularly in poor countries; and to invest in other areas that the private sector does not finance sufficiently on its own, such as public goods.

**Figure 1: Total External Financing Flows to Africa**




Source: AfDB, OECD, UNDP and UNECA, 2013, African Economic Outlook

Although ODA has fallen for two consecutive years on a global basis, by a total of 6 per cent in real terms since 2010 (to $125.6 billion in 2012), African countries have so far escaped this trend. ODA to sub-Saharan Africa has increased slightly, to reach $ 45.7 billion in 2012.[2] In sectoral terms, the focus of the MDGs on social development has led to a large increase in aid to social sectors, and the health sector in particular, in the last decade. In recent years, ODA to economic infrastructure has also been revived. However, there have been large variations in ODA flows across countries, even those with

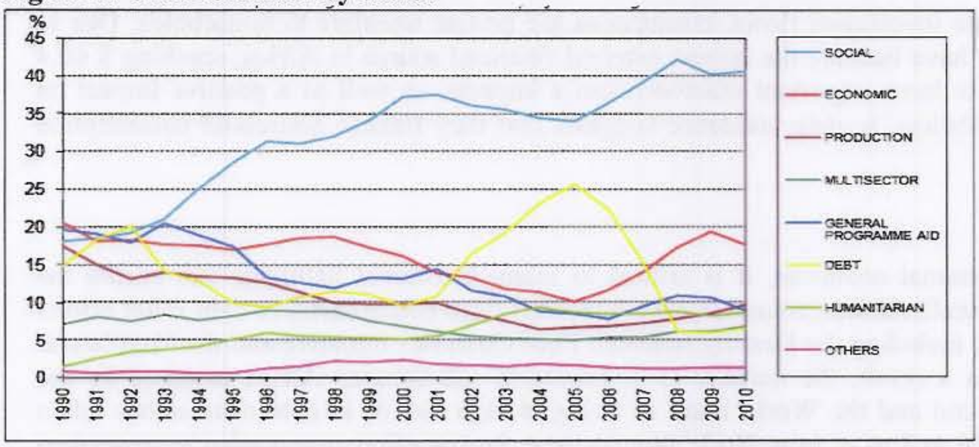
[1] AfDB, OECD, UNDP and UNECA, 2013, *African Economic Outlook*
[2] OECD DAC Aid Statistics

similar levels of development, with most of the 'under-aided' countries in Africa being Least Developed Countries.[3]

IDF flows to Africa have so far been very limited.[4] To the extent that such mechanisms have been implemented, they have been channeled through global funds, mostly in the health sector, and have amounted to less than one per cent of ODA flows to the continent in the period of 2006 to 2010.[5]

International climate financing, particularly Fast Start finance reported to the UNFCCC between 2010 and 2012, has not sufficiently flown to Africa. Only 18 per cent of the total, or $ 5.6 billion, went to Africa, disproportionately benefiting middle income countries. Moreover, climate financing has so far been focused on mitigation, while financing for adaption – critical for African countries vulnerable to the impacts of climate change – is lacking. Lastly, Fast Start finance has mostly not been additional to traditional ODA – 80 per cent of these flows were also counted as ODA, and were paid out with similar modalities, largely through bilateral channels.[6]

**Figure 2: ODA to Africa by sector**




Source: OECD, 2013, Development Aid at a Glance – Africa.

In order to address the issue of unequal access to international public financing, greater attention should be paid to so-called aid orphans – countries that receive significantly less aid than those with comparable levels of development. In addition, it also critical that ODA is not diverted from low income and least developed countries in Africa as the financing of global public goods becomes more important in a sustainable development agenda.

At the same time, ODA (and innovative financing mechanisms) need to be both increased and used more effectively according to principles laid out in the Busan Partnership for Effective Development Cooperation, e.g. by ensuring national ownership and nationally-led donor coordination based on national development strategies, or by using aid modalities such as budget support and direct access to funds.

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3 OECD, 2013, *Identification and Monitoring of Potentially Under-aided Countries*

4 'Innovative development financing' generally refers to innovative sources of finance that have been sought to complement traditional ODA, these include taxes on financial transactions and greenhouse emissions as well as the issuance of Special Drawing Rights from the International Monetary Fund.

5 UN DESA, 2012, *World Economic and Social Survey 2012: In Search of New Development Finance*

6 ODI, WRI, IGES, 2013, *Mobilizing international climate finance: lessons from the fast start period*

*Private financing flows – FDI, portfolio investments, and remittances*

In terms of private investment flows, flows to Africa are dominated by FDI. Overall, FDI to Africa reached $50 billion in 2012, with Africa the only region globally that saw FDI increase from the previous year.[7] However, FDI flows are concentrated geographically and sectorally, largely targeting resource extraction industries, notwithstanding a rise in investments in consumer-related manufacturing and services in recent years.

