AFRICAN DEPARTMENT

Mobilizing Private Finance for Development

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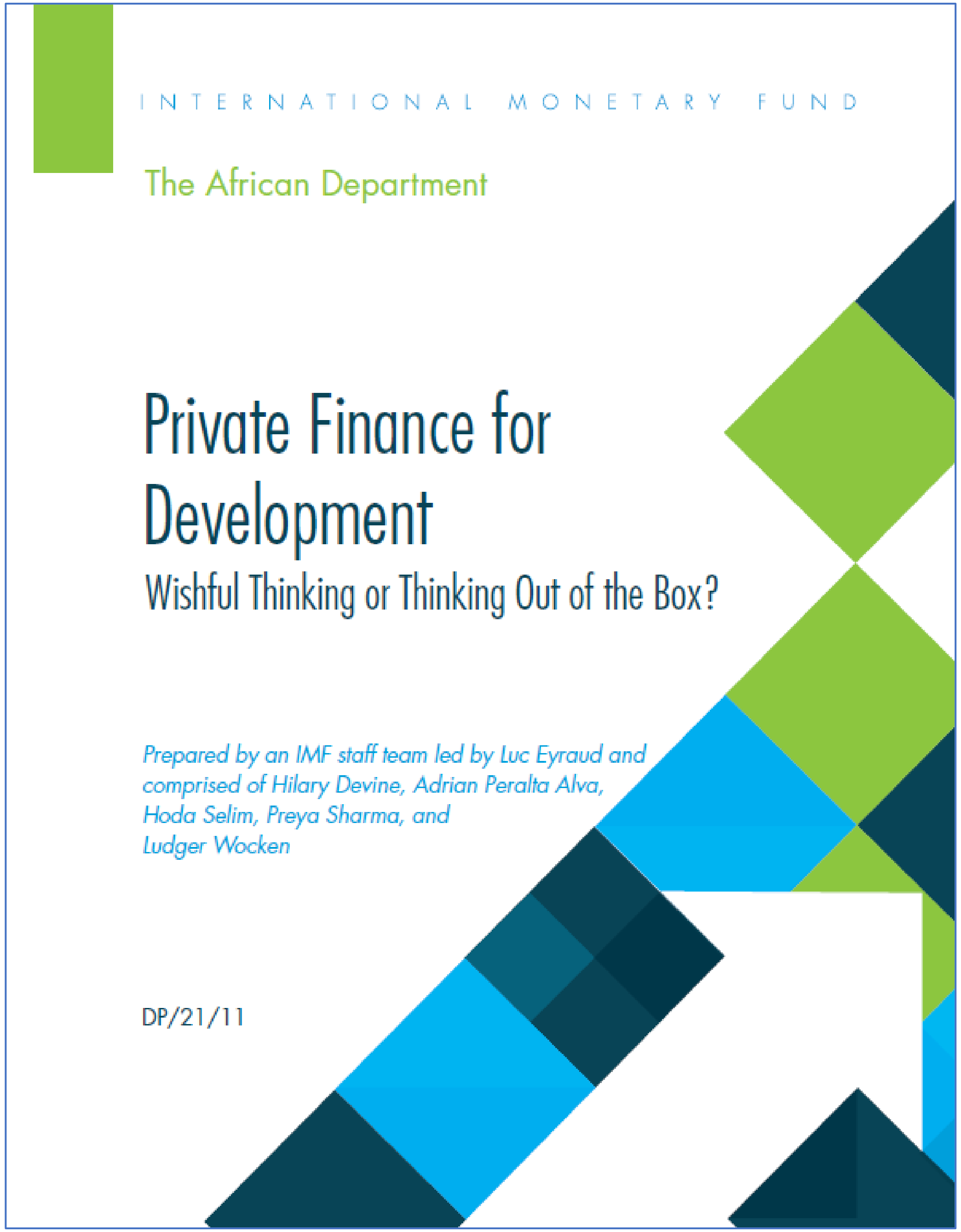
Introduction

- **Large development needs** in Africa. Likely to get even larger post Covid.
- Public resources to cover these needs are limited
- **The private sector is called on to play a greater role towards achieving development goals**—both as finance and service provider
- Private sector participation is **at the core of growth paradigms** promoted by the Compact with Africa as well as international institutions
- So far, **Africa has lagged behind other regions** in private participation

