



FINANCE IN AFRICA

Unlocking investment in an era
of digital transformation and climate transition



Chapter 2

Economic development and access to finance

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European
Investment Bank

Finance in Africa

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Economic development and access to finance



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Chapter 2

Economic development and access to finance

Africa is a high-growth region – only developing Asia is typically able to outpace it. Over the next five years, sub-Saharan Africa is expected to reverse the pattern of slowing growth observed since the start of the 2000s. However, past periods of brisk economic growth in Africa have not always delivered the hoped-for benefits. In 2023, Africa accounted for just 3.1% of global gross domestic product (GDP) in nominal terms, a minimal rise from 2.7% in 2003, despite average economic growth of 5.7% in the first decade of this period.

A factor frequently cited as restricting development in Africa is a relatively low level of industrialisation contrasted with a very high share of agriculture in GDP, a metric that has not changed in 20 years. Africa's low participation in global value chains is linked to low industrialisation and slow private sector development. This participation is weaker than that of other emerging regions and is concentrated in lower value-added activities – Africa is typically the commodity exporter, with production and processing happening in other countries. An exception to this is intra-African exports, which have a much higher industrial content than the bulk of exports that go to advanced countries.

Existing approaches for achieving increased global value chain participation – namely industrialisation through the availability of cheap labour – might not be a suitable solution for Africa. First, existing structural constraints in Africa would still be a deterrent for participation in global value chains. Second, global value chains are increasingly sophisticated, making them less labour intensive. However, the agriculture sector provides a crucial opportunity for Africa to develop regional value chains. Three-quarters of African adults classed as poor work in agriculture – too many for the economy to absorb if they were to move to other sectors. Instead, increased productivity and greater industrialisation are needed within the agricultural sector itself. African agricultural imports and exports have been growing over the past decade, but import values have grown more rapidly than export values, highlighting opportunities for increased regional processing and distribution of agricultural products. Agriculture needs to be at the centre of industrialisation in Africa.

Improving industrialisation and private sector development means overcoming key structural constraints, such as skills shortages. Building an appropriate skill base is necessary for boosting high-productivity sectors with employment potential. The digital and green transitions are creating considerable demand for new skills. However, only 9% of the workforce aged 15-24 in 15 African countries currently possess basic digital skills, while 5% hold intermediate digital skills. Green skills are needed in sectors such as renewable energies, construction, infrastructure and recycling. Returns on education seem higher in Africa than elsewhere in the world, likely reflecting the lower starting point for the region.

Limited access to finance is another constraint, with domestic and external sources of finance becoming scarcer over time. Africa has suffered from declines in foreign direct investment, overseas development aid, portfolio flows and cross-border bank flows. Domestically, government revenue as a share of GDP is 18% in Africa, well below that of other developing regions, further limiting the funds available for investment. Private sector credit in sub-Saharan Africa was 36% of GDP in 2022 (a decline from 56% of GDP in 2007), while growth in private capital stock (the productive base of the economy) has not kept pace with other regions. Microeconomic evidence from firm surveys supports the assertion that firms cannot access the credit they need and are discouraged by various factors, including collateral requirements and high interest rates. Addressing these financial constraints would accelerate industrialisation in Africa and promote convergence in living standards with advanced economies.

Economic development in Africa

Development progress in Africa

Global economic growth has been declining for 20 years, but the next five years should see a reversal of that trend. Average growth rates over the last 20 years have varied widely in some regions, being lowest in advanced countries and highest in emerging and developing Asian economies (Figure 1). However, the average growth rate has typically fallen in each successive four or five-year period. The period from 2020 to 2023, which was characterised by the COVID-19 pandemic and Russia's invasion of Ukraine, represented a low point for some regions. However, advanced economies recorded their lowest growth during the global financial crisis (2008 to 2012), while Latin America and the Caribbean saw their weakest growth from 2013 to 2019.

The economic growth rate in sub-Saharan Africa has typically lagged behind only that of emerging and developing Asia over the last 20 years. Looking ahead, the growth outlook for sub-Saharan Africa is also better than for many other regions, with expected growth of 4.1% on average between 2024 and 2028. This rate is higher than that seen during the COVID-19 pandemic or between 2013 and 2019. A similar pattern in the magnitude of growth rates is also evident in North Africa. Although the forecast of a rebound in growth is welcome, how this will affect private sector development and poverty eradication remains unclear, particularly in sub-Saharan Africa.

Figure 1

Real GDP growth (including forecasts) by region and over time (%)

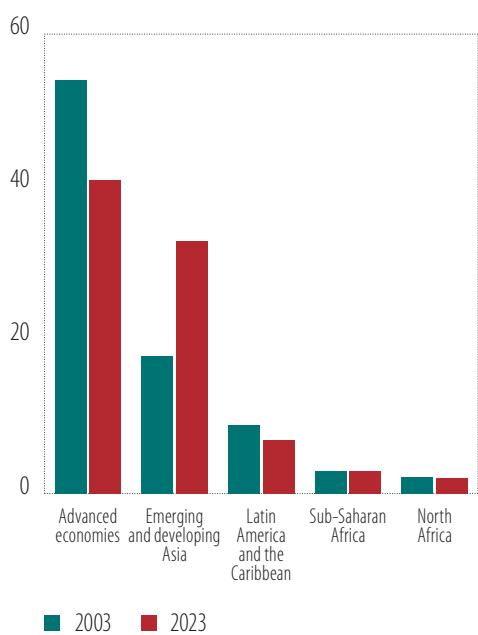


Source: *IMF World Economic Outlook Database, April 2024.*

Past periods of brisk economic growth in Africa have not always delivered the hoped-for benefits. In 2003, sub-Saharan Africa accounted for 2.7% of global GDP in nominal terms. After 20 years, the percentage has risen to just 3.1% (Figure 2), despite average economic growth of 5.7% in the first decade of that period. North Africa has seen its share of global GDP decline slightly to 2.0% from 2.2% during the same time frame. In contrast, emerging and developing Asia increased its share of global GDP to 33% in 2023 from 18% in 2003. These comparisons over time are clouded by measuring everything in US dollars, even when expressed in purchasing power parity terms, given the currency depreciation in many African countries. However, the prolonged downward trend in exchange rates in some African countries may reflect a decline in the perceived attractiveness of economic assets in these countries.

Progress in real GDP per capita, which is a measure of income per person in the economy, has been more substantial for sub-Saharan Africa compared with North Africa, but has stalled in both regions over the past decade. The exchange rate issues can be partially mitigated by looking at trends in real GDP per capita in local currency to understand how individual purchasing power in the local economy is evolving over time. Figure 3 shows an index of real per capita GDP in local currency for each region. The International Monetary Fund (IMF) performs a similar exercise without advanced countries (IMF, 2024). North Africa and sub-Saharan Africa saw per capita income grow briskly during the 2000s. For North Africa, this growth came to a halt during the global financial crisis and Arab Spring period (2008-2014). For sub-Saharan Africa, robust income growth continued until 2014, with 2008-2014 being a period of strong growth for this region. Since then, however, improvement in real per capita GDP in sub-Saharan Africa and North Africa has been limited, except for a post-pandemic bounce. In contrast, real per capita GDP continued to grow at a similar rate in advanced economies, apart from a short interruption caused by the COVID-19 pandemic. This means that while living standards have improved over the last 25 years for African and advanced countries, there has been limited convergence of these African countries (particularly North Africa) with the living standards of advanced countries. Meanwhile, developing Asia, which is excluded from the chart because its growth rate is on a different scale,¹ saw living standards grow far more rapidly than any other region during this period.

