GRAIN FISH MONEY

Financing Africa's Green and Blue Revolutions

AFRICA PROGRESS REPORT 2014

AFRICA PROGRESS PANEL

Table of Contents

About the Africa Progress Panel


KOFI **ANNAN**


MICHEL **CAMDESSUS**


PETER **EIGEN**


BOB **GELDOF**


GRAÇA **MACHEL**


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The Africa Progress Panel (APP) consists of ten distinguished individuals who advocate for equitable and sustainable development for Africa. Kofi Annan, former Secretary-General of the United Nations and Nobel laureate, chairs the Panel and is closely involved in its day-to-day work.

The respected experience and prominence of Panel members, in the public and private sector, gives them a formidable capability to access a wide cross-section of society including at the highest levels in Africa and across the globe. As a result, the Panel functions in a unique policy space with the ability to target decision-making audiences, including African and other world leaders, heads of state, leaders of industry, plus a broad range of stakeholders at the global, regional, and national levels.

The Panel facilitates coalition building to leverage and broker knowledge, and convene decision-makers to influence policy and create change for Africa. The Panel has extensive networks of policy analysts across Africa. By bringing together experts with a focus on Africa, the Panel contributes to generating evidence-based policies.

About the
Africa Progress Report

The annual Africa Progress Report is the flagship publication of the Africa Progress Panel. Published every year in May, the report draws on the best research and analysis available on Africa and compiles it in a refreshing and provocative manner. Through the report, and as part of its overall mission of promoting transformative change in Africa, the Panel makes viable, policy recommendations for African policy makers who have responsibility for Africa's progress, and for international partners and civil society organizations.

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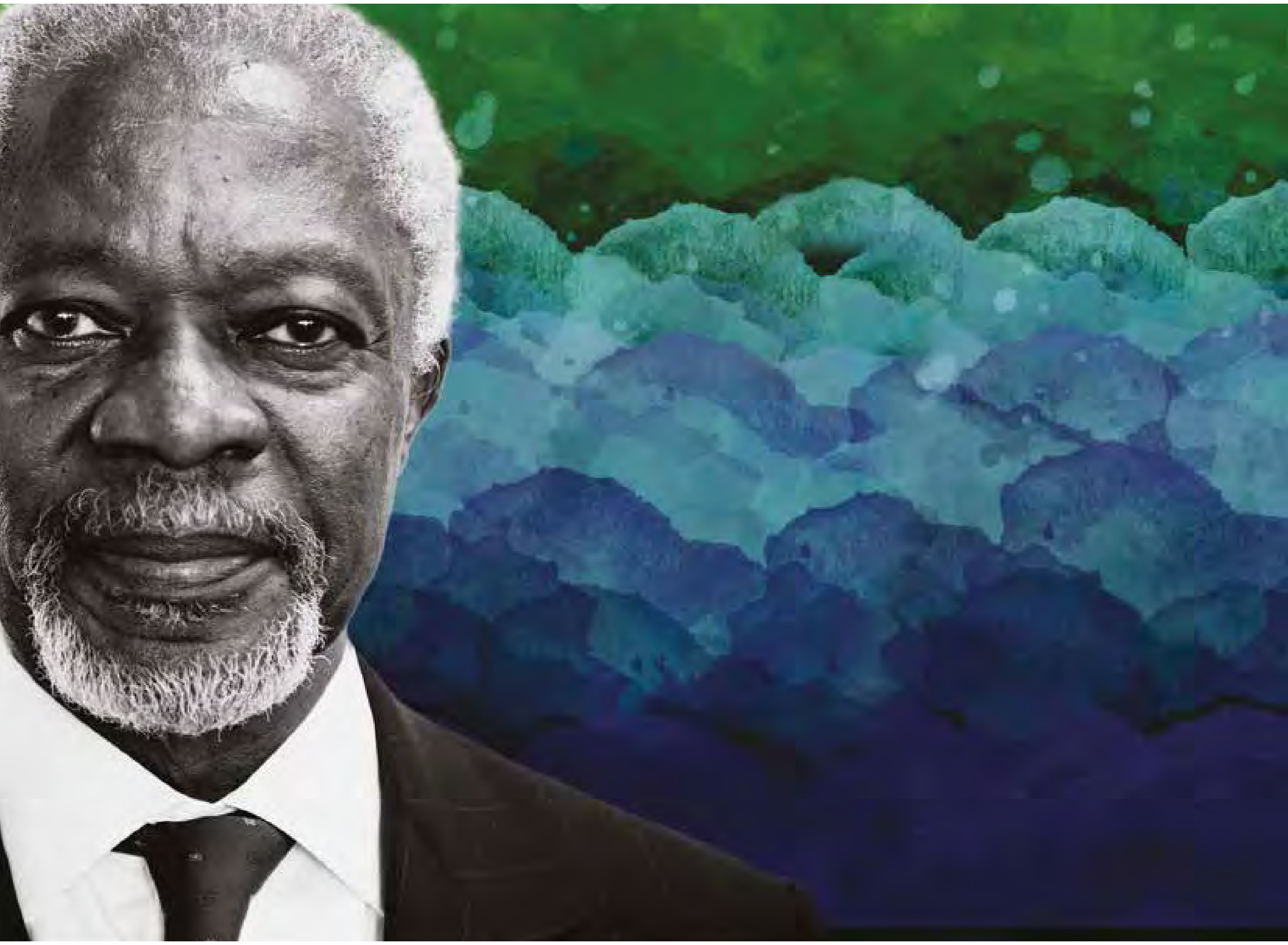


Foreword
by Kofi Annan

The world's burgeoning population needs to be fed and Africa, our continent, is well positioned to do so. We have enough resources to feed not just ourselves but other regions too. We must seize this opportunity now.

Africa's productivity levels, already beginning to increase, could easily double within five years. Indeed, our smallholder farmers, most of them women, have repeatedly proven how innovative and resilient they can be.

So why are they not yet thriving? The unacceptable reality is that too many African farmers still use methods handed from generation to generation, working their lands or grazing their animals much as their ancestors have done for millennia.

Africa may be showing impressive headline growth, but too many of our people remain stuck in poverty. This year's *Africa Progress Report* finds that if we want to accelerate Africa's transformation, then we have to significantly boost our agriculture and fisheries, which together provide livelihoods for roughly two-thirds of all Africans.

If we want to extend the recent economic successes of the continent to the vast majority of its inhabitants, then we must end the neglect of our farming and fishing communities. The time has come to unleash Africa's green and blue revolutions.

These revolutions will transform the face of our continent for the better. Beyond the valuable jobs and opportunities they will provide, such revolutions will generate a much-needed improvement to Africa's food and nutrition security. More than anything, malnutrition on our continent is a failure of political leadership. We must address such debilitating failure immediately.

Africa's farmers and fishers are equal to the challenge, but they need the opportunity. They need their governments to demonstrate more ambition on their behalf. African governments must now scale up the appropriate infrastructure and ensure that financial systems are accessible for all.

When farmers access finance – credit, savings, insurance – they can insure themselves against risks such as drought, and invest more effectively in better seeds, fertilizers and pest control. With access to decent roads and storage, farmers can get their harvests to market before they rot in the fields. Trade barriers and inadequate infrastructure are preventing our farmers from competing effectively. They are being told to box with their hands tied behind their backs.

No wonder Africa's food import bill is worth US$35 billion (excluding fish) every year.

Investing in infrastructure will certainly be expensive. But at least some of the costs of filling Africa's massive infrastructure financing gap could be covered if the runaway plunder of Africa's natural resources is brought to a stop. Across the continent, this plunder is prolonging poverty amidst plenty. It has to stop, now. Last year's *Africa Progress Report* showed how illicit financial flows, often connected to tax evasion in the extractives industry, cost our continent more than it receives in either international aid or foreign investment.

This year's report shows how Africa is also losing billions to illegal and shadowy practices in fishing and forestry. We are storing up problems for the future. While personal fortunes are consolidated by a corrupt few, the vast majority of Africa's present and future generations are being deprived of the benefits of common resources that might otherwise deliver incomes, livelihoods and better nutrition. If these problems are not addressed, we are sowing the seeds of a bitter harvest.

Global collective action is needed to nurture transparency and accountability. In the year since our last report was published, notable action has been taken on beneficial ownership, tax avoidance and evasion, and resource revenues. Further technical and financial support to African governments will also help reduce the illicit flows of timber, fish and money.

With the same goals in mind, such action must be extended to the major international commodity traders, who play a critical role in African markets, from coffee through to oil. Too often these powerful and globally influential traders have been overlooked by national and international regulation.

We have a common interest in the success of these endeavours. African forests help the world to breathe. Along with African waters, they safeguard the priceless biodiversity of planet Earth. Africa's fish and other harvests can help feed an expanding global population. And we all benefit from an Africa that is prosperous, stable and fair.

Foreign investors are increasingly choosing Africa as a lucrative opportunity, and pouring money into agribusiness. At best these investments bring jobs, finance and critical knowhow. At worst, they deprive African people of their land and water. African governments must regulate these investments and use them to Africa's advantage. Agreements between African governments and business have to be mutually beneficial.

Africans overseas are also transferring significant sums of money into Africa, but remittance charges are unethically expensive. This overcharging impacts even more negatively on rural communities. Remitting US$1,000 to Africa costs US$124 compared with a global average of US$78 and US$65 for South Asia.

Unleashing Africa's green and blue revolutions may seem like an uphill battle, but several countries have begun the journey. In these countries, farmers are planting new seeds, using fertilizer and finding buyers for their harvests. Impressive innovation and smart government policies are changing age-old farming ways.

Mobile technology allows farmers to leapfrog directly to high productivity. Young entrepreneurs mix agriculture with 21st century global markets. Africa's resilience, creativity, and energy continue to impress. These qualities are critical to our green and blue revolutions, upon which Africa's future will depend.

KOFI A. ANNAN
Chair of the Africa Progress Panel

Summary

"Africa is a land of opportunity … business opportunities are there, growth is there and the population is there."

PRESIDENT MACKY SALL
Senegal, January 2014

"Families have lived off fish for generations…but fish stocks have been reduced. Our revenues have come down. We used to be able to save a bit for our children's education or to fix our boats but it has now become harder to make ends meet."

ISSA FALL, FISHERMAN COMMITTEE
Soumbedioune, Senegal, January 2014

These two views from one country in Africa tell very different stories. President Macky Sall was speaking about his government's "Emergent Senegal" investment plan – a multibillion-dollar strategy for transforming the country's infrastructure. Ten years ago Senegal was still in the grip of a debt crisis. Now it is able to sell sovereign debt on eurobond markets. The economy is gaining strength, exports are growing and Senegal is emerging as a regional hub for transport, logistics and tourism.

Then there is the other Senegal – the Senegal of Issa Fall. Along with tens of thousands of artisanal fishers who ply their trade from *pirogues*, canoes built by hand from local timber, his livelihood is under threat. The ocean off West Africa is one of the world's richest fishing grounds. Yet catches are declining, along with the income they generate. The reason: illegal, unreported and unregulated fishing by commercial fleets from other countries. Senegal lacks the capacity to monitor the activities of these fleets. Until recently, it also lacked the political will to tackle the problem. Leaders and business interests actively colluded in, and benefited from, the illegal sale of permits to foreign fleets.

Senegal's experience is a microcosm of a wider story. For more than a decade, Africa's economies have been doing well, according to graphs that chart the growth of GDP, exports and foreign investment. The experience of Africa's people has been more mixed. Viewed from the rural areas and informal settlements that are home to most Africans, the economic recovery looks less impressive. Some – like the artisanal fishermen of West Africa – have been pushed to the brink of destitution. For others, growth has brought extraordinary wealth. Africa is now home to some of the world's fastest-growing markets for luxury goods – and signs of the new prosperity are increasingly visible alongside reminders of the old problem of poverty.

Africa stands at a crossroads. Economic growth has taken root across much of the region. Exports are booming, foreign investment is on the rise and dependence on aid is declining. Governance reforms are transforming the political landscape. Democracy, transparency and accountability have given Africa's citizens a greater voice in decisions that affect their lives.

These are encouraging developments. Yet the progress in reducing poverty, improving people's lives and putting in place the foundations for more inclusive and sustainable growth has been less impressive. Governments have failed to convert the wealth created by economic growth into the opportunities that all Africans can exploit to build a better future. The time has come to set a course towards more inclusive growth and fairer societies.

This year's *Africa Progress Report* addresses some of the central challenges facing Africa's governments. We share the view that there is much cause for optimism. Demography, globalization, new technologies and changes in the environment for business are combining to create opportunities for development that were absent before the economic recovery. However, optimism should not give way to the exuberance now on display in some quarters. Governments urgently need to make sure that economic growth doesn't just create wealth for some, but improves wellbeing for the majority. Above all, that means strengthening the focus on Africa's greatest and most productive assets, the region's farms and fisheries. This report calls for more effective protection, management and mobilization of the continent's vast ocean and forest resources. This protection is needed to support transformative growth.

The achievements of the past decade and a half should not be understated. Economic growth has increased average incomes by around one-third. On the current growth trajectory, incomes will double over the next 22 years. Once synonymous with macroeconomic mismanagement and economic stagnation, Africa now hosts some of the world's fastest-growing economies. When it comes to growth, Ethiopia rivals China, and Zambia outpaces India. Contrary to a widespread misperception, there is more to the growth record than oil and minerals – and more than exports and foreign investment. African business groups have emerged as a powerful force for change in their own right, in areas such as banking, agro-processing, telecommunications and construction.

For the first time in a generation, poverty is falling – but it is falling far too slowly. The benefits of growth are trickling down to Africa's poor but at a desperately slow pace. Next year, African governments will join the wider international community in adopting post-2015 international development goals. One of those goals will be the eradication of poverty by 2030. On current trends, Africa will miss that goal by a wide margin.

Why is growth reducing poverty so slowly? Partly because Africa's poor are very poor: those below the poverty line of US$1.25 a day live on an average of just 70 cents a day. And partly because high levels of initial inequality mean that it takes a lot of growth to reduce poverty even by a little. Raising the growth trajectory by 2 percentage points per capita and modest redistribution in favour of the poor would get Africa within touching distance of eradicating poverty by 2030.

Well-designed social protection programmes could play a vital role by protecting vulnerable people against the risks that come with droughts, illness and other shocks. By transferring cash, they can also raise income levels. Experience in other regions – especially Latin America – demonstrates that social protection can simultaneously help to reduce poverty and inequality, and boost growth in agriculture. Yet Africa underinvests in this vital area – and few governments have developed integrated programmes. By contrast, they spend around 3 per cent of GDP on energy subsidies, most of which go to the rich – three times the level of support provided for social protection. It is hard to imagine a more misplaced set of priorities.

If Africa is to develop a more dynamic and inclusive pattern of growth, there is no alternative to a strengthened focus on agriculture. Sub-Saharan Africa is a region of smallholder farmers. Some people mistakenly see that as a source of weakness and inefficiency. We see it as a strength and potential source of growth.

Africa's farmers have an unrivalled capacity for resilience and innovation. Operating with no fertilizer, pesticide or irrigation on fragile soils in rain-fed areas, usually with little more than a hoe, they have suffered from a combination of neglect and disastrously misplaced development strategies. Few constituencies can have received more bad advice from development partners and governments than African farmers. And few of the world's farmers are as poorly served by infrastructure, financial systems, scientific innovation or access to markets. The results are reflected in low levels of productivity: cereals yields are well under half the world average.

Agriculture remains the Achilles' heel of Africa's development success story. Low levels of productivity trap millions of farmers in poverty, act as a brake on growth, and weaken links between the farm and non-farm economy – links that were crucial to development breakthroughs in Bangladesh, India and Vietnam. Low productivity has another consequence that has received far too little attention. Africa's farmers could feed rapidly growing urban populations and generate exports to meet demand in global markets. However, the region is increasingly and, in our view, dangerously dependent on imports. African countries spent US$35 billion on food imports (excluding fish) in 2011. The share accounted for by intra-African trade: less than 5 per cent. If Africa's farmers increased their productivity and substituted these imports with their own produce, this would provide a powerful impetus to reducing poverty, enhancing food and nutrition security, and supporting a more inclusive pattern of growth.

It is time for African governments and the wider international community to initiate a uniquely African green revolution. We emphasize the word unique. Copying South Asia's experience and retracing the steps of other regions is not a viable strategy. Agricultural conditions in Africa are different. Yet Africa desperately needs the scientific innovations in drought-resistant seeds, in higher-yielding varieties and in water use, fertilizer and pesticide that helped to transform agriculture in other regions. Returns on investments in these key areas will be diminished if deep-rooted policy failures are not tackled. These range from exorbitant transport costs for farm produce to underinvestment in storage and marketing infrastructure and barriers to intraregional trade.

African farmers also need help to cope with the effects of climate change, which is very likely to lead to above-average warming in Africa over the course of the 21st century, reducing the yields of major cereal crops. Yields of maize, a major regional food crop, are expected to fall by around 22 per cent. The fifth assessment report of the Intergovernmental Panel on Climate Change identifies Southern Africa, West Africa and the Sahel as regions facing acute known risks. However, no region will be unaffected. Even modest changes in the timing and intensity of rainfall, in the frequency and duration of droughts, and surface temperature can have profoundly damaging consequences for production, poverty and nutrition.

All of which makes the international community's failure to provide adequate adaptation financing indefensible. Having promised much, rich countries have provided little new and additional climate adaptation financing. Commitments through climate funds are less than US$700 million – and spending is even lower. This is unjust and short-sighted. It is unjust because Africa's farmers are being left to cope with a climate crisis they did not create. Adaptation spending in Africa is dwarfed by the multibillion-dollar investments being undertaken in rich countries. And underinvestment in adaptation is short-sighted because early investments could boost growth, enhance food security and reduce climate risks.

Harnessing Africa's resources for African development is another priority. In last year's report, Equity in Extractives, we highlighted the damaging consequences of tax evasion and loss of revenue through undervaluation of mineral resource assets. This year we turn our attention to renewable resources, focusing on fisheries and logging. There are some striking parallels with tax evasion. In each case, Africa is being integrated through trade into markets characterized by high levels of illegal and unregulated activity. In each case resources that should be used for investment in Africa are being plundered through the activities of local elites and foreign investors. And in each case African governments and the wider international community are failing to put in place the multilateral rules needed to combat what is a global collective action problem.

The social, economic and human consequences are devastating. On a conservative estimate, illegal and unregulated fishing costs West Africa alone US$1.3 billion a year. The livelihoods of artisanal fishing people are being destroyed, Africa is losing a vital source of protein and nutrition, and opportunities to enter higher value-added areas of world trade are being lost. Unregistered industrial trawlers and ports at which illegal catches are unloaded are the economic equivalent of mining companies evading taxes and offshore tax havens. The underlying problems are widely recognized. Yet international action to solve those problems has relied on voluntary codes of conduct that are often widely ignored. The same is true of logging activity, with the forests of West and Central Africa established as hot-spots for the plunder of timber resources.

Placing Africa on a transformative pathway will require investing in inclusive growth. Infrastructure is one priority. No region has less-developed road networks and energy systems than Africa. Changing this picture will require significant up-front capital spending, prefaced by the development of bankable proposals and the emergence of new business models. The current financing gap has been estimated at around US$48 billion. Much emphasis has been placed on the development of "new and innovative" financing to close that gap, including the use of aid to attract private investment. Unfortunately, the delivery of real finance has been less impressive than the hype surrounding the relentless proliferation of new initiatives. Part of the problem is a failure to invest sufficiently in building the capacity of African governments to develop infrastructure projects.

Africa's financial systems are another constraint on growth. No region has a lower level of access to financial services. Only one in five Africans have any form of account at a formal financial institution, with the poor, rural dwellers and women facing the greatest disadvantage. Such financial exclusion undermines opportunities for reducing poverty and boosting growth that benefits all. Lacking access to insurance, Africa's farmers have to put their meagre savings into contingency funds to deal with emergencies, rather than investing them in boosting productivity. Similarly, lacking access to loans and saving institutions, they are often unable to respond to market opportunities.

Other weaknesses in domestic financing have to be addressed as a matter of urgency. At one level, the regional financing environment has been transformed. Ten years ago, countries across Africa were still emerging from the Heavily Indebted Poor Countries initiative. Today, many of the same countries have entered sovereign bond markets. But Africa cannot meet its financing needs in infrastructure and skills development through aid and commercial market debt financing alone. That is why there is no substitute for domestic financing. Unfortunately, economic growth has done little to increase either the rate of savings or the proportion of GDP that is collected in domestic tax revenues – outcomes that point to the need for institutional reforms.

Recommendations

In this report we document some of the great development challenges facing Africa. Meeting these challenges will not be easy. Yet Africa's political leaders, entrepreneurs, farmers and civil society have an unparalleled opportunity to transform their countries. If that opportunity is seized, this could be the generation that will be lauded throughout history for eradicating poverty. We set out in this report a broad-based agenda for change. At the heart of that agenda are five core principles, for each of which we identify the necessary practical action.

Share the wealth

Inclusive growth and expanded opportunity are essential to eradicate poverty.
African governments should set equity targets linked to the post-2015 development goals. These targets would focus on narrowing gaps in opportunity. For example, they could include halving over five years the disparities in school attendance, child survival and access to basic services linked to rural-urban divides, wealth gaps and gender divisions. Strengthening the commitment to inclusive growth demands an expansion of social protection, including cash transfers to the poor. Governments should be diverting some of the 3 per cent of regional GDP they now devote to energy subsidies into well-designed social protection programmes.

Invest in Africa's unique green revolution

African governments, the private sector and the global community must work together to invest in Africa's unique green revolution.

It is possible to double Africa's agricultural productivity within five years. As outlined by the African Union, African countries can end hunger and malnutrition and become major players in global food markets. It is also vital to unleash the potential of sustainable agriculture and aquaculture to provide food, jobs and export earnings. Some of the requirements for achieving a breakthrough in agriculture are financial. Now is the time for governments to act on their pledge to spend at least 10 per cent of budget resources on agriculture. But governments also have to create the right market conditions. An immediate priority is the promotion of import substitution to cut Africa's US$35 billion food import bill. This will require measures to cut tariffs and non-tariff barriers to regional trade, eliminate transport cartels, and develop marketing infrastructure.

Take the profit out of plunder

Africa's resources should be sustainably managed for the benefit of Africa's peoples. National and regional action alone will not be enough. The international community must develop multilateral systems that prevent the plunder of Africa's resources.

Fisheries: The global community must act collectively to unleash a blue revolution for ocean management. To stop the plunder of African fishery resources, all governments should ratify and implement the 2009 Port State Measures Agreement to tackle illegal unreported and unregulated (IUU) fishing, and establish a global register of fishing vessels. African governments should increase fines on IUU vessels, support artisanal fishing, increase transparency, and provide full disclosure of the terms on which commercial fishing permits are issued.

Forests: All commercial logging concession contracts should be subject to full disclosure, along with the beneficial ownership structures of the companies involved. Concessions should be provided with the informed consent of the communities involved, based on a clear and accurate representation of potential costs and benefits.

Close the twin deficit in infrastructure and inclusive finance

African governments must close the twin deficit in infrastructure and inclusive finance.

The lack of infrastructure is a bottleneck on growth and opportunity. The same is true of finance. Regional cooperation on energy and transport is vital in order to achieve economies of scale in infrastructure projects. African governments can also support the development of mobile banking and e-commerce to overcome financial exclusion, building on successes such as M-PESA in Kenya. Development finance institutions should work with the private sector to foster more balanced perceptions of risk.

Make tax and finance more fair and transparent

Strengthened domestic resource mobilization holds the key to financing for inclusive growth, with African governments investing in efficient and equitable tax collection. Governments should publish in a transparent manner all tax exemptions that are granted to corporate entities, both domestic and foreign. The estimated cost of the tax exemption should be made public, along with the reasons for the exemption and the principle beneficiaries.

The international community must step up efforts to combat tax evasion. Multinational corporations operating in Africa should fully disclose their financial operations and tax payments. Building on current initiatives, governments should accelerate the automatic exchange of tax information and build Africa's capacity to benefit from this information. All governments, including those of financially secretive jurisdictions, should establish public registries of beneficial ownership of companies and trusts. Multinational corporations can lead the way by publishing a full list of their subsidiaries, as well as information on global revenues, profits and taxes paid across different jurisdictions.

The international community should also deliver on its aid pledge – and go one step further by cutting the cost of remittances. The G8 should work with African governments to cut the cost of remittance transfers to a maximum of 5 per cent. That means curtailing restrictive business practices on the part of money transfer operators, strengthening competition, and creating incentives for the development of low-fee mobile remittance payments.

Introduction

Africa has taken huge strides over the past decade. Economies across the region are booming. Average incomes have risen by more than one-third, reversing a decline during the 1990s. Foreign direct investment has more than doubled. African conglomerates have started to flex their muscles. New technologies such as mobile banking are being adopted at breakneck speed. Africa's growth has been helped not only by booming commodity prices but also by improvements in macroeconomic policy. Measures of social wellbeing – for child survival, education and access to basic services – show that people's lives are improving. Poverty rates have fallen for the first time in a generation. "Africa rising" has emerged as a new catch phrase.

The Africa Progress Panel has frequently cautioned against exaggerated optimism; commentaries on Africa tend to indulge in too much hype. All too often, Africans have seen economic booms deliver nothing but false hopes. What is different this time round is that so many of the foundations needed to support a transformative breakthrough are now in place.

Africa's leaders have an unprecedented opportunity to convert the continent's great wealth into permanent improvements in Africans' lives. Agriculture and fisheries lie at the heart of this new dawn. Long recognized by policymakers as a rhetorical priority, agriculture is now attracting the serious attention needed to fulfil its transformative potential. Africa's farmers are adopting new crops and techniques, enabling them to raise productivity.

Africa's leaders have an unprecedented opportunity to convert the continent's great wealth into permanent improvements in Africans' lives. Agriculture and fisheries lie at the heart of this new dawn.

There are two sides to the story of the past decade, however. The rising tide of economic growth has failed to lift many out of poverty. In a region with some of the world's most efficient farmers, far too many people go hungry. Instead of creating markets for Africa's agricultural producers, urbanization is sucking in vast amounts of food imports. And the violence that has swept the Central African Republic and South Sudan over the past year provides a potent reminder that conflict can destroy and undermine development. On a simple growth trajectory, Africa may be tracking the pathway of some of the economic success stories in East Asia. But that is where the analogy ends. Africa lacks the skilled workforce it needs to embark upon truly transformative economic growth – and the region is not creating the jobs needed to seize the opportunity offered by the rise of its large youth population.

International commentators tend to focus on the outward signs of success. The growth of gross domestic product (GDP), surging exports, rising foreign investment and the emergence of equity markets are easy to measure – and they point to a region of opportunity. Yet there is another face of Africa. This is the face of a woman farmer struggling to raise yields. It is the face of children denied the chance to realize their potential through education. And it is the face of a generation of young people who have a right to demand and expect more from their governments.

With the right policies, Africa's farmers could capture the lion's share of a US$35 billion market in food imports and climb the value chain in exports.

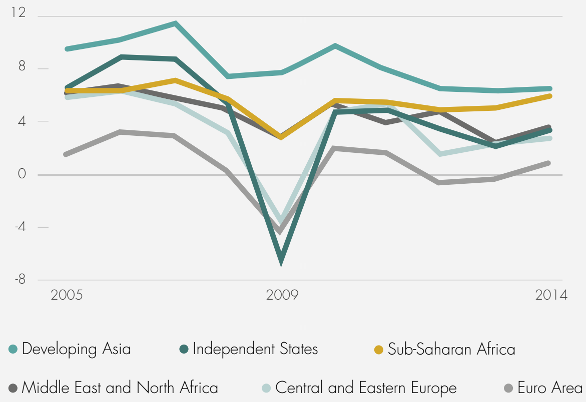
This year's *Africa Progress Report* takes a hard look at the risks and opportunities facing Africa. It asks what governments across the region need to do if they are to convert a decade of growth into transformative development. By "transformative", we mean not just increased productivity, but a transformation in opportunity and a growth pathway that benefits all, not just some, leading to the eradication of poverty.

The reason that Africa has thus far failed to reap the development gains of high growth is that, in far too many countries, rural producers have been left behind. African farmers must be at the centre of the transformation that we envisage. Most of Africa's poor live and work in rural areas as agricultural producers. Their ability to contribute to growth and participate in the benefits is determined by capacity to raise productivity, build skills through education, and withstand the shocks and uncertainties that come with an unpredictable climate. In the absence of a dynamic and inclusive agricultural sector, not only will Africa's growth suffer, but the region's poor will be left further and further behind.

Today, agriculture in Africa is staging a fragile recovery from several decades of neglect and misplaced policy advice. More governments are putting in place the public investments and policies needed to stimulate growth and create market opportunities. There is cause for hope. That is why we argue later in this report that we need sustainable green and blue revolutions across the continent – African revolutions fuelled by home grown innovation as well as lessons from other regions. With the right policies, Africa's farmers could capture the lion's share of a US$35 billion market in food imports and climb the value chain in exports. But as we show in later sections of the report, this will not happen without better protection of Africa's natural resource assets, investment in infrastructure, and greater financial inclusion, alongside coordinated national strategies to mobilize more domestic finance and harness external financial flows.

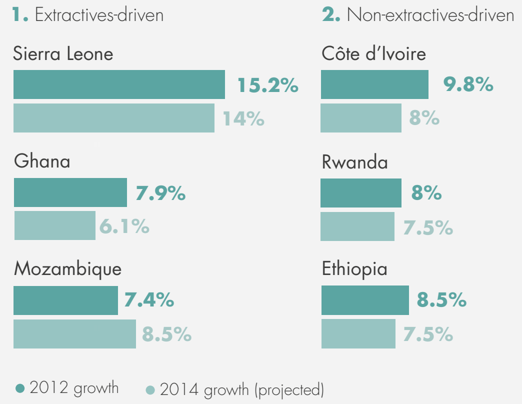
OUR PROGRESS

AFRICA REMAINS ONE OF THE WORLD'S FASTEST GROWING REGIONS



Source: IMF (2013), World Economic Outlook: Tensions and transitions.

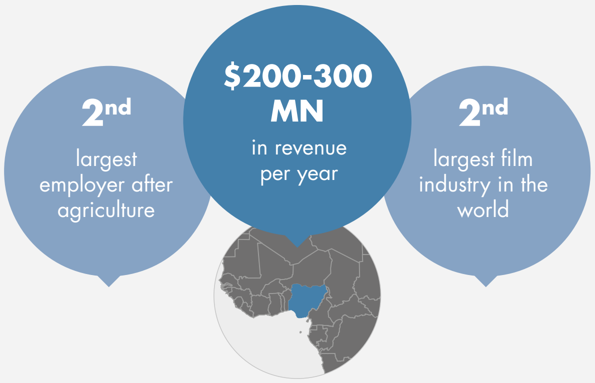
DRIVERS OF GROWTH ARE BEYOND THE EXTRACTIVE INDUSTRIES



Source: IMF (Oct. 2013), Regional Economic Outlook for Sub-Saharan Africa: Keeping the pace.

CREATIVE INDUSTRIES ACROSS AFRICA ARE BOOMING

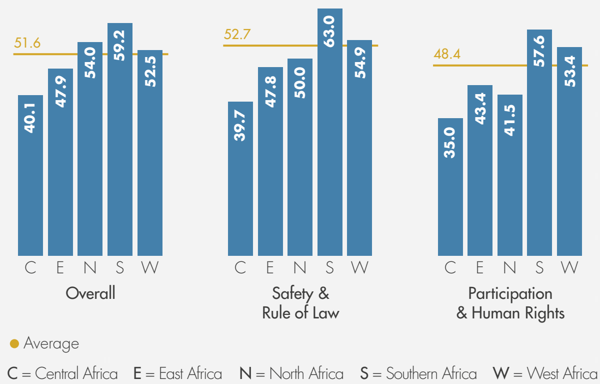
Nollywood, Nigeria's film industry, is a sector to watch



Sources: Africa Renewal (May 2013) and Financial Times (2013).

OVERALL GOVERNANCE IS IMPROVING: REGIONAL RESULTS 2012

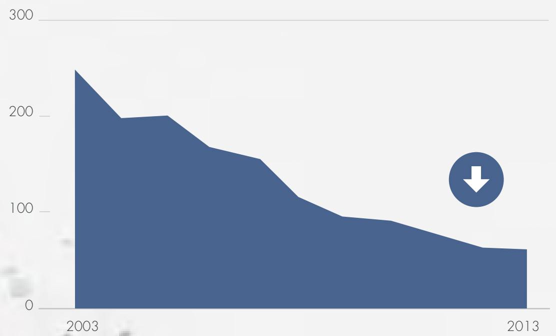
Regional Category Scores: 2012



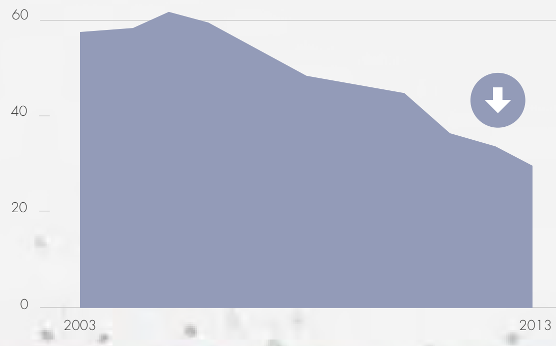
Source: Ibrahim Index of African Governance (2013).

IT HAS BECOME EASIER & CHEAPER TO DO BUSINESS IN AFRICA

1. Cost of business start-up procedures (% of GNI per capita)



2. Time required to start a business (days)

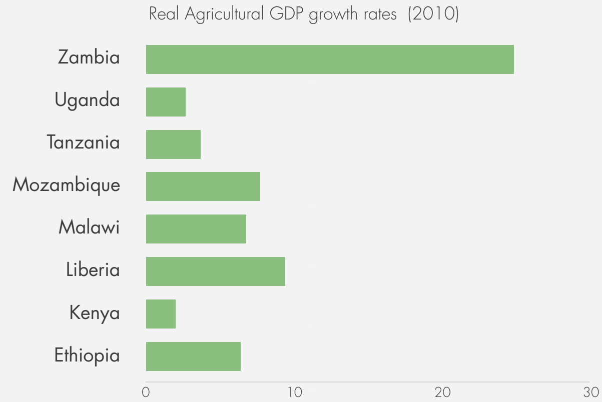


Source: The World Bank Group (2014), World Development Indicators.

MORE CHILDREN HAVE ACCESS TO EDUCATION THAN BEFORE, EVEN IF QUALITY REMAINS AN ISSUE

Source: UNESCO (2013/14), Education For All Global Monitoring Report.

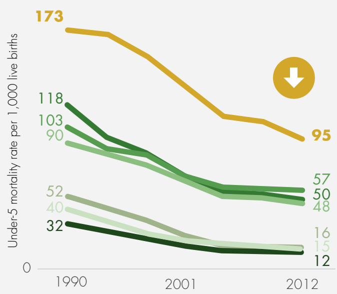
SOME COUNTRIES ARE SHOWING STRONG GROWTH IN AGRICULTURE

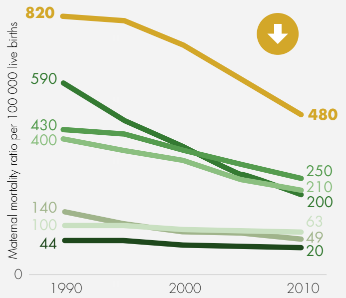


Source: AGRA (2013), African Agriculture Status Report.

HEALTH LEVELS ARE IMPROVING

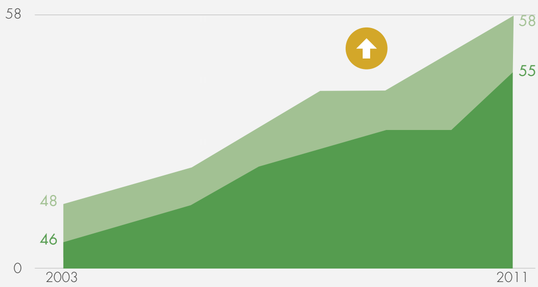
1. Child and maternal mortality rates are declining – but both still need to decline much further...





- Africa
- Europe
- South-East Asia
- Global
- Eastern Mediterranean
- Americas
- Western Pacific

2. Life expectancy is increasing



- Female
- Male

Source: WHO (2014), Atlas of African Health Statistics.

WHO KNOWS? MAYBE 2014 WILL BE THE YEAR WHEN AN AFRICAN TEAM WINS THE WORLD CUP?

*Reached the quarter finals

1970–1990

African representation at the finals

Algeria	Tunisia
Egypt	Cameroon*
Zaire	Morocco

1991–2010

Greater representation at the finals

Angola	Togo
Côte d'Ivoire	Senegal*
Morocco	Ghana*
Nigeria	Tunisia
South Africa	Cameroon

Source: FIFA World Cup

01

BUILDING ON
A DECADE OF GROWTH

The 49 countries in Sub-Saharan Africa vary enormously in their recent economic performance and their growth prospects. Ethiopia and the Democratic Republic of the Congo may both be fast-growing economies, but that is where the similarities end. The challenges facing the Central African Republic and South Sudan are not those facing Kenya or Zambia. So the sweeping generalizations that dominate media coverage of Africa – often prompted by crises – are as inaccurate as they are unhelpful.

Some of the hype surrounding Africa's growth record is at least partially justified, however (See Infographic, Our Progress), the past decade has seen a tangible shift in economic fortunes – and the outlook remains positive. Regional growth has hovered around, and often exceeded, 5 per cent a year. During 2012–2013, over one-third of countries in the region posted growth rates of over 6 per cent.

Behind this record are marked improvements in macroeconomic policy, which insulated the region from the worst effects of the global financial crisis. At the start of the 21st century, most African countries were strapped with unsustainable debt. Now many have better debt indicators than countries in the European Union. Of the region's major economies, only one of the largest, South Africa, has consistently underperformed.

Growth is pushing more and more countries towards middle-income status. In 2006, 13 countries in the region were categorized as middle-income – that is, with per capita gross national income (GNI) between US$906 and US$11,115, as calculated by the World Bank Atlas method.[1] Today, the figure has climbed to 21.[2] According to the World Bank, another 10 countries could attain middle-income status by 2025 if current growth trends continue. Excluding South Africa, growth in Sub-Saharan Africa reached almost 6 per cent in 2013 – second only to the performance of East Asia.[3]

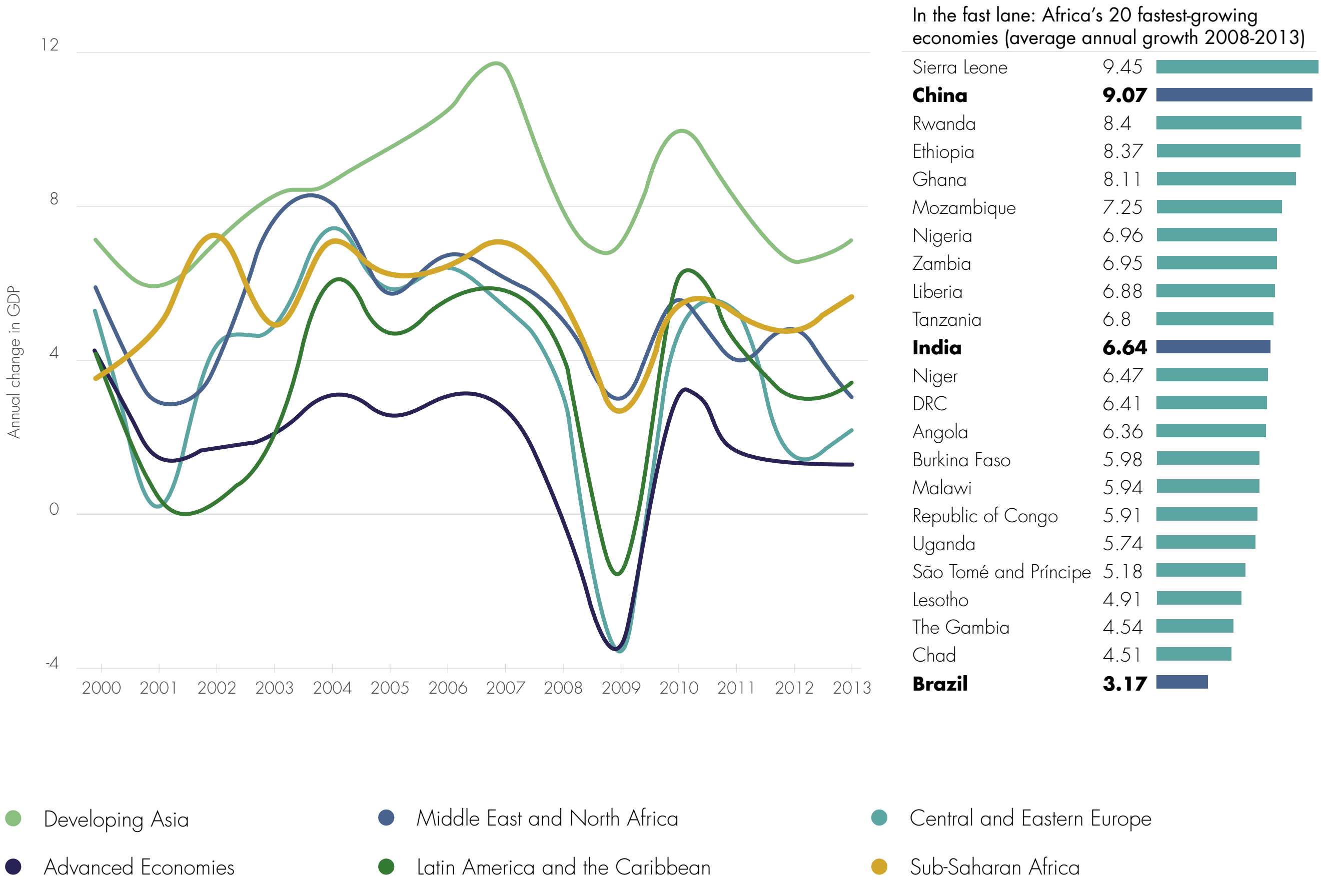
Sub-Saharan Africa weathered the global financial crisis better than any other region and rebounded strongly. Several African countries are now firmly positioned in the upper echelons of the world's GDP growth league (Figure 1). Factoring in population growth, average incomes have been rising by 3 per cent to 4 per cent a year and are now around one-third higher than in 2000.

Translated into real money terms using purchasing power parity (PPP), these gains are modest: the average increase in income for people in low-income African countries is just US$567. But this is a striking turnaround from the sustained decline in average income over the two previous decades. If the average growth for 2000–2012 continues, average incomes in Africa will double over the next 22 years. Between 1980 and 2000, they contracted by over 20 per cent.

The regional snapshot inevitably masks some significant variations (Figure 2). There are 493 million Africans living in countries that have posted annual per capita growth rates of 3 per cent or more between 2000 and 2012. Were countries such as Mozambique, Rwanda and Sierra Leone to sustain the growth record of the past decade, they would see average incomes double in less than 17 years. It would take Ethiopia just 12 to 13 years to achieve the same result.

At the other end of the spectrum, however, a large group of countries are falling far short of their growth potential:

FIGURE 1 AFRICA'S DECADE OF GROWTH (CONSTANT PRICES, SELECTED REGIONS)

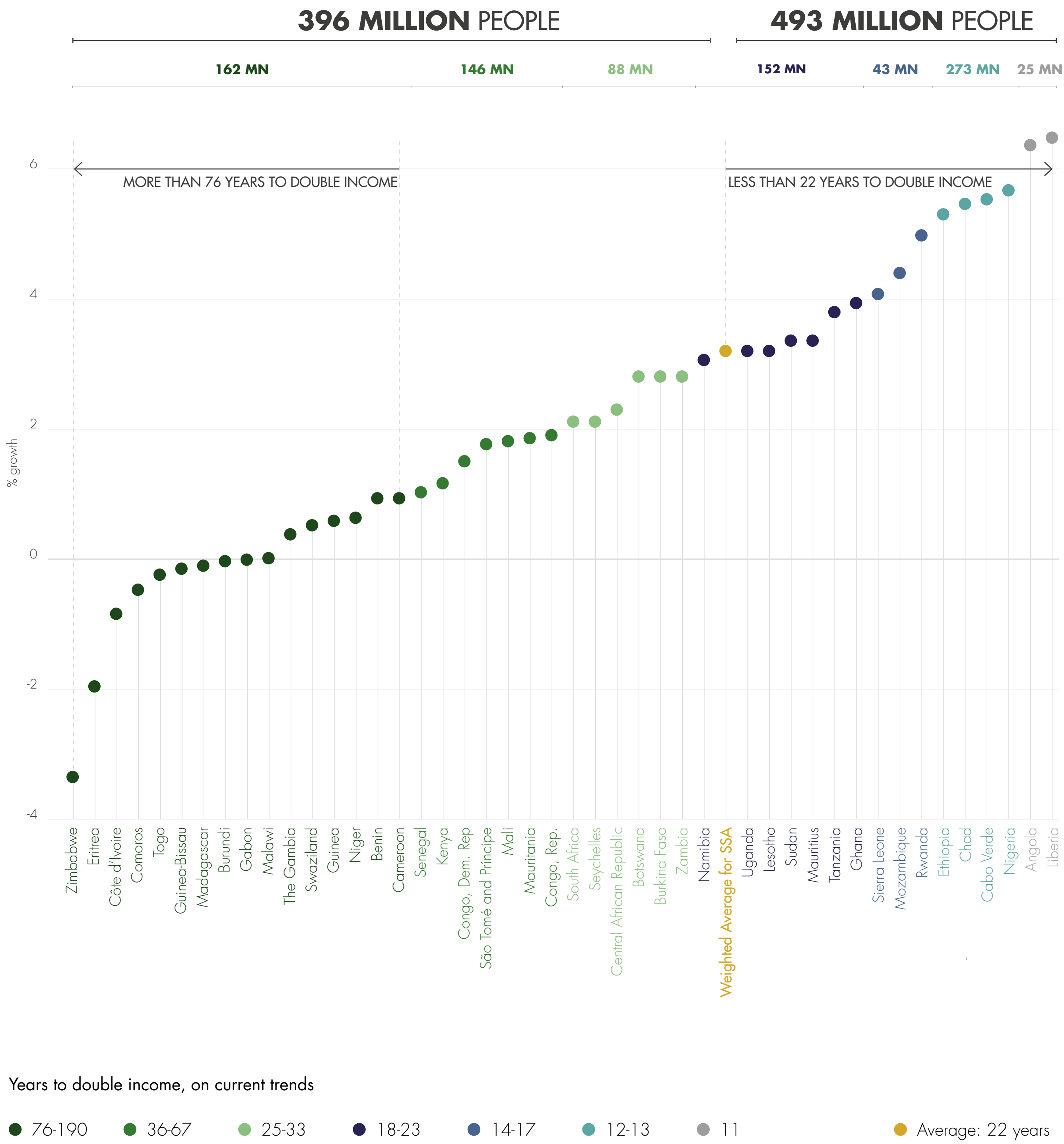


Source: IMF (2014), World Economic Outlook database.

- Some 396 million Africans live in countries that will take over 25 years to double average incomes.
- There are 16 countries either in negative per capita GDP growth or growing at less than 1 per cent. It will take them at least 76 years to double average incomes.
- Countries such as Kenya and Senegal will take over 60 years to double average incomes.

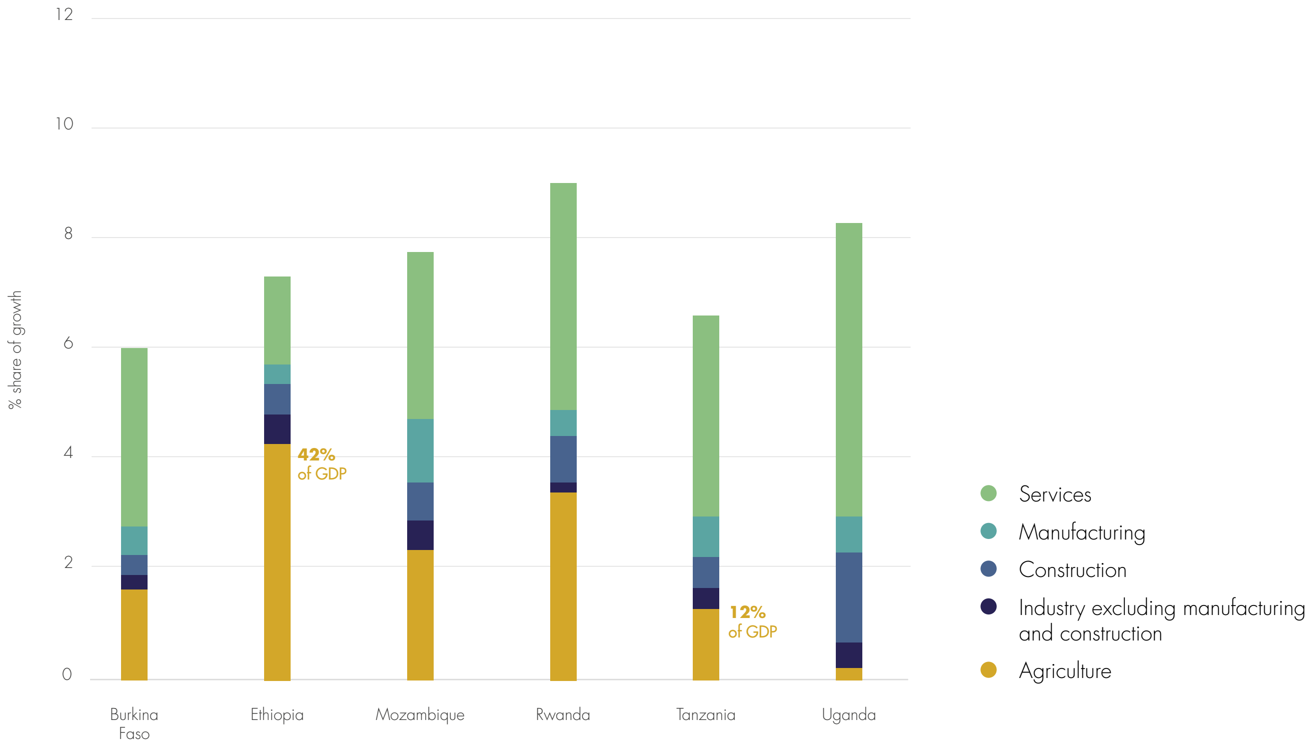
There is also considerable diversity in the growth patterns behind these figures. There is a common perception that Sub-Saharan Africa's strong growth is solely due to high global commodity prices, particularly for oil and minerals.But the growth surge has extended far beyond resource-rich countries. It spans coastal economies such as Mozambique, Senegal and Tanzania; landlocked Burkina Faso and Uganda; commodity exporters such as the Democratic Republic of the Congo, Nigeria and Zambia; and middle-income countries such as Botswana. In Ethiopia and Rwanda, two of the most prominent economic success stories, growth has been fuelled by agriculture (Figure 3).Service sectors have figured prominently in the growth records of Burkina Faso, Tanzania and Uganda.