Introduction

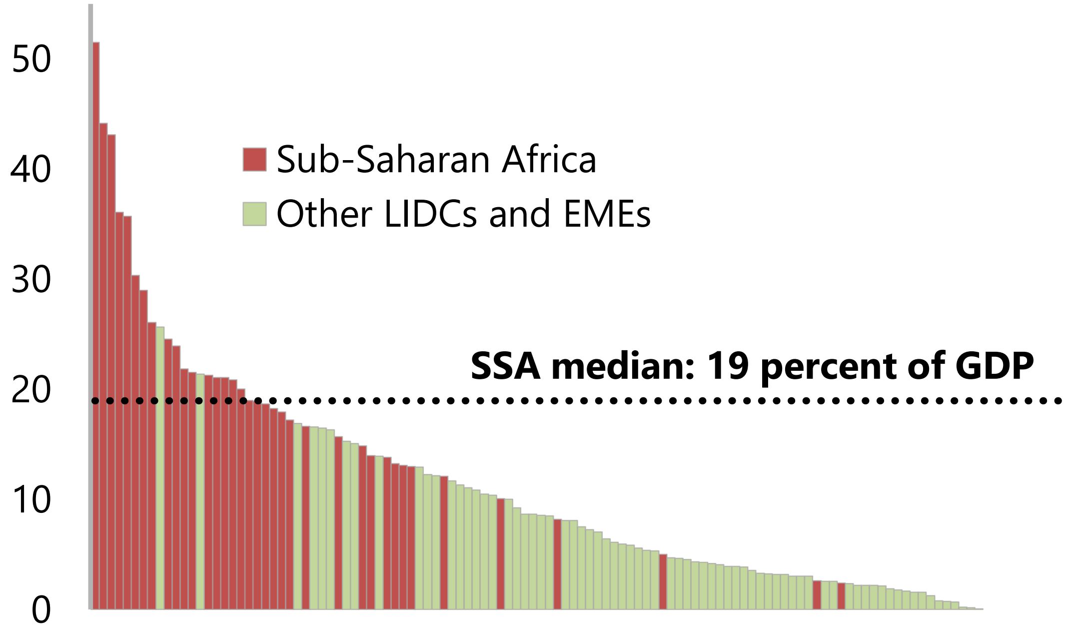
- Presentation based on 2021 **IMF paper**
- Discusses **policy levers** that governments can use to attract private investors in development sectors in Sub-Saharan Africa
- Focuses mostly on ways to mobilize **international finance**



I. The Need to Mobilize More Private Finance in Africa

Additional SDG needs of 20 percent of GDP annually in African countries

Additional Spending Needs in 2030 by Country
(percent of GDP; sample of low-income and emerging countries)



Source: Gaspar and others (2019).

Notes: EMEs = emerging market economies; LIDCs = low-income developing countries; SSA= Sub-Saharan Africa.

- Focus on **5 sectors**: roads, electricity, water, education and health
- Needs are computed for 2030 but expected to be **recurrent** afterwards
- Needs could be **covered from public and private sources**

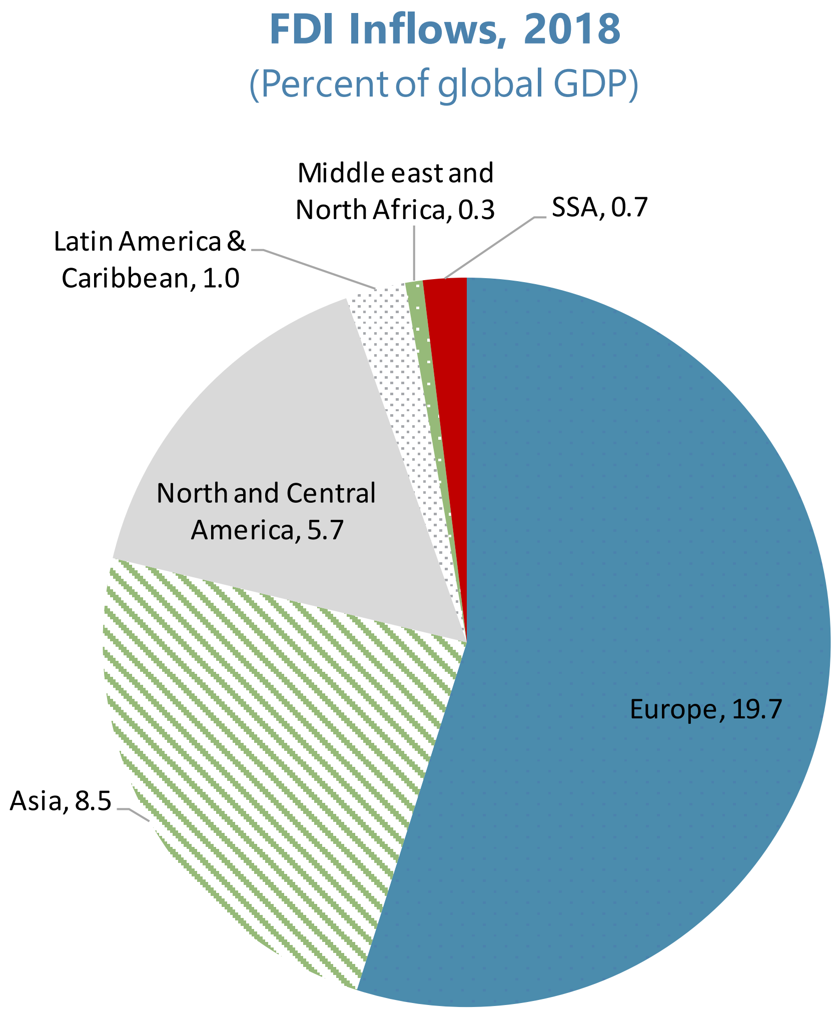
Mobilizing additional resources from all stakeholders

- **African countries** have a large domestic revenue mobilization potential (3-7% of GDP in medium term). Fiscal space could also be generated by expenditure efficiency reforms