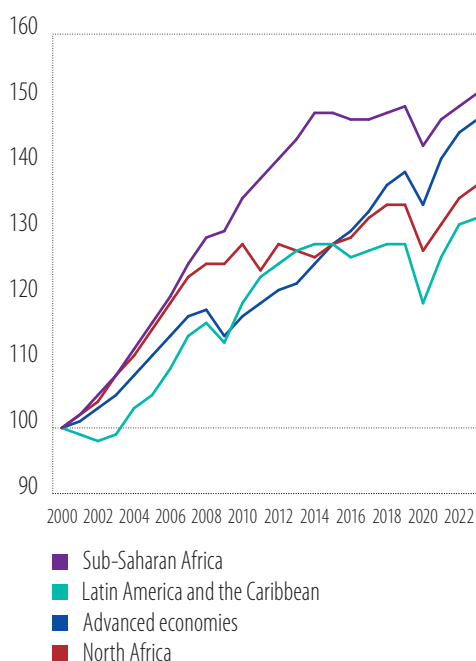
Figure 2
Share of global GDP by region over time (%)



Source: IMF World Economic Outlook Database, April 2024.

Note: In Figure 3, the share of each country in the regional real GDP per capita index is its share of nominal GDP in US dollars in its region. Therefore, even here, it is not possible to fully escape exchange rate issues.

Figure 3
Real GDP per capita in local currency (index, 2000=100)



Low industrialisation in Africa

A factor frequently cited as restricting development in Africa is the relatively low level of industrialisation on the continent. The data seem to support this view. Figure 4 shows the share of industry and agriculture in GDP in different global regions. The share of industry in GDP is lowest in Africa and highest in the Middle

¹ The Asian index would be above 400 by 2023.

East and North Africa and East Asia and the Pacific. The high level in the Middle East and North Africa is linked to the size of the fossil fuel industry in the region, whereas the transformation of the Asian economy over the last 20 or 30 years is associated with a relocation of production to Asia from advanced countries, supporting industrialisation. Sub-Saharan Africa has the highest share of GDP in the agriculture sector at 18%, compared with less than 8% of GDP in other regions. The share of employment in agriculture in Africa is significantly higher than its share of GDP in this sector, with the African Development Bank (2024) highlighting that productivity in agriculture is low in Africa – typically 60% less than economy-wide productivity levels.

Figure 4
Sectoral share of GDP by region, 2020 (%)

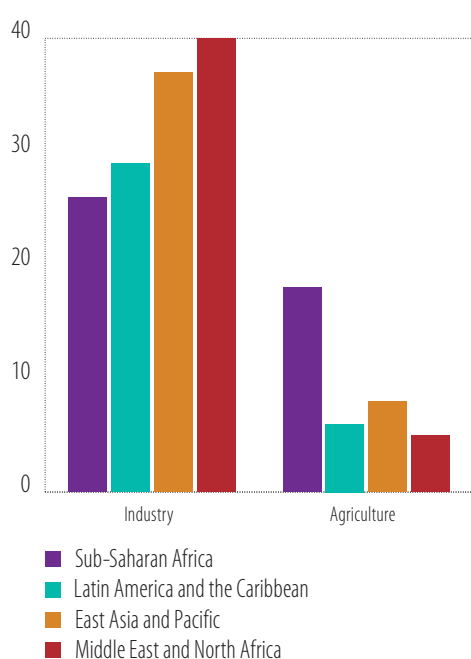
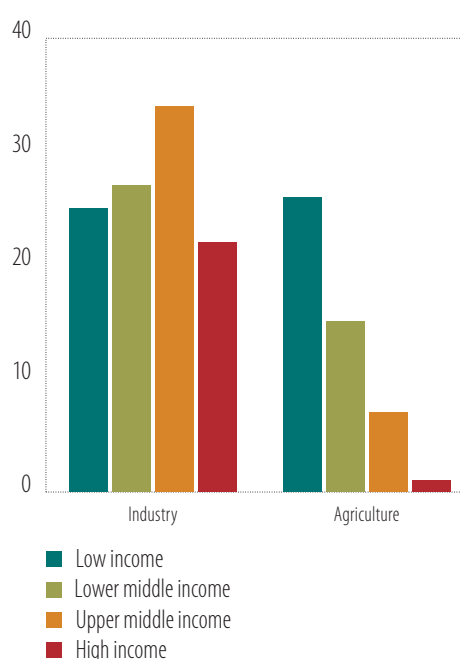


Figure 5
Sectoral share of GDP by income group, 2020 (%)



Source: [World Bank Open Data](#).

Note: For the Middle East and North Africa, the data on the share of industrialisation represent an average of the data available for the years 2018 and 2022, as the data in this region are more volatile than in other regions.

Looking at GDP shares by income group rather than geography, the most obvious trend is that the share of GDP declines as income levels increase (Figure 5). For low-income countries, agriculture is worth about 25% of GDP, compared with just 1% for high-income countries. The opposite is partially true for industry. The share of industry in GDP increases from the low-income group up to the upper middle-income group, but then declines sharply for the high-income group to a level that is even lower than that of the low-income group. The key characteristic of the high-income group is that economies are largely dominated by high value-added services.

A review of sectoral shares over time also shows that industrialisation in sub-Saharan Africa did not increase between 2000 and 2020, with industry as a share of GDP declining by 1 percentage point over this period.² In contrast, the share of agriculture increased by 1 percentage point of GDP and the services share was unchanged. In short, sectoral shares have been static, which supports the idea that industrialisation has been absent from Africa's development. The share of industry in the Middle East and North Africa fell by 5 percentage points in the same period but remained higher than other regions.

² To avoid undue influences in comparing one specific year to another, these differences are instead based on sectoral shares averaged over the three-year period of 2019-2021 compared with the same shares averaged over 1999-2001. This gives a more stable comparison than comparing 2020 and 2000.

However, industrialisation did not grow in East Asia and the Pacific or Latin America over this period. In East Asia and the Pacific, the industry share had increased during the 1990s, so the rate of industrialisation during 2000-2020 failed to keep pace with growth in nominal GDP, which was increasingly driven by services (up by 12 percentage points of GDP).

The Africa Industrialization Index 2022, which is a report by the African Development Bank, the African Union and the United Nations Industrial Development Organization, features an index aiming to capture the state of industrialisation across continental Africa. The index examines industrialisation between 2010 and 2021 by focusing on three dimensions – performance (capturing actual levels of industrialisation, using measures such as the share of manufactured products in GDP and exports), direct determinants (capturing the availability of labour and capital) and indirect determinants (capturing the business environment, infrastructure and macroeconomic stability) – creating country and regional industrialisation scores ranging from 0 to 1. According to the African Industrialization Index 2022, industrialisation levels are low in Africa and aggregate progress is slow, supporting the simple industry share analysis presented above. However, the index finds that progress is brisker among the low-income groups. Improvements in different countries over the period covered by the index were mainly in performance and direct determinants, whereas indirect determinants were slowing progress. The report highlights key bottlenecks to industrialisation, including inadequate infrastructure, a lack of access to finance and shortages of skilled staff.

Africa's participation in global value chains

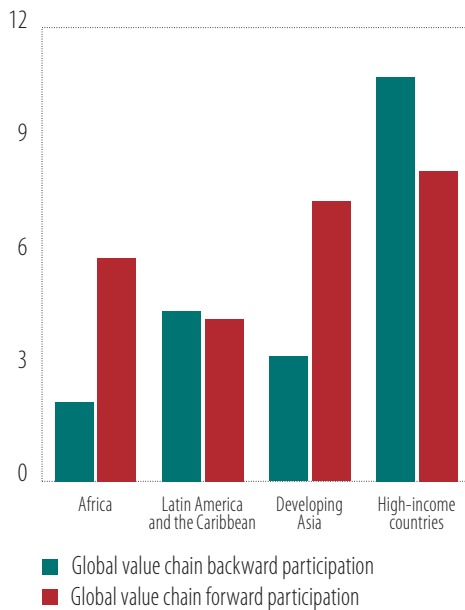
Africa's low participation in global value chains is linked to low industrialisation and slow private sector development. A global value chain is formed when the production process for a good or service takes place in more than one country, with each country contributing some of the value added. Forward participation is when a country sends its products to another country for further processing, whereas backward participation is when a country imports resources from abroad for domestic production. Backward participation is more valuable for a country as it is associated with higher value-added activity and may facilitate the development of domestic manufacturing knowledge. Each country participates differently in value chains for different products, depending on its resources and industrial capabilities. Furthermore, as value chains have stretched over more countries, an individual country will have backward and forward participation in the value chains for different products. Global value chain participation is the sum of a country's backward and forward linkages.

