REINVIGORATING **AFRICAN** CONCESSIONAL **FINANCE**

Report of the High Level Panel
on Transforming Trust in the AfDB Group into Influence

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THE HIGH LEVEL PANEL ON TRANSFORMING TRUST IN THE AFDB GROUP INTO INFLUENCE

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ABBREVIATIONS AND ACRONYMS

ADB	African Development Bank
AfDB and ADB Group	African Development Bank Group (Bank Group)
ADF	African Development Fund
AsDB	Asian Development Bank
AsDF	Asian Development Fund
EPD	Enhanced policy dialogue
GDP	Gross domestic product
IDA	International Development Association
IMF	International Monetary Fund
MCL	Moderately concessional loans
OCR	Ordinary capital resources (of AsDB)
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
PFM	Public financial management
RMC	Regional member country
US	United States of America
USD	US dollar

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The Panel believes that frontloading ODA through the Big Bond in conjunction with moderately concessional loans and enhanced policy dialogue will reinvigorate the African country–donor relationship and create a true partnership

EXECUTIVE SUMMARY

Concessional finance is dwindling as volumes of official development assistance become lower and concessional loans have smaller grant elements and less concessional interest rates. Donor countries' diminished appetite for grants shows up most recently in the pledges for the 14th replenishment of the ADF (ADF-14) and the 18th replenishment of the International Development Association (IDA-18). We are at a point where reduced concessionality has become a new reality of development finance.

This High Level Panel report aims to help reinvigorate development finance for Africa, not by making a plea for more concessional finance, but by presenting an innovative mechanism for using existing ODA better and leveraging it further. The report is being released at a time when the continent's growth prospects have deteriorated, with risks of a serious setback to poverty alleviation and debt sustainability. This downturn has coincided with fiscal difficulties in donor countries.

The core innovation recommended by the Panel consists of frontloading ODA through a Big Bond along with an Enhanced Policy Dialogue to be led by the AfDB Group. With interest rates in donor countries near historical lows (the yield on the 30-year United States Treasury bond is now at about 3 percent), a window of opportunity exists to raise USD 100 billion by securitizing annual ODA flows of about USD 5 billion over a 30-year period.

This proposed frontloading has several advantages. First, it does not require additional resources from donors, but it simply recognizes that Africa needs a big push on infrastructure and human capital in order to maintain growth. Such a big push is better achieved by USD 100 billion upfront than an equivalent present value stream of USD 5 billion a year over the next 30 years.

Second, the resources needed to service the bond are less than 11 percent of the annual USD 45 billion in grants currently provided, a fraction that will be lower if new sovereign donors, foundations, and private sector entities commit to the bond. Thus, the issuance of the Big Bond will not be at the expense of ODA to the poorest and most fragile countries.

Third, the Panel proposes that the money raised by issuing the Big Bond be on-lent to eligible African countries through moderately concessional loans, or MCLs. Illustrative terms are an interest rate of 3–4 percent on USD loans with a maturity of 40 years and grace of 10 years. Donors would be fiscally better off, while African countries would benefit from lower interest costs and longer maturities relative to Eurobonds. Eligibility for access to MCLs would be defined by a combination of debt sustainability considerations and demonstrated capacity to use funds transparently and well.

Fourth, given its long maturity and top rating backed by the credit quality of the donors, the Big Bond would be attractive to institutional investors including sovereign wealth funds, pension funds, insurance companies, and social impact investors. A particular target segment of interest is African pension funds, which have significant investible resources and can signal their commitment to the continent by buying the Big Bond.

The Enhanced Policy Dialogue (EPD) is an integral part of the Big Bond concept. Debt sustainability problems have reemerged in Africa since the completion

of the Heavily Indebted Poor Countries-Multilateral Debt Relief Initiative. One reason is that African Development Fund (ADF) countries have been increasingly borrowing from the market because the volume of concessional finance is not sufficient for the big push that Sub-Saharan Africa needs on infrastructure and human capital. Other reasons include weak fiscal and financial institutions, inadequate attention to value for money, and currency collapses, which have increased the burden of repaying foreign currency debt. Attracting foreign direct investment to sectors other than natural resources has been hard because of problems with the investment climate stemming from political and macroeconomic instability that also impede domestic private investment. In short, Africa must strengthen its foundations for long-run growth and development. At the same time, there is valid concern that African countries need to do much more to ensure that their abundant natural resource wealth is used to promote development.

The aforementioned areas constitute a natural agenda for the EPD, with a focus on growth policy, sustainable public debt, and prudent use of natural resource wealth. The EPD needs to be pursued aggressively by the AfDB Group in collaboration with the IMF and World Bank.

Above all, the EPD must engage African leaders, with whom the ultimate responsibility for solving the continent's problems resides. They must take the lead by improving governance, policy, and institutions, and fostering accountability. As Zambian Minister of Finance, Felix Mutati, observed in April 2017 in the context of discussions regarding an IMF program, "The principle of engagement is premised on the fact that Zambians take leadership and ownership of the program."

A major challenge for African leadership is the number of poor people in Africa, which is already over 400 million, and is likely to remain at this level even if growth reaches an ambitious 7 percent rate in the 2020s. Sustained high and inclusive growth is essential for reducing poverty, infant mortality, disease, and malnutrition. If growth remains at the lower rates recently experienced, the number of poor could reach 500 million. In either case, the international community's desire to "Eradicate extreme poverty for all people everywhere" by 2030—the first of the Sustainable Development Goals—will not be met. There would be severe socioeconomic dislocation not only in Africa but globally, as the absence of employment opportunities at home for a young and poor population would have global spillovers. As Germany's Development Minister, Gerd Müller, noted in a November 2016 press conference, "If the youth of Africa can't find work or a future in their own countries, it won't be hundreds of thousands, but millions that make their way to Europe."

The investment needed to support growth rates of 7 percent in ADF countries implies a significant step-up from current levels. Based on the experience of other fast-growing countries, investment would need to reach 30 percent of Africa's gross domestic product (GDP)—or an increase of 7 percentage points from current rates. The vast financing needs are reflected in the slogan "From billions to trillions" in connection with the Sustainable Development Goals (SDGs).

Experience from Africa and emerging markets indicates that the market cannot serve as a reliable source of development finance. It is myopic and unforgiving and costs quickly rise with each bond issue. Therefore, the reliance on official finance including ODA will continue for the time being. However, even the poorest African countries must do their part by increasing domestic revenue mobilization in conjunction with the emphasis on sustainable public debt in the EPD; the IMF's October 2015 Regional Economic Outlook for Sub-Saharan Africa reported that tax revenue for the median Sub-Saharan African country could be raised by 3 to 6.5 percentage points of GDP relative to levels achieved in 2014.

The Panel believes that frontloading ODA through the Big Bond in conjunction with MCLs and the EPD will reinvigorate the African country–donor relationship and create a true partnership. The Panel considered important interlinked questions in defining this new partnership: How can the frontloading be designed to lower the burden on donors? Will charging for frontloaded funds exacerbate debt sustainability problems? What are the implications for countries with low potential eligibility for MCLs? What are the principles to guide the EPD? What are the implications for the governance of the ADF and the AfDB? The report contains answers to these questions.

Frontloading through the Big Bond would accelerate the inflow of funding for programs related to the SDGs and signal to the private sector worldwide that Africa is open for business. It would raise the stakes for better economic governance in Africa, to be supported through the EPD. This combination would enable development partners to envisage the end of economic aid within one generation, say 40 years, making frontloading more palatable while serving as a powerful incentive to ADF countries to accelerate policy and institutional reform.

The AfDB Group must play a leadership role, considering that the 38 ADF countries are home to 95 percent of Africa's poor. It should combine ongoing highly concessional support with new moderately concessional support to ADF countries; and lead the EPD as the trusted partner of regional member countries. The base level of highly concessional support would continue to be provided through the ADF. A new window should be established to provide MCLs to countries and projects that meet robust eligibility criteria.

Regional integration is a top priority, given the small average size of African economies. This is an area of core expertise for the Bank Group, and a portion of the Big Bond funds should be targeted at such projects.

Given its franchise value, the Bank Group has a vital role to play in the EPD through enhanced knowledge services and convening power. To assure the success of this new partnership, the Bank Group needs to further strengthen collaboration with African institutions (such as the African Union Commission and the United Nations Economic Commission for Africa) and development partners including the World Bank and the IMF.

The Panel urges donors to participate in the Big Bond and use their goodwill to promote collaboration across development partners and multilateral development banks working in Africa.

In conclusion, the Panel emphasizes that the ultimate responsibility for reinvigorating development rests with African leaders. The international development community as well as current and future generations of Africans will look to them to continue strengthening governance, leadership, and institutions. There simply is no room for setbacks stemming from corruption, political instability, poor macroeconomic management, and the waste of natural resource wealth.

Summary of Key Messages

ALL STAKEHOLDERS

Urgently reduce poverty and create jobs in Africa, especially in ADF countries

AFRICAN POLICYMAKERS

Strengthen governance, leadership, and institutions to reduce volatility from domestic sources (failures in public financial management, corruption)

Improve domestic resource mobilization and management of public expenditure, investment and debt

Accelerate regional integration

Provide an enabling environment for private sector development and encourage increased domestic savings

INTERNATIONAL DEVELOPMENT COMMUNITY

Provide the commitments to support the issuance of the Big Bond

Use influence to promote collaboration among multilateral development banks

PRIVATE SECTOR

Purchase the Big Bond

Ensure efficiency in the delivery of projects in infrastructure and human development

AFRICAN DEVELOPMENT BANK GROUP

Establish a new window to support regional integration and accelerate growth in ADF countries:

- Secure annual commitments from existing donors and new sovereign and private sector donors to frontload resources
- Manage the issuance and proceeds of the Big Bond based on donor commitments
- Develop rules of access and provide funding via MCLs to eligible countries

Maintain base level of highly concessional funding through ADF

Take a leadership role in EPD through enhanced knowledge services and convening power

External finance—commercial and concessional—will continue to be critical in financing development. Foreign direct investment and remittance inflows will need to be accompanied by a steep increase in long-term debt financing from official and private sources

1

AFRICA FACES MAJOR DEVELOPMENT CHALLENGES THAT NEED TO BE URGENTLY ADDRESSED

The popular "Africa rising" view of the past decade has given way to a more cautious outlook for the continent's 54 countries. Without a sharp revival of growth, poverty in Africa will rise, with global consequences. The investments needed for growth will eventually have to be funded from African savings but, in the interim, external finance will need to be scaled up. Development finance needs to increase even as donors face constraints, calling for new approaches.

The "Africa rising" narrative has stalled. Growth had averaged almost 5 percent during 2000–10 and significantly reduced the incidence of absolute poverty in Africa from 46 percent in 2000 to 36 percent in 2015. However, growth slowed to 3.7 percent in 2014, to 3.5 percent in 2015, and further to 1.5 percent in 2016.

On the poverty front, even as the share of poor people in the total population was declining, 50 million more people in Africa were added to the numbers of poor in 2000–15: In 2015, 420 million people in Africa were living in absolute poverty, or more than half the world's poor.[1] The poor in Africa are young—people under 25 now make up 60 percent of the continent's population. With 500 million added to the population and 250 million added to the labor force by 2030, the situation could become critical. Growth needs to be revived quickly.[2]

Another concern is the ability of African countries to finance the investments needed for growth. African savings have declined from 22 percent of gross domestic product (GDP) in 2010 to 16 percent in 2015. Over the long term, African countries will need to take responsibility for largely financing their own development; this is consistent with the self-reliance theme that runs through the African Union's Agenda 2063 and the 2015 Financing for Development Addis Ababa Action Plan. However, in the interim, Africa will need a continuing boost from external finance, particularly concessional finance.

Africa's growth slow-down has coincided with fiscal problems in the countries providing concessional finance, which diminishes the prospects for increased aid. These factors are already reflected in declining concessional finance to Africa—as provided by OECD donors—down from USD 57 billion in 2013 to USD 51 billion in 2015. This decline has occurred in both bilateral aid and aid channeled through multilateral institutions. Further, for the next three years, donor funding will be stagnant or declining based on pledges in both the 14th replenishment of the African Development Fund (ADF-14) and the 18th replenishment of the International Development Association (IDA-18).[3] By 2020, ADF concessional finance will be 39 percent lower than its peak in 2010.

This triple threat of a slowing global economy, lower African savings, and declining concessional finance must be managed to minimize severe socioeconomic consequences not only in Africa but globally. For example, the absence of employment opportunities at home for a young and poor population would have global spillovers, such as security threats and uncontrolled migration to OECD countries.

A robust revival of Africa's growth is needed simply to prevent the number of poor people from increasing.

The ADF Policy Innovation Lab estimates that even an ambitious target of 6 percent throughout the 2020s would still leave around 400 million people poor in 2030.[4] More troubling, if growth continues at 3–4 percent a year, the number in absolute poverty would approach 500 million by 2030. In either case, the international community's desire to "eradicate extreme poverty for all people everywhere" by 2030 (the first of the Sustainable Development Goals) will not be met.

Ambitious growth will require designing broad-based private sector–led country strategies. In addition, attention will need to be paid to regional integration given the many small economies in Africa as discussed in Box 1.1.

A much higher investment rate will be needed to support a robust economic revival. Based on the experience of other fast-growing countries, investment would need to reach 30 percent of Africa's GDP—an increase of 7 percentage points from the current rate. Particularly pressing is closing Africa's widely documented infrastructure deficit, especially in power and roads, including at the regional level. This deficit is a severe constraint to improving human development outcomes, especially in rural areas, where the bulk of Africans live, and to private investment and growth. In addition, Africa must invest in skills and human capital to enable good jobs for its youth. Though African savings have to be the primary source for financing investments over the long term, they will not be adequate in the medium term. So, external finance—commercial and concessional—will continue to be critical in financing development. Foreign direct investment and remittance inflows will need to be accompanied by a steep increase in long-term debt financing from official and private sources. Sound management of public debt obligations will be vital.

Given donor fiscal constraints alongside Africa's huge development needs, especially in infrastructure, new and creative instruments for concessional finance will have to be designed, as market finance costs and maturities will not always be suitable. The next chapter discusses the need for frontloading development finance for Africa accompanied by an Enhanced Policy Dialogue that highlights the critical importance of African leadership in owning and solving the continent's development problems.