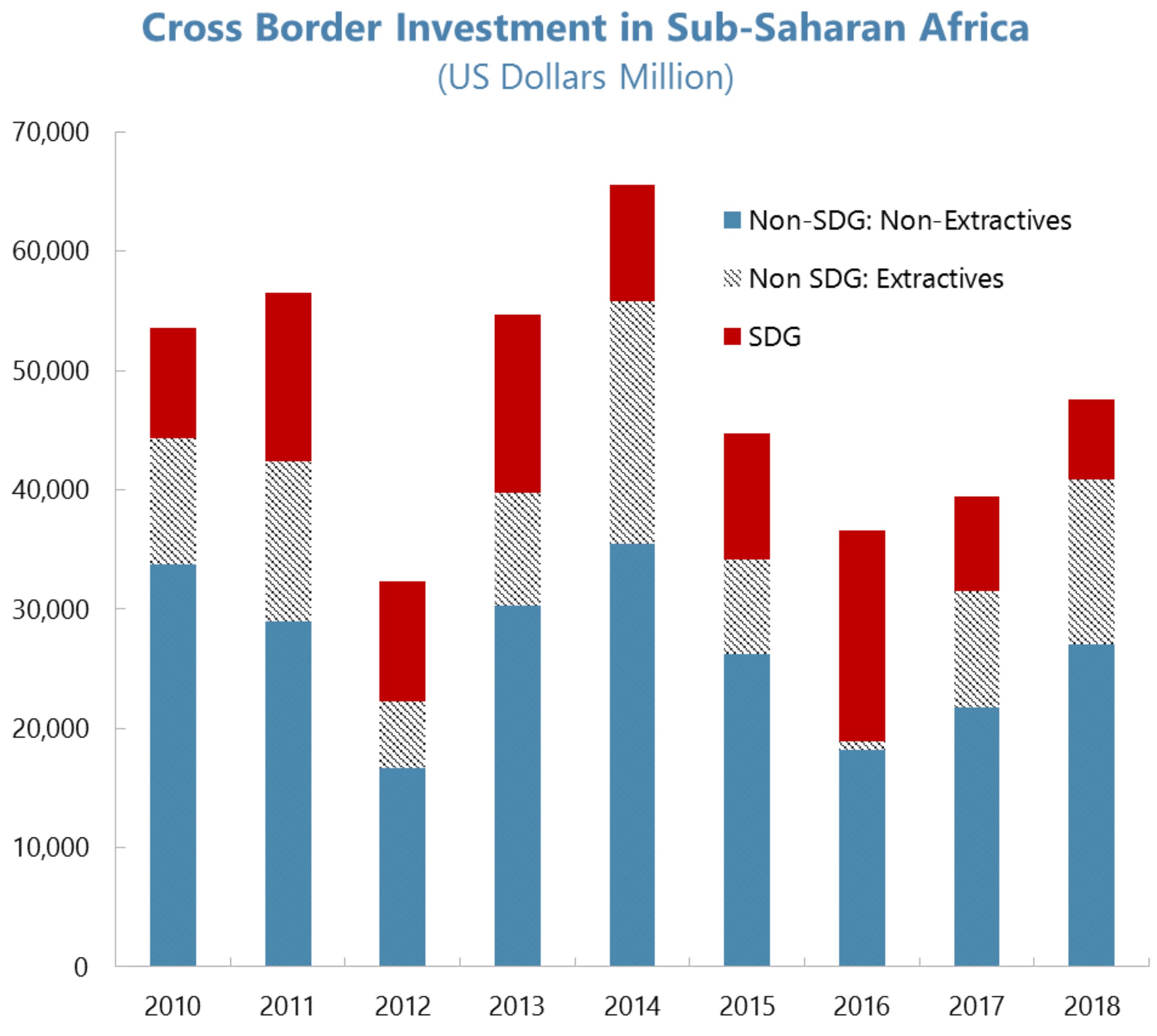
- If the **international community** delivers on the development assistance targets, the scaling-up of official aid would make a significant contribution toward meeting development needs (e.g., 4-5% of GDP if ODA reached 0.7% of GNI)

- **Private sector** has also a key role to play. Private investors could bring at least 3% of GDP of additional financing to development projects by the end of the decade

International flows to Africa are low and go predominantly to non-SDG sectors



Source: CDIS Database.



Sources: fDi Markets; and IFC staff calculations.

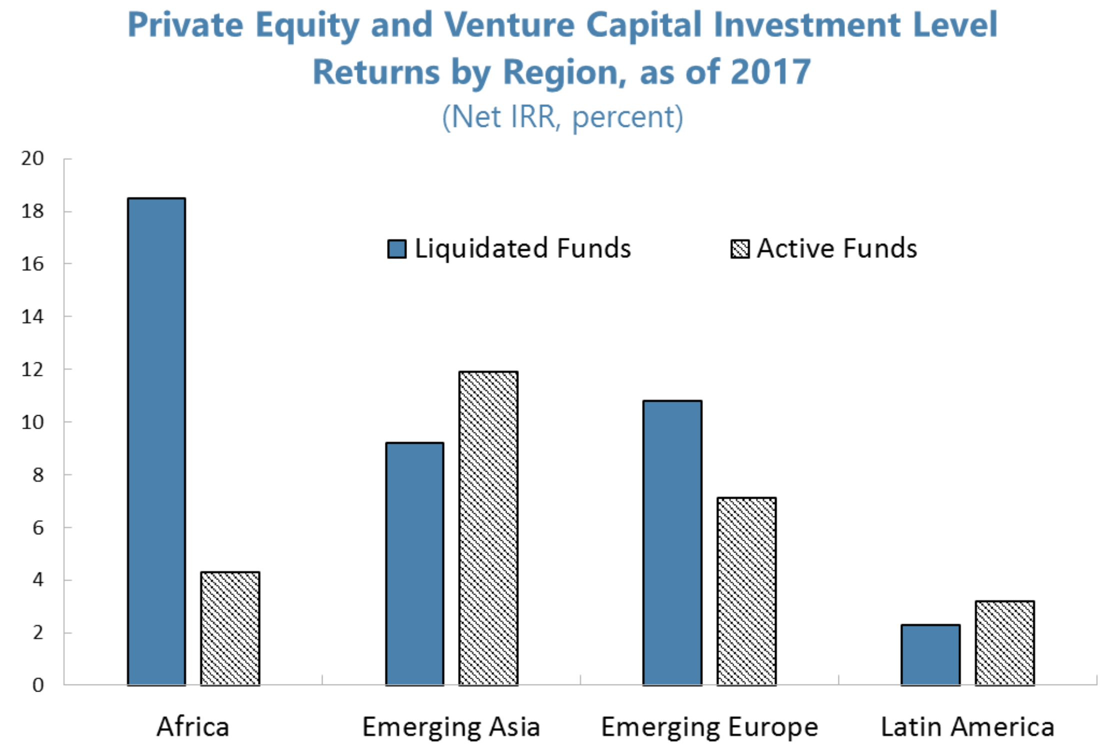
II. Obstacles to Greater Private Sector Participation in Africa