Portfolio investment flows to Africa on the other hand are comparatively small so far, and continue to be overwhelmingly concentrated in South Africa and Nigeria. Due to their volatility, portfolio flows complicate macroeconomic management, and as their role expands, capital-account management, including capital controls, will need to be considered.

Attracting private financing flows depends on creating an enabling environment for long-term investments in sustainable development, including by addressing regulatory uncertainty, weak institutional frameworks, poor governance, and other risks. At the same time, many private investors will not invest in long-term sustainable development projects on their own, and thus need to be incentivized to make such investments. This puts public policies, including industrial policies, public private partnerships, and risk sharing mechanisms, center stage.

In contrast to other private investment flows, remittances are private transfers to households. Due to their size – in 2012, they have become the largest external financial source in Africa, reaching $ 60.4 billion[8] - they are likely to have important macroeconomic impacts, as well as a positive impact on household welfare. Nonetheless, to date, evidence suggests that they finance household consumption more than investments.

*Debt sustainability*

In the mobilization of external resources, it is critical to manage external liabilities and ensure the sustainability of debt. Overall, African countries have benefited from comprehensive debt relief efforts over the last two decades, including the Heavily Indebted Poor Countries initiative and the Multilateral Debt Relief Initiative. As a result, the number of countries in sub-Saharan Africa assessed by the International Monetary Fund and the World Bank as being at high risk or in debt distress has fallen from 18 at the end of 2006 to 8 as of June 2013.[9] Nonetheless, further efforts are needed to strengthen responsible borrowing and lending practices and debt management. At the international level, there is still a need for an agreed mechanism for sovereign debt workouts to ensure legal predictability and timely debt restructuring that includes a fair burden sharing.

*Managing external finance*

One key challenge for many African countries is to manage the various streams of dispersed capital inflows in a way that maximizes their impact on sustainable development. ODA remains dispersed, with the average number of official donors per country increasing threefold since the 1960s. There has also been a proliferation of public, private, bilateral and multilateral sources of climate financing and despite donor efforts, it is likely that international public financing will continue to be fragmented. Private financing flows, which are on the increase, are inherently dispersed.

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[7] UNCTAD, 2013, *World Investment Report 2013*
[8] AfDB, OECD, UNDP and UNECA, 2013, *African Economic Outlook*
[9] MDG Gap Task Force, 2013, *MDG Gap Task Force Report 2013, The Global Partnership for Development: The Challenge We Face*

In this effort, consideration could be given to:

- Policy coordination across ministries and agencies that deal with various financing streams to better manage financing flows. This would require enhanced data collection is necessary as a sound basis for policy decisions;
- Improved macroeconomic management to minimize volatility while promoting equitable growth (such as exchange rate management, debt sustainability, etc.)
- Incentives to direct financial flows toward priority areas (e.g. by using the toolbox of industrial policies, following a coherent national sustainable development strategy)
- Creating an enabling environment to encourage long-term investments

*Key questions for discussion:*

- What role will international public finance play in financing sustainable development on the continent? How can public financing flows, including ODA and climate financing, most effectively contribute to sustainable development in an integrated manner?
- How could the international community address the unequal access to external financing for African countries, with regards to both public and private financing flows? What could be the contribution of national and regional policy makers to address this issue?
- Which measures would be most effective in attracting private financing flows toward priority areas for sustainable development in Africa? How can a global sustainable development financing framework contribute to such a reallocation of financing flows?
- Which aid modalities and policy actions by donors would further increase the effectiveness of development cooperation and development financing? Which lessons can be drawn for increasing aid and development effectiveness from a recipient perspective?

## Topic 6: Synergies between financing sustainable development and other inter-governmental processes: The Post-2015 Development Agenda & SDGs

The report of ICESDF will be one of the inputs to the forthcoming intergovernmental negotiations on the Post-2015 Development agenda, which will begin in September 2014 and conclude in 2015. Another input will be the report of the Open Working Group on Sustainable Development Goals (SDGs). In addition, The UN General Assembly decided to hold the third international conference on Financing for Development in 2015 or 2016. The report of ICESDF will also feed into this process.

Discussions on the post -2015 development agenda and its financing framework have intensified across the globe. While driven by Member States, the dialogue extends far beyond New York and involves a wide range of stakeholders, who are engaging in discourse at the national, regional and international levels. These deliberations have led to the emergence of broad parameters for the post-2015 development agenda.

In Rio de Janeiro in June 2012, UN Member States reaffirmed that the eradication of poverty and achieving sustainable development in all its dimensions are the great challenges that humanity is facing, and they have since agreed that these challenges should be at the core of a post-2015 development agenda. Moreover, good governance at all levels based on human rights, rule of law, democracy, access to justice and to information, transparency and accountability, fostering peaceful and non-violent societies, is recognized as an enabler of sustainable development.

