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#AUEUTracker

Infosheet Bulletin: Sustainable Finance and Revenue Potential

The 6th EU-AU Summit of February 2022 included Sustainable Finance as one of seven key areas of Africa-Europe cooperation. The African Union and the European Union underscored their commitment to implementing a range of initiatives, including improving the Common Framework for Debt. The European Union has expressed its support of recent progress in implementing the G20 Common Framework for Debt Treatments. Recent cases in Ghana, Zambia, and Chad demonstrate the potential of the Common Framework to deliver effective solutions. However, it is crucial to make the debt treatment process under the Common Framework timelier and more predictable. Greater clarity on the process and timelines is needed for both creditors and debtors.

Africa is estimated to require $1.3 trillion annually to achieve the Sustainable Development Goals (SDGs) by 2030. However, existing external finance sources for Africa fall short of this target, with net bilateral Official Development Assistance (ODA) flows to Africa decreasing to $34 billion in 2022. Moreover, the inflow of funds is overshadowed by outflows in the form of debt servicing and illicit financial flows (IFFs). Currently, 23 out of 54 countries are in high risk of debt distress or already in debt distress and debt service costs are increasing, with less than 10 countries in actual debt distress.In Europe, the EU's long-term financial plan spanning from 2021 to 2027, which includes funding for the Global Gateway, saw the frontloading of resources due to the Covid-19 pandemic and war in Ukraine, offering limited flexibility should future challenges arise.

To unlock its development potential, African nations must seek new avenues for securing long term, predictable, and affordable finance to deliver its sustainable development objectives. While efforts such as curbing IFFs, leveraging remittances, enhancing tax transparency, and tapping into carbon markets exist; these will not be effective without collaboration with other countries.

There is still potential to engage additional actors such as EU member countries, the USA, United Nations (including its Tax Committee), the Financial Action Task Force (FATF), the World Customs Organization, and the G20 to bolster domestic resource mobilization in Africa. This engagement could also involve supporting the reallocation of SDRs to Africa or supporting hybrid capital instruments capable of converting Special Drawing Rights (SDRs) into lending tools for African governments.

There is a compelling rationale for advocating a genuine partnership between Africa and Europe to tackle these multifaceted challenges. This approach involves strengthening public administration and governance systems in Africa while leveraging the expertise and resources of financial administrations in Europe, which has the capacity for swifter and more extensive action.

In a bid to strengthen cooperation between Africa and Europe in sustainable finance, the theme is increasingly integrated across all the work streams of the Africa-Europe Foundation and our multilateral Strategy Groups, spanning from Climate Resilience and Adaptation to Agriculture and Land-use, Energy Access and Transitions, Health and Pandemic Preparedness, to Ocean Governance and Blue Economy.

INTRODUCTION

Sustainable Finance emerged as crucial during the 6th EU-AU Summit held in February 2022, with financial commitments made in revising debt frameworks, reallocating Special Drawing Rights (SDRs), and investing sustainable investment projects. To bridge the infrastructure gap and sustainably achieve a growth rate of 5% or higher, Africa needs to invest between $130 to $170 billion annually. However, the current sources of external finance for Africa are not enough to meet this requirement.

As such, there is a need to explore new approaches and sources of sustainable finance in the continent, encompassing both external and domestic resource mobilization. With EU's cooperation, Africa could explore diversified financial strategies, including tapping into its domestic resources, and foster sustainable progress for the region.

CONTEXT

Africa is grappling with diminishing avenues for external financial support: Official Development Assistance (ODA)flows to Africa dwindled to $34 billion in 2022, reflecting a 7.4% decline in real terms compared to the previous year, and foreign direct investment (FDI) experienced a 5% decrease in 2021.

Such diminished inflows are overshadowed by the outflow of funds for debt servicing. By 2024, Africa is projected to spend $74 billion on servicing its foreign debts. Constrained by the rise in interest rates and the obligation to repay most debts in foreign currency, the continent's ability to meet its obligations is called into question.

In 2021, Africa received only 5% of the $650 billion worth of new SDRs distributed by the International Monetary Fund (IMF). The $33 billion received correspond to the smallest share among all regions, despite the essential role of SDRs in addressing the economic distress in many African countries. Currently, 23 countries are experiencing debt distress but lack financing to service it, to the point that Ethiopia, Ghana and Zambia have stopped servicing their external debt payments while Chad and Malawi are seeking to restructure their obligations.

European countries are making efforts to reallocate SDRs to Africa, including the pledge to reallocate US$ 31.3 billion as requested by the African Union. However, further actions are needed to expedite the delivery of this finance. To alleviate current financial pressures, most African countries are currently resorting to cut back on public spending, yet this short-term solution undermines long-term development plans and risks impacting global investments in a sustainable future.