FIGURE 2 AVERAGE INCOMES ARE RISING – BUT SOME ARE RISING FASTER THAN OTHERS: GDP PER CAPITA GROWTH (AVERAGE ANNUAL % 2000-2012)



Source: The World Bank Group (2014), World Development Indicators.

FIGURE 3 GROWTH PATTERNS VARY ACROSS COUNTRIES: CONTRIBUTION OF DIFFERENT SECTORS TO REAL GDP GROWTH, AVERAGE 1995-2010 (SELECTED COUNTRIES)



Source: IMF (2014), World Economic Outlook database.

What has driven the past decade of growth?

Any attempt to derive broad patterns from the diversity of African countries' experience has to be undertaken with caution. Even so, five broad sources of growth can be identified:

Domestic demand and investment: Strong growth in investment and household consumption has resulted in domestic demand rising faster than GDP in many countries. Gross fixed capital formation (a measure of investment) has increased from 16 per cent to 23 per cent of GDP since 2000.[4] Public investment has emerged as an important source of growth in many countries – including Ethiopia, Ghana, Nigeria, Tanzania and Zambia – as governments seek to address infrastructure deficits. African businesses have also emerged as an important source of investment (Box 1). Fiscal policy has been broadly expansionary, while rising consumer incomes are boosting economic activity in telecommunications, retail, services and transportation.

Foreign capital flows: Foreign direct investment (FDI) in the region has increased steadily, with a brief interruption in 2009 (see Part IV). Other private flows have also increased, with a number of governments issuing sovereign bonds. While the natural resources sector is the primary recipient, services and manufacturing have also emerged as a magnet for FDI. Around one-third of FDI in 2012 was directed to domestic markets rather than the extractives sector.[5]

Strong commodity prices: Although prices for mineral exports weakened in 2012 and 2013, they remain high, and export volumes of minerals, oil and agricultural goods have increased. Projections suggest that world prices for Africa's major mineral exports may fall back slightly over the medium term but will remain well above pre-2000 levels.[6] Prices will depend crucially on developments in China.

Deepening interdependence with China and other emerging markets: The emerging markets known as the BRICs (Brazil, Russia, India and China) now account for around one-third of Africa's exports – four times the level in 2002. This is almost equivalent to combined demand from the European Union and the United States. China is now the largest destination for Africa's exports, accounting for one-quarter of the total. The BRICs also represent a significant and growing source of foreign direct investment.

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Improved economic governance: Over the past decade, policy has improved markedly. Monetary policy has helped considerably to reduce inflation over the past two years. Only one country that benefited from debt relief before 2007 – The Gambia – is categorized by the International Monetary Fund (IMF) as facing a high risk of a return to debt distress. The regional fiscal deficit is 2.7 per cent of GDP, albeit with some large variations. [7]

Risks to growth: Debt and interdependence

The positive regional picture can sometimes obscure underlying weaknesses and risks. Public debt ratios in some countries have risen sharply, raising concerns over debt sustainability.[8] For the region as a whole, public debt increased from 29 per cent of GDP in 2008 to 34 per cent in 2013.

Strong investment spending has exacerbated current account deficits, which widened further in 2013. Several countries – including Cameroon, Chad, Ghana and Malawi – are running fiscal deficits that point to acute vulnerabilities. Ghana has emerged as a poster child for the "Africa rising" theme, with average annual growth of over 7 per cent for the past decade, surging foreign investment and exports booming. Yet the country has accumulated a fiscal deficit of 10 per cent of GDP – one of the largest in Africa.[9] In October 2013, Ghana's credit rating was downgraded.[10] While investment in infrastructure has increased the fiscal deficit in other countries, in Ghana capital investment has been shrinking as a share of GDP.

Africa's deepening interdependence with global markets through trade and capital flows brings risk as well as opportunity. Were the Chinese economy to be rebalanced through an increased emphasis on consumption rather than investment, the effects would be strongly felt in Sub-Saharan Africa through reduced export demand and, potentially, lower export prices. Similarly, a long-term decline in commodity prices represents a continued source of vulnerability. Modelling by the World Bank suggests that a decline in metals prices of one standard deviation would reduce growth by more than 1 per cent to 2.5 per cent of GDP per year in five countries: Ghana, Mali, Mozambique, South Africa and Tanzania. Africa's growing presence in international capital markets also comes with risks. The eventual reversal of monetary easing measures by the United States Treasury – or "tapering" – could see an increase in African bond yields (see Part IV).

2030

By 2030, one half of Africans will live in cities the largest 18 of which will have a combined annual spending power of US$1.3 trillion.

Each country should develop its own strategies for mitigating these risks, but many countries need to increase domestic revenue mobilization (see Part IV), rebuild reserve buffers and avoid accumulating significant debt. Governments should be cautious about entering bond markets, given public debt and current account trends, and the foreign currency risks that would come with devaluation.

Three potential sources of further growth

Standing back from the policy challenges facing individual countries, three powerful forces will combine to create new opportunities for growth:

Demography: Africa is operating in a window of demographic opportunity. Half of the world's population growth between now and 2050 will occur in Africa. This is not because of higher fertility – fertility is declining – but because of longer life expectancy. Africa's adult population, and hence its workforce, is growing rapidly: it was 460 million in 2010 and is expected to be almost 800 million by 2030.[11] The power of Africa's demography should not be underestimated. Rising per capita income coupled with rising population equals an expanded market. Moreover, Africa has the world's fastest-growing population of young people. Half of the region's population is under 25 – and the 15- to 24-year-old age group is growing at almost 3 per cent a year (Figure 4).

Africa's adult population, and hence its workforce, will increase from 460 million in 2010 to be almost 800 million by 2030.

Human geography: African cities are growing rapidly. Thirty years ago, just over one quarter of Africans lived in cities. That figure has now climbed to 40 per cent. By 2030, one half of Africans will live in cities, the largest 18 of which will have a combined annual spending power of US$1.3 trillion.[12] Across the world, urbanization has often offered opportunities for migration and better economic prospects. Cities also create markets for agricultural producers, along with opportunities to link rural and urban economies.

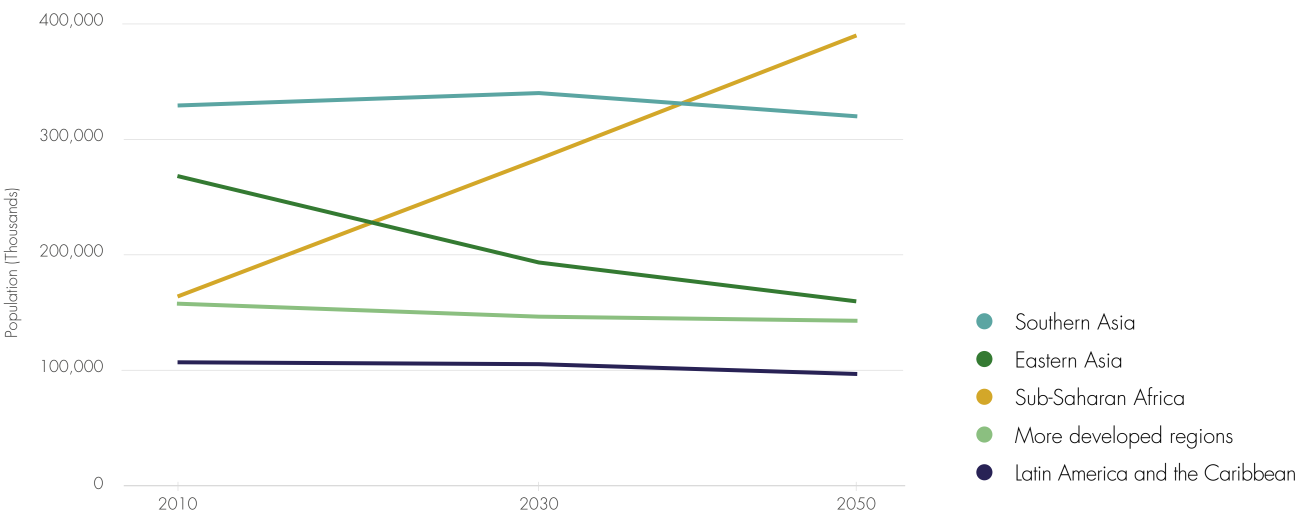
Technology: Africa has experienced a wave of technological innovation driven from below. Mobile phones have become multipurpose devices that connect people to market information, increase social and political connectivity, and support mobile banking. Global technology companies that once shunned Africa are now searching out business opportunities and talent – and African companies are drawing on new technologies for innovation.

We emphasize that these are *potential drivers* of transformative growth. In each case the opportunities come with immense risks. Demographic changes could support dynamic and inclusive growth, or fuel mounting frustration among a generation of unskilled and unemployed youth. Urbanization could provide new opportunities for migration into higher-paid occupations, or lead to the expansion of overcrowded, unsanitary informal settlements that become centres of marginalization. Technology can transform lives. But technology without skills is a vastly diminished resource – and in most cases Africa's education systems are not imparting the skills required.

The ultimate measure of progress, however, is not to be found in GDP numbers or in growth rates for exports and foreign investment. What matters most is the wellbeing of people – and the prospects for the kind of growth that will continue to improve their lives. Extreme poverty persists in Africa. Most of the poor live in rural areas and work as agricultural producers. And agriculture is a powerful engine for reducing poverty and inequality. That's why we argue in the rest of this part of the report that Africa needs not just growth but an economic transformation, with agriculture playing a central role.

The ultimate measure of progress is not to be found in GDP numbers or in growth rates for exports and foreign investment. What matters most is the wellbeing of people – and the prospects for the kind of growth that will continue to improve their lives.

FIGURE 4 AFRICA'S DEMOGRAPHIC DIVIDEND: PROJECTED INCREASE IN POPULATION, MEDIUM VARIANT, AGED 15-24, SELECTED REGIONS



Source: UN DESA, World Population Prospects: The 2012 Revision.

BOX 1 RISING AFRICAN CONGLOMERATES

Another of the misperceptions surrounding Africa's growth is that foreign investment is in the driving seat. Much of the investment – especially in banking and finance, telecommunications, retail and services – is driven by regional players. South Africa is emerging as a leading investor on the continent, followed by Kenya and Nigeria.

In recent years, increasingly dynamic large African companies have emerged, many working in partnership with foreign investors – and often with a primary focus on regional and domestic markets.

One example comes from Nigeria. Aliko Dangote, founder of what is now Africa's largest business conglomerate, has built the group's wealth on cement, as well as sugar refineries and processing plants for flour, pasta, salt and other foodstuffs. His cement division is spread across 14 African countries, and is set to expand into Asia and Latin America. In 2013, Dangote Industries announced a US$3.3 billion investment to build an oil refinery that will halve imports of petrol and diesel.

Agriculture has been another growth sector. "If I dreamt five years ago," Mr Dangote has said, "that I would invest in agriculture, I would write it off as bad dream or nightmare, but today we're investing US$2.3 billion in agriculture, US$2 billion in sugar and US$300 million in rice." These investments are part of a wider drive to transform Nigerian agriculture by strengthening links to manufacturing and entering higher value-added areas.

Major regional players are also emerging in banking. Ecobank, a Togo-based company with business across the continent, is the largest, with assets of about US$20 billion, followed by Nigerian lenders such as First Bank and Zenith. United Bank for Africa, another Nigeria-based lender, is focusing on a few big African markets, rather than trying to cover the continent. The Mara Group founded by Ashish Thakkar, one of Africa's most successful entrepreneurs, is a conglomerate with interests in 19 countries in the region. At the end of 2013 – in partnership with Bob Diamond, a former head of Barclays Bank – the group launched the US$325 million Atlas Mara fund, which purchases assets in Africa's banking sector.

Telecommunications has been a transformative growth pole. Today, Africa is one of the most dynamic regions for an industry facing low growth in more mature markets. The sharp rise in mobile phone use across Africa has increased demand for reliable networks that span the vast region. During 2012–13, IHS Towers – Africa's largest telecommunications infrastructure provider, which is listed on the Lagos stock exchange – raised over US$1 billion in debt and equity to finance expansion across the region. New shareholders include an Asia sovereign wealth fund, European investment groups and The World Bank Group's International Finance Corporation.[13]

To sustain growth, Africa needs economic transformation

Economies that have sustained high growth over the long term have typically gone through a process of economic diversification, the spread of new technologies, rising productivity in agriculture, the expansion of the manufacturing sector, and the development of a skilled workforce. These have not been characteristics of growth in Africa, even in sectors that are attracting foreign investment. As a new report by the African Centre for Economic Transformation, the Africa Transformation Report, 2014, puts it "there has been little success in altering the structures and technology levels of African economies."[14] Put differently, there has been a lot of growth but little structural transformation.

On some measures of transformation, Africa is *less* developed today than it was in 2000, or even earlier. For example, the value added in manufacturing has fallen from 14 per cent to 10 per cent of GDP since 2000.[15] The share of manufactured goods in Africa's total exports fell from 43 per cent in 2000 to 39 per cent in 2008. Over the same period, Africa's tiny share of global manufacturing exports rose only slightly, from 1 per cent to 1.3 per cent.

It could be argued that the value added in manufacturing is a poor guide to Africa's prospects. The most dynamic domestic sector has been services, with retail, construction, telecommunications and tourism playing a central role and boosting productivity. According to many, however – including the chair of the African Union Commission (AUC), Dr Nkosazana Dlamini Zuma; the president of the African Development Bank (AfDB), Donald Kaberuka; and the Harvard economist Dani Rodrik – the technologies, skills and economic linkages needed to drive sustained growth typically come from a rising manufacturing sector.[16]

"We believe we cannot achieve development unless we industrialize," Dr Zuma has stressed. "We are looking at agriculture as one of the important drivers for industrialization. We have the land, the people and the products. But we need to process more of our products in order to create jobs for the young people." Dr Zuma is also pushing for the nurturing of strong connections between agriculture and industrialization. As part of its 2014–2017 strategic plan, the AUC has prioritized agricultural production, developing the agro-processing and business sectors, increasing market access, and guaranteeing food security and nutrition, alongside promoting inclusive economic development and industrialization.[17]

According to Donald Kaberuka of the AfDB, "We could be the next manufacturing hub but there are some investments to be made. We need to increase our efforts on aviation, deregulation, open the borders and let people circulate so that when business people come they have the market in front of them."[18] Dani Rodrik's central message is that skipping industrial development may not be a credible option for transformative growth in Africa.

None of this is to discount the potential for change. With real wages rising in Asia, Africa has an advantage in labour costs – an advantage that has already brought Chinese footwear manufacturers to Ethiopia.[19] The advantage could widen as China rebalances its domestic economy to promote consumption rather than investment. But few African countries have the infrastructure or the industrial policy needed to exploit market opportunities and strengthen the link between exports and the domestic economy.

Education is another constraint. When it comes to transformation, a skilled workforce matters – and Africa has a large skills deficit. After a decade of progress in education, Mozambique has levels of secondary school enrolment around one-third lower than Malaysia's half a century ago. Vietnam achieved Sub-Saharan Africa's primary school enrolment rates a quarter of a century ago.[20] In an increasingly knowledge-based global economy, these education gaps limit the potential for transformative growth. Plainly stated, you cannot build sustained South Korean growth rates on Africa's current level of education and skills development.

If current growth patterns continue, the opportunities created by demography and human geography could become threats. In contrast to the experience of earlier industrializers, in Africa the primary force behind urbanization is not the pull of better-paid, more productive jobs in the formal sector, but the push of rural poverty. Less than one in 10 African workers find jobs in manufacturing – and just a tiny fraction of this group find employment in the formal sector. Most migration is directed to informal service sector activity, characterized by low productivity. While migration contributed to high growth in East Asia – and even in Africa during the immediate post-independence era – it does not appear to be boosting aggregate growth in most African economies.[21] With Sub-Saharan Africa's labour force expected to increase by 11 million people a year over the next 10 years, there is a danger that the region's demographic dividend will be squandered through low-skilled employment.[22]

The current state of African agriculture also illustrates the need for economic transformation. Globally urbanization and economic growth create market opportunities for agricultural producers. Yet in Africa's case, most of those opportunities have been seized by producers in other countries. As we show in Part II, imports of basic foodstuffs have been rising sharply, and domestic agriculture has so far failed to increase supply in response. Raising productivity in agriculture is vital to transformative growth, not just because it has the potential to expand markets by displacing imports, but also because most Africans will still be working in agriculture in 2020.

One area in which Africa has fallen far short of transformation is in financial inclusion – an issue we return to in Part IV. Access to credit, loans and insurance enables farmers and fishing communities to invest in productivity and secure themselves against risk. It also enables small and medium-sized enterprises to seize market opportunities. Yet after a decade of growth, three-quarters of African adults do not even hold an account at a formal financial institution. Africa's banks register some of the world's highest profit margins: returns on equity of 20 to 30 per cent are not uncommon. Yet many African banks are disengaged from the real economy and real lives, preferring to build profits on a lucrative trade in treasury bills.

There are other areas in which African governments need to rethink current policy approaches. As the authors of the *African Transformation Report* eloquently argue, transformative growth requires capable states – states that oversee industrial development strategies. This does not imply a return to "state-led" development. But it does imply more active state engagement in supporting companies, building skills and developing technologies and promoting trade.[23] Africa's governments are now trying to boost intra African trade, with a range of formal and informal barriers limiting the development of markets (see Part IV).

The consequences of 'business as usual'

***"I can't eat growth"** – Senegalese taxi driver*[24]

The ultimate measure of progress is not to be found in GDP numbers or growth rates, but in the wellbeing of people – and in prospects for enabling people to improve their lives. Africa has made some important progress in the past decade. Poverty fell from around 55 per cent in 2002 to 48 per cent in 2010. Child mortality has also been falling. The average annual rate of decline in child deaths reached 4.1 per cent for 2005–2012, up from 0.8 per cent in 1990–1995.[25] These figures help to explain why Africans are now living seven years longer on average than they were a decade ago. Education is also improving. More children are getting into school and progressing through grades – and gender gaps are narrowing. Enrolment rates for primary school have increased from 59 per cent to 78 per cent.

But in terms of translating growth into enhanced wellbeing, Africa is converging with other regions at a desperately slow pace – and in some areas the progress falls far short of what might have been anticipated (See Infographic, Despite Progress):

Nutrition: Economic growth has done little to reduce hunger. Over one in three of Africa's children are stunted as a result of poor nutrition before their fifth birthday.[26] This has devastating consequences for their cognitive development and learning opportunities. Overall malnutrition levels are only 5 percentage points lower than in 1990. One-quarter of Africans are malnourished.

Child survival: Despite some progress on child survival, 3.2 million of Africa's children did not reach their fifth birthday in 2012. Most died as a result of easily preventable infectious diseases, with malnutrition implicated in a majority of cases. Today Africa accounts for almost half of all child deaths globally – up from 29 per cent two decades ago.

Education: Headline figures on enrolment mask the depth of what can only be described as a learning crisis in Africa. Some 29 million children of primary school age, one-fifth of the total, are out of school – an increase from 39 per cent to 50 per cent in 10 years. Only one in three children will emerge from the primary school years with basic literacy and numeracy skills.

Sanitation: While Africa has improved access to clean water, it has fallen further behind in sanitation. No region has made slower progress towards the goal of providing safe sanitation, with devastating consequences for health, dignity and economic growth.

Absolute poverty: It is in terms of overall poverty numbers that the failure of growth to improve Africans' lives is most starkly evident. While the proportion of Africa's people living in poverty is falling, the number of extreme poor rose by 23 million between 2002 and 2010 – and the region's share of global poverty increased from 23 per cent to 34 per cent.

The post-2015 international development goals are likely to include eradicating extreme poverty by 2030. On a "business as usual" trajectory Africa will miss that target by a wide margin. One in five Africans are still likely to be living in absolute poverty in 2030 if Africa fails to undergo the agriculture-led economic transformation that we describe in this report (Box 2).

DESPITE PROGRESS...

29 COUNTRIES IN AFRICA HAD **AVERAGE GDP PER CAPITA GROWTH OF LESS THAN**

3% BETWEEN 2000 AND 2012

13%
AFRICA'S SHARE OF **WORLD POPULATION**

1.6%
AFRICA'S SHARE OF **GLOBAL GDP**

22%
1990

33%
2010

AFRICA'S SHARE OF **GLOBAL POVERTY**

173 million
1990-2

223 million
2010-3

NUMBER OF **UNDERNOURISHED**

40%

OF CHILDREN UNDER 5 **ARE STUNTED**

30%
1990

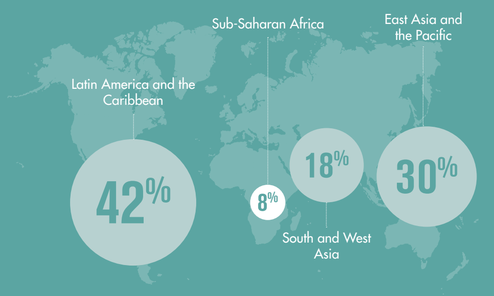
50%
2012

AFRICA'S SHARE OF GLOBAL **CHILD MORTALITY**

39%
1999

50%
2010

AFRICA'S GLOBAL SHARE OF **CHILDREN OUT OF SCHOOL**



ENROLMENT IN **TERTIARY EDUCATION**

Note: All figures refers to Sub-Saharan Africa

Sources: AfDB (2014), Statistical Data Portal.
FAO, IFAD and WFP (2013), The State of Food Insecurity in the World.
IGME (2013), CME Info.
The World Bank Group (2014), PovcalNet.
UNESCO (2013/14), Education For All Global Monitoring Report.

BOX 2 POVERTY IN 2030 – PROSPECTS OF "GETTING TO ZERO"

Given the prevalence and depth of poverty, what are Africa's prospects of eradicating extreme poverty by 2030? Sceptics might argue that a zero poverty target sets the scene for failure, repeating what some have described as the Millennium Development Goal error of adopting over-ambitious targets.[27] That view is mistaken. African governments should strive to eradicate poverty by 2030. Yet the magnitude of the challenge is undeniable – and a business-as-usual trajectory will leave Africa far short of the target.

What makes the challenges facing Africa so daunting is the region's poverty profile. Consider the comparison between Sub-Saharan Africa, India and China in Figure 5. An income of less than US$1.25 a day is the widely accepted definition of extreme poverty. Half of the extreme poor in India and China live on US$1 to US$1.25. They stand close to the exit door leading out of extreme poverty. By contrast, only one in five of Africa's poor are in this position. The average poor person in Africa lives on only 70 cents.

Over the past decade, per capita incomes in Africa have grown at around 3 per cent a year. If Africans living on 70 cents a day were to see an increase in consumption at this level over the next 15 years, their incomes would reach US$1.26 in 2030 – a desperately narrow escape from poverty.

Unfortunately, the arithmetic understates the problem on three counts. First, while it is reasonable to project a continued per capita growth rate of 3 per cent a year based on average growth over the past decade, that average masks a number of country variations, as we saw above. Second, almost half of Africa's poor –200 million people – live on less than 70 cents a day, and 3 per cent growth will not be enough to take them across the US$1.25 threshold by 2030. Third, even if average incomes are growing at 3 per cent, that is no guarantee the consumption of the poor will rise by an equivalent amount. If income gains are skewed towards the non-poor, it will retard the pace of progress towards the poverty line.

Projections carried out for the Africa Progress Panel by researchers at the Brookings Institution provide a plausible scenario for 2030 if current trends continue. If the average income per capita continues to grow by 3 per cent a year, around 266 million people – almost one-quarter of all Africans – will still be living in extreme poverty in 2030 (Figure 6). This would represent 80 per cent of global extreme poverty. Those left below the US$1.25 line in the projection can be divided into three broad groups defined by their initial distance from the poverty line and the speed with which their economies are travelling:

Within reach, but in slow-growth economies[28]: Around 34.1 million of the 2030 poor will be living within reasonable reach of the US$1.25 poverty line, but in economies that are growing too slowly to take them across it.

Out of reach in high-growth economies[29]: The second group, numbering around 133 million, is living in high-growth economies, but start too far back from the poverty line to stand a good chance of crossing it by 2030.

Out of reach in slow-growth economies:[30] Around 98.8m million people are in a group characterized by the twin burden of deep poverty and limited growth. If either burden was lifted – their distance from the line or their slow growth – they'd still be expected to remain in poverty.

This baseline scenario is one of an infinite number of possible outcomes. Africa's prospects for poverty reduction will be determined by the policies adopted by governments, not past trends.

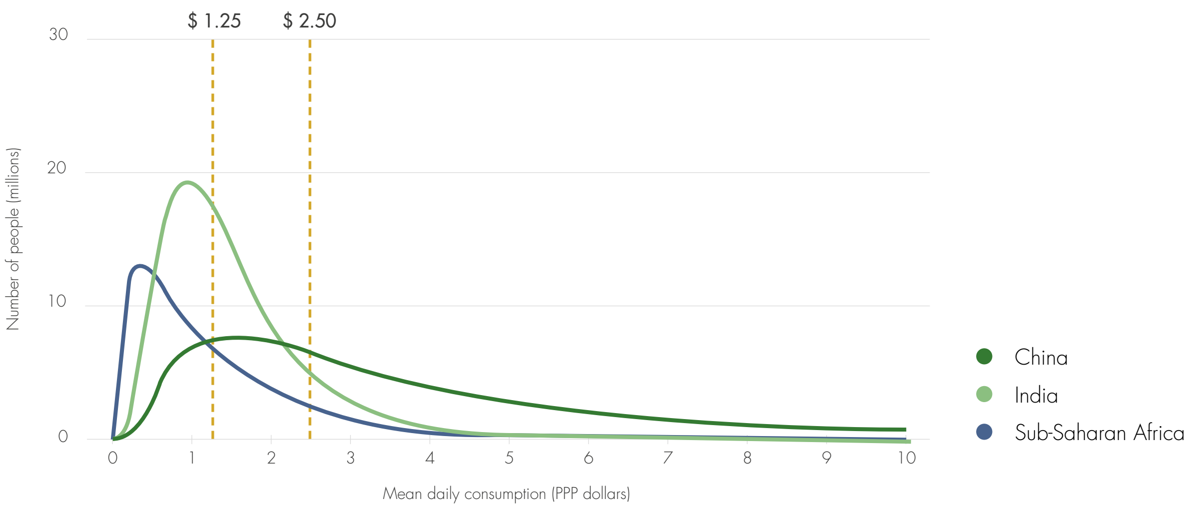
To illustrate what is possible, the researchers considered two alternative scenarios[31]. The first projects higher growth and reduced inequality: average per capita income growth increases by 2 percentage points a year and the share of consumption allocated to the poorest 40 per cent rises by 0.25 per cent of GDP a year. The second scenario projects lower growth with rising inequality: average income growth falls by 2 percentage points and the 0.25 per cent reallocation of GDP happens in favour of the richest 10 per cent.

These scenarios point to profoundly different futures for Africa's poor and for global efforts to eradicate extreme poverty. The more favourable scenario does not eradicate poverty but it more than halves it against the baseline scenario, lifting another 163 million out of poverty. Conversely, the slower growth, rising inequality scenario leaves more than one-third of Africans below the poverty line. The gap between these two scenarios is equivalent to 383 million people. Behind these statistics, important social and economic issues are at stake. More robust growth and fairer distribution would not only address the profound humanitarian challenge of eradicating poverty. It would also create a virtuous circle, with reduced poverty enabling people to realise their potential and contribute to more dynamic, and more inclusive, growth. It is sometimes forgotten that poverty, apart from its human consequences, holds back the development of markets, investment opportunities and human capital needed to drive shared prosperity. An obvious conclusion to be drawn is that governments concerned to promote growth should be concerned with equity and patterns of distribution.

Could Africa "get to zero" by growth alone? Not on any immediately plausible scenario. Using the baseline Brookings projection with unchanged distribution, per capita income would have to grow at a supercharged rate of around 7.5 per cent a year to reach 3 per cent poverty levels by 2030. Were the distribution to steadily worsen as described in the previous scenario, the growth requirement would increase to 11 per cent per capita annually – well above what China has achieved.

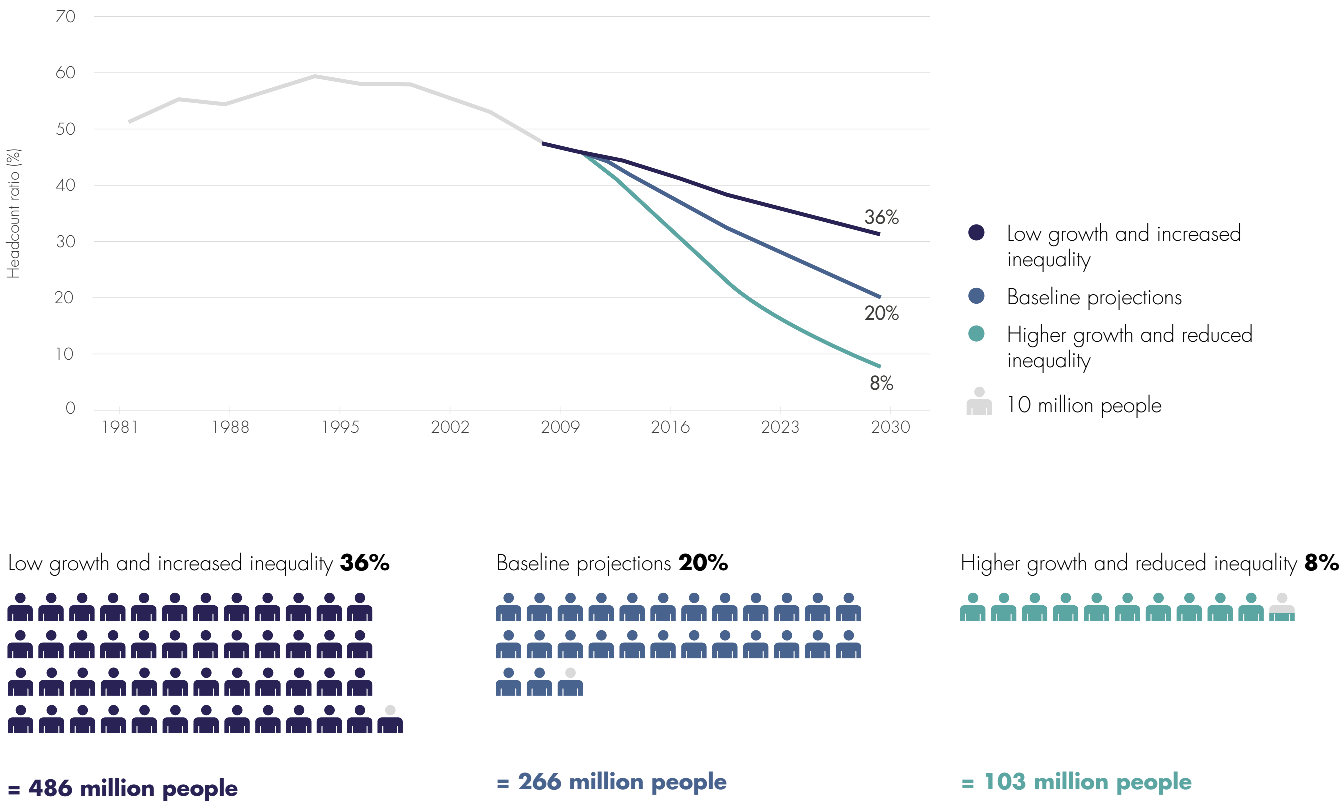
[v] The scenarios are based on the expected growth in private consumption in each economy, not the expected growth of each economy (GDP).

FIGURE 5 MOST OF AFRICA'S POOR ARE A LONG WAY FROM THE US$1.25 THRESHOLD: DENSITY FUNCTIONS FOR SUB-SAHARAN AFRICA, INDIA, CHINA, 2010



Source: Brookings Institution and Africa Progress Panel research.

FIGURE 6 PROSPECTS FOR POVERTY REDUCTION: THREE GROWTH AND DISTRIBUTION SCENARIOS TO 2030



Source: Brookings Institution and Africa Progress Panel research.

Why current growth patterns are not reducing poverty

Faster growth alone will not enable Africa to change the poverty picture. On average, 1 percentage point of growth in Africa reduces poverty by 0.69 per cent, or around one-third of the global average.[32] Put differently, Africa has to grow three times as fast to achieve the same poverty reduction impact. Changing this ratio is critical if Africa is to have any prospect of eradicating poverty by 2030.

This section focuses on the three factors that prevent growth from reducing poverty. The first is the profound depth of poverty: in Africa, it takes more growth to lift the average poor person above the poverty threshold. Second, high levels of initial inequality weaken the power of growth to reduce poverty. Third, much of Africa's growth has been concentrated in sectors such as mining and petroleum – that have little effect on the rural areas where the majority of Africa's poor are living: it is inclusive growth in agriculture that holds the key to changing their prospects.

The final section of Part I demonstrates the power of social protection to help reduce poverty. Well-designed safety net programmes and wider social welfare interventions have numerous benefits. They can help vulnerable households cope with shocks, support health and education, and contribute directly to growth. Using economic growth and natural resource revenues to finance social protection investments could yield very high social and economic returns. Yet few governments in Africa have seized the opportunity they offer.

1. The depth of African poverty

Any consideration of poverty trends in Africa has to start with a major caveat. The coverage and quality of the data available is inadequate. It provides at best a blurred and speculative picture of underlying trends, depriving policymakers of the information they need to design anti-poverty policies. No region other than the Middle East where poverty is less acute and widespread, suffers from such a large data deficit. Many factors account for the data deficit including limited technical capacity, underfunding, and poor coordination and data management. While there is much talk about the role of new technology in supporting "data revolutions," the Africa Progress Panel would urge governments and donors to prioritize the more mundane challenge of delivering on the basics (Box 3).

BOX 3 CLOSING THE GAPS IN POVERTY DATA

The World Bank's former chief economist for Africa has dubbed the state of the region's poverty data as "Africa's statistical tragedy."[33] That tragedy starts with household surveys and extends to national income accounts and population censuses.

The workhorse of poverty measurement is the household survey. Of the 49 countries in Sub-Saharan Africa, 43 report data from an income or consumption survey. However, only 28 of these countries have survey results from the past eight years – and only 14 have a post-2008 survey listed on the The World Bank Group's Povcalnet site. Many of the surveys available suffer from design and implementation flaws that diminish their value.

The data gap matters. Current estimates suggest that 413 million people in Sub-Saharan Africa live on less than US$1.25 a day. Yet fully one-quarter of that estimate is derived by extrapolation from surveys dating from 2005 or earlier.[34]

While many of the issues may appear technical, there is an urgent need for governments, donors and civil society to address Africa's data gaps. Considerable effort has been directed to framing the post-2015 development goals. Yet in the absence of data systems through which progress can be monitored, the meaning of these goals is difficult to establish. This is an area in which the African Development Bank (AfDB), United Nations Economic Commission for Africa (UNECA) and others should seek to build a joint agenda.

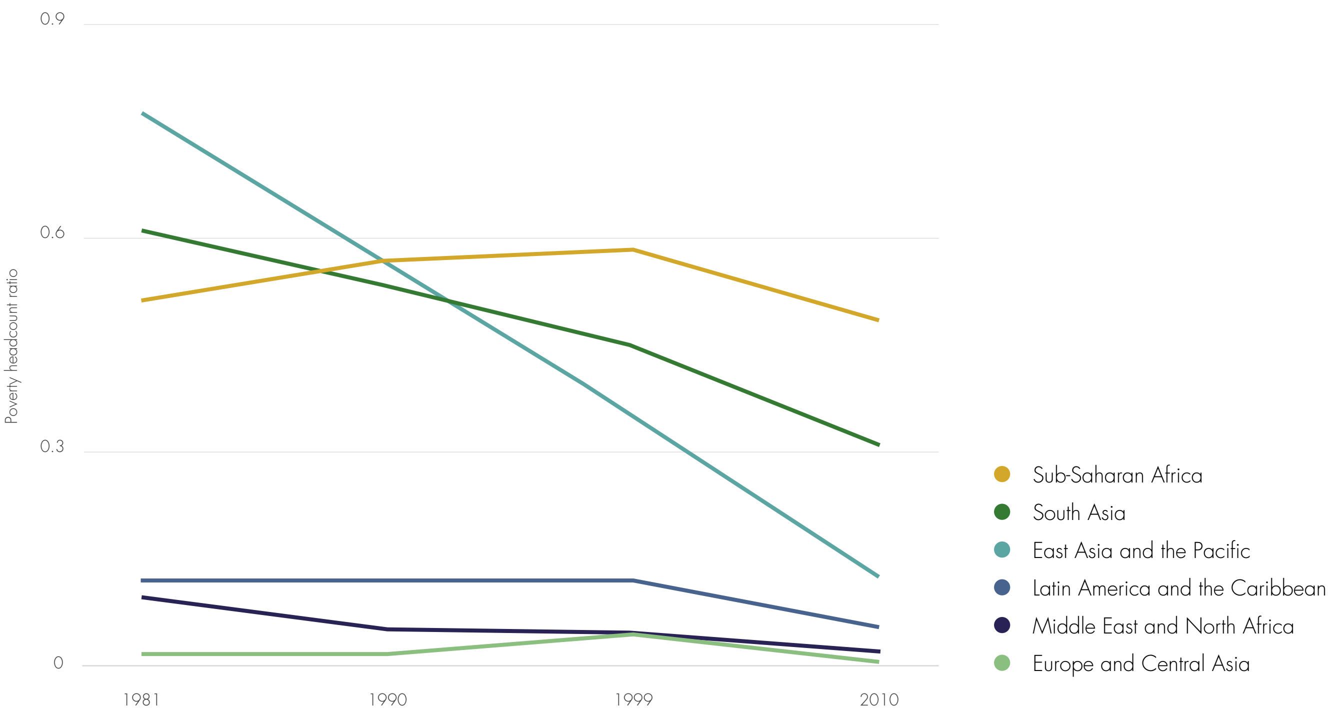
African leaders and policymakers are well aware of the difficulties involved in scaling up data collection and dissemination. The Partnership in Statistics for Development in the 21st Century (PARIS21) in 2012 helped several African countries[35] to design or implement a national strategy for the development of statistics.[36] Notable regional initiatives are also under way. These include the AfDB's Africa Information Highway, which aims to serve as the continent's first "one-stop centre" for development data. Under this initiative, data systems with common IT platforms have been installed in all 54 African countries and in 16 African regional and sub-regional organizations.[37]

Despite the data problems, it is clear that Africa remains the front line in the global war on extreme poverty. The percentage of Africans living in extreme poverty has declined by 10 points since 1999, but the absolute number of poor has increased with population growth. Almost half of Sub-Saharan Africa's people – 413 million – live below the US$1.25 threshold for extreme poverty.

When it comes to poverty, Africa is falling further behind other regions (Figure 7). Poverty levels have been falling far more rapidly in East Asia and South Asia, with the consequence that Africa's share of the world's poor has increased from one-fifth to one-third over the past decade. On current trends, Africa will account for 80 per cent of the world's extreme poor by 2030. Moreover, many Africans live precariously above the international poverty threshold. Around 250 million people live on US$1.25 to US$2.50 – and for most, just one episode of sickness or one drought could send them back to extreme poverty.

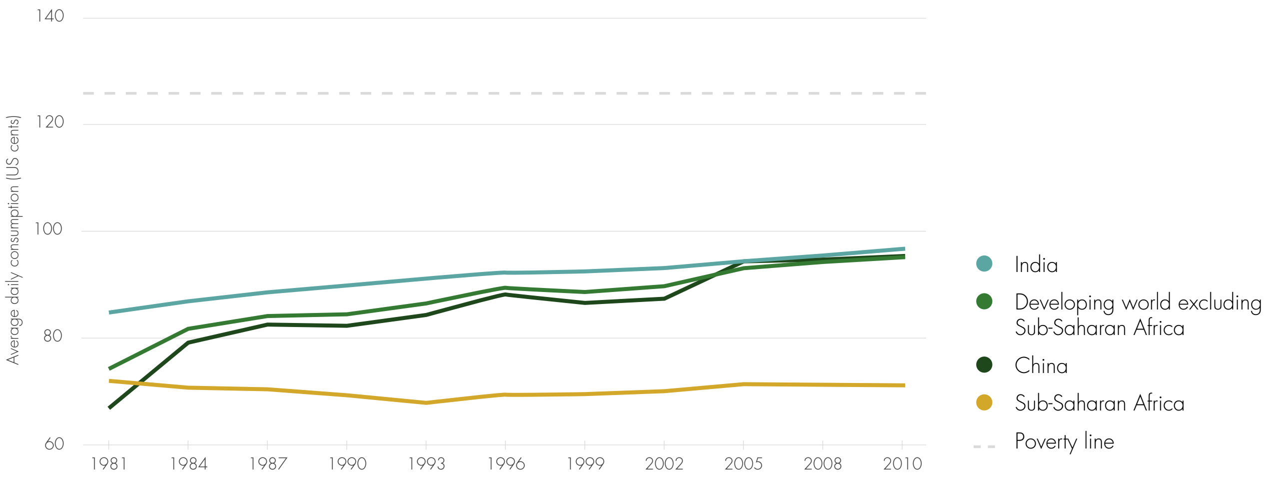
Poor people in Africa also live further from the poverty line than their counterparts in other regions – and the gap is widening (Figure 8). Average consumption for those living below the poverty line is just 70 cents a day, far below the level in other regions. At this level, daily life is a struggle for survival.

FIGURE 7 AFRICA'S POVERTY IS NOW FALLING – BUT MORE SLOWLY THAN IN OTHER REGIONS, %



Source: The World Bank Group (2014), PovcalNet

FIGURE 8 AFRICA'S POOR ARE VERY POOR – AND THEY ARE GETTING LEFT BEHIND: MEAN DAILY CONSUMPTION (US CENTS) BELOW THE POVERTY LINE, SELECTED COUNTRIES AND REGIONS, 1981-2010



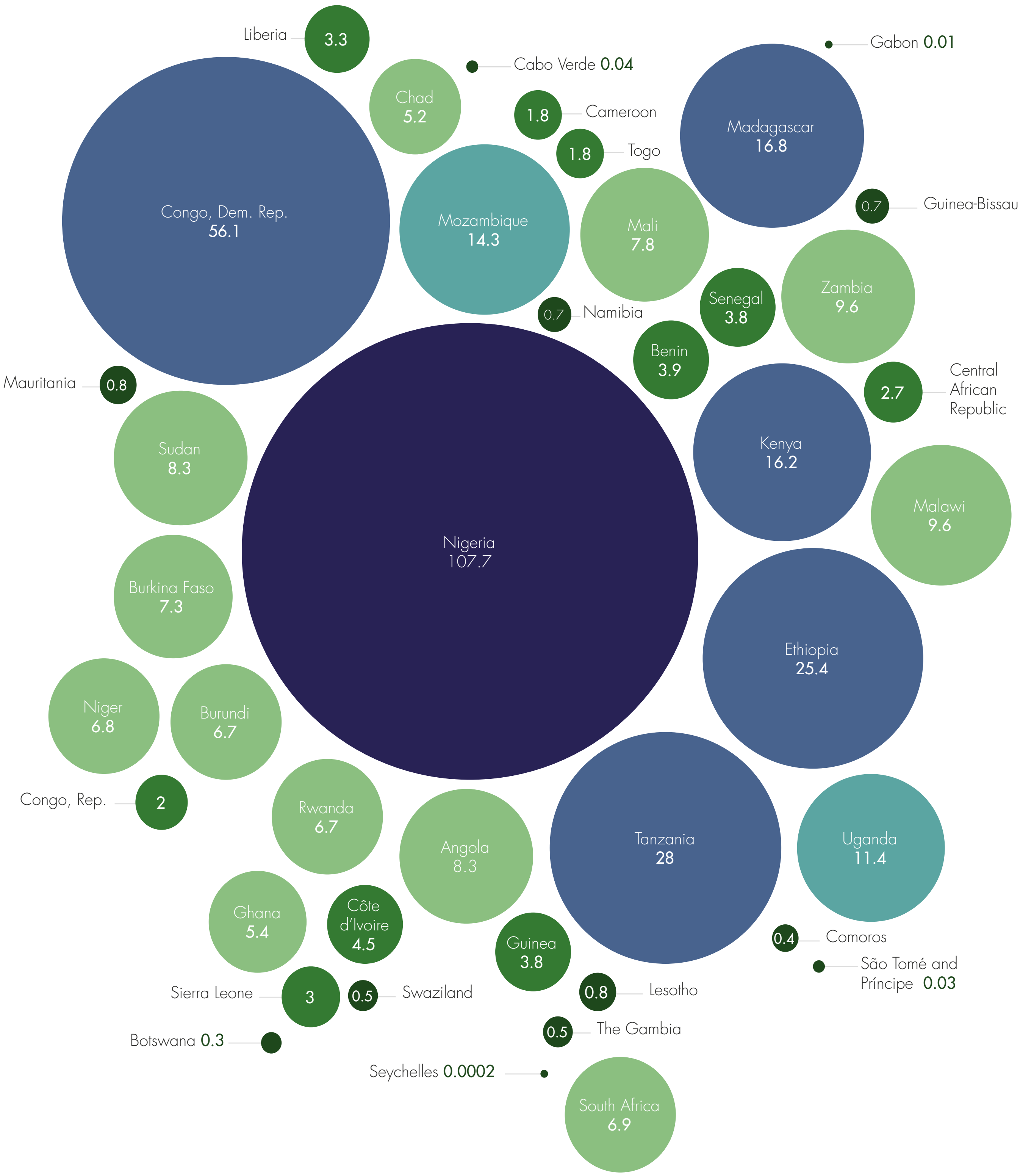
Source: Brookings Institution and Africa Progress Panel research

Consumption poverty, the primary focus of this section of the report, is just one dimension of human development. Africa also accounts for a growing share of global extreme deprivation in other areas, including education, child survival and nutrition. While consumption poverty intersects with wider disadvantages, other factors – gender, location and ethnicity – all come into play. Analysis of multidimensional poverty in Africa has identified the rural–urban divide as one of the biggest social fault lines, with rural women and girls typically facing the most acute disadvantages.[38]

Looking beyond the regional poverty snapshot, there are marked variations across countries (Figure 9). Around half of Africa's poor live in just four countries – the Democratic Republic of the Congo, Ethiopia, Nigeria and Tanzania – so the continent's overall progress in reducing poverty will depend on progress in these countries. The "African poverty rate" also disguises vastly different poverty rates and consumption levels among the poor (Figures 10 and 11). The share of the population living in poverty is over 60 per cent in 11 countries, including countries with high growth such as Mozambique, Tanzania and Zambia.

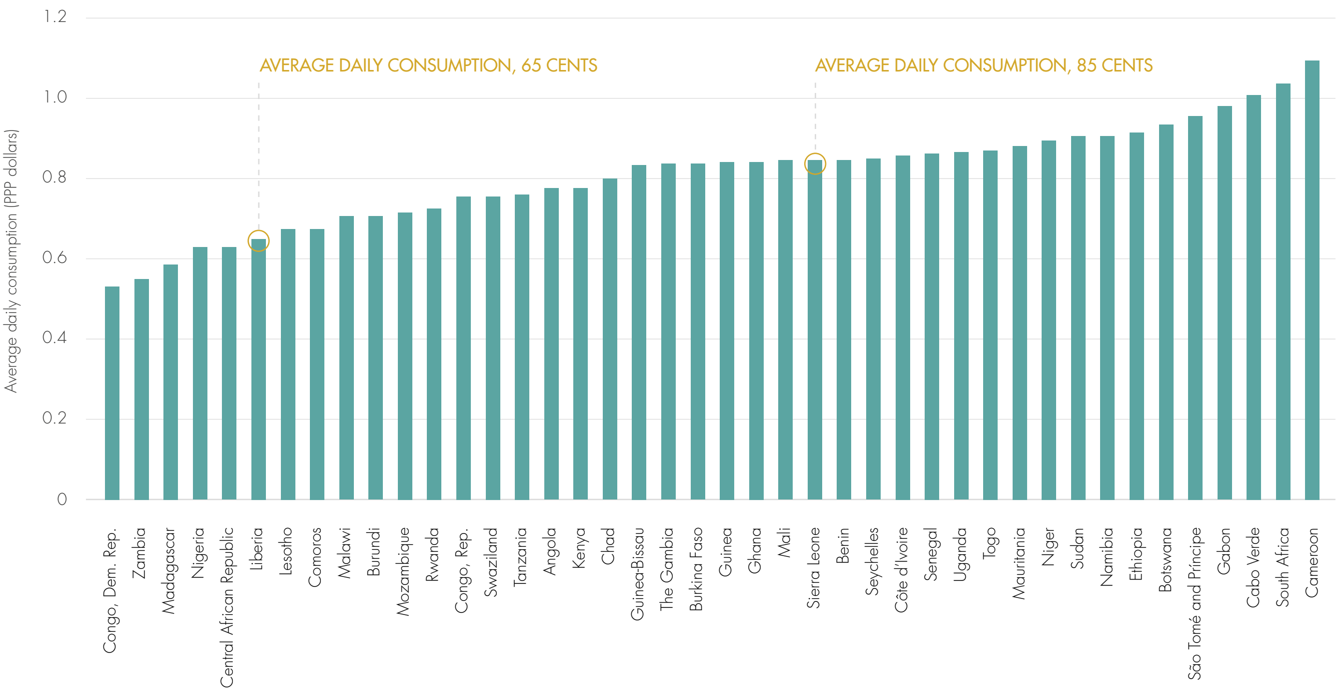
The reported depth of poverty also varies. Average per capita income for a country is a weak guide to the severity of poverty. While Ghana's average income is considerably higher than that of Mali, the average poor person in Ghana has a level of consumption similar to that of the average poor person in Mali. The average poor Angolan consumes less than the average poor person in Ethiopia, even though Angola is a middle-income country. While data uncertainties demand that such comparisons be treated with caution, they show that income inequality shapes the incidence and depth of poverty.

