FOCUS ISSUE 13: OTHER FINANCIAL FLOWS

I. Overview of commitments

Africa:

NEPAD Founding Statement (2001)

- African leaders agreed to encourage and boost private capital flows as an essential component of a sustainable long-term approach to filling the resource gap in Africa.
- African leaders also pledged that they will promote the deepening of financial markets within countries as well as cross-border harmonization and integration.

Monterrey Consensus (2002)

- Governments committed to continue their efforts to achieve a transparent, stable and predictable investment climate, with proper contract enforcement and respect for property rights, embedded in sound macroeconomic policies and institutions that allow businesses, both domestic and international, to operate efficiently and profitably and with maximum development impact.

Development Partners:

Monterrey Consensus (2002)

- To complement national efforts, development partners were encouraged to increase their support for private foreign investment in infrastructure development and other priority areas in developing countries.

G8 Summit Declaration (2007)

- At Heiligendamm, G8 countries committed to implement measures to reduce the transactions costs of remittances and improve access to financial services in Africa. They also committed to providing assistance to enhance capital markets in Africa.

World Summit Outcome (2005)

- Leaders resolved to encourage greater direct investment, including FDI, in developing countries and countries with economies in transition to support their development activities and to enhance the benefits they can derive from such investments.

II. What has been done to deliver on these commitments?

Africa:

- Over the past few years, African countries have increased their efforts to develop or enhance their national policies and laws with a view to improving the investment climate. Ten countries introduced policy measures in 2007, most of which were in the direction of making their regulatory frameworks more favourable to FDI. In 2007, 11 African countries signed a total of 11 bilateral investment treaties (BITs), and 10 countries signed 11 double taxation treaties (DTTs), raising the total number to 696 and 459 respectively.

- To increase FDI inflows, 40 African countries introduced 57 new measures affecting FDI in 2006, of which 49 encouraged inward FDI (UNCTAD's annual survey on changes to national laws and regulations in 2006).
- Of these investment promotion measures, 14 were related to sectoral liberalization, more specifically: (i) allowed partial or full foreign ownership of their telecommunications industries in Botswana, Burkina Faso, Burundi, Cape Verde, Ghana, Kenya and Namibia; (ii) open up banking industries wholly or partially in Congo, Egypt and Nigeria; (iii) open up legal services and insurance industry in Mauritius and Swaziland respectively; (iv) corporate income tax reductions (in Algeria, Egypt, Ghana, Lesotho, Mozambique, Tunisia, Uganda and the United Republic of Tanzania).
- Other major measures included the establishment of specialized investment zones or parks (in Botswana, Eritrea, Morocco, the United Republic of Tanzania and Zambia), or the setting up of advisory councils for investment promotion (Ethiopia).
- African regional entities also introduced a number of FDI-related policy and institutional reforms in 2007.
- *The Common Market for Eastern and Southern Africa (COMESA)* adopted a regional investment agreement which will, by 2010, grant all investors in COMESA national treatment, most-favoured-nation treatment and protection against expropriation and taxation measures that could amount to an expropriation. The COMESA Common Investment Area Committee has been created with a mandate to supervise the Agreement.
- *The Economic Community of West African States (ECOWAS)* created a department responsible for promoting cross-border investments and joint venture businesses and is preparing a community investment code aimed at harmonizing and simplifying investment policies within the region.
- *The Southern African Development Community (SADC)* is undertaking a joint investment promotion programme with the EU.

Development Partners:

