



Chapter 2

Foreign investment, aid, remittances and tax revenue in Africa

External financial flows into Africa hit a record in 2012 and are expected to top USD 200 billion in 2013. This highlights the growing importance of investment, official development aid and remittances to a continent on the move. This chapter puts the spotlight on emerging financial trends that Africa can take advantage of and the risks they face.



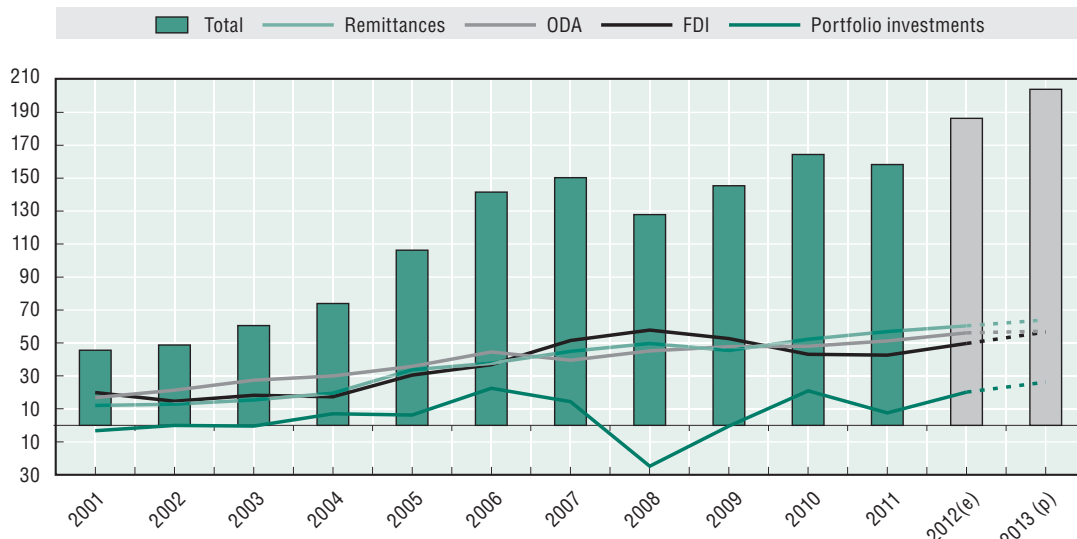
Tax revenues and external financial resources have made an impressive recovery from the dive of 2009 as the global economic crisis hit commodity prices and in turn lowered taxes from the natural resources that are so important to African nations. Foreign investment flows also suffered from the lagged recovery in global economic activity. The relatively high growth in emerging economies and gradual recovery of commodity prices have brought tax levels back to their 2008 peak, while Africa saw record investment flows in 2012.

Total external financial flows to Africa reached a historic high of an estimated USD 186.3 billion (US Dollars) in 2012, up from USD 158.3 billion in 2011. The flow of foreign direct investment (FDI), portfolio investment, official development assistance (ODA) and remittances – the main source of financing for African countries along with tax revenues – have quadrupled since 2001. This strong performance partly stems from the strong recovery of direct and portfolio investment. External flows as a share of Africa’s gross domestic product (GDP) increased to 9.2% compared with 8.3% in 2011. They are projected to reach about 9.5% in 2013, back to the average of 9.4% of GDP over the past decade.

Remittances, as highlighted in the previous *African Economic Outlook* (AEO), have also risen spectacularly. They overtook ODA and FDI as the largest external flow to Africa in 2012¹ and are an increasingly important revenue source for many African households. Policy makers do not have much influence over how remittances are spent, but with adequate regulation and measures that lower the cost of remittance services, they could improve domestic savings.

Remittances are different from, but complement, the other external financing. The importance of remittances in consumption, thereby reducing poverty, is widely recognised (Ratha 2003). Hard evidence on the impact of remittances on growth remains mixed. Chami et al. (2003) found that remittances do not necessarily increase output as they are typically not channelled towards productive investment. Gupta et al. (2007) found that remittances help families get into formal financial markets, thus contributing to long-term growth through financial deepening.

Figure 2.1. Total external financial flows to Africa
(billion USD, current)



Note: ODA includes both bilateral and multilateral flows; see Table 1 for methodological details on projections. (e) estimates, (p) projections.

Source: UNCTAD World Investment Report (UNCTAD 2012a); IMF World Economic Outlook 2012; OECD/DAC; World Bank.

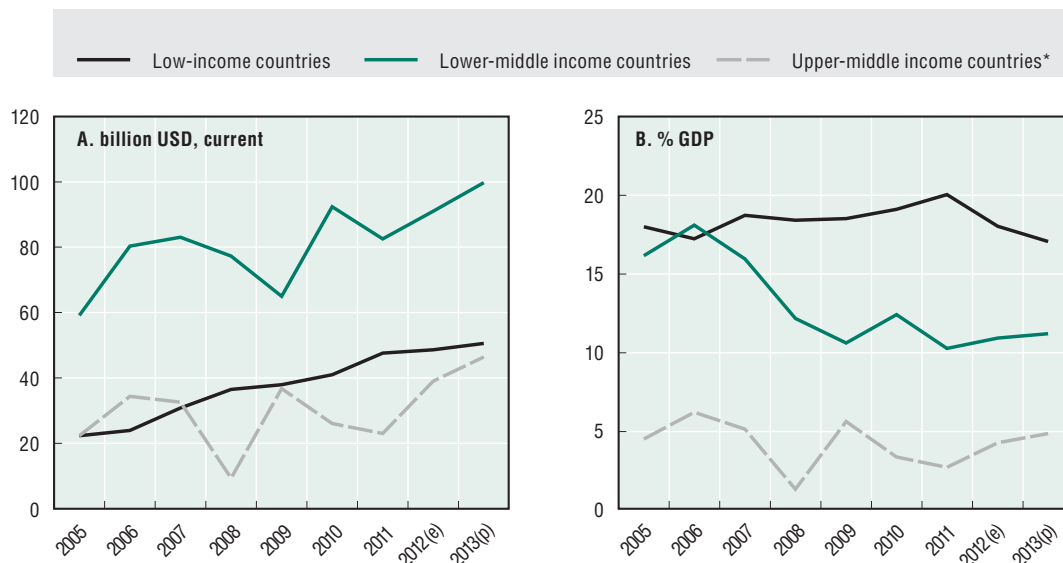
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The aggregate external financing figures hide significant country disparities, as shown in Figures 2.2a and 2.2b. In 2012, low-income countries continued to depend on external flows, which represented 18% of GDP on average, above the 11% share in GDP for lower-middle income countries and 4% in upper-middle income countries. ODA represented 64% of external financing, compared to 30% for FDI and 10% for remittances, in low-income countries.²


Remittances took up an increasing share of external flows to lower-middle income countries. They more than tripled from USD 13.1 billion in 2004 to an estimated USD 50 billion in 2012. They represented 55% of total external flows and 6% of the country group's GDP. Lower-middle income countries are a heterogeneous group mixing large emerging markets with a strong diaspora such as Nigeria, Egypt and Morocco, as well as countries where aid remains the major inflow, such as South Sudan, Cape Verde, Côte d'Ivoire and Cameroon.

Figure 2.2. Total external flows to Africa per income group



Note: * This category includes Equatorial Guinea which, according to the latest World Bank classification, is ranked as a high income country. (e) estimates, (p) projections.

Source: Authors' calculations based on UNCTAD World Investment Report 2012; IMF World Economic Outlook 2012; OECD/DAC; World Bank.