BOX 1.1 Growth Strategies and the Continuing Need for Regional Integration in Africa

Growth will have to be led by the private sector, which creates more than 90 percent of jobs. Private sector development will require African governments to ensure:

- Policy consistency, particularly in the macroeconomic environment, including exchange rate stability.
- Improvements in the business environment for the domestic and international private sectors.
- Support for diversifying away from primary exports.
- Increased investment in infrastructure.
- Increased quality of labor, through investments in primary, secondary, and tertiary education and skills development.

Sustainable finance for growth strategies requires improved national savings and better access to financial savings by small and large businesses and individual entrepreneurs—areas of particular challenge in Africa. The problem has often been compounded by national governments' heavy domestic borrowing, crowding out private sector access to debt financing in domestic financial markets.

But national growth strategies are not enough. Africa's 54 economies are diverse in size. In 2015, only six countries had a GDP above USD 100 billion (in descending order, Nigeria, Egypt, South Africa, Algeria, Morocco, and Angola), accounting for 66 percent of Africa's GDP. Thirty-six economies, with a GDP of less than USD 20 billion each, have domestic markets too small to produce high levels of sustained domestic-led growth.

Intraregional trade accounts for only 15 percent of African countries' total external trade, compared with 70 percent in the European Union, 60 percent in Asia, and 54 percent in North America.

In view of the small size and landlocked nature of many African economies, national growth strategies will need to be complemented by a strong regional integration agenda: increased investment in regional infrastructure and support for increasing intraregional trade within Africa through better integration of product, factor (particularly labor), and financial markets.

Given donor fiscal constraints alongside Africa's huge development needs, especially in infrastructure, new and creative instruments for concessional finance will have to be designed, as market finance costs and maturities will not always be suitable

By onlending the bond's proceeds to African countries through moderately concessional loans, the donor community at large would be fiscally better off, while African countries would benefit from lower interest costs and longer maturities relative to Eurobonds

2

AFRICA NEEDS FRONTLOADED FINANCE AND AN ENHANCED POLICY DIALOGUE

The importance of official development assistance as a source of external financing for ADF countries has fallen sharply since 2000. Net inflows of ODA to these countries have leveled off, while their external financing needs have picked up substantially. New ODA financing mechanisms are needed to exploit their full potential for growth.

The Need for a New Middle Ground

As the previous chapter indicated, Africa has vast and immediate financing needs for infrastructure and human capital investment. Market-based finance is unlikely to meet these needs. The capital markets tend to be myopic and unforgiving and will demand a heavy price for supplying funds while offering maturities that are insufficiently long. At the same time, Africa is unable to self-finance its investment needs because of its relative poverty. This implies that concessional finance will continue to play an important role for the time being. However, donors are facing severe fiscal and political constraints of their own.

Under these circumstances, the High Level Panel considers defining a new middle ground essential to reconciling the vast and immediate developing financing needs in ADF countries with rising fiscal and political constraints in donor countries. This middle ground has three elements:

- Frontloading ODA by raising a large volume of funds via a Big Bond, structured in a way that lowers the fiscal burden on donors.
- Charging for frontloaded ODA via moderately concessional loans (MCLs). The cost of MCLs is expected to be far below the high economic and social rates of return that would be realized from the needed investments in infrastructure and human capital. And by displacing more expensive market borrowing alternatives for ADF countries, MCLs would bolster public debt sustainability.
- Conducting an enhanced policy dialogue (EPD) to support the development and execution of homegrown programs to improve economic governance in general and the management of the public finances and public investments in particular. The EPD would aim to strengthen the foundations for long-run growth and development, and thereby ensure that the MCLs are eventually repaid.

With interest rates in donor countries near historical lows (the yield on the 30-year United States Treasury bond is currently about 3 percent), a window of opportunity exists to raise USD 100 billion through a Big Bond for Africa by securitizing annual ODA flows of about USD 5 billion over a 30-year period. This is less than 11 percent of the annual USD 45 billion in grants.[5] Commitments by new sovereign donors, foundations, and private sector entities would further reduce the debt service requirement as a proportion of grants. By onlending the bond's proceeds to African countries through MCLs, the donor community at large would be fiscally better off, while African countries would benefit from lower interest costs and longer maturities relative to Eurobonds. Given its long maturity and solid rating based on the credit quality of countries underwriting

the bond, the Big Bond would be attractive to institutional investors, including sovereign wealth funds, pension funds, insurance companies, and social impact investors.

Frontloading ODA would accelerate the inflow of funding to achieve the Sustainable Development Goals and shift perceptions in the private sector worldwide that Africa is now a place open for business. It would also greatly strengthen the incentives for better economic governance, pursued through the EPD. This would allow development partners to envisage the end of economic aid within one generation, say 40 years (excluding humanitarian aid and climate change finance). Such a sunset provision for economic aid would make frontloading more palatable while serving as a powerful signal to ADF countries to accelerate their policy and institutional reforms. The key point is that the Big Bond and EPD need to be pursued jointly.

The Big Bond will support a transition from concessional finance to market-based finance. The indispensable role of the private sector in Africa's development—by participating in infrastructure projects and investing directly in manufacturing and agribusiness along with skill and technology transfers—is clearly valuable and welcomed. However, experience over the last 10 years in Africa and the much longer experience of emerging markets indicate that market borrowing is unlikely to finance development sustainably.

- First, the 1–3 year maturities of domestic borrowing and the 7–12 year maturities of Eurobonds fall far short of the long gestations that characterize infrastructure projects—that is, 5–10 years before the start of revenues, and payback periods of 20 years or more. By providing sufficiently long maturities, the Big Bond will help with financial sustainability and demonstrate the potential for a new Africa infrastructure asset class.
- Second, market interest rates include a hefty premium for country risk. Interest rates rise progressively with each bond issuance, increasing macroeconomic vulnerability. In contrast, the pricing of the Big Bond will be based on the credit ratings of donors, helping keep interest rates manageable. Further, the repayment of MCLs will allow African countries to build a track record of repayment, prudent macroeconomic management, and management of large infrastructure projects.
- Third, market finance is rarely if ever accompanied by efforts to build fiscal and financial institutions. The Big Bond program will include a valuable program of technical assistance and policy advice, with physical infrastructure required to meet established environmental and social safeguards.

The EPD will be the channel for dispensing technical assistance and policy advice. Its main goal will be to ensure that the needed policy and institutional improvements take place and are maintained, especially in public finance management, growth policy, and making sure that Africa's natural resource wealth becomes a boon for development. The EPD will underscore that the primary responsibility for minimizing volatility from political crises and corruption shocks rests squarely with African leaders.

Useful lessons for the EPD can be drawn from the Highly Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (HIPC–MDRI). The HIPC–MDRI objective was to help countries achieve sustainable debt trajectories while freeing up fiscal space for attaining the MDGs. Participating countries implemented poverty reduction strategies and undertook macroeconomic and structural reforms. As of March 2016, debt relief of USD 74.8 billion (in end-2014 present value terms) had been provided to 36 countries, including 30 African countries.[6]

Poverty-reducing expenditures increased significantly as a percentage of GDP among HIPCs in the four years leading to completion point. Likewise, debt service fell sharply as a percentage of GDP, with the decrease continuing for about six years after completion point. Debt relief coincided with the commodity price boom, briefly interrupted by the Great Recession of 2008–09, but then picking up steam again until 2014, when China's growth slowdown became pronounced. These factors, along with the commodity boom and improved policies in ADF countries, led to a decade of high growth, fueling the Africa Rising narrative.

But as the 2016 HIPC–MDRI update notes, the attainment of the MDGs was uneven across HIPCs. While HIPCs did relatively well in gender equality in primary education and access to safe drinking water, only a few met the MDGs on maternal mortality rates and primary school completion rates. Moreover, epidemics, natural disasters, and conflicts have set progress back in some HIPCs.

Indeed, the HIPC and MDRI—together with the commodity boom and the grab for yield set off by the monetary loosening in advanced economies—enabled several ADF countries to tap the debt markets internationally and at home. But in the last few years, the external environment has become adverse (as with falling commodity prices) and aid flows have declined. The confluence of these factors, combined with economic and political governance challenges, have led some countries to incur high-cost debt in an effort to maintain growth.

The HIPC–MDRI experience points to the benefits of a financing package being accompanied by a robust policy dialogue on policy and institutional improvement and public debt sustainability. However, it also points to both the difficulty and importance of being able to maintain this dialogue at a consistently high level over the long haul, especially during good times and booms, when the country appetite for such dialogue tends to diminish.

Moderately Concessional Loans and Debt Sustainability

The proceeds of the Big Bond would be on-lent to eligible ADF countries through MCLs. An interest rate of about 3 percent with 40 years' maturity and 10 years' grace are illustrative MCL terms.[7] Such terms naturally raise concerns about debt sustainability. The ADF Policy Innovation Lab reviewed public debt sustainability in 33 of the 38 ADF countries based on data availability. Nigeria was excluded because it is expected to graduate in 2019.[8]

Two questions were posed in gauging the impact of MCLs. First, is there any evidence of deterioration in public debt dynamics over 2013–15, and if yes, what are the main factors? Second, what is the prime determinant of the marginal cost of government borrowing, the market or official creditors? This focus on public debt and market borrowings is consistent with the issues being considered in the 2016 Review of the IMF–World Bank Debt Sustainability framework, which emphasizes the importance of these variables as well as international liquidity.[9] Appendix 3 presents more detail on the conceptual framework the ADF Lab used to ascertain the debt sustainability implications of MCLs. It also discusses the concessionality embedded in MCLs.

The main findings were:

1. Public debt dynamics have become more challenging and need to be addressed. While this is most obvious for commodity exporters, it also applies to the bulk of the other ADF countries. In general, external financing dependence is large, reflected in high current account deficits.
2. Except for fragile countries, MCLs are unlikely to trigger public debt sustainability problems for two reasons. First, an MCL will be less costly and longer in maturity than the market borrowing alternatives pursued via Eurobonds and domestically. Second, poor use of funds (not just from concessional finance, but overall fiscal revenues, including proceeds from natural resources), insufficient emphasis on public value for money, and exchange rate collapses are frequently more important for debt sustainability than the interest rate on the portion of public debt from official sources.
3. The market is unlikely to be a reliable substitute for frontloaded ODA, since it is myopic and unforgiving, and costs can quickly rise with successive bond issues. For example, Ghana issued its fifth Eurobond in the post HIPC–MDRI era in September 2016 for USD 750 million, at 9.25 percent with an average maturity of just five years, a spread of more than 700 basis points over the then US 10-year Treasury yield. In the same month, Rwanda, which boasts the highest Country Policy and Institutional Assessment rating among ADF countries, was downgraded by Standard & Poor's from B+ to B, five levels below investment grade, because of its growing current account deficit fueled by imports to support its long-run development.
4. At the other extreme, concessionality in the post HIPC–MDRI world has not prevented debt sustainability problems from reemerging. And weaknesses in the foundation for sustained growth and development need urgent remediation.

Based on the ability to cope with MCLs on debt sustainability grounds, ADF countries were divided into two groups: those with high potential eligibility for MCLs, and the rest (Table 2.1). Even though the first group would benefit from MCLs on cost and maturity grounds, there is no presumption of automatic eligibility. Countries would be granted access case-by-case, subject to stringent criteria. A two-tier structure will need to be developed. Countries that do not get MCL access would continue to receive funding from the ADF window under current rules.

High potential eligibility.[10] This group includes 17 countries. Cameroon, Côte d'Ivoire, Ethiopia, Ghana, Kenya, Mozambique, Rwanda, Senegal, Tanzania, and Zambia have issued Eurobonds in the last five years. Benin, Burkina Faso, Djibouti, Lesotho, Mauritania, Niger, and Uganda have never issued a Eurobond but borrow on commercial terms in the domestic market or on semi-concessional terms from China.

Ghana, Mozambique, and Zambia have debt sustainability problems. All three have marginal borrowing costs far exceeding MCL rates and at much shorter maturities, and could therefore benefit strongly from MCLs. Ghana's interest rate on public debt has had a relatively small negative impact on public debt dynamics. The depreciation of the cedi and weak public financial management (PFM)—a fiscal hole of 4 percent of GDP for 2016 was discovered in early 2017—have been far more important. Ghana's public debt rose to 74 percent of GDP at the end of 2016, above a target of 70 percent with "significant public spending commitments that bypassed PFM systems." Ghana will need to address its fundamental fiscal imbalance, which requires implementing "the new government's intentions to reduce tax exemptions, improve tax compliance, and review the widespread earmarking of revenues."[11]

For Zambia as well as Ghana, MCL access will require reestablishing a sustainable debt profile by raising primary fiscal surpluses and lowering country risk. Based on emerging market experience, they are unlikely to grow out of their debt problems. Ghana is already in an IMF program, while Zambia is engaged in discussions on one. Mozambique has defaulted and is seeking debt restructuring, a process that needs to be completed.

Cameroon, Djibouti, Ghana, and Mauritania are classified as being at high risk of external debt distress by the IMF–World Bank debt sustainability analysis. Yet

TABLE 2.1 ADF Country Potential Eligibility for Moderately Concessional Loans

COUNTRY	ADF CLASSIFICATION[a]	FRAGILE SITUTATIONS?	MCL POTENTIAL ELIGIBILITY
Rwanda	ADF-Only		High
Senegal	ADF-Only		High
Kenya	Blend		High
Tanzania	ADF-Only		High
Ethiopia	ADF-Only		High
Cameroon	Blend		High
Uganda	ADF-Only		High
Burkina Faso	ADF-Only		High
Ghana	Gap		High
Benin	ADF-Only		High
Mauritania	ADF-Only		High
Lesotho	Gap		High
Niger	ADF-Only	Yes	High
Côte d'Ivoire	Gap		High
Zambia	Blend		High
Mozambique	ADF-Only		High
Djibouti	Gap	Yes	High
Mali	ADF-Only	Yes	Low
Guinea	ADF-Only		Low
Malawi	ADF-Only		Low
Liberia	ADF-Only	Yes	Low
São Tomé and Príncipe	Gap		Low
Chad	ADF-Only	Yes	Low
Burundi	ADF-Only	Yes	Low
Congo, Dem. Republic	ADF-Only	Yes	Low
Togo	ADF-Only	Yes	Low
Madagascar	ADF-Only	Yes	Low
Sierra Leone	ADF-Only	Yes	Low
Gambia	ADF-Only	Yes	Low
Guinea-Bissau	ADF-Only	Yes	Low
Zimbabwe	ADF-Only	Yes	Low
Sudan	ADF-Only	Yes	Low
Central African Republic	ADF-Only	Yes	Low
Nigeria	In transition to ADB		—
Comoros	ADF-Only	Yes	—
Eritrea	ADF-Only	Yes	—
South Sudan	ADF-Only	Yes	—
Somalia	ADF-Only	Yes	—

* Classification per ADF-14. Countries in each eligibility group are listed in descending order of the CPIA rating.

all exceed the operational gross national income (GNI) per capita cutoff, and the first three are natural resource rich, while Djibouti reaps rents from its strategic military location. On incentive grounds, there is good reason to charge these countries MCL rates, combining this mechanism with EPD aiming to diversify the economy and restore a sustainable debt profile.