- Several donors have taken measures to strengthen financial markets and boost private capital flows in the region. The African Financial Sector Initiative of the United States and the G8 proposal to develop a Regional Micro- Small- and Medium-size Enterprise Investment Fund (REGMIFA) are representative initiatives in this area.
- G8 countries are also stepping up efforts to enhance local bond market development in African countries. At the G8 Finance Ministers meeting in Osaka, Japan in June 2008, Ministers reiterated their commitment to boost the development of local bond markets and indicated that they are increasing contributions for the development of infrastructure in Africa.
- To reduce the cost of remittance transfers, several EU countries have set up websites that provide information to migrants on prices charged by various firms.
- Various countries and international and regional organizations have launched a number of initiatives to promote investment in Africa. *Japan*, at the Fourth Tokyo International Conference on African Development (TICAD IV) in May 2008, announced its decision to create a facility within the Japan Bank for International Cooperation (JBIC) for investment in Africa of US$2.5 billion over the next five years. This is twice the amount of total FDI flows from Japan to Africa during the past five years (2003–2007) or twice the size of Japanese FDI stock in Africa in 2007.
- *The United States* signed trade and investment framework agreements with three African countries (Mauritius and Rwanda in 2006, and Liberia in 2007). It also negotiated a Trade, Investment and Development Cooperation Agreement with the Southern African Customs Union (SACU).
- *China* expanded its support to Chinese investments in Africa, building on its general investment policy to Africa adopted in 2006. In 2007, the Export-Import Bank of China financed over 300 projects in Africa.
- *The European Free Trade Area (EFTA)* started implementing a free trade agreement (FTA) with Egypt in 2007. The Agreement includes provisions on investment, services, state monopolies and subsidies,

protection of intellectual property, capital movements, government procurement and institutional and procedural matters. In May 2008 an FTA between the EFTA States and SACU also entered into force.

- *The Organisation for Economic Cooperation and Development (OECD)* has developed various initiatives involving the promotion of private and international investment in Africa. The NEPAD-OECD Africa Investment Initiative aims to improve the capacity of African countries to strengthen the investment environment for growth and development, taking advantage of OECD's peer learning method and investment policy approaches such as the Policy Framework for Investment (PFI), the most comprehensive multilaterally-backed investment policy instrument.

III. What are the results?

1. Net private capital flows to Africa were up sharply in 2007 by US$30 billion to reach US$81 billion, the highest level on record. The rise was mostly due to a surge in FDI (US$9 billion) and private debt flows (US$21 billion). The increase was more significant in sub-Saharan Africa (Table 1). Meanwhile, net portfolio equity inflows to the region dropped by US$8 billion, with South Africa accounting for much of the decline. For South Africa, the marked decline in portfolio equity inflows likely reflects the confluence of two factors: increased risk aversion by foreign investors following the global credit turmoil; and reduced holdings of South African equities by non-resident portfolio investors. After several years of net reflows that began in the late 1990s, Africa now enjoys renewed access to commercial bank lending. Private debt flows to Africa kept pace with the upswing in overall flows to developing countries, reaching almost US$19 billion in 2007, driven by abundant global liquidity and steady improvements in credit quality of several African countries

Table 1: Net Private Capital Flows to Africa
(US$ billion)

	2002	2003	2004	2005	2006	2007e
FDI flows	13.1	18.0	16.0	26.0	36.4	45.2
North Africa	*2.6*	*3.6*	*3.5*	*10.0*	*19.7*	*20.0*
Sub-Saharan Africa excl. S. Africa	*9.8*	*13.6*	*11.8*	*10.8*	*17.2*	*19.6*
South Africa	*0.7*	*0.8*	*0.7*	*6.6*	*-0.5*	*5.6*
Portfolio equity flows	-0.7	0.7	7.3	8.2	15.4	8.9
North Africa	*0.3*	*0.2*	*0.3*	*1.8*	*1.7*	*1.7*
Sub-Saharan Africa excl. S. Africa	*0.0*	*0.0*	*0.0*	*0.0*	*0.1*	*0.2*
South Africa	*-0.4*	*0.7*	*6.7*	*7.4*	*15.0*	*7.0*
Commercial bank debt flows	-2.4	0.0	1.8	5.0	-2.4	18.6
North Africa	*-0.5*	*-1.2*	*-0.6*	*1.2*	*-0.9*	*3.5*
Sub-Saharan Africa excl. S. Africa	*-0.4*	*2.0*	*2.1*	*4.0*	*-1.2*	*12.1*
South Africa	*-1.5*	*-0.8*	*0.3*	*-0.2*	*-0.3*	*3.0*
Bonds flows	6.5	1.1	3.9	3.6	0.7	8.3
North Africa	*5.0*	*0.7*	*3.3*	*2.3*	*0.6*	*2.5*
Sub-Saharan Africa excl. S. Africa	*2.0*	*1.2*	*1.0*	*1.3*	*0.4*	*5.8*
South Africa	*-0.5*	*-0.8*	*-0.4*	*0.0*	*-0.3*	*0.0*
Total private capital flows	17.1	20.0	28.7	45.2	51.5	81.0
North Africa	*7.4*	*3.3*	*6.5*	*15.3*	*21.1*	*27.7*
Sub-Saharan Africa excl. S. Africa	*11.4*	*16.8*	*14.9*	*16.1*	*16.5*	*37.7*
South Africa	*-1.7*	*-0.1*	*7.3*	*13.8*	*13.9*	*15.6*
Memo Items						
South Africa FDI Inflows	*0.7*	*0.7*	*0.8*	*6.6*	*-0.5*	*5.6*
South Africa FDI Outflows	*0.0*	*0.0*	*1.4*	*0.9*	*6.7*	*3.7*

