BOX 2.6.1 Recent investment slowdown: Sub-Saharan Africa

Investment growth in Sub-Saharan Africa has fallen from nearly 8 percent in 2010 to 0.3 percent in 2015, reflecting a severe terms-of-trade deterioration and long-standing structural impediments, including infrastructure bottlenecks and weak business environments. Investment needs are sizable across a wide range of sectors. Policies to address the region's investment needs in infrastructure include sustaining public investment, encouraging private sector participation in infrastructure, and strengthening public financial management capacity.

Sub-Saharan Africa (SSA) accounted for a modest 2 percent of global investment, on average, during 2010-15. However, it suffered the sharpest investment growth slowdown among emerging market and developing economies (EMDE) regions despite large-scale public investment efforts until recently. Investment growth slowed from nearly 8 percent in 2010 to 0.3 percent in 2015, on average—well below the long-term (1990-2008) average of about 6 percent.

This box discusses the following questions.

- How has investment growth in the region evolved?
- What were the main sources of the investment growth slowdown?
- What are the remaining investment needs?
- Which policies can help address Sub-Saharan Africa's infrastructure investments needs?

The investment growth slowdown in Sub-Saharan Africa is concentrated in South Africa and oil exporters. It reflected domestic political tensions, a sharp terms of trade deterioration and, in some economies, domestic policy tightening. Investment needs remain sizable in agriculture, infrastructure, and health and education.

How has investment in the region evolved?

For Sub-Saharan Africa as a whole, investment growth averaged about 5 percent in 2010-2015, less than half the average annual growth of 12 percent recorded prior the global financial crisis, despite rapid public investment growth until 2014. In more than two-thirds of SSA countries, investment growth was below its long-term average in 2015 and, in more than one-third, it was negative (Figure 2.6.1.1).

Investment growth was particularly weak in South Africa and a number of oil exporters, but was robust among metals exporters. Investment growth averaged just 2.5 percent per year in South Africa in 2010-15, compared with over 9 percent in 2000-08, reflecting deep structural constraints, including inefficiencies in state-owned enterprises.

Among oil exporters, investment growth slowed significantly in Angola, Chad, and Nigeria; and was negative in Equatorial Guinea. The sharp decline in oil prices was compounded by the introduction of foreign exchange controls or weak business environments that weighed on investors' sentiment. However, in Cameroon and Gabon, large infrastructure programs continued to raise investment growth, despite a decline in investment in the oil industry.

Investment growth in metals-exporting countries averaged 11.3 percent per year over the period 2010-15 (compared with 8.5 percent in 2000-08), with double-digit growth rates in Ghana, Mozambique, and Namibia. Investment growth in Ghana benefited from a more stable economic environment, while Mozambique's and Namibia's extractive industries continued to attract foreign investment. Some metals exporters were subject to domestic shocks that held back investment, including power shortages (Botswana, Zambia), deteriorating security conditions (Niger), the Ebola virus (Liberia, Sierra Leone), and political uncertainty (the Democratic Republic of Congo, Zambia).

Investment growth has been solid in the agricultural exporters, such as Côte d'Ivoire, Ethiopia, and Senegal, supported by the implementation of infrastructure development projects. However, investment growth stagnated in commodity importers such as Cabo Verde and Mauritius, reflecting a slowdown in their main trading partners. It was highly volatile in a number of fragile or conflict affected countries.

What were the main sources of the investment slowdown?

