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Horn Economic and Social Policy Institute

# **Sustainable Financing for Trade and Investment in the Horn of Africa**

AUHIP-Pillar-II

Horn Economic & Social Policy Institute

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# Outline

- Introduction
- Trade Finance
- Investment Finance
- Structural Challenges
- Role of Multilateral Institutions
- Role of China and the Gulf States
- Conclusions
- Policy Recommendations

# Introduction

## Some facts

### financing in Africa

- AfDB estimate of Infrastructure investment in Africa (in 2016)

need: **\$130– \$170 billion a year**

gap: **\$ 68– \$108 billion a year**

- Trade financing gap:  
**\$94 billion and \$91 billion, for 2013 and 2014** respectively (AfDB, 2017)

- **Capital flight** for 1970–2015 **\$1.4 trillion,**
- About **half a trillion** in 2010 -15
- Illicit financial out flows about **\$50 billion a year ( about double the ODA inflow).**

# ...Introduction

## ...Some facts

### Trade and investment financing in HoA

#### Horn of Africa:

- **-11.4% resource balance** (saving of 12.8 %GDP and the investment of 24.2 )
- **SSA =-3%; China=3%; India=2%.**
- Heavily rely on external financing for the gaps:

Capital flight by country, 1970-2015 (billion \$)

Country	Stock of capital flight	Debt stock	Net external assets
Djibouti	-	-	-
Ethiopia	37.2	20.4	16.8
Eritrea	-	-	-
Kenya	29.4	19.1	10.3
Somalia	-	-	-
South Sudan	-	-	-
Sudan	45.9	21.4	24.5
Uganda	23.3	5.8	17.5
Total: 30 African countries	1778.2	496.9	1,281.30

Source: Political Economy Research Institute (PERI) University Of Massachusetts-

### Continental and regional Commitments for trade and investment.

*AU Agenda 2063 Framework Document:*

- investment in infrastructure as a critical input to lifting intra-Africa trade.
- Up-scaling of trade finance

*IGAD Regional Strategic Framework and Implementation Plan 2016-2020:*

- imbeds **investment and trade drivers** to fostering Economic Cooperation, Integration, and Social Development.

*The Sustainable Development Goals **emphasizes productive sectors***

*such as goal-9*

- 9.1 Develop quality, reliable, sustainable and resilient infrastructure,
- 9.2 Promote inclusive and sustainable industrialization
- **Adiss Ababa Action Agenda: “Establishing a new forum to bridge the infrastructure gap”**

# ...Introduction

## The Purposes of the study

- Assess the **state of trade and investment finance** in HoA
- Review the Region's **institutional landscape** for foreign trade and investment financing and the **macroeconomic challenges**.
- Recommend **alternative financing modalities** for foreign trade and investment

- Reviewed **financing strategies and practices** of national, bilateral, and multilateral sources.
- Case reports on financing by **the African Development Bank Group, China, the Gulf States, and**
- Referred several statistical data sources
- **Twenty Key Informant Interviews (KIIs)** with relevant officials in the region

# Trade Finance

## Global and continental facts on trade finance

- Trade finance for **working capital** needs and to **reduced financial risks**.
- Value of international trade has tripled from **\$6.2 trillion in 2000** to **over \$18.5 trillion in 2018** and a third of the latter was mediated by trade finance.
- **letters of credit (L/Cs)** covers **one-sixth** of global trade financing .
- **About 80 percent** of the L/Cs globally are denominated in US dollars, hard currencies (CGFS, 2014)
- In 2013 and 14, about **1/3 total trade in Africa** receive bank-intermediated **trade finance**.



## Trade flows in the Horn

International Trade in Goods and Services in the HoA 2018

Countries	Year 2018		
	Exports of goods and services (% of GDP)	Imports of goods and services (% of GDP)	Export plus Import (% of GDP)
Djibouti	149	179	328
Eritrea	-	-	-
Ethiopia	8	23	31
Kenya	13	23	36
Somalia	26	100	126
South Sudan	-	-	-
Sudan	10	12	23
Uganda	20	29	48

*Horn Region Experiences*  
persistent trade deficits.