Sources: World Bank, Global Development Finance (2008).

2. While net bond flows rose by a smaller amount than other private flows (US$7.6 billion), developments in 2007, which saw the expansion of African sovereign as well as corporate access to the international bond market, are noteworthy. Ghana became the first heavily indebted poor country (HIPC) to issue an external bond, with a US$750 million Eurobond issue in September 2007. The bond issue was oversubscribed several times, despite being launched as international financial markets became more unsettled[1]. Gabon issued its inaugural sovereign bond in December 2007 when it launched a US$1 billion 10-year Eurobond with a yield of 8.25% that was used to prepay its Paris Club creditors. A private Nigerian bank and a public bank successfully issued Eurobonds in 2007 before the country's first sovereign bond issue, which is expected to be launched in 2008[2]. The relatively low spreads on bond issues by African governments or corporations reflect the favourable perception of the above countries in international markets.[3] As shown in Table 2, Africa bond flows in 2007 compare favourably with other developing regions.

Table 2: Private bond Flows to Developing Regions by Region (2002-2007)

(US$ billion)

	2002	2003	2004	2005	2006	2007
All Developing Countries	8.8	19.6	41.1	52.6	25.3	79.3
East Asia and Pacific	0.1	1.8	9.7	7.8	5.5	6.5
Europe and Central Asia	3.6	8.9	23.6	28.2	33.9	52.0
Latin America and the Caribbean	-0.8	11.0	-0.3	16.0	-19.0	8.1
Middle East and North Africa	5.0	0.7	3.3	2.3	0.6	2.7
South Asia	-0.7	-3.1	4.1	-2.9	4.3	4.2
Sub-Saharan Africa	1.5	0.4	0.6	1.3	0.1	5.8

Source: World Bank Debtor Reporting System and staff estimates

3. Portfolio investments have been dominated by South Africa. In recent years 85 percent of South Africa's current account deficit was financed by portfolio investments, but that plummeted to 38 percent during the final quarter of 2007. Given South Africa's significant current account deficit, the unwillingness to continue providing short-term flows could put pressure on the rand. But developing countries' easy access to global capital markets deteriorated in late 2007 and into 2008 in the wake of the U.S. subprime mortgage crisis. Besides reducing capital flows to developing countries, the turmoil has increased borrowing costs, although less so than in previous episodes, when emerging markets themselves were the primary source of difficulty.

4. As mentioned earlier, FDI and portfolio investment together grew to US$53 billion in 2007 – a new record. Despite higher inflows, Africa's share in global FDI remained at about 3%. The inflows were supported by a continuing boom in global commodity markets and by improved policy environments. A large proportion of the FDI projects launched in the region in 2007 were linked to the extraction of natural resources. The US and Europe were the main investors in the region, followed by African investors,

[1]. The strong reception of Ghana's bond issue helps to dispel an earlier concern that access to HIPC debt relief may make it more difficult for HIPC countries to access capital markets in the future.

[2] This pattern goes against the conventional wisdom that countries must first issue sovereign bonds to set a benchmark to price subsequent corporate issues.

[3] According to the ratings by Standard and Poor's and by Fitch, Nigeria is rated BB- and Ghana, B+. These ratings rank these two countries at the level of Turkey for instance. Gabon is not rated but is believed to have a slightly better rating than Nigeria. Currently 20 sub-Saharan countries are rated. The growing use of sovereign credit ratings in Africa reflects the improving perception by international private banks of Africa's potential and gives added confidence to investors.

particularly from South Africa. Asian investors concentrated mainly on oil and gas extraction and infrastructure.