FIGURE 9 MAPPING POVERTY ACROSS AFRICA: ESTIMATED NUMBER OF POOR BY COUNTRY, MILLION, 2010



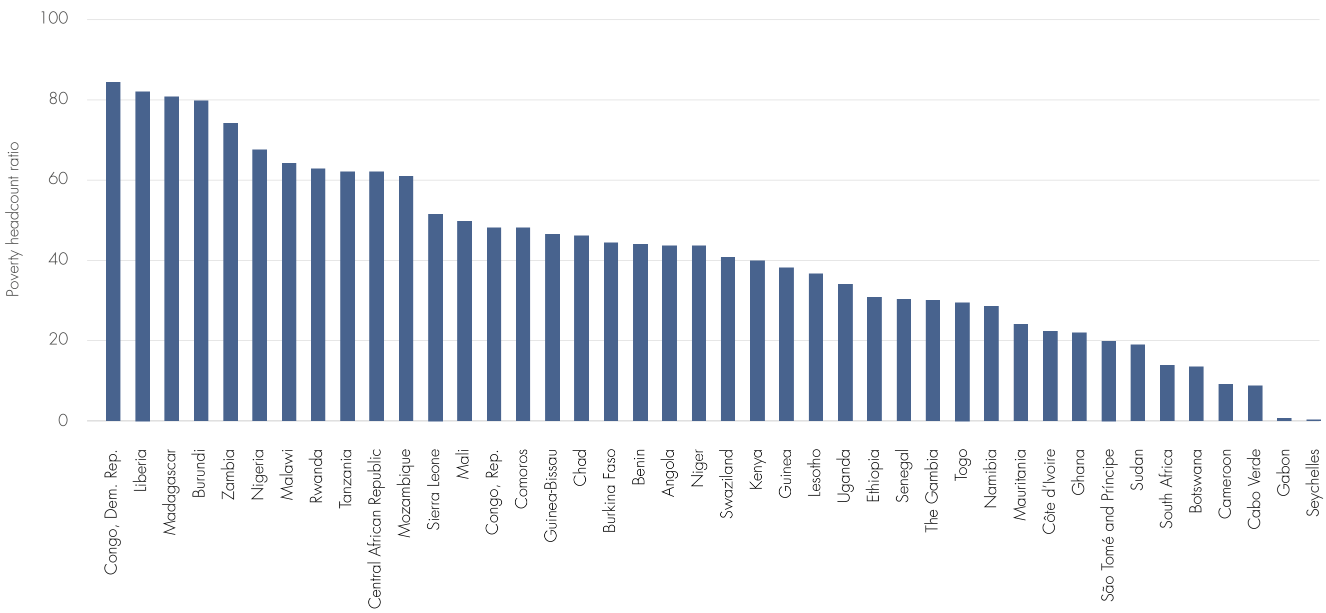
Source: Brookings Institution and Africa Progress Panel research.

FIGURE 10 AVERAGE DAILY CONSUMPTION OF THE POOR VARIES: MEAN DAILY CONSUMPTION OF THE POOR, PPP DOLLARS, 2010



Source: Brookings Institution and Africa Progress Panel research.

FIGURE 11 POVERTY VARIES ACROSS COUNTRIES: ESTIMATED POVERTY RATES, %, 2010



Source: Brookings Institution and Africa Progress Panel research.

2. Inequality remains high

Inequality in Africa is very high by international standards. The Gini coefficient, a widely used measure of inequality that ranges from 0 (perfect equality) to 1 (perfect inequality), is 0.45 in Africa – second only to Latin America.[39] The combination of high initial inequality and the average distance of a poor person from the poverty line, explains why Africa's growth has reduced poverty at relatively modest rates.[40]

For Africa, the policy objective should be on growth with redistribution; in other words, making sure the poor receive a higher share of any increment to growth than their current share. This challenge turns the spotlight squarely on the composition of growth and the imperative to increase agricultural productivity.

There is another dimension to the growth–poverty–inequality triangle that has been neglected in Africa. High initial inequality not only lowers the rate at which growth reduces poverty, but may also dampen growth. The argument that more equitable distribution harms growth appears to be the wrong way round: inequality can act as a brake on growth. Recent research from our *Africa Progress Report 2013* and from the International Monetary Fund using cross-country data finds that where inequality is lower, growth tends to be faster and more durable. Thus the combined direct and indirect effects of redistribution – including the growth effects of the resulting lower inequality – are on average pro-growth, as well as pro-poor.[41] There is a limit to what can be achieved through redistribution when aggregate incomes are so low.[42] For Africa, the policy objective should be on growth with redistribution; in other words, making sure the poor receive a higher share of any increment to growth than their current share. This challenge turns the spotlight squarely on the composition of growth and the imperative to increase agricultural productivity.

Is inequality in Africa rising? Inequality appears to be rising and falling in a roughly equivalent number of countries. Perceptions tell a different story. In seven of the eight African nations surveyed in 2013 by Pew, at least 70 per cent of people described inequality as a "very big" problem – more than in any other region. What does appear clear is that, in many countries, inequitable growth patterns are lowering the rate at which growth reduces poverty.

The comparison between Malawi and Mali is instructive. Both countries have reduced poverty over the past decade. In Malawi's case, this coincided with widening income inequality. The opposite happened in Mali, where consumption increased more rapidly among the poor than the non-poor. Had Malawi achieved the same level of growth without rising inequality, poverty would have fallen more – by 14 percentage points instead of 12 percentage points. In the case of Mali, more equitable growth boosted the decline in poverty by 6 to 11 percentage points.

The counter-examples of countries where growth has succeeded in reducing poverty are revealing. One is Ethiopia, which halved the national poverty rate between 1995 and 2011, from 60 per cent to 30 per cent. That reduction was achieved through broad-based economic growth, with agriculture making a major contribution, increased and more equitable public spending, and the development of labour-intensive manufacturing.

Another example is Rwanda.[43] In the first half of the decade after 2000, the country's strong growth – per capita incomes rose by 2 per cent annually – was not matched by poverty reduction.[44] Rising inequality weakened the power of growth to reduce poverty. If inequality had remained constant, poverty would have fallen by more than 5 percentage points instead of the 2 percentage points recorded. In the subsequent five years (2006–2011), household consumption in Rwanda grew at 3 per cent per annum, but the incidence of poverty fell by 12 percentage points. Growth in household consumption accounted for 8.5 percentage points of the reduction, with a decrease in inequality adding another 3.5 percentage points.

The success of both Ethiopia and Rwanda can be traced in no small measure to the role of agriculture, whose impact on poverty we explore in the next section. Poverty reduction and redistribution in Rwanda were fuelled by a spectacular increase in yields of cereals (by 73 per cent) and roots and tubers (52 per cent) from 2006–2011.[45]

3. Agriculture's power has been neglected

Agriculture is the mainstay of most African economies. The vast majority of the region's poor lives and works in rural areas, most of them as smallholder farmers. Unlocking the productive potential of agriculture would enable Africa's farmers to strengthen their contribution to growth and to share more equitably in the benefits. Many Asian countries with a strong track record in reducing poverty have started out by raising agricultural productivity – Bangladesh, Vietnam, Thailand and Malaysia are examples. As the experiences of Ethiopia and Rwanda noted above demonstrate, Africa has the potential to follow these examples, but the potential has yet to be realized.

If the central aim of growth is to improve lives and eradicate poverty, then agricultural growth is a highly efficient vehicle. The International Food Policy Research Institute has found that on average, agricultural growth reduces poverty roughly twice as much as growth in other sectors. The relationship is not automatic. Zambia recorded a dramatic increase in maize yields over 2006–2011, yet poverty stagnated. Underlying inequalities and government policy explain the discrepancy. Productivity gains in Zambia were concentrated on large commercial farms, largely as a result of large-scale fertilizer subsidies. Farms less than 1 hectare in size received on average 7 per cent of the maize subsidy allocated to farms of 10 to 20 hectares.[46]

As Zambia illustrates, some kinds of agricultural growth are more effective than others at reducing poverty. Productivity gains in staple food production, as in Rwanda, may hold the key. While export crops typically have higher value, staple crop production is more effective at spreading growth across the economy and reducing poverty – because staple crops have a larger role in national economies and a central role in the livelihoods of the poor. Regionally produced food staples have a very large potential to replace imported food, which points to a promising avenue for growth that reduces poverty – an issue that we return to in Part II.

Safety net programmes have a key role to play

Alongside a strengthened focus on agriculture, social protection programmes could play a decisive role in ensuring that growth reduces poverty. These programmes include cash transfers, public works programmes and a range of "safety nets" for the poor and vulnerable.[47]

In Latin America, social protection has been a key element in wider strategies aimed at overturning the region's legacy of unequal growth. Over the past decade, Brazil has combined strong economic growth with a reduction in chronic poverty and an increase in equality. The Bolsa Familia programme, which provides around 0.4 per cent of GDP through a conditional cash transfer, was responsible for around one-fifth of the reduction in inequality and a similar share of the decline in severe poverty.[48] Africa cannot duplicate this story for many reasons: average incomes are far lower, the scope for fiscal redistribution is more limited, and most countries lack the institutional capacity to design and deliver effective systems – at least ones as sophisticated as Bolsa Familia. Even so, there are lessons to be learned – and structural weaknesses to be addressed.

Sub-Saharan Africa has developed a diverse range of safety net interventions. One review in 2012 identified 123 cash transfer programmes.[49] Another has identified over 500 public works programmes – a figure that could be multiplied several times over were it to include in-kind transfers.[50]

Within this portfolio, there are several large programmes.[51] Ethiopia's Productive Safety Net Programme (PSNP) reaches 8 million beneficiaries in about 1.5 million households, providing cash and food support through public works in areas affected by drought. Ghana and Rwanda have subsidized health insurance for poor households. Kenya, Mozambique and Tanzania provide support to vulnerable groups such as orphans, widows and the elderly. Senegal operates two conditional cash transfer programmes – for orphans and the elderly – and Nigeria operates one for girls' education. Many countries have programmes that provide emergency food distribution during episodes of food insecurity. Benin, Burkina Faso, Mali and Niger have done this through cereal banks that sell food staples at subsidized prices. Kenya has developed an extensive set of hunger safety net programmes targeting arid and semi-arid areas.

Despite their breadth and scope, social protection programmes in Africa suffer from several systemic weaknesses. Chronic underfinancing is one of them. On average, governments spend 2 per cent of GDP on social protection – less than half the world average. Moreover, this average includes the very high levels reported by some countries, notably South Africa. Most countries are spending under 1 per cent of GDP.

Low spending is reflected in limited coverage. The region with the world's greatest need for social protection has by far the lowest coverage. According to The World Bank Group, only around 20 per cent of Africans benefit from some form of social protection. Moreover, the coverage available is typically limited in both level and duration. In Nigeria, a country with a poverty rate of 54 per cent and sustained economic growth, the main national anti-poverty cash transfer programme, In Care of the People (COPE), reaches around 22,000 households, covering less than 0.05 per cent of poor households nationally.[52]

Fragmentation is another concern. Africa's social protection systems have developed on a largely ad hoc basis in response to specific emergencies and the needs of identified groups or regions. Many initiatives are small, donor-funded pilots or projects operating in isolation. What has emerged is a patchwork quilt of overlapping arrangements characterized by weak coordination, inconsistent targeting arrangements and poor governance. This helps to explain why some attempts to rapidly expand social protection have had unintended consequences. During 2007–2008, Senegal introduced several measures aimed at reducing prices for food and oil, including reductions in value-added tax, tax exemptions and general consumer subsidies. The fiscal cost amounted to about 4.5 per cent of GDP – but because of poor targeting, over half of the benefits went to households in the top 40 per cent.[53]

Reforms are strengthening social protection systems

There are encouraging signs of policy reform in social protection. In 2008, members of the African Union endorsed the Social Policy Framework for Africa, which encourages member states to extend coverage and provide a minimum package of services to serve as a platform for broadening social protection as fiscal space is created.

Several countries have adopted legislation that provides a framework for comprehensive social safety net programmes, and at least one third of African countries have developed a social protection strategy.[54] Mozambique's 2011 National Strategy for Basic Social Security envisages the creation of a social protection floor for extremely poor households. In Kenya, the social protection policy advocates the establishment of a universal registry of all beneficiaries, eliminating duplication in information systems.

In 2009, Tanzania's government introduced on a pilot basis a conditional cash transfer programme – the Tanzania Social Action Fund – broadly modelled on Ethiopia's PSNP. The programme delivered cash grants averaging US$2.50 a week to 20,000 vulnerable rural households, enabling them to buy more and better food and to pay education costs for their children. With The World Bank Group support, the government is preparing to introduce the programme on a national scale.

The pace of change should not be overstated. While many governments are moving in a positive direction, there is a large gap between stated ambition and financing provision. Kenya and Tanzania still spend less than 0.3 per cent of GDP on social safety nets. This is not enough to make a real difference to poverty.

Social protection boosts inclusive growth

It is no coincidence that two of the countries with the most successful records on reducing poverty – Ethiopia and Rwanda – have developed highly effective social protection systems. Rwanda's government has identified its Umurenge programme of public works and cash transfers as a primary factor behind the country's poverty reduction achievements.[55]

There is growing evidence that social protection leads to inclusive growth. Four mechanisms stand out, each important for what we see as the primary engine of growth that reduces poverty: smallholder agriculture:

Unlocking investment through insurance: Farmers in Africa have high levels of uninsured risk. Lacking the safety net of insurance, farmers may shun investments in new technologies, seeds and markets, which can have higher returns but are also riskier. Providing social safety nets mitigates risk and enables farmers to undertake investments that could raise productivity.[56] In Ethiopia, farmers receiving support from a housing asset programme and the PSNP were found to register significant increases in yields of maize.[57]

Protecting and building productive assets: Emergencies such as drought, floods or delayed rainfall can force poor households into coping strategies that reinforce long-term poverty. Selling off assets, for example, can trap households in a cycle of low productivity. Well-designed social protection programmes can prevent such distress sales. For example, households covered by Ethiopia's PSNP were less likely to have to sell their livestock during droughts.[58] Social protection transfers can also enable households to build the productive assets they need to raise productivity. But poorly targeted programmes can skew subsidies towards large-scale producers.

Protecting and building human capital: It is not only productive assets that get sold during crises. Vulnerable households are often forced to cut spending on nutrition and health, or to take children out of school. These distress strategies transmit poverty across generations, hurting households, diminishing prospects for poverty reduction and slowing economic growth. Well-designed social protection programmes can empower households to avoid these choices. In Latin America, conditional cash transfer programmes have made support contingent on parents ensuring that their children are in school, and presenting them for health and nutrition checks. Unconditional cash transfers can produce similar outcomes. In Malawi, girls who received cash transfers were less likely to drop out of school.

Generating spillover effects: Social protection programmes can generate large multiplier effects. Every US$1 transferred through a safety net intervention can stimulate local markets, boost aggregate demand and, in the case of public works programmes that build infrastructure, support the development of a more resilient and productive local economy.

African governments have themselves articulated the broad principles required to guide the design of integrated social protection systems. None of these principles are easy to translate into policy design. Around the world, social protection systems struggle with targeting, delivery mechanisms and financing. Yet none of these difficulties justifies the continued neglect of social protection. The same is true for arguments over affordability. Higher levels of growth and natural resource windfalls are transforming public finance across Africa. More efficient and equitable taxation could generate large revenues for investment in social protection. The real challenges are political, not financial. The World Bank Group estimates that large-scale social protection programmes could be financed in Africa at a cost of 1 per cent to 2 per cent of GDP.[59] To put this in context, African governments are currently spending on average 2.8 per cent of GDP on energy subsidies that principally benefit the non-poor.

Admittedly, taking public subsidies away from the politically powerful is more than a technical operation. It takes coalition building and carefully formulated strategies for transition. Yet if Africa is to reap the benefits of social protection and set a course for eradicating poverty by 2030, political leaders must make such tough choices.

As we have shown in this section of the report, "business as usual" will leave one in five Africans living in poverty by 2030. That outcome is avoidable. Agricultural growth is critical because of its greater power to reduce poverty – and safety net programmes have a crucial supporting role to play. The next section examines the enormous potential for a uniquely African green and blue revolutions: a green revolution that could underpin inclusive growth in agriculture, with smallholders playing a central role and a blue revolution to reap the benefits of Africa's oceans, rivers and lakes. Social protection programmes could magnify the poverty-reducing effects of agricultural growth, enabling poor rural producers to withstand shocks and work their way out of poverty.

02

AFRICA'S GREEN AND BLUE REVOLUTIONS

The single most pressing challenge facing Africa's governments is to harness the continent's increasing wealth and use it to improve people's lives. Agriculture is at the heart of that challenge. If Africa is to achieve the transformative economic growth that it needs to reduce poverty, there is no alternative to the development of a vibrant and prosperous agricultural sector.

The single most pressing challenge facing Africa's governments is to harness the continent's increasing wealth and use it to improve people's lives. Agriculture is at the heart of that challenge.

Africa's farmers are the region's most important and most neglected resource. Africa has emerged as a global force in petroleum and mining, foreign investment has surged, equity markets have taken off and financial services are booming. But most Africans, and the vast majority of Africa's poor, continue to live and work in rural areas, principally as smallholder farmers. In the absence of a flourishing agriculture sector, the majority of Africans will be cut adrift from the rising tide of prosperity – and national economies will be deprived of an engine for dynamic and inclusive growth.

The case for a renewed focus on agriculture – and smallholder agriculture in particular – is overwhelming. A region where far too many people already go hungry, Africa cannot increase food production at the speed and scale required without harnessing the productive potential of smallholder agriculture. The majority of these farmers are women, most of them working on plots of two hectares or less.[1] This is not a matter, as is sometimes mistakenly assumed, of strengthening "subsistence farming," but of creating opportunities for smallholder farmers to generate a surplus, add more and more value to their produce, and develop as entrepreneurs. Nor is it a matter of favouring either commercial farms or smallholders. Large-scale commercial agriculture has a key part to play – and it can support the development of smallholder farming.

In their policy statements, governments across Africa increasingly recognize the vital role of agriculture. Collectively, they have pledged to increase to 10 per cent the share of national budgets invested in agriculture, to invest in developing new seeds and technologies, and to create an enabling market environment. Yet old habits die hard. The "10 per cent" club is still very small. Smallholder farmers remain neglected. And governments have failed to remove the barriers to regional trade that curtail smallholder markets. As a result, the continent's abundant agricultural land has yet to be harnessed for a vital structural transformation that would boost employment, income and livelihoods.

The Africa Progress Panel is convinced that too few governments recognize the extraordinary waste of productive potential that current policies allow. It is time for these governments to ask some tough questions. Why does a region that is home to 15 per cent of the world's population account for one-third of those affected by hunger? Why is a region that could feed itself increasingly dependent on food imports? And why do Africa's farmers account for such a minuscule share of an import market in food (excluding fish) valued at US$35 billion? Perhaps most critically of all, why are so many of Africa's farmers living in poverty and food insecurity, given their capacity for resilience, entrepreneurialism and innovation?

Climate change has given these questions added urgency. Africa's farmers are acutely vulnerable to climate change – more so than farmers in any other region. Their livelihoods and prospects for a better future are profoundly influenced by, temperatures, and the frequency, duration and severity of drought. In all of these areas, climate change is already adding to the risks that Africa's farmers have to manage. No constituency has contributed less to climate change – and yet none stands to lose more. That is why we need a "climate-smart" agriculture that increases the productivity of land, labour and capital invested in farming, and strengthens the resilience of farmers. National governments must take the lead – but basic principles of social justice, fairness and solidarity demand that the international community play a role.

The daunting challenges facing agriculture in Africa have to be set against the opportunities. Referring to the "Green Revolution" that increased agricultural productivity in Asia from the 1960s onward, Calestous Juma, a Kenyan Harvard professor, has written: "African countries are faced with enormous technological challenges. But they also have access to a much larger pool of scientific and technical knowledge than was available when the Green Revolution was launched."[2] That knowledge can be deployed to develop new seeds and fertilizers, to inform soil conservation practices, and to guide approaches to water management. Of course, the science has to be applied in the light of the real conditions in African agriculture. That is why the Africa Progress Panel has called for a uniquely African "Green Revolution." At the same time, governments have to create an enabling environment for the science to deliver. That means investing in the infrastructure, developing the markets, and creating the regional trade opportunities needed to increase the social and economic returns to investment in agriculture.

This part of the report is divided into three sections. The first explains why a dynamic agricultural sector must be at the core of any strategy for inclusive growth. Section 2 explores some of the underlying conditions for inclusive growth in African agriculture, focusing on strengthening smallholder participation in agricultural value chains – especially those for staple foods. Section 3 turns to the critical challenges posed by climate risk. It argues that uninsured risk represents a barrier to increased production and enhanced food and nutrition security.

1. Escaping from the 'agriculture paradox'

Nigeria's agriculture minister, Akinwumi Adesina, has described Sub-Saharan Africa's growth record over the past decade as "a disturbing paradox." To cite his words: "Africa is a continent with enormous potential for agricultural growth, yet one where food insecurity and malnutrition are widespread and persistent."[3] That observation provides a succinct and compelling description of the challenge facing governments across Africa.

Referring to the "Green Revolution" in Asia, Calestous Juma, a Kenyan Harvard professor, has written, "African countries are faced with enormous technological challenges. But they also have access to a much larger pool of scientific and technical knowledge than was available when the Green Revolution was launched."

Raising productivity is crucial

Sub-Saharan Africa remains an overwhelmingly agricultural region – and this picture will change only slowly. On average, agriculture is estimated to generate around 30 per cent of GDP across low-income African countries. That share is shrinking, especially in resource-rich economies. But extractive industries generate fewer jobs, so agriculture's share of the workforce is changing less rapidly. According to the FAO, agriculture still accounts for 58 per cent of Africa's economically active population.[4] In countries such as Burkina Faso, Guinea, Mozambique, Niger and Rwanda, the share rises to over 80 per cent.

Agriculture will remain central to livelihoods even though many Africans are moving to cities. One labour market projection estimates that one third of the new jobs that are needed to provide a livelihood for the region's youth will have to be created in agriculture.[5] Moreover, more than 70 per cent of the continent's poor live in rural areas – and agriculture is their most important economic activity.[6]

Economic growth in African agriculture has been lagging behind industry and services, however, increasing at just over half the rate of overall growth. This partly explains why poverty has not fallen as fast as it could have over the past decade. When farmers and agricultural labourers earn more, they tend to spend the extra income in the local economy. But per capita agricultural incomes rose by less than 1 per cent a year during 2000–09,[7] so local economies have not benefited from the strong "multiplier effects" of agricultural growth.[8]

Unlocking these effects will require higher levels of productivity. Increased productivity is vital not just for raising incomes and generating investment in agriculture, but also for strengthening food security, feeding a growing urban population and limiting food price inflation. International comparisons point to the potential for significant productivity gains: Between 2000 and 2010, average grain yields remained at around one third to one half of the world's average (1.1 to 1.5 metric tonnes per hectare versus 3.2 tonnes per hectare). Sub-Saharan Africa could double or even treble its productivity for some of the more basic food staples, if more farmers could access available knowledge and technologies.[9]

Protracted neglect has contributed to this state of affairs. For much of the post-independence period, African governments and development experts saw industry as the primary source of growth. Bucking the trend in other developing regions, many continued the colonial practice of taxing their farmers well into the 2000s.[10] Public investment in the sector has been limited and of poor quality. Ineffective state-owned enterprises dominated market channels for inputs and outputs, crowding out private sector investment. Spending on public research, a major source of agricultural growth in other developing regions, has been limited. Poor regulation and underinvestment in infrastructure have increased farmers' costs, reinforcing a vicious circle of low productivity.

Several factors explain the limited productivity gains registered by African agriculture. Little of the region's cultivated land –around 5 per cent– is irrigated. The vast majority of the region's farmers depend on rainfall. Partly because of uncertainties associated with rainfall, Africa makes less use of improved seeds and fertilizers than any other region. Furthermore, soil health is a challenge. The average farmer in Ghana uses only 7.4kg of fertilizer per hectare, while in South Asia fertilizer use averages more than 100kg per hectare. Unsurprisingly, output per hectare in Africa falls far below the levels registered in other parts of the world. When farmers plant the same fields without using fertilizers, they literally mine the soil: an estimated 8 million tonnes of nutrients are depleted annually in Africa.[11]

The cost of fertilizers is part of the problem. Farmers in Africa face some of the world's highest fertilizer prices, and not just in landlocked countries where transport costs are higher, like Burundi and Uganda. Farmers in Nigeria and Senegal pay three times more than their counterparts in Brazil and India. It costs only slightly less to produce fertilizer in Thailand than in Mozambique and Ghana, but transport,

7.4kg

The average farmer in Ghana uses only 7.4kg of fertilizer per hectare, while in South Asia fertilizer use averages more than 100kg per hectare

financial costs and overall margins dramatically increase the relative cost for farmers in Africa. Tendering processes, and in some cases, exclusion of foreign companies from importation, reduces competition and adds opportunities for collusion and corruption.

The legacy of the agricultural policy environment is evident in global and domestic markets. Africa's farmers have a limited presence in global markets. The region as a whole exports less than Thailand. Today, Africa accounts for just 2 per cent of world agricultural exports – a quarter of the share that it enjoyed a half century ago.

Developments in domestic markets have been even more dramatic. Urbanization has gone hand in hand with a steady increase in imports of cereals and other food staples. These imports have ranged from US$27 billion to US$35 billion in recent years. West Africa now accounts for around one-fifth of world rice imports. Nigeria's food import bill for rice currently exceeds US$2 billion a year. The reason: average annual rice production has stagnated at 28kg per capita since 1990, while per capita consumption has increased from 18kg to 34kg. Rice imports have been growing at 11 per cent a year to fill the gap.[12] (See Infographic, Africa's Food Exchange).

Regional trade plays a marginal role in meeting import demand. In total, intra-African trade accounts for just 5 per cent of cereal imports. Weak infrastructure, trade barriers and underinvestment in domestic agriculture all hamper the growth of regional self-reliance.

International policies have in some cases contributed to Africa's diminishing presence in global markets and increased reliance on imports. During the 1980s and 1990s, both the European Union and the United States heavily subsidized overproduction and exports. The effect was to reduce and destabilize export prices for crops such as sugar and cotton, and to disadvantage African farmers by lowering the price of cereals entering regional markets. Since the mid-1990s there have been major reforms in OECD farm policy, including a reduction in trade-distorting subsidies. Even so, the support provided to OECD agriculture stood at US$258 billion in 2012 – an exceptionally high figure given that world prices have been relatively high.[13]

Food imports may have a strong economic logic in countries with a limited comparative advantage in producing food, and a capacity to maintain imports during periods of high world prices. These conditions do not apply across much of Sub-Saharan Africa. The region has the land, water and agricultural skills needed to be an efficient producer – and to feed an expanding urban population. The Guinea Savannah, a vast area that spreads across 25 countries, has the potential to turn several African nations into global players in bulk commodity production.[14] In addition, countries such as Ghana, Mali, Senegal, Mozambique and Tanzania – to name a few – have large bread-basket areas that could feed regional populations, displace imports and generate exports. Yet this huge potential is not being exploited.

The upshot is that Africa is currently locked into a "triple lose" scenario. Countries are diverting precious foreign exchange – which could be used to import capital equipment and new technologies – to purchase food that could have been economically produced in the region, generating jobs and new investment opportunities. They are breaking the link between rural and urban markets – a vital source of growth in Asia. And they are creating a potentially damaging dependence on volatile food import markets.

US$258 BILLION

Since the mid-1990s there have been major reforms in OECD farm policy, including a reduction in trade-distorting subsidies. Even so, the support provided to OECD agriculture stood at US$258 billion in 2012 – an exceptionally high figure given that world prices have been relatively high

AFRICA'S FOOD EXCHANGE

Before 2000 Sub-Saharan Africa was a net exporter of food.
Now, the region has a food import bill of over

US$35 BILLION

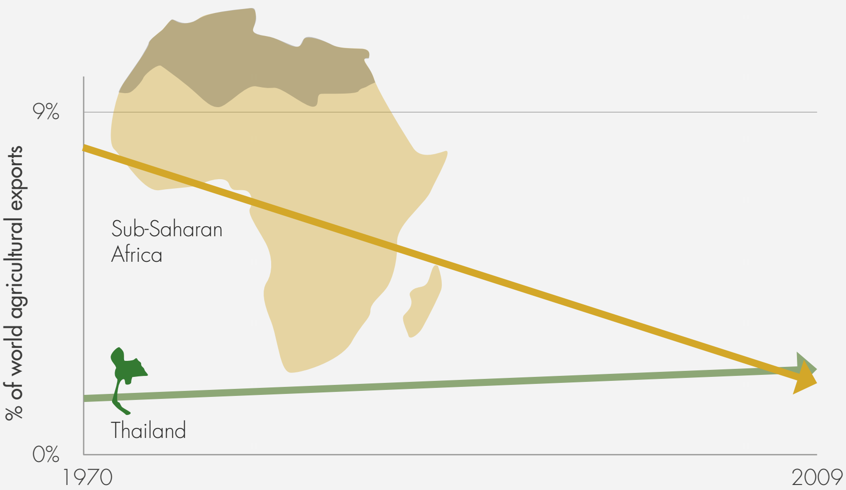
PER YEAR

AND IMPORTS EXCEED EXPORTS BY

30%

Volatile global food markets make Africa even more vulnerable.

WITH 13% OF WORLD POPULATION, SUB-SAHARAN AFRICA ACCOUNTS FOR LESS THAN 2% OF GLOBAL AGRICULTURAL EXPORTS. IT EXPORTS LESS THAN THAILAND



In 2012, support provided to OECD agriculture stood at **US$258 billion** – contributing further to Africa's diminishing presence in global markets.

REVERSING THE TREND

Africa's productivity levels could easily double within

5 years

ONLY 3.5 MILLION HECTARES OF THE

240 million

hectares suitable for wetland rice cultivation have been exploited

Nigeria spends **US$11 billion** on importing wheat, rice, sugar and fish

BUT > THE COUNTRY RECENTLY CUT ITS IMPORT BILL BY OVER

US$5 billion

Sources:
Adesina, A. (2013), Transforming Nigeria's agriculture.
Africa Renewal (2014), Agriculture is Africa's Next Frontier.
Ernst & Young (2013), Getting down to business: Ernst & Young's Attractiveness Survey.
FAOSTAT quoted in The World Bank Group (2013), Growing Africa: Unlocking the potential of agribusiness.
FAO (2013), FAOSTAT.

Note: Sub-Saharan Africa's import bill excludes fish.

Food versus exports? An illusory debate

Views on the future of African agriculture often take the form of conflicting propositions. Policymakers are variously advised to focus either on smallholder production or large-scale commercial farms, on export agriculture or domestic markets, on industry or agriculture.

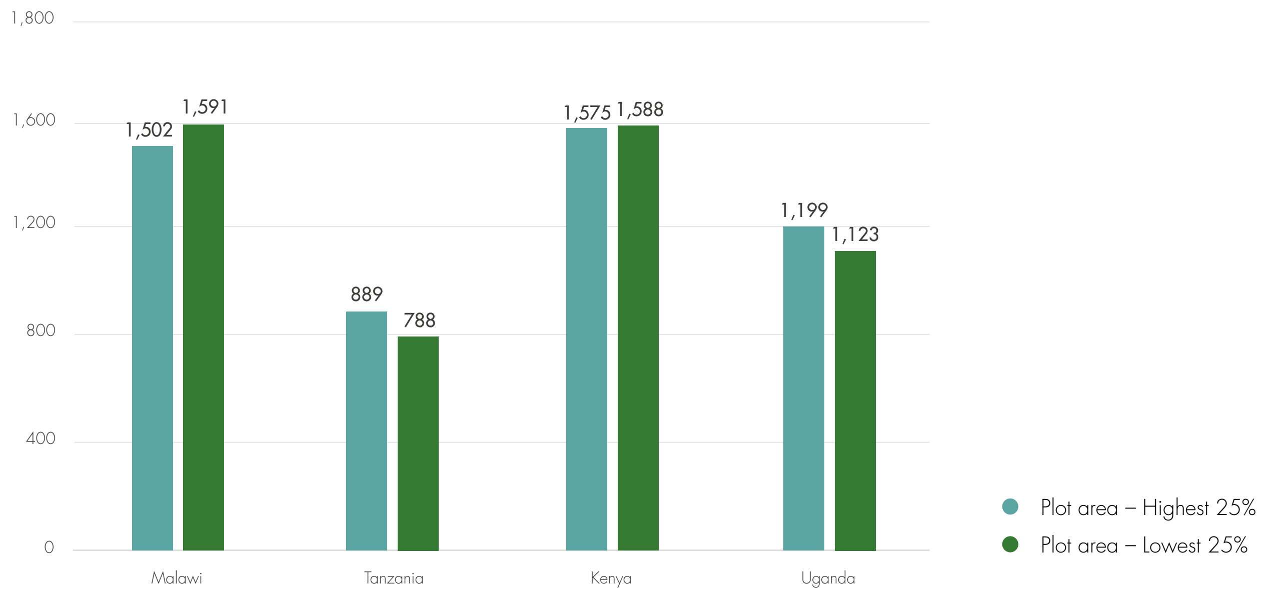
The Africa Progress Panel questions the "either-or" nature of the propositions on offer. Smallholder agriculture has a vital role to play in boosting growth, reducing poverty and ensuring food and nutritional security, alongside medium-scale and large-scale agriculture. Both export and domestic markets can underpin agricultural prosperity – and African markets for food staples should be a driver of growth through import substitution. The dichotomy between rural and urban growth is misplaced – the policy challenge is to build dynamic links between the farm economy, the off-farm rural economy and markets in urban centres.

The long-running debate over "food crops versus export crops" is just as redundant. Smallholder farmers typically produce food staples to consume at home as well as cash crops to generate income. The contention that there is a trade-off between the two is largely illusory. The same is true of the claim that agricultural producers make more money out of export crops. Value chains in food staple production are typically shorter and added value lower. However, traditional and non-traditional export crops typically account for a smaller share of GDP and employment. The International Food Policy Research Institute (IFPRI) compared the contribution to growth of promoting traditional exports, non-traditional exports and food staples. It found that food staple promotion made the strongest contribution, in part because of the widening gap between supply and demand.

Africa is far from realizing the potential of staple food crops, however, because its farmers obtain far less from their land than farmers in other regions. In a sample of six African countries in which maize is an important crop, yields from demonstration plots were two to five times actual average yields (World Bank 2007)[15]. Bringing actual yields of food staples up to the level of those demonstration plots could generate huge benefits, replacing imports and producing enough to export regionally. One study covering Central and West Africa found that it would generate US$9 billion to US$20 billion, depending on the policy environment.[16] Productivity gains and increased regional trade in food staples would not only raise the income of farm households, but also lower food costs for the non-farm population, which spends most of its income on food. This would in turn promote broader economic growth by stimulating demand for non-farm goods and services, creating a surplus for public and private investment, saving foreign exchange, and freeing resources, such as labour, for the growth of non-farm economic sectors.[17]

Like the food crop versus export crop argument, the debate over smallholder agriculture versus large-scale commercial farming has been overtaken by events. The evidence points to marked variability across countries and crops.[18] While large farms tend to produce larger surpluses, the record on productivity per hectare is more mixed. Recent research provides evidence that smallholder production of maize, a major food staple, matches productivity on large farms (Figure 12). In the last analysis, neither smallholder nor large-scale commercial agriculture has flourished in Africa.

FIGURE 12 SMALL FARMS ARE OFTEN AS PRODUCTIVE AS LARGE FARMS: MAIZE YIELDS PER HECTARE BY FARM SIZE, SELECTED COUNTRIES (KG/HA BY PLOT AREA)



Source: Larson, D.F. et al. (2012), Should African rural development strategies depend on smallholder farms? An exploration of the Inverse Productivity Hypothesis.

What is clear is that, far from disappearing, smallholder agriculture has proven robust in the face of adverse circumstances. The sector was badly damaged by the high taxation and state domination of marketing in the post-independence era, and then by structural adjustment programmes in the 1980s and 1990s. Lacking access to irrigation, infrastructure, financial services and insurance, and working on fragile soils in drought-prone areas, most of Africa's smallholders operate in a debilitating environment. Yet they have demonstrated extraordinary resilience, innovation and entrepreneurial activity. Whatever the theoretical merits of different scales of production, the hard fact remains that for the foreseeable future, the vast majority of African farmers will be female smallholder producers.

Both smallholders and larger-scale producers have vital roles to play in driving agricultural growth. Both stand to benefit from policy reforms that could unlock growth potential, including investment in infrastructure, lowering of regional trade barriers and spending on research. Targeted policy interventions will be needed to ensure a prosperous smallholder sector, including the delineation and strengthening of land rights. But the wider challenge is to create a public policy environment in which the whole agricultural sector flourishes.

Promising new directions in policy

One of the most positive developments of the past decade has been a mounting recognition among policymakers that strategies that fail to put agriculture at the centre will not deliver inclusive and transformative growth – and will in the long run fail to sustain growth. The potential for new technologies is also more widely recognized. Changes in domestic and global market conditions have helped persuade governments of the need to prioritize agriculture.

"The only promises that count are those that are kept."

By Kofi Annan

The winds of policy change can be detected in a wide range of partnerships and policy commitments. The African Union's Comprehensive Africa Agriculture Development Programme (CAADP), has been established as a reference point for national plans. Signatories to the Maputo Declaration, adopted in the same year, committed to invest at least 10 per cent of their national budgets in agriculture – a level identified as the minimum necessary to achieve the CAADP's goals. New partnerships have emerged. One example is the Grow Africa initiative, which brings together farmers, private investors and governments to unlock new investments. In 2012, 62 companies in the partnership announced over US$3.5 billion in planned investments linked to national development goals.[19]

Developments on the international stage have also been encouraging. In 2009, world leaders made a commitment at the G8 summit in L'Aquila, then again at the G20 summit in Pittsburgh, to increase agriculture funding for developing countries by US$21 billion. The Global Agriculture and Food Security Programme, a multi-donor mechanism of particular relevance for Africa, was established to mobilize and competitively allocate a portion of this external funding. Other international initiatives, such as the New Alliance for Food Security and Nutrition, have support from developed countries and the private sector.

These are encouraging promises, but the results have yet to match the rhetoric. As the chair of the Africa Progress Panel has often said, "The only promises that count are those that are kept". The Africa Progress Panel urges all those who have made these bold commitments to honour them, working closely with African partners to transform African agriculture.'

Underpinning these shifts is a growing recognition that investments in agriculture pay off. Perceptions started to change with the successes of Asia's Green Revolution. New technologies enabled agriculture in Asia to raise its productivity, overcome national resource constraints, and emerge as a dynamic source of growth. Underlying conditions in Africa are different from those in Asia in many respects. To mention just one, agriculture in Africa is overwhelmingly dependent on rainfall rather than irrigation. Yet in Africa, as in Asia, if science is backed by the policies needed to create an enabling environment it can transform agriculture, as illustrated by the success of programmes initiated under the Alliance for a Green Revolution in Africa (AGRA) (Box 4).

Many of the approaches developed by AGRA are as relevant to aquaculture as they are to agriculture. Africa has the potential to develop fisheries sectors that could play a critical role in combating food insecurity, providing livelihoods and supporting transformative growth. There are strong links with agriculture. Yet despite Africa's abundance of lakes and rivers, its consumption of fish protein is in decline. The reason: neglect and misplaced policies (Box 5).

BOX 4 TOWARDS A UNIQUELY AFRICAN "GREEN REVOLUTION"

Africa has often been bypassed by the scientific and technological innovations that are transforming agriculture. But now a new generation of farmers and political leaders is seeking to drive a uniquely African Green Revolution.

The Alliance for a Green Revolution in Africa (AGRA) is part of the wider effort. Created in 2006 through an alliance between the Rockefeller Foundation (which played a critical role in the Asian Green Revolution) and the Gates Foundation, AGRA is now working in 17 countries in Sub-Saharan Africa. It has combined scientific research with the dissemination of new seeds and financing. Among the results:

- More than 330 new crop varieties have been developed and released to farmers, including drought resistant seeds.
- Over 380,000 hectares of depleted soils have been rejuvenated.
- New approaches to fertilizer management have enabled smallholders to increase productivity.
- Over 1 million smallholders have received training in improved storage systems and strategies for reducing post-harvest losses.

Recognising that finance is critical to the adoption of new technologies, AGRA has been prominently involved in initiatives aimed at strengthening access to affordable credit and fair prices. The Farmer Organisation Support Centre in Africa, for example, helps farmers to negotiate input prices, credit and sale prices.

The message underpinning AGRA's work and its success is that smallholder farmers working alone can only achieve so much. Transformative change requires science, and private investment. Critically, it also requires the development of infrastructure and inclusive financial systems – issues that we examine in Part IV.

BOX 5 AQUACULTURE – AN UNDER-UTILISED RESOURCE

As in agriculture, Africa has all of the natural resources needed to develop a vibrant fisheries sector – and as in agriculture the potential has yet to be realized.

Fish already accounts for just over one-fifth of Sub-Saharan Africa's protein intake. The share is far higher in West African coastal countries such as Ghana and Sierra Leone, where fish makes up more than half of protein intake. But per capita fish consumption has stagnated in Africa, at less than 10kg – under half the global average. And the region accounts for a tiny share of fish production: 0.6 per cent and shrinking.

The underlying problem is neglect, combined with a flawed development model. Until recently, few governments saw aquaculture as a priority. With the encouragement of donors, some focused not on commercial market development but on building and stocking small ponds to produce fish for local consumption. While valuable for the immediate beneficiaries, these ponds produce small amounts of fish – and many have failed because of technical problems.

Recent years have seen some changes. Starting from a low base, aquaculture in Africa is growing: from 55,690 tonnes in 2000 to almost 600,000 tonnes in 2010. Much of this growth is taking place in countries such as Ghana, Kenya, Namibia, Nigeria and Uganda, supported by the FAO's Special Programme for Aquaculture in Africa and by the New Partnership for African Development (NEPAD).

More commercial approaches can support both nutrition and livelihoods. Burkina Faso and Mali are testing projects aimed at integrating rice production with aquaculture. In Madagascar, highland rice cultivation is already combined with fish farming.

Getting the right type of fish is critical. The vast majority of farmed fish in Africa are freshwater species, mainly the Nile tilapia and sharp-tooth catfish. These omnivorous fish are high value and relatively easy to raise. New strains of Nile tilapia in Ghana and Malawi are also up to 30 per cent faster growing and could dramatically increase commercial market potential.

Not all investment decisions have been wisely made. Some projects have failed because the emphasis has been placed on producing large fish for export markets that are difficult to penetrate. Meanwhile, potentially more profitable local markets for smaller fish have not been exploited.

Governments and donors need to learn from past successes and failures. On-farm ponds will remain important and can be developed further to improve household food and nutrition security. Work in Malawi has shown how successful integrated agriculture-aquaculture can be at the farm level. Farmer pond projects have produced catches averaging 1,500 kg a year, providing a vital source of nutrition, raising overall productivity, and increasing incomes by 60 per cent a year.

Thousands of ponds financed through projects will inevitably add up to less than the sum of their parts, however, in the absence of a wider strategy. Governments need to create the incentives and infrastructure that small and medium-sized investors need to meet local demand and then penetrate higher value-added export markets. Fisheries strategies also need to include investment in freezing, drying, processing and canning.[20]

African countries can learn a great deal from Asian countries such as Bangladesh, India, Thailand and Vietnam that have built economic success on balanced growth strategies that link rural and non-rural sectors. Similarly, there are lessons to be drawn from Asia's Green Revolution, including the critical roles played by investment in infrastructure and more inclusive finance. While agriculture represents as much as 40 per cent of GDP in some African countries, only 0.25 per cent of bank lending goes to smallholder farmers. Africa can also learn from the less positive experiences of the Asian Green Revolution, including the systematic neglect in some cases of marginal producers and disadvantaged areas.

Just as with overall economic growth, some patterns of agricultural growth are more likely than others to reduce poverty and enhance food and nutrition security. Here, too, international experiences can help to inform debates in Africa. In Brazil, agricultural GDP growth has tended to exceed overall GDP growth over the past two decades. Much of the growth has been driven by large-scale, capital-intensive production, however, which is oriented towards export markets but creates fewer jobs and food and nutrition security at home.

Importing a Brazilian commercial farming model into Africa is neither plausible nor socially desirable; Brazil has almost as much farmland with more than 975mm of rain each year as the whole of Africa. Yet Brazil's experience does provide important lessons for Africa. Brazil's success was the result not of a quick fix, but of long-term policies and the development of institutions, notably the Brazilian Agricultural Research Consortium, or Embrapa, and institutions aimed at strengthening the productivity of "family farms." Brazil has demonstrated that smallholder agriculture can flourish alongside large-scale producers – and that the whole agricultural sector can benefit from a vibrant agribusiness industry.

In Africa, shifts in underlying market conditions could reinforce the emerging directions in policy. While prices for traded cereals have fallen from their peak in 2008, they remain high by the standards of recent history. Strong growth in emerging markets, dietary changes (notably a transition to cereals-intensive meat and dairy production), urbanization and ecological pressure on agricultural land are likely to keep prices high. The United Nations estimates that global food demand will double by 2050, with much of that growth driven by developing countries. High prices alone will not stimulate the investment needed to boost productivity. But they send a clear signal to the market, which could make a difference if backed by the right policies and investment in infrastructure.

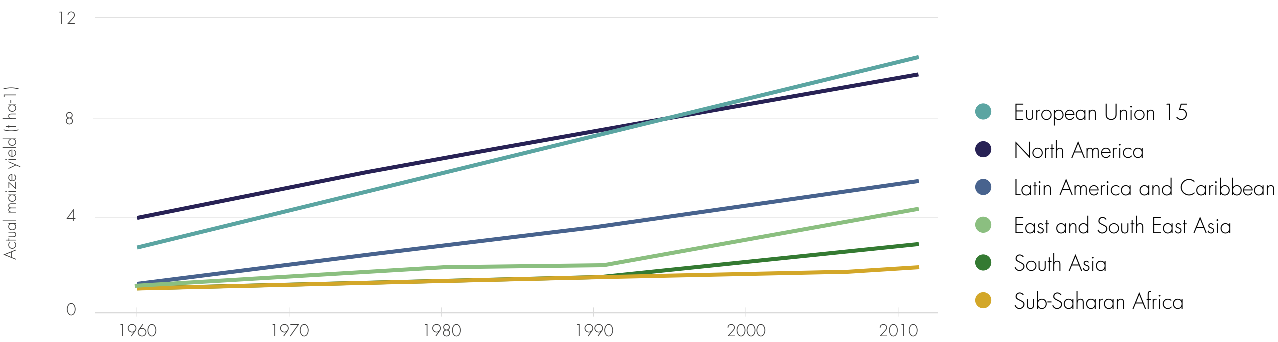
Underlying market conditions in Africa are also favourable. Africa is the world's most rapidly urbanizing region. In marked contrast to the 1990s, when urbanization was associated with economic stagnation, rural-urban migration is taking place in a context of high growth, the rise of a middle class, and growing demand for food.[21] More than half of food purchases in Eastern and Southern Africa occur in urban areas, rising to 60-70 per cent in West Africa. In West Africa, the urban population is around one-half of the total but accounts for over two-thirds of food purchases.[22] The critical importance of this development is that the African marketed food economy is already urban – and urban growth will create new markets.

African agriculture is already showing some green shoots (Figure 13). Since 2000, and more especially since 2005, growth has been accelerating. Countries such as Ethiopia and Nigeria have posted agricultural growth rates in excess of 6 per cent, with a wider group – including Burkina Faso, Ghana, Rwanda and Sierra Leone – growing at 4 per cent to 5 per cent. In Ethiopia, Ghana and Rwanda, the increase has been driven by higher yields among smallholder staple food producers (and in Ghana's case, cocoa producers). Smallholders have also driven growth in cash crop production in Burkina Faso, Ghana and Sierra Leone.[23]

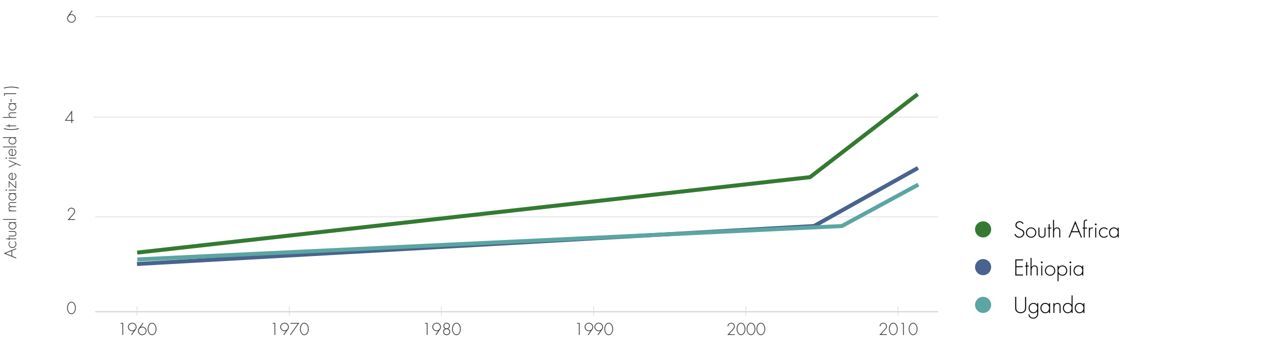
Evidence is also emerging that the new global partnerships are delivering results. One prominent example is the Southern Agricultural Growth Corridor of Tanzania. Launched by the Tanzanian government in 2010 with the support of several donors, the initiative aims to lift 2 million people out of poverty by bringing 350,000 hectares of farmland into cultivation, with a focus on rice and other food staples, sugar and livestock. The long-term goal is to generate US$3 billion in public and private investments, with the government and donor countries contributing to a US$50 million catalytic fund to support the start-up of agribusiness enterprises. International companies such as DuPont, General Mills, Monsanto, Yara and Syngenta are involved.

FIGURE 13 CROP YIELDS IN AFRICA

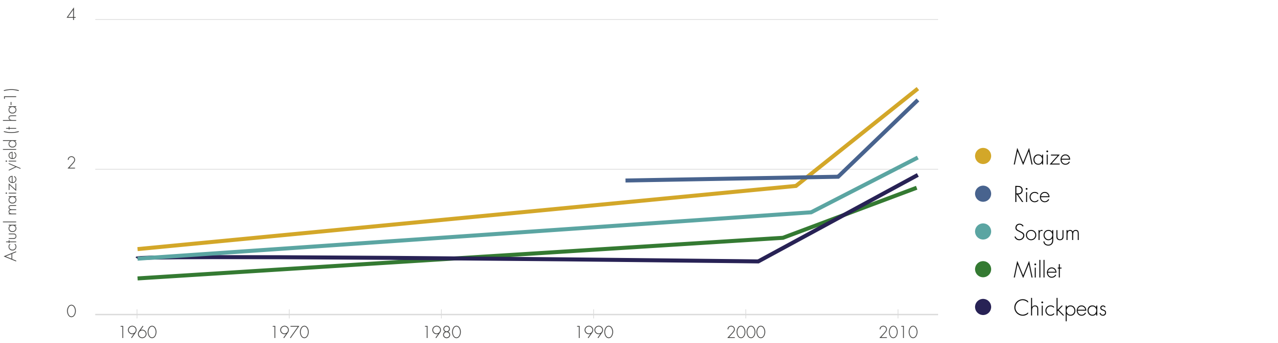
1. BY GLOBAL STANDARDS, YIELDS IN SUB-SAHARAN AFRICA REMAIN VERY LOW…



2. .. BUT SOME COUNTRIES HAVE STARTED TO SHOW IMPRESSIVE PRODUCTIVITY INCREASES.



3. … AND IN ETHIOPIA, THESE GAINS COVER SEVERAL CROPS.



Source: Wageningen University and FAOSTAT (2014).

Other countries are embarking on ambitious strategies aimed at increasing markets for Africa's farmers through import substitution. One example is Nigeria. Until recently, the country was a metaphor for all that was wrong with African public policy on agriculture. Instead of being invested in agricultural infrastructure and skills, oil revenues were used to finance a flood of cheap imports. The agricultural sector was starved of public investment. Under the Agricultural Transformation Agenda adopted in 2011, the government has set out a bold path aimed at supporting import substitution and raising productivity (Box 6).