Emerging markets can accelerate their industrialisation by participating in global value chains. Baldwin and Venables (2013) argue that participation in global value chains enables emerging markets and developing economies to be part of an industrial production process without all the knowledge needed for manufacturing a product in its entirety – a country can specialise in an individual element of the process. Ignatenko et al. (2019) find that participation in global value chains positively affects income per capita, as well as components of income per capita, namely investment and productivity. However, the process is not automatic and upper-middle-income and high-income countries appear to be the main beneficiaries. In addition, Ignatenko et al. report that participation in global value chains is linked to various factors, including proximity, common language, currency volatility, rule of law, infrastructure, trade barriers and labour costs. A lack of infrastructure, trade frictions, currency volatility and lower institutional quality in some African countries could therefore be a barrier to greater global value chain participation.

Africa's participation in global value chains is weaker than that of other emerging regions and is concentrated in lower value-added activities. In a comprehensive study of Africa's role in global value chains, the African Union Commission and the Organisation for Economic Co-operation and Development (OECD) (2022) find that African countries are typically commodity exporters, with production and processing happening in other countries. This forward participation in global value chains equated to 5.9% of African GDP in 2019, which is similar to other regions (Figure 6). However, for backward participation in global value chains, Africa – at just 2.1% of GDP – lags behind other developing regions including developing Asia (3.3%) and Latin America and the Caribbean (4.5%). Furthermore, with forward participation standing

at almost three times the level of backward participation, Africa exhibits a degree of imbalance not seen in other regions. The report also highlights the fact that Africa's share of backward participation in global value chains was static at close to 2% in the 20 years between 2000 and 2019, in line with the static share of industry in GDP over the same period.

Figure 6
Global value chain participation by region, 2019
(% of GDP)



Source: AUC/OECD Africa's Development Dynamics 2022.

Figure 7
Value of agricultural imports and exports
(\$ billion)



Source: FAOSTAT (crops and livestock products).

Existing approaches to increasing global value chain participation and industrialisation might not be the solution for Africa. Boosting industrialisation in Africa by mimicking the approach of other countries (such as those in Asia) and attracting manufacturing production via cheap labour may not be successful. First, this approach has not worked to date in Africa, and existing structural constraints in the region would still be a deterrent for participation in global value chains. Second, the literature points to increased sophistication in global value chains, making them less labour intensive. For example, Sen (2019) shows that countries with higher trade integration require fewer workers per unit of manufacturing production, and Pahl and Timmer (2019) provide long-term evidence on declining employment per unit of exports. These trends could accelerate if recent developments in artificial intelligence are incorporated into manufacturing processes. A problem for Africa has been meeting the strict product standards required for exporting to advanced economies, and this requirement could become more onerous for certain product categories.

Nonetheless, developing regional value chains could accelerate the industrialisation of Africa. The African Union Commission/OECD (2022) report shows that processed and semi-processed goods account for 79% of intra-African exports, compared with just 41% of exports to other destinations. This means that the industrial content in intra-African exports is much higher than that of exports leaving the continent. However, regional value chains in Africa account for only 2.7% of the continent's global value chain participation, compared with 26% in Latin America and the Caribbean and 43% in developing Asia. This is because Africa's trade – from an import and export perspective – is mainly linked to OECD countries and Asia. For example, the United Nations Economic Commission for Africa (2023) shows that more than 80% of African imports and exports are from and to countries beyond the continent. In effect, if Africa could boost its regional trade networks, a corresponding increase in industrialisation and reduction in exposure to global shocks could follow.

The agriculture sector offers a major opportunity for Africa to develop regional value chains. As discussed above, at 18%, the share of agriculture in GDP is higher in sub-Saharan Africa than in other regions, and the importance of agriculture to employment is even greater. The 2023 edition of our Finance in Africa report (EIB, 2023) shows that there are 26 countries in sub-Saharan Africa where more than 40% of the population work in agriculture. In addition, Christiaensen (2020) reports that three-quarters of African adults classed as poor work in agriculture – too many for the economy to absorb if these workers were to be redeployed in other sectors. Instead, increased productivity and greater industrialisation are required in the sector. African agricultural imports and exports have been growing over the past decade but import values have grown more rapidly than export values (Figure 7), highlighting opportunities for increased regional processing and distribution of agricultural products. Reinforcing this is the fact that while food accounts for 8% of merchandise imports globally, of the 39 countries where this share is above 20%, 17 are in Africa, with Egypt and Rwanda just below 20%.³ The development of regional agricultural value chains could help meet this growing agricultural import demand. Furthermore, as African countries become wealthier, the demand for agricultural products will grow further. Developing regional value chains would also be the first step in developing the expertise needed to facilitate greater participation for agriculture in global value chains.

The European Investment Bank (EIB) is already helping African banks to lend money to the agricultural sector. For example, the [Green African Agricultural Value Chain project](#) will provide up to €200 million to financial intermediaries across sub-Saharan Africa for on-lending to eligible small and medium-sized enterprises and mid-caps active in agriculture value chains. By primarily directing the on-lending to this type of company, the project will enable smaller farmers to benefit from value chain integration through investments in commercial value-added processes. In addition, the focus on members of agriculture value chains that integrate smallholders is aimed at increasing the participation of smallholder farmers in market-integrated, nutrition- and gender-sensitive value chains. First Capital Bank in Zambia was the first bank to receive funding from the ongoing project.

Overcoming constraints on growth

Improving industrialisation and private sector development means overcoming key structural constraints in the economy, particularly inadequate levels of infrastructure, low skills attainment and a lack of finance to the private sector. The EIB is working to alleviate access to finance constraints for the private sector in Africa, and this lack of finance will be the subject of discussion for the remainder of this chapter. Meanwhile, Box 1 reviews the problems caused by a lack of skilled labour on the continent.

Box 1

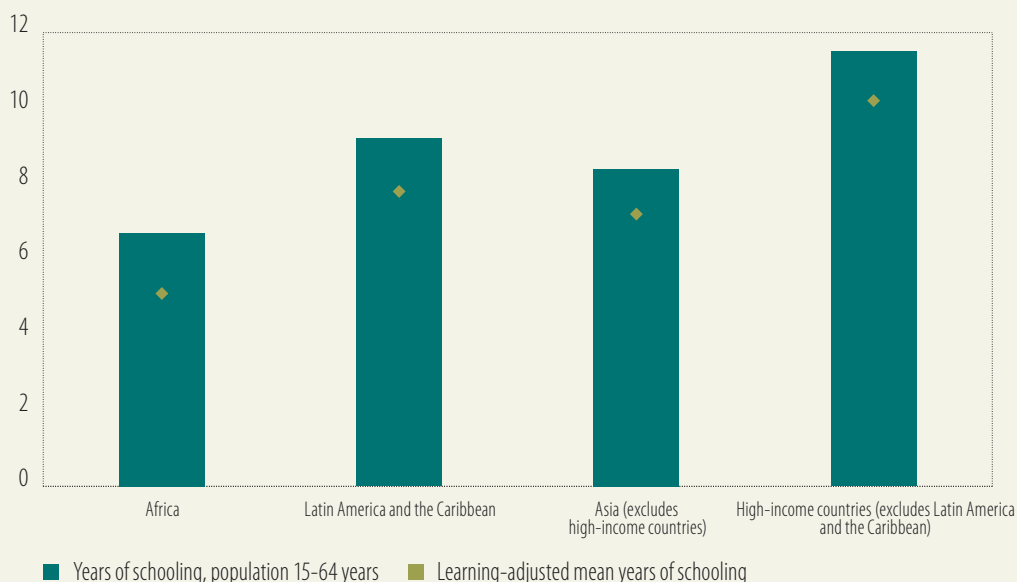
Building a skilled workforce for Africa's productive transformation

This contribution draws on findings in the African Union Commission and OECD flagship report *Africa's Development Dynamics 2024: Skills, jobs, and productivity* (African Union Commission and OECD, 2024).