Significant international trading activities

**Source:** World Bank's World Development Indicators Database, 2019

# ...Trade Finance

## Trade misinvoicing in the horn

- Trade misinvoicing **Up to 5th** of total trade values of Djibouti, Ethiopia, Kenya, and Uganda.
- Misinvoicing in Imports are much higher than exports
- Sudan (2012-18)

trade value gap **47.6% its trade value** (GFI,2020)

Sudan's export of gold **205,446 kms** while importers reported of **404,732 kg** (a gap of 199,286 kilograms)

Trade Misinvoicing of the Horn with the advanced economies, 2006-2015

Country	Import misinvoicing		export misinvoicing		Inflows (b)+(c)	Outflows (a)+(d)
	Over invoicing (% of total trade) (a)	Under invoicing (% of total trade) (b)	Over invoicing (% of total trade) (c)	Under invoicing (% of total trade) (d)		
Djibouti	27.1	69.6	0.4	4.8	70.0	31.9
Eritrea	25.1	11.0	1.2	15.2	12.2	40.3
Ethiopia	15.5	27.0	8.1	2.5	35.1	18.1
Kenya	10.7	19.7	3.1	7.4	22.8	18.0
Somalia	0.0	0.0	0.0	0.0	0.0	0.0
South Sudan	-	-	-	-	-	-
Sudan	20.2	14.6	0.2	23.8	14.8	44.0
Uganda	22.1	5.1	3.0	7.1	8.0	29.2

Source: Global Financial Integrity (2019).

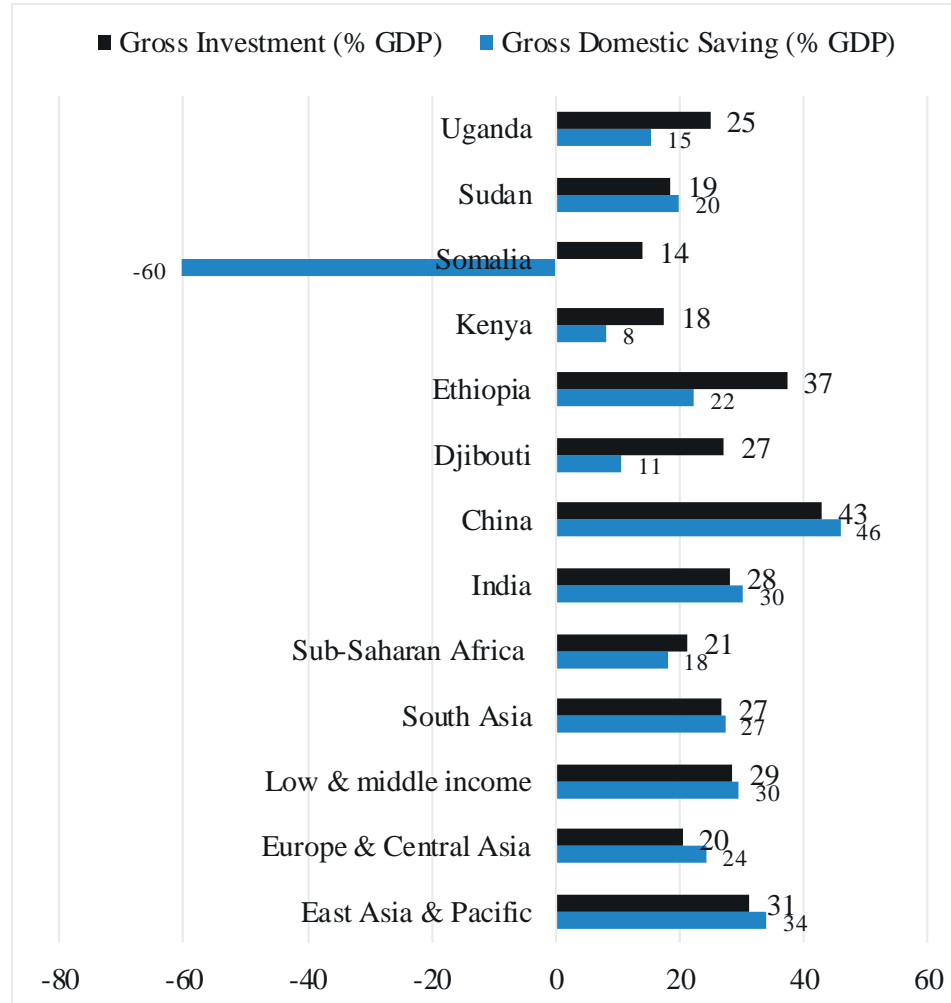
- Ethiopia, Kenya, and Uganda have active trade finance .
- trade financing policies favor exports over imports.
- The low value-added sectors often receive financing at the high-end of the value chain, than at earlier production stages.
- Letter of Credit and CAD are dominant products
- The challenges that highly capital account controlled economies face, like Ethiopia, are distinct from the challenges to more capital liberal economies, such as Kenya.