Why are investors not coming more to Africa ?

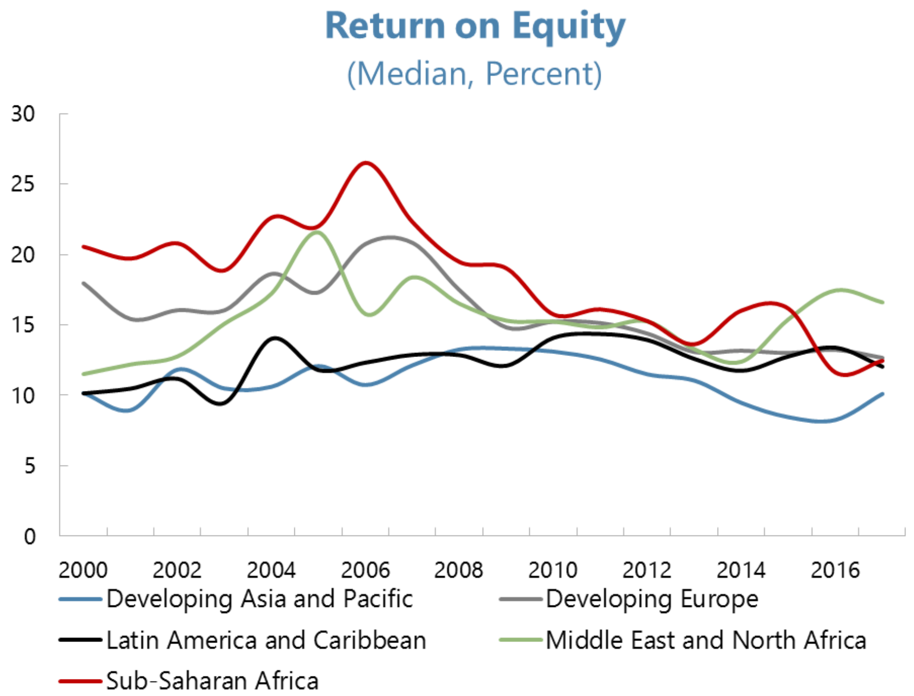
Have investment returns become too low in Africa?