5. The growth of FDI inflows was spread across 35 countries (see Figure 1), and included many natural resource producers that have been attracting flows in the past few years, as well as new host countries. As a result, for almost half of Africa, FDI flows contributed more than 20 percent of fixed investments (see Table 3). The distribution of the inflows changed slightly. While most countries of North Africa continued to attract inward FDI, large inflows to Nigeria and South Africa, combined with good performance in Equatorial Guinea, Madagascar and Zambia – each receiving about US$1 billion or more inflows in 2007 – boosted overall FDI to sub-Saharan Africa. The value of cross-border mergers and acquisitions (M&As) in the region fell in 2007 due partly to the smaller number of mines and exploration projects available for sale. Because of reduced investments in new mines, the number of investment projects in the region also declined to 380 in 2007, from 473 in 2006. South Africa, Egypt and Morocco are also major investors in Africa.

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Figure 1: Distribution of FDI Flows by Range, 2007

Range	Inflows	Outflows
Over $3.0 bn	Nigeria, Egypt and South Africa	South Africa
$2.0 bn to $2.9 bn	Morocco, Libyan Arab Jamahiriya and Sudan	..
$1.0 bn to $1.9 bn	Equatorial Guinea, Algeria and Tunisia	..
$0.5 bn to $0.9 bn	Madagascar, Zambia, Ghana, Kenya, Democratic Republic of Congo, Namibia, United Republic of Tanzania, Chad and Burkina Faso	Egypt and Morocco
$0.2 bn to $0.4 bn	Botswana, Mozambique, Côte d' Ivoire, Uganda, Mali, Congo, Mauritius, Cameroon, Gabon, Ethiopia and Seychelles	Liberia, Angola, Algeria and Nigeria
Less than $0.2 bn	Djibouti, Cape Verde, Mauritania, Somalia, Guinea, Lesotho, Sierra Leone, Senegal, Togo, Zimbabwe, Rwanda, Gambia, Malawi, Benin, Liberia, Swaziland, São Tomé and Principe, Central African Republic, Niger, Guinea-Bissau, Comoros, Burundi, Eritrea and Angola	Mauritius, Gabon, Botswana, Kenya, Tunisia, Rwanda, Sudan, Senegal, Seychelles, United Republic of Tanzania, Mauritania, Congo, São Tomé and Principe, Zimbabwe, Swaziland, Malawi, Mali, Niger, Cape Verde, Mozambique, Côte d'Ivoire, Benin, Cameroon and Burkina Faso

Source: UNCTAD, World Investment Report, 2008

Table 3: FDI inflows as Share of Investment in Selected Non-Oil/Commodity Producing Countries, 2006