Low potential eligibility. MCLs are likely to exacerbate debt sustainability problems in six of this group of 16 countries: Burundi, Central African Republic, Liberia, Madagascar, Mali, and Zimbabwe. The reasons include fragility from regional insecurity; political instability; poor governance; epidemics such as Ebola; weak ability to use natural resource wealth to promote development; or some combination. The other 10 countries exhibit similar characteristics but are somewhat better off: Chad, Democratic Republic of Congo, The Gambia, Guinea, Guinea-Bissau, Malawi, São Tomé and Príncipe, Sierra Leone, Sudan, and Togo.

Yet even countries with low potential eligibility today can, over the next 10–15 years, transform themselves

with the right incentives and political will. Guinea and Togo, for instance, both have a high share of local currency debt in total public debt, which is typically at short maturities and at commercial terms. Both countries also have ambitious public investment programs. For example, Guinea is planning a 550 megawatt hydroelectric dam at Souapati, costing around 20 percent of GDP. Its financing will not be feasible using current instruments. Access to MCLs at some point could help because of the very long maturities involved, assuming the project has been adequately vetted. Such potential access could serve as a powerful incentive for reform.

Enhanced Policy Dialogue

EPD will aim to improve leadership, governance, and institutions. They should focus on improving public financial management, achieving sustainable public debt trajectories, and ensuring that Africa's natural resource wealth is put to good use, thereby reinvigorating growth prospects. This will help to make frontloaded ODA a success.

The big push that African countries need on infrastructure and human capital investments will pay off only over the long run. But there will be an immediate impact on public and external debt and current account deficits owing to the paucity of national savings. Indebtedness will then have to be brought down to sustainable levels, which rests on being able to increase growth and mobilize more domestic resources, while keeping country risk low.

The ADF Lab visited five countries—Côte d'Ivoire, Ghana, Mozambique, Rwanda, and Uganda—to discuss the preceding debt sustainability results with senior policymakers in the ministries of finance, central banks, and debt management offices, as well as nongovernmental organizations and the private sector. Three insights emerged for policies and institutions.

First, policymakers generally agreed that MCLs are unlikely to be pivotal in causing debt sustainability problems. Weaknesses in fiscal and financial institutions, governance failures, and exchange rate collapses are much more important. A point repeatedly made was that the key variable is how public resources are used—not just borrowed funds, but total fiscal revenues, including those from natural resource wealth. The interest rate on loans from official sources is secondary. It is the waste of public resources that hurts the most.

Second, countries would welcome MCLs if accompanied by a bigger envelope of resources that would reduce dependence on market borrowing. Even countries that have not issued Eurobonds have often borrowed at commercial terms in the domestic market or on semiconcessional terms for public investments, including loans from China. However, absorptive capacity would need to increase to ensure sound public investment selection and execution along with adherence to environmental and social safeguards.[12]

Third, concern was expressed about whether natural resource wealth would be used to further development or be squandered. MCLs could serve as a wake-up call for improved governance by signaling that the era of cheap money is over. But candid EPD at the highest levels would remain essential in diversifying away from commodities and addressing the natural resource curse.[13] Ghana's fiscal laxity may be explained in part by the expectation that revenues from new oilfields would bail out the government. Mozambique's hidden debt, which came to light last year, is probably linked to its natural gas wealth. And Zambia's Eurobond borrowing spree was linked to soaring copper prices. Nigeria is repeating its own costly exchange rate policy mistakes of the mid-1980s. Now is a good time to combat—or pre-empt, in the case of new discoveries—the natural resource curse given the indifferent outlook for hydrocarbon, mineral, and metal prices over the medium term. For example, it would be timely to prepare a transparent plan for the utilization of Uganda's USD 1.5–2.0 billion in annual oil revenues ahead of the expected start of revenues in 2020.

The Panel proposes three principles to guide the EPD, for which restoring debt sustainability, reinvigorating growth, and prudently managing natural resource wealth constitute a natural agenda.

First, EPD must focus explicitly on the requirements for making frontloaded ODA a success by building on the current Country Policy and Institutional Assessment ratings and guidance from the IMF and World Bank's Debt Sustainability Framework. EPD must reinforce the importance of debt sustainability and establishing a solid foundation for long run growth and development.

Second, the Bank Group can use its African franchise value to emphasize leadership, economic governance, and PFM institutions, the latter with a twin focus on public spending and enhanced domestic revenue mobilization. EPD needs to be integrated with the Bank Group's decentralization strategy and its expertise in regional infrastructure and other aspects of regional integration.

Third, the EPD agenda will require the Bank Group to collaborate actively with African institutions (such as the African Union Commission and the United Nations Economic Commission for Africa), development partners including the World Bank and the International Monetary Fund (IMF), and the private sector.

Establishing a high standard for access to MCLs—for example, the need to meet specified PFM criteria and have demonstrated absorptive capacity—will serve as a powerful incentive for countries to participate in EPD. Part of the frontloaded funds can be used for regional infrastructure projects, with the rest set aside for MCL-eligible ADF countries.

At the same time, the Panel emphasizes the critical importance of maintaining existing levels of concessional finance from all sources to fragile countries with low potential eligibility for MCLs. For the ADB, this can be achieved through a two-tier structure. The current ADF window will distribute funds in accordance with the Performance-Based Allocation system, as well as other set-asides, such as the transitional support facility. And a new window will be created for frontloaded funds for MCL-eligible countries. The availability of funds from the new window for MCL-eligible countries will also provide the opportunity, at a subsequent ADF replenishment, to recalibrate the manner in which scarce resources are distributed to all ADF countries. Capacity building and other technical assistance for ADF countries not deemed eligible for MCLs should be simultaneously pursued as part of the Bank Group's Knowledge Bank to prepare them for future MCL access. These ideas are pursued in Chapters 4 and 5.

Enhanced policy dialogue will aim to improve leadership, governance, and institutions. It should focus on improving public financial management, achieving sustainable public debt trajectories, and ensuring that Africa's natural resource wealth is put to good use, thereby reinvigorating growth prospects. This will help to make frontloaded ODA a success.

The Panel recommends that ADF be retained in its current structure with ADB management switching attention to the much larger payoff for eligible ADF countries from designing and implementing the Big Bond as a separate window

3

INCREASING CONCESSIONAL FINANCE FROM THE AFRICAN DEVELOPMENT BANK GROUP

As Africa's development bank, the African Development Bank has been a trusted institution over the last five decades. Its financing support to African countries has been relatively modest and its concessional finance window—the African Development Fund—is facing increasing demands at a time when traditional donors will not be increasing their funding. Emulating innovations at the Asian Development Bank and the International Development Association can be used to better leverage existing ADF resources, but this approach is unlikely to increase the ADF's financing capacity immediately or significantly.

Governance Structure of the African Development Bank Group

The ability to increase financing through the ADF is determined by its articles of establishment, which are distinct from the ADB's. These articles prescribe its governance and define eligible sources of financing. ADB was established by African countries as their regional development bank over five decades ago. The ADB shareholding structure was wholly-owned by regional member countries. Soon after it began its operations in 1964, two major constraints became apparent: the limited amount of resources and projects that were not viable for nonconcessional financing.[14] This led to the start of negotiations for a concessional window in 1966. Voting rights were divided 50:50 between donors and the ADB; no voting rights were provided directly to regional member countries.

Concessional financing windows were also created in other multilateral development banks: the Fund for Special Operations at the Inter-American Development Bank (established in 1959), IDA at the World Bank (in 1960), and the Asian Development Fund at the Asian Development Bank (in 1974). Even though the motivation for establishing concessional finance windows was similar, in practice there were significant differences in the enabling charters. The ADF was established in 1972 as a separate legal entity. It, hence, differed from the Fund for Special Operations and the AsDF, which were set up as funds administered by their host institutions. It also differed from IDA, which was set up as a separate legal entity, like ADF, but had shareholding participation from recipient countries and no participation from the World Bank itself.

Over the last 50 years, the shareholding structure of the ADB has changed significantly. It now includes 27 nonregional countries as members. In contrast, the ADF has changed only marginally—1 percent voting rights for RMCs were introduced in 2002, but only one African country (Angola) has joined as a state participant to-date. Egypt, Libya, and South Africa have made financial contributions to the Fund without becoming state participants. Another RMC, Nigeria, chose not to participate in the ADF and established its own Trust Fund window in 1974. While the portion of donor voting rights has remained unchanged at 50 percent, new nonregional donors have participated only modestly in the ADF. Instead, a number of these countries (China, India, and South Korea) have deployed the bulk of their support to the Bank Group through bilateral trust funds.

Efforts to reform the governance structure of the ADF over the past 15 years have resulted in only modest change. To understand the slow pace of progress, the ADF Lab interviewed African policymakers and other stakeholders. Interviewees attributed the slow pace of reforms to the design of proposals as "technical fixes" for the ADF, rather than addressing governance in a holistic manner for the Bank Group. They noted that the fundamental issue with ADF's governance is that it is primarily donor-driven. Interviewees emphasized the need for strong partnership with RMCs anxious to participate in the replenishment process given their positive perception of the African Development Bank as "their Bank."

The Bank Group's Franchise Value

A recent client assessment report noted that the African Development Bank Group was "a preferred partner" for 84 percent of regional stakeholders among the bilateral and multilateral agencies funding African development.[15] Confidence in the Bank has increased dramatically since the mid-1990s. Its main strengths were assessed as: responsiveness in supporting key areas of national development strategies; its policies addressing fragility, the financial crisis, and climate change; its convening power and global advocacy of African positions; leadership and staffing by Africans; and its decentralization. Its main weaknesses were seen to be limited lending; excessive conditionality; insufficient involvement in policy formulation, advice, and knowledge exchange; cumbersome procedures; and governance structures seen by clients as dominated by nonregional influences.

The Bank Group has demonstrated its resilience, facing and overcoming serious challenges. In the mid-1990s, it lost the confidence of its financiers as well as its AAA credit rating. Through sustained effort over eight years, confidence was restored and the AAA rating regained. Following the global financial crisis, the Bank Group received the highest proportional capital increase, with its capital base tripling to nearly USD 100 billion. But it has not been immune to the fragility on the continent. Its headquarters was relocated from Abidjan to Tunis for a decade owing to civil conflict. In its temporary home, its staff experienced the impact of the Arab Spring in Tunisia. It successfully moved back to Abidjan in 2015. Under new leadership, it initiated a comprehensive reform program to decentralize and improve its business delivery model.

The Panel therefore strongly believes that the Bank Group should be instrumental in reinvigorating concessional finance for Africa. Moreover, the trust of its regional member countries puts it in a unique position to influence this process (Box 3.1).

The Bank Group and Concessional Finance in Africa

The Bank Group provides development finance to African countries through two windows.[16] The ADB provides nonconcessional finance to 16 countries, while the ADF provides concessional finance to 38 countries.[17] The ADF is funded primarily by grants from donor countries through a series of replenishments. These funds are provided to ADF-eligible countries in the form of grants and highly concessional loans (Box 3.2).[18] Loan repayments and transfers from ADB constitute additional sources of funding.

During the last decade (2005–14), financing from the ADB and ADF represented around 7 percent of official finance to Africa, while the ADF component amounted to around 4 percent of concessional finance

BOX 3.1 The Bank Group's Franchise Value

What role for the Bank Group?

- Drive economic integration of the continent by financing regional infrastructure and regional public goods.
- Provide an African perspective, generate knowledge, and support African-led strategies.
- Serve as a voice for development in Africa and for Africa internationally.
- Leverage its knowledge and resources through partnerships.

Why is the Bank Group the right institution for these roles?

- African credentials: an African focus, elected African president, strong presence, universal African membership, speaks the languages, and understands the culture.
- Preferred partner of choice and able to address politically sensitive issues with African governments and other stakeholders.
- Instrumental role in a wide range of continental initiatives and convening power with an African perspective on policy issues. The Committee of Ten African Ministers and Governors, established during the global financial crisis of 2008–09 with the United Nations Economic Commission for Africa and the African Union Commission, is an example of how the ADB mobilized influential regional policy dialogue.

BOX 3.2 ADF Country Classification and Lending Terms

Per capita income and creditworthiness are used to differentiate which countries have access to the Bank Group's concessional finance window, the ADF. In addition, debt sustainability is used to determine whether countries receive grants, highly concessional loans, or a combination of the two.

- ADF-only countries are not deemed creditworthy and their per capita GNI was below USD 1,215 per annum in 2015. Loans are provided with a 40-year term and costs consist of: a 0.50 percent commitment fee and 0.75 percent annual service charge. The loan grace period varies (5 or 10 years) depending on whether countries are above or below the average per capita GNI.
- Blend and gap countries have per capita GNI income above USD 1,215 per annum in 2015 and receive ADF funds. ADF highly concessional loans are provided with a 30-year term and 5-year grace period and costs include a 0.50 percent commitment fee, 1 percent interest rate, and 0.75 percent service charge. Blend countries are deemed creditworthy and receive ADB resources in addition to ADF resources, whereas gap countries are not deemed creditworthy and thus do not have access to ADB resources.
- ADB countries, deemed creditworthy for nonconcessional financing and whose income is above the operational cut-off, have access only to ADB resources. Over time, ADF countries graduate from being blend countries to being countries with access to ADB funds only.

(USD 21.3 billion). While ADF financing has been small at less than 0.1 percent of the GDP of ADF countries, it targets key areas such as economic infrastructure, regional integration, and governance (Box 3.3).