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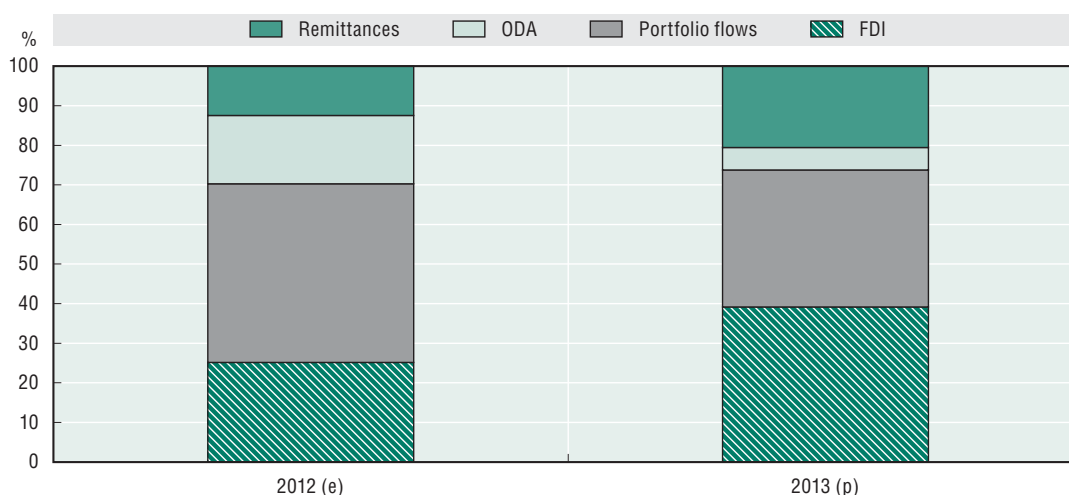
Upper-middle income countries in Africa have a larger share of foreign investment as external flows. Portfolio inflows represented 47% of total external finance in 2012, followed by 29% for FDI and 14% for remittances. This large portfolio share was directed almost exclusively at South Africa. In other economies, direct investment represented the largest share of external flows. According to the United Nations Conference on Trade and Development (UNCTAD), portfolio flows³ tend to increase in relative importance once a country reaches upper-middle income status. They can help to strengthen financial infrastructure and liquidity. They also pose a risk in terms of increased volatility and the risk of a sudden reversal of capital flows, as witnessed in South Africa in 2008.

Outlook for external flows

External financial flows to Africa are projected to increase by 9.5% to a new record of USD 203.9 billion in 2013, compared with USD 186.3 billion in 2012 (See note Table 2.1). Figure 2.3 shows the projected contributions of remittances, ODA and investment respectively to this USD 17.6 billion increase in external finance. As in 2012, investment growth is expected to underpin external flows. In 2013, however, almost the entire projected increase in FDI to Africa is expected to be in sub-Saharan Africa, while in 2012 northern Africa absorbed half the increase in FDI. This confirms sub-Saharan Africa's economic dynamism as well as the hesitance of investors over political developments in North Africa, particularly in Egypt.



Figure 2.3. Respective contributions of external financial flows to annual increase of total external flows in Africa



Note: See Table 2.1 for methodological details on projections. (e) estimates, (p) projections.

Source: UNCTAD World Investment Report 2012; IMF World Economic Outlook 2012; OECD/DAC; World Bank.

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Global economic turbulence still poses significant risks to the outlook for external finance of all kinds. Uncertainty about the recovery, particularly in the euro area, may have a negative impact on trade and investment. The second quarter of 2012 saw a drop in some commodity prices due to lower demand in emerging economies. A new deceleration of global economic activity could bring down commodity prices again. This may in turn affect investment into commodity exporting economies.

Low-income countries are exposed to adverse shocks as their economies and export base tend to be less diversified. Countries which have not replenished fiscal and foreign exchange reserves following the 2008 global economic recession are at particular risk. As spending pressures in major donor countries are likely to result in a stagnation of ODA at best, low-income countries will have an increased reliance on domestic sources of financing.

Table 2.1. Summary of external financial flows and tax receipts in Africa (billion USD, current)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012(e)	2013(p)
1. Inward foreign direct investment (FDI)	20.0	14.6	18.2	17.4	30.5	36.8	51.5	57.8	52.6	43.1	42.7	49.7	56.6
2. Portfolio investments	-3.3	-0.1	-0.4	7.1	6.3	22.5	14.4	-24.8	-0.4	21.0	7.5	20.1	26.2
3. Official development aid (net total, all donors)	16.8	21.4	27.4	30.0	35.8	44.6	39.5	45.2	47.8	48.0	51.3	56.1	57.1
4. Remittances	12.1	12.8	15.4	19.5	33.7	37.7	44.9	49.7	45.4	52.3	56.9	60.4	64.0
5. Tax revenues	145.4	137.7	174.1	219.1	279.4	333.9	371.5	485.4	384.4	465.7	513.7
Total external flows (1+2+3+4)	45.6	48.8	60.6	73.9	106.3	141.5	150.3	127.9	145.4	164.4	158.3	186.3	203.9
North Africa	14.2	13.6	15.0	20.2	27.4	37.3	42.5	32.6	24.3	43.0	32.0	38.5	45.0
West Africa	7.9	9.6	10.7	13.7	34.5	45.1	40.9	41.9	47.0	51.0	56.9	59.4	61.9
Central Africa	2.8	4.0	8.8	5.4	6.9	6.4	9.8	7.8	10.0	14.9	15.1	14.0	14.7
East Africa	7.7	8.4	10.9	12.9	14.6	18.3	21.3	23.7	23.5	22.3	24.4	28.2	29.6
Southern Africa	11.6	11.5	12.7	19.1	20.2	31.3	31.8	16.9	34.8	28.1	24.6	38.6	45.3

Note: The sum of regional country groupings does not match the total external flows as ODA also includes non-allocated ODA flows to Africa. (e) estimates, (p) projections.

Source: OECD/DAC, World Bank, IMF and African Economic Outlook data. Author's estimates for 2012-13 ODA data, by using the forecast rate of increase for Country Programmable Aid in the 2012 OECD Aid Predictability Report. Projections for 2012: FDI and portfolio: IMF, Remittances: World Bank. (This table excludes loans from commercial banks, official loans and trade credits.)



An in-depth look at each of the finance sources

Foreign Investment flows

According to the International Monetary Fund's (IMF) *World Economic Outlook* FDI to Africa recovered to nearly USD 50 billion in 2012. UNCTAD estimated FDI to Africa in 2012 at USD 45.8 billion, equivalent to a 6% growth rate compared to 2011. Sustained economic growth and Africa's emerging middle class increasingly attracted market-seeking investment. It is expected however that resource-seeking investment will remain the key driver as long as commodity prices remain high.

The most noteworthy African investment trend of recent years has been the rise of south-south investment, as documented in the 2011 edition of the *African Economic Outlook*. Emerging partners compensated for the drop in FDI from Organisation of Economic Co-operation and Development (OECD) members in 2012. Their share of total announced greenfield investment in 2012 increased to an estimated 60%. By contrast, portfolio investment still comes mainly from OECD countries, particularly the United States.

Direct investment

After three consecutive years of decline, 2012 saw FDI to Africa recover to an estimated USD 49.7 billion, compared with USD 42.7 billion in 2011 according to the *World Economic Outlook* (October 2012). This represents 2.5% of Africa's GDP, still below the 2.9% average over the past decade. In 2013, FDI of about USD 56.6 billion is predicted, close to its historic peak in 2008. Sub-Saharan African countries are expected to receive most of this investment.