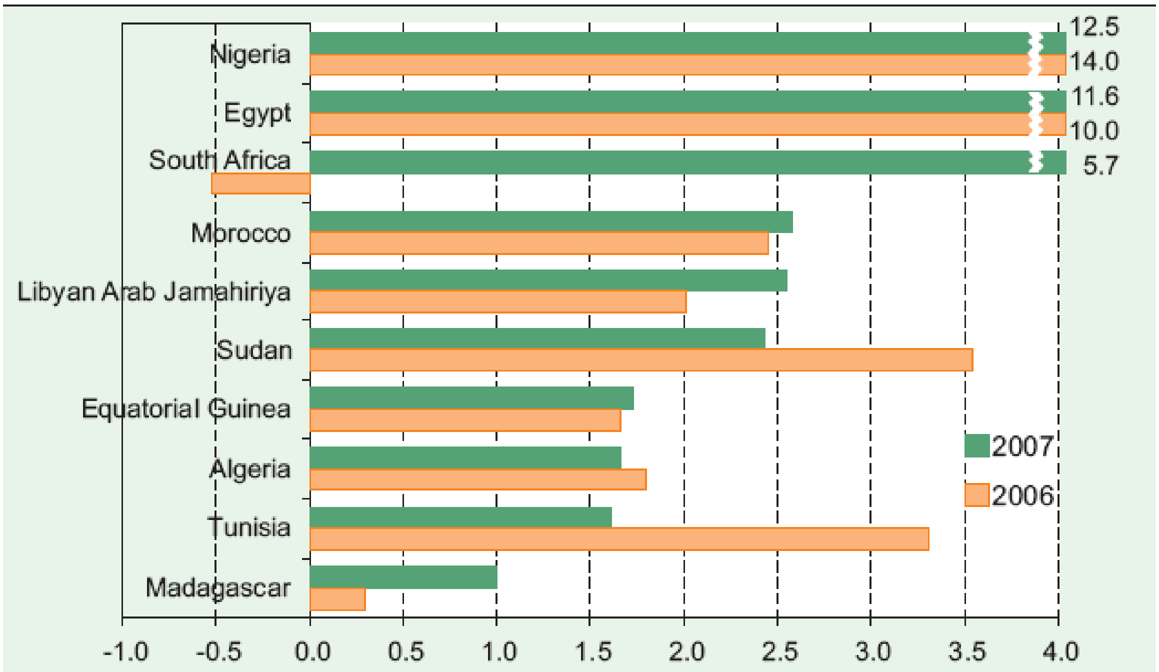
Country	FDI Inflows in 2007 (US$ million)	2005	2006 (percent)	2007
Burkina Faso	600	3	2	37
Cape Verde	177	21	30	34
Central African Republic	27	21	22	29
Egypt	11,578	32	50	43
The Gambia	64	37	58	40
Madagascar	997	8	25	61
Malawi	55	14	15	26
Mozambique	427	9	9	23
Namibia	697	22	24	40
Seychelles	248	81	132	248
Sierra Leone	81	104	69	81
Tanzania	600	20	18	18
Tunisia	1618	12	46	20

*S*ource: UNCTAD (2008)

6. In *North Africa*, renewed privatization programmes and policies aimed at improving efficiency contributed to maintaining large FDI inflows to North Africa in 2007. Inflows to Egypt remained very large, reaching nearly US$12 billion in 2007, a 15% increase from 2006. The major industries that attracted FDI to that country included textiles, oil and chemicals, and generic pharmaceutical production. Privatization of several state-owned enterprises also played a role in the sub-region. In *West Africa*, the primary sector and privatization schemes of telecommunications companies led to another year of large inflows (US$15.6 billion). FDI mostly reflected expansion projects in Nigeria's oil industry, and upgrades of projects already operating in Burkina Faso, Côte d'Ivoire and Mali. *Eastern and Central Africa* each received about US$4 billion of FDI each. There were significantly higher inflows to Kenya (telecoms and railways), Madagascar (nickel exploitation) and Mauritius (tourism). In Central Africa, much of those inflows went into the primary and services sectors, including infrastructure development, with a large part of the increase reflecting greater spending on oil and mining exploration. FDI inflows to *Southern Africa* grew more than fivefold, the highest among the sub-regions, to US$7 billion in 2007. A major increase in FDI to the top five host countries – South Africa, Zambia, Namibia, Botswana and Mozambique – accounted for this impressive growth.

7. Cross-border M&As in the extraction industries and related services continued to be a significant source of FDI, in addition to new inbound M&A deals in the banking industry. Nigeria, Egypt, South Africa and Morocco were the largest recipients (see Figure 2). Together with foreign investors, leading African firms (such as Eskom, MTN, Vodacom, Spoornet and Transnet of South Africa) played an important role in infrastructure projects (electricity, telecommunications and water), illustrating a trend towards greater diversification of inflows in some countries, away from traditional sectors (e.g. oil, gas and other primary commodities).