Investment returns were high in the 2000s…

…but have declined during the past decade

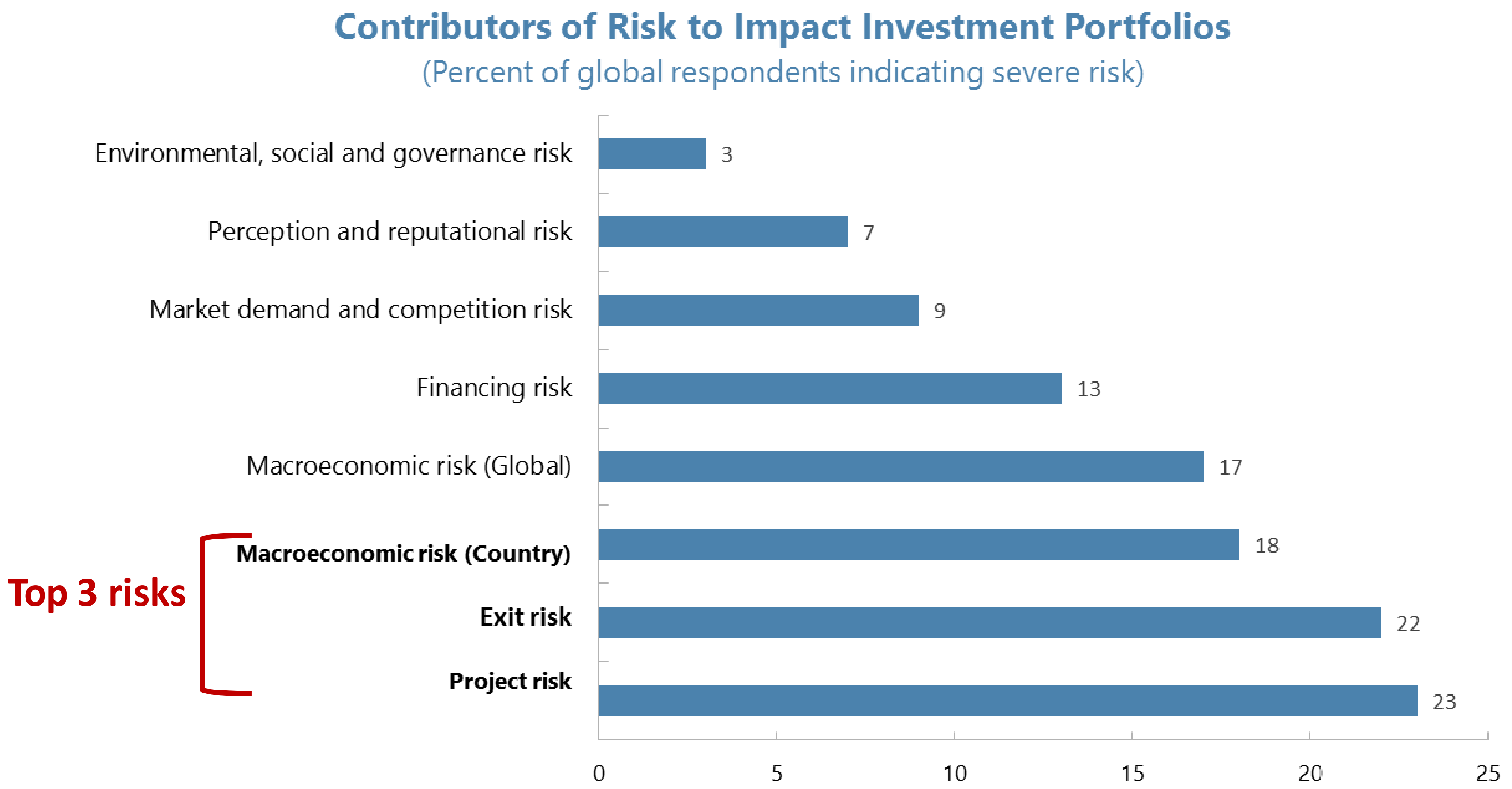


Source: Cambridge Associates; and IFC.



Sources: Orbis Van Djik Database; and IMF staff calculations.
Note: Observations , Developing Asia and Pacific 2465, Developing Europe 6668, Latin America and Caribbean 274, Middle East and North America 122 Sub-Saharan Africa 41.

What are the main risks?

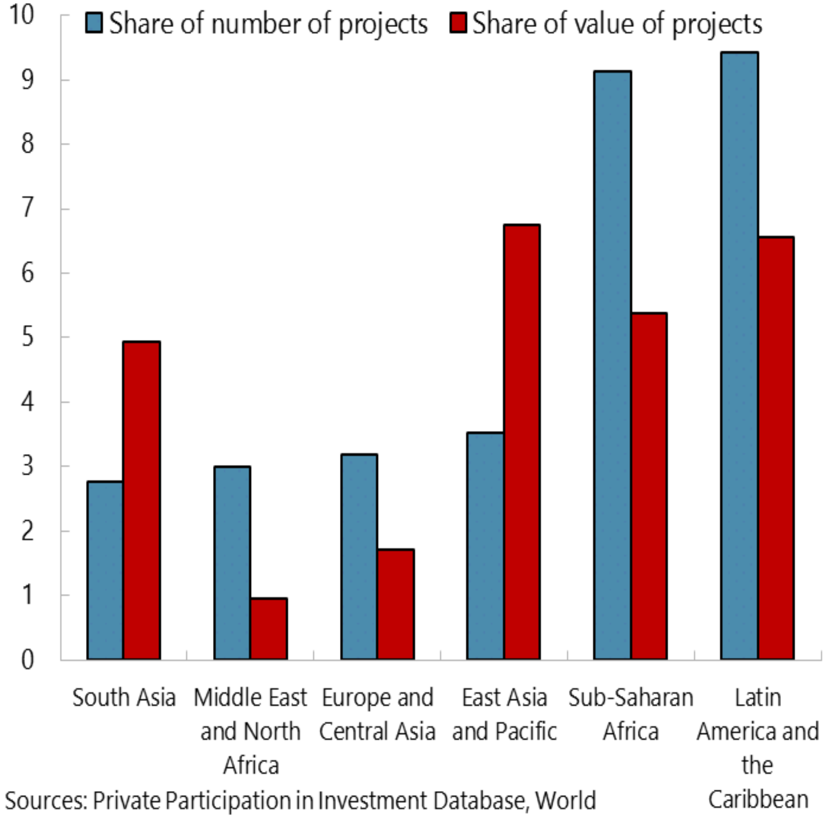


Source: Annual Impact Investor Survey 2020, GIIN.