"AFRICAN INSTITUTIONS, IN CONSULTATION WITH NATIONAL AUTHORITIES, WILL BE INVOLVED IN THE USE OF THESE SDRS TO SUPPORT THE CONTINENT'S RECOVERY. WE WILL SEEK TO ENSURE INCREASED SPENDING THROUGH INTERNATIONAL PROGRAMMES IN THE FIELDS OF HEALTH, CLIMATE, BIODIVERSITY, EDUCATION AND SECURITY TO FACILITATE ECONOMIC RECOVERY. WE AGREE TO EXAMINE LENDING INSTRUMENTS FOR SUSTAINABLE INVESTMENT PROJECTS IN PRIORITY SECTORS. WHILE ENHANCING OUR CAPACITY TO FACE THESE CHALLENGES, WE AGREE THAT RECOVERY INVESTMENTS SHOULD CONTINUE BUILDING RESILIENCE AND MORE SUSTAINABLE ECONOMIES TO ACHIEVE OUR LONG-TERM PRIORITIES."

Final Declaration of the 6th EU-AU Summit: A Joint Vision for 2030 (February 2022)

AU-EU JOINT OBJECTIVES AND AREAS OF ACTION

African countries have room to leverage various resources and increase their revenue potential to foster robust economies. Despite Europe's own sustainable finance challenges, particularly in transitioning to green initiatives, a collaborative effort is needed to empower Africa in securing funding for implementing proposals and enhance climate finance accessibility. Europe's substantial influence in multilateral bodies and as shareholders in institutions like the Bretton Woods institutions gives the EU and its member states significant weight to advocate for governance reforms beneficial to Africa. Collaborative efforts between the African Union and the European Union could capitalize on Africa's resource potential and contribute significantly to the sustainable finance sector.

Illicit Financial Flaws in Africa, estimated to annually outflow $88.6 billion, hold the potential to add substantial revenue to the continent if curbed. Mainly driven by trade mis-invoicing and criminal activities such as money laundering and smuggling, with government corruption contributing only 5%, such flows represent a significant challenge, and efforts to address it by the African Union and the European Union are underway.

Additionally, Africa can tap into the potential of remittances from Africans living overseas. In 2022, these remittances increased by 6.1%, with Nigeria alone receiving approximately 38% of the total. However, despite their importance, transaction costs for remittances in Africa remain high and lack transparency. Streamlining these processes could unlock significant economic benefits for the continent's development.

Domestic resources are crucial for financing development in Africa, but governments often struggle to raise tax revenues due to limitations in tax administration capacity. Addressing this challenge by prioritizing the training and deployment of skilled tax auditors, Africa can effectively tackle complex international tax arrangements diverting profits from corporate taxation, thus enhancing its capacity to raise tax revenues for financing development.

Focus

Despite Africa still securing the largest share from European Development Finance Institutions, which committed 3.6 billion in 2022, there is a 5% decrease from the previous year, indicative of a shifting focus towards climate finance (45% increase from 2021 level). This caused a nagging apprehension regarding the perceived trade-off between climate and development financing in Africa.

Both Africa and Europe share a mutual interest in advancing towards net-zero emissions more swiftly. Through joint efforts, they can explore innovative financing mechanisms to support Africa's domestic financial resource. With Europe's expertise, Africa could realize the full potential of carbon pricing and markets, with equitable market access beyond merely putting a price on emissions (in EU ETS and CBAM) as critical means for climate action.

The AEF inception phase has highlighted that economic resilience leads to climate resilience, and not the other way round. As such, addressing issues such as debt restructuring, credit raising and opening up fiscal space are essential prerequisites for making significant progress on climate resilience and adaptation.

Africa and Europe should collaborate and implement swift solutions such as utilizing hybrid capital instruments. The proposal by the African Development Bank (AfDB), in partnership with the Inter-American Development Bank, shows potential as it aims to recycle Special Drawing Rights (SDRs) through a hybrid capital instrument capable of converting SDRs into lending instruments for African governments. Continued efforts from the EU should focus on recycling at least 30% of national allocation SDRs, with an emphasis on directly channelling them to the AfDB.

Global taxation stands as a notable solution to raise additional revenue, emphasizing the establishment of a system that adheres to the polluter pays principle, wherein global "bads" bear taxation to support public "goods".

PROGRESS HIGHLIGHTS

- €450 million Team Europe Initiative on Combatting IFFs and Transnational Organised Crime (TOC) is expected to be launched in 2024, as an essential complement to other global efforts to ensure accountable and responsive governance

- An Africa Initiative was launched in 2014 by the African members of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes. Since its launch in 2014, nine African countries have identified or recovered €233 million in additional revenue via Exchange of Information Requests (EOIRs). The EU supports the Global Forum with a €2 million contribution in 2023-2027.

- The EU also supports the implementation of the G20/OECD Inclusive Framework on Base erosion and profit shifting with a €5 million contribution in 2022-2026, in line with the Addis Tax Initiative principles.