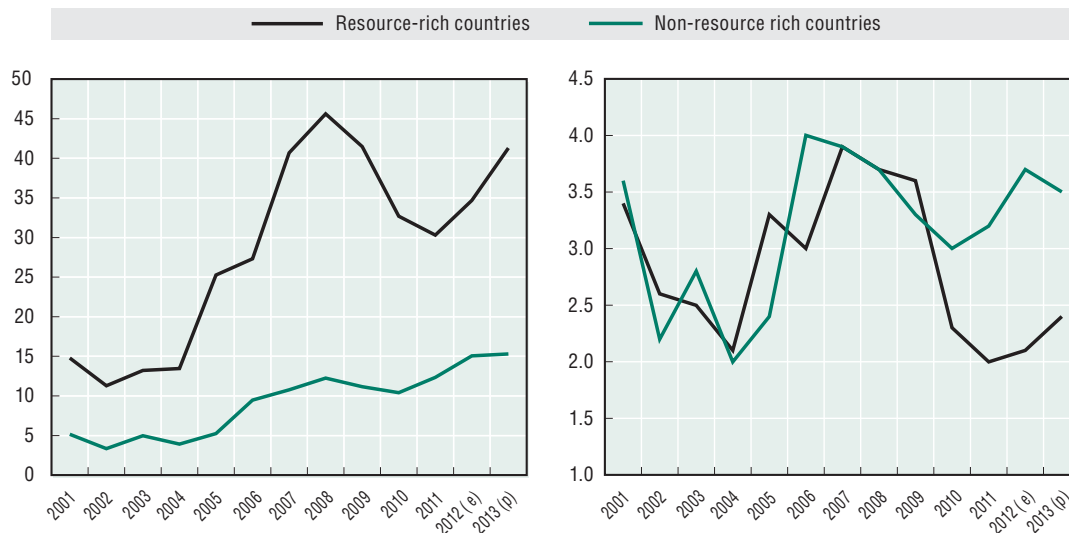
North and southern Africa largely drove this investment recovery in 2012. Egypt and Libya saw their FDI increase to an estimated USD 3.5 billion and USD 1.5 billion respectively. This mainly came from planned investment projects that were delayed due to the political unrest in 2011. This could only be a temporary boost for Egypt as its lingering political unrest is unlikely to foster new projects in the near future. South Africa saw two years of subdued FDI in 2009-10, but a recovery which started in 2011 was extended. Angola recorded much lower cyclical disinvestments in its oil industry estimated at –USD 1.4 billion in 2012 compared to –USD 5.6 billion in 2011. The money is mainly repatriated earnings and repayment of loans.

FDI to developed countries fell 32% in 2012 and this was the first time that global FDI flows to developing countries exceeded those to developed countries (UNCTAD 1999). Africa increased its share in global FDI from 2.7%, its lowest point in the past decade, in 2011 to 3.8% in 2012. In addition, Africa's share of FDI to developing countries increased from 6.1% in 2011 to an estimated 7.3% in 2012. These improvements remain below their 2009 peaks, when Africa received 4.4% of global flows, and 10.1% of that to all developing countries.

FDI to Africa remained mainly concentrated in resource-rich countries and in extractive industries (Figure 2.4a).⁴ Resource-rich countries' share of total FDI stood at 70% in 2012, compared with an average of 76% over the decade. In line with global commodity prices, FDI to resource-rich countries showed more volatility and remains exposed to future shocks. However, FDI as a share of GDP is higher for non resource-rich countries (Figure 2.4b). It represented 3.5% of GDP compared to 2.4% for resource-rich countries. By 2013 FDI to non resource-rich countries is projected to be three times its 2001 value.



Figure 2.4. FDI to resource-rich countries versus non-resource-rich countries



Note: (e) estimates, (p) projections.

Source: Authors' calculations based on UNCTAD World Investment Report 2012 and IMF WEO 2012.

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The rising investment from emerging economies is one of the most notable economic developments over the past decade. According to the fDi Markets' database on cross-border investment, south-south investment made up the largest share of announced greenfield investment to Africa for the second year in a row.⁵ Despite having dropped from USD 43.7 billion to USD 24.9 billion in 2012, the share of total announced greenfield investment to Africa increased from 53% in 2011 to 61% in 2012.

India, followed by the United Arab Emirates (UAE) and Qatar contributed up to 60% of total south-south greenfield investment to Africa in 2012. The UAE made the largest total greenfield investment to Africa over the past decade (2003-12), some USD 133 billion, about 30% of total south-south investment for the period. The UAE's announced investment peaked in 2007-08. The country is mainly active in port and tourism infrastructure as well as telecoms. India and China followed with USD 52 billion and USD 45 billion respectively. (See the *African Economic Outlook 2011* theme chapter on Africa's Emerging Partners for a more in-depth analysis.)

OECD countries' share of FDI to Africa decreased from USD 33 billion in 2010 to USD 21.9 billion in 2011. This explains the slower recovery of FDI to Africa following the 2008 economic crisis, compared to global FDI flows. The largest individual investors in 2011 were France and the United States with USD 5.7 billion and USD 5.1 billion respectively, followed by Italy and Germany. Over 2005-11, the United States was the largest investor with USD 37 billion, followed by France and the United Kingdom, both at around USD 31 billion.

Net merger and acquisitions (M&As) in Africa fell by about 10.7% to USD 7.2 billion in 2011 (UNCTAD 2012). This remains below the five-year average of USD 10.3 billion. Net M&As to South Africa increased from USD 3.9 billion to USD 5.2 billion, above the country's five-year average. South Africa remains Africa's main M&A destination, followed by Egypt and Nigeria with respectively USD 609 million and USD 539 million. The average deal value for the past three years decreased compared to the three years preceding the economic crisis. The average for 2005-08 was USD 123.7 million and USD 82.2 million for 2009-12. South Africa is the exception, recording an increase in the average value of deals.



Outlook for direct investment in Africa

FDI to Africa is projected to increase by more than 10% in 2013, bringing it close to its record levels of 2008. The southern African region should see most growth, with new resource-seeking investment in Angola, Mozambique and South Africa. The global economic downturn nevertheless represents a risk. Fiscal consolidation in the United States and the protracted euro area crisis are slowing global demand, which could affect demand and prices for commodities. Conflict in Mali, unrest in northern Nigeria and lingering political uncertainty in Egypt could dampen investment prospects for those regions.

Market-seeking investment to Africa is likely to become more prominent. The continent's decade of strong growth has given households a growing purchasing power. This income increasingly attracts investors to Africa, ahead of commodity prices. The rapid move of populations into cities also drives demand for new types of services and goods. Policy continuity and political stability in Africa's middle-income countries, except for Egypt, Libya and Tunisia, improved the business environment, enabling more long-term investment. However, as long as strong global demand for resources sustains commodity prices, resource-seeking investment is expected to remain Africa's largest FDI driver.

Box 2.1. Improving Africa's attractiveness: The NEPAD-OECD Africa Investment Initiative

During 2011-12 the NEPAD-OECD Africa Investment Initiative completed Investment Policy Reviews (IPRs) in four Southern African Development Community (SADC) countries: Mozambique, Botswana, Tanzania and Mauritius. A review is also under way in Nigeria.

Examples of the policy impact of the initiative's work in 2012 include:

- Mauritius's budget process already features several recommendations, including codifying investment regulations in a single legal text; updating the country's Model Bilateral Investment Treaty; and streamlining the administration of Intellectual Property Rights. These are expected to be implemented in 2013.
- Botswana is considering grouping all legislation for investor protection and investment restrictions within an investment code – one of the central IPR recommendations.
- Tanzania's IPR feeds into the review of the Tanzania Investment Act 1997 and the 1996-2013 National Investment Policy.
- In Mozambique, following the IPR recommendations on infrastructure, the government expressed interest in a training programme on preparing and implementing public private partnerships in the energy sector.
- At the regional level, the 14 SADC members identified the OECD Policy Framework for Investment (PFI), on which IPRs are based, as the reference for the SADC Regional Investment Policy Framework. The Initiative is working with the SADC secretariat to design a regional framework, to seek greater competitiveness and co-ordination of investment policy across the region.
- In addition, the Initiative's work on encouraging private participation in infrastructure development has shed light on common challenges faced across southern Africa.

