COOPERATION WITH AFRICA

G20 Compact with Africa

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Abstract

The G20 Compact with Africa (CWA), under the G20 Finance Track, promotes sustainable development in reform-minded African countries by improving the framework conditions for mobilizing private sector investments. The initiative identifies commitments in the macroeconomic, business and financing frameworks that form country-led investment compacts. The CWA is governed through the G20 Africa Advisory Group (AAG), co-chaired by Germany and South Africa. The African Development Bank Group, the International Monetary Fund, and the World Bank Group coordinate the initiative. While the CWA has been successful to date, it could benefit from further coordination of stakeholders as recommended in this brief.

Challenge

In April 2018 the AAG assessed progress in identifying policy and support actions under business, macro-economic, and financing[1] There were 101 commitments identified in the nine countries that were participants in the initiative at that time. Twenty three percent of commitments were reported as wholly achieved; and 74 percent of commitments were reported as on track.

In October 2018 the AAG assessed private sector activity in Compact countries.[2] The monitoring report signaled that sound policies to improve investment conditions are paying off and investment interest in Compact countries is growing. Total FDI inflows to CWA countries amounted to $20 billion in 2017. The total annual volume of inbound FDI to all CWA countries increased by 36 percent over the past five years, from $14.9 billion in 2013 to $20.2 billion in 2017.

While the CWA has been successful to date, the monitoring reports, peer reviews and policy notes have indicated areas for further strengthening, which are briefly summarized in this report. With the implementation of these recommendations, and with the continuing support from the G20 and international organizations, the CWA initiative promises to be an important initiative to mobilize private sector investment in the continent.

Context and Purpose of the G20 Compact with Africa

The G20 Compact with Africa (CWA) Initiative[3], under the G20 Finance Track, provides a framework for boosting private investment and increasing the provision of infrastructure in Africa. The initiative aims to help African countries achieve sustained and inclusive economic growth by mobilizing governments and their international partners to implement concrete measures to create a better environment for private investment.

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[1] G20 African Advisory Group (2018), "G20 Compact with Africa – Compact Monitoring Report."
[2] G20 African Advisory Group (2018), "Trends in FDI and Cross-Border Investments in Compact with Africa Countries."
[3] G20 Compact with Africa, https://www.compactwithafrica.org/content/compactwithafrica/home.html.

Participation in the CWA sends a strong signal to private investors about the country's interest in attracting investment and their commitment to implementing key reforms. G20 and other partner countries and international organizations (IOs) coordinate more closely, step up technical assistance, and provide support for early stage project preparation. They take multilateral action to strengthen cooperation on tax avoidance, harmonize risk-mitigation instruments and make them more accessible and user-friendly to private investors, and review regulation for institutional investors. G20 members and other partner countries encourage their domestic investors to respond to the investment opportunities in participating African countries.

Areas of Focus

The CWA initiative covers the Macroeconomic, Business, and Financing Frameworks. The Macroeconomic Framework identifies considerations for maintaining macroeconomic stability, while providing for adequate investment in non-commercial infrastructure. These include: ensuring sustainability of public debt over time; increasing domestic revenue mobilization via an investment-friendly tax system; combining domestic tax reforms and enhanced international cooperation to contain profit-shifting and tax evasion; ensuring sound public investment management; and, improving the performance of public utilities.

The Business Framework aims to make Africa more attractive for private investors. This includes setting up reliable regulations and institutions; establishing investor protection and dispute resolution mechanisms; providing political risk insurance; improving project preparation; and standardizing contracts.

The Financing Framework aims to increase the availability of financing at reduced costs and risks. This includes supporting risk mitigation instruments to attract and sustain private investment; developing domestic debt markets and a domestic institutional investor base; and, creating instruments for institutional investors.

The initiative identifies commitments in these three areas that provide the basis for country-led investment compacts. Individual investment compacts are adapted to country-specific circumstances and priorities. The commitments include indicators and timelines and bilateral and multilateral support for their achievement.