Three risks rank high in investors' surveys

Elevated project failure,…

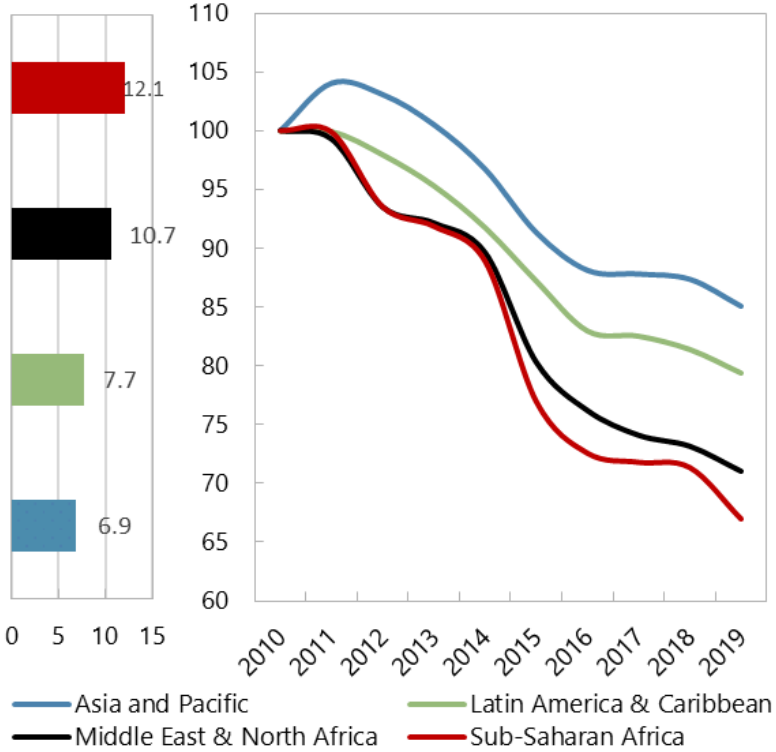
Cancelled or Distressed PPP Investment, 1983-2020
(Percent)



Sources: Private Participation in Investment Database, World Bank; IMF staff calculations.

…high currency depreciation,…

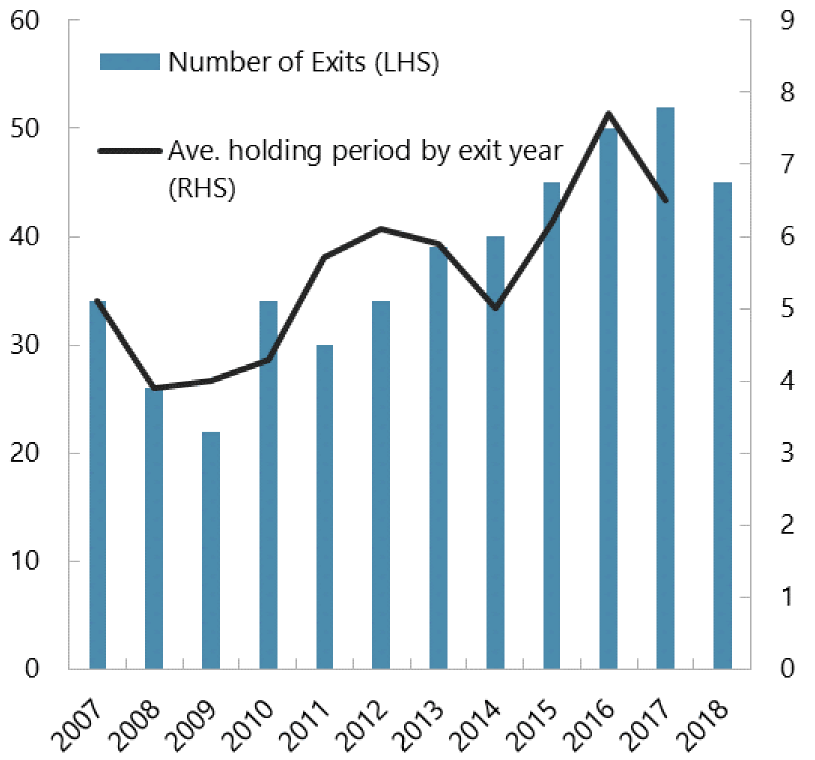
Exchange Rates Movements Against USD by Region, 2010–19
(Standard Deviation (LHS), Index 2010 = 100 (RHS))