Over the last decade, ADB concessional finance represented only about 11 percent of multilateral aid and was a third of the size of the financing provided by each of the two largest multilateral institutions operating in Africa (IDA and the EU institutions). Notwithstanding the introduction of concessional donor loans in the most recent replenishment, the total replenishment size has progressively decreased from its peak of USD 9.5 billion in ADF-12 (2011–13) to USD 7.5 billion in ADF-13 (2014–16) to less than USD 6 billion in ADF-14 (2017–19). This decrease coincides with a simultaneous increase in the size of IDA resources for Africa, amounting to USD 45 billion in IDA-18.[19] In view of this growing imbalance, consideration needs to be given to increasing the volume of concessional flows channeled through the Bank Group. One solution, identified in a recent report, is to rebalance future funding across the MDB system.[20] Other solutions focus on increasing the size of ADF through leveraging existing financial resources and optimizing the balance sheet.

Options for Enhancing Financing

Two approaches for mobilizing additional resources have been recently used by other MDBs. One is the merger between the Asian Development Fund (AsDF) and the Ordinary Capital Resources of the Asian Development Bank (AsDB). The other is market borrowing, as planned by IDA. The ADF Lab reviewed the applicability of these approaches to the Bank Group. Based on this assessment, the Panel concludes that, at best, a modest increase can be secured in the size of the ADF. However, certain obstacles need to be overcome, including governance, and due consideration must be given to the potential downside risks for the Bank Group balance sheet.

BOX 3.3 Composition of ADF Financing (2005–14)

ADF funding over the last decade was distributed as follows:

- 67 percent to ADF-only countries (21 percent to 17 fragile states and 46 percent to 12 other countries). This share is higher than that of all concessional finance that went to ADF countries (55 percent), confirming the ADF's focus on the poorest countries.
- 13 percent to regional programs, which is higher than the 9 percent of all concessional finance provided for this purpose in Africa.
- A sectoral focus on economic infrastructure at country and regional levels (46 percent of financing)—more than 20 percentage points higher than bilateral and other multilateral donors.
- 16 percent for social sectors in ADF compared with bilateral and other multilateral donors (averaging 45 percent and 41 percent, respectively).

BOX 3.4 The AsDF–AsDB Merger

The merger, which was effective as of January 2017, was designed to address shifting demand and the mismatch in funding supply.

Shifting demand. An estimated 5 to 12 countries (of 29 AsDF recipients) were expected to graduate within the next decade, thereby reducing demand for concessional assistance and increasing demand for ordinary capital resources (OCRs).

Funding mismatch. With an equity-to-loan ratio of 26.9 percent (close to the threshold beyond which the credit rating would have been affected), lending volumes to AsDB countries were close to their maximum. On the other side, there was considerable unleveraged equity in the AsDF window, with an equity-to-loan ratio of 112.5 percent.

By adding AsDF's equity of USD 34.6 billion to AsDB's equity of USD 18.3 billion, the merger raised overall lending and grant capacity by up to 40 percent, from USD 3 billion a year for AsDF (concessional loans and grants) and USD 10 billion for OCRs (loans, guarantees, equity investments) to a combined total of USD 15–18 billion. AsDB's AAA rating has been retained on account of the increased equity combined with a higher targeted equity-to-loan ratio of 37–40 percent, to offset the increased riskiness of the combined portfolio.

Three points stand out. First, the merger did not require changes in governance because AsDF is a window of AsDB and not a separate legal entity. AsDF equity could thus be transferred to ordinary reserves without affecting shareholder paid-in capital, the basis for voting rights. Second, the creditworthiness of AsDF borrowers had improved significantly over the years, making borrowing against the loan book a feasible option. Third, careful preparation and review were part of a lengthy process, with close to two years elapsing from proposal to implementation, allowing for broad consultations with all stakeholders.

Prospects for a Merger of the ADF and ADB

The highlights of the AsDF–AsDB merger are described in Box 3.4; these are similar to those at the Inter-American Development Bank, which also merged its concessional and nonconcessional windows.

Overall, a merger of ADF and ADB requires preconditions that are likely to take time.[21]

- Since the ADF and ADB are separate legal entities, a merger would require realignment in shareholdings and voting rights in the combined entity. Given the lack of success with reforming governance within the ADF alone (previous section), any merger would likely take a long time.
- Demand for concessional ADF resources will remain strong for the foreseeable future. The graduation trajectory for the ADF is much slower, with 27 of 38 ADF countries currently having access only to the ADF.
- In principle, a merger of the ADF and ADB should yield synergies and expand funding capacity given the potential to borrow against the ADF's balance sheet. But the extent of this leverage will also affect the credit rating of the merged entity. Accordingly, the Panel recommends that the Bank Group's management should carefully assess the likely impact of the proposed merger on the institution's AAA rating.

The Market Borrowing Option of the International Development Association

The highlights of IDA's market borrowing option are in Box 3.5.

BOX 3.5 Market Borrowing by the International Development Association

IDA obtained its first credit rating of AAA from two rating agencies in September 2016, which will enable it to generate three dollars of financing commitments for every one dollar from partner contributions, up from the 2:1 ratio for IDA-17.

The key factors underpinning the AAA credit rating were a high assessment of capital adequacy based on moderate borrower quality, strong risk asset coverage, and low leverage; a very high assessment of liquidity; medium strength of members' support given the high creditworthiness of its shareholders; and long history of successful replenishments—despite the lack of contractual support in the form of callable capital. The big risk was in not obtaining an AAA rating, which would have relegated IDA to the second rung relative to its multilateral development bank peers, with concomitantly higher borrowing costs.

IDA preferred a market borrowing to the merger option, even though the latter would have involved lower borrowing costs (estimated at 30–35 basis points) because a merger would have been more complicated and time-consuming. Higher transaction costs will arise from IDA being a first-time issuer with a limited history of issuance and no track record of investor relations.

Given IDA's experience, the following key factors are likely to affect the ADF's credit rating:

- ADF's lower borrower quality and more limited graduation prospects (already identified in the merger option) would also be applicable to market borrowing.
- Particularly over the next few years, ADF's liquidity situation will be hampered by several factors that lower its internally generated resources—a fact highlighted during the recent ADF-14 replenishment. These factors include greater dependence on earnings from its investment portfolio at a time of low yields in advanced economies; lower transfers from the nonconcessional window, ADB; ADF loans being offered at longer maturities and lower interest rates; and legacy issues such as loan write-offs under the Multilateral Debt Relief Initiative being a bigger share of the ADF's loan portfolio.
- The strength of member support. The ADF may be perceived less strongly than IDA on this, because IDA is a much larger global institution with a more diversified base of nonborrowing members. IDA is also viewed as one of the most efficient concessional lending institutions.

These factors suggest caution in pursuing the market borrowing option for ADF, particularly if an AAA rating is not secured. But market borrowing even with an AAA rating would require a move to moderately concessional loans to maintain ADF's financial sustainability, which would cause difficulties for ADF countries unable to cope with such terms (as discussed in Chapter 2). The Panel believes that ADF is valuable in its current form as a stable source of funding, particularly for fragile states. It should therefore continue to provide grants and highly concessional loans to all eligible countries in line with the rules negotiated at the recent ADF-14 replenishment.

To conclude, scaling up ADF by emulating the merger and market borrowing options is unlikely to yield large benefits until the preconditions on governance and improved creditworthiness of ADF countries are met. The Panel recommends that ADF be retained in its current structure with ADB management switching attention to the much larger payoff for eligible ADF countries from designing and implementing the Big Bond as a separate window, as discussed in the next chapter.

The success of the Big Bond should ultimately be measured by the transformative way that it propels Africa toward self-reliance and self-financed growth. Donors will be signaling their commitment to maintaining Africa's growth momentum with a big push on infrastructure and human capital, while reducing their own fiscal burden

4

THE BIG BOND

There is an urgent need for increased investment and related development expenditures throughout Africa. Immediate action on a Big Bond issue of USD 100 billion would make an important contribution to reducing poverty in ADF countries. Equally important is the signal transmitted by the Big Bond: that Africa is open for business, that donors recognize Africa's need for a big push on infrastructure and human capital even as the donor fiscal burden is lowered, and that African leaders must take primary responsibility for the continent's future.

Implementing the Big Bond will require the creation of a new financing facility within the Bank Group. The key design and operating principles for this facility are described here. Appendix 4 contains a Q&A on the Big Bond, discussing the underlying motivation and why now is a particularly appropriate time.

Key Design Principles

The facility would support selected African countries by providing MCLs for national and regional projects that can accelerate growth prospects but for which commercial financing would not be appropriate on cost and maturity grounds. It would be designed with the idea of having an "open architecture" that would crowd in new donors and draw on the implementing capacity of a large number of public and private institutions working in Africa.

- Selectivity would be a key principle: Each project would be assessed on individual merit and the country's macroeconomic fundamentals supported through an EPD. Not all African countries would therefore benefit directly through national projects.
- Funding would be provided to national governments and to regional public, private, or public–private institutions that have the ability to borrow funds.
- Borrowing countries, institutions, or project vehicles would need to demonstrate their ability to service the MCLs. Many of Africa's existing institutions with credible track records are likely to be used as implementing institutions.

Target Donors

The initial commitments sought from donors would aim to support a funding target of USD 100 billion. The facility for issuing the Big Bond should be designed to be open to accepting commitments and guarantees from sovereign donors and nonprofit entities such as foundations and social impact investors.[22]

For existing donors, this would provide an opportunity to frontload ODA to Africa while simultaneously lowering their fiscal burden. For potential donors considering support to the Bank Group (including Australia, Malaysia, New Zealand, Poland, Russia, and Singapore), this financing structure would encourage participation in a pooled multilateral facility rather than deploying new bilateral trust funds or investing in building capacity in bilateral aid programs in Africa. For existing donors with

trust funds (China, India, and Japan), the facility could form a collaborative platform and an opportunity to make further contributions.

Target Investors

The target investors for the bond would be financial institutions looking for stable long-term returns, such as pension funds, insurance companies, and sovereign wealth funds. The objective would be to develop a core set of institutional investors that would begin to invest African savings. But given the small size of the pool of long-term savings in Africa, the initial issuance would also target similar institutions in OECD and emerging market countries.

Use of Funds

Since MCLs need to be repaid, the projects financed would need to generate revenues. It is therefore expected that a significant proportion of the USD 100 billion raised would be spent on infrastructure.

Infrastructure spending in Africa has increased over the last decade but remains well short of needs. The Infrastructure Consortium for Africa (ICA)—a partnership initiated by the G8 in 2005 and hosted by the ADB—notes that commitments for infrastructure reached USD 83.4 billion in 2015 or 3 percent of African GDP. Of those commitments, 33 percent were from national budget allocations, 57 percent by bilateral and multilateral financiers, and 9 percent by the private sector.[23] By sector, 42 percent each were committed to transport and energy, 10 percent to water, 3 percent to ICT, and 3 percent to multisectoral and other projects. Despite the increasing levels of infrastructure financing, there is still a significant backlog of unfunded priority projects. So, a greater focus on financing priority infrastructure projects would be logical. Funding shortfalls are particularly acute in two areas.

First, regional infrastructure is underfunded. Priority regional infrastructure has already been identified through a lengthy prioritization process under the Programme for Infrastructure Development in Africa (PIDA), a partnership hosted by the Bank Group.[24] Needs for continental infrastructure investment for energy, transport, transboundary water, and ICT are estimated at USD 360 billion for the period to 2040, with 51 projects costing USD 67.9 billon considered to be the Priority Action Plan (PAP) up to 2020. Sixteen megaprojects with the potential to transform the continent have been identified for fast-tracking, and five are expected to be completed in the next few years (Box 4.1). While some funding has been made available for regional projects (in 2015, USD 3.4 billion was committed including USD 1.2 billion for PIDA PAP projects), considerable additional funding is required.

Second, infrastructure project preparation is costly, lengthy, complex, and risky in Africa, and the availability of bankable projects remains a concern. A key constraint is that sufficient financing is not available for high-quality project preparation.[25] While project design costs are a modest proportion of total project costs (5 percent), their absolute size can be significant for larger projects. Against USD 0.2 billion in project preparation funds available in 2013, the Bank Group estimated project preparation needs of around USD 3.1 billion just for PIDA PAP projects, a financing gap of USD 2.9 billion in 2013.

Infrastructure financed through the Big Bond would be expected to reflect current international best practice and to meet rigorous environmental and social safeguards. This is consistent with the increasing focus on climate-resilient infrastructure in Africa. Increasingly, the quality of infrastructure is a concept that incorporates elements of economic efficiency, social inclusion, safety and resilience, environmental sustainability, as well as the convenience and comfort seen as vital for sustainable development.

To the extent that the Big Bond facility will give case-by-case consideration to projects for which MCLs are provided, it could also consider financing noninfrastructure activities. Two such activities are highlighted due to their potential importance. First, institutional capacity building for the EPD to be successful is important; this could include investments in improving fiscal and public financial management systems. Second, investments in human capital are needed to better prepare the African workforce for participating in job opportunities. To the extent that such projects would not directly generate revenues, consideration would need to be given to other sources for funding MCL repayments.

Implementing Agencies

The Bank Group should coordinate the issuance of the Big Bond and assume primary responsibility for allocating funds in line with newly established selection criteria. Project execution should involve the ADB (among the largest financiers of regional projects in Africa—Appendix Figure 5.1) as well as the many institutions in Africa, some of which were established with its support, such as Africa 50. To accelerate project implementation, consideration should be given to contracting out to the private sector or public–private partnerships.

Outcomes

Development outcomes from the Big Bond would arise from the outputs of the projects financed; recent

BOX 4.1 PIDA Priority Action Plan Projects

PIDA has identified 51 cross-border infrastructure projects comprising more than 400 actionable sub-projects across four main infrastructure sectors, namely energy, transport, transboundary water, and ICT. The estimated total cost of project implementation is USD 360 billion up to 2040. The table below indicates the priority projects up to 2020.

SECTOR	NUMBER OF PROJECTS	COST IN USD BILLION
Transport	25	25.4
Energy	15	40.3
TWR	9	1.7
ICT	3	0.5
Total	51	67.9

During the 2014 Dakar Financing Summit, 16 megaprojects with the potential to transform the continent were identified for fast-tracking (see list in Appendix Table 5.1). Five of these will be completed in the next few years: the Abidjan-Lagos Corridor, the Dakar-Bamako Rail Link, two hydro-electric dams—Sambangalou in Guinea and Ruzizi III in Rwanda, and the road from Serenje to Nakonde in Zambia.