There is also a recognition that we need to do things differently. Transformative actions are needed to ensure decent jobs, backed by sustainable technologies, and a shift to sustainable patterns of consumption and production. In the case of Africa, the challenges of structural transformation and its financing have been recognized and articulated in several documents, including a report from the Pan-African Parliament and other actors.[1]

We are moving towards a single, ambitious agenda with one set of sustainable development goals building on, but going beyond the Millennium Development Goals. At the international level, the Open Working Group on sustainable development goals is beginning the critical consensus building phase of its work, based on a document shared on 21 February 2014 by its co-chairs, which contains a number of focus areas for possible goals and targets.

In Africa, the Economic Commission for Africa, the African Union Commission, the African Development Bank and the United Nations Development Programme have jointly organized a series of subregional and regional consultations on sustainable development goals and the post-2015 development agenda.

The regional consultations were designed to: identify Africa's priorities for the post-2015 agenda; identify enablers and critical success factors for the post-2015 development agenda; and align the post-2015 priorities with other development programmes and agendas, including Rio+20 and the New Partnership for Africa's Development (NEPAD).[2] Finally, on 31 January 2014, the African Union (AU) Heads of States and Government adopted the Common African Position (CAP) on the post-2015

[1] United Nations Millennium Campaign Africa, 2014, Structural transformation and the challenge of financing Africa's post-2015 development agenda, published by.

[2] ECA, AU, and AfDB, 2013, Africa Regional Consultative Meeting on the SDGs – Outcome Document.

development agenda. The CAP is the result of regional and continental consultations conducted over the past two years. It was launched on 28 February 2014 in Ndjamena.

Africa's priorities for the post-2015 agenda are presented under six pillars: environmental sustainability, natural resources management and risk management of natural disasters; finance and partnership; human-centered development; peace and security; science, technology and innovation; and structural economic transformation and inclusive growth. Under structural economic transformation and inclusive growth, the Ndjamena Declaration highlights commitments related to agriculture, food security and nutrition, green growth, infrastructure and information and communications technology (ICT). The Declaration also discusses, inter alia, poverty eradication, education, health care, gender and women's empowerment, water management and disaster risk reduction (DRR).

Expanding the poverty eradication agenda to one that also addresses the interlinkages of sustainable development, in its economic, social and environmental dimensions, requires rethinking of the global partnership for development, and a sustainable development financing strategy should be part of this paradigm shift. The MDGs have shown that international commitment to agreed goals can make a difference. Yet, the MDG framework presents challenges that have been identified and will have to be kept in mind in the post-2015 context. The African consultative process identified the following gaps:

- Limited focus on economic growth and transformation;
- Limited emphasis on the role of domestic resource mobilization in Africa's development agenda;
- Tendency to neglect issues relating to the quality of service delivery;
- Silent on inequality including spatial and horizontal inequality; and
- Disproportionate focus on outcomes with limited consideration of the enablers of development: exclude factors such as infrastructure and peace and security.

The Common African Position on the post-2015 development agenda includes the following key recommendations:

- African stakeholders must stay actively involved in the formulation of the post 2015 development agenda. Their participation so far shows keen interest and drive to set a new global development agenda.
- The post 2015 agenda should emphasize inclusive economic growth and structural transformation as a key element of sustainable development.
- The post 2015 development agenda must reorient the development paradigm away from externally-driven initiatives toward domestically-inspired and funded initiatives that are grounded in national ownership.
- Social inclusion and equity are key, and progress must be measured in terms of both the availability and quality of service delivery.
- Harnessing science, technology and innovation is critical to deepen and sustain the improved socio-economic performance of the continent. This will be achieved by training people, investing in technological innovation, facilitating technology transfer and research and development (R&D) and bridging the gap between the skills the educational system produces and the ones that the private sector wants.
- Africa's priorities need to be financed and to this end resource mobilization and innovative financing methods will need to be effected. In addition, implementation of the strategies will require consolidation of existing partnerships and forging of new ones; and implementing existing commitments and promoting quality and predictability of external financing.
- There is also need to enable global governance architecture that reinforces the principles of fair trade and deters illicit financial flows.

Key questions for the discussion at the Africa outreach meeting of the ICESDF are the following:

- How to best translate the critical objectives of the region for post-2015 into an effective sustainable development financing strategy?
- What needs to change in the financing framework to enable inclusive economic growth and structural transformation as a key element of sustainable development in Africa?
- How to better ensure country ownership of the development process in the region?
- How to improve global governance and ensure more accountability of every stakeholder? How to improve the role of the private sector in the new financial schemes? How to improve the quality and outcomes of all partnerships?
- How to ensure that the financing strategy will cater for technological development and capacity development?