CWA Countries and Partners

The CWA has twelve African participants: Benin, Burkina Faso, Guinea, Côte d'Ivoire, Ghana, Egypt, Ethiopia, Morocco, Rwanda, Senegal, Togo and Tunisia. All twenty G20 countries participate, as do some other countries which have, or had, observer status at the G20. The African Development Bank Group (AfDB), the International Monetary Fund (IMF), and the World Bank Group (WBG) coordinate the initiative.

The CWA is governed through the G20 Africa Advisory Group (AAG), co-chaired by Germany and South Africa. The UN Economic Commission on Africa, the African Center for Economic Transformation (ACET) and the OECD also participate in the CWA. G20 Development Finance Institutions (DFIs) are encouraged to maximize their investment impact in CWA countries through closer cooperation in project implementation to reap synergies and enhance peer-learning.

A "compact team" coordinates in-country activities, including updating policy matrices, coordination among development partners, and dialogue with respective governments. The compact teams consist of the Compact government, representatives from the three coordinating IOs and bilateral partners.

The Think 20 (T20) African Standing Committee advocates in particular for Africa, and under that umbrella has a working group on CWA.

Progress in Implementing the Compact with Africa

Overall, progress in implementing the CWA has been satisfactory, with sustained support from the international community, active engagement of African participants and increasing outreach to the investment community. The results of two progress monitoring reports by the AAG in April and October 2018 are summarized below.

Policy

In April 2018 the AAG assessed progress on commitments under the three Frameworks.[4] There were 101 commitments identified in the nine participating countries. Twenty three percent of commitments were reported as wholly achieved, and 74 percent of commitments were reported as on track. It was determined that Japan and Norway had supported the most private investments in Compact countries.

There was a focus on maintaining macroeconomic stability, with 43 percent of the reforms monitored relating to the Macroeconomic Framework, and 33 percent of these wholly achieved. Commitments under the Macroeconomic Framework clustered around three recurring themes: (i) achievement of macroeconomic stability and debt sustainability; (ii) increased domestic revenue mobilization; and, (iii) more effective public investment management.

The Business Frameworks accounted for 37 percent of the 101 commitments, with only 22 percent of these being wholly achieved during the period. Issues addressed included investor protections, strengthening of commercial courts, and standardization of contracts among the aspects addressed.

The Financing Frameworks accounted for 21 percent of the 101 commitments, with only 5 percent of these reported as wholly achieved. Only a few of the Compact countries—Côte d'Ivoire, Ghana, Morocco, and Rwanda—included commitments to develop domestic bond markets or alternative markets for small and medium enterprise listings.

A consistent commitment to reform can be seen in the progress Compact countries are making in closing the Distance to Frontier, a key measure of the annual Doing Business report. While these reforms are necessary, they are not in themselves sufficient to create an investor-friendly business environment. Additionally, there was significant misalignment between some of the areas being supported by AAG members and priority reforms as captured in the matrices. There is significant scope for Compact countries, together with private sector stakeholders and key development partners, to reassess where

[4] G20 African Advisory Group (2018), "G20 Compact with Africa – Compact Monitoring Report."

the most critical reforms are needed.

Investment

In October 2018 the AAG assessed private sector activity in Compact countries.[5] The monitoring report signaled that sound policies to improve investment conditions are paying off and investment interest in Compact countries is growing. At the same time, it underscored the long-term nature of this initiative, as it requires time to build up a track record that strengthens investor confidence. As the data covers the five-year period between 2013-2017, there are indications that the Compact countries were already implementing reforms before the start of the Compact that helped to attract investment.