REGION	NUMBER OF PROJECTS	COST IN USD BILLION
Continental	7	3.0
North Africa	2	1.3
West Africa	16	6.2
Central Africa	9	12.6
Southern Africa	6	12.6
East Africa	11	23.3
Total	51	67.9

Source: PIDA (2016a).

experience of African projects shows that improved infrastructure is good for growth, human development, and private sector development.

Sustainable, inclusive, and high-quality infrastructure is of cross-cutting importance to increasing economic growth, attaining the Sustainable Development Goals (SDGs), and meeting the ambitions of the Paris Agreement (2015 COP21). Across Africa, infrastructure contributed almost 1 percentage point a year to per capita economic growth from 1990 to 2005, whereas the deterioration in power infrastructure over the same period caused a slowdown in per capita growth.[26] Further simulations have suggested that catching up with the regional leader in infrastructure, Mauritius, could result in a 2.2 percentage point increase in per capita growth in the region.[27]

Improved infrastructure can generate strong human development ouctomes on the continent:

- Increased access to improved water and sanitation saves time, especially for women, and slows the spread of water-related diseases such as diarrhea, which remains a major cause of infant mortality and malnutrition.
- Improved access to electricity has major benefits for the delivery of quality health and education services and will boost the productivity of small businesses.
- Road networks greatly improve connectivity and access to global and local markets, primarily benefiting the continent's 15 landlocked economies.
- Finally, improved telecommunications allow the democratization of access to information and reduce transport costs by enabling remote transactions.

The success of the Big Bond should ultimately be measured by the transformative way that it propels Africa toward self-reliance and self-financed growth. Donors will be signaling their commitment to maintaining Africa's growth momentum with a big push on infrastructure and human capital, while reducing their own fiscal burden. The private sector worldwide will mobilize as they receive the message that Africa is seriously open for business. And most important, African leaders will be committing to improved economic governance that will pave the way to regional and national self-reliance.

The private sector, domestic and foreign, needs to be convinced that policies are predictable and credible, that there is a level playing field, and that political and macroeconomic stability are assured over the long haul. Only then will it be willing to make the long-run commitment to support growth by investing in and transferring technology to Africa

5

EFFECTIVE PARTNERSHIPS AND IMPROVED KNOWLEDGE SERVICES TO MAXIMIZE THE IMPACT OF CONCESSIONAL FINANCE

Strong leadership, governance, and institutions are needed for Africa's transformation and self-reliance. African institutions and development partners can support these efforts through the enhanced policy dialogue (EPD). The Bank Group has a key role, but it needs to ramp up its knowledge services.

Self-reliance and Leadership

The economic priorities for African leaders include:

- Creating a robust foundation for long-run growth and development that will attract foreign direct investment to areas other than natural resources and will generate jobs for Africa's youth while transferring technology.
- Placing public debt and current account balances on a sustainable trajectory.
- Ensuring that natural resource wealth is used to support development and is shared across generations.

Experience from emerging markets underlines the crucial importance of strong leadership, governance, and institutions. The private sector, domestic and foreign, needs to be convinced that policies are predictable and credible, that there is a level playing field, and that political and macroeconomic stability are assured over the long haul. Only then will it be willing to make the long-run commitment to support growth by investing in and transferring technology to Africa. Country priorities include better and more transparent management of public finances, and a big push on infrastructure and regional integration in trade and finance to compensate for the small size of most economies.

While there has been considerable focus on mobilizing more domestic revenue in Africa, this needs to be accompanied by assurances of value for money in the public finance realm, including the transparent selection and implementation of public investment projects.

Continental Vision and Partnership with the International Community

Beyond national priorities, there is also a continent-wide vision for Africa's transformation: Agenda 2063. The African Union and the New Partnership for Africa's Development provide oversight for the implementation of this agenda.

Steady progress toward the goals set in Agenda 2063 will gradually transform the continent. However, one of the many challenges facing Africa is the need for reform in economies whose development potential is far greater than their actual performance in the past decade or so. A related concern is the need to move Africa from the donor-dominated development agenda to a genuine partnership in addressing the major development challenges that will confront the continent for several more decades.

ODA has played a major role in meeting the external financing requirements of Africa. As recently as 2000, net inflows of ODA were equivalent to 84 percent of the total net external financing requirements of ADF countries. But its importance has declined steadily since: By 2010 it accounted for 74 percent, and by 2015, 34 percent. As a recent report of Germany's

Federal Ministry for Economic Cooperation and Development put it:

"African ownership must be strengthened and the days of 'aid' and of 'donors and recipients' put behind us. The [European Union] and its member states want to engage in a partnership between equals. That means reaching a new agreement on political, economic, and social and cultural cooperation. Our starting point will be the African Union's Agenda 2063."[28]

The Panel strongly endorses the position taken by the German Federal Ministry. Further, the Panel believes that the ideas expressed in this report are complementary to Germany's ongoing efforts under its presidency of the G20 and the EU's forthcoming new Africa strategy.

The Bank Group: A Key Partner

The Bank Group is well positioned to be a major partner in realizing the ambitious goals of Agenda 2063. It has articulated a bold agenda in its Ten Year Strategy for the activities to be undertaken in 2013–22. The strategy is designed to place it at the center of Africa's transformation and to improve the quality of Africa's growth. The strategy is supported by five operational priorities—the High 5s[29]—that are well aligned with the Sustainable Development Goals.

This program is ambitious and will require a hefty increase in the Bank Group's knowledge and financial services. As complements to the financing solutions discussed, there is a need to substantially increase knowledge services tailored to the circumstances of each country. As a trusted partner, the Bank Group can play a leadership and catalytic role by ramping up its delivery of knowledge services and using its franchise value as a convener in partnership with other African entities and with the international community in conducting the EPD.

From a "Project" Bank to a "Knowledge" Bank

The Bank Group needs to complete its transition from a project bank to a bank whose knowledge services are an equally high priority.[30] After 40 years of its existence, the Bank Group remains largely a "project bank" providing loans and equity for the economic advancement of the RMCs. In the 2000s, it began to emphasize the importance of complementing its financing with knowledge services. In 2007, it established the Chief Economist's Complex and set itself the goals of enhancing its knowledge, research, and dissemination capacity and of providing intellectual leadership on development issues in Africa, including country analysis, cross-country comparisons, and best practice identification and dissemination. As part of the new 2016 business delivery model, the Complex has been re-organized as the Chief Economist and Vice Presidency for Economic Governance and Knowledge Management. Its mandate has been vastly expanded to provide leadership on macroeconomic management, natural resources, governance, and budget support.

These developments notwithstanding, the bulk of the Bank Group's human and financial resources continues to be applied to the preparation and implementation of projects and programs. Less than 5 percent of the operational budget expenses has been spent on knowledge services in recent years. This contrasts sharply with 12 percent at the Inter-American Development Bank, 32 percent at the Asian Development Bank, and 33 percent at the World Bank.

The Panel believes that the Bank Group should take early action to execute the agenda for Enhanced Policy Dialogue by significantly ramping up its knowledge capabilities. The Bank Group needs to clearly define the scope of its role in EPD to decide the right mix of knowledge programs and products at the continental, regional, national, and sectoral levels. This will respond to the growing demand among RMCs for policy advice and will build on the Bank Group's franchise value as a trusted African institution. In this quest, the Bank Group must collaborate with the IMF, the World Bank, and other development partners.

Finally, as part of its knowledge mandate, the Bank Group should take a larger role in promoting the development of knowledge-based institutions in each of its five regions. As experience in other global regions indicates, an important part of any strategy to build knowledge-based services within countries and regions is to ensure that there are opportunities to draw on existing knowledge institutions, such as universities, think-tanks, and not-for-profit bodies. By contracting knowledge work to these institutions, and through staff exchanges, the Bank Group can help in building these capacities throughout Africa.

The Panel believes that the Bank Group should take early action to execute the agenda for Enhanced Policy Dialogue by significantly ramping up its knowledge capabilities. The Bank Group needs to clearly define the scope of its role in EPD to decide the right mix of knowledge programs and products at the continental, regional, national, and sectoral levels

APPENDIX 1
ABOUT THE ADF POLICY INNOVATION LAB

The ADF Policy Innovation Lab (the Lab) was created, under the Bill & Melinda Gates Trust Fund, to support the efforts of the African Development Bank Group for reinvigorating concessional finance to respond to the changing reality of its clients.

Positioned as an independent think-tank, the objectives of the Lab are to examine the future of the ADF and its strategic positioning vis-à-vis other development institutions as well as to amplify the voice of Africa in the debate about the future of concessional finance.

The Lab comprises a High Level Panel and an Advisory Team as indicated in this report.

The High Level Panel on Transforming Trust in the AfDB Group into Influence

Nancy Birdsall

Nancy Birdsall is a senior fellow and president emeritus of the Center for Global Development where she served as founding president for its first 15 years from 2001 to 2016. From 1993 to 1998, she served as executive vice president of the Inter-American Development Bank, where she oversaw a USD 30 billion public and private loan portfolio. Before that she worked for 14 years in research, policy, and management positions at the World Bank, including as director of the Policy Research Department. Prior to launching the Center, she served for three years as senior associate and director of the Economic Reform Project at the Carnegie Endowment for International Peace, where her work focused on globalization, inequality, and the reform of the international financial institutions.

Luísa Diogo

Luísa Dias Diogo was the first female Prime Minister of Mozambique from February 2004 to January 2010. Before becoming Prime Minister, she was Minister of Planning and Finance, and she continued to hold that post until February 2005. In August 2010, UN Secretary-General Ban Ki-moon appointed her to the High-Level Panel on Global Sustainability, which was co-chaired by presidents Tarja Halonen of Finland and Jacob Zuma of South Africa. In 2012, she became the chairperson of Barclays Bank in Mozambique. In 2016, she was appointed by Erik Solheim, the Chairman of the Development Assistance Committee, to serve on the High Level Panel on the Future of the Development Assistance Committee under the leadership of Mary Robinson.

Ngozi Okonjo-Iweala

Ngozi Okonjo-Iweala is a Senior Adviser at Lazard and Board Chair of Gavi. She was previously the Minister of Finance in Nigeria and Coordinating Minister for the Economy. As Minister of Finance, she spearheaded the negotiations with the Paris Club of Creditors that led to wiping out USD 30 billion of Nigeria's debt. Prior to her government service, she had spent 21 years at the World Bank, rising to the position of Vice President and Corporate Secretary. From December 2007 to August 2011, she was Managing Director of the World Bank where she had oversight responsibility for the World Bank's USD 81 billion operational portfolio in Africa, South Asia, Europe, and Central Asia. She also spearheaded initiatives to assist low-income countries during the food crisis and later the financial crisis, and chaired the raising of USD 49.3 billion in grants and low-interest credit for the world's poorest nations.

Mary Robinson

Mary Robinson is President of the Mary Robinson Foundation: Climate Justice. She served as President of Ireland from 1990 to 1997 and UN High Commissioner for Human Rights from 1997 to 2002. She is a member of the Elders and the Club of Madrid and the recipient of numerous honors and awards including the Presidential Medal of Freedom from President of the United States Barack Obama. She is also a member of the Lead Group of the Scaling Up Nutrition (SUN) Movement. Between March 2013 and August 2014, she served as the UN Secretary-General's Special Envoy for the Great Lakes region of Africa. In July 2014, she was appointed the

United Nations Secretary-General's Special Envoy for Climate Change.

Ngaire Woods

Professor Ngaire Woods is the inaugural Dean of the Blavatnik School of Government and Professor of Global Economic Governance at Oxford University. Her research focuses on global economic governance, the challenges of globalization, global development, and the role of international institutions. She founded the Global Economic Governance Programme. She is co-founder (with Robert O. Keohane) of the Oxford-Princeton Global Leaders Fellowship Programme. She led the creation of the Blavatnik School of Government and, before her appointment as Dean, served as the School's Academic Director. She has served as an Advisor to the IMF Board, to UNDP's Human Development Report, and to the Commonwealth Heads of Government.

The Advisory Team

Aloysius Uche Ordu. Lead Advisor

Aloysius Ordu is CEO, Omapu Associates LLC, an advisory services, fund raising, and consultancy firm. He is also senior adviser at one2fiveadvisory—a boutique financial services firm—and he serves on the Board of Partnership for Transparency Fund.

He was previously Vice President at the African Development Bank, accountable for Country and Regional Operations and Policies, Resource Mobilization & Partnerships from March 2009 to November 2011. He was a member of the senior management team that led the ADB's general capital increase (tripled to USD 100 billion) and the record 12th replenishment of the ADF (USD 9.5 billion). Prior to that, he was Regional Director for East Africa (May 2007–February 2009).

Aloysius previously worked at the World Bank for 22 years, where he served in various capacities, including Director of Operations Policy and Country Services, Director of Operations Quality in Latin America and the Caribbean, and other managerial positions in the East Asia and Middle East regions. Prior to the World Bank, he worked in the private sector—at the Midland Bank Group and at the Economist Intelligence Unit, London, UK. He holds a PhD in Economics (Sussex), MSc in Quantitative Economics (Bristol), and BSc in Economics & Law (Wales), UK.

Brian Pinto. Advisor

Brian Pinto's expertise is in economic policy in emerging markets, honed by three decades of experience. He was Chief Economist, GLG, Emerging Markets (2013–15) where he tracked 15 major emerging markets on foreign exchange and interest rates, advised portfolio managers on trading strategy, and analyzed country fundamentals against a backdrop of unprecedented easing by developed market central banks in an environment marked by fears of deflation and secular stagnation.

Prior to that, he served in various capacities as an economist at the World Bank. He lived in Poland and Russia during critical periods in their economic transition in the 1990s. He served as Adviser to the Managing Director for Africa, Europe and Central Asia, and South Asia during the global financial crisis (2008–09), and then as Senior Adviser in the Poverty Reduction and Economic Management network specializing in growth policy and sovereign debt.

He holds a PhD in Economics (University of Pennsylvania, USA), and degrees from the Indian Institute of Management, Ahmedabad, and Loyola College, Madras University, India. His publications have appeared in the Brookings Papers on Economic Activity, the Economic Journal, Journal of International Economics, The Review of Economic Studies, and other professional journals. His second book, *How Does My Country Grow? Economic Advice Through Story-Telling,* was published by Oxford University Press in 2014.