- Additionally, the Neighbourhood, Development Cooperation and International Cooperation Instrument (NDCCI) - Global Europe, specifically, its financial arm, the European Fund for Sustainable Development Plus (EFSD+), will make available up to €135 billion for guaranteed investments in infrastructure projects between 2021 and 2027 globally.

- The World Bank announced a new roadmap for high-integrity carbon markets, aiming to collaborate with 15 countries to generate up to 126 million forestry credits by 2028, certifying their environmental and social integrity, with the potential for these credits to generate up to $2.5 billion.

- The EU, through the IMF, has allocated €50 million to capacity building and training programmes for the improvement of economic governance, taking a climate and gender lens to management

- Bilateral programmes include a €303 million Support Programme for Economic Governance (PAGE) in Tunisia to improve private sector ecosystems and monitor economic policies; in Morocco, €62 million to the HAKAMA II public governance programme and €50 million for the Appui Européen à Réforme de l'Administration Publique programme; and in Libya technical assistance to public economic and finance institutions (e.g. ministries and central bank) to improve the business environment in the country.

- The AU Agenda 2063 Flagship African Continental Financial Institutions aims to accelerate regional integration and socio-economic development through the establishment of institutions to manage the African financial sector. Key initiatives include setting up the African Central Bank, the African Investment Bank, the African Monetary Fund and the Pan-African Stock Exchange.

- The newly established Global Taskforce on Tax, formed at the June 2023 Paris Summit, will explore innovative finance mechanisms, including levies on maritime fuels, airline tariffs, and financial transactions, with a two-year mandate and co-chaired by Laurence Tubiana under the European Climate Foundation.

- More than 140 countries have committed to implement a new global tax agreement aimed at ensuring multinational companies pay a minimum rate of tax. The deal, which was proposed by the Organisation for Economic Co-operation and Development (OECD), imposes a minimum effective rate of 15% on corporate profits. The policy is aimed at ending the benefit of shielding multi-billion-dollar profits in tax havens. It is also intended to remove the incentive for nations that operate as tax havens for corporate giants. The OECD estimates the Global Minimum Tax (GMT) policy will reduce under-taxed profits by around 80%, as it applies across geographies.

- The Pan-African Conference on Illicit Financial Flows and Taxation (PAC2024), an annual premier forum for the collective convergence of actors to discuss issues of illicit financial flows and taxation in Africa, took place in Tunis, Tunisia from 26th – 28th June 2024. The event hosted by the AUC, TJNA and ATAF featured the official launch of the Team Europe Initiative on Fighting IFFs and related tax organised crime in Africa. The event looked at the substantial strides African countries have taken in combating IFFs considered the evolving dynamics of national, regional, and international taxation policies. It underscored the persistent challenges confronting the continent in its efforts to combat IFFs and highlighted the commitment of actors to address those challenges.

- On May 10, 2024, the IMF's Executive Board approved the use of Special Drawing Rights (SDRs) for the acquisition of hybrid capital instruments issued by prescribed holders. This authorisation is subject to a cumulative cap of SDR 15 billion until further notice, which is aimed at mitigating potential liquidity risks in the SDR market.

- The EU contributes to capacity development initiatives in many African countries. The EU strongly supports the World Bank / IMF Debt Management Facility (DMF) and UNCTAD's Debt Management and Financial Analysis System Program (DMFAS) aimed at strengthening debt management capacity.

- The Global Green Bond Initiative (GGBI), steered by the European Commission together with an EIB-led consortium of European Development Finance Institutions and Multilateral Development Banks, consists of mobilising private capital through a de-risked green bond fund that will invest in green bonds issued in low- and middle-income countries with a substantial allocation to Africa. By acting as an anchor investor in local green bond issuances, the fund will aim to attract additional private investment to each issuance. So far, about EUR 1 billion of public investments have been committed to this initiative, which could in turn enable to attract private capital and support a total of EUR 15-20 billion in green bonds to finance sustainable investments globally.

RECOMMENDATIONS AND AEF STREAM OF WORK

All these initiatives are to be welcomed as a collaborative approach between Africa and Europe to foster sustainable finance in Africa. However, substantial work lies ahead as the process for implementing reforms is cumbersome and bureaucratic. Within the array of ongoing initiatives, African and European countries face challenges in determining which ones to prioritize. Since these initiatives are interconnected, the success of one relies on the completion of others.

Illicit Financial Flows

- The pivotal regulation of the 2015 Mbeki report by the AU/ECA High-Level Panel on IFFs has not significantly altered the amount of IFFs in Africa. This suggests that the implementation of recommendations may have been hindered by treating the problem as technical rather than political, considering that despite the small percentage of IFFs attributed to corruption, some governments are enablers of both commercial and criminal activities.