CWA countries have demonstrated resilience as a destination for foreign direct investment (FDI) in the region against the backdrop of declining FDI inflows into Africa. Total FDI inflows to CWA countries amounted to $20 billion in 2017. The total annual volume of inbound FDI to all CWA countries increased by 36 percent over the past five years, from $14.9 billion in 2013 to $20.2 billion in 2017. During the same period, investment flows to CWA countries increased as a share of total inbound FDI to Africa, rising from 29 to 48 percent of total FDI to the region, representing a combined $92 billion in reported FDI for the five-year period. The capturing of a larger "market share" of inbound FDI by CWA countries may indicate stronger investor confidence in this group relative to other destinations in the region.

There were important variations at the country level, which is particularly significant in resource-rich countries. Since 2013, several CWA countries increased significantly the proportion of FDI inflows as a percentage of GDP. Egypt more than doubled from 1.45 percent in 2013 to 3.14 percent in 2017. Ethiopia increased from 2.82 to 4.45 percent, Senegal from 2.10 to 3.25 percent, and Côte d'Ivoire from 1.30 to 1.67 percent. Likewise, during 2017, Egypt ($7.4 billion), Ethiopia ($3.6 billion), Ghana ($3.3 billion) and Morocco ($2.7 billion) received 84 percent of total FDI flowing to CWA countries, a reflection of both their market size and level of trade integration.

[5] G20 African Advisory Group (2018), "Trends in FDI and Cross-Border Investments in Compact with Africa Countries."

G20 countries and the IOs have organized or supported more than 30 investment events that included CWA countries. On October 30, 2018 Chancellor Merkel hosted eleven African leaders and industry CEOs for the G20 Investment Summit - German Business and the CWA Countries. This was followed by the Africa Investment Forum (AIF), organized by the AfDB, which took place on November 7-9, 2018 in South Africa with CWA as an event partner. The AIF featured a "G20 Compact with Africa" panel with a high level policy dialogue between G20 members and other donors, updates from Compact country ministers on policy reforms, and discussion of two flagship investments in Compact countries. Encouragingly, $18.5 billion in investment interest was secured for specific projects in Compact countries.

<u>**Additional Tools and Support**</u>

The CWA initiative has supported the development of numerous tools including the MDB Toolbox "Instruments Available to Support Private Sector Investment in Compact with Africa Countries", and the "Global Infrastructure Outlook: Infrastructure Investment Need in the Compact with Africa Countries."

The ***IFC Support for G20 Compact with Africa Initiative (ISCA)***[6] conducts Country Private Sector diagnostics and Sector Deep Dives on Compact countries, which will create an analytical basis to identify the constraints to private sector development and attracting finance for development. It will also address the lack of a pipeline of bankable transactions, create products to address financing bottlenecks and mobilize capital, and, work to close gender and access gaps and address climate change. IFC estimates the program will cost US$41 million. The German KfW Development Bank has contributed Euro 10 million and the Norwegian Ministry of Foreign Affairs has contributed NOK 5 million.

Germany is developing "***Reform Partnerships***" to create a more favorable environment for private investments.[7] The selected countries will receive €100 million in the framework of this program. The German government also

[6] G20 African Advisory Group (2018), "G20 Compact with Africa – Compact Monitoring Report."
[7] G20 Investment Summit: German Development Ministry expands reform partnerships. https://germanyinafrica.diplo.de/zadz-en/-/2157236

announced a €1 billion fund to tackle unemployment in Africa, to which Compact countries will be eligible.

The Government of Germany has contributed to the ***Think Africa Trust Fund*** at the WBG to support peer to peer learning, advocacy, and peer reviews for the CWA. Through the trust fund ACET, working with partners such as the IMF and the OECD, has convened or supported five ***peer learning events***. The focus of the CWA peer learning for 2019 will be blended finance and public-private partnerships. At the request of the AAG, ACET also undertakes an ***independent peer review*** of the CWA semi-annually.

The WBG has also initiated a ***multi-donor trust fund to support the government of Tunisia*** in its implementation of the CWA. The fund has received contributions from Norway, the Netherlands, and Germany, totaling approximately $5m.