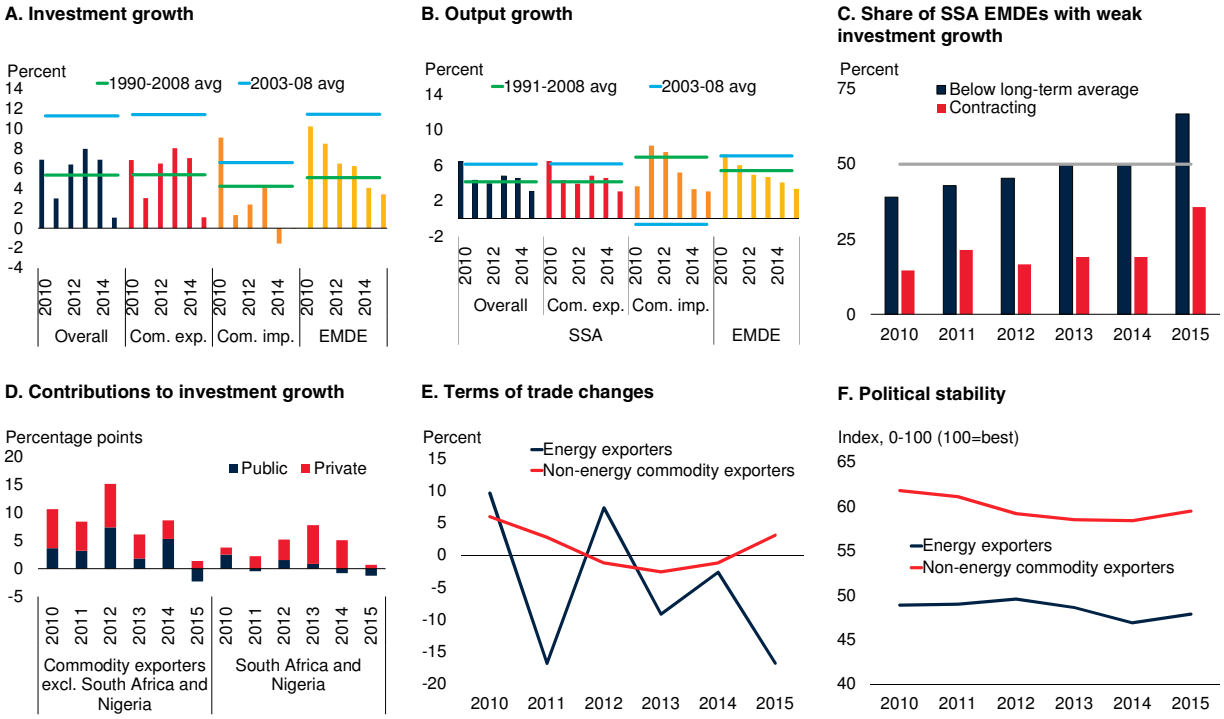
External shocks, including the end of the commodity super cycle, a marked slowdown in major trading partners, and rising domestic vulnerabilities contributed to the investment growth slowdown in the region. Prior to the global financial crisis, higher commodity prices, low global risk aversion and favorable domestic growth prospects prompted significant capital inflows in the region. Average

Note: This box was prepared by Gerard Kambou.

BOX 2.6.1 Recent investment slowdown: Sub-Saharan Africa *(continued)*

FIGURE 2.6.1.1 Investment growth slowdown

Investment growth has slowed sharply from about 8 percent in 2010 to near-zero in 2015, despite significant public investment until 2014. The slowdown has reflected a severe terms of trade deterioration in commodity exporters as well as long-standing structural bottlenecks and political tensions.



Sources: Haver Analytics; Oxford Economics; World Economic Outlook, International Monetary Fund; World Bank Development Indicators, World Bank; Political Risk Services International Country Risk Guide (ICRG).
A. Weighted averages.
C. Long-term averages are country-specific and refer to available data over 1990-2008.

net FDI inflows grew from 0.5 percent of GDP in 1974-1994 to 2.2 percent of GDP in 1995-2008 (Calderon and Boreux 2016). By contrast, over the period 2010-15, which saw a sharp decline in commodity prices, net FDI flows averaged 1.9 percent of GDP.

This period of investment growth slowdown in the region coincided with a weak growth recovery in the European Union, the slowdown of economic activity in China as it embarked on the rebalancing of its economy toward more domestic consumption, and the appreciation of the U.S. dollar. The European Union, the United States, and China are the region's main sources of foreign investment. The triple blow of weak growth in major export markets, lower commodity prices and a higher U.S. dollar hits the region's oil exporters particularly hard. During 2010-15, net FDI flows averaged just 0.4 percent of GDP in oil exporters, down from 2.5 percent of GDP in 2004-08. Net FDI flows were negative in Angola and Equatorial Guinea. In contrast, in oil importers, net FDI flows rose, averaging over 3 percent of GDP, as investors responded to growth opportunities in construction, light manufacturing and renewable energy.