Progress in educational achievements must continue increasing the supply of skilled workers in African labour markets. The number of young people completing at least secondary education in Africa will more than double between 2020 and 2040, reaching 240 million. This builds on significant progress achieved in the past 20 years: Mean years of schooling have increased by over two years for 28 African countries with available data. However, the number of learning-adjusted years of schooling, which is a measure merging the quantity and quality of education, is more than two years lower in Africa than in any other world region. In 2020, the learning-adjusted number of years of schooling was 5.1 in Africa, compared with 7.2 years in developing Asia and 7.8 years in Latin America and the Caribbean (Figure 8). The COVID-19 pandemic has also set back learning by about 0.5 to 2 years, with the most vulnerable students bearing the brunt.

3 World Bank World Development Indicators Database.

Figure 8
Average years of schooling and learning-adjusted years of schooling by world region, 2020



Source: EIB staff calculations based on World Bank (2023b).

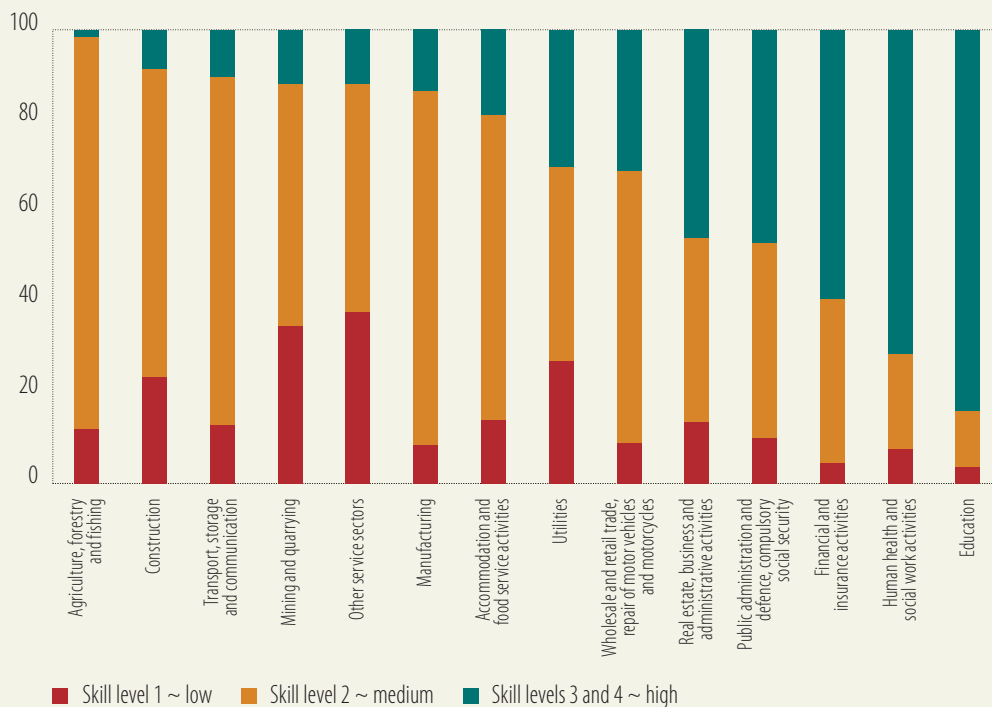
Note: Learning-adjusted years of schooling merge the quantity and quality of education into one metric, reflecting that similar durations of schooling can yield different learning outcomes. See Filmer et al. (2020) for the detailed methodology.

Building the appropriate skill base is necessary for boosting high-productivity sectors with employment potential. African countries must identify industries that combine potential for productivity growth and creation of quality jobs (Rodrik and Stiglitz, 2024). Manufacturing is strategic, but its growth remains limited: The sector employed about 8% of Africa's workforce in 2022, compared with 12% in developing Asia and 19% in China (Newfarmer and Heitzig, 2023).

Employment in financial and insurance activities grew at an average annual rate of 4% between 2000 and 2021, a higher rate than agriculture (at 1.7%), although from a lower base. Although the financial and insurance sector accounts for less than 2% of total employment in Africa, about 60% of the workforce in this sector is formal, with employment contracts and paid taxes, varying from 47% in West Africa to 71% in North Africa. Almost half of the occupations in the sector require high educational attainments to match the expected complexity and range of tasks, unlike the agriculture or manufacturing sectors that rely primarily on medium-skilled occupations (Figure 9). Only the education and health sectors have a higher share of workers in skilled occupations. Skills development in commodity-based economies could also boost productivity in strategic sectors:

- Central and Southern Africa's mining sector needs to overcome skills shortages to develop downstream industries like cobalt refining and electric vehicle manufacturing, where value addition per worker is higher than in extraction.
- West Africa ranks among the world's top producers of a dozen agri-food products, such as fonio, shea nuts, yams and cocoa beans. However, about a quarter of these products are lost after harvest. Boosting research and development, technical skills and conservation techniques will reduce this waste, support the development of higher-value products and enhance regional food security and resilience to climate change.

Figure 9
Percentage of workers in low-, medium- and high-skilled occupations by economic activity in Africa, 2021 or latest available data



Source: *ILOSTAT (2023), ILO Labour Force Statistics (database).*
 Note: Skill level is defined as a function of the complexity and range of tasks and duties performed in an occupation. Skill level 1 (low) covers elementary occupations. Skill level 2 (medium) covers plant and machine operators and assemblers, craft and related trade workers, skilled agricultural, forestry and fishery workers, service and sales workers, and clerical support workers. Skill levels 3 and 4 (high) cover technicians and associate professionals, professionals, and managers. Data are based on labour force statistics across 31 African countries.

The digital and green transitions are creating demand for new types of skills. Digital skills enable workers to use digital technologies productively, and range from basic (for example, internet navigation or mobile communication) to intermediate (use of spreadsheet and presentation software) and advanced (programming). By 2030, 70% of the projected demand in five African countries (Côte d'Ivoire, Kenya, Mozambique, Nigeria and Rwanda) will be for basic digital skills and 23% for intermediate digital skills, especially in services (Figure 10). However, only 9% of the workforce aged 15-24 across 15 African countries currently possess basic digital skills while 5% hold intermediate digital skills (UNICEF, 2022).

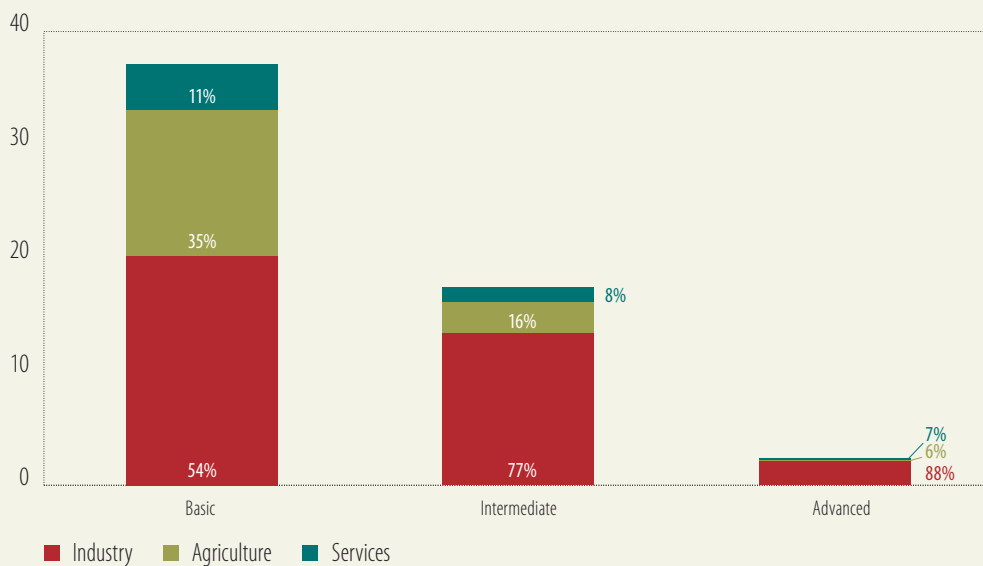
- In East Africa, progress in digital skills development is highly uneven: The share of the population aged 15 years and over who possess basic digital skills ranges from 33% in Mauritius to 4% in South Sudan. Despite these shortcomings, digital sectors have grown steadily in the region. East Africa registered the highest number of mobile money accounts (1 106 per 1 000 adults compared with 600 for Africa, 533 for developing Asia and 245 for Latin America and the Caribbean). Country-specific expansion of digital skills provision, especially through technical and vocational education and training institutions, can effectively respond to increasing demand for digital skills in the region.