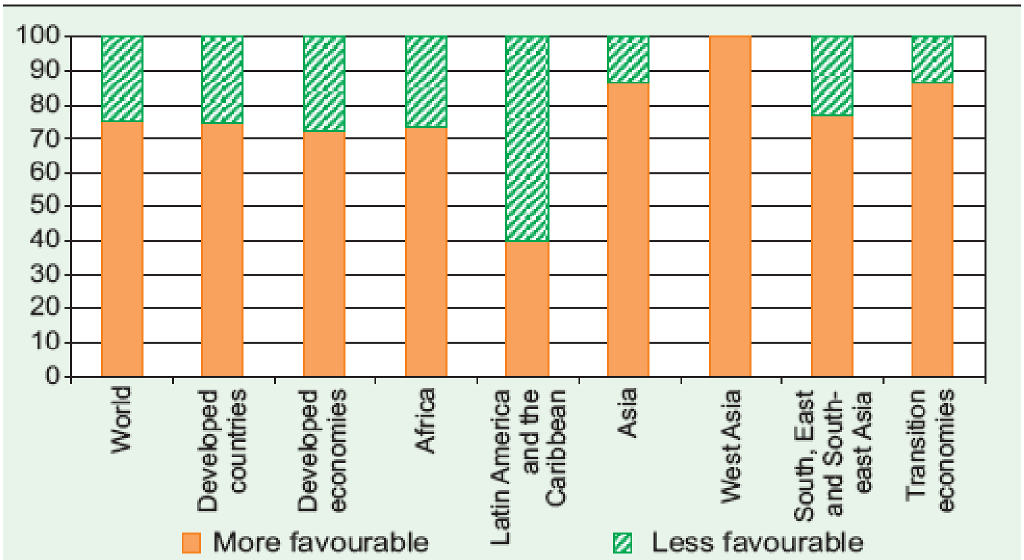
Figure 2: Africa: Top 10 Recipients of FDI Inflows, 2006–2007
(US$ billion)



Source: UNCTAD (2008)

8. The 10 leading FDI host countries accounted for over 80% of the region's FDI inflows. Nine countries received FDI inflows of US$1 billion or more. South Africa and Madagascar rejoined the list of top 10 FDI host countries, displacing Chad and Ghana from the 2006 list, though inflows remained large in those two countries in 2007. Compared to other developing regions, Africa's changes in regulatory frameworks compared well with other developing regions (Figure 3). The top 10 host countries in 2007 shared a number of common features: large reserves of natural resources and/or active privatization programmes, liberalized FDI policies and active investment promotion activities.

Figure 3: Regulatory Changes, by Nature and Region, 2007 (%)

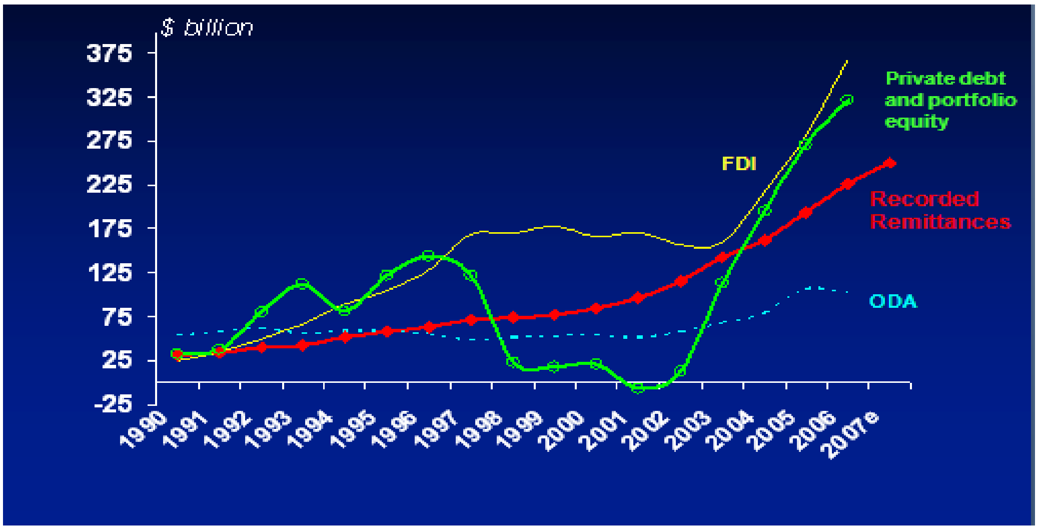


Source: UNCTAD database on national laws and regulations

Workers' Remittances

9. Over the past decade, remittances have become increasingly prominent. Remittance flows to developing countries are estimated to have reached US$265 billion in 2007. This amount, however, reflects only transfers through official channels. The true size of remittances received by developing countries is believed to be in excess of US$300 billion. Compared to ODA and other financial flows, remittances are the largest source of external financing in many developing countries (Figure 4).