- The current EU-funded initiatives on IFFs largely focus on the origin (Africa). Without concerted efforts to address at the same time the destination, such as Europe or the United States of America, and include entities such as the United Nations (and its Tax Committee), the Financial Action Task Force (FATF), the World Customs Organization, and the G20 curb illegal outflows will be hard.

Tax Revenue

- Africa should enhance cooperation between tax and law enforcement agencies through initiatives like the Oslo Dialogue and OECD's Task Force on Tax Crimes and Other Crimes (TFTC) to counter financial crimes more effectively and address domestic capacity constraints.

Focus

AEF has hosted a series of high-level broadcast dialogues under its 'Commitment Tracking'program, aiming to assess progress since the 6th EU-AU Summit of February 2022, analyse obstacles to implementation, and identify partnership opportunities. The July 2023 #AUEUTracker Special Dialogue spotlighted the AU-EU commitment to "Combatting Illicit Financial Flows" within the framework of Sustainable Growth. Additionally, starting from September 2023, AEF launched a new working group on IFFs to pursue pragmatic, solutions-oriented approaches, building upon the aspirations of the AU/ECA High-Level Panel.

Climate adaptation and Carbon Markets

- At the 2023 Paris Summit for a New Global Financing Pact, the EU launched a Call to Action for Paris-aligned carbon markets. Championed by France and Spain, the Call aims to lay the foundations for robustly designed, high integrity domestic and international carbon markets to drive the necessary emission reductions, which if realised, could generate substantial financial flows for mitigation and adaptation, therefore supporting all goals of the Paris Agreement.

- Besides EU ETS and CBAM, many other enablers need to be in place to achieve climate adaptation. These include establishing a framework of policies and regulations that provide a stable, long-term context for investment in energy and a platform able to mediate between domestic and international funders, matching projects with finance providers.

Focus

AEF inaugurated a Cross-Continental Working Group on Carbon Markets at the 2023 Ibrahim Governance Weekend in Nairobi. This initiative aims to foster unified strategies for market development and explore opportunities under Article 6 of the Paris Agreement, enabling Africa to leverage its carbon credit potential, accelerating green industrial progress through collaborative innovation, and meeting the demand for low-emission products in both African and EU markets.

Hybrid instruments to leverage SDRs

- The proposal of the AfDB holds promise and was approved by the IMF Executive Board. The AfDB and African nations should commit to strategically allocate and transparently utilize funds, ensuring that they are directed towards areas that will yield the greatest impact in terms of sustainable finance.greatest impact in terms of sustainable finance.

The Demand for a Fair International Financial Architecture

- Financial shocks, both recent and from the past, have exposed significant vulnerabilities within the International Financial Architecture (IFA). These events highlight the urgent need for a more adaptable system that ensures greater equity in both its processes and outcomes especially for African countries. AEF and its partners can support the reform through advocating and commitment tracking around increased and quality representation in decision making boards, increasing the speed and agility of response, ensuring the scale of financial support meets real needs, securing sustainable and affordable financing, fostering global solidarity, and promoting economic self-reliance.

Sustainable finance frameworks

- There is a rapidly growing demand from countries to build a conducive environment for sustainable finance to enable private financial flows to be channeled towards sustainable investments. The year ahead until the upcoming 4th International Financing for Development Conference will be an opportunity to shift gears and accelerate the flow of private finance towards sustainable investments globally.

- The need for credible and interoperable sustainable finance frameworks and the risk posed by the fragmentation of sustainable finance frameworks worldwide were identified and discussed in the context of the EU High-Level Expert Group on scaling-up sustainable finance. The Working Group could contribute to coherent and coordinated dialogue on the support for sustainable finance technical assistance through a Sustainable Finance Advisory Hub. The Hub can support partner countries and share arising best practice in developing credible sustainable finance frameworks (taxonomies, disclosure requirements, standards) and help central banks, supervisors, and financial institutions integrate sustainability considerations.

Debt Management

- The working Group can advocate for enhanced debt management capacity. Sound public debt management is critical in managing debt risks and increasingly complex debt instruments. There's need for key ecosystem stakeholder to ensure that international debt management capacity building initiatives are well-resourced and well-coordinated, to deliver sustainable capacity in beneficiary countries.

Contribution to International Negotiations

- The Working Group should contribute to international negotiations, for example The United Nations (UN) negotiations on the framework convention on international tax cooperation. The negotiations seek to move multilateral tax negotiations onto a more explicitly political footing, allowing for fresh thinking about the structure of multilateral cooperation. This will create a fertile negotiating environment that overcomes some of the challenges faced by Least Developed Countries (LDCs) in existing tax bodies. Ultimately, the negotiations aim to achieve inclusive decision-making on global tax issues, where all countries participate on an equal footing. This will lead to more equitable and effective global tax governance that supports sustainable development and reduces inequality.