Source: NEPAD-OECD Africa Investment Initiative.



Outward African FDI

Total African investment in other countries halved to USD 3.5 billion in 2012 from USD 7 billion the year before (UNCTAD 2012). South Africa's importance for intra-African investment increased during the past decade and was equivalent to 6% of the country's GDP in 2011, according to the IMF. The main destinations for South African investment in Africa are Mauritius and Nigeria. Mauritius acts as a hub for investment in third countries. South Africa in particular plays an important role through its African Renaissance and International Cooperation Fund.

The value of announced intra-African greenfield investment dropped significantly to USD 3.1 billion in 2012 from an average USD 11 billion in the past three years (fDi Markets). African investors represented 7.7% of total announced greenfield projects in Africa in 2012. Totalling USD 27.3 billion, South Africa accounted for 45% of intra-African greenfield investment for 2003-12. Mauritius, Egypt, Kenya and Nigeria followed with USD 7.8 billion, USD 7.8 billion, USD 6 billion and USD 5.4 billion respectively.

Regional FDI

FDI to North Africa doubled in 2012 in a context of low investor confidence. The major risk to the 2013 outlook is lack of clarity and predictability in the region's economic policies. In **Egypt**, the realisation of two of Africa's largest announced greenfield projects in 2012, worth more than USD 5 billion, will depend on the return of political stability and reaching an agreement on an IMF loan.⁶ **Morocco** is estimated to have exceeded USD 3 billion FDI for the first time in 2012, reflecting the positive investor perception of government reforms and the country's stability. Morocco expects to diversify investment into textiles, electronic components, offshore services and tourism as part of its Vision 2020 programme. A recent USD 1 billion investment by the French car manufacturer Renault in a car plant is expected to open the way for further auto industry finance. **Tunisia's** unclear economic policies and complex investment code bears on investors' confidence.

Table 2.2. FDI flows to African regions
(billion USD, current)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012 (e)	2013(p)
North Africa	4.9	3.2	4.0	5.3	10.7	19.8	21.7	20.9	16.4	13.8	5.8	10.2	10.8
West Africa	2.0	2.8	3.3	3.2	6.3	6.9	9.5	12.4	13.5	11.7	16.1	15.1	16.0
Central Africa	1.5	2.2	2.7	2.2	2.7	2.7	5.8	4.0	6.1	9.4	8.4	8.2	8.1
East Africa	1.6	1.6	2.5	2.8	4.1	5.6	5.4	5.3	4.4	4.5	4.8	6.6	7.3
Southern Africa	9.9	4.8	5.7	3.8	6.7	1.8	9.2	15.3	12.3	3.7	7.6	9.5	14.3

Note: (e) estimates, (p) projections.

Source: UNCTAD World Investment Report 2012; IMF World Economic Outlook 2012 for estimates and projections.

In 2012 West Africa remained the region that attracted the largest FDI volumes, estimated at USD 15.1 billion and sustained mostly by resource-seeking money. **Nigeria, Guinea, Ghana** and **Niger's** resource sector attracted an estimated 88% of total FDI to the region. **Nigeria's** largest announced greenfield project in 2012 amounted to nearly USD 2 billion to increase oil production. The other large greenfield projects for Nigeria were in manufacturing and information and communications, signalling some diversification. Portfolio inflows to Nigeria picked up in 2012 and surpassed FDI flows, which are on a downward trend. Lower transaction charges in Nigeria's stock market could have a further beneficial impact on portfolio investment. If this trend continues it might expose Nigeria to the risk of sudden capital flow reversals. Ghana is likely to see further investment in oil exploration and exploitation. The



oversubscription of Ghana's bond issuance in January 2012 signals strong investor confidence in the country. Privatisation prospects in Togo are likely to raise investment for the country. Serious risks emanate from instability in the Sahel region and in northern Nigeria.

FDI flows to Central Africa stagnated at around USD 8 billion in 2012 and are projected to hover around that figure in 2013. FDI remained concentrated in the **Democratic Republic of the Congo (DRC)**, **Congo Republic** and **Equatorial Guinea**, attracted by natural resources. These three countries are likely to continue receiving 80% of the region's FDI in the near future. FDI to Central Africa as a share of GDP averaged 6.4 % over the past decade. This is about twice the average of other regions and highlights the role of natural resources – especially oil – in the region's economic growth.

East Africa attracted an estimated USD 6.6 billion in 2012, above the USD 5.6 billion peak in 2006. On the back of recent resource discoveries in **Tanzania**, **Uganda** and **Kenya**, FDI is expected to exceed USD 7 billion in 2013. The expansion of household purchasing power, improved infrastructure and regional integration may trigger further investment in Kenya. Progress made under the United States-East African Community Trade and Investment Partnership could underpin investment in the medium term, in particular in Kenya's banking and booming telecommunications sectors.

FDI to southern Africa is projected to recover strongly in 2013 as a result of investment in Angola's oil sector and South Africa's power sector. In July 2012, ExxonMobil announced plans to invest USD 2.5 billion in a new oil extraction facility in **Angola**. The country's new legal framework is expected to provide better transparency and guarantees to investors in a move to develop the mining sector and diversify the economy. Chinese investment in Angola remains large and concentrated in oil, agriculture and construction. The sizeable offshore gas reserves discovered recently in **Mozambique** are likely to trigger significant inflows for coming decades (see the theme chapter in this volume). The liberalisation of **South Africa's** power sector is expected to facilitate FDI in electricity generation. Already in February 2012 India-based JSW Energy announced an USD 800 million greenfield project for a power plant. Investment in the country's sizeable mining reserves might be deterred to upward pressure on wages, strike threats and costly electricity. The current debate on resource nationalism in South Africa heightens policy uncertainty.

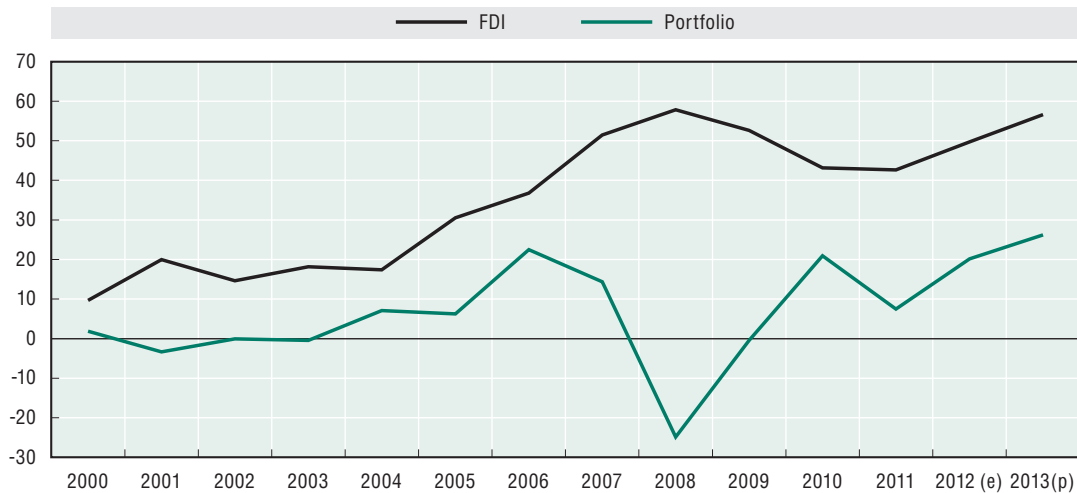
Portfolio investment

Portfolio investment recovered strongly to an estimated USD 20.1 billion in 2012, from USD 7.49 billion in 2011 (IMF 2012b). The IMF forecasts portfolio investment to increase to USD 26.2 billion in 2013, above the pre-crisis peak of USD 22.5 billion in 2006. This recovery is largely due to South Africa which saw inward portfolio flows triple from USD 6.5 billion in 2011 to USD 18.5 billion in 2012, close to its pre-crisis level of USD 21.3 billion in 2006. The second largest recipient was Nigeria with USD 6.7 billion. Jointly they accounted for 95% of total portfolio flows to Africa in 2012. Their share of total FDI to Africa is projected to increase from 40% in 2012 to 46% in 2013 (IMF 2012).