Source: IMF WEO; and IMF staff

…and difficulties to divest

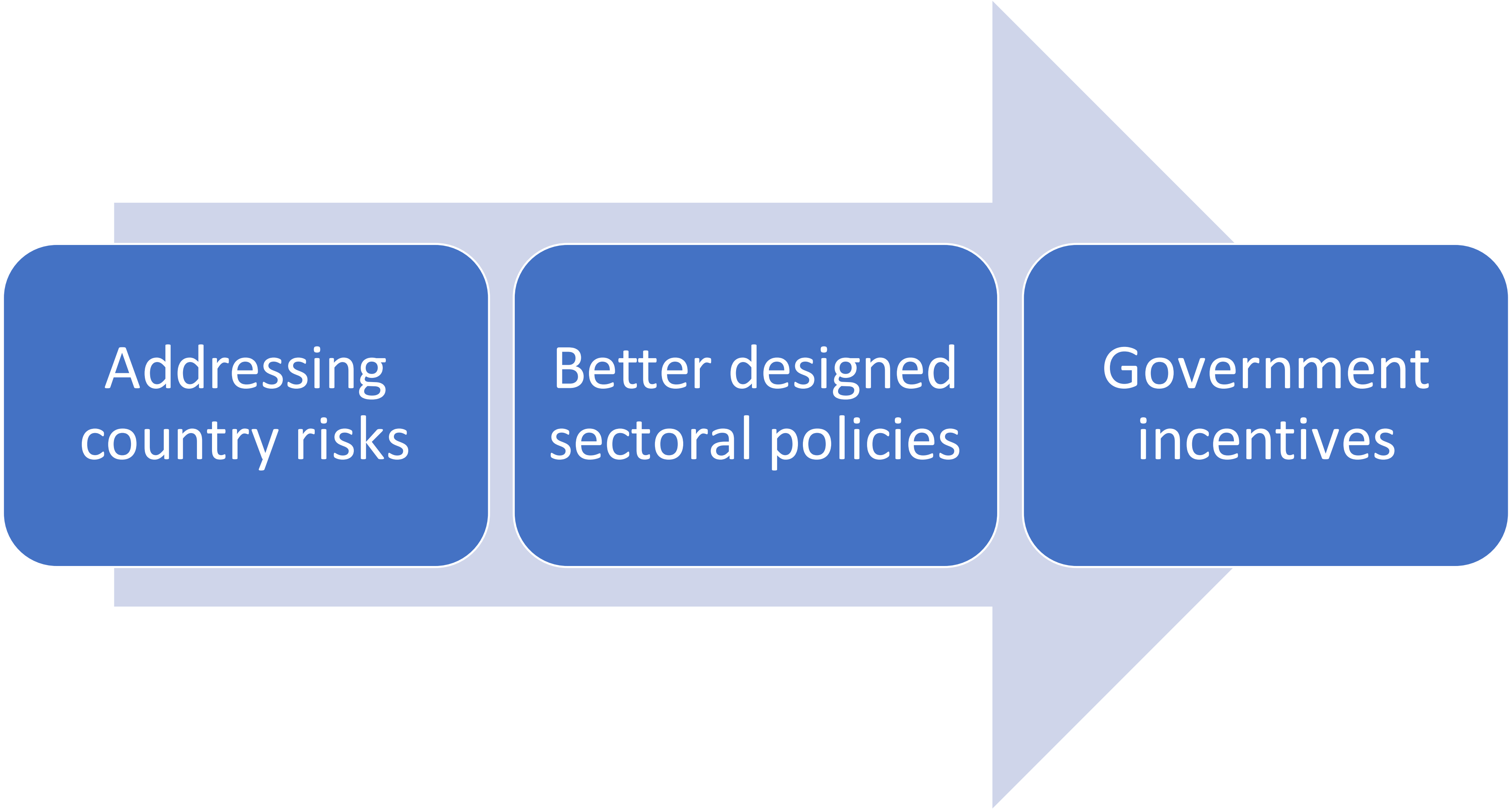
Private Equity Exit Activity in Africa, 2007-18



Sources: E&Y and AVCA (2018); and AVCA (2020b).

III. Creating an Environment More Private-Finance Friendly

Three complementary approaches



1. Addressing country risks

- **Project risk**: Many projects are not perceived as "investment-ready" in Africa (well-developed and advanced, financially viable, sufficiently large…). Project preparation facilities can help expand the pipeline

- **Currency risk**: Could be mitigated by prudent macroeconomic policies, sound FX management, and hedging mechanisms

- **Exit risk**: Can be reduced through financial market development, better protection of investors' rights, and prudent removal of some capital account restrictions

2. Improving the design of sectoral policies

- **Price setting mechanisms** that enable cost recovery

- Regulations providing a conducive **framework for the private sector** to operate (e.g., free access to education sector)

- **Transparent public sector governance** when the private sector works closely with SOEs (e.g., distribution and production of electricity)

- Adequate provision of **complementary inputs** (e.g., skilled personnel)

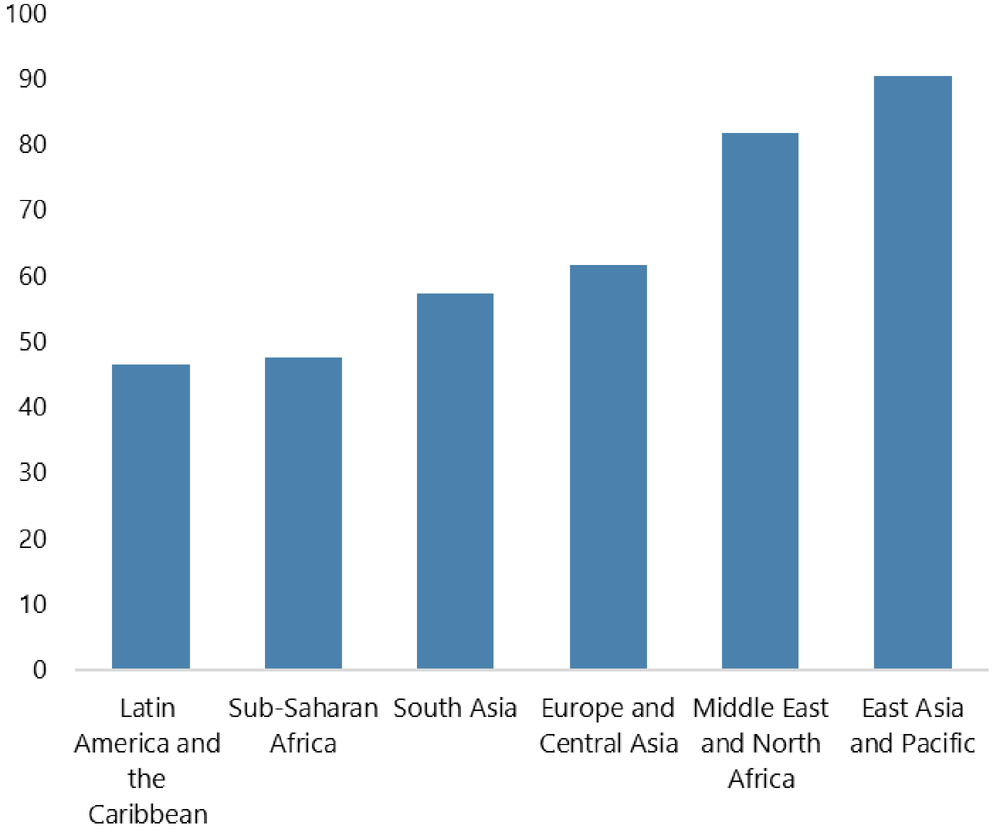
3. Providing the right public incentives