In addition to the unfavorable external environment, the slowdown in investment growth reflected weak macroeconomic fundamentals and policies, and an uncertain institutional and legal framework in some countries. Fiscal and current account balances have deteriorated across the region over the past 5 years (World Bank 2015u). In 2014, 33 countries registered fiscal deficits greater than 5 percent of GDP (up from 25 in 2007), while 15 countries had a current account deficit that exceeded 5 percent of GDP (up from only 5 in 2007) (Calderon and Boreux 2016). This meant that, in some countries, policy makers lacked the ability to conduct

BOX 2.6.1 Recent investment slowdown: Sub-Saharan Africa *(continued)*

countercyclical policies to support economic activity, while rising vulnerabilities weighed on capital inflows. Large current account deficits and falling capital flows put pressures on real exchange rates. Rising inflation, reflecting deep currency depreciations, prompted central banks in a number of commodity exporters to tighten policy, making it costly for firms to invest.

In many countries, basic reforms to improve the business environment—including the rule of law—have been negligible, especially among resource–rich countries. Uncertainty about the enforcement of contracts, property rights and the direction of policy was compounded by weak investment planning and execution capacity. These factors played a significant role in slowing investment growth across the region.

What are Sub-Saharan Africa's remaining investment needs?

Sub-Saharan Africa's strategic priorities to reinvigorate growth and reduce poverty call for investments in agriculture, infrastructure, and health and education (World Bank 2016z).

In *agriculture*, which provides the livelihood for almost two -thirds of Sub-Saharan Africa's population, investments are needed to raise farm productivity. Increasing investments in agricultural R&D is not only essential for boosting growth in the region but also for accelerating its transformation. Infrastructure investments are needed to support agricultural productivity growth and potential export diversification. These include investments to build or improve irrigation, road, and storage infrastructure, and to develop higher value chains and markets.

Countries in the region have made progress in improving their *infrastructure*, although results vary. Improved infrastructure was partly responsible for the region's recent strong growth performance (Calderon and Serven 2008). That contribution reflected mostly advances in information communication technology (ICT). The region has experienced an unprecedented increase in mobile phone subscriptions. By contrast, progress in the power sector has been far more limited. Only a third of households have access to electricity (World Bank 2016z).

- The deterioration in the quantity and quality of *power infrastructure* has increased the need for investment in renewable energies. These have the potential to improve access to electricity while addressing climate change challenges.
- *Transport infrastructure* development has also been limited. In many countries, only a small proportion of the road network is paved. Railways development is inadequate.

Across the region, investments are needed to improve the quality of *education and skills*, the health status of the populations, and the coverage of infrastructure services, notably access to improved sanitation. Despite recent progress, Sub-Saharan Africa lags other regions (Figure 2.6.1.2).

The region's infrastructure investment needs are large, estimated at 15 percent of GDP, reflecting insufficient and inefficient spending on capital, operation, and maintenance expenditures (Foster and Briceno-Garmendia 2010). Financing to address these investment needs has increased. The external sources of financing for infrastructure have expanded. Official development finance (ODF)—led by the World Bank and the African Development Bank—has increased appreciably. ODF investments are supporting transport and water and sanitation investments in a number of countries. China emerged as a major bilateral source. Chinese investments have increasingly targeted the energy sector and hydropower in particular. Direct private sector involvement surged. Private participation in infrastructure (PPI) now accounts for more than half of total external finance, with a large share of the investments going to the telecom, energy and transport sectors (Gutman, Sy, and Chattopadhyay 2015).

Which policies can help address the region's remaining infrastructure investment needs?

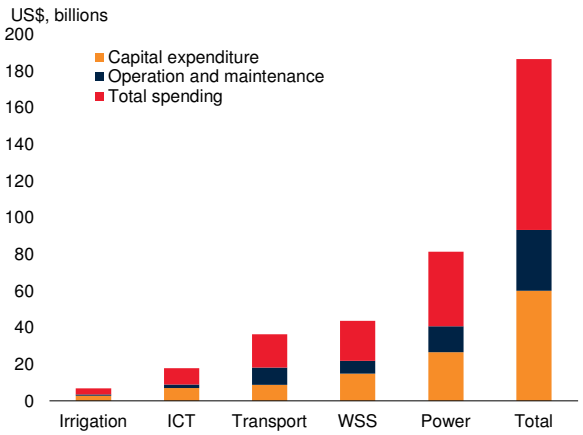
Financing from multilateral development banks, China, and the private sector tripled between 2004 and 2012 (Gutman, Sy, and Chattopadhyay 2015). External financing for infrastructure grew fastest in the energy sector, with Ethiopia, Ghana, Kenya, Nigeria, and South Africa among the largest recipients. Untapped opportunities remain, including in renewable energy (EBRD 2016) as well as in other investments that can support private sector development. Innovative financing solutions for infrastructure investment that mitigate risk factors for investors have been developed. Tools such as blended finance, co-financing between private investors and development finance institutions, public-private partnerships and climate finance are being deployed in countries across the region (IFC 2016). Nevertheless, financing investment projects remain challenging. Although private investment has become significant and