Portfolio outflows from Africa decreased from USD 8.5 billion in 2011 to an estimated USD 6.5 billion in 2012. South Africa and Angola represented 78% of this, with USD 3.9 billion and USD 1.2 billion respectively. Egypt saw a negative portfolio flow for the second straight year. The IMF estimates USD 3.9 billion left the country in 2012. These capital outflows, the result of political instability following the ousting of President Mubarak in 2011, are a serious threat to the economy. DRC and Libya also saw negative portfolio flows, worth USD 2 billion and USD 0.4 billion respectively.



Figure 2.5. Foreign direct investments and portfolio investments to Africa
(billion USD, current)



Note: (e) estimates, (p) projections.

Source: UNCTAD World Investment Report; IMF World Economic Outlook.

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Portfolio investment stocks in Africa remain highly concentrated. In 2011, according to the IMF's co-ordinated portfolio survey, the portfolio investment stock in Africa was USD 200 billion.⁷ This is roughly five times the portfolio stock of a decade earlier and reflects the increasing importance of these flows to Africa. Over 80% of the stocks are held in South Africa and northern Africa, with South Africa alone representing 70%. This balance has remained unchanged for ten years. In recent years, Mauritius has consolidated its position as an investment gateway to Africa, with USD 15 billion in portfolio investment stock, second to South Africa. In 2011 the United States held the largest stock of African portfolio investment, worth USD 86 billion, representing 43% of the total stock.

Official development assistance

According to the latest OECD Development Assistance Committee (DAC) figures, nominal aid volumes to Africa increased from USD 47.9 billion in 2010 to USD 51.2 billion in 2011. This represents a real increase of 0.6% in 2010 constant USD. These are the highest nominal aid flows to Africa ever and are the result of a USD 3.22 billion in nominal bilateral aid volumes between 2010 and 2011. This made up for the decline in multilateral aid for the second year in a row from USD 18.3 billion in 2010 to USD 17.9 billion in 2011.

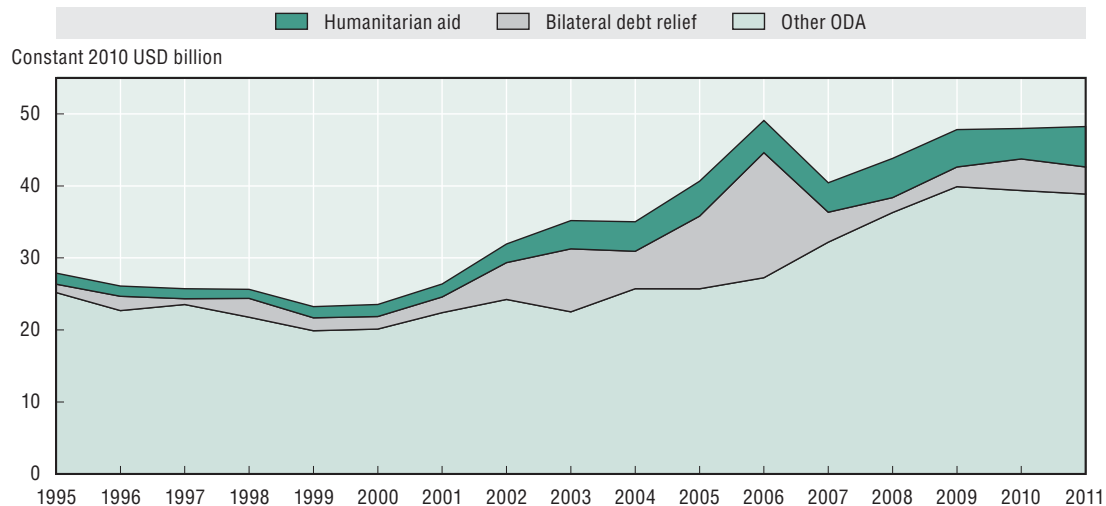
So far, African countries have been spared severe ODA cuts in comparison to global net ODA flows which decreased by 2.7% in real terms – the first fall since 1997. Indeed, in real terms, total net ODA disbursements to Africa remained at their 2010 level as shown in Figure 2.6. There are different trends in the disbursements however. Bilateral aid to core development programmes and projects (*i.e.* excluding debt relief grants and humanitarian aid) decreased for a second year in a row. Humanitarian aid reached a record level of USD 5.6 billion and compensated for other components of bilateral aid. Humanitarian aid averaged USD 3.8 billion in the period 2000-10. Bilateral debt relief in 2011 dropped to USD 3.8 billion, compared to USD 4.4 billion in 2010.

OECD/DAC nominal assistance volumes amounted to USD 134 billion in 2011 compared to USD 128.5 billion in 2010. This represented 0.31% of the combined gross national income of DAC countries in 2011 compared to 0.32% in 2010. This relative decline reflects increasing



fiscal constraints in donor countries. Sixteen OECD countries recorded ODA cuts, with the largest in Austria, Belgium, Greece, Japan and Spain. Against this background, Africa's share of total net ODA (bilateral and imputed multilateral) was 38%, up from the 2000-10 average of 37%.

Figure 2.6. Net official development aid disbursements to Africa



Source: OECD/DAC.

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Net bilateral ODA from DAC countries still represents the largest share of total net official assistance volumes to Africa. Their share of total ODA has remained stable at about 64% for the past five years. Multilateral ODA provides around 35% of the net total, with the remaining 1% attributed to non-DAC countries.

Smaller OECD donors to Africa tended to reduce assistance to Africa. Yet, in 2011 this decrease was still compensated by an increase in assistance from the largest DAC donors to Africa: the United States (USD 9.4 billion), France (USD 4.6 billion), United Kingdom (USD 3.4 billion) and Germany (USD 2.6 billion). All four increased their official assistance to the continent, totalling 61% of bilateral DAC ODA to Africa. Ten DAC countries lowered their ODA volume to Africa in 2011: the largest being Austria (-50%) followed by Greece (-47%) and Spain (-44%).

ODA outlook: country programmable aid

In 2013, according to the latest OECD/DAC survey on donor forward spending plans, Country Programmable Aid (CPA) volumes to Africa should stabilise around USD 41.9 billion.⁸ For 2014 and 2015 the survey indicates a decrease of CPA to Africa to USD 40.5 billion and USD 39.6 billion respectively. These projected values are slightly higher than the last observed peak of USD 39 billion in 2009. In 2012, CPA to Africa is estimated to increase to USD 41.1 billion from USD 37.6 billion in 2011. This should come from an expected increase in outflows from multilateral agencies, which reflects the delayed effect of earlier replenishment rounds to enable developing countries to overcome the impact of the economic crisis.

While overall CPA to Africa should remain stable in 2013, the distribution by recipient country is expected to change. The largest projected increase in CPA flows is expected in DRC, Kenya and Senegal with respective increases of USD 214 million (+13%); USD 167 million (+7%) and USD 102 million (+13%). Guinea-Bissau is likely to see CPA increase by 39%, which reflects



the expected resumption of ODA after a *coup* attempt in April 2012 caused the suspension of development aid. The strongest declines are expected in Côte d'Ivoire, Rwanda and Ethiopia by USD 111 million (-20%), USD 92 million (-8%) and USD 83 million (-3%) respectively.