# Investment Finance

## Investment in the Horn

- Developing countries have high investment demand
- SSA under invests
- Ethiopia and Djibouti invest well above their means

Domestic Savings and Investments % GDP (for the year 2016)



Source: World Bank's WDI database, 2019

# Investment Finance

## Source of investment Finances in the Horn

- Horn Countries significantly depend on external financing particularly ODA
- 20 African countries have over \$92 billion outstanding Eurobond stock,
- Kenya and Ethiopia with \$4.8 billion, and \$1 billion, Eurobond stock respectively.

Country	Net external Finance Inflows (% Gross Investments)					
	FDI		ODA		Personal Remittances	
	2016	2017	2016	2017	2016	2017
Djibouti	31.4	17.8	36.8	14.4	11.4	6.3
Eritrea	-	-	-	-	-	-
Ethiopia	14.4	12.8	14.7	13.1	2.8	1.3
Kenya	3.2	4.6	17.8	17.1	14.2	13.6
Somalia	-	-	-	-	-	-
South Sudan	(1.6)		316.7		216.1	
Sudan	5.7	4.8	4.3	3.8	0.8	1.0
Uganda	10.2	11.4	28.6	32.6	18.7	20.1

Source: World Bank's WDI database 2019

# Structural Challenges in the Horn

High current account deficits:

*high current account  
deficits:*

Current Account Balances % GDP (2002-17)

Country	Current Account Balances (%GDP)			
	2002-2005	2006-2009	2010-2013	2014-2017
Djibouti	40.1	-8.9	-1.3	11.6
Eritrea	-0.7	-7.8	4.6	19.3
Ethiopia	-5.6	-7.3	-4.3	-9.1
Kenya	-0.5	-3.8	-8.1	-7.0
Somalia	-	-	-2.9	-7.9
South Sudan	-	-	-0.5	-0.6
Sudan	-5.0	-8.7	-7.6	-8.0
Uganda	-0.6	-4.9	-7.9	-5.9

Source: IMF World Economic Outlook, 2019.

# ...Structural Challenges in the Horn

## Official international reserves Constraints

- Over-valued exchange rates are the norm except for Djibouti, which has the world's oldest currency board arrangement,.
- Some countries are below IMF's estimate reserves of 3.5 months import cover.
- Some are holding in excess.

Foreign Exchange Reserves in months of imports

Countries	Total Reserves in Months of Imports		
	2016	2017	2018
Djibouti	5.2 ( 3.2*)	6.4 (4.3*)	3.2*
Eritrea	-	-	2.7*
Ethiopia	1.8	1.8	2.4
Kenya	5.3	4.3	4.8*
Somalia	-	-	-
South Sudan	0.4	-	0.2*
Sudan	0.2	0.2	-
Uganda	5.2	5.5	4.1
East Asia & Pacific	14.3	13.3	11.9
Europe & Central Asia	8.3	9.1	8.7
Middle East & North Africa	26.2	21.2	19.9
South Asia	8.2	7.9	6.7
Sub-Saharan Africa	5.8	5.8	5.0
China	16.8	15.5	13.4

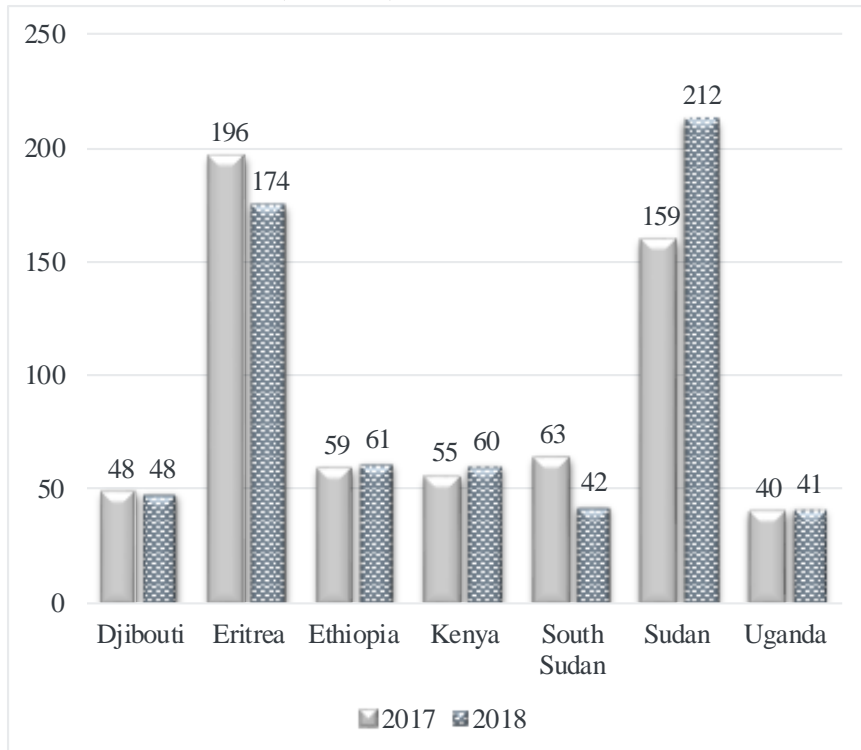
Source: World Development Indicators 2019,