BOX 2.6.1 Recent investment slowdown: Sub-Saharan Africa *(continued)*

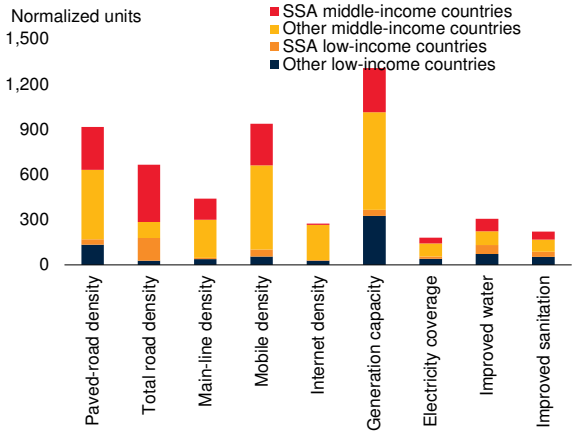
FIGURE 2.6.1.2 Investment needs

Sub-Saharan Africa's investment needs are high across a wide range of sectors. There has been progress in improving infrastructure in the region, but progress has been slow, especially in energy and transport.

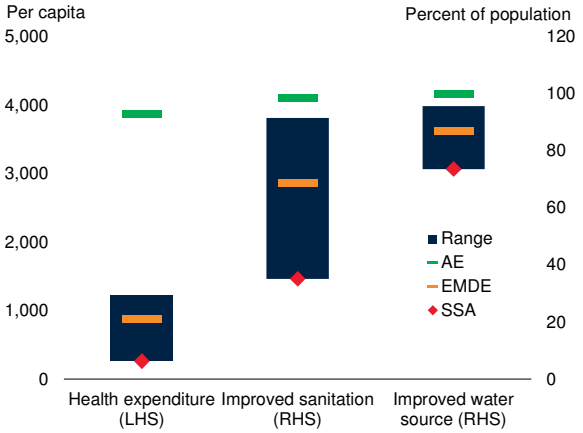
A. Total infrastructure spending needs



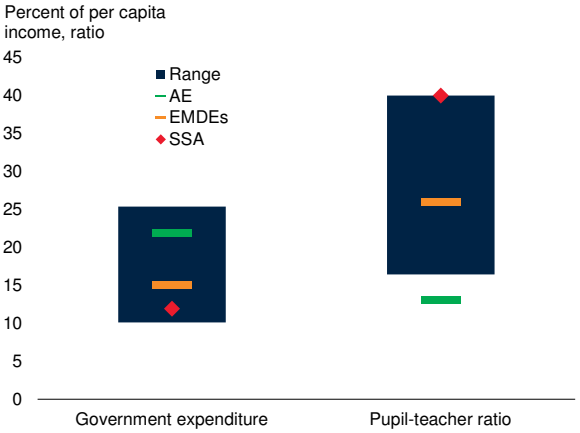
B. International perspective on Africa's Infrastructure deficit