CPA per capita in 2012 is expected to increase from USD 37 to USD 39, due to higher flows to large population countries such as Nigeria, Kenya, Tanzania, Uganda and Egypt. From 2013 onwards, CPA per capita is projected to decrease as the result of sustained population growth and the stagnation of CPA flows. This would end the trend of increasing CPA per capita over the past decade.

In 2012, Africa's share of global CPA is estimated to increase to 42%, from 41% in 2011. This is the second year in a row that Africa has attracted more CPA than Asia (USD 38.8 billion, or 40%). Going towards 2015 the difference is expected to disappear, with both regions projected to attract about USD 39.5 billion, or about 41% of total CPA.

The decreasing CPA trend indicates that ODA volumes to Africa in the short term will at best remain stable in nominal values. This is mainly driven by low-income countries which are likely to receive a relatively larger share of global ODA, while they make up half of African countries.

Significant short-term risks to this outlook remain. Fiscal pressures on donors are likely to persist for years. An April, 2012 OECD report highlighted that the United States and the United Kingdom would require significant fiscal consolidation to maintain their debt sustainability by 2050. The two countries represented about 32% of total ODA to Africa in 2011. OECD research (1996) on the impact of recession on aid budgets indicated that it takes three to five years for aid budgets to reflect the full impact of a shrinking economy. In addition, given current events in the Sahel region and in North Africa, it is likely that development partners will change some of their ODA projects.

Box 2.2. Under-aided countries

There is no agreed definition of what constitutes an under-aided country. It can be in absolute or relative terms. Receiving insufficient aid in absolute terms means not being able to finance needs to meet the Millennium Development Goals (MDGs) or other development goals – a situation many countries face. The OECD-DAC instead determines which low-income countries are under-aided in relative terms – that is, receiving less aid relative to others that have similar needs and characteristics.

Some countries are under-aided in part because of inadequate co-ordination amongst donors of their individual incentives, frameworks and priorities. Development assistance providers rarely take into consideration the decisions of other actors when making their own allocations. The recent decision by several donors to focus development assistance on fewer countries has aggravated the situation, with donors exiting from some of the same countries. Besides, there is no commonly agreed framework or co-ordination mechanism for development providers to seek analysis of aid allocation patterns.

The OECD-DAC has developed a methodology and established an initial framework for identifying potentially under-aided countries, based on research initially conducted by the World Bank. It draws on four established aid allocation models that are based on countries' needs/poverty and/or institutional performance. Two of them, the UNDP-TRAC-1 aid allocation model and the IDA 15 performance-based allocation model, are currently applied by the United Nations Development Programme (UNDP) and the World



Bank. The egalitarian model and the Collier/Dollar poverty-efficient aid allocation model are more theoretical even though they are partially adopted in other aid allocation approaches. The models range from more simplistic approaches that assume equal aid per capita to more sophisticated formulas based on countries' past institutional performance, poverty levels and income. The amount of aid that countries would receive if all aid was distributed according to these four allocation models is compared to the actual volume of aid that countries receive today. Countries that are found to receive significantly less aid than the models would indicate relative to their needs and institutional performance are considered "under-aided".

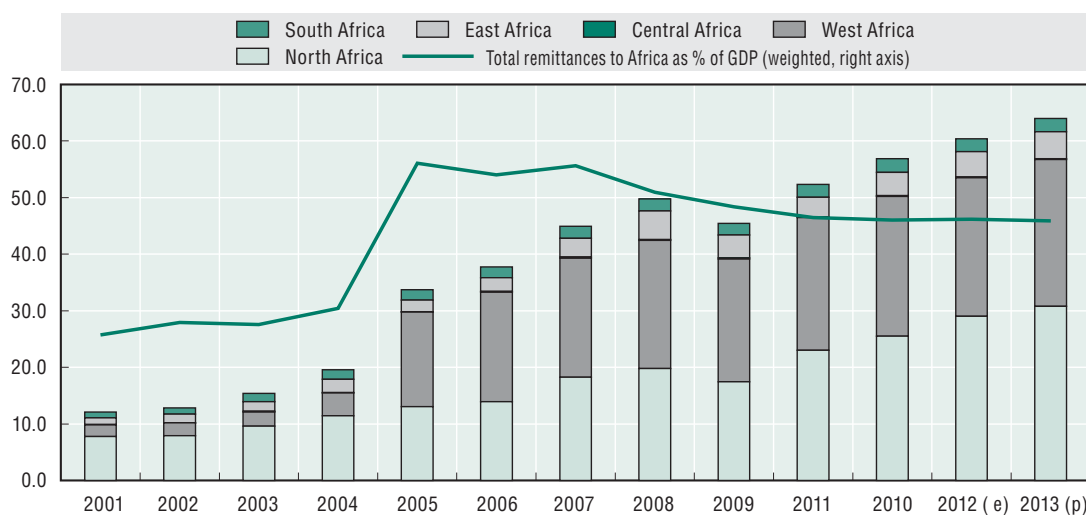
The most recent data find that nine countries – Bangladesh, Burkina Faso, Gambia, Guinea, Madagascar, Malawi, Nepal, Niger and Togo – are potentially under-aided according to needs- and performance-based aid allocation criteria. These are all least developed countries with significant MDG gaps and with limited institutional capacity. Most of the aid they receive is in the form of grants and concessional loans from multilateral agencies. In addition, many of these countries appear to be the chronically under-aided, according to the same criteria, over at least the past five years. The DAC High Level Forum in December 2012 agreed to systematically monitor under-aided countries, and the OECD will therefore play a key role in refining the methodology.

Source: OECD/DAC (2012) *Identification and Monitoring of Potentially Under-aided Countries*.

Remittances

In 2012, for the first time, remittances became the largest external financial source to Africa, ahead of FDI and ODA. In sub-Saharan Africa an estimated 13% of remittances come from other African countries (AfDB). They amounted to USD 60.4 billion compared with USD 56.9 billion in 2011 (World Bank, 2012b). This is a record for the third year running, following the 2009 global financial crisis. Remittances to Africa represented 11% of global remittances in 2012, compared to 8% in 2001. This estimate does not include the unrecorded flows through formal and informal channels. The true size of remittance flows to Africa is expected to be even larger.⁹ Remittances are an important source of revenue for some 120 million people in Africa to support consumption, education and health expenses.

Figure 2.7. Remittances to Africa
(billion USD, current)



Note: (e) estimates, (p) projections.

Source: World Bank 2012. Authors' calculations for 2012 and 2013 data based on World Bank projections.

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Remittances to African countries are unevenly distributed (Figure 2.7). In 2012, northern and western Africa received 89% of total remittances. This is an increase from the early 2000s when their share averaged 80%. Their proximity to Europe and their population size explain those figures. Nigeria and Egypt together represented 64% of total remittances to Africa with respectively USD 21 billion and USD 18 billion. Sudan, Kenya and South Africa are the only countries from other regions that received over USD 1 billion in remittances. They received USD 1.4 billion, USD 1.3 billion and USD 1.1 billion respectively.

Northern Africa represented 90% of the USD 3.9 billion increase in remittances in 2012. Eastern Africa recorded the remaining remittances, worth USD 400 million. This is a 10% increase compared to 2011. Western Africa and southern Africa saw their remittances decrease by 1% and 9% respectively. These drops are due to lower recorded remittances in large recipient countries such as Côte d'Ivoire, Senegal, South Africa and Mozambique.

The importance of remittances expressed as a share of GDP is also very heterogeneous across Africa. In 2012 the average share of remittances to GDP in Africa equalled 3.0%. This has been stable throughout the past decade. However, for some countries remittances represent a pillar of economic growth. Table 2.3 shows the 15 African countries with the largest share of remittances to GDP for the period 2005-11. Migrant workers to South Africa explain the importance of remittances to Lesotho's economy.