# ...Structural Challenges in the Horn

## Debt Accumulation and Distress

- Eritrea and the Sudan are the two highly indebted countries in the Horn. However, most of their debts are borrowed domestically.

Central Government (% of GDP)



External Debt

Countries	External Debt (% GDP)		
	2016	2017	2018
Djibouti	62.9*	70.5*	71.4*
Eritrea	-	-	-
Ethiopia	32	33	33
Kenya	32	34	36
Somalia	42	42	39
S.Sudan	-	37.2*	34.6*
Sudan	24	19	57
Uganda	43	46	46

Source: WDI, 2019; \* IMF' 2019



# ...Structural Challenges in the Horn

## High Cost of capital

### High Cost of capital:

Nominal Interest Rate Spread.

Country Name	2012	2013	2014	2015	2016	2017	2018
Djibouti	-	-	-	-	-	-	-
Eritrea	-	-	-	-	-	-	-
Ethiopia	6.88	6.88	6.88	7.75	7.75	6.5	6.5
Kenya	8.15	8.67	8.14	6.90	7.87	5.99	4.77
Somalia	-	-	-	-	-	-	-
South Sudan	10.05	12.20	17.27	12.58	9.35	9.42	16.00
Sudan	-	-	-	-	-	-	-
Uganda	9.35	11.17	10.77	9.83	10.65	11.58	10.46
Sub-Saharan Africa	7.27	7.07	7.21	6.77	7.31	7.25	9.12
East Asia & Pacific	5.00	5.00	4.64	4.66	4.76	4.71	5.00

Source: World Bank's WDI (2019) and National Bank of Ethiopia

# Role of Multilateral Institutions

## Some Initiative

NEPAD Program for Infrastructure Development in Africa (PIDA) initiative	envisaged identifying and assessing <b>critical cross-border infrastructure investments in Africa</b> over the period 2012-2040 with a cost of \$360 billion by 2040.
AfDB's Africa50 Infrastructure Fund established in 2013,	independent <b>infrastructure fund that focuses on high-impact national and regional projects</b> , mostly in the energy and transport sectors, with a particular emphasis on increasing the pipeline of investment-ready projects
Horn of Africa countries, a Regional Initiative	launched in 2014 to address drivers of fragility in the region. With over \$8 billion pledged.

# ...Role of Multilateral Institutions

## AfDB Group

- the AfDB financed **526 projects in the HoA**, and **60% after 2000**
- **before 2010, 93 %** sovereign project financing
  - before 2000, only one such project financing **in Uganda**
  - Between 2000 and 2009, it grew to five;
  - for **this past decade, it is 28** (14 Kenyan, 7 for Uganda, 5 for Ethiopia (Ethiopian Airlines receiving five times), and 2 for Sudan.

Number of AfDB Financed National Projects in the HoA

Country	Number of Projects Financed			
	before-2000	2000-09	2010-20	Total
Djibouti	18	15	14	47
Eritrea	5	4	10	19
Ethiopia	60	30	23	113
Kenya	45	26	43	114
Somalia	21	2	22	45
South Sudan	0	0	13	13
Sudan	30	3	21	54
Uganda	59	36	26	121
HoA	238	116	172	526

Source: AfDB's database, 2020.