Figure 4: Remittance Flows in Developing Countries (US$ billion)



Source: Adapted from Dilip Ratha's presentation

10. Workers' remittances are becoming important sources of development finance in both sub-Saharan and North Africa. Table 4 shows that between 2000 and 2007, recorded remittances from sub-Saharan Africa more than quadrupled to reach US$19 billion. The increase is similarly rapid in North Africa, reaching also US$19 billion. Four of the largest remittance recipient countries in Africa are in North Africa. It should be noted that a large proportion of flows to SSA is unrecorded. Recent estimates suggest that 73% of remittances flow to SSA were through unofficial channels. One of the factors militating against enhanced remittance flows to SSA is the high cost of transfers. For instance, the average cost of sending US$200 from London to Nigeria is about 14% of the amount sent. In addition, the average cost of sending the same amount from Benin to Nigeria is as high as 17%.[4]

Table 4: Remittances in Africa – Ten Largest Recipients and Sub-totals (US$ billion)

	2000	2001	2002	2003	2004	2005	2006	2007
Nigeria	1.4	1.2	1.2	1.1	2.3	3.3	5.4	9.2
Egypt	2.9	2.9	2.9	3.0	3.3	5.0	5.3	7.7
Morocco	2.2	3.3	2.9	3.6	4.2	4.6	5.5	6.7
Algeria	0.8	0.7	1.1	1.8	2.5	2.0	2.5	2.9
Tunisia	0.8	0.9	1.1	1.3	1.4	1.4	1.5	1.7
Kenya	0.5	0.6	0.4	0.5	0.6	0.8	1.1	1.6
Sudan	0.6	0.7	1.0	1.2	1.4	1.0	1.2	1.2
Uganda	0.3	0.3	0.4	0.3	0.3	0.4	0.8	0.9
South Africa	0.3	0.3	0.3	0.4	0.5	0.7	0.7	0.7
Senegal	0.2	0.3	0.3	0.5	0.6	0.6	0.6	0.9
Lesotho	0.3	0.2	0.2	0.3	0.4	0.3	0.4	0.4
Sub-Saharan Africa, total	4.6	4.7	5.0	6.0	8.0	9.3	12.4	19.0
North Africa, total	6.6	7.8	7.9	9.6	11.5	13.0	14.8	19.0
Africa	11.2	12.5	12.9	15.6	19.5	22.3	27.2	38.0

Source: World Bank, Migration and Remittances Fact Book, 2008 plus updates.

[4] Ratha, Mohapatra and Plaza (2008).

11. To increase the developmental impact of remittances, there is the need to create domestic conditions that would allow workers to transfer funds, and recipients to deposit funds, through the formal banking system. In this regard, there is the need for African governments and advanced countries to take more measures to reduce the transactions costs of remittances. Strengthening competition in the remittance industry as well as adopting new technologies such as internet and mobile telephony will contribute significantly to achieving this objective. The large and steady flows of remittances can potentially be used to raise significant bond financing by using securitisation of future remittance flows. The African Export-Import Bank (Afreximbank) has been active in facilitating future-flow securitisation. In 1996, it co-arranged the first-ever such arrangement in favour of a development bank in Ghana backed by its Western Union remittance receivables. Securitisation of future remittance flows has the potential to boost resources for development in the region and efforts should be made to explore this option which by some conservative estimates will yield US$2 billion annually to SSA.

12. Diaspora bonds, which work on the same principle, have been issued in a number of large remittance recipients (Philippines, Armenia, Sri Lanka, Pakistan and Bangladesh) and are being considered by Kenya and Ghana. Tapping this source of finance, however, requires building legal infrastructure, enforcing creditor rights, developing partnerships with banks abroad, and financial market development.

IV. What are the key priorities?

Actions by African countries:

- Continue efforts to improve the business environment and to promote public/ private partnerships (PPP).
- Improve capacity to monitor and manage private capital flows.
- Foster regional integration and south-south cooperation.
- Create the conditions (including human capital development) that would foster more diversified FDI to higher value-added activities.

Actions by development partners:

- Support Africa’s effort to promote private capital flows and build an enabling domestic business environment.
- Support further infrastructure development, risk alleviation instruments and techniques to facilitate PPP.
- Reduce the transactions costs of remittances and increase their developmental impact through measures that encourage migrants to use the banking system for sending money to their home countries.

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