Table 2.3. Average share of remittances to GDP (Top 15 African countries)

	Average (2005-11) in %
Lesotho	35.4
Nigeria	10.4
Senegal	10.4
Cape Verde	10.4
Togo	10.3
Gambia, The	9.0
Liberia	7.9
Morocco	7.7
Egypt	5.3
Guinea-Bissau	5.1
Tunisia	4.4
Mali	4.4
Uganda	4.3
Benin	3.6
Sudan	3.6

Source: Authors' calculations based on World Bank data.

Intra-African remittances rose from USD 3 billion in 2000 to USD 5.7 billion in 2011. By contrast, their share in total remittances to Africa decreased from 25% in 2000 to 10% in 2011. South Africa is an important destination for migrants and represents the largest share of intra-African remittances with USD 1.4 billion in 2011 (World Bank, 2012a and b).

Since 2008, Africa has been the most costly region of the world to send remittances to. In 2012, it cost an average 12.4% of the transferred sum to send money to Africa, whereas for South Asia it was only 6.6% (World Bank's Remittance Prices Worldwide Database). Sending money to South Africa, Tanzania and Ghana is even more expensive, costing respectively 20.7%, 19.7% and 19%. The international community has yet to live up to its commitment to reduce the cost of remittances by 5% by 2014.¹⁰ This could save up to USD 4 billion annually, according to World Bank calculations.

"Send Money Africa" indicates that increasing competition for cross-border payments would lower transaction costs. Banks, the most expensive remittance service provider, are often the only channel for African migrants. Regulatory hurdles slow the introduction of



cheaper alternatives and new technologies such as mobile money transfers. M-Pesa in Kenya and Tanzania are successful examples, but the regulatory void between telecom and financial regulations complicates the development of international mobile remittances. In addition, allowing customers to make informed decisions requires more transparent information.

The scope is still wide for policy makers to harness remittances for productive investment. Policies that lower the cost of remittance services may help reduce poverty and increase the financial inclusion of rural households which typically are prone to credit-rationing. At macroeconomic level, “formal” remittances could be a source of development finance and facilitate financial and human capital accumulation through increased spending on education and health. However the risk of Dutch disease effects following exchange rate appreciations due to large remittance inflows remains. And this could undermine the competitiveness of non-traditional sectors and hamper much-needed structural change.

Outlook for remittances

According to the World Bank, remittances to Africa are projected to keep increasing in the medium term, but at a slower pace than in the second half of the 2000s. In 2013, recorded remittances to Africa are projected to increase by 6% to USD 64 billion, against a 7.9% increase to other developing regions. The large African diaspora in Europe, which suffers from the euro area crisis, might be an explanation for this. The average growth rate of remittances to Africa for the past 10 years has been 17%.

Risks to this outlook stem from any further global economic downturn and policy tightening towards migrants. So far, migrants have sustained the volume of transfers throughout the crisis, but as they face tougher economic conditions they may have to reduce payments. According to the *OECD International Migration Outlook (2012b)*, migrant unemployment rates have increased faster than those of native-born workers in France, Greece, Italy, Spain and the United Kingdom since early 2009. Migrant workers in Spain had an unemployment rate of 31.5% compared to 19.5% in 2011. The weaker employment prospects in key countries such as Italy, Spain and the United Kingdom might affect the prospects for future transfers to Africa.

Taxation

Government tax revenue reached a record USD 513 billion in 2011, after USD 466 billion in 2010, according to this year’s AEO. Tax accounted for 26.8% of Africa’s GDP, up from 26.6% in 2010. The tax share peaked at 31.1% in 2008 as the financial crisis struck, which suggests there is still room to increase tax revenues. The 2011 figure was cut by the conflict in Libya. Libya’s tax revenues, which come 90% from oil, plummeted from USD 48.6 billion in 2010 to USD 13.5 billion in 2011.

From 2000 to 2011, Africa’s tax share increased by an annual compound rate of 0.3% (Figure 2.8). Resource taxes as a share of GDP increased by an annual rate of 0.9%. Over the same period, direct taxes and indirect taxes as a share of GDP increased at an annual compound rate of 1% and 0.5% respectively. The share of trade taxes in GDP declined at an annual rate of 5%.

Direct taxes represent more than 10% of GDP for South Africa, Namibia, Seychelles, Lesotho, Zambia, Zimbabwe and Malawi. Since 2000 Mozambique, Uganda, Algeria, Niger, Mali and Tanzania saw the biggest increase in the share of direct taxes in GDP. They grew at an annual compound rate of more than 7%. Indirect taxes represented more than 10% of GDP for Zimbabwe, Mauritius, Morocco, Mozambique, Djibouti, Senegal and Seychelles. Indirect taxes as a share of GDP increased strongest for Cape Verde, DRC, Comoros, Burkina Faso and The Gambia in 2000-11, growing at an annual compound rate of more than 10%. Trade taxes



have lost significant weight as a share of GDP for middle-income countries, decreasing at an annual compound rate of between 6.5% and 7%. In contrast the share of trade taxes in GDP for low-income countries grew at a compound rate of 0.1% after 2000.

Resources remain the foundation of tax collection in Africa, representing 10.6% of GDP. They accounted for an average 40% of total tax collection for 2008-11, compared to an average 35% for 2000-04. In 2011 resource taxes accounted for half the increase in tax collection. In Angola, Libya, Congo Republic, Equatorial Guinea, Algeria, Chad and Nigeria resource taxes represented more than 20% of GDP in 2011. Nigeria, Algeria, Angola and South Africa, all resource-rich countries, accounted for more than 75% of the increased taxes collected in Africa in 2011.

Africa's resource taxes rely on volatile international commodity prices (Figure 2.8). On the back of the commodity price boom between 2002 and 2008 resource taxes increased from about USD 45 billion to USD 230 billion. As the global economic crisis hit in 2009, resource taxes fell back to USD 129 billion. This drop in revenue was larger than the foreign investment and official development assistance that year. This highlights the importance for resource-rich countries to adopt macroeconomic management that smooths the impact of volatile commodity prices on their public finances (see this year's AEO theme chapter).

Figure 2.8. The tax mix in Africa: Collected amounts for each type of tax as a share of GDP (weighted)



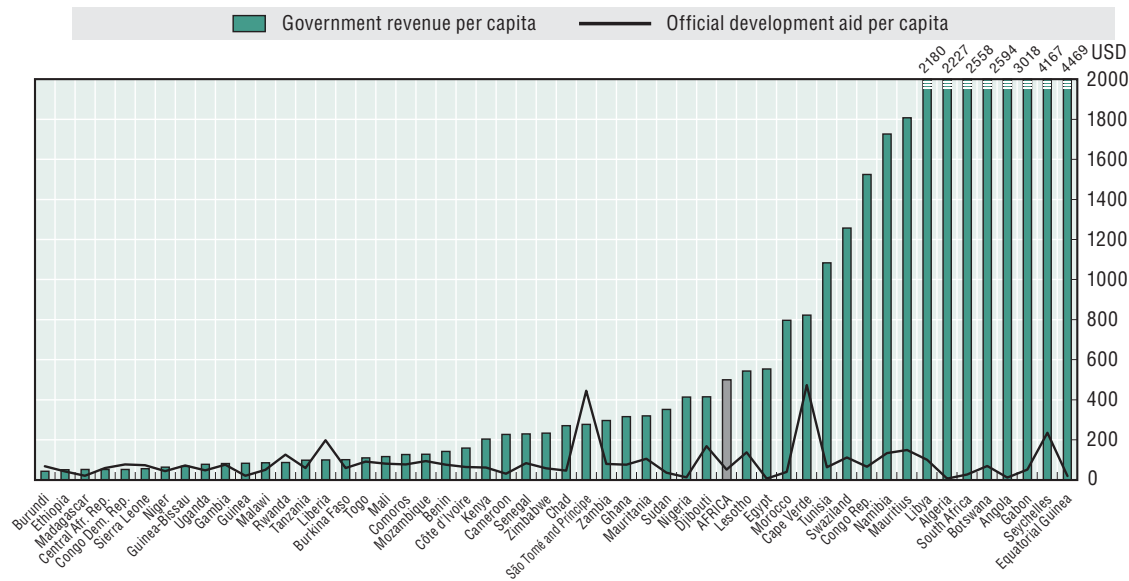
Source: World Bank, Authors' calculation, based on African Economic Outlook country surveys, 2013.
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The 2010 AEO argued that resource rich countries are driving “this remarkable quantitative rise in average tax shares across the continent”, while non-resource rich countries have made most progress in broadening their tax base. After 2000 the GDP share of direct and indirect taxes for non-resource rich countries grew at an annual compound rate of 2.7% and 1.9% respectively. In contrast the same tax categories for resource rich countries recorded a lower annual compound growth of respectively 0.5% and 0.2%. Many non-resource rich African countries moved towards more politically onerous taxes such as those on consumption, wages and profits on ordinary types of activities. In contrast, resource-rich countries barely changed their tax mix over the past decade. Their increased tax collection came mainly from natural resources.