Green skills, which are those needed for developing or modifying products, services or operations in response to climate change, will also be necessary for supporting climate adaptation and mitigation and driving productive transformation in sectors such as renewable energies, construction, infrastructure and recycling. In Africa, renewable energy and sustainable infrastructure could generate over 9 million job opportunities from 2019 to 2030 and a further 3 million jobs by 2050.

- North Africa is the region with the greatest potential for developing solar and wind energy and is set to become the leading exporter of green hydrogen, with estimated exports of \$110 billion a year by 2050. Egypt, Morocco and Algeria have expanded solar energy, with the latter two ranking second and third in solar production on the continent, behind South Africa. Egypt and Morocco also dominate African wind energy production after South Africa. Developing specific technical skills (for example, construction and installation) and managerial skills (like project management) could create at least 2.7 million jobs, improve energy security and contribute to the efforts to reduce global emissions.

Figure 10

Number of jobs (in millions) requiring digital skills in 2030 in five African countries, by skill level



Source: EIB staff calculations based on World Bank (2021).

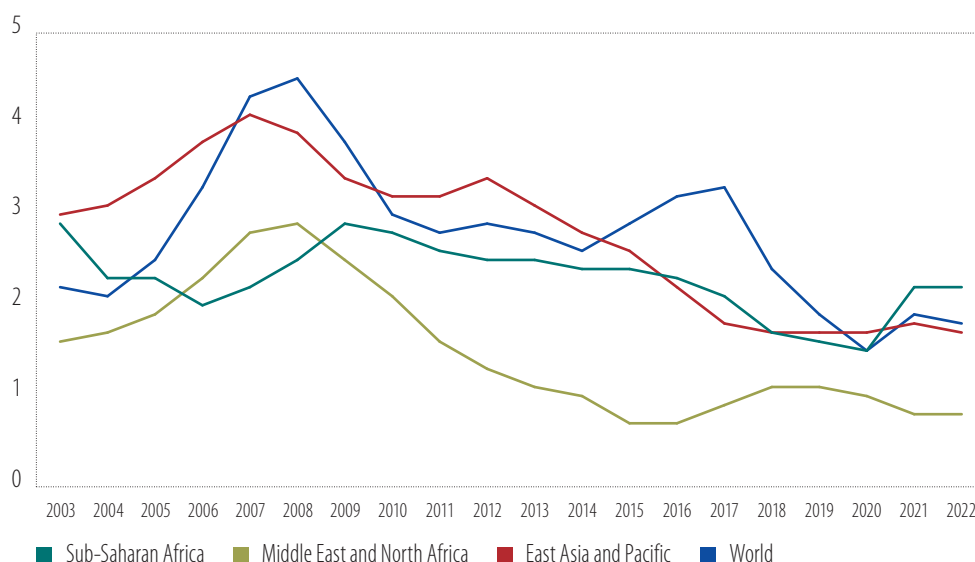
Note: Data cover Côte d'Ivoire, Kenya, Mozambique, Nigeria and Rwanda.

Accelerating Africa's progress in education would bring huge benefits for development. Macroeconomic analysis reveals that foundational skills acquired in primary and secondary education highly correlate with economic growth. Microeconomic analysis of over 7 600 manufacturing firms in 27 African countries suggests that a 10 percentage point increase in the share of employees with high school and university degrees is associated with an increase in average firm productivity of between 4.2% and 4.8% (Okumu and Mawejje, 2020). Returns on education seem higher in Africa than elsewhere in the world: Each additional year of education could increase African learners' earnings by 8.2% to 11.4%, compared with 7.6% to 9.1% for countries in Latin America and the Caribbean (Peet et al., 2015).

Financing constraints are still hindering private sector development, with inadequate flows of external and domestic finance. For external finance, recent research (Bill and Melinda Gates Foundation, 2023; International Monetary Fund, 2023; Piemonte et al., 2019) has highlighted how the types of financing available to countries tend to depend on the income level of a country, with low-income countries relying more on official development assistance, and middle- and high-income countries featuring private foreign direct investment in a more prominent role. The International Monetary Fund notes that foreign direct investment was vital for the successful development of East Asia, whereas many countries in sub-Saharan Africa are stuck at the early stage of development, relying on official development assistance rather than foreign direct investment and with the private sector playing a more limited role (International Monetary Fund, 2023). This situation is becoming more problematic as official development assistance flows dry up.

During the period before the global financial crisis, the level of net inward foreign direct investment as a percentage of GDP was much higher among developing Asian countries than in sub-Saharan Africa (Figure 11) or the Middle East and North Africa region. However, the gap between sub-Saharan Africa and East Asia and the Pacific narrowed after the global financial crisis, mainly because global foreign direct investment flows began slowing. The Middle East and North Africa region had similar levels of foreign direct investment to sub-Saharan Africa until the global financial crisis when foreign direct investment fell more sharply in the former. Global foreign direct investment in 2022 is at levels not seen since the late 1990s. Indeed, capital flows more generally (including portfolio flows and cross-border banking flows) stagnated in the period after the global financial crisis (Tiftik et al., 2023). This reduced flow of international capital is concerning for regions such as Africa, where large amounts of capital need to be mobilised to achieve development goals and climate targets.

Figure 11
Inward foreign direct investment flows by region (% of GDP, three-year moving average)



Source: IMF World Economic Outlook Database, October 2023.
Note: East Asia and Pacific (excluding high-income countries), Middle East and North Africa (excluding high income countries).

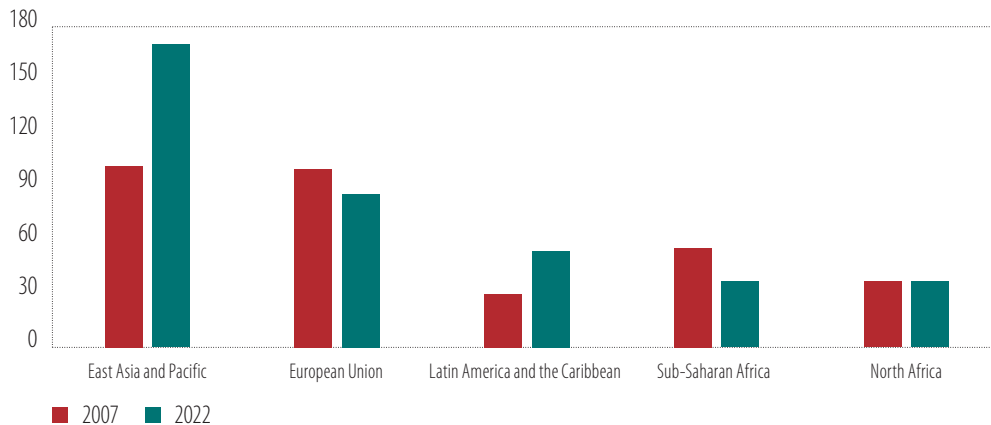
Against a background of declining foreign investment, domestic resources are the largest source of investment funding in most economies, but sub-Saharan African countries operate under considerable constraints. Public investment is currently hampered by relatively low government revenue as a percentage of GDP and high debt levels. Government revenue equalled 17.7% of GDP in sub-Saharan Africa in 2022, compared with 26% in North Africa⁴ and 30.6% in Latin America and the Caribbean, meaning sub-Saharan African governments have fewer resources available for domestic investment. In addition, higher public debt levels and interest rates are diverting resources from other uses such as public investment. For private investment, saving rates in sub-Saharan Africa are sometimes low due to a young population, high levels of informality in the economy and relatively low-income levels, reducing the availability of investment funds. Furthermore, low levels of financial inclusion and shallow bank credit markets mean that savings are not always channelled to the most productive investments.