Gaiv Tata. Advisor

Gaiv Tata is Director of Growth Solutions for Development LLC, a firm that provides support to governments, private sector entities, and multilateral agencies to further their financial and private sector development agendas. He also serves as Senior Advisor to the CEO of the World SME Forum (endorsed by the G20 Finance Ministers and Central Bank Governors) that aims to improve the growth and impact of SMEs globally.

He is a Visiting Fellow at the Center for Global Development and was a member of the CGD Working Group that published the report on the Unintended Consequences of Anti-Money Laundering Policies on Poor Countries.

Previously, he worked at the World Bank for about three decades. From July 2011 to June 2014, he was Director for Financial and Private Sector Development in the Africa Region and Director for the Global Practice on Financial Inclusion and Infrastructure. He served in diverse operational, analytic, and fund raising positions, and led policy dialogue and country strategy formulation, provided implementation support for the Bank's activities in Uganda through a field-based assignment, and was a member of the team that prepared the 2005 World Development Report on improving the investment climate. He was a member of the management team that led two highly successful rounds of fund raising for the International Development Association—the World Bank's fund for the poorest.

Russell Cheetham. Advisor

Russell J. Cheetham, a Fulbright scholar in the 1960s, subsequently had a distinguished career at the World Bank for 27 years, mainly in operations in East Asia and the Pacific, South Asia, and the former Soviet Union. Before his retirement in 1996, he was Vice President of the East Asia and Pacific Region where he oversaw the Bank's lending and advisory operations of the Bank in the region, which at the time involved a loan portfolio of USD 25 billion and new yearly lending of about USD 5 billion. He has traveled extensively in Asia, Africa, Eastern Europe, and the former Soviet Union and lived in Papua New Guinea (1961–66), the Philippines (1975–77), Indonesia (1980–84), and Moscow (1991). He is the recipient of various awards, including the Bintang Jasa Pratama First Class conferred by the Government of Indonesia.

Shortly after retiring from the World Bank, he established the Asia-Pacific Investment Services Corporation that provided advisory services to businesses in Asia, Europe, the US, and the former Soviet Union (including the Ansaldo Corporation in Italy, the Frank Russell Company in the United States, Daewoo Corporation in Korea, and Garuda Airlines in Indonesia). He undertook advisory work in Southeast Asia for a number of governments and international organizations (including the Australian Government and the Asian Development Bank), and for several years he was retained as Senior Economic Advisor to the Government of Timor-Leste. He also undertook work in Afghanistan for the U.S. Government, and for the African Development Bank. His assignments with the ADB included extensive travel in Africa (Burundi, Ethiopia, Ghana, Nigeria, Sudan and South Sudan, and Zimbabwe) and consultation with political and business leaders that culminated in a series of major reports on the development of infrastructure in these countries.

He previously served as an adviser to the Organisation for Economic Co-operation and Development in Paris on "fragile states." For a number of years, he held the position of Managing Director of the SC&M Investment Management Corporation, an asset management and investment banking company headquartered in Chicago. He was also a member of the board of a publicly traded company in the United States, and in that capacity was chairman of the Board's Audit Committee.

Benoit Chervalier. Advisor

Benoit has over 19 years of executive-level experience in the international financial field in public and private organizations. He is currently Chairman and Co-Founder of one2five advisory, a merchant bank dedicated to sovereign financial advisory services in Africa. He was previously Director of Rothschild & Cie's Sovereign Franchise for Africa.

Previously, he served as Head of the Bank Group's Resource Mobilization and Allocation team from 2010 to 2014, a period that included the ADF-13 replenishment that successfully raised USD 7.5 billion in 2013. From 2006 to 2010, he worked at the French Treasury as Head of the Evaluation Office responsible for assessing development projects and programs. In that capacity, he was elected as Vice President of the OECD's DAC Peer Group in charge of the evaluations of Multilateral Development Banks.

Prior to that, he worked at the German Federal Ministry of Finance in Berlin in the International Financial Division with responsibility for Multilateral Development Banks and G8/G20 issues. In 2005 and 2006, he was a recipient of the German Federal Ministry of Finance fellowship. Before getting a fellowship from the German Marshall Fund of the US, he was Deputy Head of the Division of Foreign Investments in France at the French Treasury and Advisor to the Minister of Education on international matters. He holds an MSc in Economics from Sciences Po and an LMD from the Kennedy School of Harvard University.

Cristina Duarte. Advisor

Cristina Duarte has 30 years of professional experience, mostly in leadership and senior management positions in government and in the private sector. She served as Cape Verde's Minister of Finance, Planning and Public Administration from 2006 to 2016. Prior to that, she was the Director of a reform program on private sector development and competitiveness—an experience that was preceded by her service as Director for Planning and Studies in the Ministry of Agriculture and Rural Development.

In the private sector, she served as Vice President of Citibank. Before then, she provided advisory services to several international financial organizations and nongovernmental organizations. Over her long career, she developed strong leadership and strategic management skills, playing an instrumental role in public policymaking and in the private sector. She has been involved in numerous international programs representing Cape Verde or the private sector.

She holds a Masters in Business Administration/International Management (Arizona, USA) and a Bachelor of Art in Economics (Instituto Superior de Economia, Lisbon, Portugal).

Lauréline Pla. Coordinator

Lauréline Pla is a Senior Resource Mobilization Officer in the Finance Complex of the African Development Bank. Prior to her current position, she worked as Economist on the African Economic Outlook in the Chief Economist Complex for over six years. In that capacity,

she coordinated the production of country notes and analyzed recent economic, social, and political developments and short-term prospects for the 23 Francophone African countries. Prior to joining the ADB, she worked as a consultant for the Trade, Finance, and Economic Development Division of the United Nations Economic Commission for Africa in Addis Ababa, where she contributed to the preparation and publication of flagship studies and technical papers.

She holds a MSc in economics from the University Pierre Mendès France, Grenoble (France) and is currently a PhD Candidate in Economics with the Center of Studies and Research on International Development (CERDI) in University of Auvergne (France).

Luisa Teixeira Felino. Young Professional

Luisa Teixeira Felino joined the African Development Bank as a Young Professional. Following completion of her first rotation in the Private Sector Department of the ADB, she recently joined the Chief Risk Officer's Department. Prior to joining the Bank, she worked as an Economist in the Economics and Research Department of Banco BPI (Portuguese Investment Bank). In this role, she worked on global macroeconomic issues and served as country economist for Angola and Mozambique. Previously, she had gained extensive experience as a Research Analyst at the World Bank (in the Economic Policy Department of the Latin American and Caribbean Region) and at the European Central Bank (in the Directorate Economic Developments). In addition, she gained financial sector experience working as a Credit Risk Analyst at Santander Bank.

She holds a masters degree in Project Analysis, Investment and Finance from the Economics Department of the University of York, UK, and a degree in Economics from the Portuguese Catholic University, with an exchange program at Bocconi University.

APPENDIX 2
AFRICA FACES MAJOR CHALLENGES IN THE NEXT TWO DECADES

With 420 million people in absolute poverty, Africa now accounts for more than 50 percent of poverty in the world.

Given the very uneven growth among African countries during 2000–15, it is perhaps not surprising that there was a substantial increase in the number of Africans in absolute poverty.[31] Although the incidence of absolute poverty in Africa declined from 47 percent of the population in 2000 to 36 percent in 2015, the number of people in absolute poverty increased from about 370 million in 2000 to about 421 million in 2015 as a result of the continued rapid growth in the population and labor force during this period (Appendix Table 2.1).

Because of substantial variations in the development performance of individual countries during 2000–15, the incidence of absolute poverty in Africa varies widely. Nigeria and the Democratic Republic of Congo account for one-third of the poverty in Africa, with 89 million and 56 million below the absolute poverty line respectively. In eight countries, 60 percent or more of the population is in absolute poverty: Benin, Burundi, Côte d'Ivoire, Democratic Republic of Congo, Guinea-Bissau, Madagascar, Malawi, and Zambia. And in nine countries, the incidence of poverty is less than 10 percent. These include five of the six countries of North Africa and in Sub-Saharan Africa, Cape Verde, Gabon, Mauritius, and Seychelles. The West and East Africa Regions account for two-thirds of the population in absolute poverty, although the Central Africa Region has the highest incidence of poverty.

Continued rapid population and labor force growth compound the poverty problem.

After several decades of rapid population growth, people below the age of 25 now make up 60 percent of the African population (Appendix Table 2.2). Africa is currently adding about 30 million people a year to its population. With continued rapid population growth, the United Nations (UN) puts the African population at about 1.68 billion by 2030—an increase of 500 million during 2016–30 (United Nations 2016). The implications for expanding access to basic health and education services throughout the region are profound. Moreover, rapid population growth is translating into even faster growth in the urban population of Africa, as large numbers of people move from rural areas. About 40 percent of the population currently lives in urban areas, but the urban population is projected to be in the range of 830 million by 2030—about 50 percent of the population. A key concern about the rapid urbanization in Africa is the very high proportion of urban dwellers that live in slums. About 56 percent of the urban population (about 200 million people) in Sub-Saharan Africa lived in slums in 2014 (UN-Habitat 2016).

With rapid population growth for several decades, the African labor force has grown at close to 3 percent a year. As a result, there were 160 million new entrants into the labor force during 2000–15. Young people now account for a substantial share of the labor force. According to the International Labour Organization (ILO), 9 out of 10 working youth in Sub-Saharan Africa are poor or near poor (ILO 2015). The labor force is

APPENDIX TABLE 2.1 Incidence of Absolute Poverty in Africa

	POPULATION IN POVERTY (MILLION)			% OF TOTAL POPULATION IN POVERTY		
COUNTRY GROUP	2000	2010	2015	2000	2010	2015
ADF countries	339	376	399	58.6	49.1	45.3
ADB countries	30	23	22	14.0	9.0	7.9
Total Africa	369	399	421	46.5	39.2	36.3
Memo items:						
Sub-Saharan Africa	362	394	417	55.9	46.1	42.8
North Africa	7	5	4	4.7	3.0	2.5

Source: Prepared by the ADF Lab (2017b).

APPENDIX TABLE 2.2 Africa's Population and Labor Force Growth, 2000–30

INDICATOR	2000	2010	2015	2020	2030
Population by age group (% of total population)					
0–14 years	42.7	41.4	41.0	40.2	37.3
15–24 years	20.1	19.9	19.4	19.2	19.8
25–64 years	33.8	35.3	36.2	36.9	38.8
65+ years	3.4	3.4	3.5	3.6	4.1
Total	100.0	100.0	100.0	100.0	100.0
Labor force					
Labor force (millions)	311.0	408.5	472.4	546.2	718.5
Labor force growth (% p.a.)	2.6	2.8	3.0	3.0	2.8
Increase in labor force (millions)	7.6	11.0	13.5	15.7	19.4
Memo items:					
Total population (millions)	808.5	1,039.6	1,183.3	1,338.9	1,682.8
Population growth rate (% p.a.)	2.5	2.6	2.6	2.5	2.2

Source: Prepared by the ADF Lab (2017b).

projected to increase to about 720 million by 2030—an annual increase of about 3 percent over the 2015 level of about 470 million. Africa will need a strong recovery from the recent economic slowdown to create substantially more productive employment opportunities during 2017–30. However, low skill levels in the labor force, especially among young people, is an ongoing impediment to stronger economic growth. One of the most important challenges facing Africa today is the need to create productive employment opportunities for these new entrants into the labor force, and to improve skills within the existing labor force.

Six countries account for two-thirds of Africa's GDP. Only six African countries had economies with GDP in excess of USD 100 billion in 2015 (Appendix Table 2.3), three of which were in Sub-Saharan Africa (Nigeria, South Africa, and Angola), and three were in North Africa (Egypt, Algeria, and Morocco). These countries accounted for 66 percent of Africa's GDP in 2015, one-third of the population, and 25 percent of the poverty (with Nigeria accounting for 21 percent of African poverty and the other five countries accounting for 4 percent).

The small size of many African economies poses major development challenges. The domestic markets of many African countries are too small to produce high levels of sustained domestic-led growth. A majority of African countries have had to look to export-led growth to achieve strong economic performance. According to the African Development Bank (ADB), oil and other natural resource products accounted for more than 50 percent of export earnings for 19 African countries in 2014. There is a clear need for increased emphasis on regional integration of product, labor, and financial markets within Africa. However, progress on increasing regional integration within Africa has been slow in the past two decades. Cross-border trade within Africa is quite limited, with most African countries depending heavily on export markets outside Africa to generate foreign exchange earnings. Intraregional trade accounts for only 15 percent of the total external trade, compared with 60 percent in Asia, 70 percent in the European Union, and 54 percent in North America.

The IMF projects a slow recovery from the sharp downturn in economic growth since 2010.[32] Its October 2016 forecasts for GDP growth in the global economy

APPENDIX TABLE 2.3 Classification of 54 African Countries by Size of GDP in 2015

	NUMBER OF COUNTRIES			
REGION	GDP LESS THAN USD 20 BILLION	GDP USD 20–49 BILLION	GDP USD 50–99 BILLION	GDP MORE THAN USD 99 BILLION
Central Africa	6	2		
East Africa	8	2	3	
North Africa	1	2		3
Southern Africa	9	1		2
West Africa	12	2		1
Africa Region	36	9	3	6

Source: Prepared by the ADF Lab (2017b).

and in Africa have been used in this report for the economic outlook during 2017–21. The IMF projections indicate that GDP growth of the 38 ADF countries would average 4.3 percent a year in real terms during 2017–21—the same that prevailed during 2011–16 (Appendix Table 2.4). The IMF projects a modest recovery in GDP growth to an average of 3.7 percent a year for the 16 ADB countries in Africa. The total GDP of Africa is projected to grow at an annual average of 4 percent during 2017–21. The implication is that GDP growth for Africa would average about 3.8 percent a year during 2011–21, compared with 5.3 percent during 2000–10.

As a result, the number of people in poverty in Africa will increase further by 2021.

With continued weak economic growth and the African population expected to grow at an average of about 2.6 percent a year, the likelihood is very high that the number of people in absolute poverty in Africa will continue to increase. The analysis for this report suggests that about 435 million Africans would be in absolute poverty by 2021, even though the incidence of poverty would decline from 36 percent in 2015 to 32 percent by 2021. A continuing increase in the number of people in absolute poverty raises serious concerns about the social and political consequences, not only for Africa, but with the prospect of larger amounts of legal and illegal migration, for OECD countries as well.