Only eight African countries continue to receive more aid per capita than tax per capita. If Africa was a single country, it would have raised, in 2011, ten times more tax revenue per citizen than aid. However, Figure 2.9 shows that at individual country level significant disparities persist. Thirty-two countries raise less than USD 365 per year per person. That kind of tax revenue is a major obstacle to providing proper public services. Eight African countries collect more than USD 1 825 per year per citizen. With the exception of the Seychelles, these are all resource rich-countries.

Figure 2.9. Aid and government revenue per capita in Africa in 2011



Note: "Government revenue" includes: direct taxes, indirect taxes, trade taxes, other taxes and non-tax revenue.
Source: Authors' calculations, based on OECD/DAC, IMF's *World Economic Outlook* and *African Economic Outlook* country surveys, 2013.

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Moving reliance from foreign aid to domestic taxes increases the legitimacy and accountability of a government. A healthy public finance system is needed for rapid, equitable and sustainable growth. Government revenue should finance basic security, education, health services and public investment while avoiding inflationary financing (Di John 2009). Fair and efficient taxation forces the state to engage with taxpayers and move towards an equitable social contract.

Many countries face persistent challenges to raising tax revenues. Most African economies have large informal sectors that escape taxes. Excessive granting of tax preferences, inefficient taxation of extractive industries and the inability to fight transfer pricing abuses by multinational enterprises add to the obstacles. Severe capacity constraints of tax administrations combined with a lack of public trust that taxes will be well spent result in an unbalanced tax structure relying on a narrow set of taxes to generate revenues. Resource-related taxes typically distract governments from trying more politically demanding forms such as corporate income taxes, personal income taxes, value added tax excise taxes.

The 2010 *African Economic Outlook* signalled the importance of conducting policy reform in the right order. The tax base needs to be deepened in the short run by limiting tax preferences and negotiating fairer taxation with multinationals. In the medium term the capacity of the tax administration should be raised. In the long run, African countries must improve the balance between different taxes. Eventually it becomes a story of strengthening the fiscal legitimacy of the state, which must be accompanied by a public debate on better governance, transparency and the use of the increased public resources for the government.



Africa's “haves” and “have-nots”

After one record level in 2011, external financial flows reached a new record high of USD 186.3 billion in 2012. Foreign investment and remittances drove this recovery. Both surpassed aid as the most important external source of finance for Africa. Sub-Saharan Africa has been particularly dynamic in attracting an increasing share of external financial resources after the 2008 economic crisis. In contrast, with the notable exception of Morocco, the full resumption of foreign investment to northern Africa has been lagging due to lingering political unrest and economic policy uncertainty in the region. Through their impact on investment and tax revenue, the evolution of commodity prices will determine future external financial flows to Africa.

Looking at individual financial flows before and after the 2008 economic crisis, we find two major trends. Firstly, remittances have become a crucial source of finance to Africa and overtook aid and FDI for the first time. The second is the confirmation of Africa's increased integration with emerging economies. Not only through trade – as highlighted in the 2011 *African Economic Outlook* – but increasingly so through investment flows. Indeed, given the sluggish economic growth in OECD countries, investment in Africa increasingly comes from emerging economies. Although this provides an opportunity to further diversify trade and investment partners, the majority of investment from emerging economies is resource-seeking.

The increased external financial flows reflects Africa's projected economic dynamism and its improved macroeconomic management. However, the external financing is highly concentrated in a handful of countries. Five countries account for more than 50% of total external flows: Nigeria, South Africa, Egypt, Morocco and DRC. Indeed, these populous, resource-rich countries offer large potential markets for foreign investors and have a strong diaspora for sustained remittance inflows.

In contrast, half of African countries rely on aid as the largest external source of finance for development needs. These are mostly post-conflict countries, resource-poor, small economies, landlocked or a combination of these characteristics. Strong population growth combined with the likely stagnation of aid in the near future will lead to a further decrease of aid per capita. The donor community needs to pay special attention to vulnerable countries, which may suffer the most should the global economic downturn worsen.

Volatile commodity prices can have a strong impact on investment and tax revenue in Africa. It is important that African policy makers lower their exposure to these potentially strong external shocks as well as ensure that resource wealth benefits the entire population and future generations. The specific policy challenges these entail are further discussed in this year's thematic chapter.



Notes

1. These estimates are based on World Bank data. The revised figures, made available end of 2012, indicate that recorded remittances have already surpassed FDI and ODA since 2010.
2. The sum of these shares exceeds 100% as portfolio inflows to low-income countries recorded negative figures. These negative figures represented disinvestments in the DRC and in Eritrea.
3. UNCTAD definition of investment flows.
4. Resource-rich countries include: Algeria, Angola, Botswana, Cameroon, Chad, Congo Republic, DRC, Côte d'Ivoire, Egypt, Equatorial Guinea, Gabon, Ghana, Guinea, Liberia, Libya, Mauritania, Namibia, Nigeria, Sierra Leone, South Africa, South Sudan, Sudan and Zambia.
5. fDi Markets is an online database tracking cross border greenfield investment covering all sectors and countries worldwide. It provides real-time monitoring of investment projects, capital investment and jobs.
6. Qatar Petroleum International plans to build a USD 3.6 billion new oil refinery in Cairo. Emaar Properties, based in the United Arab Emirates, is investing USD 2 billion in real estate in Cairo.
7. The CPIS collects information on the stock of cross-border holdings of equities and debt securities from 75 investor countries and territories (IMF 2013a)
8. Country Programmable Aid (CPA) is a sub-set of gross bilateral ODA that measures actual transfers to partner countries. CPA is critical for delivering international aid commitments in support of the MDGs, but also represents the proportion of aid that is subjected to country allocation decisions by the donor. For more information, see: www.oecd.org/dac/aid-architecture/cpa.htm.
9. According to Freund and Spatafora (2005) up to a share of 75% of total remittances to Africa are not officially recorded. This share is larger than in other continents.
10. The “5x5” objective is the G8’s commitment to reduce the cost of remittances by 5% by 2014. The commitment was made at the 2009 Aquila Summit. It was endorsed by the G20 in 2010 which established a “Development Action for Remittances”.

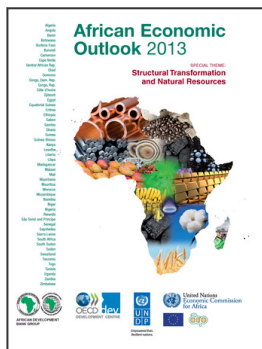


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