BOX 6 AGRICULTURAL TRANSFORMATION IN NIGERIA

Despite having abundant fertile land, two of Africa's largest river systems, and entrepreneurial farmers, Nigeria is one of the world's largest food importers – and has some of the world's worst malnutrition. Oil wealth that could have been used to develop agriculture has been used to finance food imports, effectively decoupling urban growth from the rural sector. But this picture is now changing.

The Agricultural Transformation Agenda (ATA) is an attempt to break with the past and set a course for agricultural transformation. Launched in 2011, the strategy aims at boosting food production by 20 million tonnes, creating 3.5 million jobs in agroprocessing industries, and making Nigeria self-sufficient in rice by 2015.

The ATA is built on four pillars: infrastructure to improve market access; agricultural insurance to smooth incomes if crops are damaged by bad weather; a privately managed fertilizer subsidy programme for poor farmers; and increased import tariffs to promote self-reliance through import substitution. Each pillar is supported by a range of initiatives. The Growth Enhancement Support Scheme (GESS) aims at improving access to fertilizers and seeds. The Nigeria Incentive-Based Risk-Sharing System for Agricultural Lending (NIRSAL) addresses access to finance and insurance.

Research undertaken for this report by Centre for the Study of the Economies of Africa, Nigeria, finds that there are signs of success despite the ongoing political economy challenges.Nigeria is still far from self-reliant in rice, but production reached an estimated 3.1 million tonnes in 2013–14 – up from 2.2 million tonnes five years earlier. The fertilizer programme, which relies heavily on mobile payment technology, has started to clear up a notoriously corrupt subsidy system that largely bypassed small farmers. Nigeria's Coordinating Minister for the Economy and Minister of Finance, Ngozi Okonjo-Iweala, says that 90 per cent of the country's smallholders are now obtaining fertilizer, as opposed to 11 per cent before the programme. Today, seed and fertilizer companies are selling directly to farmers, not to the government.

As domestic production increased, the private sector responded with 14 new industrial-scale rice mills. In the cereals sector, Nigeria is trying to cut a US$4 billion wheat import bill by replacing imported wheat flour with high-quality, homegrown cassava flour to use in producing bread. The government is also developing the cassava value chain by producing starch that can be utilized in sweeteners to reduce sugar imports.

The new strategy has several fundamental weaknesses. For example, Nigeria still spends just 1.6 per cent of the national budget on agriculture – a derisory amount given the level of ambition set out in the ATA. But if the new policy agenda is backed by credible public investment commitments, it could transform not just Nigerian agriculture, but food and nutrition security and food markets across the region.[24]

2. Enabling agricultural growth that benefits all

Encouraging as recent developments have been, much of Africa is a long way from establishing the agricultural sector as an engine of growth that benefits every section of society. Public investment in agriculture is too low, too inefficient and too inequitable. Opportunities for regional trade are hampered by a failure to lower the barriers created by transport cartels and non-tariff measures.

Many African farmers are trapped in a vicious circle. Their productivity is low because the costs of inputs such as fertilizers are prohibitively high compared with the prices they can get for their produce – and because they lack access to marketing infrastructure, new seeds, and the training and advice offered by extension services. Farmers operating in high-risk environments have little access to risk mitigation options such as insurance.

Agricultural policy in Africa, as in many regions, is sometimes seen as a battleground between advocates of higher prices for farmers and those who insist on lower prices for consumers. This is an unhelpful way of framing the problem. Africa's farmers could feed the region's fast-growing urban populations and their own families, if governments created the policy conditions needed to lower transaction costs, increase efficiency and support innovation. This section looks at four key conditions for success: boosting regional trade, linking farmers to markets, raising public spending and avoiding "land grabs."

Governments must lift barriers to regional trade

Africa's US$35 billion market in food could be served by African farmers themselves, if they had access to the infrastructure and financing needed to raise productivity – and if they had access on reasonable terms to the markets in question. Unfortunately, policy failures in Africa are providing farmers in other parts of the world with what amounts to preferential access to African markets, creating a dependence on imports and undercutting domestic livelihoods in the process.

Transport costs are a major obstacle to the development of regional markets, especially in food staples – and for small farmers. One study in Cameroon found that domestic handling and transport costs accounted for 21 per cent to 35 per cent of the shipment value of cassava over a 130km distance.[25] The costs of transporting food staples across the border between Nigeria and Chad are equivalent to adding almost 600km to the journey. But the "first mile" is often the most costly: it is more expensive to transport food from the farm gate to the local market than from secondary to wholesale markets.[26]

Food staples are bulky, so transport costs can significantly increase prices, and reduce the producers' share of the final market value. On one estimate, African farmers typically receive around 20 per cent of the final value of food staples.

Improved seed varieties move across borders with even greater difficulty than food. Use of modern seeds is fundamental to raising productivity, yet African farmers are often unable to access seeds in a neighbouring country. Sourcing seeds is complicated and often expensive, with under-resourced and under-staffed public agencies unable to provide effective regulation for the development of the private sector.

US$35 BILLION

Africa's US$35 billion market in food could be served by African farmers themselves, if they had access to the infrastructure and financing needed to raise productivity – and if they had access on reasonable terms to the markets in question.

Food staples valued at over US$4 billion are lost every year in Africa as a result of postharvest inefficiencies, much of it due to poor storage.

Researchers at the Overseas Development Institute (ODI), a British think tank,[27] have carried out comprehensive reviews of the barriers restricting regional trade. The following are identified as being among the most damaging:

Transport cartels: The costs for Africa's trucking operators are not much higher than costs in other parts of the world. Profit margins, by contrast, are exceptionally high, particularly in Central and West Africa, where they reach 60 per cent to 160 per cent.[28] The trucking industry in West Africa in particular is characterized by high prices and poor service, driving up the cost of marketing food staples and other agricultural produce. National rules on the use of national fleets and protection of quotas for politically powerful trucking associations help keep costs high. When Rwanda reformed its trucking rules in the mid-1990s, prices fell by 75 per cent in real terms.

Storage: Poor post-harvest storage and quality management are responsible for 40 per cent of the cost in value chains, according to one study. Translated into financial terms, food staples valued at over US$4 billion are lost every year in Africa as a result of post-harvest inefficiencies, much of it due to poor storage. In 2012, an estimated 7 million tonnes of Africa's maize harvest – 18 per cent of the total – was lost post-harvest.[29] The absence of good quality storage facilities in regional trading systems undermines market opportunities for farmers.

Sanitary and phytosanitary (SPS) arrangements: Governments have a legitimate interest in ensuring that marketed products meet stipulated quality standards, but SPS provisions often have the same effect – intended or unintended – as trade barriers. The cost of obtaining an SPS certificate is often a significant bribe at the border. The under-resourcing of SPS services can also lead to significant delays.

Non-tariff barriers (NTBs): While governments have been lowering tariff barriers to regional trade, many NTBs remain. One study of fertilizer markets in West Africa found that individual countries were stipulating their own blends of inputs, and restricting market entry for fertilizer products with different blends. There is worrying evidence from some regions that NTBs are increasing even as tariffs diminish. Between 2000 and 2010, the total number of NTBs applied in Zambia, Malawi and Mozambique increased from 400 to over 1,400. Traders travelling from Ghana to Nigeria are reported as having to pay 40 different fees. On one estimate, eliminating NTBs in maize trade between Kenya, Tanzania and Uganda would generate benefits of US$5 billion.

National policies: While most governments have partially liberalized domestic food markets, government interventions continue to introduce high levels of uncertainty and unpredictability into the market – and often favour large farms. One example comes from Kenya, where the National Cereals and Produce Board has defended a floor price for maize by restricting imports. Most of the maize purchased has been from large-scale, politically influential farmers in the Rift Valley.

Governments across the region are grappling with these problems. While Africa's regional economic communities have so far made tariff reductions their top priority, attention is now turning to the need to support agriculture and improve regional food and nutrition security. In 2013, the Economic Community of West African States (ECOWAS) established the Regional Agency for Agriculture and Food, based in Lome, Togo. The

East African Community has adopted an Agriculture and Rural Development Strategy to frame a common set of policies. Recurrent food crises in the Horn of Africa and the Sahel region have given added urgency to improving regional food trade.

African governments have made some efforts to increase harmonization and establish common standards. For example, the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC) have established a joint procurement strategy aimed at facilitating cross-border fertilizer trade. COMESA has introduced a Simplified Certificate of Origin document that covers a range of products not required to go through complex certification rules. It has also created a "Green Pass" which, accredited by authorities in one country, allows the movement of food and agricultural products across all member countries. Other regional economic communities are discussing the harmonization of sanitary and phytosanitary arrangements. However, overall progress has been painfully slow, in part because political leaders have failed to send the right signals to their trade negotiators.

Current restrictions on regional trade in food staples are self-defeating. While governments across the region are stepping up public investments in transport infrastructure, at the same time they are lowering the returns on those investments by limiting opportunities for trade. Worse, they are keeping Africa's farmers out of markets, severing the link between expanding urban demand and rural supply, and reinforcing dependence on food imports. One estimate suggests that non-tariff barriers may be raising the price of food staples in Africa by around 15 - 25 per cent.[30] Where markets have been allowed to flourish, as they have between northern Mozambique, eastern Zambia and Malawi, and in Uganda, there have been benefits for producers and consumers alike. Preventing the connection of food surplus to food deficit regions reduces the welfare of both, adding to food security risks in the process.

Farmers need much better access to markets

Governments and producer organizations can do more than simply eliminate the barriers described above. They can develop institutions that facilitate farmers' participation in higher value-added markets, including export markets.

Adding value to production holds the key to agricultural transformation. At present, Sub-Saharan Africa's exports are concentrated in primary agricultural products. Less than half of agricultural output is supplied to domestic processing sectors. This means that the bulk of final market value, and associated income, is generated outside of Africa, which in turn limits the flow of revenues needed to finance investment. There is considerable scope for intensifying agricultural processing activities before exporting goods to regional and international markets. The same is true for domestic food staples. When Sierra Leone imports rice it is already bagged and milled. This limits the development of a milling sector that could add value and create markets for farmers.

Climbing value-chains is not straightforward. Agro-processing companies will not invest in African markets unless farmers are able to produce the volumes needed to sustain operations, which in turn means raising productivity. Other problems described in this chapter – a lack of storage facilities, high transport costs, regional trade barriers, and (especially for exports) quality control – restrict opportunities for value-addition, reinforcing a cycle of low productivity and under-investment.

African farmers tend to have less market power than traders, agro-processors and exporters. Lacking access to warehousing and storage facilities, they typically have to sell when prices are low (after the harvest) and often lack information on prices. They are linked to consumer markets through trading networks characterized, in many cases, by low levels of trust.

The absence of established certification programmes adds another source of unequal power relationships: it leaves traders as the arbiters of quality. All of these challenges escalate as producers move up the value chain. More stringent quality standards and delivery requirements, as well as access to capital, inputs and market information, are widely cited as factors that may skew opportunity in favour of large farms because they make it more difficult for smallholder farmers, especially the more disadvantaged, to participate in markets.

How can farmers wield more power in the marketplace? Commodity exchanges can play a critical brokerage role, linking producers to consumers through trading networks underpinned by clearly defined rules. Where such exchanges function effectively, they lower transaction costs by reducing the number of intermediaries, improving the dissemination of market information, reducing margins between producers and consumers, and maintaining quality standards. Unfortunately, efforts to set up agricultural commodity exchanges in Africa have met with limited success. Start-ups in Kenya, Malawi, Nigeria and Uganda are limited principally to providing price information, rather than facilitating bulk trade. One exception is the Ethiopia Commodity Exchange. Dealing principally in coffee, the exchange has secured higher prices and an increased share of the final value of exports for producers (Box 7).

BOX 7 ETHIOPIA COMMODITY EXCHANGE

Smallholder farmers often enter markets carrying major disadvantages. Lacking access to information, storage capacity and quality control mechanisms, they may be drawn into unequal exchanges with traders. Because they are geographically dispersed, they may be unable to pool risk, share price information, and establish payment systems that protect their interests.

The success of the Ethiopia Commodity Exchange (ECX) shows that these disadvantages can be overcome. It also underlines the critical importance of institutions in creating opportunities for smallholders to contribute to agricultural growth and participate in its benefits.

During the 1990s, market liberalization in Ethiopian agriculture focused on "getting the prices right." While the reform process led to some increases in trade, traders continued to operate in few markets and over short distances, and typically purchased from known producers. Limited access to storage facilities, the absence of certification and the risk of disputes, all increased trading costs and eroded producers' share of final value. Coffee farmers typically received around 30 per cent of the final export price, for example.

Established in April 2008, ECX provides a reliable clearing and payments system, enforces contracts and disseminates market information. Through its certification process, ECX establishes quality control standards that maintain a price premium.

In its first year of operation, the exchange handled transactions involving over 113,000 tonnes of commodities, mostly coffee, maize, pea beans and wheat, valued at 2.5 billion Ethiopian birr (US$130 million). By the end of 2013, trade volume amounted to 2.65 million tonnes valued at 90 billion Ethiopian birr (roughly US$5 billion). ECX was operating through 17 delivery centres and maintained a warehouse capacity of 300,000 tonnes. Eleven settlement banks were involved in financing.

Smallholder coffee farmers have been among the main beneficiaries. Their share of the final value of their beans has increased from less than 40 per cent to nearly 70 per cent, with the increased revenues helping to drive down poverty, support investment and expand opportunities for health and education.

ECX cannot be viewed in isolation. Wider public policies have created an enabling environment for increased rural prosperity. Yet ECX introduced rules, norms and practices that have supported the development of more efficient and equitable markets, creating a win-win scenario for farmers and traders – and contributing to Ethiopia's record in combining high growth with rapid poverty reduction.[31]

The globalization of agricultural trade has created new opportunities and challenges for Africa. An increasing proportion of higher value-added trade in agricultural produce is oriented towards supplying supermarket chains. The rewards for successful entry into global value chains are potentially very large, as witnessed by the growth of Kenya's horticulture sector. Yet the barriers to entry are high. Those barriers can be lowered through agricultural cooperatives, especially when governments and the private sector themselves cooperate to create an environment conducive to smallholder entry:

Outgrower programmes: These link producers to markets through agro-processing companies, which often supply capital, inputs and technical advice, along with a link to the market. In Malawi, outgrowers are contracted to supply sugar cane to a multinational South African sugar company, Illovo, which exports half of its production to Europe. Another example comes from Ghana, where outgrowers supply Blue Skies, a company that provides pineapples to major supermarket chains.

Emerging challenge funds: Several bilateral donors are promoting smallholder entry into international markets. The Africa Enterprise Challenge Fund provides grants to support business proposals that stimulate commercial investments in agriculture. One grant has facilitated the creation of a company that buys cocoa from a war-affected district of Sierra Leone, operating through 8,000 farmers. The Food Retail Industry Challenge Fund, which supports 26 projects across around a dozen countries, plays a similar role.

Certification: While entry to higher value-added markets offers premium prices, it also demands higher quality standards. Meeting global requirements can exclude smallholders – as it has in Kenya's horticulture industry. However, several donors, governments and private sector companies are working with smallholders to help them meet certification standards.

Governments need to keep their spending promises

Public investment is crucial if farmers are to increase production. But in Sub-Saharan Africa the symptoms of underinvestment are immediately visible – in the shocking state of rural feeder roads, the lack of storage facilities, poor infrastructure for water management, and low levels of research and innovation. Evidence shows that public investment in agriculture can yield very high social and economic returns. Yet this is seldom reflected in national budget priorities.

The continued gap between policy declaration and action is illustrated by the record of African governments in acting on their commitment under the 2003 Maputo Declaration to allocate "at least 10 per cent of national budgetary resources to agriculture and rural development". On the basis of the most recent evidence, only seven countries have achieved the 10 per cent target. Twenty-eight countries are less than halfway towards the commitment, and 18 are moving away from it. Leaving aside the question of whether or not 10 per cent is an appropriate target, the trends are worrying. Moreover, there is little evidence to suggest that Africa is scaling up investment in agricultural research and development.[32]

Research and development was central to the productivity gains that transformed agriculture in South Asia and East Asia.[33] In Sub-Saharan Africa, too, returns to national agricultural research are significant, especially for large countries. Many of the technological improvements that are raising productivity in African farming can be traced back to the Consultative Group for International Agricultural Research (CGIAR). Benefits from the CGIAR centres in Sub-Saharan Africa are estimated to be over US$6 for each US$1 invested.

7

Only 7 African countries have achieved their commitment under the 2003 Maputo Declaration to allocate "at least 10 per cent of national budgetary resources to agriculture and rural development".

In addition to CGIAR, nearly all Sub-Saharan African countries have national agricultural research systems, but the quality of many deteriorated when government investments in agricultural research stagnated in the 1980s and 1990s. Spending on national agricultural research in the region has recently grown, reaching US$576 million in 2008, but the growth has been mainly concentrated in Ghana, Nigeria, Tanzania and Uganda.

Investing in better rural feeder roads can also bring high returns, by dramatically lowering the costs of inputs and marketing, and hence increasing the margins secured by farmers.[34] Even low-quality feeder roads raise more poor people out of poverty for every dollar than high-quality trunk roads, making them a win-win strategy for growth and poverty alleviation.[35] Research in Ethiopia found that access to all-weather roads reduced poverty by 7 per cent and increased consumption growth by 16 per cent.[36] Yet only around one in three rural Africans has access to an all-weather rural feeder road.

Politics often appear to outweigh public interest in determining public spending patterns. Investment in areas that benefit the public – research and development, roads and education for example – generate higher returns, especially over the long term. Yet many governments invest in areas that generate more pronounced private benefits.

Avoiding land and water grabs

In working for the transformation of African agriculture, governments have to exercise stewardship, responsibility and fairness. The sharp hike in world prices in 2008 generated a wave of concern over the danger of "land-grabbing" in Africa – the large-scale acquisition of land by foreign investors. With pressures on the global food system mounting, the potential market value of Africa's land and water resources is rising. Climate change policies are also having an effect, with investors actively seeking fertile arable land on which to grow bio-fuels.

The dangers posed by these global forces are real. As we argued in the 2012 *Africa Progress Report*, large-scale land acquisitions may result in local people losing access to the resources on which they depend for their food and security. Many countries do not yet have in place the legal mechanisms needed to protect local rights and take account of local interests, livelihoods and welfare. Lack of transparency, legislative gaps and weak compensation provisions all place African farmers at risk. It should be added that the risks go beyond international land-grabbing. As the value of Africa's land and water resources rise, there is a risk that powerful local elites will exploit opportunities to extend their claims at the expense of those with more limited resources and a weaker political voice.

Many countries do not yet have in place the legal mechanisms needed to protect local rights and take account of local interests, livelihoods and welfare. Lack of transparency, legislative gaps and weak compensation provisions all place African farmers at risk.

Justified as it is, the focus on land-grabbing by foreign investors may have diverted attention from more fundamental concerns. The underlying problem is not the nature of the crop – there is nothing inherently damaging about bio-fuel production – or even the source of investment, but the weakness of underlying entitlements and rights.[37] African governments and the wider international community have adopted some encouraging principles. The FAO's *Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security* (VGGTs) provide a widely accepted benchmark. The African Union Declaration on Land Issues and Challenges in Africa identifies many of the risks, and African governments, regional bodies and development banks have articulated some clear principles to guide policy.[38]

These include:

- Mapping and documenting land rights, and identifying unutilized resources.
- Identifying local land rights, interests and claims.
- Recognizing customary land tenure rights and claims by statutory land laws.
- Adopting innovative and inclusive large-scale land-based investment (LSLBI) models that empower smallholder farmers and communities and protect national food security.
- Structuring land deals to consider:
  - optimal land size and land lease period;
  - the distribution of potential costs and benefits;
  - impacts on food security and livelihoods;
  - compensation arrangements;
  - provisions for withholding production for domestic use to address food and energy security;
  - fiscal and other provisions.
- Ensuring transparency.

In negotiations where large amounts of investment (and associated political interests) are at stake, there is a danger that people with weaker claims – such as women farmers, pastoralists and customary users of water and land – will be marginalized. It follows that establishing a fair and equitable land system should be a precursor to large-scale leasing deals.

Several countries in Sub-Saharan Africa have piloted fast, effective and low-cost approaches to land registration. Rwanda is completing a nationwide programme to issue land titles (with a photomap) at less than US$10 per parcel. Côte d'Ivoire, Benin and Burkina Faso have been piloting rural land tenure maps to register individual and communal lands. Tanzania has surveyed almost all of its communal lands; around 60 per cent have been registered; and Mozambique and Ghana are scaling up their communal land registration pilots. It should be emphasized that registration of communal land has to be supported through legal enforcement of claims – and should not be viewed as a step towards the wholesale privatization of land rights.

3. Risk management – a strategy for agricultural growth and equity

African farmers have to grapple with the threats posed by drought, floods, unpredictable rainfall, and the depletion of soil nutrients – and climate change is magnifying those threats. At the same time, most of Africa's farmers live below or marginally above the US$1.25 poverty threshold. That makes them chronically vulnerable. They can't afford the insurance that would protect their assets and families when disaster strikes – and that would enable them to invest in increasing productivity.

This section examines the impact of climate change on Africa, the adaptation strategies of its farmers, and the need to boost international adaptation financing. After showing how uninsured risk keeps African farmers poor, it explores promising new ways of providing farmers with the insurance they need in order to contribute to an agricultural transformation.

Climate change will hit African farmers hard

Climate change will have profoundly damaging consequences for Africa. Rising temperatures and changing rainfall will increase exposure to the consequences of drought, floods and other extreme weather events, speeding up the destruction of vital ecosystems. Inevitably, it is the world's poorest people – many of whom live in Africa – who will be hit earliest and hardest by the effects of global warming.

The effects of climate change, which are already exacerbating risk and vulnerability for Africa's farmers, will become more pronounced over the course of the 21st century. If current emission trends continue, warming is likely to exceed 2°C. This will result in large changes to most natural cycles, including those shaping temperature and rainfall patterns across Africa. More severe and protracted droughts are likely. This will exacerbate some of some all-too-familiar food security risks. The images that accompanied the 2011 East Africa drought and the 2013 floods that displaced some 100,000 people in Mozambique provide a forceful reminder of what is at stake.

Africa's farmers are leading the way in adaptation, partly because of their capacity for innovation and partly because they have no choice.

Understandably, international attention has tended to focus on the elevated risks of such extreme weather events. But such a focus misses the damaging impact of the small increases in risk that global warming tends to produce. It does not take a drought or a flood to push farmers into destitution if they are operating at the very margins of survival with limited resources on fragile soils. Delayed or excessive rainfall, higher temperatures during key periods in the production cycle – notably pollination – or a slightly more protracted drought can spell disaster.

The effects of climate change are complex – and so are the consequent challenges for policymakers. Warming by 2°C could reduce total crop production by 10 per cent in Sub-Saharan Africa by 2050, and increase the undernourished population by at least 25 per cent.[39]

The report on adaptation from the Working Group of the Intergovernmental Panel on Climate Change underscores the imperative to adapt to an increasingly uncertain environment:

- Projected maximum and minimum temperatures over equatorial Eastern Africa show a significant increase in the number of days warmer than 2°C above the 1981-2000 baseline by the middle and end of this century. Projections for Ethiopia show warming in all four seasons, which may bring more heat waves.
- Regional climate model studies suggest drying over most parts of Kenya, South Sudan and Uganda by the end of the century.
- Rainfall decreases are also projected during the Southern Hemisphere spring months, delaying the onset of summer rains over a large part of Southern Africa. The risk of drought is projected to be high in southwestern areas of Southern Africa during the 21st century and beyond.
- The impact of climate change on yields of maize may be most pronounced in Southern Africa, where losses of 18% to more than 30% have been estimated by mid-century.
- Across Africa, reductions in yields have been estimated at approximately 15 per cent for sorghum and 10 per cent for millet by 2050. In the Sahel, millet yields could fall by 20 per cent with warming of 2°C.

Many of the crops at risk – such as maize, sorghum and millet – play a vital role in the cropping systems of Africa's farmers, and in regional food and nutrition security. In the absence of alternatives, production losses will reduce incomes and damage food and nutrition security.

Farmers are finding inventive ways to adapt ...

Preventing such setbacks will require adaptation, increased resilience and the development of "climate-smart" agriculture. Africa's farmers are leading the way in adaptation, partly because of their capacity for innovation and partly because they have no choice. They are adopting land and water management practices aimed at reducing soil erosion, capturing more rainfall, increasing soil organic matter and replenishing nutrients. Their efforts provide valuable lessons in the types of strategies needed to restore the productivity of cropland and produce enough food for a growing population under climate change:[40]

- Farmers in Burkina Faso and Niger are using water-harvesting techniques such as building stone lines and improved planting pits, increasing average cereal yields from 400kg to 900kg per hectare (kg/ha) or more. Applying small quantities of fertilizer directly to seeded crops or young shoots early in the rainy season, combined with practices like water-harvesting, can increase millet and sorghum yields from fewer than 500 kg/ha to 1,000 or 1,500 kg/ha.
- By planting *Faidherbia albida* trees that provide shade and lock nitrogen in the soil, farmers in Malawi have increased their maize crop yields from fewer than 2 tonnes per hectare to 3 and 4 tonnes per hectare. Yields are more than 7 tonnes per hectare when these practices are combined with agroforestry, fertilization and other strategies.
- In West Africa, farmers are boosting soil fertility by applying crop residues, compost, mulch, livestock manure, leaves and fertilizer. These practices have resulted in crop yield increases of 33 per cent to 58 per cent over a four-year period. Farmers also saw revenue increases of 179 per cent from maize and 50 per cent from cassava and cowpea.

Africa's farmers are extraordinarily resilient, as these examples show, but they bear little responsibility for the forces driving climate change. Yet countries with the biggest carbon footprints have failed to act on their international commitments, let alone their responsibilities, to support adaptation.

... but financing for climate change adaptation is vital

Estimating the adaptation financing required by Africa is hazardous. The World Bank Group estimates that US$18 billion annually will be required up to 2050. Even "good case" scenarios will require substantial financing. The United Nations Environment Programme (UNEP) estimates that US$35 billion will be required annually even if global warming remains below 2°C. [41]

Africa's farmers are extraordinarily resilient but they bear little responsibility for the forces driving climate change. Yet countries with the biggest carbon footprints have failed to act on their international commitments, let alone their responsibilities, to support adaptation.

Developed countries have made several commitments to finance climate change adaptation, including a pledge to mobilize US$30 billion between 2010 and 2012 under the United Nations Framework Convention on Climate Change. This "fast start" finance was made in conjunction with an agreement that by 2020, developed countries would mobilize US$100 billion of climate finance per year for developing countries from public and private sources. Unfortunately, donors have contrived to produce a highly fragmented delivery system, wrapped in inconsistent, and occasionally opaque, reporting systems.

Looking across the 18 separate climate funds in operation in Africa, it is estimated that US$682 million in adaptation financing was approved between 2003 and 2013, but just US$293 million has been disbursed. The financing covered 165 projects, suggesting an average grant of around US$10 million.

What of the "fast start" financing commitment? Donors themselves report having exceeded their US$30 billion commitment.[42] However, adaptation financing represented US$5.6 billion, a small share of the total. Several African countries figure in the list of top 10 recipients for "fast start" adaptation financing, including Ethiopia, Kenya, Mozambique and Niger. But most of the reported amounts are modest in scale – between US$100 million and US$224 million – and it is not clear how much of the financing represents new money. Not all adaptation financing travels through dedicated climate funds, however. Some development assistance also targets adaptation goals. According to UNEP, total aid spending on adaptation in Africa was running at around US$1.1 billion during 2010 and 2011.[43]

Standing back from the detail of the estimates, two themes stand out. First, adaptation financing remains much lower than even the most conservative assessment of need. As one group of commentators has written: "The extreme vulnerability of many Sub-Saharan African countries to the likely impacts of climate change means that adaptation should be seen as a higher funding priority. … These small projects are unlikely to achieve impact at scale without significant additional and integrated spending."[44] Second, the highly fragmented nature of the adaptation financing system does not lend itself to the type of coordinated, system-wide and region-wide responses required for adaptation planning.

Africa's farmers cannot be allowed to sink or swim under climate change with only their own resources to rely on. Rich countries are now investing billions of dollars annually in strengthened flood defences and insurance payouts for drought, floods and storms. There is a danger that the world will drift into what Archbishop Desmond Tutu has memorably described as "adaptation apartheid," with governments in rich countries protecting their own citizens but turning their backs on the world's most marginalized people. Priorities for preventing that outcome should include:

- A commitment to scale up adaptation financing for Africa to US$20 billion a year by 2020 and US$35 billion a year by 2050, with a focus on agriculture.
- Clearer donor reporting systems that make it possible to track delivery against commitments.
- The development of flexible financing instruments to support the scaling up of successful projects into national plans.
- Greater coordination within and across African governments to integrate adaptation into national and regional food security strategies.

There is a danger that the world will drift into what Archbishop Desmond Tutu has memorably described as "adaptation apartheid," with governments in rich countries protecting their own citizens but turning their backs on the world's most marginalized people.

The high cost of coping: uninsured risk traps farmers in poverty

African farmers' strategies for coping with disaster are as sophisticated as their ways of dealing with the long-term effects of climate change. During periods of hardship they might borrow against future harvests, transfer labour or migrate. But poverty sets limits to their coping options. When catastrophe strikes in the form of a major crop loss, the choices are often stark.

To carry on putting food on the table, they may have to take children out of school or cut back on health spending. Alternatively, they may sell productive assets such as cattle or farm implements. In the long term, these options reinforce the persistent poverty that holds back the transformation of African agriculture. Enabling poor households to better deal with shocks is thus vital for improving short-term welfare and long-term opportunities for escaping poverty.[45]

Restricted capacity to cope with climate risk is a hallmark of rural poverty in Africa. Almost half of Ethiopia's rural households were affected by a drought between 1999 and 2004. The average reported fall in consumption was 16 per cent – a very big drop given the already high levels poverty. Survey work carried out for the 2007 Human Development Report showed that droughts can cause long-term harm to children. In Ethiopia and Kenya, children aged 5 or less were respectively 36 per cent and 50 per cent more likely to be malnourished if they were born during a drought year. In Niger, children aged 2 or less born in a drought year were 72 per cent more likely to be stunted, or short for their age – a sign of malnutrition. These findings highlight not just the immediate human costs of an inability to cope with climate events, but the potential for those costs to be transmitted across generations.[46]

Droughts can cause long-term harm to children. In Ethiopia and Kenya, children aged 5 or less were respectively 36 per cent and 50 per cent more likely to be malnourished if they were born during a drought year.

One tool that has considerable power to help people cope with climate shocks is not widely recognized as such: insurance. By pooling risk across a large and diverse group, people are able to reduce the costs – the premium – of insuring themselves against catastrophic or damaging events, such as sickness, the destruction of property, the loss of assets, or protracted unemployment. Fundamentally, insurance is an investment in risk management. It enables people to rebuild their lives, livelihoods and assets, and can provide a safety net that gives entrepreneurs and small enterprises the confidence to take reasonable risks in investment.

Agricultural producers in rich countries enjoy access to highly subsidized risk insurance, including "last resort" risk provision delivered by governments in the event of catastrophic losses caused by droughts or floods. In 2012, the US Department of Agriculture spent US$27 billion on crop insurance, which included payments linked to an unusually severe drought in the Midwest.[47] And between 2001 and 2012, the US Federal Emergencies Management Agency more than doubled spending on crop insurance, from US$3.4 billion to US$7.6 billion, reflecting the impact of extreme weather events.

Farmers in Africa operate in a very different risk environment. As we show in Part IV, only a small minority have access to formal insurance markets. Because farmers in any one locality face common risks, the scope for pooling risk is limited: when a drought strikes, all farmers will be affected at the same time. Africa's farmers have to find other ways of managing risk and coping with uninsured risk. They hold back savings that could otherwise have been used to finance investment or consumption. Surveys show that over half of savings in many countries across Africa are geared towards emergency preparedness (see Part IV).

Uninsured risk is part of a vicious circle that keeps Africa's farmers poor and holds back the development of agriculture. Fearful of future loss of income from climate risks, farmers with limited savings may be reluctant to invest in seeds, fertilizers, irrigation or other assets with an uncertain future return.[48] They are more likely to put their money into liquid assets that can be used in the event of an emergency.

Uninsured risk, in other words, deters agricultural producers from undertaking investments that might increase productivity. In the Ethiopian Highlands, for example, a survey covering over 1,500 households found that, when faced with decisions over whether to use new technologies, farmers were more sensitive to potential losses than they were to gains. Households with more assets – whether in the form of oxen, land or cash – were less risk averse, underlining the importance of insurance mechanisms.[49] Research in Tanzania found that households less able to secure themselves against risk were more likely to invest in crops that offered higher levels of food and nutrition security but lower returns.[50] In Uganda, poor farmers unable to insure themselves against fluctuations in income were averse to the risks of investing in higher-return coffee production.[51]

While the evidence remains partial and fragmentary, uninsured climate-related risk would appear to be at the heart of some of the wider challenges facing African agriculture. Underinvestment in inputs such as fertilizer, hybrid seeds, or labour is one factor behind low crop yields in Africa – and the riskiness of adopting new agricultural methods or tools may contribute.

New approaches extend risk insurance

If uninsured risk is part of the problem holding back the development of African agriculture, insurance is an obvious solution. But in a market where poverty is very high, risk is acute and information about the characteristics of individual farmers is limited, the cost of the insurance premium is unlikely to be affordable. The good news is that recent evidence points to a considerable potential for extending affordable insurance.

One important innovation is index-based insurance. This allows individual farmers to protect themselves against production risks through mechanisms that pay out in the event of an observable trigger event, such as reduced rainfall. Because the event can be independently monitored and verified, it reduces the cost of assessing claims and cannot be influenced by the actions of individual farmers.

Several projects have demonstrated the considerable potential of index-based insurance, including the Index-Based Livestock Insurance programme for Kenyan pastoralists and Kilimo Salama ("Safe Agriculture") in Kenya and Rwanda. This suggests a potential for scale-up, but that potential should not be exaggerated. Few projects operate on a non-subsidized basis. Many countries and rural areas lack the necessary weather-station infrastructure. Several field trials have identified complexity as a barrier, with farmers reporting uncertainty in their understanding of the relationship between risk and premium charges. Combining index insurance with access to savings, credit and cooperative marketing arrangements could expand provision, but the low level of financial inclusion in rural Africa is a limiting factor.[52]

Should governments subsidize risk insurance? There are dangers with subsidies, including capture by large commercial farm interests. Governments also have to balance the efficiency and equity effects of a dollar invested in insurance against other options, such as investment in rural feeder roads, education or social protection. But there may be a compelling market-based rationale for subsidizing access to market-based crop insurance that is well designed and targeted. In most African countries, full-cost insurance would exclude the poor from the market. That would prevent them from investing in new technologies and seeds, creating high social costs in terms of lost growth, employment and investment opportunities.[53] In such cases, public subsidies might avert what amounts to a market failure that damages wider social interests.

Social protection can play a key role in buttressing farmers against risk. Africa's farmers would be less averse to the risks that come with new investment opportunities if they knew that failure was not an automatic route into long-term destitution. Putting in place the safety nets that enable people to cope with downturns without having to sell assets, take children out of school or cut consumption could help to unlock investment. This has already happened under Ethiopia's Productive Safety Net Programme. More broadly, social protection provides a way for governments to subsidize the entry of poor people into insurance markets. In Rwanda, the government has progressively increased the coverage of community-based health insurance by subsidizing annual membership fees for 1.5 million of the poorest citizens. Similar approaches could be developed in Benin, Mali and Senegal, where *mutuelles de santé* (health insurance associations) cover many people.[54]

The African Risk Capacity: insurance on a regional scale

Many of the insecurities experienced by uninsured farmers at a local level are mirrored at a national level. Climate disasters such as drought reduce government revenues, divert spending towards emergency relief and curb economic growth. It has been estimated that a 1-in-10-year drought event would reduce Malawi's GDP by around 4 per cent. In Kenya, the 2008–2011 drought cycle is estimated to have cost 2 per cent of GDP annually.[55,56] Here, too, insurance can make a difference.

The current approach to drought focuses on action after the event. Governments and aid donors typically estimate losses and seek funding through humanitarian appeals, with delivery often occurring after a protracted delay. Insurance cannot substitute for humanitarian action, but if African governments pooled their drought risk, they might be able to reduce the cost and increase the predictability of recovery finance.

This is the central aim of an innovative exercise in regional cooperation. The Africa Risk Capacity (ARC), established as a specialized agency of the African Union in 2012, is a groundbreaking effort to pool risk across the region.[57] Underpinning the concept is the basic principle of any kind of insurance: approaching the market as a group will reduce the individual premiums faced by each member.

The ARC's objective is to use the natural diversification of weather risk across Africa to enable participating countries to insure against probable risks. Initial modelling work has demonstrated that by pooling their resources, countries could halve the contingent funds they would need to respond to an extreme national drought event. This would free resources for investment in programmes aimed at strengthening resilience and reducing vulnerability. ARC payouts have been designed to arrive in finance ministries within two to four weeks, and to reach households within 120 days.

Detailed analysis carried out at IFPRI and Oxford University illustrates why pooling through the ARC could be a win-win scenario.[58] Researchers effectively measured the benefits of insurance payouts that enabled households to avoid damaging coping strategies such as reducing food consumption, taking children out of school or selling productive assets. The benefits were found to be considerable: for every US$1 spent on insurance through the ARC, countries stand to save US$3.50 after a crisis unfolds.

Developing and implementing the ARC should be a top priority for the region and its development partners. If successful, it could create a drought response system that saves lives and prevents climate risk from trapping farmers in poverty, thus boosting agricultural growth.

An important caveat on the ARC concerns its scope. It is likely to be highly cost-effective at dealing with more extreme weather events, supplementing national resources to facilitate recovery. For countries with high levels of vulnerability and exposure to frequent hazards, however, insurance has to be supplemented by investment in emergency preparedness. Niger is one such country (Box 8).

BOX 8 EMERGENCY PREPAREDNESS IN NIGER

Insurance is not a panacea. In countries facing chronic risks as well as exceptionally high levels of poverty and vulnerability, standard risk insurance mechanisms will be less effective than investment in risk management and resilience. Niger is a case in point.

Niger is vast, arid and landlocked. Of its 17 million people, more than 7 million live below the poverty line. The country was ranked last out of 187 countries on the United Nations Development Programme's Human Development Index in 2013. Over 50 per cent of GDP and the vast majority of livelihoods depend on agriculture, but structural deficits in agricultural crop production result in almost permanent food insecurity. Niger suffers from uncertain, irregular and insufficient rainfall, and has experienced three major droughts since 2000, along with recurrent floods and epidemics. Drought causes estimated annual crop losses of US$44 million.

Insuring Nigeriens against the risks they face would require subsidies far in excess of budget capacity. The ARC identifies Niger as a country carrying a large burden of uninsurable risk. But investment in emergency preparedness and early delivery of support could reduce the costs of responding to crises, both for the governments and the wider humanitarian community. Exploring three cost-benefit scenarios for investment in early preparedness showed that projected returns to every US$1 in investment varied between US$3.25 and US$5.70.[59]

AFRICA'S AGRICULTURE: GROWING GLOBAL

Global and continental challenges present rich opportunities to be tapped.
The region must now maximise its agricultural potential.

World

2000

6 BILLION
Population

2.9 BILLION
Urban

2015

7.2 BILLION
Population

3.9 BILLION
Urban

2050

9.6 BILLION
Population

6.3 BILLION
Urban

70% Increase in food demand by 2050

Africa

Urbanization
rising rapidly

23 MILLION CHILDREN
attend classes hungry

US$35 BILLION
food import bill, excluding fish

African farmers and fishing communities can raise productivity and...

FEED AFRICA AND THE WORLD

Sources:
UNEP, UNDP, The World Bank Group, and WRI (2013), World Resources Report: Creating a sustainable food future.
UN DESA (2014), Online database.
WFP (2012), Two minutes to learn about school meals.
FAO (2013), FAOSTAT.

Conclusion: African agriculture's opportunities

Analyses of African agriculture have a tendency to focus on the region's undoubted problems. Less attention has been directed towards the extraordinary opportunities available to unleash the potential of Africa's farmers, reduce poverty and enhance nutrition. With an estimated 60 per cent of the world's uncultivated arable land, fast-growing urban markets and millions of resilient, innovative farmers, African agriculture could emerge as a key element in a global food and nutrition security system that is currently under acute pressure. (See Infographic, Africa's Agriculture: Growing Global).

Many of the problems that hold back agricultural development could be resolved through domestic policy reforms. Africa's governments need to take off the handbrake that has been holding back agricultural growth. That means investing in infrastructure, removing barriers to regional trade, and applying the lessons of science to embrace a uniquely African Green Revolution. The wider international community also has a role to play in acting on its aid promises, and in supporting the efforts of Africa's farmers to adapt to climate change. For several decades, smallholder farmers have been swimming against a tide of policy indifference. Over the next decade, governments must create the opportunities that these farmers need if they are to drive growth, share in its benefits and feed a growing population.

Africa's governments need to take off the handbrake that has been holding back agricultural growth. That means investing in infrastructure, removing barriers to regional trade, and applying the lessons of science to embrace a uniquely African Green Revolution.

03

FISH AND TIMBER:
The Cost of Mismanagement

In our 2013 report, *Equity in Extractives*, we asked how governments could harness the region's resource wealth to economic and social development. We argued that the influx of capital generated by the foreign demand for oil, copper, iron ore and other metals could fund the path-breaking improvements in infrastructure, health and education needed to drive growth that will enhance wellbeing for all of Africa's people.

This year we use a similar lens to examine a wider set of resource mobilization issues. No less than non-renewable petroleum and metals, Africa's renewable fishery resources and forests are a potential source of wealth and opportunity. Governed wisely, they could support livelihoods, promote food security, generate export earnings and support vital ecological systems. But in the absence of effective national institutions and international cooperation, Africa's forestry and fishery resources are consolidating the power and personal fortunes of ruling elites, and enriching foreign traders. As with oil and minerals, governments across the region need to take responsibility for stopping the plunder of public assets – a task that most have failed to address.

Protecting assets and managing resources, renewable and non-renewable

While there are many differences in the challenges posed by renewable and non-renewable resource management, there are also similarities. Four recurrent themes stand out:

The integration of Africa into global trading activities characterized by illegal and unethical practices: In the case of oil and minerals, much of the illegality is centred on the enrichment of national elites and their interaction with multinational companies engaging in practices – such as transfer pricing – that facilitate tax evasion, opaque concession trading and the under-reporting of profits. Opaque company operations managed through tax havens are at the centre of the system. The fisheries equivalent is the plunder of Africa's oceans through opaque and illegal fishing practices.

Weak international cooperation: Many of the practices that facilitate the looting of resources in Africa – tax evasion, overfishing and overexploitation of forests – are global in nature. Yet international cooperation in tackling these problems has, for the most part, been limited to information exchanges, voluntary codes of conduct and broad statements of principle. While the markets in which companies operate and report profits are now globalized, the laws that regulate their practices are still overwhelmingly national – and countries have failed to coordinate legislative changes that would limit the extensive opportunities available for illegal practices.

Political failure on the part of Africa's governments: As we showed in last year's report, many African governments have not put in place the policies needed to harness resource wealth to development.. More broadly, governments have failed to develop accountable and transparent institutions, to share resource wealth equitably, and to publish the terms of mining and logging agreements – opening the door to corruption, opaque deals and large revenue losses.

Capacity constraints: To manage revenue wealth and curtail plunder, governments require institutional capacity. Resources have to be identified and valued. The activities of companies, many of them operating on a global basis, have to be monitored. The terms of concessions and the allocation of permits have to be framed in the light of national priorities. All too often, however, authorities in Africa lack the technological, financial and wider capabilities needed to manage forestry, fisheries and other resources, and to prevent tax evasion.

This is a global issue. Many of the companies most closely associated with tax avoidance and evasion are global multinationals, with offices in several jurisdictions. Their accountants shift profits from one country to another with ease. Media reports of largescale tax avoidance by well-known companies such as Google, Starbucks, and Apple have helped place this issue firmly on the global political agenda. The solution can only come from global collaboration.

Last year's *Africa Progress Report* highlighted issues of opaque business practice in the extractives industries operating in Africa. But this year's report shows how these issues affect other industries too. African countries' losses of assets – renewable and non-renewable – are large, under-reported and almost certainly rising. Nowhere is this more evident than in fisheries and logging. In both sectors, poor governance and ineffective international cooperation are failing to prevent theft, corruption and lost opportunities for development. (See Infograhic, Africa's Losses: Cost of Illicit Flows).

Today, Africa is at the epicentre of a struggle between sustainable management and the unsustainable "mining" of marine assets. Unsustainable mining has the upper hand in that struggle. According to the FAO, most commercially exploited fish stocks are at the limit of sustainable exploitation, with a third of stocks overexploited.[1] Some estimates place the overexploitation figure even higher.[2] Illegal, unreported and unregulated (IUU) activity is a major obstacle to sustainable management. The most widely cited estimates put the value of the IUU catch at US$10 billion to US$23.5 billion.[3] Most of this catch occurs not on the high seas but in coastal waters under national jurisdiction.[4] Sub-Saharan Africa is estimated to lose around US$1 billion annually.[5]

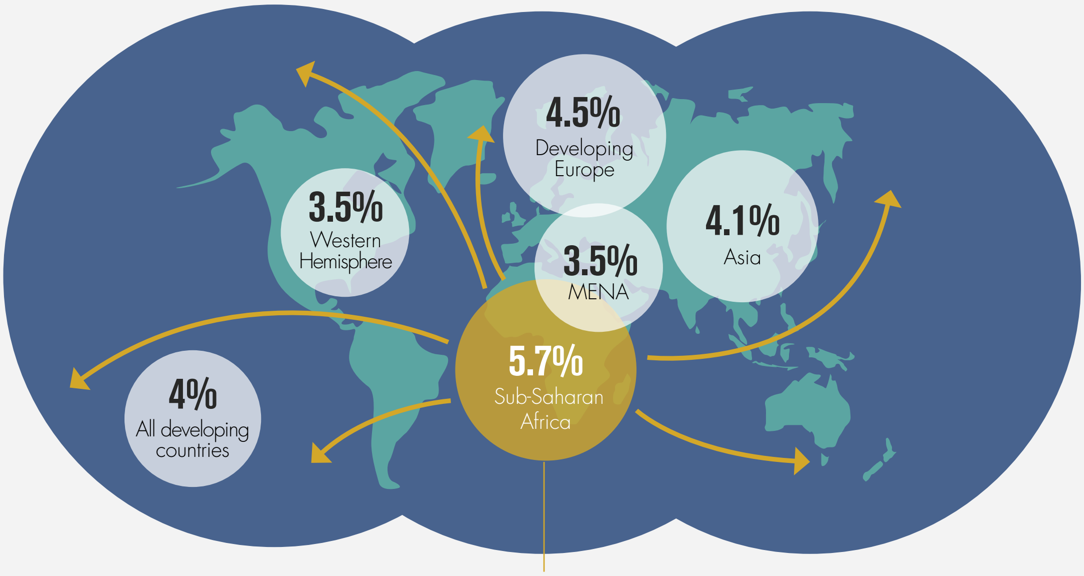
Africa's coastal fisheries – a resource under threat

The rapid depletion of Africa's coastal fisheries is part of a global crisis in fisheries management. Overexploitation is at the centre of that crisis. Illegal, unreported and unregulated (IUU) activity is one of the primary drivers of overexploitation. (See Infographic, Caught in the Rip Tide).

African coastal waters contain some of the world's most prized fishery assets. The Gulf of Guinea and coastal waters of East Africa include some of the world's richest tuna fishing grounds. According to the FAO, half of the fish stocks off the west coast of Africa are overexploited.

AFRICA'S LOSSES: COST OF ILLICIT OUTFLOWS

Percentage of GDP that regions are losing in illicit financial flows



*MENA: Middle East and North Africa

Total illicit financial flows out of Africa

US$50 BILLION

EVERY YEAR

This is equal to 5.7% of Africa's GDP and exceeds regional public spending on health

RESOURCE PLUNDER

Illegal logging

GLOBAL
US$100
BILLION EVERY YEAR

AFRICA
US$17
BILLION EVERY YEAR

IUU fishing

(illegal, unreported and unregulated)

GLOBAL
US$23
BILLION EVERY YEAR

WEST AFRICA
US$1.3
BILLION EVERY YEAR

Sources:
Canby, K. and Oliver, R. (2013), Trade flows, illegality hot-spots and data monitoring.
GFI (2013), Illicit Financial Flows from Developing Countries: 2002-2011.
INTERPOL and UNEP (2012), Green Carbon, Black Trade: Illegal logging, tax fraud and laundering in the world's tropical forests.
High Level Panel on Illicit Financial Flows from Africa (2014).
OECD (2012), Illegal trade in environmentally sensitive goods.

The IUU catch in African waters is very high. West Africa has some of the world's highest reported rates of IUU fishery activity, with one-third to one-half of the catch affected. In Sierra Leone, 252 incidences of illegal fishing by 10 industrial vessels were reported over an 18-month period up to July 2012. In Liberia, over 40 vessels have been investigated for illegal fishing since 2011.[6]

IUU fishery activity is the economic equivalent of the under-reporting of exports and profits on minerals. Once again, the data has to be treated with caution. One estimate from the OECD puts losses from the illegal catch alone at just under US$1 billion annually.[7] Factoring in under-reporting and unregulated activity would increase the figure. West Africa alone could be losing as much as US$1.3 billion annually.[8] In the case of Senegal, the IUU loss – around US$300 million in 2012 – is equivalent to around 2 per cent of GDP.[9]

These figures understate the real social, economic and environmental costs of overfishing. Unlike the mining and petroleum sectors, fisheries represent a critical source of employment, trade and food and nutrition security. In West Africa, up to a quarter of jobs are linked to fisheries, and the sector provides essential proteins, minerals and other nutrients to the diets of the region's people. Up to two-thirds of all animal protein eaten by people in coastal West African states is fish.[10] Meanwhile, artisanal fishers are linked to consumers through a vast intra-regional trading network in which women play a central role.[11] Apart from draining the region of revenue, overfishing is reducing fish stocks, lowering artisanal catches, harming the marine environment. It also is putting the livelihoods and food and nutrition security of millions of people in West Africa at risk.

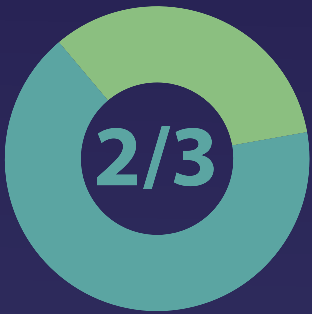
Failures that enable overexploitation

African governments need to focus not only on maintaining fish stocks and the integrity of the marine environment, but also limiting the unequal competition between industrial fishing fleets and artisanal fisheries.