- Improving the business environment is just the first step

- Most development sectors present **characteristics that hinder private sector involvement** (e.g., initially high costs/low returns, long implementation periods, necessity to maintain universal access…)

- **Government incentives are often necessary** to attract investors in these sectors and ensure that projects come through

Government Support to PPI Infrastructure Projects, 2011—20
(percent of total projects)



Sources: World Bank, PPI database; and IMF staff calculations.

3. Design of government incentives

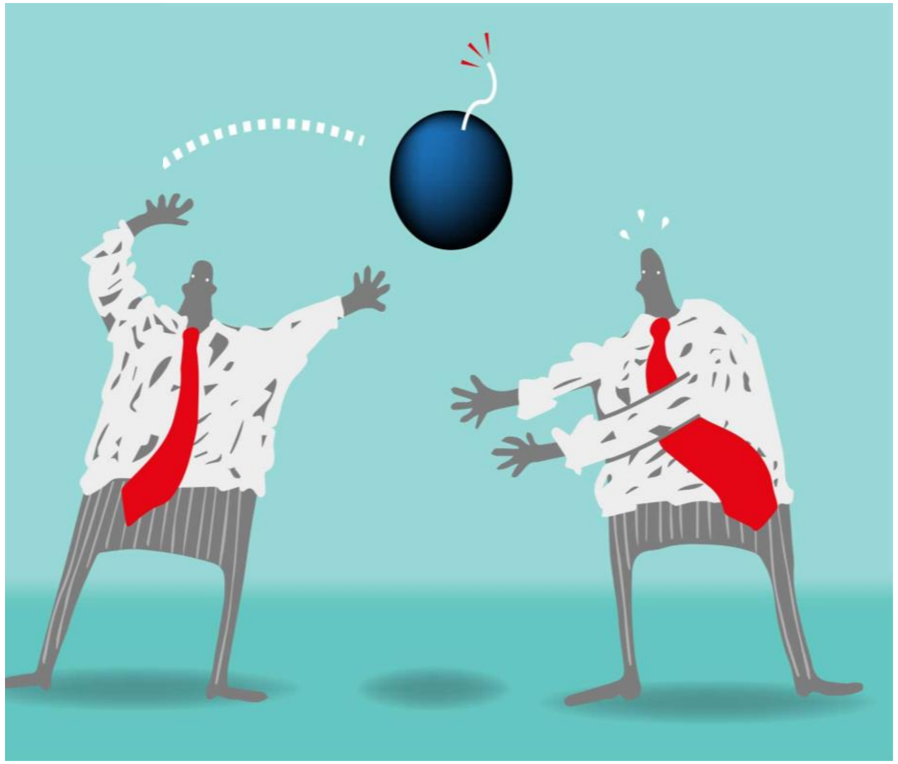
- Incentives can be **costly and risky**, as shown by the mixed experience with PPPs
- **Careful design** is essential
- For instance, subsidies are often more efficient than guarantees: more transparent, less fiscal risk, and less likely to distort incentives
- Challenge is to attract private investors **without overcompensating** them

Best practices

- Should address clear market failures
- Temporary
- Transparent
- Display additionality
- Leave sufficient risk to private parties
- Minimize risk of contingent liabilities for the state

3. Blending: new approach to public incentives?

- **Transfer the cost of public incentives to donors**
- Several blending facilities exist
- New paradigm is very **promising**
- Scaling up may create **challenges**: fragmentation; complexity and lack of public awareness; risk of over-subsidizing some private investors, while excluding others from the market; lack of transparency



Conclusion

Main lessons

- **Africa needs more private finance** to achieve its developments objectives. Sole reliance on public investment is not sustainable

- Raising the contribution of private finance by **3% of GDP** by the end of the decade is a realistic aspiration

- Main problem is that **returns have declined, and risks are still high** in Africa

- **Business environment reforms** (project preparation, financial development, judicial reforms) **and sectoral policies** are key to improving risk-adjusted returns

- **Public incentives are often needed** to make projects more attractive to private investors. But this **entails costs and tradeoffs**, which can be mitigated by sound policy design

Private finance: a new paradigm for all African countries?

- The choice between public and private finance approaches needs to pay heed to **country circumstances**

- **Middle-income economies** with relatively strong institutions and market access are more attractive to international investors and could benefit more significantly from programs meant to catalyze private investment

- **Low-income countries and fragile states** have a smaller economic size and sometimes weaker state capacity. They are less likely to attract international investors. Raising more official aid and channeling it to government budgets, while improving public expenditure efficiency, may be a safer and more actionable way of investing in infrastructure