⁴ Egypt is a notable exception among the large countries in the region, with government revenue of 19% of GDP, which is more in line with the average for sub-Saharan Africa.

Sub-Saharan Africa has seen credit as a share of GDP decline over the last 15 years. Private sector credit in 2022 was 36% of GDP, a decline from 56% of GDP in 2007 (Figure 12), highlighting that credit provision to the private sector has failed to keep pace with economic growth. Moreover, of the 30 countries across the world with the lowest share of credit to the private sector as a percentage of GDP, 24 were in sub-Saharan Africa. In North Africa, credit as a share of GDP between 2007 and 2022 was unchanged at 37%, as credit expansion in countries like Morocco and Tunisia was offset by a sharp drop in credit as a share of GDP in Egypt. In contrast, East Asia and the Pacific saw rapid growth in the provision of credit to the private sector between 2007 and 2022, which may have contributed to brisk growth in the economy and incomes. In Latin America and the Caribbean, credit as a percentage of GDP was 30% in 2007 – lower than that of sub-Saharan Africa. However, the credit market of Latin America and the Caribbean grew relative to GDP between 2007 and 2022, while that of sub-Saharan Africa shrank. Like sub-Saharan Africa, credit to the private sector in the European Union shrank relative to the size of the economy between 2007 and 2022. This metric had been on an upward trajectory until the global financial crisis, but with banks at the centre of the crisis, domestic credit and cross-border bank flows declined in the aftermath.

Figure 12

Credit to the private sector (% of GDP)



Source: *IMF World Economic Outlook Database, October 2023.*

Note: *East Asia and Pacific (excluding high-income countries), Latin America and Caribbean (excluding high-income countries).*

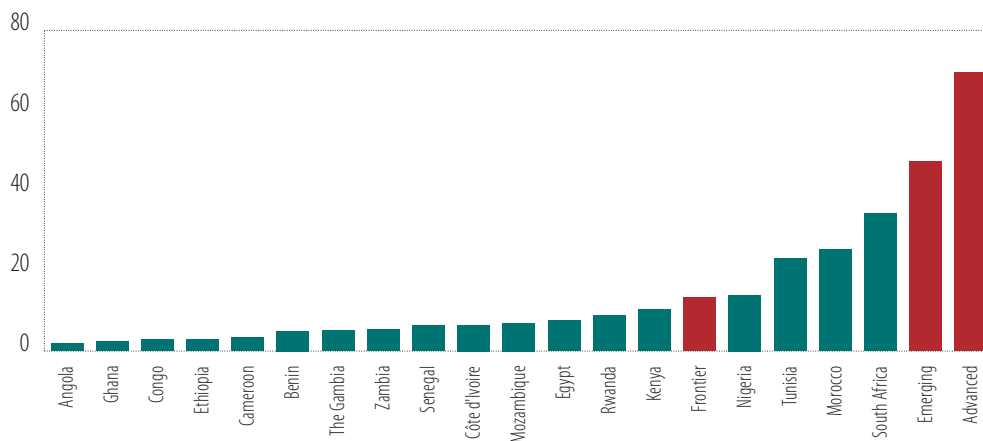
A multi-country comparison highlights the low levels of household and corporate sector indebtedness in Africa. Of the 18 Africa countries with data available, 13 have household debt of less than 10% of GDP (Figure 13). Moreover, only Nigeria, Tunisia, Morocco and South Africa have household debt ratios above the frontier (or pre-emerging) market average, but their debt ratios remain below the averages for emerging market and developing economies.⁵ As African economies develop more mature credit markets, opportunities for lending to households could represent a significant growth opportunity for banks and a source of finance for investment.

The corporate sector is generally more indebted than the household sector in Africa. For corporate debt, only six countries have debt of 10% or less of GDP compared with 13 countries for household debt (Figure 14). The frontier market average for corporate debt is also higher at 25% of GDP, vs. 13% for household debt. As shown in *Finance in Africa 2023* (EIB, 2023), the banks taking part in our survey tended to lend to large firms rather than small and medium-sized enterprises. A considerable share of credit in Africa is therefore channelled towards large firms rather than small firms and households. Nonetheless, African corporate indebtedness remains well below the emerging and advanced market averages.⁶

⁵ The frontier group are excluded from the broader emerging market and developing economies group when calculating these averages.

⁶ For corporate debt, indebtedness is higher in emerging markets compared with advanced markets, as the average for emerging markets is heavily skewed by China. Chinese corporate sector debt equates to 164% of GDP and has a weight of over 40% in the calculation of the emerging market weighted averages. The median, rather than the average, emerging market corporate indebtedness ratio is close to 45%.

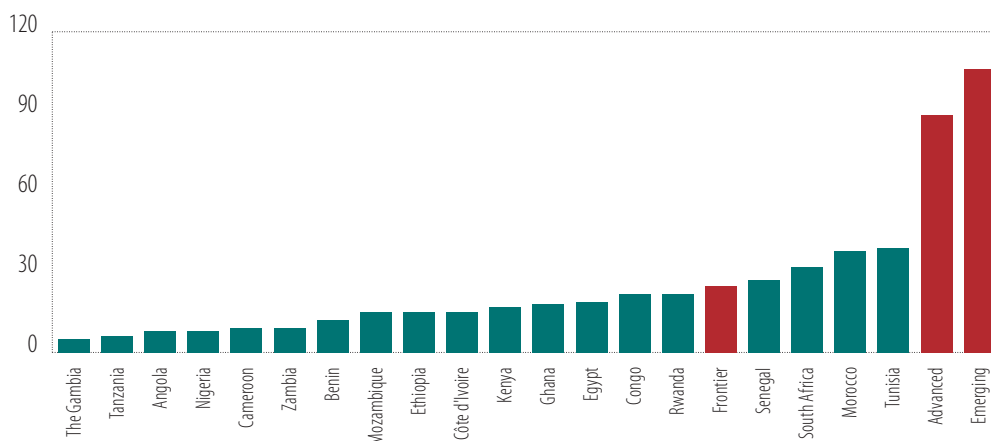
Figure 13
Household debt (% of GDP, 2023Q4)



Source: Institute for International Finance, Global Debt Monitor and Frontier Markets Debt Monitor (subscription required).

The relatively low level of private sector credit may be limiting the rate of private investment, partly through degradation of the private capital stock. According to International Monetary Fund data,⁷ the median private capital stock was equal to 88% of GDP across 48 African countries in 2019, which is the latest year for which data are available. For the other 113 countries across the globe in the sample, the median was 155% of GDP (Figure 15). This means that African countries have a lower private capital productive base relative to other regions. In contrast, public capital stock ratios across the two groups of countries are broadly similar, at 54% of GDP in Africa and 59% in other countries. This suggests that the biggest difference between the two sets of countries is in their private productive capacity.