Rising global demand for fish, especially in emerging markets, and conservation measures in other regions, have made African waters a magnet for fleets from around the world. While fleets from the European Union remain the primary foreign presence, fleets from China, the Philippines, Russia, South Korea and Taiwan have also expanded in recent years. Credible estimates by Greenpeace suggest that a majority of IUU fishing can be traced to vessels from East Asia and Russia.

The subsidies that governments provide to support their fishing industries end up reinforcing the pressures on global fish stocks. Financial support for fishing fleets, tax exemptions (notably on fuel), and other measures add up to about US$27 billion annually – equivalent to 41 per cent of the reported value of the global catch.[12] Major subsidizers include the European Union, Russia and East Asian nations with significant "distant water fishing fleets." At least part of these subsidies goes to fleets that are implicated in illegal fishing activities in Africa. Via the European Maritime and Fisheries Fund, the European Union will make around €6.5 billion (US$8.9 billion) available from 2014 to 2020 to support the fisheries sector.[14] Despite appeals from the scientific community,[15] the fund will subsidize investments – including the purchase of new engines – that promote overfishing. Most of the benefits of EU subsidies flow directly to powerful fishing industry interests, notably the companies that operate large fleets from Spain.[16]

CAUGHT IN THE RIP TIDE



of Africa's countries have access to the sea yet **opaque, illicit and illegal practices** are destroying the **potential for a blue revolution**

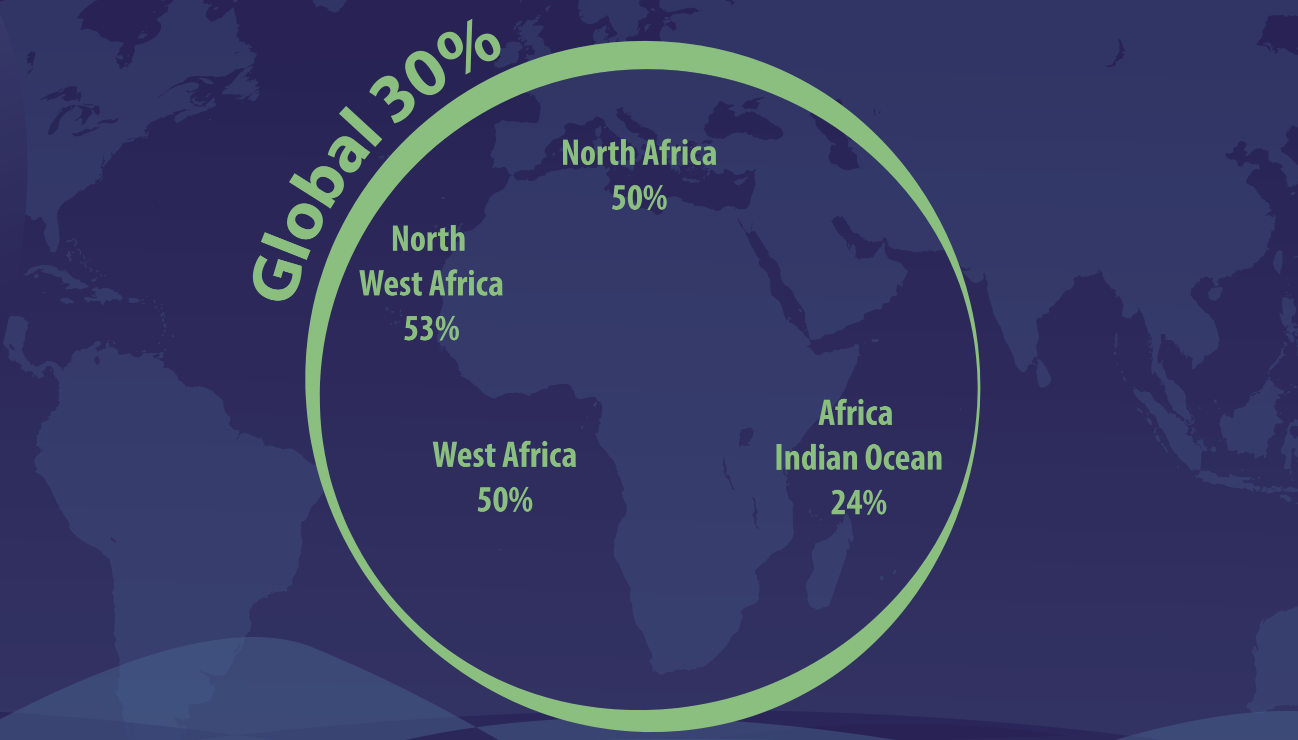
OPAQUE FISHING PRACTICES PLUNDER AFRICA'S OCEANS

$10 - 23 billion
lost every year from the world's oceans in the form of Illegal, unreported and unregulated (IUU) catches

$1.3 billion
lost each year from West Africa's shores

$300 million
lost each year from Senegal

OVERFISHING HAS REACHED ALARMING LEVELS



GLOBAL COLLECTIVE ACTION IS NEEDED TO STOP ILLEGAL, UNREPORTED AND UNREGULATED FISHING

'Financing the plunder' - Rich nations hand over US$27 billion a year in cheap fuel, insurance, etc. to those who are depleting the oceans.

Africa is at the epicentre of a struggle between sustainable management and unsustainable mining of marine fisheries

The majority of Africa's IUU catch can be traced to Russian or East Asian flagged vessels

International voluntary rules for global fishing are a 'coordinated catastrophe' (Global Ocean Commission)

Sources:
Copeland, D. (2014), West Africa has vast marine wealth but it is being depleted by the world's highest levels of illegal fishing.
Economist (2012), A sea of riches: Coastal waters could feed many more Africans, but need better protection.
Economist (2014), Governing the high seas: In deep water.
FAO (2012), State of the World Fisheries and Aquaculture.
Lam, V. et al. (2013), Global Fisheries Subsidies.
OECD (2012), Illegal trade in environmentally sensitive goods.
USAID (2013), Estimation préliminaire des captures de la pêche illicite non déclarée et non réglementée au Sénégal.
Greenpeace (2012), The plunder of a nation's birthright. The fishing license scandal: A drama in five acts.

In theory, foreign fleets operate in African waters on terms dictated by fishery agreements. Countries allocate fishing rights in their exclusive economic zones through private licences, joint ventures and access agreements. In practice, few African governments are able to monitor or enforce the terms of these agreements; most lack the capacity to effectively patrol their coastal waters. For example, Madagascar's exclusive coastal zone, which is subject to extensive illegal fishing by Asian fleets, is overseen by 3 small monitoring vessels, 8 speedboats, 18 inspectors and 22 observers.[17]

BOX 9 MAURITANIA: FAILING TO REALISE THE POTENTIAL OF ITS FISHERIES SECTOR

Mauritania's long Atlantic seaboard is one of the world's most abundant ocean fishing grounds. Bilateral agreements have been signed with neighbouring countries, as well as Russia, Japan and the EU.

Yet the benefits have been limited, whether measured in terms of export earnings or national food security. The terms of formal agreements have improved, but they remain unequal. The EU pays just Euro 70 million (US$97 million) for 100 ships to operate in Mauritanian waters. The agreement, the EU's largest in Africa in terms of finance and volume of catch, includes provisions requiring the fleet to operate at least 20 miles from shore, to use Mauritanian crew, and to transfer 2 per cent of the catch to government.[18] Other formal agreements will reflect the terms negotiated with the EU. However, extensive unregulated, unreported and illegal commercial fishery activity has been reported.[19] There have also been concerns over a lack of transparency. In 2013, the Mauritanian government revoked an agreement negotiated with a Chinese fisheries company that provided 25 year fishing rights and extensive tax breaks. That agreement had been fiercely opposed by local artisanal fishery groups and international environmental organisations.[20]

There are concerns that Mauritania has been unable either to effectively monitor compliance with agreements or to secure wider economic benefits. Just five to 10% of the reported catch is unloaded at Mauritanian ports, and a much smaller percentage is processed locally.[21] Almost the entire landed catch is exported as a frozen product, with limited local value-added.

Some fishery agreements open the door to unsustainable and exploitative practices. African nations have been receiving from European fleets around 6 percent of the value of the catch taken from their waters, of which about a quarter comes from the fleets themselves and the remaining three quarters is paid by European taxpayers. The EU is the only region with an online database of all the contracts. But contracts negotiated with Asian fleets, in particular, are often opaque and poorly designed.[22] Many fall into the category of "pay, fish, go" arrangements that merely specify the number of vessels allowed annually, rather than a ceiling on catches. Payment rates are often very low: levels of less than 4 per cent of the value of landed catch have been reported for South Korea and Taiwan.

A new generation of bilateral EU "fishery partnership agreements" with a small number of African countries could represent an improvement over past practices.[23] They incorporate higher payment for industry (lower for the European taxpayer), technical capacity-building measures, support for local processing, and monitoring arrangements aimed at strengthening sustainability.[24] The EU should be applauded for its efforts to improve sustainability, but it must make more effort to expand fairer access fees to more countries, to negotiate partnership agreements openly, and to help coastal states overcome many of their governance issues, especially on monitoring, control, and surveillance.

In addition, the new generation of agreements still suffer from a systematic failure on the part of the European Union to apply the precautionary scientific principle with respect to catch levels and stocks, to regulate on net sizes, and to disclose the details of individual agreements.[25] One review of the agreement with Mauritania indicates that insufficient attention has been directed to providing technical and financial support for the local processing that could add value to the catch.[26] There are also concerns that in developing bilateral deals, the European Union has actively – if inadvertently – obstructed the development of regional fishery management policies.

Even the best-designed fishery agreements cannot address some of the sustainable resource challenges facing Africa. The region faces systemic governance challenges. Countries are weak in logistics and expertise and have limited information on fish stocks and catches. There is frequently a lack of clarity over which government agency has responsibility. When vessels are caught engaging in IUU activities, judicial penalties are often derisory.

Not all of the blame for overfishing can be laid at the door of unscrupulous foreign fleets. Corruption has had a corrosive effect on regulation, opening the door to overfishing. In Senegal, highly placed political figures were able to sell illegal permits to foreign fleets for personal gain (Box 10). Moreover, African-flagged vessels – including Ghana's commercial tuna fleet – have been implicated in IUU activities. At a regional level, governments have must do much more to harmonize laws, coordinate surveillance and share information.

BOX 10 REDUCING THE ILLEGAL CATCH IN SENEGAL

If illegal commercial fishing is an epidemic across West Africa, its most virulent form is to be found in Senegal – and the worst affected victims are the country's artisanal fishers.

Senegal is one of the world's most fishery-dependent countries. At the centre of the local industry are the 52,000 artisans who use canoes known as *pirogues* to fish for sardines, grouper, snapper, shrimp and mackerel. But the artisanal fishers are just one link in a wider chain. Fisheries are estimated to employ directly or indirectly 600,000 people. Fish accounts for three-quarters of animal protein intake.

Senegal's rich coastal waters provide jobs, food and income – but also act as a powerful magnet for large-scale commercial fishing fleets. These fleets operate across a spectrum of legal, illegal and grey area activities. But it is the illegal catch that appears to be growing most rapidly, with devastating consequences for Senegal's people.

Senegalese law regulates how close to the coast trawlers of different sizes are allowed to fish. Licences to fish are provided under agreement between the government and the flag country of an applicant vessel. The regulatory framework is based on the recognition that competition between artisans and industrial fleets has to be managed in the interests of sustainability and national development. One large trawler is capable of catching 250 tonnes of fish in a single day – equivalent to what 50 *pirogues* might catch in a year.

Over the past decade, the government has responded to growing pressure from artisanal fishers by attempting to strengthen regulation. An agreement with the European Union was cancelled in 2006. In 2012, the new government revoked the licenses of 29 foreign fishing trawlers – several of them 10,000-tonne factory ships – registered in Lithuania, Russia, Ukraine and other jurisdictions. However, vessels appear to have been reflagged as "charter" vessels registered in Mauritania, the Gambia and Guinea-Bissau. With nominal Senegalese ownership, these vessels have a legal right to fish. Along with illegal vessels, they have made frequent incursions into designated artisanal zones.

Recent evidence has provided an insight into the scale of the IUU catch in Senegal. Researchers at the University of British Colombia conservatively put the losses in 2011 at US$300 million – around 10 per cent of the value of exports.

As in other countries, two deep fault lines run through the formal regulatory system. The first is capacity. Like other countries in Africa, Senegal has very limited monitoring and tracking capabilities. Much of the evidence surrounding the illegal activities of Russian vessels has been provided by Greenpeace, an independent global campaigning organisation. However, there is encouraging evidence of a more robust approach to protecting national fisheries. In early 2014, a Senegalese court handed out the largest ever fine on a foreign vessel, US$12 million, to the operators of a Russian ship, the Oleg Naydenov.

The second fault line has been in domestic governance. Under the previous government, 11 special authorization protocols were signed by the then minister of maritime economy for politically well-connected individuals acting on behalf of the agents of 21 ships (including the Russian vessel mentioned above). These protocols, which provided for extensive fishing rights in sensitive artisanal areas, were not published at the time. They appear to have been inconsistent with Senegal's own fishing laws and were contested by the prime minister, but were endorsed by the then president.

Taking action to ensure fisheries are sustainable

African governments have primary responsibility for policies that maintain fish stocks while enabling their people to benefit from them. But Africa's capacity constraints mean it is crucial to strengthen international cooperation in defence of marine ecology and sustainable fisheries, which are vital global public goods.

There is no shortage of credible frameworks for action. The FAO-sponsored International Plan of Action to Prevent, Deter and Eliminate Illegal Unreported and Unregulated Fishing sets out many of the elements needed to tackle IUU activities. There is also an FAO code of conduct, which includes the use of Vessel Monitoring Systems (VMS) to monitor the location of fishing vessels. Much of the institutional architecture required for effective multilateral action is in place. Dozens of UN organizations, regional bodies and commissions have responsibilities touching on overfishing. The authority of the World Trade Organization could be brought to bear on the subsidies that promote overfishing.

International cooperation has so far been ineffective, however, partly because the overlapping mandates of international bodies and agreements leave loopholes so vast as to make them irrelevant. The UN Convention of the Law of the Seas has been ratified by almost every country in the world (the United States is an exception) but is weak on conservation, and has no powers of enforcement. The FAO does not have the resources to monitor compliance with its own code of conduct. The Global Ocean Commission has described the patchwork of voluntary rules and fragmented institutions as a "coordinated catastrophe."[27] To that concern can be added the undue power of fishery lobbyists in informing the approaches that governments bring to multilateral forums.

Not all of the news is bad. In 2010, the European Union, the largest global seafood market, introduced regulations that aim to increase the traceability of catches and allow for the blacklisting of illegal fishing vessels and non-cooperative countries.[28] Questions remain about how far the EU Commission and some EU member states will go in enforcement. But three countries – including Guinea – have been listed as non-cooperative. Another eight have been given a "yellow card" warning, including South Korea, identified for failing to control its vessels operating in West Africa, and Ghana. Concerns about illegal fishing by Ghanaian-flagged vessels have led to several shipments of tuna being held up or refused entry to the EU market – a move that has prompted Ghana to address deficiencies in fisheries management and establish a dedicated ministry.

There is also evidence of a more robust approach in Africa itself. Efforts are being made to improve policy and legal frameworks and increase enforcement capacity. Targeted international support is growing, through funding, training and the provision of seaborne and air patrols. NEPAD and the FAO are cooperating to support the development of stronger regulatory frameworks. Critically, several governments are now trying to ensure that IUU crimes do not pay. In 2013, Liberia charged two South Korean vessels US$1 million each for illegal fishing. National action by civil society and local communities is also making a difference. In Sierra Leone, fishing communities backed by an international NGO have taken monitoring and surveillance into their own hands (Box 11).

None of this is enough. There is a need for far stronger international and regional cooperation, and improved governance. The elements of successful fishery governance can be identified by looking at what has worked best in other parts of the world. Iceland has an unrivalled record – and one that has some resonance for Africa. The fisheries sector has played a pivotal role in Iceland's transformation, providing jobs, generating exports and supporting the development of a high value-added export industry. Success has been built on three pillars: science, strategy, and enforcement (Box 12). But a precondition for that success was the protection of the country's vital marine assets from overexploitation by predatory commercial fleets from more economically powerful countries.

There are limits to the power of analogy; Senegal is not Iceland. Yet African countries could usefully follow Iceland's example, with political leaders prioritizing action aimed at protecting coastal waters from IUU activities and monitoring stocks. More widely, the wider international community could turn what are currently broad principles for sustainable fisheries policies into practical action. Among the priorities:

Regional action and harmonization: Governments across Africa have a strong interest in cooperation. Their navies should be working together more closely to monitor and protect coastal waters from IUU activities, especially the inshore territorial waters vital to artisanal fisheries. Governments could also support the development of artisanal fisheries and meet shared food security goals by developing regional markets for fishery trade. Their scientific communities should be cooperating more effectively in monitoring marine ecologies and fish stocks. In all of these areas, the benefits of pooling expertise and resources are underexploited.

Enhanced transparency: African governments and their trading partners should disclose in full the terms of fisheries agreements, including not just information on quotas and prices but also commercial interests and associated payments to nationals connected to the agreements.

Global registration of fishing vessels: Unlike passenger and cargo ships, fishing vessels are not required to carry a unique ID registration number. Governments could – and should – make this mandatory and use technology to track and share information on fishing fleets. The International Maritime Organization (IMO) provides a ready-made institutional framework.

Tackling "irresponsible flag states": Many commercial fishing vessels operating in Africa are registered to states that are either unwilling or unable to carry out their regulatory responsibilities. This transfers the burden of controlling "rogue vessels" to African governments that often lack the capacity for effective regulation. "Flags of convenience" are a maritime equivalent of tax havens. The system makes it possible for beneficial owners to hide behind shell companies or nominees. Here, too, the IMO could establish a registry of fishing vessels sailing under a flag of convenience. This would give African governments the option of avoiding agreements with such vessels.

More effective port measures: One of the most effective ways in which governments can regulate through multilateral rules is via controls in ports where the fisheries catch is landed and reported. Coastal nations can help keep illegally caught fish out of the market place by denying port entry and services to foreign vessels suspected of illegal fishing. The FAO has adopted a legally binding agreement to this effect, the Port State Measures Agreement. But this treaty needs 25 ratifications before it can enter into force. To date, only 11 states, including the European Union, have ratified the agreement.[29]

Legal enforcement: Norway has led an initiative that would establish IUU fishing as the "transnational crime" that it is. Such an approach could bring IUU activities under the remit of Interpol, with police, customs agencies and justice ministries playing a more active role in enforcement. Given that IUU represents a form of theft from national revenues comparable in nature to tax evasion and avoidance, there are strong grounds for the G8, G20 and other country groupings to consider this option.

Ending subsidies: The Rio+20 declaration of 2012 included a commitment "to eliminate subsidies that contribute to illegal, unreported and unregulated fishing and overcapacity."[30] But there is a clear lack of political appetite to act on this commitment. Governments have been unable to agree on the precise definition of a harmful fisheries subsidy, let alone a plan of action. The WTO is the most promising route for effective multilateral engagement, not least because its rules are legally binding. As a starting point, all OECD and middle-income countries should agree to a comprehensive ban on production-related subsidies – including fuel exemptions – that facilitate overfishing.

BOX 11 A GLOBAL PROBLEM MEETS LOCAL ACTION IN SIERRA LEONE

Faced with weak interactional action and failing domestic governance, some fishing communities in West Africa have found an innovative way of taking the law into their own hands. Armed only with rudimentary surveillance equipment supplied by a London-based organization, the Environment Justice Foundation (EJF), they are driving off fleets of "pirate" trawlers by filming and reporting them.

Over a two-year period, local fishers in the Sherbro river area of Sierra Leone filmed and identified 10 international trawlers working illegally in their protected waters and made 252 separate reports of illegal fishing. The evidence was passed on to African governments and EU, fishing ports and other communities. Nine of the 10 ships identified by the Sierra Leonean communities were found to have licences to export their catches to Europe.

The effect of communities policing their own waters has been spectacular, EJF says. More than US$500,000 in fines has been collected from the vessel owners, US$6 million worth of fish has been seized and none of the vessels has been reported in Sierra Leone's inshore exclusion zone for six months.[31]

BOX 12 ICELAND'S STRATEGY FOR SUSTAINABLE FISHERIES: SCIENCE, MONITORING AND ENFORCEMENT

Once a desperately poor Danish colony, Iceland has emerged as a prosperous society. Since the mid-1970s,[32] improved governance of fisheries has played a central role, creating jobs, generating export revenues, financing public investments – and pushing Iceland to the top of the Human Development Index.

Iceland's fisheries wealth can be traced partly to its location. The warm Gulf Stream meets cold polar currents in the country's coastal waters, making them exceptionally rich in nutrients, plant and animal life. But Iceland's success is also the product of political leadership and a fisheries policy grounded in science, monitoring and enforcement.

Protection of fish stocks was crucial. Foreign fleets had been exploiting Iceland's rich coastal waters since the arrival of steam power. It took 75 years for the country to win jurisdiction over its fishing grounds, eventually extending its exclusive economic zone to 200 nautical miles from the coastline by 1975. When UK vessels threatened that zone, Iceland deployed its navy to assert its legal rights.

Encroachment by foreign commercial fleets was not the only problem. Iceland's own large and increasingly industrial fishing fleet was depleting vital stocks. Supply management was vital to the future of the industry and the national economy, so in 1984 Iceland allocated vessel quotas, based on rigorous scientific evidence on fish stocks.

Regulation and monitoring has been critical to the effectiveness of the quota system. The Directorate of Fisheries receives records of landings for each vessel, which take place only in designated landing ports with certified scales and weighing personnel. The directorate also uses a computerized catch registration system to collect, store, process, and disseminate information on the catches of all Icelandic vessels.

Countries in Africa can draw some useful lessons from Iceland's experience – and so can the wider international community. The practices underpinning the quota system – the use of science to establish establishing a sustainability ceiling on the catch, the allocation of quotas and rigorous monitoring of landed fish – are precisely what are missing at an international level. Similarly, if African countries are to protect their fish stocks, they too will need to assert their rights in territorial waters – a move that will require international support.

Managing Africa's precious forestry resources

Covering approximately 200 million hectares, the forests of Africa's Congo Basin are second in size only to those of the Amazon Basin and support the livelihoods of 60 million people.[33] They provide food, fuel and vital ecological services. They also provide a global public good, absorbing the greenhouse gases that contribute to climate change.

Today, the Congo Basin forests are at the frontier of a struggle to harness Africa's resources for sustainable development. Rapidly growing global demand for timber has increased the export value of commercial logging.

Illegal logging activities are flourishing, often with the covert, and sometimes overt, support of political elites. Assets that could enhance the lives of millions of Africans across generations are being sold off at a fraction of their real value to secure short-term profits.

On one detailed estimate by The World Bank Group, the proportion of Congo Basin forests at risk of deforestation ranges from 64 per cent in the Central African Republic to 92 per cent in the Republic of Congo – and extensive deforestation is already evident in Cameroon.[34] The northern and southern parts of the region, which have an abundance of commercially valuable species such as African mahogany, are particularly at risk.

Many of the elements of the fisheries story discussed in the previous section are being played out in the forests of the Congo Basin and beyond. Here, too, the commercial value of an African natural resource is increasing as a result of global forces, notably the insatiable demand for timber to support construction in growing urban centres. Since the colonial era, European companies have played the leading role as concession holders and/or sub-contractors in joint ventures with local entrepreneurs and elites.[35] In recent years they have been joined by Asian companies, especially from China.[36,37] Logs and lumber from Africa currently make up about 4% of China's forest product imports, with a value of US$1.3 billion, according to Chinese government statistics. But this Chinese market is huge and set to grow.[38]

As with fisheries, Africa is integrated into a timber export market in which illegal, unregulated and unreported trade flourish, generating fortunes for some, while depleting a vital resource. Illegal timber trade is estimated by INTERPOL to be worth up to US$100 billion annually.[39] And here, too, corruption, limited capacity and poor regulation in Africa, combined with weak international cooperation, are undermining sustainable resource management.

African governments allocate commercial rights to forestry resources through permits, as in the fisheries sector. However, there is a vast gap between the formal rules set out in forestry agreements and reality on the ground. Systematic abuse of poorly regulated logging permits – by companies, forest officials and politicians – is undermining efforts to fight deforestation and prevent illegal timber exports. "Shadow permits" are often sold to foreign companies through corrupt political processes.[40] In Cameroon, dozens of "small titles," a long-standing byword for illegal logging, were provided in 2011. Ghana's forestry commission has been challenged by national and international civil society groups over failure to enforce stewardship rules in concession areas.

Trade with emerging markets has added another layer of complexity. The few large-scale Chinese concessions and forestry companies operating in Africa are mostly in Cameroon, Gabon and Ghana. In the DRC, there are no official Chinese-owned forestry concessions, but an apparently increasing share of the 4 million cubic metres of timber currently produced each year under artisanal permits is being bought by informal Chinese timber traders.[41]

While the international community recognizes the vital importance of forests as a global public good, action to protect that good has been limited. There are hundreds of "good stewardship" principles adopted by companies exporting and using timber. These agreements are entirely voluntary. Most are based on labelling, using information to inform consumer choice. While such initiatives have made a difference, they are not a substitute for regulation backed by enforcement. The European Union has established comprehensive voluntary partnership agreements (VPAs) aimed at keeping illegal timber out of the EU. But companies have exploited loopholes and weak governance to circumvent these agreements. One estimate for 2011 put illegal exports at 12.4 billion (US$17.1 billion).[42]

In addressing the challenge of sustainable resource management, African governments have to consider two sides of the balance sheet. One side is easy to measure. Export value can be assessed in terms of dollar earnings, even though the headline figures and projections often exaggerate reality. On the other side of the balance sheet, sustainably managed forests can support a vast range of agricultural activities and livelihoods. They can also provide a foundation for a transition from logging to timber industries that add value. For countries lacking the scientific, technical and commercial capabilities to assess the forestry balance sheet, it is often difficult to identify the appropriate level of exploitation – let alone to enforce compliance with quotas.

Aid donors have played no small part in misrepresenting the balance sheet. They have consistently overestimated the commercial returns to logging. Countless reports have made the case for a regulated, industrial-scale, export-based logging model, often with scant regard for underlying regulatory capabilities. Unsurprisingly, the anticipated development benefits have seldom materialized.[43]

Actual revenues received by producer governments have been a fraction of those projected. Tax evasion has contributed to the shortfall. In 2012, the finance ministry in the DRC is estimated to have received less than 10 per cent of tax dues from logging (a loss of US$11 million), partly as a result of tax evasion but also because of tax breaks that systematically undervalue the country's forestry assets.[44] At the same time, overexploitation and therefore depletion of tropical forests has been far higher than projected, primarily due to corruption and illegal logging.

The experience of Liberia is instructive. Timber exports were used to finance violence and human rights abuses perpetrated by the National Patriotic Front of Charles Taylor and other Liberian warring factions during the years of civil conflict (1989–2003). The trade was brought to an end by United Nations Security Council (UNSC) sanctions in May 2003. Following the peace settlement, the international community put forestry at the centre of reconstruction planning. Unfortunately, two familiar mistakes were made and "the Liberian forestry sector remains in disarray as the ongoing issues related to the illegal allocation of forest resources through the misuse of private use permits remains unresolved." This, according to the UNSC Panel of Experts' final report of November 21, 2013, "is a symptom of larger, unaddressed problems in the forestry sector, the broader weakness of natural resource governance and the persistent inadequacies of the land tenure framework in Liberia."

The core issues can be summed up as follows: First, the export and revenue potential of the sector was vastly exaggerated. Second, while lip service was paid to the "Three Cs" of forestry – commerce, community and conservation – the focus was overwhelmingly on commerce, and insufficient attention was paid to regulatory capacity. A key recommendation in the UNSC report presented by the Special Independent Investigative Body to the president of Liberia in December 2012 was to hold accountable, including through criminal prosecution, those responsible for any illegal activity related to the issuance of private use permits.[45] As the UNSC Panel has reported, some of the individuals implicated have been dismissed from the Forestry Development Authority and the Ministry of Lands, Mines and Energy. Several indictments are underway (see Box 13).

BOX 13 LESSONS FROM LIBERIA'S FORESTRY REFORMS

As a small country emerging from civil war with a government enjoying the support of the international community, Liberia faced enormous challenges in forestry reform – along with great opportunities to harness a vital asset to national development. The lessons of the past decade are revealing.

An early, and positive, first step was a presidential decree in February 2006 that all existing concessions were illegal; the forest sector thus began with a clean slate.[46] The Liberia Forest Initiative (LFI) created the legal, institutional and regulatory framework for forest management and timber concessions, and established key agencies such as the Forest Development Authority (FDA).[47]

On paper, the new framework represented a model of good principles. The record on converting those principles into practice was less encouraging. Four areas stand out:

Logging concessions: The first two rounds of concession allocations, or forest management contracts (FMCs), in 2008 and 2009, were rushed. None of the companies met the government's legal and financial requirements. The pre-assessment of available commercial timber was flawed. Companies overbid substantially, either through a failure of understanding, or because they believed potential earnings could be raised by other means. The government's own due diligence process revealed that the bidders lacked the financial capital or the technical knowledge necessary to manage forests at all, let alone sustainably.[48]

Revenue shortfall: The financial outcomes, detailed in the table below, are a testament to the unrealistic expectations surrounding the potential for industrial-scale logging in Liberia. Revenues have consistently fallen short of the projections made by UN agencies, the World Bank and, under the guidance of donors, the government of Liberia itself. Actual export earnings in 2013 were one-10th of World Bank projections, for example. Revenue generation has also fallen short of expectations because of non-payment by companies. As of August 2013, logging companies owed the state US$43.7 million in arrears.

Private use permits: With returns from the concession system falling short of expectations, logging companies sought out other sources of revenue. Their chosen vehicle was a mechanism known as private use permits (PUPs). Originally designed to allow private landowners to profit from their forests, PUPs have lower environmental requirements than concessions for commercial logging operations – and they generate far lower returns to the government. There is evidence that some companies were able to exploit this loophole in collusion with senior figures in the FDA. Logging companies fraudulently obtained deeds covering 40 per cent of Liberia's forests. Global Witness, together with two internationally lauded Liberian NGOs, Save My Future (SAMFU) Foundation[49] and the Sustainable Development Institute (SDI)[50], exposed the PUP scandal in 2012. As a result, the president placed a moratorium on granting of PUPs and ruled all the 63 PUPs issued to be illegal. The government has cancelled 29 of the illegal logging permits and is in the process of cancelling the remaining concessions.[51] On February 22, 2014, the Liberian ministry of justice indicted eight former government officials for facilitating the award of PUPs, including the former head of the Forestry Development Authority.[52]

Community forest management agreements (CFMAs): CFMAs have the potential to balance commercial interests with the interests of forest-dependent communities. However, many logging companies have used CFMAs to exploit regulatory loopholes. As of February 2014, there were at least five CFMAs that were de facto logging concessions, covering 220,000 hectares.

INFLATED EXPECTATIONS: PROJECTED VERSUS ACTUAL REVENUES FROM LOGGING IN LIBERIA

Fiscal year	Predicted total revenue from logging (US$ million)			Actual revenues
	UN Panel of Experts[53]	*World Bank*[54]	*Government of Liberia*[55]	
2011–12	15-20	39.2	46.1	5.2
2012–13	15-20	39.2	184	12.4
2013–14	15-20	34.2	> 17.6[56]	3.5

Six principles for managing Africa's forests sustainably

As commercial pressure to exploit Africa's forests mounts, there is an urgent need to rethink approaches to sustainable resource management and to strengthen regulation. In countries marked by conflict and weak governance, there are no easy answers – and there are no blueprints. But six central principles should apply:

Strengthened transparency: All commercial logging concession contracts should be subject to full disclosure, along with the beneficial ownership structures of the companies involved. No concessions should be provided without the prior informed consent of the communities involved, based in turn on a clear and accurate representation of potential costs and benefits. Equally important is a strengthening of the rights of forest-based peoples and communities. Community forest management agreements (CFMAs) could provide enhanced opportunities and livelihoods for forest-dependent people if they are developed as originally intended.

Enhanced monitoring and regulation: Even the best regulatory frameworks count for little in the absence of effective monitoring. Regional organizations, commercial companies and international partners should be doing far more to support the development of monitoring and information systems. So should governments. One promising development is a regional initiative that will help 10 countries in the Congo Basin to set up advanced national forest monitoring systems: Burundi, Cameroon, Central African Republic, Chad, the DRC, the Republic of the Congo, Equatorial Guinea, Gabon, Rwanda, and São Tomé and Principe. The forestry project will be managed jointly by the Central Africa Forests Commission and the FAO in close collaboration with the Brazilian National Institute for Space Research. The Congo Basin Forests Fund, launched by the governments of Norway and the United Kingdom through the African Development Bank, is funding the initiative with €6.1 million (US$8.4 million). The establishment of protected areas is crucial for the long-term sustainability of contiguous forests. In 1999, the states of Central Africa agreed to the Yaoundé Declaration for the conservation and rational use of Central African forests. As a result, new protected areas have been established in Cameroon (4), Gabon (13) and Equatorial Guinea (10).

Rethink the balance between ecology and exports: Governments and the public in many countries remain insufficiently informed about the actual and potential value of forests, including the non-monetary aspects of the environmental benefits that they provide. Agencies such as the World Bank and the African Development Bank should be more active in seeking to change this perspective. This does not imply a policy of "zero exploitation." If selective harvesting practices are followed, the environmental footprint of timber operators can be minimized. However, the implementation of such practices has been hampered by the lack of a regulatory framework and control. It is now of vital importance to introduce and regulate sustainable forestry practice, with independent certification.

Dialogue with China: No multilateral framework on sustainable forest management in Africa will have credibility unless China is involved. The application of official Guidelines on Sustainable Overseas Forests Management and Utilization by Chinese Enterprises, jointly issued by the Chinese State Forestry Administration and the Chinese Ministry of Commerce, is a useful starting point.[57]

Paying Africa for the public goods it provides: The UN collaborative initiative on Reduced Emissions from Deforestation and forest Degradation in developing countries (UN-REDD) presents new opportunities to conserve forests. If countries in Central Africa are to benefit from a REDD mechanism, national incentive schemes geared towards poor communities must address the complex problem of forest destruction by slash-and-burn farmers without land title.

International action and informed consumer choice: New legislation in Europe, the United States and Australia puts the onus on timber importers and traders to be ready to demonstrate that their timber is legal. These rules apply irrespective of whether the timber has passed through a third country (such as China or Vietnam) during the manufacturing process. This has precipitated major, systemic change in forest-rich developing countries, strengthening the hand of reformers. The European Union could play a leadership role in strengthening multilateral action. Its Voluntary Partnership Agreements (VPAs) with timber-exporting countries include comprehensive forest governance reforms aimed at stamping out illegal trade. However, neither the EU Timber Regulation nor the VPAs take account of the widespread use of shadow permits. EU governments should strengthen legislation requiring importers to do proper checks all the way along their supply chains in order to eradicate shadow permit trading.

04

BUILDING THE BRIDGES AFRICA NEEDS:
Infrastructure and Finance

If Africa is to make the transition from high growth to transformative growth that we have described, with agriculture at its heart, then it must overcome three major obstacles. The first is a lack of access to formal financial services. Two-thirds of adult Africans do not have a bank account, let alone access to savings, credit or insurance. The second obstacle is the weakness of Africa's infrastructure: its poor roads and ports, its lack of electricity, sanitation and water. The third is the lack of funds for public investment. To close the region's vast deficits in infrastructure, governments must mobilize the tax revenues and external finance needed to underpin public investment. This would support the development of agriculture and a skilled workforce.

Overcoming these three deficits is a condition not just of rising prosperity but also of shared prosperity. Agriculture is the key to the kind of growth Africa needs, but no sector suffers more from financial exclusion, infrastructural weaknesses and lack of public investment.

Inclusive finance plays a vital role in development. Without access to financial services, poor people and small enterprises have to rely on their own limited resources to invest in entrepreneurial activity, or to insure themselves against risk. As we saw in the previous section, uninsured risk is part of the poverty trap in which millions of smallholder farmers are caught. Springing that trap will require changes in financial regulation and exploitation of new opportunities created through technological innovation, such as mobile banking.

Like financial systems, infrastructure occupies a pivotal position in social and economic life. Companies use energy to produce the goods and services on which employment depends. Transport systems link people and markets. Social infrastructure – such as water and sanitation – enables people to avoid health risks. But Africa's poor infrastructure acts as a bottleneck constraining growth, driving up the costs of producing and marketing goods. The costs are spread across society, but the poor, smallholder farmers, and small and medium-sized enterprises bear the brunt.

This section of the report is divided into three parts. Part one highlights the limited access to financial services evident across much of Africa. Part two asks why Africa finds it so difficult to attract investment for infrastructure programmes that offer high returns, in a world awash with liquidity. Part three shows that while external finance such as foreign direct investment and eurobonds can play an important supplementary role, no country can afford to neglect the development of domestic revenues and the accompanying social contract between governments and citizens.

1. A lack of financial services is holding Africans back

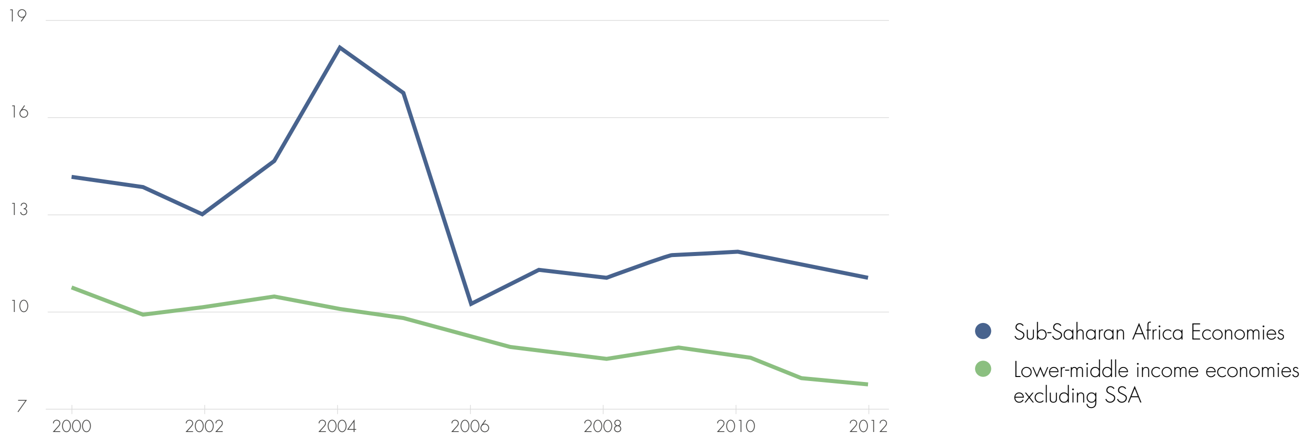
Developing the financial sector is one of the most urgent challenges facing Sub-Saharan Africa. As the governor of Ghana's central bank has put it: "An efficient financial sector provides the rudiments for income growth and job creation [and] … financial development contributes to the reduction of poverty and inequality."[1]

Despite the robust growth of the past decade, the poor coverage of the region's financial systems remains a brake on growth. The vast majority of low-income households, agricultural producers and firms lack access to financial services. The resulting deficit traps people in poverty and restricts market opportunities. While low average income is a constraint, in much of Sub-Saharan Africa the policy environment is not conducive to the development of efficient and equitable financial systems.

Financial systems cover far too few people

Africa's banks typically serve a minority of the population. One way of measuring the coverage of the financial system – or "financial depth" – is by the ratio of private credit to GDP. That ratio averages 31 per cent in lower-middle income countries. In Uganda and Zambia it is less than 20 per cent, and in Chad it is just 5 per cent. In addition, only a third of African countries have stock markets, most of which are small and illiquid. The weak role of banks in Africa is reflected in interest rate spreads – the gap between the borrowing rates and lending rates of financial institutions – which are among the largest in the world (Figure 14). The spread matters on several counts. Low interest rates for savers deter the development of deposits, while a combination of high interest rates and the domination of short-term credit limit investment opportunities. Although individual country circumstances vary, the following are among the primary factors behind large interest rate spreads:

FIGURE 14 AFRICA HAS SOME OF THE WORLD'S LARGEST INTEREST RATE SPREADS (LENDING RATE MINUS DEPOSIT RATE, %)



Source: The World Bank Group (2014), World Development Indicators.

Market concentration: Market power and the "too big to fail" syndrome are characteristics of many banking systems around the world. However, international comparisons suggest that Africa is home to some of the most concentrated banking systems. In Mali, five banks account for over two-thirds of assets and 70 per cent of deposits.[2] Ethiopia's banking sector comprises one state-owned bank and 18 commercial banks, with one state-owned entity accounting for 70 per cent of the commercial market. Around 85 per cent of Mozambique's banking system assets are held by three banks.[3]

Reach and size: Most of Africa's banking systems operate as small enclaves in the wider economy. In Mozambique and Tanzania, over half of the population has no access to financial institutions. Financial services are dominated by informal providers. The vast majority of Africans access services through microfinance companies and rotating savings and loans groups. Out of a population of 90 million, only 7 million Ethiopians have deposit accounts[4] (and only 112,793 reported borrowing from a bank in 2012). By contrast, the country's 31 microfinance institutions serve 3 million clients. Patterns of provision vary across countries. In Nigeria, the northwest has one-quarter of the formal banking coverage of the southwest; rural coverage is less than half of urban coverage. The limited reach of banks restricts people's access to savings and drives up the costs of delivering services and providing loans. Reinforcing the problems that come with a limited reach, many individuals and companies are unable to meet the formal eligibility requirements for opening an account.

The regulatory environment: Governments use banking systems for a variety of objectives, not all of which are conducive to developing more efficient and equitable financial systems. In Ghana, commercial banks operate a highly lucrative trade in government securities, reducing incentives to seek investment opportunities in the private sector. In Ethiopia, banks are required to hold the equivalent of 27 per cent of their lending in national bank bills. The lower returns on these bills lead to banks raising fees and commission charges. In Zambia, the government holds a stake in 39 state-owned enterprises[5], most of which are unprofitable – and many of which borrow from commercial banks with government guarantees. Many banks are structured principally to secure large profits on trade in treasury bills, rather than to develop wider saving and lending systems.

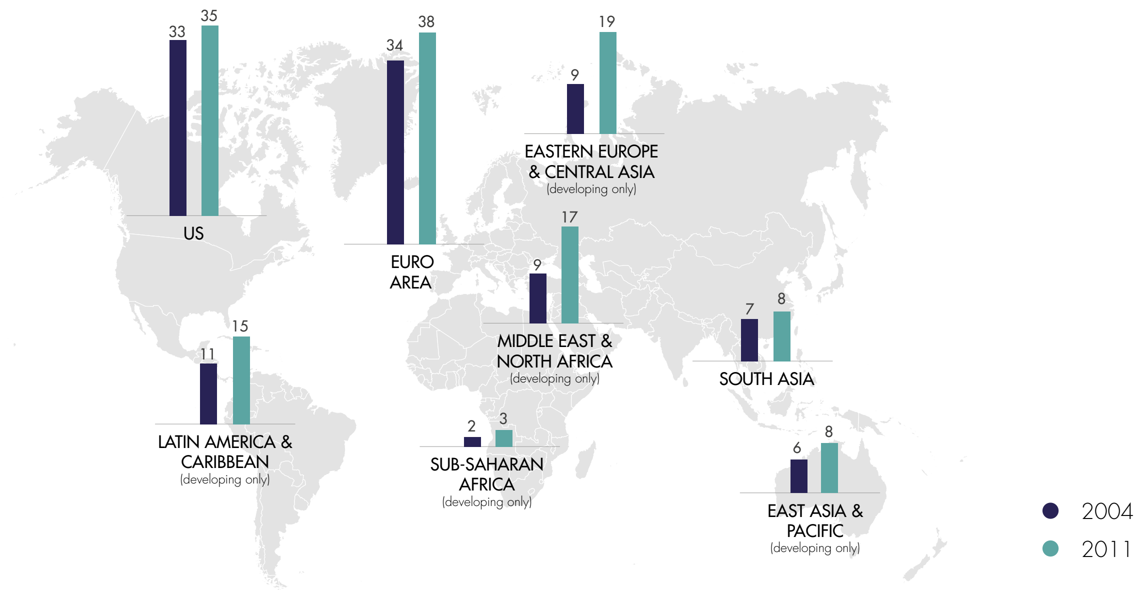
Macroeconomic conditions: While macroeconomic management has strengthened, uncertainties continue to hamper financial development. The inflationary risk associated with Ghana's large fiscal deficit has led to a squeeze on credit and a sharp increase in interest rates. In February 2013, Ghana's central bank authorities raised interest rates to 18 per cent – a prohibitive level for potential investors.

Financial sector weaknesses have far-reaching implications for the real economy. Less than one-quarter of African businesses hold a loan or line of credit – and the problems do not end there. Most banks reprocess savings in the form of short-term loans rather than the long-term credits that companies need to finance investment. Almost 60 per cent[6] of the loans extended by African banks have a maturity of less than one year. Over half of companies surveyed by the World Bank in Burkina Faso, Cameroon, the Democratic Republic of the Congo (DRC), Côte d'Ivoire, Mozambique, Malawi, Niger and Nigeria cited access to finance as a major constraint on investment. In Nigeria, a survey by the World Economic Forum identified access to financing as the single biggest constraint, ahead of corruption and infrastructure.

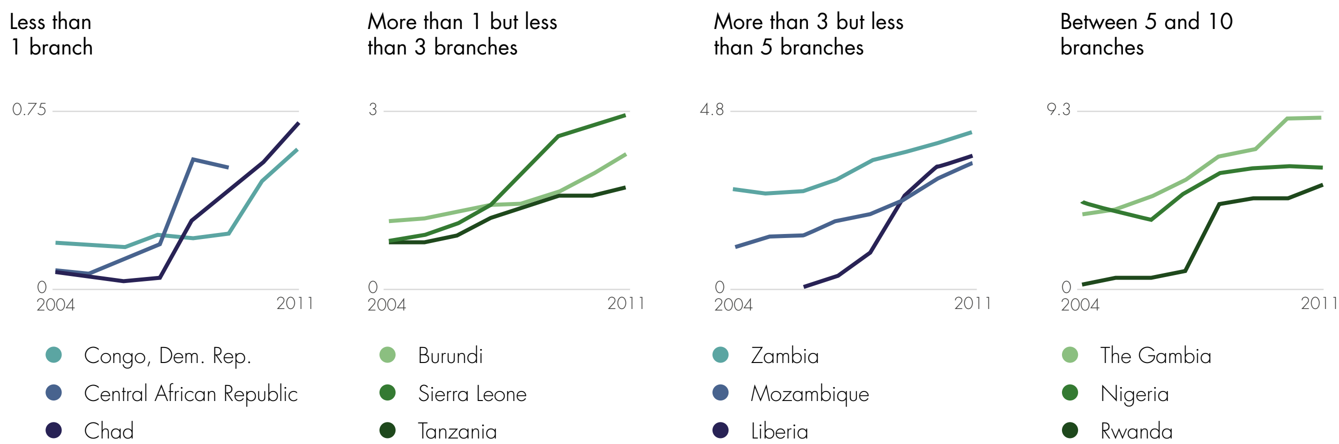
Mapping the gap in financial services

The social and geographic reach of Africa's financial system is increasing. The number of commercial bank branches per head of population, for example, is rising (Figure 15). This trend has to be placed in context, however: Africa's bank branch-to-population ratio is still only 3 to 100,000 – half the level in South Asia. Moreover, there are 4 countries in the region with less than 1 branch for every 100,000 people.

FIGURE 15 AFRICANS LACK ACCESS TO BANKING: COMMERCIAL BANK BRANCHES PER 100,000 ADULTS



BANK PRESENCE IS GROWING FROM A LOW BASE: COMMERCIAL BANK BRANCHES PER 100,000 ADULTS



Source: The World Bank Group (2014), G20 Financial Inclusion Indicators.

Most Africans are disconnected from the formal financial system. Over two-thirds of the adult population – 316 million people – have no bank account. Coverage rates vary enormously across Africa. In half of the countries for which data is available, fewer than 15 per cent of adults have accounts at a formal financial institution.

Financial system coverage tends to rise with economic growth, as measured by per capita income, but the relationship is far from straightforward (Figure 16). Zambia and Senegal have comparable GDP per capita, for example, yet in Zambia penetration of formal institutional accounts is four times higher. At a lower level of average income, Liberia has a far higher level of coverage than Niger. Such facts graphically illustrate that factors other than income are determining financial penetration.

Behind the national numbers there are marked disparities within countries; inequalities in access to financial services both reinforce and reflect wider disadvantages, including wealth, the rural-urban divide, gender and education (Figure 17):

The wealth divide: As might be expected, poorer people are far less likely to have a financial account than their wealthier counterparts. Almost half of Africans in the richest 20 per cent are registered with a formal financial institution. That is four times the rate for the poorest 20 per cent. But the relationship is not automatic. This can be illustrated for a large group of countries by ranking countries on their levels of coverage and dividing their populations into the top 60 per cent and the bottom 40 per cent. Ghana and Rwanda have comparable rates of account coverage. Yet the poorest 40 per cent in Rwanda are twice as likely to have an account as their Ghanaian counterparts. Such disparities show that there is scope for governments to implement policies that improve the access of the poor to basic services.

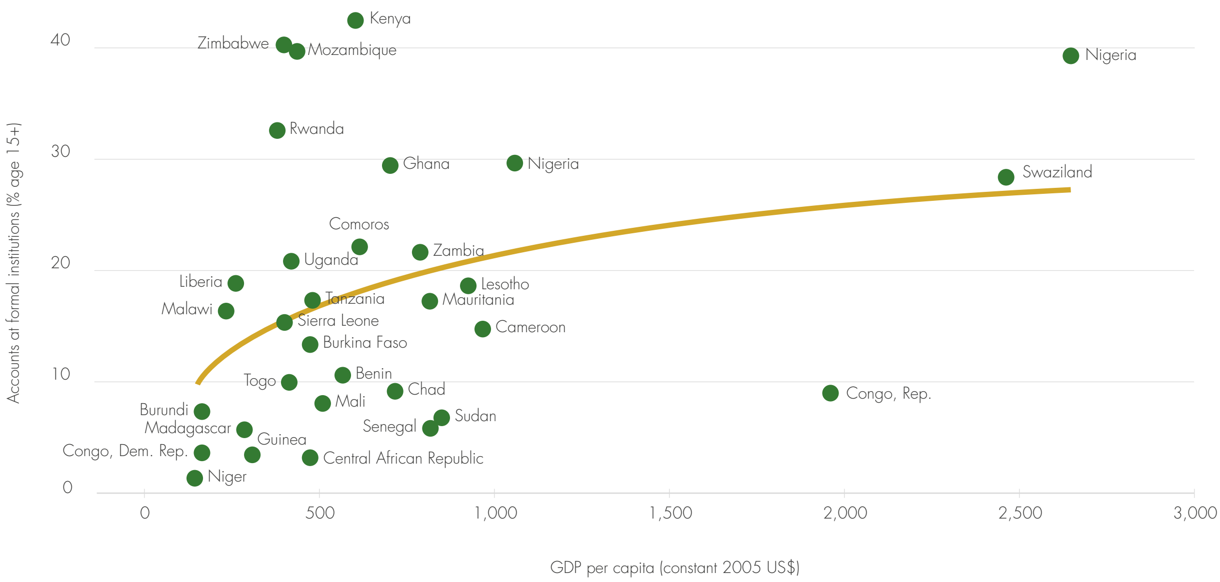
The rural-urban divide: While almost half of urban dwellers have a bank account, among rural Africans the share is only 20 per cent. Given that most Africans live and work in rural areas, this disparity represents a major barrier to more inclusive growth.