To stop the ongoing increase in the number of people in poverty in Africa, the ADF countries will have to grow by at least 7 percent a year during the 2020s. For the purposes of this report, a High Growth Scenario has been developed to evaluate the implications for investment and savings requirements, and for required inflows of capital from official and private sources elsewhere in the world. It is assumed that during 2022–30 the ADF countries grow at an average of 7 percent a year and ADB countries grow at an average of 5 percent a year (Appendix Table 2.4). Africa's GDP would increase from USD 2.28 trillion in 2015 to USD 4.75 trillion in 2030 (both at 2015 constant prices), and it would then account for about 4 percent of global GDP, compared with 3 percent in 2015. In other words, Africa would continue to account for a very small share of global output.

With 7 percent growth in the ADF countries during 2022–30, the total number of people in absolute poverty in Africa would decline from 435 million in 2021 to about 406 million by 2030—a modest reduction from the 2015 level of 421 million. But the implication is that in the absence of a major push to improve access to and quality of health, education, infrastructure, and other services in both rural and urban areas, and increased emphasis on creation of productive employment opportunities for the rapidly growing labor force, it is highly unlikely that the first goal of the Sustainable Development Goals (SDGs) to "eradicate extreme poverty for all people everywhere" by 2030 can be met.

Investment requirements for 7 percent growth in the 2020s will be substantial.

For the ADF countries, gross investment would have to rise from 24 percent of GDP in 2021 to about 30 percent by 2030 (Appendix Table 2.5). In other words, gross investment increases from USD 315 billion in 2021 to about USD 1,120 billion by 2030 (at current USD prices).

To avoid unsustainable levels of dependence of foreign capital inflows, there will have to be a significant increase in national savings. Mobilizing national and foreign savings for this level of investment by 2030 poses a considerable challenge for Africa. National savings declined to 16 percent in 2015 (Appendix Table 2.5). The IMF has projected a weak improvement in national savings to about 19 percent of GDP by 2021, largely because of the impact of a slow recovery in export earnings on incomes and government revenues. It is assumed that the recovery in national savings continues during the 2020s and reaches 22 percent of GDP by 2030. Foreign savings would have to rise to about 7.6 percent of GDP by 2030. In other words, the net inflow of offshore funds would have to increase from USD 148 billion in 2015 to USD 520 billion by 2030.

A multipronged approach will be required to ensure that growth in Africa is broad-based and inclusive.

To ensure that there is no recurrence of domestic or external debt crises in Africa in the decade ahead, the case is compelling for promoting improved national savings throughout Africa and for ensuring access to financial savings by small and large business entities and individual entrepreneurs. The financial systems in Sub-Saharan Africa have had a lot of difficulty mobilizing deposits and, through intermediation, making them available to potential investors. As a result, the levels of bank lending to the private sector are low by comparison with other regions. In many cases, the problem

APPENDIX TABLE 2.4 GDP Growth Rates for Africa, 2000–30 (USD, constant prices)

COUNTRY GROUP	2000–10	2011–16	2017–21	2022–30
ADF countries	6.8	4.3	4.3	7.0
ADB countries	4.4	3.0	3.7	5.0
Africa	5.4	3.6	4.0	6.0

Source: Prepared by the ADF Lab (2017b).

has been compounded by heavy domestic borrowing by national governments that crowd out private sector access to debt financing by domestic financial markets. The result is that very little investment in Sub-Saharan Africa is done with bank credit or other forms of credit.

In addition to measures that improve the national savings performance, there is a need for increased action by governments in a number of other areas.

- Increase emphasis on regional integration for the 36 African countries with very small domestic economies. International experience indicates that such integration can foster improved economic opportunities and prosperity.
- With export-led economic growth being the only option for many of these small African countries for some years to come, increase emphasis on diversification of export products and more intraregional trade within Africa.
- Improve the operating environment for domestic and international business entities and individuals.
- Reduce the extent of illicit financial outflows from Africa—estimated to have been equivalent to 4.4 percent of GDP in 2013.
- Increase investment in country-specific and regional infrastructure.
- Increase emphasis on access to education at primary, secondary, and tertiary levels, given that the under-25 age group will increase from 715 million in 2015 to 960 million by 2030.
- Increase emphasis on skills development for the 460 million people already in the labor market in Africa, along with the 250 million new entrants into the labor market during 2016–30.

Such a program will require a much larger role for private sector activities.

If the GDP of ADF countries does grow at 7 percent a year in real terms during the 2020s, the total GDP for Africa would increase by USD 2.47 trillion during 2016–30 to a total of USD 4.75 trillion by 2030. A large share of the increase would come from expansion of private sector activities in agriculture, mining, manufacturing, and services. Somewhat incomplete information on investment by the private sector in Africa suggests that it has been in the range of 14–15 percent of GDP in recent years, with the public sector accounting for the remaining 7–8 percent of GDP. If there is to be a substantial increase in economic growth in Africa during the 2020s, gross investment will have to increase to about 30 percent of GDP (see Appendix Table 2.5). Assuming governments embark on substantial programs of investment in public infrastructure, it is likely that public investment could increase to 10 percent of GDP in the 2020s, which means that private investment would be in the range of 20 percent of GDP—a substantial increase over recent levels. Early action on improving the operating environment for the private sector will play a key role in facilitating increased investment in Africa.

The program will also require increased access to external financing from both official and private sources.

The external financing requirement for Africa increased from USD 85 billion in 2010 to USD 190 billion by 2015, primarily because of the sharp decline in international commodity prices (Appendix Table 2.6). If 7 percent growth is realized by the ADF countries in the 2020s,

APPENDIX TABLE 2.5 Gross Investment and Savings Requirements, 2000–30 (USD millions, current prices)

COUNTRY GROUP	2000	2010	2015	2021	2030
Gross investment					
ADF countries	36	162	220	315	1,117
ADB countries	83	301	288	394	908
Africa	119	463	508	709	2,025
National savings					
ADF countries	37	156	158	260	760
ADB countries	87	273	202	329	745
Africa	124	429	360	589	1,505
Foreign savings					
ADF countries	–1	6	62	55	357
ADB countries	–4	28	86	65	207
Africa	–5	34	148	120	520
Investment and savings as % of GDP					
Gross investment	18.1	23.8	22.3	23.6	29.6
National savings	18.9	22.1	15.8	18.8	22.0
Foreign savings	–0.8	1.7	6.5	4.8	7.6

Source: Prepared by the ADF Lab (2017b).

APPENDIX TABLE 2.6 Sources of External Finance for Africa, 2010–30 (USD millions, current prices)

COUNTRY GROUP	2010	2015	2021	2030
External financing requirement				
ADF countries	–50	–110	–136	–313
ADB countries	–35	–80	–90	–301
Africa	–85	–190	–226	–614
Net capital inflows				
Official grants	38	21	21	26
Private remittances	44	51	59	75
Foreign direct investment	51	46	54	125
Portfolio equity investment	6	12	15	28
Net long-term debt	34	28	61	315
Net short-term debt	3	2	6	25
Other inflows & discrepancies	–91	30	10	20
Total inflows	85	190	226	614

Source: Prepared by the ADF Lab (2017b).

external financing will continue to increase and is likely to be in excess of USD 600 billion a year by 2030. Official grants would play a minimal role in financing these requirements, while private inflows of remittances and equity investment would increase from USD 109 billion in 2015 to about USD 225 billion by 2030. A substantial increase in the inflow of long-term debt financing from both official and private sources will be required to ensure that the 7 percent growth scenario can be realized. Sound management of these external debt obligations will be required to ensure that the debt problems of the past decade do not reemerge.

In the event that there is no significant improvement in the development performance of ADF countries during the 2020s and economic growth remains in the current range of 4 percent a year, the number of people in absolute poverty would approach 500 million by 2030.

APPENDIX 3
DEBT SUSTAINABILITY AND THE DEVELOPMENT IMPLICATIONS OF MODERATELY CONCESSIONAL LOANS

This appendix has two goals. The first is to present the conceptual framework for assessing the debt sustainability and development implications of MCLs for ADF countries. The second is to discuss the concessionality embedded in MCLs.

Debt Sustainability and the Development Implications of MCLs

The ADF Lab focused on *public* debt sustainability in examining the implications of Moderately Concessional Loans (MCLs). In contrast, the IMF–World Bank Debt Sustainability Framework (DSF) assesses debt distress in relation to total *external* debt, public plus private. Three main reasons underlie the focus on public debt:

i. The immediate impact of less-concessional terms will be on the public finances and public debt.
ii. Fuller debt coverage is enabled, since both public and publicly guaranteed external debt *and* domestic debt are included. Domestic (local currency) debt has become increasingly important at the margin for governments and is typically at commercial terms.
iii. Addressing unsustainable debt requires policies to remedy public debt dynamics (via fiscal policy, domestic revenue mobilization, and so on, and growth policy).

In addition to public debt dynamics, the vulnerability of ADF countries to shifting market sentiment has grown, especially in countries where external financial integration is high and nonresidents hold a large fraction of local currency government debt. Likewise, current account deficits, total external debt and foreign exchange reserve adequacy are becoming increasingly important, and these variables are touched upon where relevant. The 2016 review of the IMF–World Bank LIC debt sustainability framework (DSF) launched during the 2016 Spring Meetings echoes many of the above concerns, in particular the need to pay more attention to public debt and market borrowings (IMF 2016b).

Two Questions

Two questions were posed for each ADF country. Is there any evidence of deterioration in public debt dynamics based on outcomes for 2013–15? And what is the marginal cost of borrowing?

The answer to the first question is obtained by using the standard framework for public debt sustainability based on primary fiscal deficits (total revenue minus non-interest spending), the interest rate on public debt, and the GDP growth rate. These three variables determine public debt dynamics—that is, the path of the ratio of public debt to GDP (the "debt ratio") over time. For example, if the government is running a primary deficit and interest rates exceed growth rates, the debt ratio will grow without bound in the absence of corrective fiscal policy, eventually resulting in a crisis. Similarly, a rise in the ratio of the primary deficit to GDP, or an increase in interest rates or a collapse in growth rates or some combination of these outcomes, will worsen debt dynamics and could precipitate a crisis.

The exchange rate has become a key variable impacting public debt dynamics for ADF countries. This is because the average share of public debt denominated in foreign currency ("forex debt") is close to 70 percent. Large currency depreciations such as we have witnessed over the last couple of years quickly increase the burden of forex debt and the debt ratio. Therefore, the framework incorporates calculations that enable the impact of currency volatility on forex debt to be captured. These show that the strong appreciation of the US dollar, which started in 2014, along with the collapse in commodity prices linked to the slowdown in China's growth, has been a major factor in increasing debt ratios in ADF countries over the past three years.

Similarly, debt ratios can be adversely affected by contingent liabilities from state-owned enterprises and commercial banks. If the state-owned energy company, or a failing bank, needs a bailout, this will add to the public debt burden.

The second question, on the marginal cost of borrowing, is relevant when assessing whether a country can cope with MCLs. A country issuing a USD 1 billion Eurobond at a 10 percent yield with a bullet payment at the end of 10 years could actually improve its debt profile by obtaining funds from official sources at 3–4 percent with 40 years maturity and 10 years grace. But this crucially assumes that MCLs are accompanied by an expanded envelope of official resources that will

displace more expensive market borrowing. This is an important consideration given the vast and immediate investment needs in Africa to meet the Sustainable Development Goals (SDGs).

The two questions taken together enable assessing the impact of MCLs on debt sustainability. Since debt sustainability is essentially a forward-looking exercise, the conclusions about countries' ability to cope with MCLs reflects the judgment of the ADF Lab on how key variables are likely to move in the light of the medium-term macroeconomic outlook for Africa.[33]

Development Issues

Debt sustainability is not an end in itself but a necessary foundation for long-run growth and development. Therefore, the working paper containing the debt sustainability assessments for the ADF countries (ADF Lab 2017) also dwells on issues falling under the rubric of African development. The guiding principles draw from:

- Development economics and the notion of diminishing marginal returns to capital, which imply high returns to investment, public and private, in Africa.
- Estimates of the sources and marginal cost of government borrowing especially as public investment is ramped up, subject to data availability.
- The importance of long debt maturities and grace periods. This is essential considering that Africa will need substantial time, possibly at least another generation, to establish a solid foundation for long-run growth. Based on the Solow Model and development economics, this would require technology convergence (faster total factor productivity growth) and capital deepening (raising capital/labor ratios, importantly through large public investments in infrastructure), as well as sustainable public finances, and good governance, leadership, and institutions to underpin the management of economic and political volatility.

This combination of debt sustainability and development is the perspective in ADF Lab (2017). The country assessments are in Annex 3 of ADF Lab (2017). Annex 2 of ADF Lab (2017) contains a guide to interpreting these country pages, while Annex 4 contains the derivations of the formulas used for calculating the interest rate on public debt as well as its two subcomponents, that on local currency debt and that on foreign currency debt, expressed in local currency-equivalent terms. Doing so captures the effect of exchange rate movements on debt dynamics.

Concessionality Embedded in MCLs

Illustrative MCL terms consist of a 40-year USD loan with 10 years grace and an interest rate of 3 percent, benchmarked off current readings on the US 30-year Treasury bond. While "harder" than concessional terms, MCLs nevertheless retain a significant degree of concessionality and are also highly concessional when compared with the commercial terms many ADF countries borrow on.

APPENDIX TABLE 3.1 Comparison of ADF/IDA and MCL Lending Terms

	MATURITY (YEARS)	GRACE PERIOD (YEARS)	SERVICE CHARGE (%)	INTEREST RATE (%)	TOTAL INTEREST RATE (%)	GRANT ELEMENT[a] (%)
ADF (UA loans)						
ADF-Only (regular)	40	10	0.75	0.00	0.75	77.6
ADF-Only (advance)	40	5	0.75	0.00	0.75	72.5
Blend, gap, and graduating	30	5	0.75	1.00	1.75	58.8
IDA 17 (USD loans) (effective January 1, 2017)						
Regular (small Island)	40	10	1.41	0.00	1.41	71.4
Regular (IDA only)	38	6	1.44	0.00	1.44	66.7
Blend	25	5	1.47	1.38	2.85	46.9
Transitional Support	25	5	0.75	3.08	3.83	39.4
Hard-term Lending	25	5	0.75	2.12	2.87	46.8
ADF—MCLs (USD loans)						
Scenario 1	40	10	0.75	2.25	3.00	56.4
Scenario 2	60	20	0.75	2.25	3.00	63.3
Scenario 3	40	10	0.75	3.25	4.00	47.0
Scenario 4	60	20	0.75	3.25	4.00	52.7

a. We assumed equal principal payments over the remaining maturity of the loan following the expiry of the grace period, no commitment charge, and the OECD–DAC 9% discount rate for assessing the loan concessionality, with a minimum grant element of 45%.