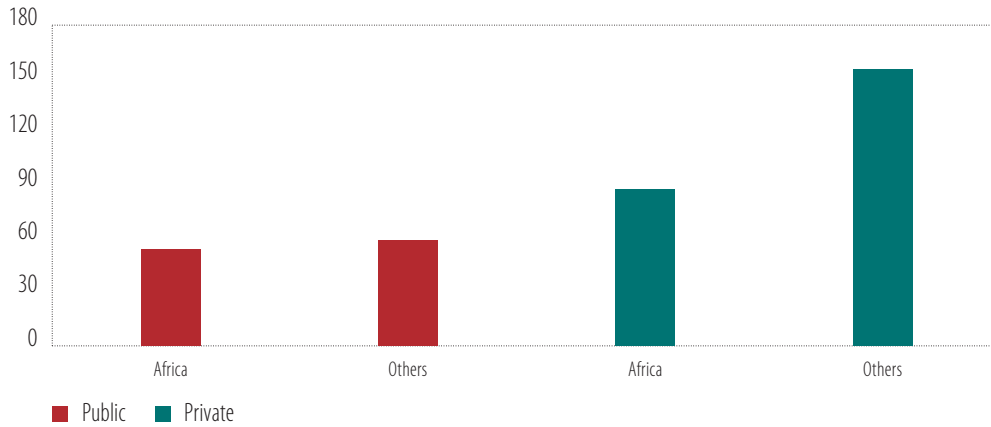
Figure 14
Corporate debt (% of GDP, 2023Q4)



Source: Institute for International Finance, Global Debt Monitor and Frontier Markets Debt Monitor (subscription required).

7 IMF Investment and Capital Stock Dataset (ICSD).

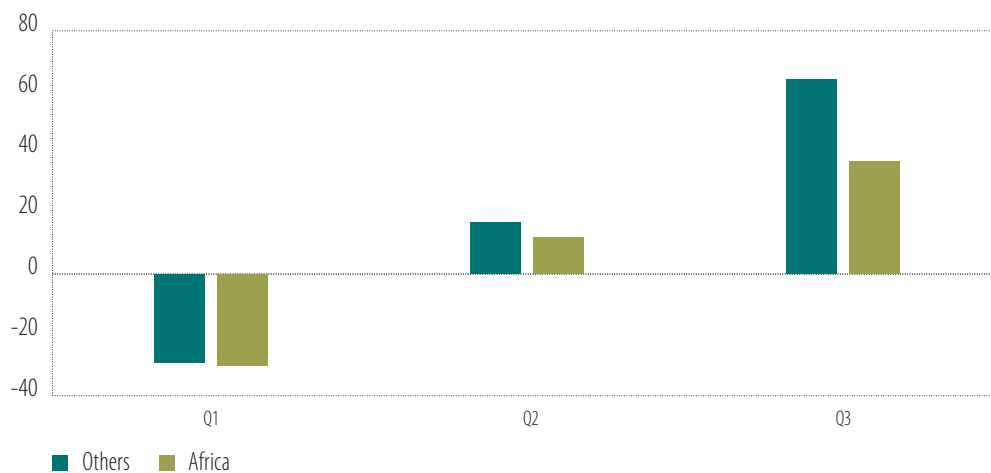
Figure 15
Median capital stock by region (% of GDP)



Source: IMF Investment and Capital Stock Dataset.

Even the top-performing countries in Africa have been less likely than other regions to see their private capital stock grow significantly relative to the size of the economy over the last 20 years. Figure 16 shows how much the capital stock in Africa changed between 2000 and 2019, as a percentage of GDP and broken down by quartile. The 25th percentile (also known as the first quartile) for African and other countries is close to -30 percentage points, meaning that a quarter of countries in both groups saw their private capital stock ratios decline by at least 30 percentage points of GDP. A moderate difference emerges for the median country (second quartile in Figure 16) in each group, with an increase of 12 percentage points of GDP for Africa compared with 17 percentage points of GDP for other countries. However, the 75th percentile or third quartile, which represents the top-performing countries in each group, shows an increase of 64 percentage points of GDP for other countries compared with only 37 percentage points of GDP for Africa. This means that even the top-performing countries in Africa saw their private capital stock increase at a much slower rate than other regions, despite the capital stocks coming from a lower starting point. Diminishing access to finance is therefore potentially linked to weaker growth in private capital stock, which in turn has contributed to disappointing convergence in living standards.

Figure 16
Change in private sector capital stock to GDP ratio 2000-2019 (percentage points of GDP)



Source: IMF Investment and Capital Stock Dataset.

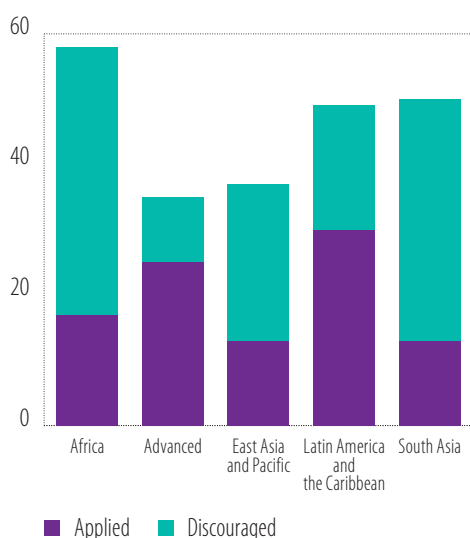
Microeconomic evidence on access to finance constraints

A lack of finance at the firm level is potentially restricting private sector development and industrialisation in Africa. Academic literature documents how finance has driven industrialisation for centuries. Heblich and Trew (2018) show that banking sector access by firms was a causal factor in the industrial revolution, with these firms having higher industrial employment. Svilokos et al. (2019) demonstrate a link between financial conditions, such as real interest rates, and industrialisation in Central and Eastern Europe. In addition, Brixiová et al. (2020) show that across 42 countries, African firms with access to finance create more jobs than credit-constrained firms, and the impact is strongest for manufacturing jobs.

This section examines the ability of African firms to access external finance based on World Bank Enterprise Survey data. The World Bank Enterprise Surveys feature data from interviews of more than 219 000 firms in 159 economies across the globe. These data are suitable for measuring financial access because they represent the experience of a broad cross-section of firms and individuals. Furthermore, the surveys contain a module specifically dealing with firms’ access to finance. The EIB, the European Bank for Reconstruction and Development and the World Bank have worked together to collect data in North Africa, Eastern Europe and Central Asia.⁸ This section discusses the data for 18 African economies that have been fielded since 2020: Botswana, Central African Republic, Côte d’Ivoire, Egypt, Ghana, The Gambia, Lesotho, Morocco, Madagascar, Mauritius, Rwanda, Sierra Leone, Seychelles, Chad, Togo, Tunisia, Tanzania and South Africa.

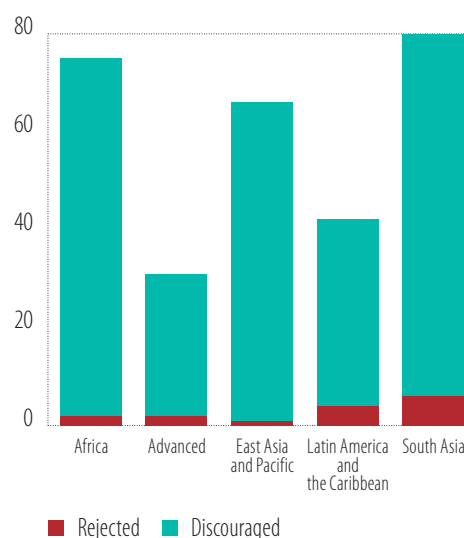
Africa has the highest share of firms needing loans. Understanding whether a firm that needs a loan can obtain one is of particular interest, as there may be market failures. Figure 17 compares the percentage of firms needing loans in Africa with the benchmark groups used throughout this chapter, distinguishing between firms that need a loan and applied for one and those that need a loan but did not apply for one – also known as discouraged firms. The banking systems of advanced economies are characterised by a low share of discouraged firms as a percentage of the total number of firms and relative to firms needing a loan. Africa has the highest share of firms needing a loan (58%), ahead of South Asia (51%) and Latin America (49%). However, Africa also has the highest share of discouraged firms (41%).

Figure 17
Need for loans



Source: Enterprise Survey and EIB staff calculations.