The gender divide: Women are less likely than men to have an account at a formal institution. There are only three in which the disparity favours women. The gender gap is particularly marked in Cameroon, Mauritania, Mozambique and Nigeria. Gender disparities reflect a mix of social, cultural and legal barriers to women's participation in the financial system.

The education divide: Having a secondary education increases the likelihood of people holding a bank account. In Zambia, those with a secondary education tend to be three times as likely to have an account, and in Tanzania five times as likely.

What are the forces blocking access to financial services? In an innovative global survey, adults without formal accounts were asked why they do not have one. Respondents could give more than one reason. In Sub-Saharan Africa, five factors stood out (Figure 18). By far the most important is poverty: not having enough money was cited by 81 per cent of respondents. But around one-third also cited the cost of holding an account, distance or lack of necessary documentation. Another important factor, cited by 16 per cent, was lack of trust.

FIGURE 16 FINANCIAL SYSTEMS DEEPEN WITH GROWTH – BUT THE RELATIONSHIP IS NOT AUTOMATIC: GDP PER CAPITA AND ACCOUNT AT FORMAL FINANCIAL INSTITUTIONS, SELECTED COUNTRIES 2011



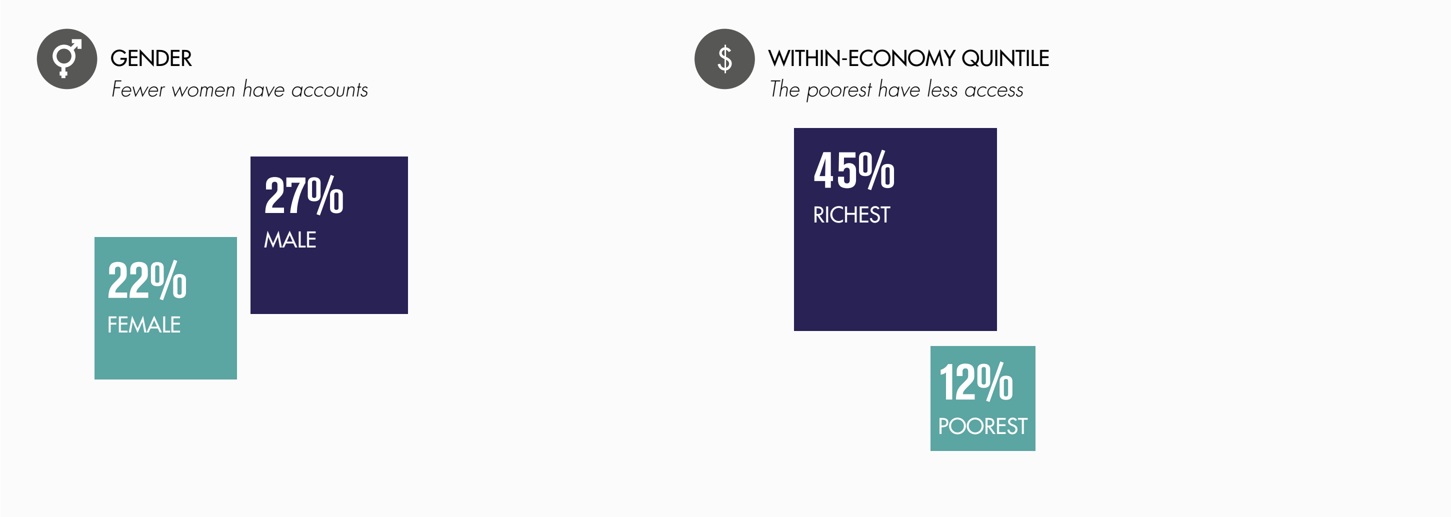
Source: The World Bank Group (2014), G20 Financial Inclusion Indicators and World Development Indicators.

Survey evidence of this type helps to turn the spotlight on underlying problems. For example, fixed transaction costs and annual fees can make banking unaffordable. Maintaining a cheque account in Sierra Leone can cost the equivalent of 27 per cent of GDP per capita in annual fees alone.[7] Even where fees are lower, they often represent a large share of the income of the poor. There are many reasons why the cost structure of banking varies. Yet common themes in Africa are a lack of competition, regulatory frameworks that deter the establishment of rural branches, and an undeveloped institutional infrastructure.

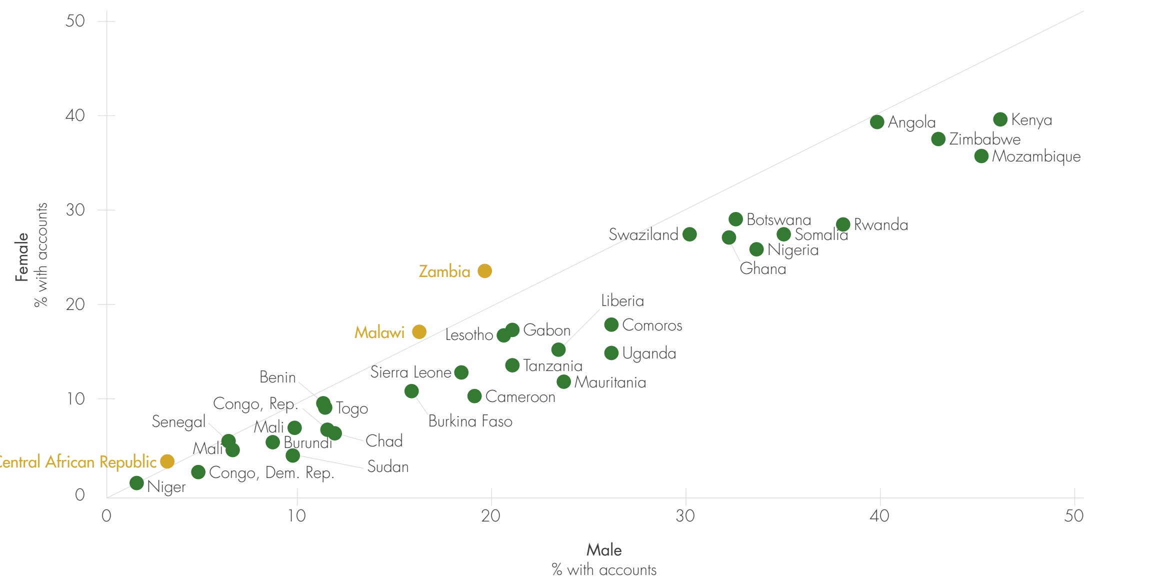
Documentation requirements can pose another barrier. Formal financial institutions typically require evidence of income and assets as a condition for opening accounts. This often excludes people in the rural sector and the informal economy, including potentially viable small enterprises. On one estimate, documentation rules reduce the share of adults with an account by 23 per cent in Sub-Saharan Africa.[8]

Distance from a financial institution is a major barrier, especially in rural areas. Almost half of Tanzanians without an account cite distance as a reason– and the country has one of the world's lowest levels of branch penetration, with 0.5 branches per 1,000km. Technology and other innovations can help to overcome the distance barrier.

FIGURE 17 UNEQUAL ACCESS: ACCOUNT AT FORMAL FINANCIAL INSTITUTIONS BY GENDER, WEALTH, EDUCATION

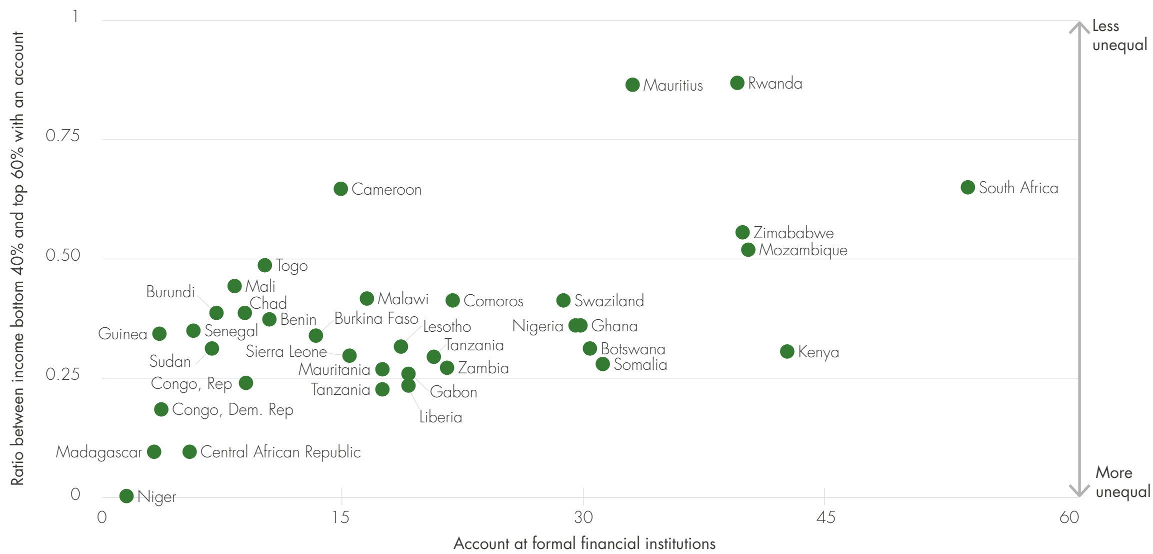


There is a large gender divide in most countries (% age 15+, 2011)



Source:
The World Bank Group (2014), Global Findex

The wealth divide: Ratio between income bottom 40% and top 60% with an account (% age 15+, 2011)



Source:
The World Bank Group (2014), Global Findex

AND RESIDENCE (% AGE 15+, 2011)

EDUCATION LEVEL
Education matters

12% PRIMARY OR LESS

56% TERTIARY OR MORE

38% SECONDARY

RESIDENCE
Rural populations are left behind

21% RURAL

38% URBAN

Source: Demirguc-Kunt and Klapper (2012)

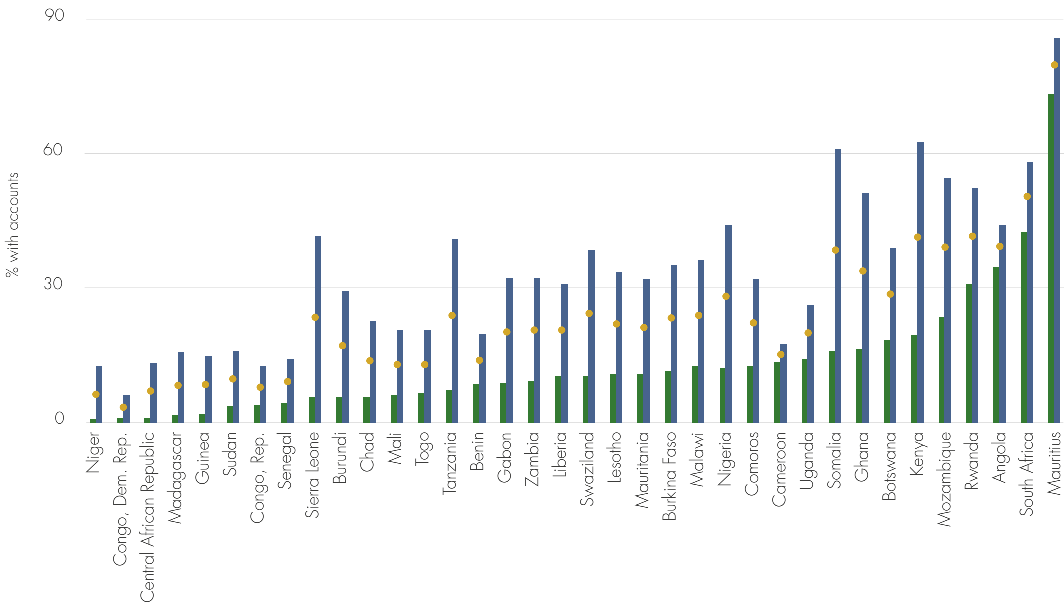
Education matters for financial accounts (% age 15+, 2011)

Source:
The World Bank Group (2014), Global Findex

Primary education and less

Second education and more

National average level



The rural-urban divide: Ratio between income for rural and urban areas (% age 15+, 2011)

Source:
The World Bank Group (2014), G20 Financial Inclusion Indicators

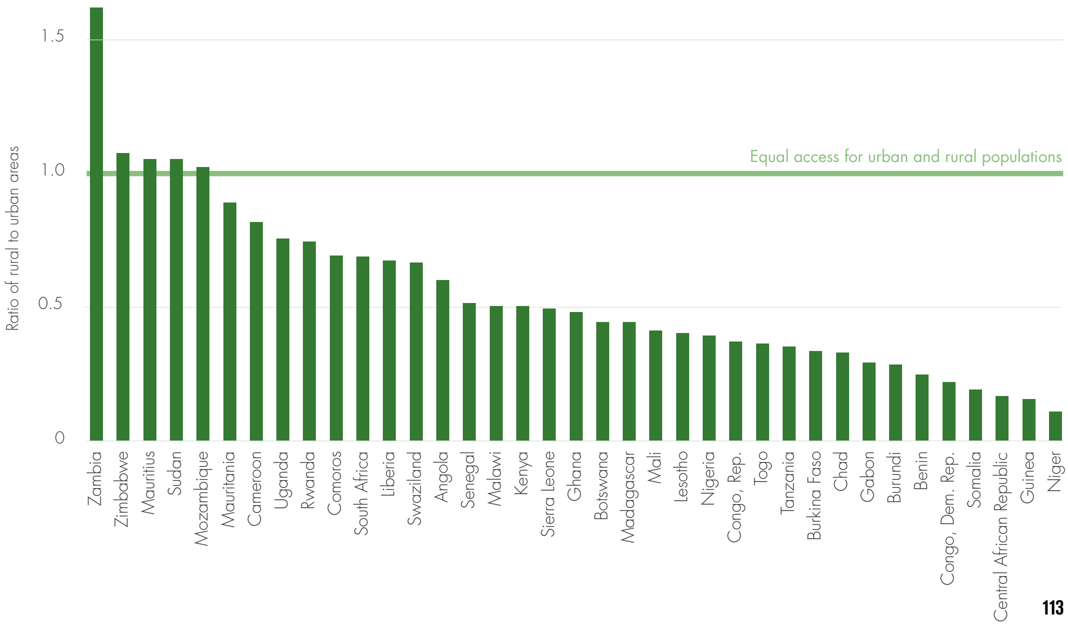
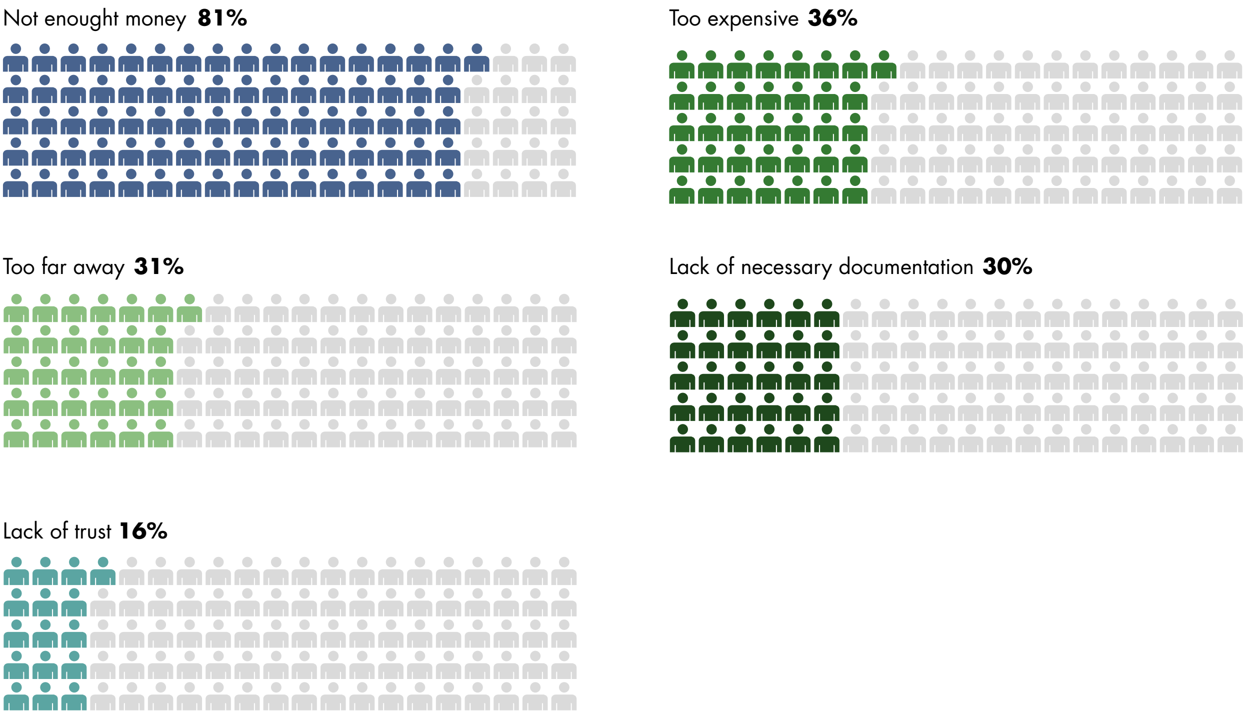


FIGURE 18 MONEY AND DISTANCE ARE THE BIGGEST BARRIERS TO FORMAL ACCOUNT OWNERSHIP: NON-ACCOUNT HOLDERS REPORTING ON REASONS FOR NOT HAVING AN ACCOUNT (%) IN 2011



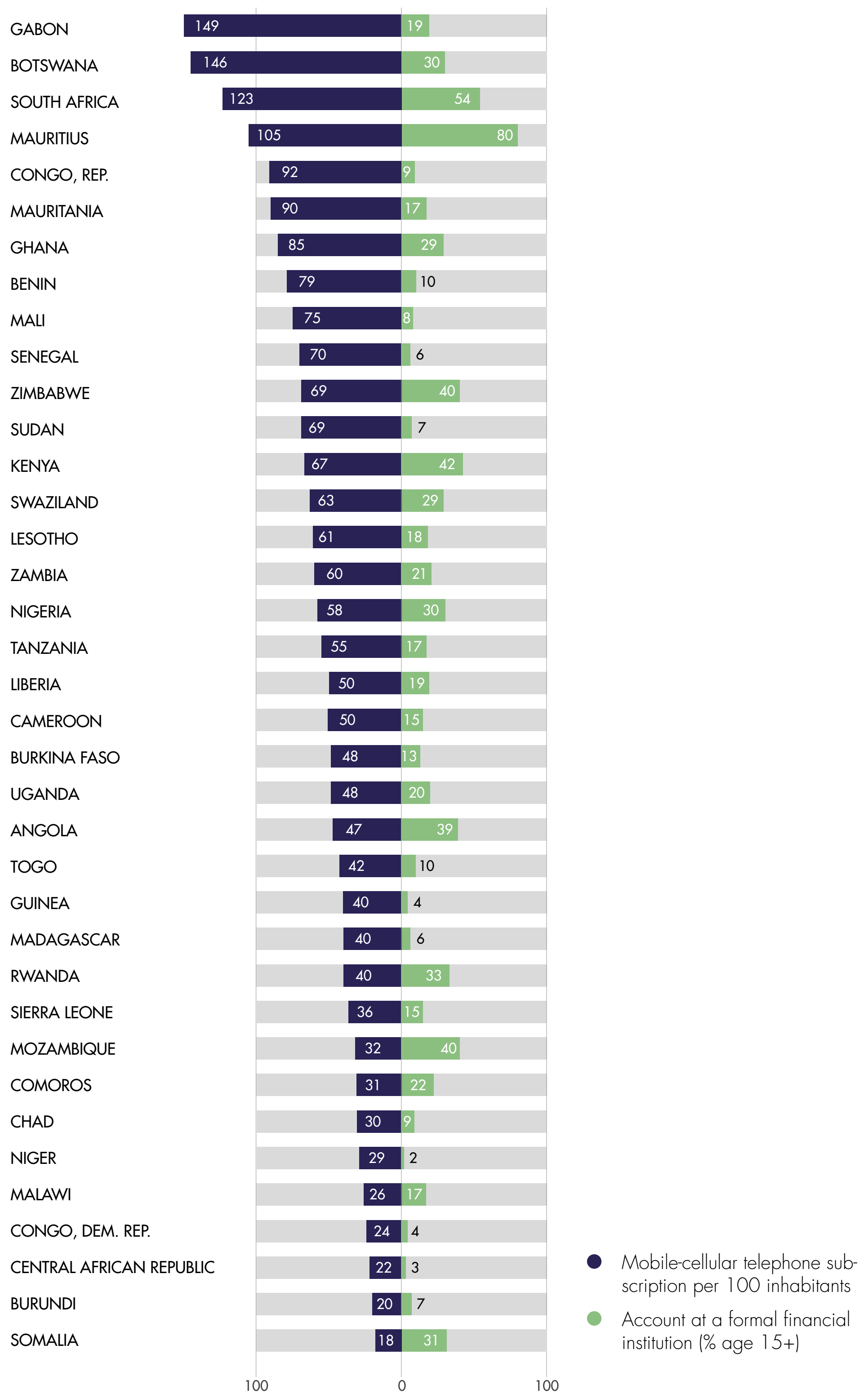
Source: Demirguc-Kunt and Klapper (2012).

The mobile banking revolution – and its limits

Sub-Saharan Africa has emerged as the global growth centre for mobile telecommunications. Mobile phone subscriptions have risen from 90 million to 650 million over the past seven years. The spread of mobiles has changed not only the nature of communication, but also opportunities for banking, commerce and investment (See infographic, Africa's Applied Tech Innovations: Developed by Africans, For Africa and the World). Commentators point to extensive opportunities for "technological leapfrogging," or skipping the development of branch networks by exploiting opportunities for mobile banking. The opportunities are real. Yet the gap between potential and delivery remains large.

The potential is evident from the extraordinary story of M-PESA (Box 14). In just six years, this mobile payments system has enabled more than 15 million Kenyans to send and receive money electronically for the first time. One recent survey found that 86 per cent of households in Kenya report using mobile phones to make payments, or send and receive money – one of the highest rates in the world. Yet the very success of M-PESA raises its own set out questions. Why is it that while three-quarters of Africans have access to a mobile phone, just one-quarter have a bank account (Figure 19)? Does being able to send and receive money using mobile phones equate to access to a country's financial system?

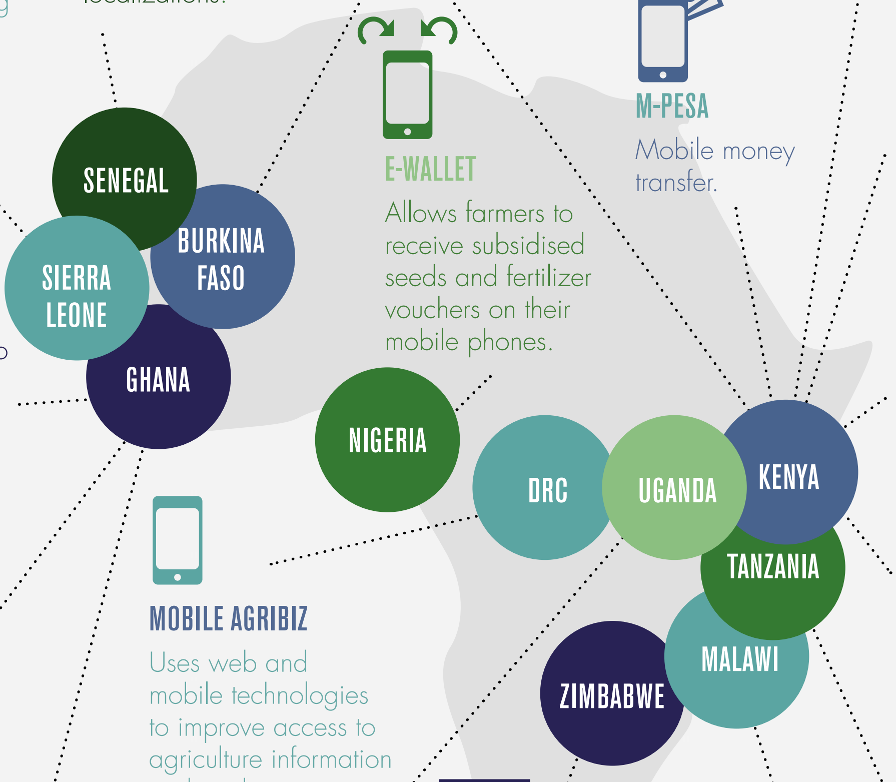
FIGURE 19 MOBILE PHONE COVERAGE IS RUNNING AHEAD OF FINANCIAL INCLUSION: MOBILE SUBSCRIPTIONS AND ACCOUNTS AT FORMAL FINANCIAL INSTITUTIONS, SELECTED COUNTRIES 2011



Source: The World Bank Group (2014), Global Findex, and UN ITU.

AFRICA'S APPLIED TECH INNOVATIONS:
DEVELOPED BY AFRICANS, FOR AFRICA AND THE WORLD

Mobile technology can accelerate Africa's productivity in farming and fisheries. Innovation hubs are springing up all over Africa, incubating the next generation of technologists.



COMMUNITY SURVEILLANCE PROJECT
Helps fishing communities fight against illegal, unreported and unregulated fishing through the use of mobile phones and GPS-enabled cameras.

MLOUMA
Connects farmers to food purchasers by displaying real-time market prices and localizations.

TEXT TO CHANGE MAGRI
Provides best practice information on planting, harvesting, and pest and disease management to farmers.

ICOW APP
Uses mobile phones to encourage best practice for dairy farmers and increase milk production.

M-FARM
Connects farmers with each other in a virtual space. Helps farmers collectively buy inputs directly from manufacturers and sell produce to the market.

M-PESA
Mobile money transfer.

E-WALLET
Allows farmers to receive subsidised seeds and fertilizer vouchers on their mobile phones.

ESOKO
Enables farmers to collect and send out market data using simple text messages.

EFMIS-KE
Provides fisherfolk with greater access to market information.

INTELLECT TECH
Helps farmers and insurance firms track compensation claims in real time.

COCOALINK
Connects cocoa farmers with information about good farming practices.

MOBILE AGRIBIZ
Uses web and mobile technologies to improve access to agriculture information and market accessibility for small farmers.

E-VOUCHER
Helps cash-strapped small scale farmers access agricultural inputs.

FARMING INSTRUCTOR
Provides online and offline agricultural information to farmers and their communities.

FARMERLINE
Uses voice and SMS to collect data, share new farming techniques, and better link smallholder farmers to other actors along the agricultural value chain.

POULTRY GUIDE
Provides poultry farmers with information and market linkages to improve their productivity and profits.

M-MALAWI
Supports and advances the growth of mobile money in Malawi through a series of coordinated interventions.

BOX 14 M-PESA PROVIDES BANKING SERVICES FOR KENYA'S UNBANKED

M-PESA was introduced in Kenya in 2007 by the mobile phone company Safaricom. Originally, it was intended to be a service that allowed microfinance borrowers to conveniently receive and repay loans using the network of Safaricom airtime resellers – who would later play a critical role to the services success. However, teething difficulties with microfinance applications led to M-PESA being launched as a simple money-transfer system to make it easy for urban-rural transfers of money.

At the time of its launch, M-PESA faced questions from Kenyan authorities and the banking sector. Banks – the largest tax-payers at the time – claimed that M-PESA would be an unregulated banking system. Government action, led by the Ministry of Information and Communication and Ministry of Finance, led to a custodial arrangement being agreed with the regulator of banking (the Central Bank of Kenya, CBK). The way forward for Safaricom was thereby cleared and M-PESA started operations

Today, the M-PESA system allows users to deposit and withdraw cash, transfer funds to other users, and make payments by using a simple text-based menu accessible on even the most basic mobile phones. Users can also repay loans made by microfinance institutions and make deposits in their bank accounts. Safaricom deposits the full value of its customers' balances in two regulated banks.

Safaricom, which is 40 per cent owned by the British telecommunications company Vodafone, makes its money by charging a small transaction fee when customers withdraw or transfer cash through one of the 40,000 M-PESA agents operating across the country. The cost of making remittances via M-PESA is about half that of other formal domestic remittance services.

M-PESA has more subscribers than Kenya's top five banks combined. Safaricom airtime resellers were its first M-PESA agents and continue to be its most valuable resource. Stringent Know Your Customer requirements are another M-PESA success factor. Banking regulators oblige banks to collect identification documents of clients and then to have those documents verified by banks. Safaricom avoided this bureaucracy by making it a requirement that the Kenya Government-issued national identity card, which every Kenyan must possess by law, be presented as a pre-requisite to clients being able to open an M-PESA account. This is one of the reasons that M-PESA grew so rapidly.

New product lines have been brought to the market. Safaricom partnered with the Commercial Bank of Africa (CBA) to pilot M-KESHO, a mobile lending service that led to M-SHWARI, a savings and loan service launched in 2012. M-SHWARI has signed up 2.3 million subscribers. While most of the transactions are very small (the median is just $1), around one-third of customers have applied for small loans. This suggests that M-SHWARI may be the answer for many farmers and other small and medium-scale entrepreneurs seeking small amounts of capital to start or grow their business.

Another promising offshoot is 'Linda Jamii', a micro-insurance health cover service that allows subscribers to contribute to health insurance via M-PESA. Nearly 40 million Kenyans (more than 97 per cent of the population) lack access to healthcare because they are uninsured. Bob Collymore, Safaricom's CEO, describes 'Linda Jamii' as being "to medical insurance what M-PESA is to financial services".

M-PESA has been a groundbreaking success in Kenya because it facilitates transfers of relatively small amounts of money when compared to the formal banking system. One study[9] indicates that the volume of transactions effected between banks using the RTGS (Real Time Gross Settlement) method is nearly 700 times the daily value transacted through M-PESA. On the other hand, the average mobile transaction is about 100 times smaller than the average transaction by cheque, and half the size of the average ATM transaction.

M-PESA will ultimately bring more and more Kenyans into the formal economy, in ways they can afford. Filling the unmet need for inclusive financing will be critical in unlocking the transformative potential of agriculture and other key sectors. This calls for a wide range of innovative financial products and services, ranging from mobile-enabled micro-finance and micro-insurance all the way to equity financing. Entrepreneurs typically need very small amounts of money to breathe life into their business ideas, and innovations like M-PESA, M-SHWARI and 'Linda Jamii' provide a powerful indication of the way forward.

While Africa has emerged as a global growth pole for mobile telecommunications, outside Kenya and South Africa the spread of mobile phones has not increased access to financial services. In Uganda, a survey on financial inclusion has found that the majority of adults (54%) used mobile money services to withdraw cash, while 46% used the service to send money. Usage of other mobile-enabled products and services was relatively low (see (Box 15). In several West African countries, including Mali and Senegal, the share of the population with cellular phone subscriptions is even higher than in Kenya. Yet while in Kenya there are 1.6 mobile phone subscriptions for every formal financial account, in Mali the ratio is 9.4 and in Senegal it is 11.7.

BOX 15 IN UGANDA, MOBILE MONEY DOESN'T YET MEAN FINANCIAL INCLUSION

A recent study by a Ugandan think tank reported that there had been a "remarkable improvement" in access to financial services in Uganda since 2009. However, the improvement has been in the non-bank formal sector, largely driven by the growth of mobile telephone money services.[10]

Mobile services are used largely for money transfers, the FINSCOPE III study found, rather than for borrowing, saving, investing or insurance. If the data on mobile money are excluded, the study concludes, formal financial inclusion in Uganda remains low, particularly when compared with African countries where similar studies have been carried out, including Kenya, Namibia, South Africa and Swaziland.

The study found that use of formal banking services by the adult population had remained static, despite growth in the number of commercial banks and branches. Furthermore, use of formal banking services was skewed heavily towards the richest 20 per cent of adults; concentrated in urban areas and other more developed regions; and dominated by middle-aged, better-educated men. Overall, access to formal banking in Uganda tended to reinforce patterns of wider inequality.

The study concluded that although much has been done to increase the supply of formal financial services, much more needs to be done to spur demand and access. Key policy recommendations include:

- targeting underserved and neglected areas by improving road and energy infrastructure;
- promoting broad-based long-term savings and investment;
- improving financial education and dissemination of financial information;
- ensuring that mobile technologies are harnessed for services beyond money transfer, including savings and credit.

These disparities point toward regulatory failure. In Kenya, mobile banking spread because central bank authorities allowed mobile service providers to compete with established banks. Rules and safeguards were developed to protect consumers against fraud and to regulate deposit and payment systems. In other countries, regulations have not kept up with mobile technology – governments are failing to open banking systems to more competition.

The low rate of digital payment means Africans lose opportunities at many levels. It contributes to high charges for remittances. It deprives Africans of access to competitive banking services, driving up the profits of inefficient commercial banks. It means people have to travel long distances to make payments for bills and insecurity in having to store and carry money: many customers in Sub-Saharan Africa live and work too far from a branch office to use a bank. It imposes processing, security and transport costs on companies.

There are also losses for the financial sector. If other countries achieved Kenya's level of mobile money transactions, the revenues of financial service providers could rise by at least US$6 billion and up to US$15 billion. In Ethiopia and Nigeria, revenues could more than double. These findings underline the opportunities that Sub-Saharan Africa presents for financial service providers, mobile operators and others seeking new markets.

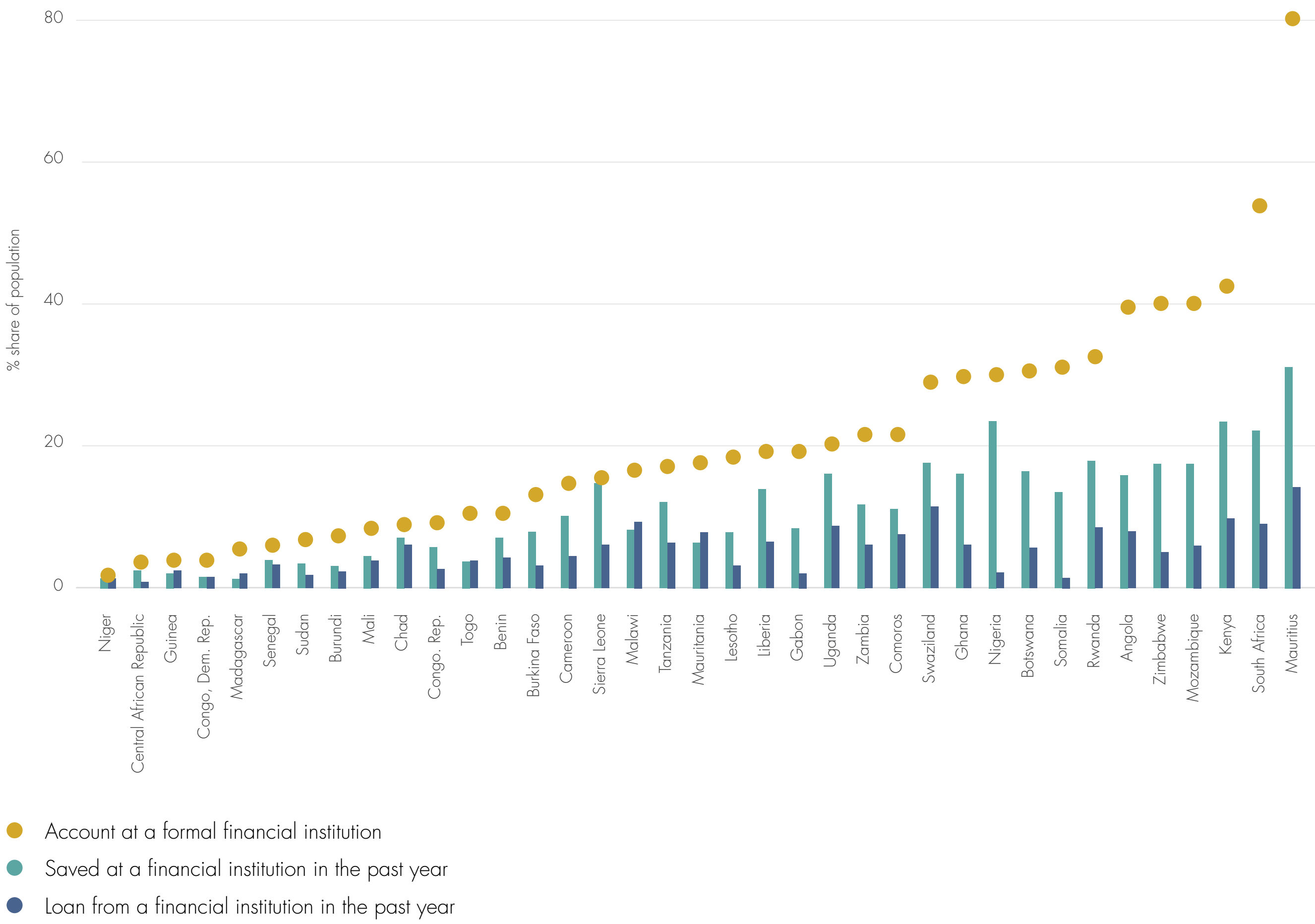
Beyond account registration: savings, credit and insurance

To enjoy the benefits of financial inclusion, people need not just a bank account but also to be able to save and borrow. But data for Africa suggest that savings and loan activities carried out through formal financial institutions are far more limited than implied by account registration data (Figure 20). A few populous countries – principally Kenya, Nigeria and South Africa – report relatively high levels of savings at formal institutions, but across Sub-Saharan Africa only 12 per cent of adults are covered – half the level for account registration. Savings clubs and traditional associations are the common alternative to formal institutions: roughly one in five Africans report using a savings club.

Loan activity is even more restricted than savings. Credit plays a vital role not just in unlocking productivity gains and expanding markets, but in enabling people to invest in their homes, educate their children and cope with emergencies. In no region do formal financial institutions account for a smaller share of loans than Sub-Saharan Africa. Almost one-third of adults report family and friends as their only source of new loans, while just 2 per cent report a formal institution as their sole source. Emergency and health loans are the most commonly reported reason for borrowing among the poor in Africa. However, outstanding credit for school fees is the most commonly reported source of loans for adults across the region.

Small and medium-sized enterprises (SMEs) make limited use of formal savings institutions (Figure 21). At one level this is something of a paradox. Business surveys consistently identify limited access to finance as a major constraint among SME operators. The implication is that many companies are unable to exploit market opportunities because of credit shortages, regulatory barriers or interest rates in the formal financial sector.

FIGURE 20 HAVING AN ACCOUNT DOES NOT MEAN IT IS USED FOR SAVINGS AND LOANS: FORMAL FINANCIAL INSTITUTION DATA (% AGE 15+, 2011)



Source: The World Bank Group (2014), Global Findex.

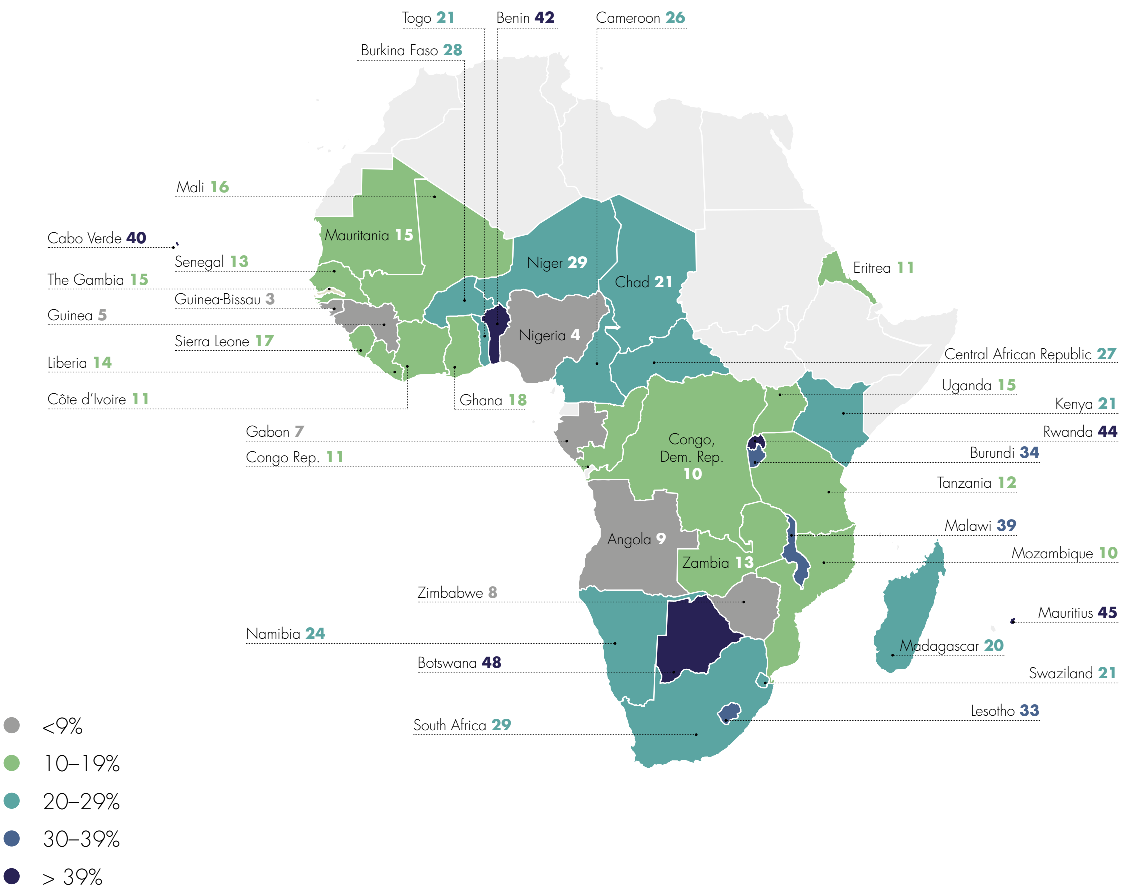
Savings and loan activity is marked by the same social disparities as financial account registration in general: the poor, women, the less educated and rural dwellers all have significantly less access. The rural-urban divide is particularly marked. This has far-reaching implications for the place of agriculture in boosting growth and reducing poverty. While informal savings and loans institutions offer advantages, including flexibility, informality comes with risk of fraud and collapse. Moreover, when loans and savings are pooled across small groups, the cyclical nature of local economies can restrict the funds available during key periods.

Nowhere are the social and economic consequences of financial exclusion more evident than in insurance. As we showed in Part II, the ability to mitigate risk is vital in agriculture, where people are particularly vulnerable to severe weather events and climate variability. But only 6 per cent of Africans working in agriculture and fisheries report purchasing insurance. Once again there are marked disparities (Figure 22).

Insurance provision is most limited where it is most needed. Of the poorest 40 per cent of the rural population in Tanzania, just 1 per cent purchases agricultural insurance. That compares with 15 per cent among the wealthier population group. Gender gaps are also marked, with women having less access to insurance than men.

Lacking access to larger and more diversified risk insurance pools, people are left with no alternative but to self-insure. As a consequence, resources that could be deployed in productive investment are put aside to mitigate risk. In 34 out of 36 countries for which data is available, money put aside to cover emergencies accounted for over half of total savings, rising to over 80 per cent in Kenya, Nigeria and Tanzania. Such numbers underline the case for developing institutionalized insurance as a way of unlocking productive investment.

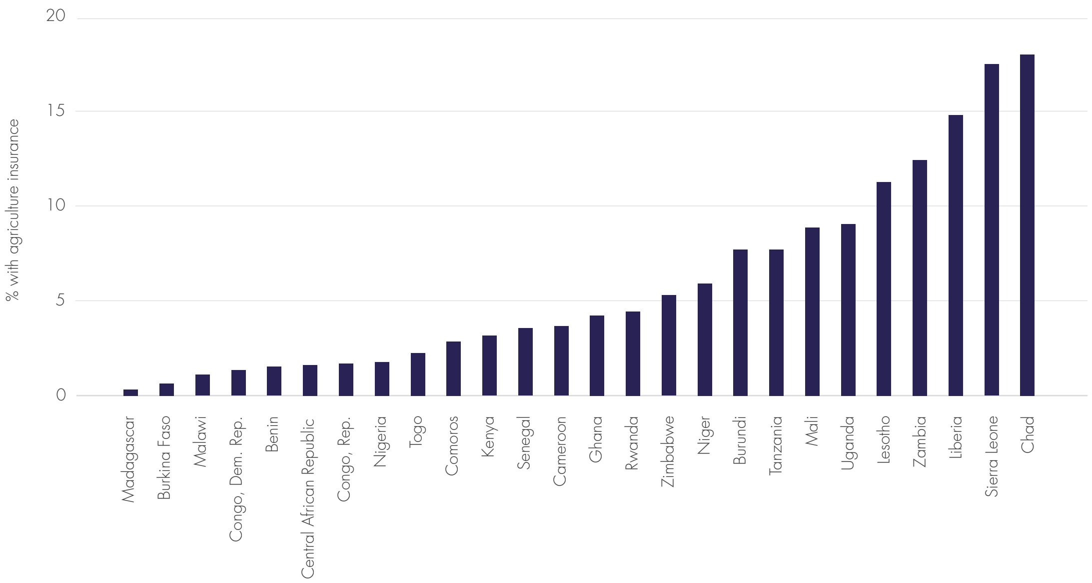
FIGURE 21 FEW SMALL AND MEDIUM ENTERPRISES HAVE ACCESS TO FORMAL FINANCIAL INSTITUTIONS: PERCENTAGE OF COMPANIES WITH AN OUTSTANDING LOAN OR LINE OF CREDIT (5-99 EMPLOYEES, LATEST AVAILABLE YEAR)



Source: The World Bank Group (2014), G20 Financial Inclusion Indicators.

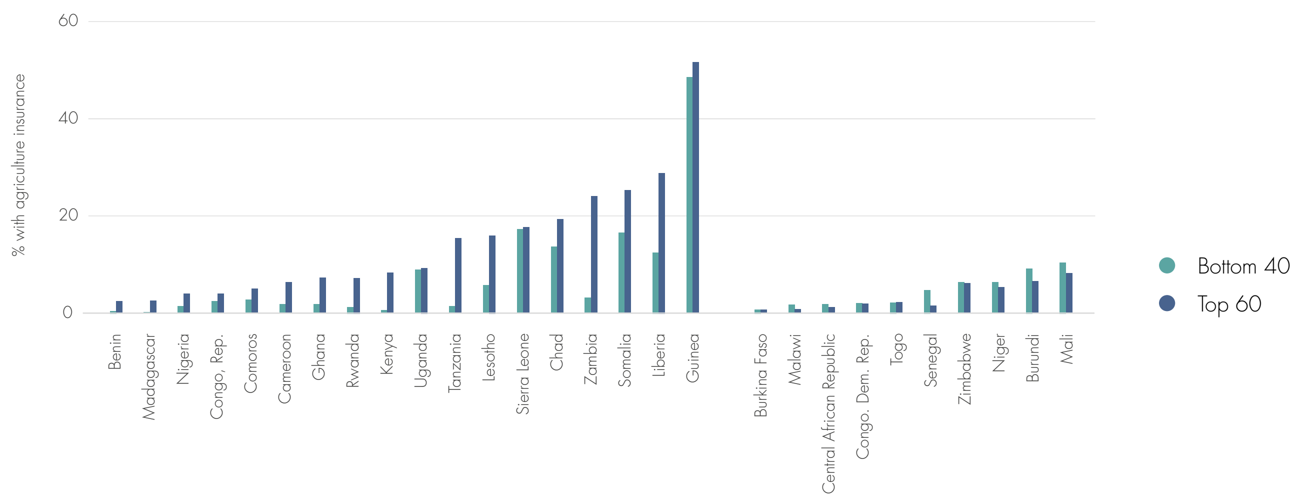
FIGURE 22 AFRICA'S FARMERS FACE HIGH RISK WITH LITTLE INSURANCE

1. Few farmers have access to formal insurance: Purchase of agriculture insurance (% working in agriculture, age 15+, 2011)



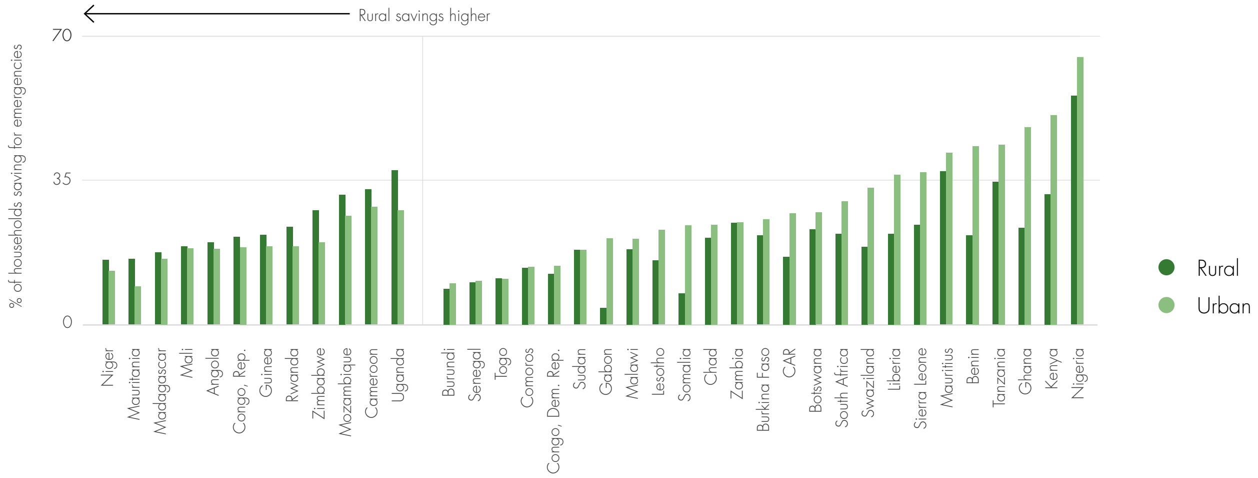
Data source: The World Bank Global Findex

2. The poorest households have the least access: Purchase of agriculture insurance by wealth group (% working in agriculture, age 15+, 2011)



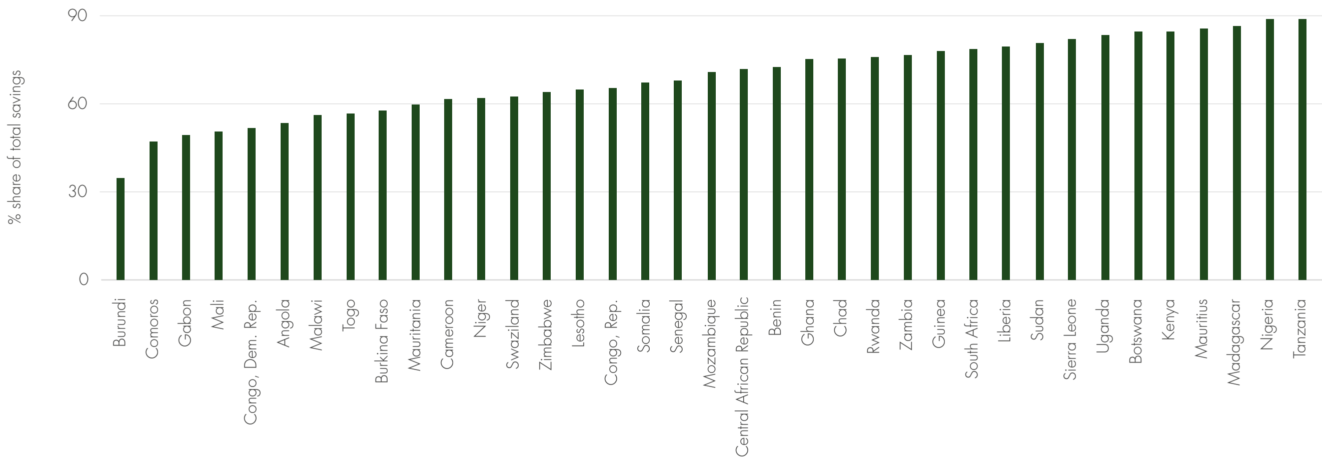
Data source: The World Bank Global Findex

3. Many households save for emergencies: Rural and urban areas (% age 15+, 2011)



Data source: The World Bank Global Findex

4. Preparing for emergencies absorbs a large share of total savings (age 15+, 2011)



Data source: The World Bank Global Findex

2. Lighting the road to growth for all: the infrastructure challenge

Africa must tap into global markets for infrastructure financing.