G20 DFIs are encouraged to increase engagement with Compact teams' work on the ground and identify priority projects in CWA countries, in line with respective comparative advantages. The AfDB is coordinating a synthesis of ***DFI action plans*** for the AAG meeting in April 2019. The IFC will coordinate a G20 toolbox covering the instruments of G20 DFIs for promoting private investment.

CWA Looking Ahead

While the CWA has been successful to date, assessments have indicated areas for further strengthening. The AAG has been active in championing quick action to address these areas.

On Macroeconomic Frameworks, Compact countries are steering an appropriate course and should remain focused on increasing domestic revenues, including pursuing reforms leading to adoption of broad-based consumption taxes, simplified tax design and improved tax administration.

On the Business Framework, countries should identify and prioritize the reforms most critical in the specific country context. Three key areas were identified:

- Promote diversification: targeting improvements in transport and energy infrastructure; simplifying regulations and administrative procedures for starting a business; increasing efficiency of the legal system; reducing regulatory uncertainty.

- Boost agricultural productivity: improving land titling; increasing access to credit for investment in new farming techniques; improving awareness in new farming techniques; improving infrastructure needed to connect farms to markets.

- Strengthen governance: working with state-owned enterprises to reduce the extent to which corruption and lack of competition continue to crowd out private investment.

Regarding Financial Frameworks, the AAG encourages development partners to commit to structured and comprehensive financial sector deepening in Compact countries. They should also commit to identify and work with institutional investors to establish a public infrastructure investment facility for Compact countries.

Proposal

T20 Policy Recommendations: Greater African Engagement

The CWA working group of the T20 Africa Standing Group makes five recommendations, based on recent assessments.

1. ***Enhance Country Teams:*** Compact teams in each country should be consolidated. Closer alignment between Compact teams and other stakeholders, including existing private sector working groups, can help to foster greater engagement with the private sector. CWA countries would benefit from expanded experience sharing Compact team experiences through case studies and peer-to-peer learning. Likewise, capturing good practice and successes and sharing these with investors will reduce risk perceptions. Compact governments should take advantage of the country teams to discuss investment needs and seek financing solutions from

development partners.

2. ***Promote private sector investment***: Identify the key challenges and bottlenecks to greater private sector investment. A systematic assessment of the role of G20 international trade and investment policies for investment in CWA countries should be undertaken. G20 and bilateral partners should develop private sector involvement strategies to encourage companies in their countries to sustainably increase private investment in Compact countries. Additional monitoring of individual G20 country investments, as well as exploiting the linkages between FDI and investment promotion strategies in CWA countries, should be undertaken.

3. ***Increase Domestic Private Sector Dialogue***: CWA will benefit from greater domestic private sector dialogue in each of the Compact countries, which can provide lessons learned to scale investments. Typically foreign investors will rely on domestic partners, hence such dialogues should include SMEs and build upon recent CWA Investor Forums.

4. ***Use the AIF Project Platform:*** Investment opportunities for private sector investment in Compact countries should be listed on the AIF project platform. The platform will reduce intermediation costs, improve the quality of project information and documentation, and increase active and productive engagements between project sponsors and investors.

5. ***Develop African Expertise for Infrastructure Development:*** Through the CWA, G20 can support efforts to develop African infrastructure experts. This will provide credible, pre-vetted, African technicians who can support G20 investors and infrastructure companies and ensure that any risk assessment incorporates a full appreciation of the political economy, culture, and ethnic challenges where the project is based.

References

- G20 African Advisory Group (2018), “G20 Compact with Africa – Compact Monitoring Report”.
- G20 African Advisory Group (2018), “Trends in FDI and Cross-Border Investments

in Compact with Africa Countries".

- G20 Investment Summit: German Development Ministry expands reform partnerships, https://germanyinafrica.diplo.de/zadz-en/-/2157236.