C. Selected health care indicators



D. Selected education indicators



Source: Haver Analytics; Pierce, and Foster 2008; Regional Economic Outlook, International Monetary Fund; World Bank; Yepes.
A. ICT=information and communication technology; WSS=water supply and sanitation. Estimates by Foster and Briceno-Garmendia (2010).
B. Road density is measured in kilometers per 100 square kilometers of arable land; telephone density in lines per thousand population; generation capacity in megawatts per million population; electricity, water, and sanitation coverage in percentage of population. SSA stands for Sub-Saharan Africa.
C. Blue bars denote range of unweighted regional averages across EMDE regions. Health expenditure per capita in purchasing power parity terms, unweighted averages of 199 EMDEs, 34 AEs, and 47 SSA economies. Access to improved sanitation facilities (in percent of population), unweighted averages for 150 EMDEs, 33 AEs, and 47 SSA economies. Access to improved water sources (in percent of population), unweighted averages for 148 EMDEs, 34 AEs, and 47 SSA economies. AE stands for advanced economies; and EMDE for emerging market and developing economies. Latest available data available during 2011-15.
D. Blue bars denote range of unweighted regional averages across EMDE regions. Government expenditure per primary student (in percent of per capita income), unweighted averages of 87 EMDEs, 32 AEs, and 29 SSA economies. Pupil-teacher ratio in primary education (headcount basis), unweighted averages for 165 EMDEs, 31 AEs, and 44 SSA economies. Latest available data available during 2011-15.

covers a broad range of countries, it has focused more on ICT than other sectors.

Despite the rising importance of external finance, public sector budgets remain the primary source of funding for infrastructure investments in the region. Countries across the region finance about 65 percent of their infrastructure expenditures with domestic resources (IMF 2014b). In some countries, the fiscal space created by the heavily indebted poor countries (HIPC) debt relief facilitated these

BOX 2.6.1 Recent investment slowdown: Sub-Saharan Africa *(continued)*

expenditures. Others took advantage of low interest rates to issue Eurobonds to finance infrastructure investments. Governments spend most of their resources on transport and energy. Nonetheless, the level of public finance remains insufficient to cover their infrastructure needs. Sub-Saharan African countries need to mobilize more domestic resources to finance infrastructure investment. Tax-to-GDP ratios are far below the EMDE average in a number of countries, reflecting a failure to reform weak tax systems, especially in oil exporters.

The capacity of countries in the region to effectively use resources for infrastructure investment remains a critical issue. The efficiency of public investment in Sub-Saharan Africa lags behind other EMDEs, reflecting poor project selection, weak enforcement of procurement procedures, and failure to complete projects (Dabla-Norris et al. 2012). These weaknesses point to a need to increase absorptive capacity in public infrastructure in the region.

Sub-Saharan Africa's infrastructure development faces major geographic and physical challenges, reflecting its low population density, low urbanization, and large number of landlocked countries. A sizable number of small countries makes it difficult for firms to exploit economies of scale. As a result, Sub-Saharan Africa's infrastructure services are more expensive than in other regions, suggesting that greater gains could be achieved through deeper forms of regional integration.

Four key areas of policy priorities to address investment needs and ensure sustainable financing are the following:

- *Sustaining public investments.* Domestic resources—tax and nontax revenue—are likely to remain the dominant source of financing for infrastructure. Increasing domestic revenue may provide the most sustainable way of financing infrastructure investment. This will require improving tax collection as well as cost recovery. In many countries, debt levels are still manageable, and borrowing to increase spending on infrastructure remains a viable option. However, debt sustainability should not be compromised.
- *Encouraging greater private sector participation in infrastructure.* Countries need to strengthen the pipeline of bankable projects that can meet the financial objectives of private investors. Innovative fund and deal structures, such as guarantees and risk sharing, should be developed. Blended finance instruments that can leverage private sector development financing should be promoted. Public-private partnerships (PPPs) are a tested strategy that can be applied to numerous sectors (IFC 2016). However, governments have to establish autonomous regulatory agencies to oversee the private agents. The terms of the partnerships have to be monitored carefully to ensure PPPs deliver a normal return and not a monopoly profit.
- *Strengthening public investment management systems.* An effective public financial management capacity is critical in scaling up infrastructure investment spending. Countries should seek to strengthen capacity for project selection and appraisal, and enhance monitoring of project execution to minimize leakages. Operation and maintenance expenditures for existing infrastructure should be fully integrated in a medium-term expenditure framework to ensure that they receive adequate budgetary resources.
- *Promoting regional integration of infrastructure*. A regional approach to the provision of infrastructure services is needed to overcome the region's geographic and physical challenges. This will require effective regional institutions, setting priorities for regional investments, harmonizing regulatory frameworks and administrative procedures, and facilitating cross-border infrastructure (Kessides and Benjamin 2012).