Although Africa has one-sixth of the world's population, it accounts for just 3 per cent of the world's electricity generation. Africa's energy deficit is a vivid instance of the huge infrastructure gap that undermines the region's competitiveness in global markets, diminishes prospects for economic growth, and reduces the power of growth to alleviate poverty. The infrastructure deficit also reinforces wider problems identified in this report. One reason Africa's farmers struggle to compete against imports in urban areas is that their produce faces such high transport costs. High energy costs restrict investment opportunities for small and medium-sized enterprises, holding back the development of off-farm employment and of markets. Poor physical access and infrastructure deters rural branch bank expansion, increasing the cost of credit and reducing access to financial services.

Closing Africa's infrastructure deficit will require significant financial resources. Domestic financing will have to play a critical role, which is why we highlight the importance of strengthened tax efforts below. Regional integration would help by creating the economies of scale lacking in small countries with low average incomes. Yet even in the most optimistic scenario, domestic financing alone will be insufficient – the financing requirements for energy, roads and port systems are simply too large relative to the size of national economies. The implication is that Africa must compete for financing in a global market.

That market is changing in important ways. Estimates of the financing requirements for global infrastructure are necessarily imprecise. The McKinsey Global Institute puts the figure at US$57 trillion between now and 2030. Despite the surfeit of global liquidity, all countries are struggling to harness the required investment. Part of the problem is that new banking rules are discouraging banks from undertaking the type of long-term loans needed to finance infrastructure. This has created new opportunities for insurers, pension funds and sovereign wealth funds. But currently only a tiny fraction of their assets – around 0.8 per cent – are invested in infrastructure, and Africa barely registers on the market radar screen. Private equity firms are taking up some of the slack, but they provide finance on terms likely to prove unaffordable for low-income African countries.

All of this begs the question of how Africa can tap into global markets for infrastructure finance. The answer varies by country. One problem facing the region is that international investors often view the whole of Africa as an equivalently high-risk investment market, failing to differentiate between conditions in specific countries. Even so, there are several interlocking systemic problems to be addressed simultaneously:

Project design and the need to develop bankable proposals that are "debundled" into planning, construction and operating stages. This matters because Africa's pipeline for bankable projects is limited, in part because of a failure to recognize that public finance has a key role to play in planning, while construction and operations create opportunities for public–private partnerships.

Capacity to pay and responsibility for oversight. It is critical to look at demand as well as supply. Who will pay for these projects? Who will pay for their maintenance? While the development of telecommunications infrastructure has demonstrated a capacity to pay, full private cost-recovery may prove unfeasible in areas such as energy and transport.

Intra-African trade could attract investment by expanding markets and raising returns. However, intra-African trade remains very low as a result of tariffs, customs procedures and rules of origin. This leads to long and costly wait times for transit and shipping, especially for smaller companies.

Political risks linked to corruption, breach of contract and unforeseen policy changes. These are especially important given the long time frames and amount of capital involved in infrastructure financing.

Expansion of insurance could help to unlock foreign investment and reduce the returns demanded. There are currently large insurance gaps for dealing with foreign exchange risks and catastrophic risks.

The scale of the infrastructure deficit

On any measure of infrastructure coverage and quality, Sub-Saharan Africa falls far behind the rest of the world.

Total power generation for the region (minus South Africa) is 28 gigawatts (GW) – roughly equivalent to that of Argentina. Half of the world's population without access to electricity lives in Sub-Saharan Africa, with 80 per cent of people relying for cooking on traditional stoves that burn wood.

Africa has the world's least developed network of paved roads. On one standard measure, the density of the region's network of paved roads is one-third the level in South Asia.[11] Only 14 per cent of rural households have access to a paved road. Companies using Africa's ports face the world's longest delays in delivery: transit typically takes 15 to 20 days, compared with three days in East Asia.

Social infrastructure is equally underdeveloped. Only 31 per cent of the region's population has access to improved sanitation facilities. Behind that figure there are marked differences between richer and poorer households, and between rural and urban areas. The richest households are more than 10 times as likely as the poorest to have access to improved sanitation – no other region has such a large equity gap. Around half of the rural populations of countries such as Ethiopia and Mozambique practice open defecation, rising to over 80 per cent in countries such as Burkina Faso and Niger. Despite the urban advantage in sanitation, one-third of Africa's urban population does not have access to improved facilities.

There is compelling evidence that infrastructure shortfalls undermine investment opportunities. Companies in Africa face higher power costs than any other region – and they lose more working days as a result of power outages. In some African economies, losses from power outages amount to more than 10 per cent of sales. More than 80 per cent of companies in Ghana, Tanzania and Uganda cite concerns with power reliability and affordability. While port delays have been declining, they remain excessive and transport costs are rising.

Infrastructure deficits have equally marked effects on people's daily lives. Restricted access to energy results in mainly girls and women walking long distances to collect firewood, often at the expense of education and other activities. Poor sanitation is major cause of ill health, especially when combined with inadequate access to clean water.

Why is the financing gap for infrastructure so large?

It might have been assumed that a decade of high growth would have transformed financing for Africa's infrastructure. The backdrop could hardly be more encouraging. Economic growth is increasing demand for energy, water, sanitation, transport, and information and communications technology (ICT). For instance, power generation capacity – currently 68,000MW in Sub-Saharan Africa – will need to grow by more than 7,000MW a year to keep pace with demand. Trade opportunities are expanding and the business environment is improving. Population growth is adding to demand.

High levels of regional growth have coincided with a propitious international environment. Since 2008 the world has been awash with liquidity. While returns to investment in secure assets in OECD countries have been close to zero, the potential social and economic returns to investment in Africa's infrastructure are very high. Reported returns to foreign investors in power projects in Sub-Saharan Africa are higher than in any other developing region.[12] Investments in cross-border power transmission have exceptionally high returns, typically paying for themselves in less than a year.[13]

Moreover, the G8 and the G20 have identified African infrastructure financing as a priority – and aid donors have developed a range of mechanisms aimed at leveraging private finance for Africa's infrastructure. The G8 established the Infrastructure Consortium for Africa (ICA) at the G8 Gleneagles Summit in 2005. Another initiative, the Private Infrastructure Development Group (PIDG), is a large coalition of donor agencies and development finance institutions that pool financial resources for investment in infrastructure (Box 16).

Returns to foreign investors in power projects in Sub-Saharan Africa are higher than in any other developing region.

None of this appears to have materially reduced the financing gap in African infrastructure. That deficit was estimated in 2009 at US$48 billion annually for the next decade. Since then, economic growth and urbanization have almost certainly widened the gap, despite increased public investment. As an approximation, Africa needs to double investment in infrastructure.

Translated into national financing terms, the deficit is very large. Public finance dominates infrastructure investment in Africa, accounting for around two-thirds of the total. Private investment in Africa represents another 20 per cent. The African Development Bank estimates that to meet infrastructure investment requirements, low-income countries would have to spend around 15 per cent of GDP a year.

Disbursements of official development finance (ODF) – a broad category including development lending as well as aid – have increased, but there is little evidence of a strong leveraging effect. In real terms, ODF increased from US$7.3 billion in 2008 to US$10.1 billion in 2010.[14] Donor reporting systems make it difficult to unravel leveraging effects. However, flows other than development assistance decreased between 2010 and 2012.

Emerging markets are an increasingly important source of investment in infrastructure. Reporting on non-OECD development finance for Africa is fragmentary, so data are incomplete, but China is now probably the single largest source of infrastructure finance – commitments were reported at US$13 billion in 2012.[15] China uses a mix of grants, export credits, resource-backed loans and other instruments. The China-Africa Development Fund provides equity finance to ventures backed by Chinese enterprises, the China Development Bank provides non-concessional finance, and the Export-Import Bank provides export credits and risk guarantees. There has been considerable criticism of the "package financing model" provided by China. Many of the criticisms are not well supported by evidence, however[16] – and OECD financing is coming to resemble the Chinese model with respect to infrastructure. Brazil also has a growing presence in infrastructure, with its National Bank for Social and Economic Development (BNDES) supporting Brazilian business ventures in Mozambique and other countries.

Why does the infrastructure financing gap remain so large despite apparently favourable macroeconomic conditions for an investment boom? Part of the answer can be traced to domestic and regional market conditions. Financial markets in Africa remain far too shallow to support investment on the required scale. High interest rates and a low rate of saving are not conducive to the long-term public investments needed for infrastructure. There are some exceptions: Kenya has successfully issued three infrastructure bonds since 2009, raising over US$1 billion. Incentives played an important role. Bonds could be used as collateral to acquire bank loans, and banks could count them as reserves.

Private sector participation is unlikely to prove more than a supplement to domestic public investment. Specialized infrastructure funds have emerged in some countries. Yet private equity funds remain limited in scope, typically generating amounts ranging from US$5 million to US$120 million per project in equity, various forms of debt and foreign currency financing.[17] For the private sector, the perceived risks of investment are typically far too high to attract investment on a sufficient scale. Uncertainties over the capacity of governments to develop and implement projects, the regulatory environment, and the macroeconomic environment can act as a powerful barrier to investment.

Structural market conditions are also unfavourable. In some areas – such as power and transport – Sub-Saharan Africa's markets are small in relation to the large up-front capital investments required to deliver projects on the required scale. Moreover, despite a decade of growth, average incomes are low and poverty levels remain high. Both factors constrain the potential for generating commercial returns.

International initiatives are failing to unlock sufficient finance

The effectiveness of international initiatives on infrastructure financing depends partly on the domestic and regional policy environment created by African governments. Even so, there is worrying evidence that despite a proliferation of "new and innovative" approaches to development finance for infrastructure, these approaches are failing to deliver on the anticipated scale. The accompanying hype and complexity appear to be obscuring fundamental design flaws.

Private investment for infrastructure is flowing to Africa as a trickle. Figures on commitments can overstate the real money transfers involved. For example, the Africa Infrastructure Consortium reported private sector commitments to infrastructure projects under the Programme for Infrastructure Development in Africa (PIDA, See Box 16) at US$3.5 billion in 2012. Actual disbursements in the same year were US$81.7 million.[18] The OECD put total investment in Sub-Saharan Africa's infrastructure at US$13 billion in 2012, with over 90 per cent directed to the ICT sector.[19] But investments in new projects in 2009 added up to just US$1 billion, partly reflecting the impact of the financial crisis. For every US$1 of private equity capital raised for investment in China in 2012, just 8 cents was raised for Africa.[20]

These disappointing outcomes occurred despite highly propitious background conditions. Global capital markets have been in a state of exceptional liquidity, with the real interest rate on risk-free assets hovering around zero. Large sums have been directed to emerging market economies, but little to Africa. Projects in the region are perceived as financially risky and too small to warrant the costs of initial investments in assessment. This is true even for countries with better governance – and despite donor efforts at leveraging. For example, InfraCo Africa, a PIDG-funded company that initiates infrastructure projects, has been unable to raise finance for a Ghanaian electricity project despite a projected yield on equity of 20 per cent.[21]

The Ghanaian project is not exceptional. A World Bank Group analysis of the African electricity sector undertaken in 2011 found that despite several attempts, few privately financed projects were operating. As the Oxford University economist Paul Collier has observed: "This massive wedge between the risk-free rate of interest acceptable to financial markets, which is currently around zero, and the risk-corrected rate demanded for African infrastructure, suggests that more effectively addressing risk is central to private finance."[22]

Current international initiatives are doing little to lower the angle on this wedge. At the heart of these initiatives is a concerted drive to use official aid to catalyse long-term private investment. Investment funds managed by development finance institutions (DFIs) play a central role. Targeting African infrastructure projects, these funds provide capital either directly to private investors or indirectly to intermediary financial institutions in the form of equity, loans or risk mitigation instruments. For example, the Netherlands Development Bank (FMO) manages Dutch government funds such as the Access to Energy Fund and the Infrastructure Development Fund (IDF), which has so far invested in nine projects in the power sector. Proparco, France's development finance institution has provided capital to the Africa Infrastructure Investment Fund, a privately managed equity fund.

Another example of the investment fund approach is the Commonwealth Development Corporation (CDC). Operating on a commercial basis, CDC is privately managed but owned by the United Kingdom's Department for International Development (DfID). In 2011, DfID established a new investment policy for CDC, giving it a tighter geographic focus and limiting investments to poorer countries. New investments in Africa in 2012–2013 included an agribusiness project in the Democratic Republic of the Congo, a recycling project in Kenya and banking in Nigeria.[23]

Investment funds can also serve as multidonor vehicles. One prominent example is the Africa Infrastructure Fund created in 2002 with equity from the PIDG group of donors. The fund, managed by a division of Standard Bank, provides long-term project financing. By the end of 2011 it had financed 35 projects. InfraCo, also financed under the PIDG structure, undertakes initial project assessment and preparation activities.

The closest US counterpart to the European development finance institutions is the Overseas Private Investment Corporation (OPIC). In 2012, OPIC committed US$907 million to projects in Sub-Saharan Africa, providing a mixture of loans and risk guarantees. Reflecting priorities outlined by the current US administration, projects in Africa now account for nearly a quarter of OPIC's global portfolio – up from 6 per cent a decade ago.

Some new approaches to development financing have aimed to use aid to attract private investors and soften borrowing terms. "Blending" is an umbrella term covering a vast array of instruments that mix concessional finance (grants, or loans with a grant element) with debt finance and other investment flows. While specific arrangements are often enormously complex, they typically combine interest rate subsidies that reduce the debt burden on borrowers, including governments; technical assistance to cover preparatory work and project supervision; direct grants to finance project components that have social and environmental benefits over and above their commercial returns; and insurance premiums to share risk.

The European Union has been in the forefront of developing blended finance. Since 2007 it has established eight blending facilities, including the EU-Africa Infrastructure Trust Fund. An ITF interest rate subsidy for a project to finance rehabilitation of the Beira Corridor in Mozambique, for example, enabled the government to undertake investments without breaching the debt sustainability provisions of the Heavily Indebted Poor Countries (HIPC) initiative. However, not all blended finance demonstrates a leverage effect. An evaluation of the ITF found that an interest rate subsidy and grant to the Central African Republic had crowded out other sources of finance.

Risk mitigation has emerged as another pillar of infrastructure financing. Infrastructure projects often require large up-front investment in physical assets that once constructed, cannot be moved in the event of unanticipated problems. The long gestation period involved in many projects and complex financing arrangements, such as the creation of special purpose vehicles for public–private partnerships, add to the risks facing foreign investors, as do foreign currency risks. Alongside these commercial risks are the political risks in an uncertain governance environment.

"Blending" and risk mitigation are emerging as pillars of infrastructure financing.

Development finance institutions and multilateral development banks have developed a range of risk instruments that are widely deployed in Africa infrastructure projects. These include credit guarantees that can lower the cost of borrowing by covering losses in the event of a default, and partial risk guarantees (PRGs) that cover losses from a debt default occurring as a result of a political event. The Multilateral Investment Guarantee Agency (MIGA), which is part of the World Bank Group, provides guarantees against non-commercial risks and technical assistance. Sub-Saharan Africa accounts for around one-quarter of MIGA's overall portfolio, a figure that has risen rapidly.

Currency risk insurance is less widely available, even though this is arguably the single greatest risk for equity investors. The African Development Bank's Currency Exchange Fund provides a range of products that mitigate currency risks through medium-term and long-term swap arrangements. The hedging effects have in some cases moved infrastructure projects up four levels in credit rating.

Box 16 provides an overview of some of the most prominent blending and risk mitigation initiatives. It is difficult to determine whether such arrangements achieve the desired leverage effects, given the uncertainties over whether or not loans and private investment would have materialized in the absence of concessional aid. However, there are strong grounds for concluding that leverage effects have been seriously overstated by donors and DFIs concerned to signal the effectiveness of their approaches.

The EU-Africa ITF, for example, claims to have generated US$12 for every US$1 in grants. No evidence has been presented to substantiate this claim, other than reference to the size of the projects to which the Trust Fund contributes. The same approach has been applied by the PIDG and by Power Africa. Ultimately, this is unhelpful because it deflects attention from the need to collect evidence that can inform public opinion and guide policy. What is clear is that aggregate private financing falls far short of the level required to close Africa's infrastructure financing gap.

Underinvestment in risk mitigation may be contributing to that shortfall. Risk is probably a greater barrier to private investment than the terms of loans and anticipated returns on private investment. According to the Infrastructure Consortium for Africa (ICA), the most comprehensive source of reporting on infrastructure finance, total private investment in infrastructure has fallen since 2008 from US$4.5 billion to US$522 million.[24] Private investors responding to an ICA survey cited partner risk, political risk and the regulatory environment as the main deterrents to investment, ahead of profitability.

Globally, there is evidence that foreign investors are increasingly concerned over risk and that emerging market risk insurance premiums are rising. New political insurance issued by members of the Berne Union – the leading association of public, private and multilateral insurance providers – increased by 33 per cent in 2012, even as foreign direct investment fell. The US$100 billion of investment insurance issued in 2012 represented a historic high and over three times the volume issued in 2005. Investor surveys by MIGA highlight concerns over macroeconomic stability, political risk and 'resource nationalism'.

BOX 16 INNOVATIVE FINANCE: THE MAJOR INITIATIVES

While it is beyond the scope of this report to review of the proliferation of often overlapping programmes that have emerged over the past decade, we can provide a snapshot of major initiatives and approaches:

African Development Bank (AfDB): Over the past five years, the AfDB has delivered over US$5.4 billion in critical infrastructure investments through private sector and PPP financing. The bank has developed a range of financing instruments aimed at leveraging private sector investments. These include long-term debt financing to private equity funds; the Currency Exchange Fund, designed to help investors hedge interest rate risks; and the First Loss Investment Portfolio Guarantee, a country risk management instrument. In 2013 the AfDB approved two major energy-related partial risk guarantee (PRG) programmes. The first was for the Lake Turkana Wind project in Kenya. The second, a US$184 million programme and associated loan of US$3.1 million, was provided to support the Nigerian power sector privatization programme.

Programme for Infrastructure Development in Africa (PIDA): Led by the African Union, the New Partnership for Africa's Development (NEPAD) and the African Development Bank, PIDA has identified 51 core projects aimed at transforming Africa's infrastructure. Costs are estimated at around US$360 billion between 2011 and 2040, with investments of US$68 billion by 2020. Attracting private sector participation through public–private partnerships (PPPs) is seen as essential to the delivery of various infrastructure projects envisioned under PIDA.

Infrastructure Consortium for Africa (ICA): Hosted by the African Development Bank, the ICA plays the role of a catalyst for projects rather than a funding agency. Its members include all G8 and G20 countries and a range of regional and multilateral banks. Through its Energy Platform, the ICA has carried out diagnostic surveys of power purchase agreements in Ghana, Kenya, Mozambique and Tanzania, providing technical assistance and advice on risk management.

Private Infrastructure Development Group (PIDG): Established in 2003, PIDG is a multidonor organization governed by development agencies.[25] Its members commit funds through a range of mechanisms, including a technical assistance facility; a mechanism that supports the preparation of projects for private sector involvement (DevCo); InfraCo Africa, which invests in bankable projects not being developed due to high risks in the early stages; the Emerging Africa Infrastructure Fund (EAIF), which provides long-term loans to private-sector infrastructure projects; and GuarantCo, which provides local currency guarantees. The scale of PIDG's operations illustrates the infrastructure financing problem: in 2012 just US$98 million was committed to the EAIF and nothing to InfraCo, reflecting a slowdown in the project pipeline.

Emerging Africa Infrastructure Fund (EAIF): Created in 2002, the EAIF pools funding from DFIs and private commercial banks. By the end of 2011, it had financed 365 projects, which were co-financed by an additional US$2.5 billion in private equity and development finance. The fund had grown to US$705 million by the end of 2011. Projects supported by EAIF include Seacom, the undersea fibre optic cable along the coast of East Africa; a 25-year concession to operate three container ports in Senegal; and the Rabai power plant in Kenya. EAIF provides lending on longer terms than loans from commercial institutions, averaging 12 years and often topping up projects that have already secured funding from other sources.

Power Africa: President Barack Obama's Power Africa initiative is one of the most ambitious plans for regional infrastructure development. The five-year strategy envisages doubling electricity access in Sub-Saharan Africa, providing access to 50 million people by 2020. It has an initial focus on six countries.[26] For the first, five-year phase, through 2018, the U.S. government has committed more than US$7 billion in financial support and loan guarantees. The framework includes financing from commercial banks, private equity firms and major energy companies. The initiative is seen as a focal point for the energy infrastructure activities of a range of US agencies, including the Export-Import Bank, the Agency for International Development (USAID) and the Overseas Private Investment Corporation (OPIC).

EU-Africa Infrastructure Trust Fund: Supported by 12 EU member states, the EU-Africa Infrastructure Trust Fund uses its grants to leverage additional finance from EU development finance institutions. In 2012 the fund disbursed 35 million euros (US$48.5 million) in grants for 35 projects. Interest rate subsidies have accounted for 60 per cent of these grants and technical assistance 25 per cent, with energy and transport dominating the portfolio. Examples of EU-Africa ITF supported projects include 18 million euros (US$25 million) in grants and interest rate subsidies for the Itezhi-Tezhi Hydropower Project in Zambia, and a 22 million euro grant (US$30.5 million) for technical support and interest rate subsidies for the West African Power Pool initiative.

Project development – a weak link

Current approaches to "new and innovative" financing are not achieving their aims partly because they are failing to address what may be the single greatest barrier to infrastructure financing in Africa – a shortage of bankable projects. The private sector is unlikely to play more than a marginal role in developing, assessing and preparing projects, given the uncertainties, costs, risks and long-time horizons involved. That means governments, donors and regional development banks have to be heavily involved, but so far they have been paying far too little attention to this initial stage.

The underlying problem is one of systemic failure. The preparation stage of project development is open-ended and may lead nowhere, as indicated by the lack of success in African electricity projects. The transition from initial planning to project completion can take many years. Institutions with risk capital, such as investment banks, do not have the appetite for ventures entailing unquantifiable and uncontrollable risks, especially when they come with long periods of preparation. Governments lack the resources and, in many cases, the expertise needed to fill the gap.

Bringing a large-scale infrastructure project to the market is a complex exercise, especially when the project spans several countries. Consider the Central African Interconnection. One of the PIDA priority projects, this envisages a 3,800km transmission line from the DRC to South Africa. Another priority project, the North-South Multimodal Corridor, envisages a transport network across five countries in Southern Africa, plus the DRC. The viability and potential returns from both projects are contingent on a regulatory framework and policies on pricing involving all of the governments, some of which have a weak record on infrastructure governance. Elsewhere in the region, regulatory complexity and political factors can represent barriers to projects with potentially very large rates of return, such as the West African Power Pool (Box 17) and the Kazungula Bridge project in southern Africa (Box 18).

BOX 17 ENERGY COOPERATION ON THE MANO RIVER

The four countries in the Mano River region graphically illustrate the overwhelming case for regional cooperation on infrastructure – and the complexity of moving from project conception to delivery.

Access to electricity is around 2 per cent in Liberia and Sierra Leone, and 10 per cent in Guinea. The unavailability and high cost of electric power are among the main obstacles to developing the economy and reducing poverty in these countries. Côte d'Ivoire enjoys a more favourable situation, with an electrification rate of 34 per cent and a low-cost production capability.

The Côte d'Ivoire, Liberia, Sierra Leone and Guinea Interconnection Project (CLSG) envisages the construction of 1,400km of high voltage power lines so that Liberia, Sierra Leone and Guinea can import electricity from Côte d'Ivoire. If successful, the CLSG project will increase the average rate of access to electricity in the four countries from 28 per cent to 33 per cent, electrifying 125 locations along the transmission line as well as 70 schools, 30 health centres and nearly 1,500 small commercial and industrial units. The long-term aim is to develop a regional electricity grid and market by gradually integrating isolated and small-scale national grids into a unified system.

The CLSG is part of the West African Power Pool, which was created in 1999 under the auspices of ECOWAS. It took a decade for momentum towards project development to emerge, but there are now signs of progress. Design, financing and progress towards implementation have been complex. Pre-investment studies were funded by the EU-Africa Infrastructure Trust Fund. The African Development Bank is providing around one-third of the US$204 million in total finance through a complex mix of loans and grants, with the World Bank, the European Investment Bank, the German government agency KfW and the EU-Africa Trust Fund providing the balance of external financing. The four countries are providing around 12 per cent of the finance.[27]

The project is underpinned by a complex technical agreement. The governments of the four countries have established, by treaty, a supranational special purpose company to finance, build, operate and own the electric interconnection line. The share capital will be owned equally by the national power corporations of the four countries. The power link is expected to begin operating in 2017.

BOX 18 THE MISSING LINK OVER THE ZAMBEZI

Southern Africa's transport system has long been recognized as having a missing link in the form of a bridge over the Zambezi River at Kazungula, a crucial transit point where the borders of four countries almost meet: Botswana, Namibia, Zambia and Zimbabwe. The absence of a road or rail bridge increases delays and costs for goods being transported across Southern, Eastern and Central Africa. The only crossing point is a ferry between Botswana and Zambia associated with restrictive business practices.

Bridge projects have been on the drawing board since the early 1980s. But their implementation has been dogged by political differences and competing territorial claims, notably on the part of Zimbabwe. The African Development Bank has now developed a US$260 million project proposal as part of a wider transport corridor. An economic analysis of costs and benefits points to a rate of return of 23 per cent. The Kazungula Bridge project is now planned for completion by the end of 2017 – four decades after initial plans were drawn up.

The bird's-eye view of the emerging institutional map for infrastructure suggests that the planning environment is improving. One recent survey found that 67 project preparation facilities are operating in Africa. However, only 12 of these have even the most basic technical capabilities. Moreover, most focus on later stages of the project cycle, whereas the biggest gaps are in the early stages. To make matters worse, financing of project development has stagnated. After rising sharply between 2005 and 2010, it has now dropped back to 2008 levels. Project preparation is heavily under-resourced – and under-resourced preparation tends to lead to protracted delays and a high rate of failure.

Fragmentation tightens the project planning bottleneck. Currently, the 12 major facilities involved in project preparation largely duplicate one another's operations. Coordination often occurs by accident rather than design. The multi-donor PIDG underinvests in project development for Africa, especially in the early stages. The same is true of the European Union. The World Bank's International Finance Corporation has a high level of expertise in complex project development, but the Bank has invested far too little in project development capacity in Africa. The same charge might be levelled at the wider donor community, much of which continues to demonstrate a preference for "home country" technical expertise and consultancy firms.

The weak capacity of African governments and institutions is also evident at many levels. The AfDB-hosted Infrastructure Project Preparation Facility (IPPF) has played an important role in preparing landmark projects, including a complex power interconnection project involving Benin, Ghana and Togo. But the impact of the IPPF has been limited. Until recently it has been a predominantly grant-processing facility. Insufficient attention has been directed to early stage project development, and to following projects through to financial closure and implementation. These issues have been addressed via a business plan developed for 2011–2015, though the resources needed to implement that plan – around US$147 million – have yet to be mobilized.

Regional economic communities are now setting up their own project preparation facilities and coordinating their efforts. For example, the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC) and the Southern African Development Community (SADC) have now joined forces to establish a joint unit, and the Economic Community of West African States (ECOWAS) is creating its own Project Preparation and Development Unit. These are encouraging developments but are underfunded and lack high-level political backing.

The current patchwork of fragmented national, regional and multilateral initiatives is failing to mobilize the critical mass of financing needed for infrastructural transformation. There is a growing danger, captured in economic assessments across the region that infrastructure constraints will act as an increasingly powerful brake on growth.

An agenda for closing Africa's infrastructure financing gap

To solve Africa's infrastructure financing problems, far-reaching institutional reforms are required that combine action at the national level with initiatives that add value to the current regional and global architecture. We identify seven priorities:

To solve Africa's infrastructure financing problems, far-reaching institutional reforms are required that combine action at the national level with initiatives that add value to the current regional and global architecture

1. Promote the role of the African Development Bank as the primary one-stop agency for investors

The deficit in international economic governance is reflected in the fact that a standard contract suitable for many low-income countries in Africa has not yet been provided: no authority has played the coordinating role. For Africa, the most likely agency would be the African Development Bank, since it is governed by Africans and provides infrastructure finance itself.

2. Strengthen the role of MIGA

MIGA's operations in Africa need to be scaled up and for this it needs more public capital. Further, if the infrastructure project is strategic, covering the cost of the insurance premium should be regarded as a legitimate use of finance from the World Bank's International Development Association (IDA): currently there is no mechanism for a country's IDA allocation to be used in this way. One of MIGA's most valuable attributes is the ability to offer large amounts of coverage over extended periods, and to be able to do this in high-risk destinations. MIGA's ability to cover a 20-year power off-take agreement, for example, often represents an essential criterion in making sure a project in a difficult environment goes forward. MIGA has recently quadrupled its portfolio in Africa.

3. Broaden and deepen risk mitigation instruments

Risk mitigation financing has been developed in a fragmented and haphazard fashion. No systematic analysis has been undertaken of the type of risk instruments needed to unlock private investment, or of the specific risks holding back investments. These are areas in which the G20's multilateral development bank working group might have been expected to provide policy guidance. Several multidonor initiatives – including the PIDG – appear to be investing too little in risk mitigation.

Within this broad picture, the limited provision of foreign currency risk mitigation instruments is a cause of particular concern. As noted above, the AfDB's innovative Currency Exchange Fund (TCX) has helped investors to hedge interest rate risks associated with financing in local currency, but the TCX facility is limited. It could be expanded with support from development finance institutions operating through the AfDB private sector window. More should be done to encourage finance from local investors, thus avoiding currency risk at source.

4. Going to scale – strengthening Africa's capacity and voice
Donors often stress the importance of coordinated action in support of national plans and national capacity, but coordination among development finance institutions is often weak and haphazard. African governments and institutions have an insufficient voice on a number of multidonor initiatives. And donor alignment behind regional priorities is sometimes limited. The PIDG has some but not all the elements of public action that are needed, and it lacks scale. There is a danger that, while recognizing the opportunity, public agencies will respond with a plethora of small, uncoordinated and incomplete initiatives. While the goal of attracting private finance into African infrastructure has become sufficiently compelling to trigger action, there is no agreed analytic foundation around which actions can be guided.

5. Mobilize African resources for Africa's infrastructure
Economic growth has enhanced African governments' own capacity to finance public investment in infrastructure, but national efforts need to be supplemented by regional initiatives. There are some promising examples. For example, The Africa50 Infrastructure Fund that the AfDB recently launched with the Made In Africa Foundation will not only finance projects but also help develop bankable projects. Africa50 aims at raising US$500 million by the first half of 2014 to help shorten this time to less than three years. The bank also plans to launch a pan-African infrastructure bond to raise about US$22 billion that will be used solely to finance Africa's infrastructure development.

6. Build a hub-and-spokes model for project preparation
Building a pipeline of bankable projects to unlock investment in Africa will require a greatly strengthened focus on project preparation, with an emphasis on developing African capacity. The focal point for this effort should be the AfDB's Infrastructure Project Preparation Facility. This will require a significant expansion of the currently underfunded resource envelope for 2011–2015, from US$147 million to around US$500 million. However, effective delivery requires two measures. First, with the support of development partners, the AfDB needs to identify the technical, legal and financial requirements for a successful scale-up. Second, a strengthened central hub will only operate effectively if it is linked to strong regional hubs, building on the initial investment in project preparation undertaken by regional economic groupings. We therefore propose that African donors and governments jointly finance the development of technical units in these groupings.

7. Win-win scenarios for investors and African infrastructure
Currently Africa is largely excluded from the very deep pool of savings contained in pension funds. None of the exclusion can be traced to a rational assessment of risk. Currently, OECD pension funds are required by law to hold assets of at least A- quality. A rule adopted by the rating agencies, which is of considerable importance for African infrastructure, is that an African project cannot be rated more highly than the sovereign debt of the country. Most African governments are far below this threshold and there is no realistic prospect of getting them to A- in the near future.

Given the questionable performance of ratings agencies, the current institutional arrangements may be less than ideal. Infrastructure projects with the backing and insurance of MIGA, AfDB and established development finance institutions could prove less risky than some investments in OECD markets. This is an area in which the G8 could take the lead in piloting the development of new ratings approaches.

3. Harnessing the power of domestic tax and savings

Taxation not only underpins public finance, it is also at the heart of the social contract between citizens and states. For countries facing large infrastructure financing deficits, fair and efficient taxation – allied to the mobilization of domestic savings – is a precondition for long-term growth that benefits all.

Strengthening tax collection is critical
In last year's *Africa Progress Report*, we highlighted the losses incurred by African revenue authorities as a result of tax evasion by foreign companies. Those losses remain large, principally because of transfer pricing – the practice of shifting profits to lower-tax jurisdictions. Africa is estimated to lose over 5 per cent of GDP per year as a result of illicit financial outflows[28] – an amount that exceeds public spending on health.

International cooperation to tackle tax evasion in Africa has stepped up over the past year. Largely as a result of leadership by the Prime Minister David Cameron of the United Kingdom, the G8 summit in June 2013 provided impetus to efforts aimed at strengthening multilateral tax rules. At the G20 summit in September 2013, countries agreed to adopt automatic exchange of tax information as the new global standard. In an effort to subject anonymous shell companies to the sunlight of transparency, the UK government has also committed to establish the world's first public registry of corporate beneficial ownership. There is an opportunity to build on these initiatives at the 2014 G20 summit in Australia.

These are encouraging developments – but the pace of progress is too slow. Revenue authorities in Africa are seldom able to estimate, let alone stop, the outflow of funds through the complex webs of shell companies and offshore accounts, and the invoicing of transactions across tax jurisdiction by multinational companies.

More effective sharing of information across OECD tax jurisdictions will not resolve these concerns. Insufficient attention has been paid to the development of Africa's capacity to monitor and investigate practices such as transfer pricing. Moreover, wealthy countries have moved too slowly to address their own global tax evasion loopholes. An OECD study reveals that 27 of its 34 member countries are either "non-compliant" or only "partially compliant" with recommendations on transparency of corporate ownership established by the Financial Action Task Force, the anti-money laundering standard-setting body – and none are "fully compliant."

Tax revenue levels are rising – but slowly
Robust growth has been accompanied by modest increases in domestic revenue mobilization. The average tax-to-GDP ratio increased from 18 per cent in 2000/2002 to 21 per cent in 2011/2013. To put the figures in the wider public finance context, that increase was equivalent to half of the 2013 aid receipts. But governments across the region have been increasing public spending far more rapidly than they have been increasing revenue collection. While public spending has increased by 3 per cent to 4 per cent of GDP, the median increase in revenue is just 1 per cent.

Current tax-to-GDP ratios for many countries suggest there is scope for increasing tax revenues. There are still 17 countries in the region with tax-to-GDP ratios of less than 15 per cent. Only three of the eight countries in the West African Economic and Monetary Union (WEAMU) reached their "convergence target" of a 17 per cent tax-to-GDP ratio in 2011.[29]

Average tax-to-GDP figures for Sub-Saharan Africa conceal as much as they reveal. Tax ratios have tended to increase more in resource-rich middle-income countries than in low-income countries. In fact, much of the increase in the average tax ratio can be traced to a marked increase in revenue from natural resources. This has been accompanied by a downward trend in trade taxes, an increase in indirect taxes and stable income taxes.[30] Given that indirect taxes are often regressive, with the poor paying a higher proportion of their income in tax, this is worrying.

So too is the wider failure of governments in resource-rich countries to broaden and deepen the national tax base. Analysis by the IMF, covering 20 "resource-intensive" countries in Africa, suggests that every 1 per cent increase in resource revenues lowers non-resource revenues by up to 0.12 per cent of GDP. That evidence suggests that easy revenues from extractive industries may deter political leaders from embarking on deeper tax reforms.[31]

Persistently high poverty and the domination of the informal sector restrict the tax base. In Senegal, the tax base comprises 500 large enterprises, 10,000 medium-sized enterprises and 40,000 small businesses. Overcoming non-compliance with tax rules among small enterprises, traders and informal sector firms poses a challenge. Efforts to overcome that challenge and extend personal income taxes in Mozambique, Tanzania and Zambia have met with limited success, with non-compliance of employers in registering their employees an additional barrier.[32]

Informal sector taxation is often neglected. The sector may appear to offer limited potential for revenue increases, and collection costs are high. However, the potential benefits include building a culture of tax compliance among small and medium-sized enterprises, reducing a sense of unfairness among formal companies and hence encouraging tax compliance, and increasing the economic growth of small companies through the benefits associated with formalization.[33]

Tax reform is urgent

In addition to a country's economic and labour market characteristics, tax policy design and administration matter. Many countries in Africa pay a high price for poor design.

Large amounts of tax revenue are routinely given away in the form of what are euphemistically described as "tax incentives." In the 1980's about 80 per cent of African countries provided tax incentives.[34] Evidence of the benefits in attracting investors is at best unclear. While taxation matters for foreign investors, considerations such as infrastructure and rule of law matter more.[35] Exemptions also create opportunities for corruption.[36] As we highlighted in last year's report, mining companies have been showered with exemptions at a time when Africa's resources are rising in value.

Tax evasion through transfer pricing and the under-reporting of profits by transnational corporations is a major drain on revenues.[37] While difficult to quantify, illegal, unreported and unregulated export activity in sectors such as forestry and fisheries generates multimillion-dollar losses for revenue authorities (see Part III).

The ingredients of successful tax reform include developing a unified tax administration system, improving information and accounting systems, and putting in place governance systems that tackle fraud. Clear rules, including the simplification of tax codes and minimization of exemptions, are vital. While taxing the informal sector is difficult, incentives and measures aimed at reducing the cost of compliance can make a difference.[38] Strengthening the demand side of tax accountability by encouraging broader citizen engagement is a reform priority. Burundi illustrates the potential benefits of reform. Far-reaching administrative reforms helped to increase the tax-to-GDP ratio from 14 per cent in 2009 to 17 per cent in 2012.[39]

Reversing the proliferation of tax incentives is another reform challenge. Although renegotiating mining contracts is controversial, tax exemptions have been overturned in some countries. In Mozambique, a 2009 law ended the special low-rate regime for large projects and established increases in the taxation of mining and petroleum companies.[40] In addition to national initiatives, regional agreements may be particularly helpful in combating excessive incentives and blocking downward tax competition.

Tax policy involves more than technical design and implementation. Taxation is at the heart of the accountability relationship between states and citizens. This idea is central to the social fiscal contract: a pattern of regular and routine accountability based on the principle of reciprocity and mutual obligations.[41] When taxation is accompanied by effective and fair public services, it can strengthen the legitimacy of states. Improving tax diversification is critical in this respect. In countries where government budgets rely predominantly on natural resources or aid, there is a danger that political leaders may be less accountable to their citizens. Efforts to strengthen personal and corporate income tax can have important consequences since it is direct taxes that are particularly effective in institutionalizing state-citizen relations.[42]

Redirecting subsidies that drain public finance

While strengthening revenue mobilization is vital, the amount of resources available for public investment in priority areas such as infrastructure and basic services is also determined by budget priorities – and there is considerable scope for making more money available by reordering these priorities.

Energy subsidies illustrate the scope for reform. The IMF estimates that governments in Africa spend around 2.8 per cent of GDP on subsidies aimed at reducing the cost of fuel, with around half of that amount accounted for by losses in state power utilities. These subsidies disproportionately benefit higher-income people, who consume the most power. In Senegal, energy subsidies exceed public spending on health and education – and just 12 per cent of the benefits go to the poor.

Subsidies in agriculture can have similar effects. Zambia is an example. During 2010–13, subsidies for maize farmers averaged close to 3 per cent of GDP, with large-scale commercial farmers capturing the lion’s share of the benefits.

Redirecting subsidies can be politically challenging, as several governments in Africa have discovered to their cost. Successful reform requires the development of political constituencies. Public information campaigns have facilitated successful reform in several countries. But governments can also redirect energy subsidies and pro-rich farm subsidies into programmes that have a visible payoff for the poor, including social protection, health coverage, education and public transport.

Tapping savings for investment: domestic bond markets

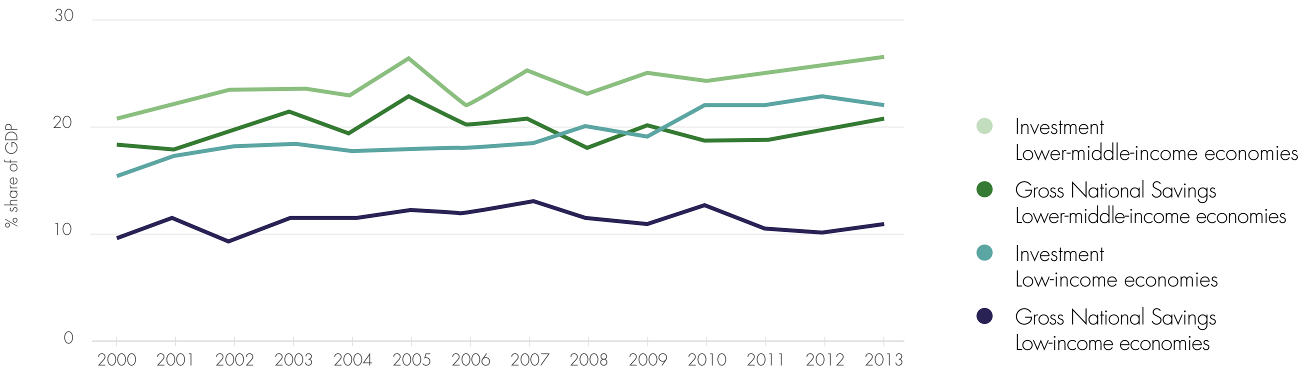
Developments in savings mirror those in taxation. High-growth developing countries in East Asia were able to finance increased investment out of higher levels of savings. In Africa, economic growth has yet to translate into a regional shift in savings. The savings-to-GDP ratio in 2013 was below the level reached in 2006. The widening gap between savings and investment (Figure 23), which is filled by external resource flows, is a major constraint on both public and private investment.

Several governments have sought to secure access to domestic savings through bond markets. Some have mobilized considerable amounts through this route for infrastructure financing. For example, Kenya has issued three infrastructure bonds since 2009, valued at US$1 billion.

The problem is that Africa's banks are very poor at intermediating between savings and investment. Almost without exception, their commercial activity focuses on short-term deposit and loan activity – usually at high interest rates. The shallowness of regional financial systems is reflected in the cost of government borrowing. Last year Uganda issued a US$32 million domestic bond, principally to finance infrastructure, at a yield of 15 per cent. Kenya and Tanzania similarly issued 15-year bonds priced respectively at 14 per cent and 17 per cent. Despite these high returns, neither issue was fully subscribed, although Tanzania's central bank accepted US$7 million of the bond issue.

FIGURE 23 THE GAP BETWEEN SAVINGS AND INVESTMENT

Low-income and lower-middle income countries in Sub-Saharan Africa



Source: IMF (2014), World Economic Outlook database.

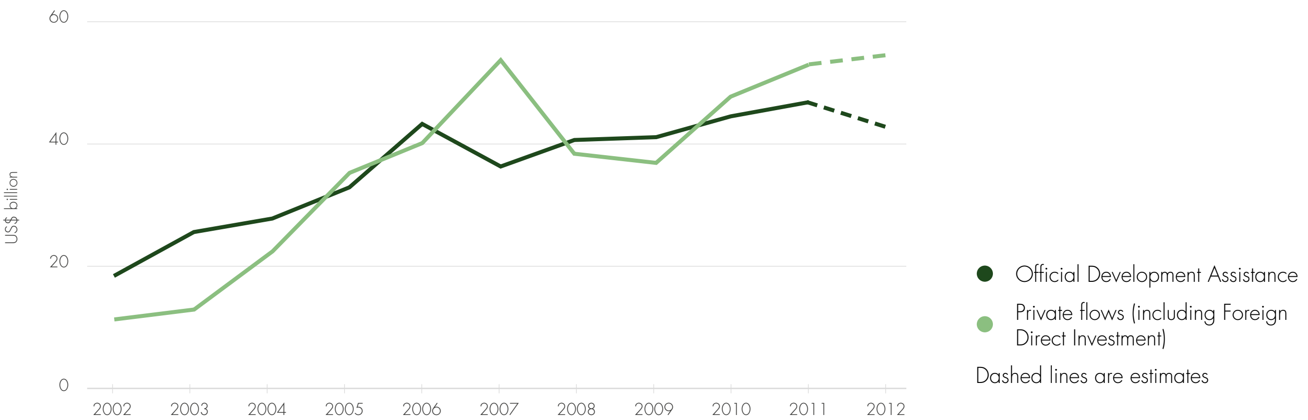
There are some indications that local currency debt markets may be strengthening. The International Finance Corporation has launched a domestic bond programme that will issue local currency debt in several countries, including Ghana, Kenya, Nigeria, Uganda and Zambia. In 2013, the scheme launched its first naira-denominated bond in Nigeria, raising US$76 million at a rate of 10 per cent. This was followed by the launch of a four-year bond in Zambia for US$150 million at 15 per cent. The issue was five times oversubscribed. While there may be important lessons, the IFC operates with the authority of a triple-A rated lender.

4. Balancing the risks and opportunities of external finance

This section examines the opportunities as well as the risks presented by a wide range of sources of external finance – including aid, "blended" finance, foreign direct investment, private equity and bond financing. The challenge, both for African governments and aid agencies, is to develop policies and financing instruments that mobilize the full range of external resources that can underpin inclusive and transformative growth.

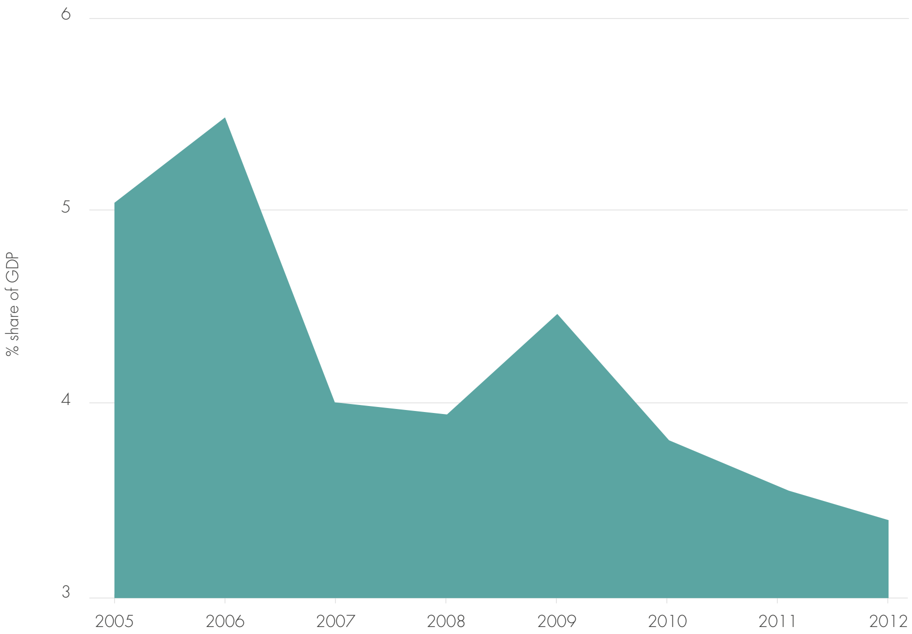
Aid will remain important for many countries
After rising through to 2008, partly as a result of debt relief under the HIPC initiative, bilateral aid to Sub-Saharan Africa fell 8 per cent in real terms between 2011 and 2012. Including multilateral development assistance, total aid was US$48.2 billion or 3 per cent of regional GDP, compared with 5 per cent in 2005 (Figures 24 and 25).