### Challenges to AfDB's financing in the HoA:

- the **lack of project readiness**, which is a major constraint for all countries. In such instances, the Bank incorporates feasibility studies as part of project financing.
- **insecurity and limited institutional capacity**. To address this the Bank often includes capacity building activities as part of projects.
- **Design and planning insufficiencies** often pose a challenge to actual project implementations.
- **Limited accessibility of the Banks resources to non-sovereign clients**
- The Bank's direct operations require a minimum **project size of \$30 million**.
- Insufficient **information on fund availability** and country **policy restrictions**

### ▷ Why IGAD Development Bank:

- financial sector dominated by **commercial banks**,
- Countries **Limited access to international financial markets**,
- **National DBs lack innovative financial products**, scarce loanable funds, and limited ability to attract local and external funds.
- Others

### ▷ Prospective functions of the IGAD DB:

- Trade, investment finance and other projects with dev't impact
- Innovative **financial services for SMEs** either directly or through commercial and development banks. **Islamic banking products**
- Promote trade and investment through
- Serve the public and the private sector, while **public sector as principal client during the early periods.**

# The Role of China and the Gulf States

## The Role of China

### China

- Chinese loans 2000-15:
  - 67 % Chinese Exim Bank
  - 13 %, CDB
  - HoA highest recipient in Africa (With a 34 % share)
- China is also a big bilateral lender to the horn.
- Its funding is flexible yet expensive

Chinese Loans to the Horn and Africa in millions USD ( 2000-15)

Country	Lenders				Total	% share from Africa's
	Chinese Exim bank	Chinese Development Bank /CDB	Supplier's Credits	Other		
Djibouti	1,301	-	-	616	1917	2.0
Eritrea	488	-	-	16	504	0.5
Ethiopia	7,245	655	4,165	1,003	13,067	13.8
Kenya	6,319	240	-	290	6,849	7.3
Somalia	-	-	-	-	-	-
Sudan	4,837	-	598	1043	6,477	6.9
South Sudan	182	-	-	-	182	0.2
Uganda	2,806	-	-	71	2,877	3.0
Total for the Horn region	23,176	895	4763	3,038	31,872	34
Total for Africa	63,052	12,297	6,946	12,147	94,441	
Horn region's share from Africa's total (%)	37%	7%	69%	25%	34%	

Source: Johns Hopkins University (2017)

# ...The Role of China and the Gulf States

## The Role of the Gulf States

- Trade with HoA, particularly with Djibouti, Eritrea, Ethiopia, Somalia, South Sudan, and Sudan.
- Over the period 2000-17 ,
  - 434 investment projects, \$13 billion.
  - ODA 309 projects totaling \$6.6 billion.
- Ethiopia and Sudan attract large investments from the Gulf states.
- Agriculture, manufacturing, and construction
- Saudi Arabia and the United Arab Emirates (UAE) are the two key players.

Gulf States Investment Recipients (for the year 2000-17)

Recipient Countries	ODA		Investment	
	Number of projects	Value (millions USD)	Number of investments	Value (millions USD)
Sudan	132	4,681	52	3,253
Djibouti	82	1,359	5	330
Ethiopia	47	547	365	8,595
Somalia	32	23	6	778
Eritrea	14	14	-	-
South Sudan	2	14	6	3

Source: Netherlands Institute of International Relations, 2018.

# Conclusions

Trade and investment financing in the Horn blend promising developments with structural challenges.

## promising developments:

- Continental and regional commitments to promote trade and investment.
- IGAD Member states joint planning and implementation of regional investment initiatives.
- Broadening trend in sources of external financing
- Opening up of a venue s with China and the Gulf states for financing.



## Structural Challenges

- Saving shortfalls , current account deficits, foreign reserves
- capital outflows ( often illicit)
- Unsustainable external financing and debt
- Commercial bank dominated financial systems with limited medium/long term funding for investment at affordable terms.
- Not properly/over burdened National DBs with ambitious and less coordinated lending activities

# Policy Recommendations

- Engaging the **private sector** to free up financial assets, such as through asset sales programs.
- **syndication and securitization:** private sector resources can also be mobilized by enabling securitization of investment projects. Individual projects should be formed in a way to allow syndication and securitization possible.
- Reaping existing potential in regional institutions , for instance, **AfDB funding** both for trade and investment financing.
- Reaping the opportunities being created by **regional communities and continental initiatives**
- Development Banks could join hands in program identifications, information, and data generation by harmonizing their financing structures and standards in their capacity of development and technical assistance interventions.
- Setting up an IGAD Development and associated Investment Funds.
- Strengthening regulatory frameworks and enforcement mechanizes to ensure proper use of resources and hence reduce illicit activities.

# Thank You!



*Finance is a lubricant for trade and investment flows*