International Growth Centre public lecture

Financing Africa's Future: infrastructure, investment and opportunity

Dr Donald Kaberuka
President of the African Development Bank (AfDB)

London School of Economics and Political Science

Tuesday 23 September 2014

Check against delivery

http://www.afdb.org/en/news-and-events/article/financing-africas-future-infrastructure-and-investment-opportunity-13531/#.VCQjbLxd5jc.twitter

---

Good evening everyone.

It is an immense privilege and honour to be with you today.

My thanks to the IGC, Faculty of the LSE for the invitation to speak about Africa and investment opportunities.

When Professor Collier (or Sir Paul) first broached the idea, it was not immediately obvious to me as to what I could say on this subject that he, as a prolific writer on African development, has not articulated more convincingly.

I am nonetheless glad to be here.

As President of Africa's leading development institution, I am all too aware of the volatility of the narrative on Africa. So any opportunity to add our perspective and some context, is very much welcomed, and will hopefully avoid the hype or old-fashioned caricatures on Africa.

Africa today
The achievements on the socio economic front in Africa over the last decade:

Average incomes are up by 30% in the last ten years. Remember that between 1980 and 2000 incomes had actually declined by 20%.

Contrary to popular views, while strong commodity prices have indeed played a part, many other factors have as well. That is why a country like mine or Ethiopia, not blessed with oil or minerals, are among the strong performers.

In fact, Ethiopia has not only been a strong performer, but also holds a strong record on poverty reduction: 60% in 1995, down to 30% today.

It has used a combination of higher agricultural productivity! Attracting manufacturing jobs and also implemented effective redistribution policies.

Such other factors have been:

- Investments, especially in infrastructure.

- By some measures gross fixed capital formation is up to 23% from around 12% a decade ago.
- Domestic demand due to demographic dynamics and urbanization.
- FDI, incidentally 30% of which is outside the extractive industry.
- Stronger links with the emerging markets; there is a tendency to focus on China, but there is also Brazil, whose investments in the last decade have increased dramatically, (4.3 billion to 27) and Turkey (2.1 billion to 13.3).
- Finally, despite the recent "blip" with Ghana, it still maintains a record of implementing strong and effective policies.

The downside

Nonetheless there are issues of significance on the downside:

- Poverty is falling, but not fast enough except in a few countries.
- Social indicators improving, but inequalities remain too high.
- FDI has increased, but there is limited job creation.

The reason for that:

- is the limited structural change, diversification;
- agriculture share in GDP has in fact declined (and that is where jobs begin);
- manufacturing (Ethiopia the exception) hampered by fragmented markets; and
- poor infrastructure especially energy and port capacity.

So for those Africans who "metaphorically" decry that "we can't eat economic growth", there are still issues that need to be addressed.

A question we need to ask ourselves is how do we promote growth that is sustainable and equitable?

That said, eliminating poverty in the next two decades remains an achievable goal, on the condition that right policies (including best practices on active social policies, not the full-blown welfare state which is impossible at that level of development), are in place and a number of key bottlenecks are eliminated.

Of late some new threats are appearing, jihadism in all its versions, epidemics, and in a few cases – macroeconomic slippages.

Going forward

Going forward and to ensure sustainability, there will be many obstacles to overcome, but I consider **THREE** of those quite critical:

For simplicity, I will call them the three I’s:

- INTEGRATION (the single market or at least five regional markets);
- INSTITUTIONS (stability, rule of law, property rights, predictability); and
- INFRASTRUCTURE
-

This evening I want to concentrate on the third one: Infrastructure! And, in the spirit of tonight’s discussion, I want to look at it as both a challenge and an opportunity.

There is no point labouring on the critical role of infrastructure (or what was termed as social overhead capital sometime back) for transformation.

Yet African countries are now only able to spend about 5% of GDP on infrastructure, a figure which must rise to nearer 15%. Till then, this gap is costing the continent 2% of GDP.

At the last AGM of the AfDB in Kigali, the President of Uganda observed that this is why, among other things, services were growing faster than manufacturing.

You are familiar with the dire statistics:

A decade of rapid growth, increase in population, urbanisation, and increased investment in extractives has raised the demand for everything from rails, ports and roads/ bridges.

Sub-Saharan Africa has less energy than Spain at 70 000 MW. And if you exclude South Africa, there is not much left, around 28 000 MW. The region needs to bring into the system about 20 000 MW each year.

Until then, congested ports, power cuts are diminishing opportunities for business, large and small.

Some are able to self-provide, but the costs knock on down to the consumers and the economy as a whole. This is not to mention impact on education and health as well as gender equality.

East Africa, the most dynamic region among LICs in Sub Saharan Africa, is now trying to fix the 100-year-old famous "lunatic express" rail line with some help from China.

The needed investments are estimated at about USD 92 billion a year. At this point, only half of that has been raised.

But each of these sources has its limits:

Domestic taxation, but that has restrictions – with most being limited below 17% of GDP.

- In addition, as Paul [Collier] has been saying, tax evasion incentives are severely undermining the tax base.
- Domestic bond markets, but markets still shallow.
- Natural resource-linked deals with China, but a limited range of countries.
- IFIs and donors (ODA flattening out and IFI credit policy limitations),
- Rating considerations: there are discussions to leverage or blend IDA ADF; however they are not making progress.
- Sovereign bond issuance (in last 7 years about USD 16 billion for 5 countries).

Different types of facilities from China are bringing in approximately USD 12-15 billion a year.

- China Africa Fund (grants to ventures backed by Chinese firms).
- Exim Bank export credits and guarantees.
- Sometimes China Development Bank for non-concessional finance.
- Of late SAFE via IFIs.

I must mention a new source which is better-targeted subsidies, thereby opening up the fiscal space.