FIGURE 24 PRIVATE FLOWS HAVE OVERTAKEN AID: DEVELOPMENT ASSISTANCE AND PRIVATE CAPITAL TRANSFERS (US$ BILLION)



Data Sources: OECD and UNECA (2013), Mutual Review of Development Effectiveness and the OECD-DAC International Development Statistics database

FIGURE 25 FROM PEAK TO PLATEAU: AID FLOWS ARE FALLING AS A SHARE OF AFRICA'S GDP



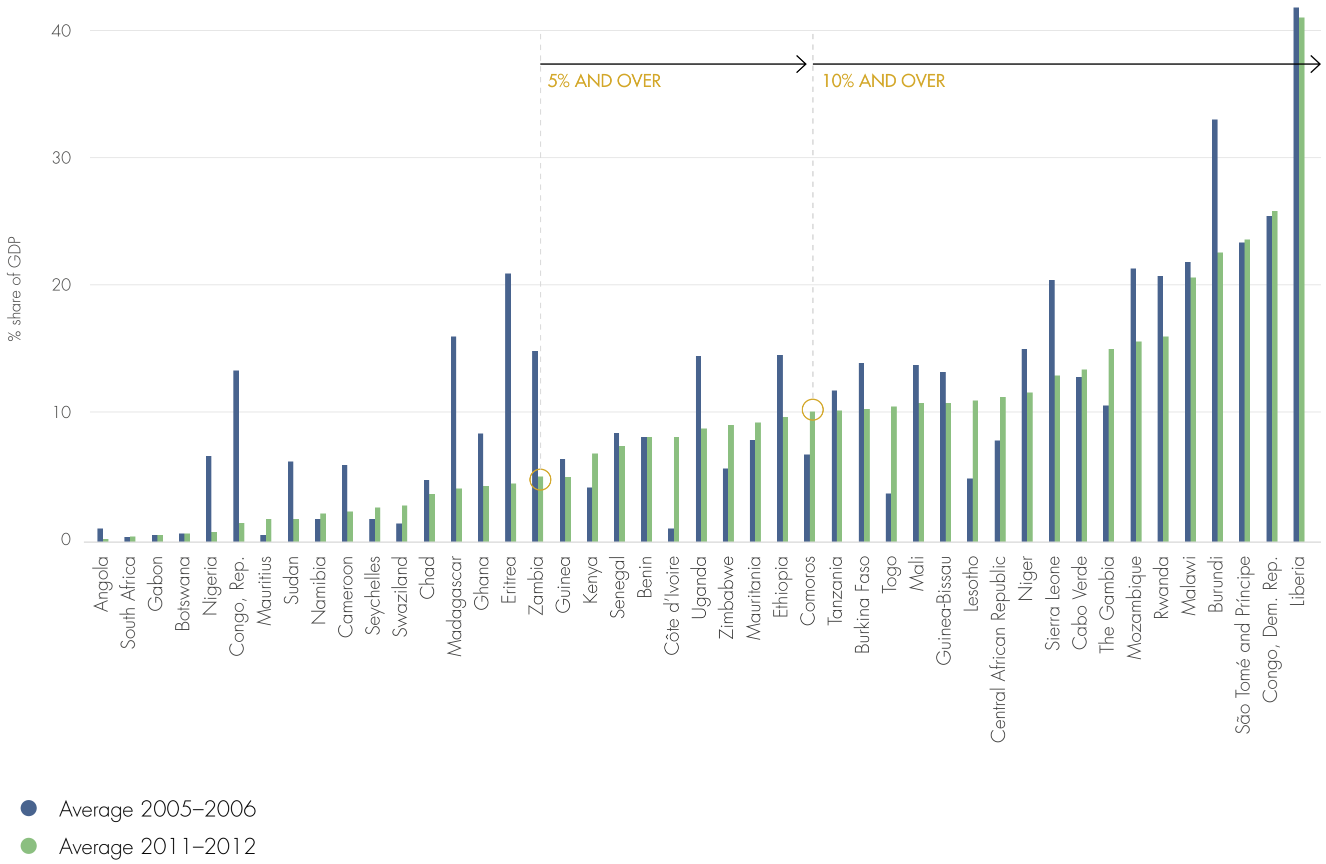
Source: OECD DAC and The World Bank Group's World Development Indicators (2014).

Patterns of aid are also changing. Emerging markets are a growing source of concessional finance. Direct comparisons between OECD and emerging market aid are fraught with difficulties because of different reporting conventions, and disputes over what should – and should not – be scored as aid. The best recent estimate for Chinese support to Africa, encompassing both concessional flows and other official finance, is that it is comparable to US development assistance – around US$9 billion to US$11 billion annually. Private philanthropy is also growing. Non-traditional aid represented 9 per cent of overall aid in Ethiopia in 2009, and 7 per cent in Zambia.[43]

Private flows have moved in the opposite direction to aid. Sub-Saharan Africa weathered the mid-2013 turmoil in financial markets better than other regions. Net private capital flows to the region continued to rise, reaching 5.3 per cent of GDP, significantly above the developing country average. Private inflows of capital now exceed aid by 28 per cent. That gap is set to widen. With the OECD anticipating a shift in aid resources towards middle-income countries in the form of soft loans, and net private capital flows set to rise to US$75 billion, development assistance will be less than external flows by 2014.[44]

The regional overview obscures some marked variations. In 26 Sub-Saharan Africa countries, aid represents more than 7 per cent of GDP (Figure 26). In about half of these countries it represents more than 10 per cent of GDP.

FIGURE 26 AID REMAINS CRITICAL FOR MANY COUNTRIES: AID AS A SHARE OF GDP



Source: OECD DAC and The World Bank Group's World Development Indicators (2014).

Such figures suggest that reports of the demise of aid as a development resource may be premature. For many countries in the region, aid will remain a vital source of development finance, especially for basic services. Over one-third of aid to Africa is directed towards social sectors.[45] But aid also plays a critical role in supporting development more broadly. While there is considerable scope for improving aid efficiency, claims that aid hinders growth and poverty reduction are refuted by the experiences of Ghana, Rwanda, Tanzania, Uganda and many other countries.

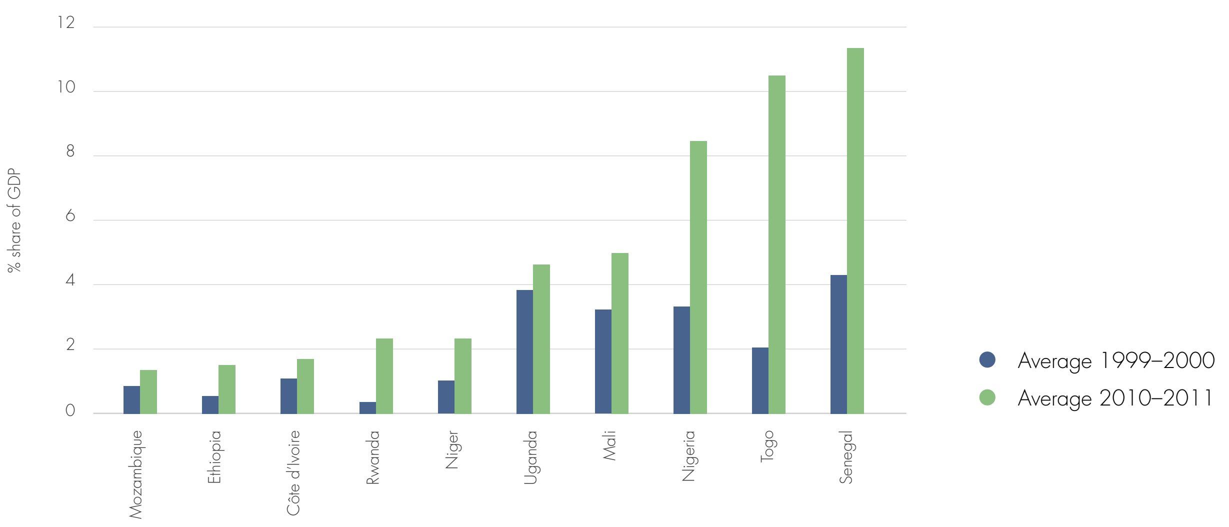
Aid helps to finance investments in health, education, water and sanitation, and national institutional capacity that are needed to make growth inclusive and sustainable. That is why OECD projections that aid is likely to stagnate in countries such as Burundi, Chad, Madagascar, Malawi and Niger represent a major cause for concern.

Reducing remittance charges: an urgent priority
Remittances from African migrants are on the rise (Figure 27). Unlike aid, remittances go directly to households. They provide a financial lifeline for families facing hardship, as well as a source of investment for agriculture, housing and education. Remittances also play a vital role in the balance of payments of many countries, helping to finance current account deficits and stabilizing currencies. World Bank projections suggest that remittances to Sub-Saharan Africa could reach US$41 billion by 2016.

Unfortunately, the full development potential of remittance transfers has yet to be realized. This is because charges on remittances to Africa are far higher than for any other region (See Infographic, The Remittance Super Racket). Research by the Overseas Development Institute ODI (Watkins, K. and Quattri, M. (2014). *Lost in Intermediation: How excessive charges undermine the benefits of remittances for Africa*.) suggests that the region could be losing US$1.4 billion to US$2.3 billion a year as a result of what has been termed a "remittance super tax" on Africa – the charges levied by what amounts to a 'duopoly' of money transfer operators (Box 19). Sending remittances to Sub-Saharan Africa currently costs around 2.3 per cent. US$1.4 billion would be saved if this cost (fee plus foreign exchange margin) was reduced to the global average of 7.8 per cent. If the 12.3 per cent was reduced to the G8 and G20 suggested level of 5 per cent instead, the reduction would generate an additional US$900 million. This implies that the total loss of sending remittances to Sub-Saharan Africa is in the range US$1.4 to US$2.3 billion, averaging US$1.85 billion each year.

While there are many technical and regulatory issues to be addressed, the charges imposed on African remittances are fundamentally indefensible. The international community and African governments should seek as a matter of urgency to put the reduction of remittance charges at the centre of the international development agenda.

FIGURE 27 REMITTANCES ARE INCREASING IN MANY COUNTRIES: TRANSFERS AS A SHARE OF GDP, SELECTED COUNTRIES

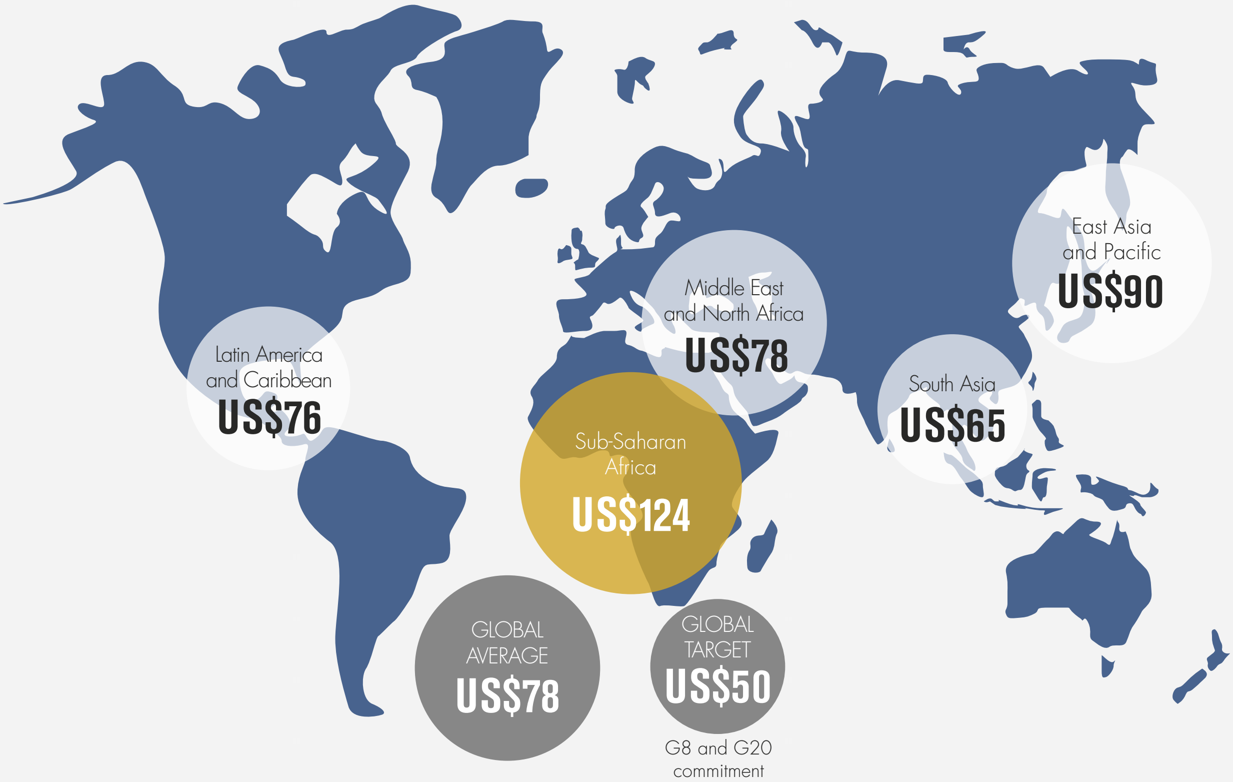


Source: The World Bank Group (2014), World Development Indicators.

THE REMITTANCE SUPER RACKET

Global money transfer operators and Africa's banks are overcharging Africans

CHARGE TO SEND US$1,000 TO…



THE TOTAL OVERCHARGE OF SENDING REMITTANCES TO SUB-SAHARAN AFRICA AVERAGES

US$1.85 BILLION

PER YEAR

WHAT COULD US$1.85 BILLION FINANCE IN SUB-SAHARAN AFRICA?

14
MILLION CHILDREN
of primary school age could go to school – almost half of the region's out-of-school population

8
MILLION PEOPLE
could have access to improved sanitation through Ventilated Improved Pit (VIP) latrines

21
MILLION PEOPLE
could have access to safe water through the construction of boreholes

Sources:
The World Bank Group (2014), Remittance Prices Worldwide.
Quattri, M. and Watkins, K. (2014), Lost in Intermediation: How excessive charges undermine the benefits of remittances for Africa.

BOX 19 AFRICA'S "REMITTANCE SUPER RACKET"

Migrants from Africa, the world's poorest region, pay the world's highest remittance fees. On average, someone sending US$200 home to pay for the education of a brother pays US$24.8 – a charge of 12.3 per cent.

Why are remittance charges so high? And why, in an era of mobile banking and internet transfers, do they show no sign of falling? The Overseas Development Institute in London has identified several barriers to lower charges:

The power of money transfer operators (MTOs): Global MTOs account for 80 per cent of transfers to Africa. Just two companies – Western Union and MoneyGram – account for two-thirds of this amount. Both companies operate exclusivity agreements with their agents and commercial banks, which raises the cost of market entry. MTOs account for US$900 million taken from African migrants and their families through excessive charging.

Questionable pricing practices: Many MTOs appear to charge an "African fee" that is uniform and unrelated to underlying conditions in the receiving countries. There is also evidence that MTOs are able to manipulate exchange rate variations. In March 2011, Malawians remitting money from the United Kingdom faced a foreign currency conversion fee in excess of 5 per cent.

Financial regulations: Regulatory authorities in many countries require remittances to pass through national banks, many of which are characterized by high costs.

Low levels of financial inclusion: Few Africans, especially in rural areas, have access to accounts in formal financial institutions – and such institutions have a limited presence in many areas.

Intra-African remittances are also subject to excessive charges, some of which are the highest in the world. Malawian labourers working in South Africa, Ghanaians sending money home from Nigeria, and Rwandans sending remittances from Tanzania all face charges of more than 20 per cent.

Governments could take several steps to reduce the costs of remittance transfers:

- review the practices of global MTOs , especially the transparency of the information they provide on foreign currency conversions;
- authorize post offices and microfinance institutions to play an expanded role in remittance payouts;
- challenge exclusivity arrangements involving MTOs and undertake reforms aimed at increasing competition;
- promote mobile banking. Kenya has seen remittance transfers double since 2004, to US$1.2 billion, partly because of the growth of the mobile payment service M-PESA (Box 14), which enables people without a formal bank account to receive remittances.

"Blending" aid and loans carries risks for the poorest countries

A central feature of new development assistance arrangements is "blending," which aims to use aid to leverage private finance. Blended finance links an aid grant with loans from publicly owned institutions or commercial lenders, to public or private sector borrowers in developing countries. As the discussion above of infrastructure financing shows, the primary source of blended finance has been European development finance institutions and The World Bank Group.'s low-income country lending arm, the International Development Association (IDA).

There are compelling grounds to develop blending, along with some causes for concern. When aid can unlock private investment through risk guarantees, equity stakes and other mechanisms, blending can have powerful financial multiplier effects. With high returns available in many areas of infrastructure financing, blending can help to mitigate the market failures that limit investments. Moreover, sustained high growth means that blended finance is not an immediate threat to debt sustainability for many countries.

Set against these benefits are several potential downside risks. One is that blended finance could divert aid towards higher-growth countries better able to leverage private investment, and away from countries with weaker governance. Another is that at a time when aid budgets are under growing pressure, there will be a trade-off between blending and access to basic services.

Another concern is that blending could make development finance less affordable and less available to the poorest countries. As donors reallocate aid towards leveraging private finance, there is a danger that recipient countries will have to fund infrastructure through more expensive loans.[46] Further question marks hang over the degree to which blending produces the leveraging effect that is sometimes claimed.

The focus on blending may also have diverted attention from other pressing issues. One concerns what is reported as development assistance. Donors in the OECD are required by convention to provide aid as a resource that is "concessional in character."[47] However, a former chair of the OECD's Development Assistance Committee has raised concerns over donor practices that appear to allow for non-concessional transfers to be counted as aid.[48] These concerns have to be taken seriously not just because of their source, but also because of the amounts involved. On one estimate, since 2008 US$32 billion that has been registered as aid fails to meet the OECD's own rules, with France, Germany and Japan the principal over-reporters.[49] There is an urgent need to clarify the rules and their application, not least in the light of the rise of aid blending.

The second issue also relates to concessionality. Most low-income and lower middle-income countries in Africa are eligible for aid in the form of grants by bilateral donors, by the International Development Association, or by the African Development Fund (the concessional arm of the African Development Bank).[50] In theory, lower middle-income countries are also eligible to borrow from the International Bank for Reconstruction and Development (IBRD), The World Bank Group's non-concessional facility.[51] Some countries – India, Pakistan and Indonesia are examples – are also eligible for a blend of IDA and IBRD support. In Sub-Saharan Africa, however, no countries currently draw on either the IBRD or the IBRD/IDA blend option; and only a handful draw on the African Development Bank's non-concessional facilities.

These apparently technical distinctions matter. Several Sub-Saharan African countries are now mobilizing resources through international bond markets. Reported interest rates since 2012 have varied between 8 per cent and 12 per cent on 10-year bonds. Meanwhile, loans from the IBRD currently carry an interest rate of 1 per cent to 2 per cent on 20-year loans, reflecting the World Bank's triple A credit rating in bond markets.[52] These interest rate differences could translate into very large potential savings. There are compelling grounds for African governments, the World Bank and the African Development Bank to reconsider whether the existing architecture is appropriate for potentially high-growth economies with large unmet infrastructure financing needs.

Foreign direct investment: beyond extractives

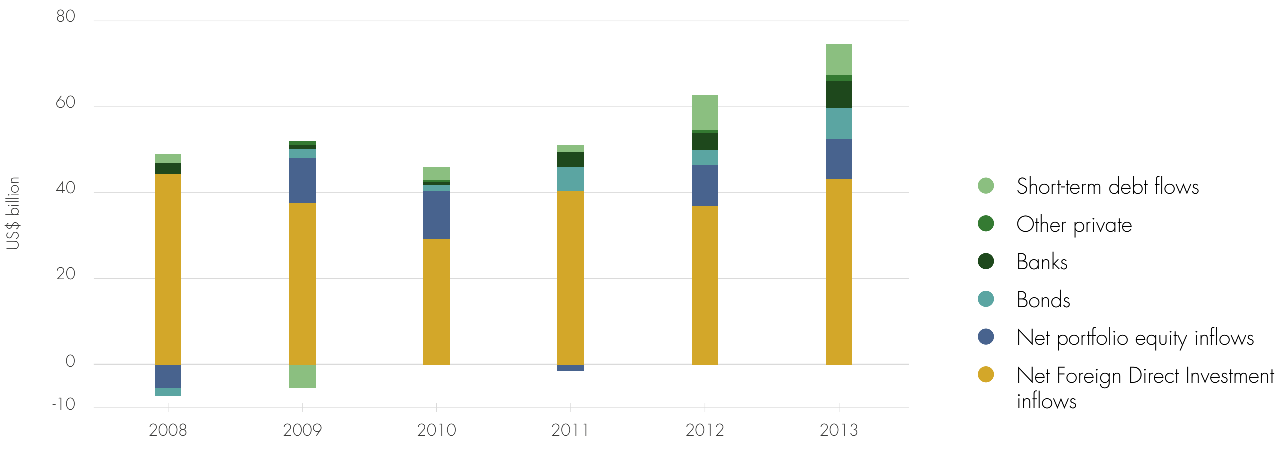
For investors seeking returns, emerging markets and "frontier markets" (as countries in Africa are often described) have become an attractive option as slow growth and loose monetary policy have lowered returns in equity and bond markets in the United States and Europe. This has provided African governments with access to a global pool of savings in a period of historically low interest rates, though this may soon be reaching an end. Sustained rapid growth and strengthened macroeconomic management in Africa have also favoured greater private investment.

Around 70 per cent of private capital flows to Africa arrives in the form of foreign direct investment (FDI) (Figure 28). This is important since FDI is the least volatile type of inflow and the least likely to experience abrupt outflows if market conditions change.

The mining and oil sectors continue to account for the bulk of FDI, but investment is also flowing into other areas. Around one-third is now directed to domestic markets. Between 2008 and 2012, the share of consumer-related industries in the value of new investment ventures in Africa grew from 7 per cent to 23 per cent.

Much of this domestic market investment has been directed towards public–private partnerships. Growing energy demand, regulatory reform and infrastructure investment have prompted an increase in partnerships between foreign and domestic investors. In November 2013, for example, the US energy company AES purchased a majority

FIGURE 28 FOREIGN DIRECT INVESTMENT DOMINATES PRIVATE CAPITAL FLOWS: PRIVATE TRANSFERS BY CATEGORY (US$ BILLION)



Source: The World Bank Group (2014), Global Economic Prospects.

stake in Cameroon's power utility, Société Nationale d'Électricité (SONEL). Partnerships between global and national companies are also becoming more common: during Nigeria's recent US$2.5 billion privatization process, local companies that had formed consortia with foreign players – including Siemens, Manila Electric, Symbion Power and KEPCO – emerged as winners of most projects. Investments in manufacturing remain the exception rather than the rule. Even so, during 2013 Nigeria became the first Sub-Saharan African country outside South Africa to attract a new investment from a global car maker: Nissan will build cars and light duty trucks in the country.

One of the most important FDI events of 2013 was the purchase by Prudential, one of the world's largest global insurance companies, of a Ghanaian insurer.[53] Prudential's purchase signals that high levels of poverty and low average incomes are not an automatic barrier to insurance. Nine out of 10 of the customers of the Ghanaian insurer bought by Prudential earn less than US$10 a day, while one-fifth live on less than US$2.50 a day.

Alongside FDI, private equity – capital that is put into new or growing businesses in return for part ownership or a profit share – has taken off, albeit from a low base. On one estimate, private equity firms invested US$1.13 billion across Sub-Saharan Africa in 2012. While the industry is still in its infancy, political stability, infrastructure investment and the growth of consumer markets have made Sub-Saharan Africa a hotspot. African private equity firms are playing an expanding role alongside established global players, across a wide range of sectors. Consumer industries, infrastructure, banking and agro-processing all figure prominently. So do real estate and, to an increasing extent, private health insurance. Another shift has been the spread of private equity firms to new markets. While the East African market is dominated by Kenya, growth has also taken place in Ethiopia, Rwanda and Tanzania.

Recognizing the critical role of small and medium-sized enterprises in African markets, several private equity firms are gearing their operations towards specialization in that area. As ever, growth has to be placed in perspective. There were only 58 private equity deals reported in Sub-Saharan Africa in 2012. The scale of the investments remains modest: in 2013 half of the private equity flows into Africa were valued at less than US$10 million. However, volumes are growing.

Africa's return to international bond markets

Sub-Saharan Africa's transition from intensive care under the HIPC initiative to a presence on the eurobond market is a remarkable turnaround. Since Ghana's initial highly successful bond offering in 2007, there has been a steady wave of new entrants and return issues. Low international interest rates, high domestic growth and low levels of public debt have made the region's bonds an attractive proposition. However, participation in eurobond markets carries significant risks – and it does not offer a magic bullet solution to infrastructure financing problems.

Between 2007 and 2013, Sub-Saharan African countries raised US$14 billion from sovereign bond issues, of which US$6.5 billion or 50 per cent was raised in 2013 alone. In some cases, African countries have borrowed at rates below those applied to eurozone economies. Zambia's 2012 yields were below those of Spain; Nigeria's rates were lower than those for Ireland. Among the major bond issues:

Zambia issued a heavily oversubscribed 10-year US$750 million eurobond in September 2012, with the funds earmarked for a number of infrastructure projects with a yield of 5.6 per cent.

Nigeria made its debut on the bond market in 2011 and returned with a US$1 billion issue in 2013. Yield rates were 5 per cent to 6 per cent on an issue that was four times oversubscribed.

Rwanda issued a US$400 million bond paying a coupon of 6.8 per cent that was nine times oversubscribed.

Ghana issued a US$750 million bond in 2013, in its second foray into the eurobond market, which was three times oversubscribed at a rate of 7.8 per cent. The bond's proceeds were earmarked for capital investment and reducing public debt.

Mozambique entered the market for the first time with a US$500 million seven-year bond issued by a government-backed agency at an 8.5 per cent yield.

Gabon raised US$1.5 billion from an oversubscribed 10-year eurobond issue and debt exchange.

Several countries have indicated an intention to either enter or return to eurobond markets in 2013, including Angola, Cameroon, Kenya, Mozambique, Tanzania and Uganda. While Sub-Saharan Africa has yet to participate on any scale in Islamic bond markets, this could be about to change (Box 20).

BOX 20 ISLAMIC BANKING IS GAINING GROUND[54]

The global market for Islamic bonds – or sukuk – is estimated at US$140 billion, and Islamic banks have emerged as a significant force in global finance. Yet Sub-Saharan Africa does not figure with any prominence in the world of Islamic finance. That could be about to change – and the effects will be significant.

Sukuk already figure in government operations. Structured to pay a fixed profit rate rather than an interest dividend, these bonds could supplement other sovereign debt operations. The Nigerian state of Osun issued a US$62 million sukuk in 2013. The government of Senegal has announced plans for a US$200 million issue in 2014, geared towards infrastructure and energy.

Other financing vehicles that comply with sharia, or Islamic law, are becoming more common. The central banks of Mauritius and Nigeria are shareholders in the Malaysia-based International Islamic Liquidity Management Corporation. Meanwhile, the Islamic Development Bank is providing investment for the new port of Lekki in Nigeria.

Other countries are making moves to encourage the growth in this area: In 2013 South Africa amended its tax laws to make definitions of sharia-compliant products more transparent. Yet there are calls for even faster change, with banks in South Africa pushing for greater lucidity in terms of tax legislation. Concerns remain that conventional banking laws continue to dictate Islamic finance. Zambia is formulating a new Islamic banking framework. Uganda, with a 12 per cent Muslim population, is also making regulatory changes.

Several major conventional banks are now also planning moves into the Islamic banking sector in Africa. Standard Chartered announced in July 2013 that it would soon start offering Islamic banking products in Kenya, before moving into other countries in the region.

Challenges remain. These include the need for Islamic banking institutions to appeal to non-Muslim customers, greater transparency and the availability of attractive products that are offered at the same standards of service delivery as conventional products.

Comparisons with aid illustrate the scale of Africa's eurobond issues. Ghana's 2013 issue was equivalent to around one-half of average development assistance inflows over the previous three years. For Zambia, the 2012 issue represented over two-thirds of aid levels. While development assistance and bond finance are very different, the comparison illustrates the attraction of the latter for governments seeking to mobilize additional finance for infrastructure.

It is not only governments that are borrowing. Some corporate entities have successfully issued eurobonds, including Guarantee Trust Bank and Ghana Telecom.[55] Nigeria's Guaranty Trust Bank issued US$400 million in bonds at 6 per cent at the start of 2013. Kenya's ARM Cement, Nigeria's Sterling Bank and Kenya Power are all expected to issue eurobonds in the near future.[56] While municipal bonds are a rarity, the municipalities of Lagos in Nigeria and Lusaka in Zambia have entered sovereign debt markets.

Conditions have been highly favourable. Excess liquidity has given African governments access to a deep pool of international savings. The average cost of bond financing fell in 2012, to its lowest level ever.[57] With high income countries gradually withdrawing the monetary stimulus measures adopted in the wake of the financial crisis, notably the tapering-off of the US Federal Reserve's quantitative easing policies, investors have turned to emerging markets and "frontier markets" to secure returns. From an African government perspective, the desire to tap the flood of money from rich countries is understandable. The region has large infrastructure financing needs, a scarcity of local savings, inefficient banking systems and a history of high inflation – all of which serve to keep domestic interest rates high in many African countries. Yields on eurobonds are significantly lower than those on domestic market bond issues (Figure 29).

African governments have turned to bond markets for a variety of reasons. Apart from raising long-term finance for infrastructure, bond issues can set benchmarks for corporate debt and facilitate debt restructuring (the substitution of lower-interest for higher-interest debt stock).

Recourse to bond markets comes with several risks, however. Although Sub-Saharan African bond yields were only modestly affected by the tapering-off of the US Federal Reserve's quantitative easing policies, this picture could change with deeper tapering.

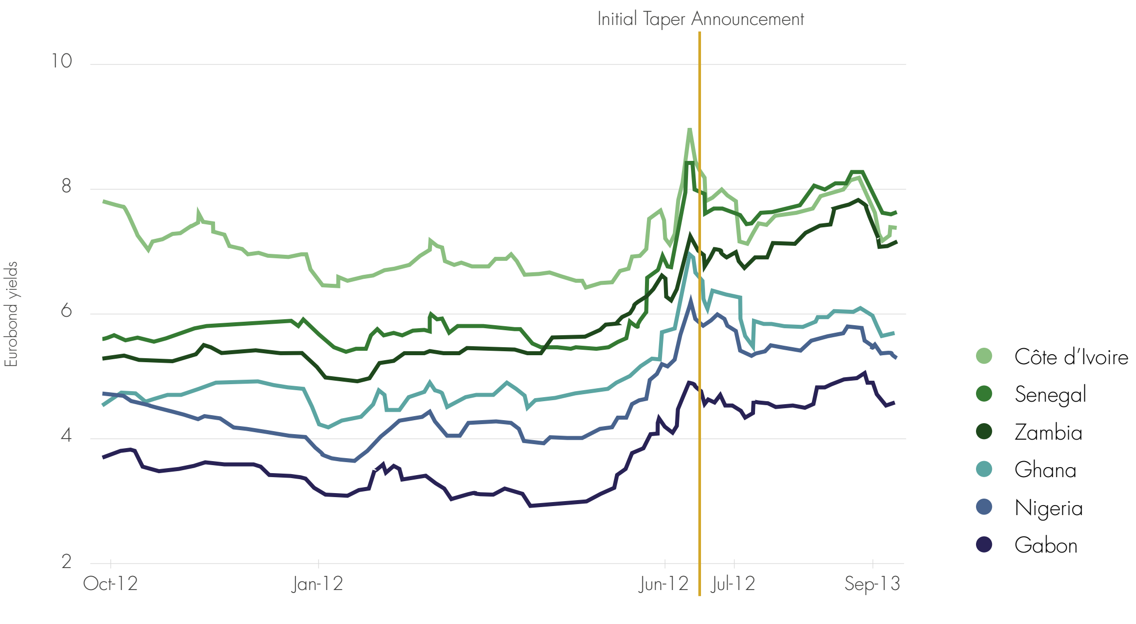
Not all of the risks are external. Large current account and fiscal deficits carry the risk of devaluation, which can in turn make an apparently sustainable debt burden unsustainable overnight. Devaluation is not the only threat. Where bonds are issued to finance major infrastructure projects, governments need to ensure that debt liabilities are offset against productive investments. Long delays between borrowing and the initiation of projects can erode the benefits of bond finance. This appears to have happened in Zambia. One year after the successful (and heavily oversubscribed) issue of the US$750 million bond on euromarkets, few of the planned investments had taken place. The problems associated with the design of major infrastructure investment projects, which we identified above, appear to have been a major factor behind the delay.

Several governments have attempted to draw on the savings of diaspora communities. For example, Ethiopia adopted this approach with the Millennium Corporate Bond in 2008 and the Grand Ethiopian Renaissance Dam bond in 2011 with mixed results.[58]

Conclusion

Finance and infrastructure are sometimes viewed as technical issues of concern principally to financial regulators, engineers and companies linked to banking, insurance and construction. Nothing could be further from the truth. In this report we have highlighted the consequences of the deficits in finance and infrastructure for the most important development challenge facing Africa – strengthening the bridge that connects economic growth to the wellbeing of people. More inclusive financial systems, expanded infrastructure and healthier domestic revenues, will enable Africa's farmers, to realize their potential and to contribute to inclusive growth and food security and nutrition.

FIGURE 29 AFRICAN BOND ISSUES WERE AFFECTED BY THE US TAPER ANNOUNCEMENT: YIELD DATA 2012 (SELECTED COUNTRIES)



Source: Bloomberg as quoted by Standard Chartered (2013), Standard Chartered Africa Focus: A wealth of diversity.

05

POLICY RECOMMENDATIONS

Grain, fish, money: a shared agenda for achieving a breakthrough in Africa

During more than a decade of economic growth, Sub-Saharan Africa has built up an impressive track record on generating wealth. The business environment for domestic and foreign investors has improved beyond recognition, as has the political environment. The great forces driving globalization, including the rise of emerging markets, urbanization and the growth of a global middle class, are boosting demand for Africa's resources. It is hard to imagine a more propitious environment for a breakthrough in improving the lives of Africans. Yet welcome as the economic wind-change has been, the benefits of growth in Africa have not been spread equally.

This report has highlighted a major source of the disconnection between wealth creation and wellbeing: the neglect of agriculture and fisheries. This neglect represents a double burden. First, the vast majority of Africa's poor live and work in rural areas, mostly as smallholder farmers. It follows that growth that bypasses the rural poor will fail to reduce poverty significantly. Second, agriculture and fisheries have the potential to act as powerful engines of growth. Africa's farmers are among the most resilient, innovative and entrepreneurial in the world. Linked to a vibrant agroprocessing sector, they could feed the region's growing urban populations, generate exports and raise productivity. Yet many governments publicly declare their support for agriculture, only to ignore smallholder farming and fishing communities. The result is that Africa is squandering its most productive assets.

That is not the only thing that is being squandered. In the last year's *Africa Progress Report* we highlighted how African countries were losing vast amounts of money through tax evasion and the undervaluation of mineral resources. This year we examined parallel losses through illegal, unreported and unregulated (IUU) activity in fisheries and logging. African governments are failing to protect valuable national forests and fisheries. Powerful vested interests, domestic and foreign, are essentially being "licensed to plunder". At the same time, the wider international community has failed to develop the multilateral rules needed to effectively govern global markets.

As we have stressed in successive *Africa Progress Reports*, there can be no policy blueprints. Each Sub-Saharan African country faces different challenges and opportunities. Even so, some broad principles can be identified that should guide the formulation of practical policies. Empowered African citizens at home and abroad have a fundamental role in implementing the recommendations below.

Recommendations for African governments

The renewed commitment to agriculture by Africa's political leaders and policymakers is commendable. But to meet the challenges and seize the opportunities at hand, African leaders need to be even bolder. Political leadership and perseverance are needed to drive crucial change in the agricultural sector.

Take action to spread the benefits of growth more equally: Next year, African heads of state and government will join leaders of other member states of the United Nations to set some ambitious 2030 development goals, including the eradication of poverty. High levels of inequality are limiting the power of growth to reduce poverty. Meanwhile, a lack of education and low levels of skills are restricting Africa's prospects of securing a greater share in the benefits of globalization. Policymakers across the region need to make sure economic growth is transformative and expands opportunity.

Priorities:

- Set equity targets linked to the post-2015 development goals. These targets should focus on narrowing gaps in opportunity. For example, they could include halving over five years the disparities in school attendance, child survival and access to basic services linked to rural-urban divides, wealth gaps and gender divisions.
- Monitor poverty and human development deficits more effectively, with more reliable data.
- Target a greater share of subsidies towards supporting the welfare of the poor.
- Build integrated social protection systems that effectively target the rural and urban poor.
- Strengthen the quality and access of education through more effective teacher training and the development of national learning assessment.

Accelerate a uniquely African green revolution: A large productivity gap separates farmers in Africa from their counterparts in the rest of the world. Closing that gap would support growth, reduce poverty, and enhance food and nutrition security. Africa's smallholder farmers need access to seeds, fertilizers and technologies that boost productivity. Flawed policies, including restrictions on regional trade, also need to be revised.

Priorities:

- Implement the Maputo Declaration commitment to spend at least 10 per cent of national budgets on agriculture and rural development. Reaching this target will be critical to achieving the Comprehensive Africa Agriculture Development Programme agricultural growth target of 6 per cent per year
- Strengthen the entitlements and rights of women. Reinvigorate the role of farmers' cooperatives and associations that provide support to smallholder farmers, particularly women.
- Significantly invest in agriculture research and innovation.
- Prevent "land-grabbing" through rigorous implementation of the African Union Declaration on Land Issues and Challenges and the comprehensive adoption of the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security endorsed by the Committee on World Food Security.

- Foster greater intra-regional trade in agricultural products. The swift removal of all tariffs and non-tariff barriers that limit intra-regional trade should be an essential component of this effort.
- Develop import substitution policies aimed at reducing dependence on imported food staples.
- Support investments in agriculture that mitigate the risks of and promote adaptation to climate change.

Stop the plunder of natural resources: Africa's forests, coastal waters and biodiversity are environmental assets that underpin fragile ecosystems, support livelihoods and generate wealth. These resources should be harnessed on a sustainable basis for Africa's development.

Priorities:

- Implement full transparency in tendering for permits in sectors such as logging and fisheries, following best practices in the extractives sector. Holders of public office should be barred from participation in any tendering processes – and full details of all permit sales should be made public. Contracts between governments and fishing companies should be published in ways that are easily accessible and understandable by citizens and interested parties. The terms of such contracts should also be properly enforced.
- Strengthen scientific capability to ensure that resources can be documented and commercial activities monitored.
- Rigorously enforce fines on fishing vessels engaged in IUU trade, following the example set by Senegal.
- Protect artisanal fishery sectors more effectively, through policies designed to reduce dependence on raw exportation, combat illegal activities, create employment and increase incomes. Invest in freezing, drying, processing and canning.
- Continue to deepen collaboration among governments to monitor and protect African coastal waters from illegal activities, especially the inshore territorial waters vital to artisanal fisheries.
- Develop aquaculture by creating the incentives and providing infrastructure for small and medium-sized investors to become viable, environmentally friendly and productive aquaculture entrepreneurs.
- All commercial logging concessions should be conditional on the informed consent of the communities involved, based on a clear and accurate representation of potential costs and benefits. Indiscriminate illegal logging creates undesired social erosion problems and desertification thus affecting agriculture productivity.
- Make public concession contracts and disclose beneficial ownership structures to deter corrupt and illegal practices and enable tax authorities to ensure companies are paying the right amount of tax in line with their contracts and the requirements of the fiscal regimes.

Invest in infrastructure and develop more inclusive financial systems: Africa will not achieve a breakthrough in improving people's lives unless governments close the twin deficit in infrastructure and inclusive finance. The lack of infrastructure is a bottleneck on growth and opportunity. The same is true of finance. Few Africans, especially those living in rural areas, have access to the saving, credit and insurance facilities they need to seize opportunities for investment and mitigate risk.

Priorities:

- Develop regional cooperation on energy and transport in order to achieve economies of scale in infrastructure projects.
- Increase investment in infrastructure – such as water and sanitation – to reduce inequalities in access.
- Support the development of mobile banking and e-commerce to overcome financial exclusion, building on successes such as M-PESA in Kenya.

Mobilize resources for inclusive growth: The financing environment in Africa today would have been unrecognizable 10 years ago. Countries then seeking debt write-offs through the Heavily Indebted Poor Countries initiative are now entering sovereign bond markets. Dependence on aid is declining. Private capital flows and remittance transfers are increasing. The challenge for governments is to develop policies and financing instruments that mobilize the full range of domestic and external resources to underpin inclusive and transformative growth.

Priorities:

- Publish in a transparent manner all tax exemptions that are granted to corporate entities, domestic and foreign. The estimated cost of each tax exemption should be made public, along with the reasons for the exemption and the principle beneficiaries.
- Increase the domestic revenue base through reforms aimed at promoting the efficiency and equity of taxation systems, and raising the share of revenue to GDP. Increase incentives for domestic savings.
- Reform financial regulation to remove the stranglehold enjoyed by banks on remittance payments. Allow microfinance institutions, where more people have accounts, to play an expanded role.
- Take precautionary approaches to sovereign debt issues that reflect foreign currency risks.
- Support the Extractive Industries Transparency Initiative (EITI) and implementation of the revised EITI standard, which now requires disclosure of production figures, ownership, licences and the fiscal regime.
- Publish online all contracts that relate to the export of Africa's natural resources – oil, gas, mining, timber and fisheries. This would allow African countries to build a stronger common negotiating position and allow citizens, who are interested, informed and empowered, to monitor the agreements.
- Review and, where appropriate, revoke the extensive tax holidays and other breaks provided to foreign investors operating in extractive industries and natural resource sectors where it is clear that such incentives are no longer needed to provide competitive advantage to attract investment that is needed for sustainable and inclusive growth.

Recommendations for the international community and multilateral system

Support efforts to reduce poverty: High growth in Africa should not deflect international attention from continuing development challenges. The region accounts for a rapidly rising share of world poverty, of child deaths and children out of school. Development assistance will continue to play a role in addressing these challenges.

Priorities:
- The G8 should act on its pledges to African countries to provide further support towards meeting the MDGs.
- Bilateral donors, multilateral development banks and regional development banks should work with African governments to improve the quality of data available.
- Ensure the use of aid to attract private capital investment is not allowed to divert resources from poverty-focused investment.
- Development partners should work with governments to develop strategies aimed at expanding opportunity at the bottom of the social pyramid, with social protection a priority.
- With African farmers and fishing communities bearing the brunt of the global risks associated with climate change, provision for climate adaptation financing should be increased to US$35 billion a year by 2050.

Support sustainable resource management: Many of the challenges facing Africa in natural resource management can only be met through international cooperation and multilateral agreements. Yet international cooperation remains weak, with an undue emphasis on voluntary codes of conduct that lack enforcement mechanisms.

Priorities:
- All governments should ratify and implement the 2009 Port State Measures Agreement to tackle IUU fishing.
- Establish IUU fishing as a "transnational crime," as outlined in an initiative led by Norway. This could bring IUU activities under the remit of INTERPOL, with police, customs agencies and justice ministries playing a more active role in enforcement.
- Establish under the framework of the IMO a registry of fishing vessels sailing under flags of convenience.
- Provide extra support for Africa's coastal nations to monitor fish stocks and to control their waters.
- Support the development of monitoring and information systems. Regional organizations, commercial companies and development partners should cooperate with governments to increase such support. The establishment of protected areas is crucial for the long-term sustainability of contiguous forests and maritime ecosystems.
- Eliminate subsidies that contribute to IUU fishing and overcapacity. This commitment was included in the 2012 Rio+20 declaration, but there is a clear lack of political appetite to act on it. The World Trade Organization is the most promising route for effective multilateral engagement because its rules are legally binding.

- Involve China in a multilateral framework on sustainable forest management in Africa. The application of official Guidelines on Sustainable Overseas Forests Management and Utilization by Chinese Enterprises, jointly issued by the Chinese State Forestry Administration and the Chinese Ministry of Commerce, is a useful starting point.
- Take advantage of new opportunities to conserve forests offered by the UN collaborative initiative on Reduced Emissions from Deforestation and Forest Degradation in developing countries (UN-REDD and REDD+).
- Strengthen European Union legislation requiring timber importers to do proper checks all the way along their supply chains in order to eradicate shadow permit trading. The European Union could play a leadership role in strengthening multilateral action to achieve this. Its Voluntary Partnership Agreements (VPAs) with timber-exporting countries include comprehensive forest governance reforms aimed at stamping out illegal trade. However, neither the EU Timber Regulation nor the VPAs take account of the widespread use of shadow permits.

Mobilize resources: Despite high growth, Africa lacks the resources needed to finance infrastructure investments on the scale required. At the same time, the aid financing architecture has been overtaken by events. African governments that are able to access sovereign bond markets are unable to borrow (at lower interest rates) from the non-concessional facilities of the World Bank and the AfDB. While remittances play an important and increasing role in development financing, underlining the importance of Africa's diaspora as stakeholders, many of the benefits are lost because of high charges.

Priorities:
- African governments should cooperate to seek more innovative solutions for infrastructure financing, with the AfDB playing an expanded role in facilitating regional cooperation. Explore the possibility of using Africa's foreign exchange reserves – around US$450 billion in 2012 –to finance infrastructure bonds.
- Governments, regional banks and multilateral development banks should invest more in designing and developing bankable projects. Currently, Africa's infrastructure financing project pipeline is limited, largely because insufficient attention has been directed to project development. The focal point for efforts to change this picture should be the AfDB Infrastructure Project Preparation Facility, with an increase in the currently underfunded resource envelope for 2011–2015, from US$147 million to US$500 million.
- Many of the reports on the leveraging effects of "new and innovative financing" are overstated and based on unclear evidence. Development finance institutions in partner countries should report more transparently on the operations in this area.
- Mitigate the real and perceived risk that is a major barrier to infrastructure financing in Africa, by scaling up further the operations in Africa of the Multilateral Investment Guarantee Agency. Covering the cost of insurance premiums should be regarded as a legitimate use of finance from the International Development Association (IDA): currently there is no mechanism for a country's IDA allocation to be used in this way.

- Governments in the G8 need to act on a 2008 summit commitment to work towards halving the average global cost of remittance transfers, from 10 per cent to 5 per cent over five years. Africa is losing US$1.8 billion a year through excessive remittance charges. Financial regulators in G8 countries should investigate the pricing of remittance charges and governments should legislate to improve transparency on foreign currency charges. African governments should revoke exclusivity agreements, which constitute a restrictive business practice.
- All G8, G20 and OECD countries should establish public registries to show the real ownership (the beneficial ownership) of all companies and trusts registered in any given country. This standard should be implemented as a priority in countries and jurisdictions ranked highest on the Financial Secrecy Index compiled by the Tax Justice Network.

Recommendations for the private sector

Act as champions of transparency: Transparent businesses build trust. All companies including foreign investors should engage in a race to the top on transparency, supporting the efforts of global initiatives and meeting the demands of civil society in Africa. Supporting transparency initiatives will help to inform and empower interested citizens to hold their governments accountable for use of revenues received through taxation. While there are tentative signs of improvement, some companies are either opposing enhanced transparency or delaying action.

Priorities:

- Other companies should follow the example of Rio Tinto and Tullow Oil, which have set a gold standard for project-by-project disclosure in line with the spirit of a European Union directive that will oblige oil and mining companies to publish tax, royalty payments and other transfers to foreign governments. Major companies represented by the American Petroleum Institute should halt their opposition to the 2010 US Dodd-Frank legislation, which could support transparency initiatives in Africa.
- Companies operating in Africa and financial regulators in the countries where they are registered should make public the full beneficial ownership of their interests, including those registered in offshore financial centres.

Support infrastructure development: Private companies operating in infrastructure often expect very high returns to compensate for investment risks in Africa. In many cases the perceived risks are far greater than the actual risks. Cooperation between the private sector, the World Bank Group and the AfDB could correct the underlying biases that exacerbate risk perception.

Priorities:

- Development finance institutions should work with the private sector to foster more balanced perceptions of risk.
- The private sector and the World Bank Group should work together to develop foreign exchange and political risk mitigation mechanisms.
- Private companies engaging in national and multilateral initiatives aimed at expanding access to energy, roads and social infrastructure should develop long-term partnerships with African counterparts.

Create the conditions for inclusive growth: Africa's private sector is an emerging economic force but has yet to engage sufficiently with governments to create conditions for broad-based growth. Meanwhile, foreign investors are failing to grasp the full market potential of investment opportunities in Africa.

Priorities:

- Identify the policy incentives required to scale up investment in agroprocessing, and climb the value-added chain in agricultural exports.
- Press for action to eliminate the transport cartels and remove the tariffs and non-tariff barriers that restrict intra-African trade.
- Foreign investors should partner with African companies to build economic linkages between export sectors and domestic markets, with an emphasis on creating jobs and adding value.
- Seize the opportunities created by Africa's technology revolution to develop product lines that can accelerate the continent's transformation and contribute innovative African solutions to global opportunities and challenges.

LIST OF ACRONYMS AND ABBREVIATIONS

AfDB	African Development Bank
AGRA	Alliance for a Green Revolution in Africa
ARC	African Risk Capacity
ATA	Agricultural Transformation Agenda
AU	African Union
AUC	African Union Commission
BRICs	Brazil, Russia, India and China
CAADP	Comprehensive Africa Agriculture Development Programme
CDC	Commonwealth Development Corporation
CFMA	community forest management agreement
CGIAR	Consultative Group for International Agricultural Research
CLSG	Côte d'Ivoire, Liberia, Sierra Leone and Guinea Interconnection Project
COMESA	Common Market for Eastern and Southern Africa
COPE	In Care of the People (Nigeria)
DFI	development finance institution
DfID	Department for International Development (United Kingdom)
DRC	Democratic Republic of the Congo
EAC	East African Community
EAIF	Emerging Africa Infrastructure Fund
ECOWAS	Economic Community of West African States
ECX	Ethiopia Commodity Exchange
EJF	Environment Justice Foundation
EU	European Union
EU-Africa ITF	EU-Africa Infrastructure Trust Fund
FAO	United Nations Food and Agriculture Organization
FDA	Forest Development Authority
FDI	foreign direct investment
FMC	forest management contract
FMO	Netherlands Development Bank
GDP	gross domestic product
GESS	Growth Enhancement Support Scheme
GNI	gross national income
GW	gigawatt
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
ICA	Infrastructure Consortium for Africa
ICT	information and communications technologies
IDA	International Development Association
IDF	Infrastructure Development Fund
IFPRI	International Food Policy Research Institute
IMF	International Monetary Fund

IMO	International Maritime Organization
IPCC	Intergovernmental Panel on Climate Change
IPPF	Infrastructure Project Preparation Facility
IT	information technology
IUU	illegal, unreported and unregulated
LFI	Liberia Forest Initiative
LSLBI	large-scale land-based investment
MIGA	Multilateral Investment Guarantee Agency
MTO	money transfer operator
NEPAD	New Partnership for Africa's Development
NIRSAL	Nigeria Incentive-Based Risk-Sharing System for Agricultural Lending
NTB	non-tariff barrier
ODF	official development finance
ODI	Overseas Development Institute
OECD	Organization for Economic Cooperation and Development
OPIC	Overseas Private Investment Corporation (United States)
PARIS21	Partnership in Statistics for Development in the 21st Century
PIDA	Programme for Infrastructure Development in Africa
PIDG	Private Infrastructure Development Group
PPP	purchasing power parity
PRG	partial risk guarantee
PSNP	Productive Safety Net Programme
PUP	private use permits
REDD (or UN-REDD)	UN collaborative initiative on Reduced Emissions from Deforestation and forest Degradation in developing countries
SADC	Southern African Development Community
SMEs	small and medium-sized enterprises
SONEL	Société Nationale d'Électricité (Cameroon)
SPM	special purpose mechanism
SPS	sanitary and phytosanitary arrangements
SPV	special purpose vehicle
TCX	Currency Exchange Fund
UNEP	United Nations Environment Programme
UNSC	United Nations Security Council
USAID	United States Agency for International Development
VGGTs	Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security
VMS	vessel monitoring system
VPA	voluntary partnership agreement
WEAMU	West African Economic and Monetary Union
WTO	World Trade Organization

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