Source: ADF, IDA (http://ida.worldbank.org/sites/default/files/pdfs/ida-terms-effective-jan-1-2017.pdf), and own calculations.

Appendix Table 3.1 compares MCL terms with those offered by ADF and IDA. ADF and IDA loan terms are linked to country incomes and creditworthiness. As countries advance to Blend or other transition status, interest rates rise and maturity and grace periods shorten. The ADF Lab believes there is a case for raising interest rates but not for shortening maturities and grace periods. This is because it is likely to take another generation for African countries to reap the benefits from their needed infrastructure and human capital investments and establish a solid foundation for sustained rapid growth. So, the scenarios for MCLs include an interest rate of 3 percent or 4 percent on a USD loan with maturity–grace periods of 40–10 years or 60–20 years.

The table contains the grant element for the various loan terms using the OECD–DAC discount rate of 9 percent. It is apparent that a 3 percent USD MCL loan with maturity–grace of 40–10 or 60–20 (Scenarios 1 and 2 in Appendix Table 3.1) has a level of concessionality comparable to that for IDA Blend, Transitional Support, and Hard-term Lending USD loans. A direct comparison of MCL and ADF terms was not possible because the latter terms are for UA loans.

Lastly, the ADF Lab proposes a two-tier structure with MCLs to apply only to ADF countries deemed eligible for such terms, as Chapter 2 noted in the main report. Fragile countries would still need as high a degree of concessionality as is now provided.

APPENDIX 4
Q&A ON THE BIG BOND

1. What is the Big Bond?

The "Big Bond" is a mechanism for frontloading development assistance to Africa by securitizing a portion of grants currently given. For example, the yield on 30-year US Treasuries is currently around 3 percent. At this yield, an opportunity exists to raise USD 100 billion by securitizing annual ODA flows of about USD 5 billion over a 30-year period. This is less than 11 percent of the annual USD 45 billion in grants currently provided to Africa.

2. Why the Big Bond?

The proceeds of the Big Bond are urgently needed to finance the big push on infrastructure and regional integration that ADF countries need. The larger amounts, much lower interest rates and far longer maturities through the Big Bond than attainable through the commercial debt markets will boost debt sustainability in ADF countries while lowering the pressure on foreign exchange reserves. Equally important, the Big Bond will transmit a powerful signal to the private sector worldwide that Africa is open for business, while simultaneously serving as a powerful incentive for improvements in economic governance in ADF countries (discussed further below).

3. Why now?

Interest rates in donor countries are close to their historical lows. Therefore, securitizing a relatively small fraction of total donor grants would enable a large volume of funds to be raised upfront at exactly the moment Africa needs it most to restore its growth and poverty alleviation momentum.

4. What are the mechanics?

The Big Bond will be underwritten by a set of donor countries, which could include current donors as well as new sovereign and nonsovereign donors. These countries need to commit to make the approximately USD 5 billion annually in debt service (principal plus interest) on a USD 100 billion 30-year bond at current market yields for AAA rated issuers. The bond will be an attractive investment instrument for institutional investors in Africa and the world over. The USD 100 billion raised will be intermediated through the ADB with the proceeds lent to eligible ADF countries via MCLs (Moderately Concessional Loans, see chapter 2). The repayments from these loans can be used for future ODA. These mechanics can be modified once the concept gains acceptance.

5. Why is the ADB the natural intermediary for the Big Bond?

The ADB is Africa's regional development bank on the continent. Its franchise value will enable a much more candid policy dialogue with African country leaders than can be pursued by the IMF or the World Bank. Its decentralization plans and expertise in regional integration so vital for the continent will be important vehicles for intermediating the funds from the Big Bond and in conducting the associated policy dialogue. The availability of far greater resources will also be a huge spur to strengthening both the capacity and the clout of the ADB. In addition, as noted below, the ADB will need to partner with other African institutions as well as the World Bank and IMF.

6. Why should donors be interested?

Many donor countries are facing situations of high sovereign indebtedness and sluggish growth. The Big Bond will not impose an additional fiscal burden on current donors since a portion of grants now given will be set aside to service it. Besides, as noted, new donors can also participate. And with the Big Bond proceeds being lent to eligible ADF countries in the form of MCLs, the repayments could be utilized for future ODA, actually *reducing* future fiscal demands on donors. Equally important, by helping to support Africa's growth, the

Big Bond will enable job creation for Africa's youth, an essential part of any solution to the costly migrant and security threats many donors are grappling with.

7. Won't converting grants into loans cause debt sustainability problems for ADF countries?

To the contrary, the Big Bond will alleviate debt sustainability pressures in MCL-eligible countries as the dependence on costly commercial borrowings subsides as chapter 2 and ADF Lab (2017a) set out. And the much longer maturities and grace periods compared with Eurobonds will reduce pressure on foreign exchange reserves by stretching out and pushing principal repayments into the distant future.

8. Will ADF countries not eligible for MCLs suffer from a diversion of resources to the Big Bond?

This valid concern can be addressed at three levels. First, no ADF country is automatically eligible for MCL access, nor is any ADF country permanently excluded. For example, Ghana, Mozambique, and Zambia from the high potential eligibility list (see Chapter 2) will need to demonstrate that they have the absorptive capacity and the necessary program for policy and institutional reform that will put public debt on a sustainable trajectory. Likewise, Guinea and Togo from the low eligibility list can over time demonstrate their commitment to reform that opens up access for their ambitious public investment programs. Indeed, many of the low eligibility countries are natural resource-rich and exhibit weak governance. Second, ADF concessional assistance will continue under the current allocation rules with a sharper focus on countries with low MCL eligibility. Third, the regional infrastructure projects financed via the Big Bond will have benefits for *all* countries.

9. Can African countries absorb the large amount of funds that the Big Bond will mobilize?

Intermediating the Big Bond's proceeds through the ADB working in collaboration with other African development institutions as well as the World Bank and IMF will increase assurances that the money will be used well. Part of the proceeds can be used for regional infrastructure projects vitally needed for integrating the continent, increasing competition, and spurring growth. Access to MCLs will be a powerful incentive for countries to improve economic governance and create a roster of bankable infrastructure projects, individually and in concert with other countries in the region.

The Enhanced Policy Dialogue (EPD) discussed in the report is an integral part of the package, with its focus on sustainable public finances, better growth policy, and ensuring natural resource wealth is used prudently and transparently.

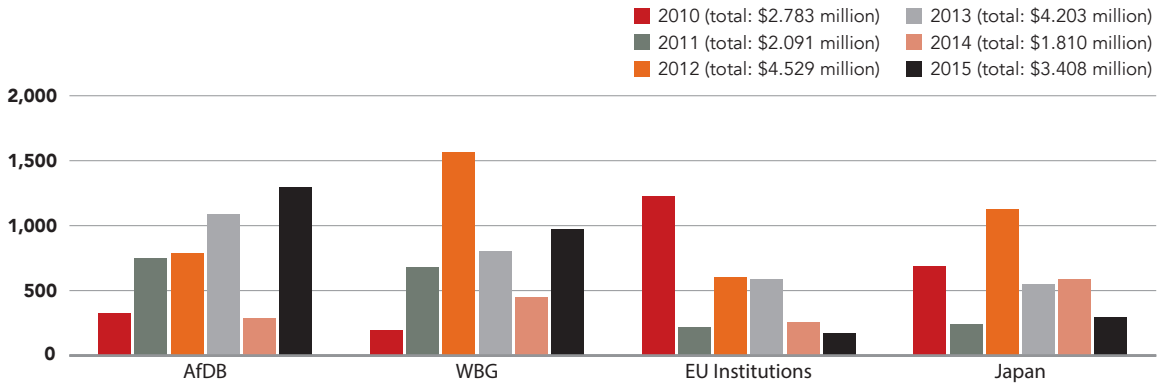
Crucially, the Big Bond needs to be accompanied by a stipulation that economic aid to Africa will continue only for another generation, say, 40 years; climate change finance and humanitarian aid are not included here. Such a sunset provision, which the ADF Lab's conversations with African policymakers indicate will not come as a major surprise, will signal that the time has come not just for new financing instruments, but also African self-reliance. The positive impact via better use of resources already available to ADF countries should not be underestimated. As Ghana's Vice President noted during the 2017 Spring Meetings of the IMF and World Bank, "Fundamentally, we [the Africans] have to take leadership," not just nationally, but regionally.

10. So the Big Bond is a win-win?

Yes. The Big Bond could lower the fiscal burden on donors while helping Africa to maintain its growth trend and powerfully reinforcing incentives for improved economic governance, at the national and regional levels.

APPENDIX 5
THE STATE OF INFRASTRUCTURE IN AFRICA

APPENDIX FIGURE 5.1 Trends in Regional Infrastructure Portfolios, 2010–15 (USD millions)



Source: ICA 2016b.

APPENDIX TABLE 5.1 PIDA's 16 Megaprojects to Transform Africa

1.	Ruzizi III hydropower
2.	Dar es Salaam port expansion
3.	Serenge-Nakonde road (T2)
4.	Nigeria-Algeria gas pipeline
5.	Dakar-Bamako rail line modernization
6.	Sambangalou hydropower
7.	Abidjan-Lagos coastal corridor
8.	Lusaka-Lilongwe ICT terrestrial fibre optic
9.	Zambia-Tanzania-Kenya transmission corridor
10.	North Africa transmission corridor
11.	Abidjan Ouagadougou road-rail
12.	Douala Bangui Ndjamena corridor road-rail
13.	Kampala Jinja road upgrading
14.	Juba Torit Kapoeta Nadapal Eldoret road
15.	Batoka Gorge hydropower
16.	Brazzaville Kinshasa road rail bridge and the Kinshasa Illebo railways

Source: PIDA 2016b.

NOTES

1. The headcount for absolute poverty is defined by the World Bank as the number of people living on no more than USD 1.90 a day at 2011 GDP on a purchasing power parity basis.
2. The United Nations projects that the African population will increase by some 30 million every year, for an increase of 500 million during 2016–30, reaching 1.68 billion by 2030 (United Nations 2016).
3. The large increase over IDA-17 in the size of the IDA-18 replenishment (from USD 52 billion to USD 75 billion) is on account of proposed market borrowing and higher repayments from countries on its large loan portfolio.
4. Headcount poverty would decline from 421 million in 2015 to 406 million in 2030. Growth projections for 2017–21 were based on IMF projections of annual average growth of 4 percent. Growth projections were 7 percent in 2022–30 for ADF countries and 5 percent for ADB countries (see Appendix 2).
5. Average total grants to Africa for the period 2011–15. See OECD–DAC (2017), table 2a.
6. IMF 2016a.
7. Using the OECD Development Assistance Committee 9 percent discount rate to compute concessionality leads to a 56 percent grant element for MCLs, well above the 45 percent threshold for low-income countries and least-developed countries. MCL terms are also comparable to IDA blend and hard-term USD loans. The ADF makes loans in units of accounts (UA based on Special Drawing Rights), preventing direct comparability.
8. For details, see ADF Lab (2017a).
9. IMF 2016b.
10. In each group, countries are listed in descending order of their Country Policy and Institutional Assessment rating for the 2016 ADF Performance-Based Allocation.
11. IMF 2017a.
12. It was mentioned during the Lab's visit to Uganda that Ethiopia builds power projects at one-third the dollar cost per megawatt-hour compared with Uganda.
13. An oil or copper boom has two effects. The first is Dutch Disease, where the real appreciation of the exchange rate leads to a shrinkage of agriculture and manufacturing, leading to a concentration of the commodity in exports and fiscal revenues. The policy challenge is to smooth real appreciation by recognizing that the boom will not last forever. The second is the failure to use natural resource wealth prudently because of weak institutions and corruption. The "curse" refers to this latter set of effects. See ADF Lab (2017a).
14. ADB 2016.
15. Woods and Martin 2012.
16. The Nigeria Trust Fund (NTF) is the third constituent institution of the African Development Bank Group. It was created in 1976 by agreement between the Bank Group and the Nigerian government. The NTF is a self-sustaining revolving fund.
17. The level of concessionality of a loan is defined by OECD–DAC as a measure of the grant element compared with a loan at market rate. Technically, the outflows for the loan and the repayment are calculated using a discount rate, which, as of 2016, varies by the classification of the recipient country. For low-income countries and least development countries (the categories under which all ADF countries fall), a discount rate of 9 percent is used. For a loan to be considered as concessional, its grant element needs to exceed 45 percent.
18. Over the last decade, the ADF provided a majority of its support (68 percent) as highly concessional loans. This percentage was far higher than that from bilateral assistance (13 percent) or other multilaterals (38 percent).
19. WBG 2016.
20. CGD 2016.
21. It should be noted that IDA evaluated similar options and decided not to proceed given that the changes would be difficult to undertake quickly; IDA instead chose to retain its current governance and borrow from the market against its own equity. The merger options, "IDA +2," included transfer without ownership rights, ownership rights but no voting rights, and both ownership and voting rights.
22. The nature of the commitments provided by different donors will vary based on the flexibility afforded

by their legislative frameworks and budgetary scorekeeping practices for aid. See Leo (2010).

23. ICA 2016a.
24. PIDA is an initiative of the African Union Commission (AUC), the NEPAD Agency, African Development Bank (ADB), and Regional Economic Communities (RECs).
25. World Economic Forum 2015.
26. Calderón 2008.
27. Escribano, Guasch, and Pena 2008.
28. Federal Ministry for Economic Cooperation and Development 2017.
29. Light Up and Power Africa, Feed Africa, Industrialize Africa, Integrate Africa, and Improve the Quality of Life of the People of Africa.
30. The Asian Development Bank went through a similar transition in the 1980s.
31. Absolute poverty is defined by the World Bank as a country's population that is living on no more than USD 1.90 per day at 2011 levels of GDP on a purchasing power parity (PPP) basis.
32. See IMF 2016c and IMF 2017b.
33. A recent comprehensive assessment of Africa's macroeconomic situation is in IMF (2016d).

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