Figure 18
Credit-constrained firms

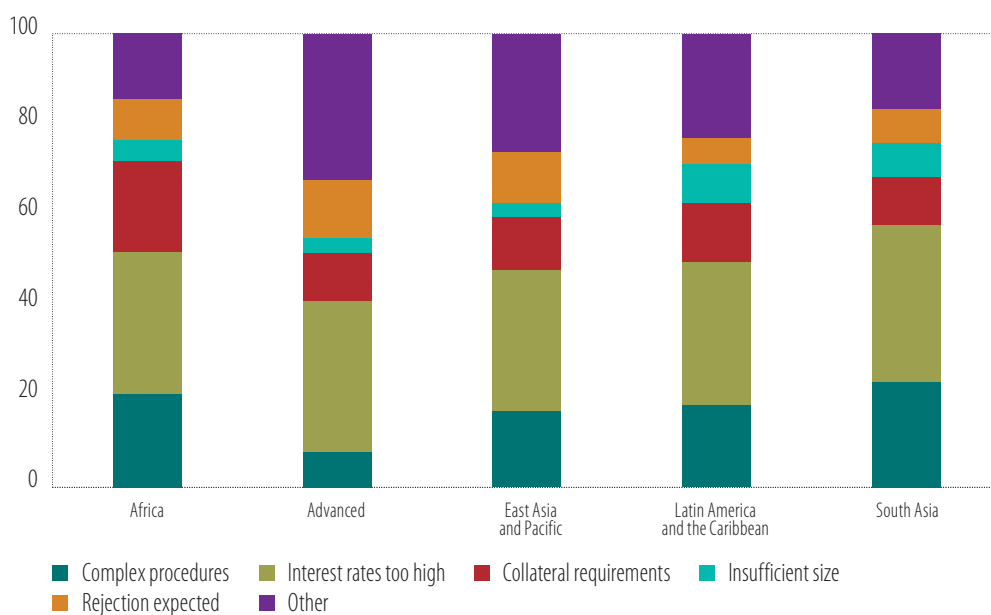


8 This cooperation has led to the following reports: European Investment Bank (2022a, b) and European Investment Bank (2022c).

Most firms in need of a loan are unable to obtain one, meaning that credit is constrained. Credit-constrained firms are those that need a loan but either have their loan application rejected or are discouraged from applying in the first place. Discouraged firms need a loan but refrain from applying because of what they perceive as complex application procedures, unfavourable interest rates, high collateral requirements, insufficient loan amounts, fear of being rejected and other, unspecified reasons. Only firms needing a loan can be credit constrained. Figure 18 expresses credit-constrained firms as a percentage of firms needing a loan. According to the survey, 74% of African firms in need of a loan are credit constrained, second only to South Asia (80%). Most credit-constrained firms are discouraged from applying for a loan. Meanwhile, rejections are rare across all regions. In summary, the results indicate that firms in Africa are frequently unable to obtain the financing they need.

Stringent collateral requirements, complex application procedures and high interest rates discourage firms from applying for a loan. Given the high share of discouraged firms among credit-constrained companies, it is useful that the survey provides additional information on why firms are discouraged. Figure 19 shows that discouraged firms in Africa most frequently cite high interest rates as the reason that they did not apply for a loan (31%), ahead of complex applications procedures (21%) and stringent collateral requirements (20%). As in Africa, firms in other regions also refer to high interest rates as the key reason for not applying for a loan. In this context, it is important to note that complaints about high interest rates cannot be viewed in isolation from the returns companies can generate with their assets. Firms discouraged by high interest rates state that their marginal cost of funding is high relative to the marginal return on capital. Africa has the highest share of firms affected by stringent collateral requirements, including a lack of high-quality collateral such as real estate on the side of firms. However, the high share of firms citing collateral constraints can also indicate collateral regimes that make pledging movable assets challenging for firms. The significant percentage of firms citing complex application procedures likely reflects constraints on the supply and the demand side of the market: Clients might not be sophisticated enough to feel confident in approaching a bank, and banks may not have lending programmes adapted to the needs of small and medium-sized firms.

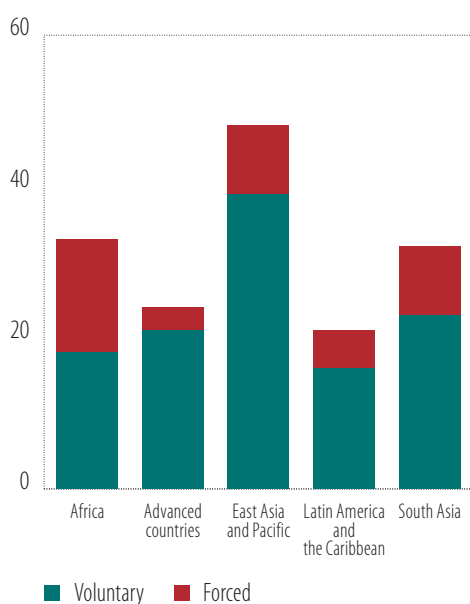
Figure 19
Factors discouraging firms from applying for a loan



Source: Enterprise Survey and EIB staff calculations.

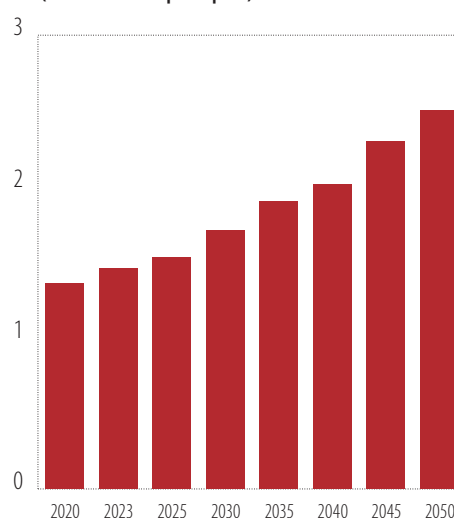
An operating environment characterised by ineffective financial intermediation may induce firms to become financially autarkic or self-sufficient. In this analysis, financially autarkic firms are those that operate using internal finance only. The phenomenon of these zero-leverage firms is not limited to small firms in low and middle-income countries – 10% of listed US companies fall into this category (although the capital structure choices of these firms may be driven by different considerations).

Figure 20
Financially autarkic firms



Source: Enterprise Survey and EIB staff calculations.

Figure 21
Projected African population (billions of people)



Source: United Nations Population data.

To qualify as financially autarkic, a firm must meet several conditions. First, the firm must finance its working capital from internal sources only. This definition excludes firms that use supplier credit to finance their working capital. If the firm invests, the investment also needs to be financed exclusively from internal sources. In addition, the firm must not have any outstanding loans or access to an overdraft facility. Combining data on firm liability structure with information on loan demand makes it easier to understand whether a firm prefers self-finance. This applies to firms that are financially autarkic and do not need a loan (referred to as voluntarily autarkic). Financially autarkic firms that need a loan are by construction credit-constrained, because if they had obtained a loan, they would no longer be autarkic. These firms are referred to as forced autarkic.

Africa has the highest share of forced autarkic firms. Figure 20 shows the share of financially autarkic firms by region. In total, 33% of firms in Africa are deemed financially autarkic – the second highest share after East Asia and the Pacific (48%). Although both regions have a comparable share of credit-constrained firms, the share of overdraft facilities is lowest in East Asia and the Pacific. The next step in the analysis is understanding whether firms prefer operating with zero-leverage or whether they would prefer to take on debt but are credit constrained. Figure 20 also provides information on the relative importance of voluntary and forced autarkic firms. In all regions, most financially autarkic firms are voluntarily autarkic.

If Africa could address the challenges outlined in this chapter, the payoffs for growth and development would be huge. The urgency of investing is heightened by a rapidly growing population. Africa has a youthful and growing population, with the total population expected to almost double between 2020 and 2050 (Figure 21). The World Bank (2023a) reports that the working age population in Africa is not expected to peak until close to the year 2100. As the working age population grows, Africa is expected to enjoy a so-called demographic dividend. However, to benefit from this dividend, Africa must provide

more education, healthcare and infrastructure. In addition, creating more robust employment, supported by a thriving private sector, will be necessary to absorb these new entrants to the labour force. Against this background, investment is imperative and the EIB will continue to provide sustainable investments in Africa with a view to underpinning inclusive development on the continent.

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Chapter 2 **Economic development and access to finance**



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