I could also add that the African Development Bank has just revised its policies to allow low-income countries with strong credentials to borrow from our commercial window – for infrastructure financing.

Remember we charge less than 2% above Libor, for 20-year loans; more competitive than sovereign issuance where they may pay maybe 8% for 10 year loans.

The story of telecoms and IT

In this landscape a truly successful oasis is IT and telecoms, following the deregulation in the 1990s.

Today SSA boasts 20 undersea cables with capacity of 100 Terrabytes – opening new vistas for leapfrogging and service delivery. The question to be asked is: Can energy, etc., replicate telecoms?

Yes and No

NO. Risks, costs of entry and exit are not the same; and

YES. If institutional reforms are credible.

Remember for these types of investments, the questions asked are mainly; risks of not being paid, political risks, etc.

So, to recap. Despite all the above resources, the gap remains large and it is crippling the economies.

The African Development Bank
At this point the AfDB is the largest founder of infrastructure in SSA. Infrastructure is 60% of all our operations.

We lend about USD 4 billion to 5 billion each year from our public- and private-sector windows.

Since 2006 we have closed at least 50 PPPs:

- HKB bridge in Abidjan
- New airports in Dakar and Tunisia
- Power in Kenya
- Submarine cables

And many more.

We also house a number of key initiatives:

- NEPAD IPPF
- ICA
- ACFA financing
- AWF
- SAFE co-financing

We have gathered a lot of experience from financing, regulation, maintenance, etc.

So what can be done to close the financing gap? Within a multi-fora of discussions, in the last two years including in the G20, a number of proposals were made:

DERISKING
Broaden, deepen risk mitigation instruments especially for things like power off-take agreements, which are very long-term, forex, counterparts, political, etc.

BUILDING PIPELINE of BANKABLE PROJECTS
I will come to that in a moment

EARLY RISK TAKERS

DEVELOPING TEMPLATE STANDARD CONTRACTS on PPA, etc. MDBs were asked to take the lead and we are. We still need to figure out how to deal with "shy global pools of funds and attract them to finance Africa's Infrastructure".

AS THE PRESENT APPREHENSIONS ARE NOT BASED ON OBJECTIVE ANALYSIS OF THE RISKS.
As Paul has said a few months back, vis-à-vis global capital (Pensions, SWF, Insurance), the gap we are discussing here, critical though it might be for Africa's resources, is not that big for global players. Yet they need to pay pensions in the future.

Now they seem to be constrained by a number of factors which I am sure Paul will mention – OECD rules, rating agencies, etc. – which means that they invest very little in Infrastructure as a whole?(I gather less than 1% in this asset class?) and almost in nothing, even in highly attractive African Infrastructure projects.

Shy Private Capital?
The African Development Bank's fairly large appetite for infrastructure projects proves that these are very attractive propositions.

Such as the building of airports, bridges, rail, ports, etc. And it is clear now, that if the gap is to be closed a new approach is needed to tap into both Africa's pool of savings as well as globally.

By this, we need to understand and be opportunistic in utilizing an attractive investor base made up of SWFs, pension funds, insurance companies and HNW.

Africa50
Having analysed our own experience, the gaps, the concerns of investors, the limited traditional resources, the AfDB decided to design a new vehicle to respond to all those concerns.

That vehicle, known as AFRICA 50, was incorporated last month. I would like to take a few minutes to describe our approach and the vehicle. It is a vehicle focused on transformational but commercially viable projects.

An autonomous entity, run on private sector principles, legally and financially independent from the Bank.

Our role is simply that of a:

- SPONSOR
- INCUBATOR
- ANCHOR INVESTOR
- FUNDRAISER
- SERVICE level AGREEMENTS to do some things for them
- COFINANCIER

The business model is built on two independent, but complementary business lines.

FIRST LINE. To deal with the fundamental problem identified by all: Developing a pipeline of bankable projects. The average today is: 7-10 years, e.g. IPP. Africa50 will cut that by half. It will also charge success fees at the construction phase/ closure.

By taking on this early phase de-risking phase, which is the most complex from a legal, financial, institutional standpoint, we hope to increase the deal flow and accelerate delivery.

The African Development Bank has committed to put in up to USD 100 million.

SECOND LINE: Mobilise financing for projects. It will provide a whole range of credit enhancement and bridge finance. All these products now available on the market, but are fragmented and hard to reconcile in any single project.

FOCUS 1: Africa's own pools of savings, HNW, SWF, Insurance firms. At some point these were considered a small part of reserves, but they are more cautious now.

FOCUS 2: Global pools of savings. The Bank as anchor investor is taking equity of 1/2 billion dollars.

We aim for total equity of USD 3 billion to begin rising to USD 10 billion and beyond.
The target is a single-A rating, so it will have fewer constraints than a AAA-rated institution like ourselves.
We hope to float our first Bond early in the year.

Conclusion.
Africa is at a turning point. We will wait to see whether it is a tipping point.

Economies must grow, but grow equitably and transform. Inequality is in itself a brake to economic growth; it limits growth of the middle classes.

One of the key impediments to overcome is infrastructure. Governments have stepped up mobilisation of resources including private capital, but the gap remains large vis-à-vis the needs, but small vis-à-vis pools of capital.

Funding infrastructure requires a paradigm shift that attends to the concerns of the global pools of funds looking for a good return.

We believe that subject to changes in OECD and rating agencies approaches African infrastructure is an attractive asset class. In the post 2009 financial crisis, growth was anemic.

An Africa that is growing fast is an asset to the world. And infrastructure is a good investment as the explosion in IT and telecommunication has demonstrated, and to an extent energy is beginning to show the same trends where reforms are deep and predictable over the long term.

Thank you again for listening and, once Paul has finished, I would be happy to take a few questions.

END