



Contemporary Issues in African Trade and Trade Finance

CIAT

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HEAD OFFICE

African Export-Import Bank
72[B] El Maahad El Eshteraky Street
Heliopolis, Cairo 11341
P O Box 613 Heliopolis
Cairo 11757, Egypt

Tel: +202 2456100/1/2/3

Email: info@afreximbank.com

Website: www.afreximbank.com

EDITOR-IN-CHIEF

Oyeyemi Kale African Export-Import Bank

EDITORIAL COMMITTEE

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The Contemporary Issues in African Trade and Trade Finance (CIAT) is introduced by the bank to provide a platform for the staff of Afreximbank and other individuals knowledgeable in African trade and trade finance to publish articles in the areas of trade, trade finance and economic development in Africa. The CIAT publishes technical and non-technical papers. Edited by a committee, drawn from both internal and external sources, it also publishes relevant papers at conferences or seminars and those presented at the bank's internally organised Knowledge Sharing Sessions. The journal welcomes editorial comments and responses which will be considered for publication to the extent that space permits.

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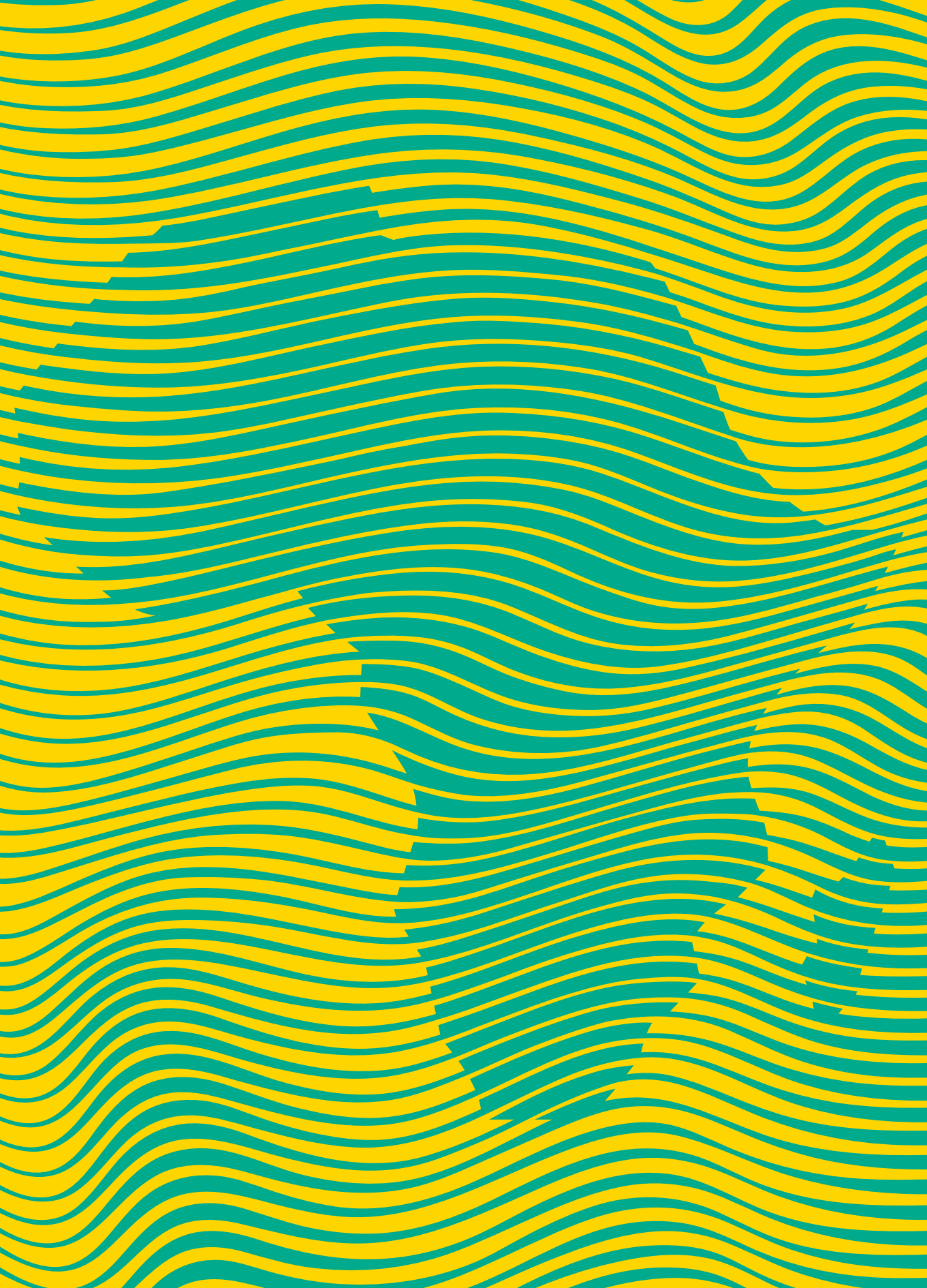
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Foreword

Significant financing deficits and inadequate infrastructure are constraining Africa's economic growth and development.

The African Development Bank estimates that Africa requires between US\$140 billion and US\$170 billion annually to meet its infrastructure funding needs. The financing gap ranges from US\$68 billion to US\$108 billion. By 2030, the annual financing gap is projected to reach approximately US\$402 billion, representing about 12 percent of the continent's projected GDP. Therefore, considerable resources are needed to close the financing gap for infrastructure development and the structural transformation of African economies.

African financial institutions are not sufficiently capitalised to fully fund the continent's growth and development needs. Additionally, Africa's financial markets are not deep enough to provide the capital required to address the annual financing needs of countries in the region. Diversifying the sources of funding, including tapping into pension funds, is crucial to bridging the financing gap, spurring economic growth, and improving living standards. According to the Organisation for Economic Co-operation and Development

(OECD), pension fund assets in OECD countries amounted to US\$54 trillion in 2020, with a significant portion invested in the bond market. This represents a substantial pool of resources in the debt capital market that can potentially be accessed for infrastructure funding. In contrast, pension fund assets in Africa (excluding South Africa) are estimated at less than US\$100 billion. The scarcity of capital in Africa will require creativity and innovation to leverage the limited resources available to close the financing gap.

The papers in this volume of Contemporary Issues in African Trade (CIAT) address various aspects of Africa's development challenges, with a particular focus on three inherently linked themes: finance, trade, and economic development.

Andreas Klasen, of the University of Oxford, explores the roles, challenges, and opportunities encountered by African multilateral development banks (MDBs) and African and non-African export credit agencies (ECAs) in financing the continent's industrial and trade infrastructure. He also examines the rising debt burden in

Africa and the shrinking fiscal space to finance infrastructure projects. Klasen advocates for the adoption of innovative financing instruments by African MDBs, ECAs, and export-import banks to leverage private sector resources and prioritise green infrastructure. He further recommends expanding partnerships between African and non-African MDBs to scale up infrastructure financing.

Joshua Abor, of the University of Ghana, examines the role of development finance institutions (DFIs) in scaling up climate finance. He argues that DFIs can leverage their expertise and long-term relationships with the private sector to overcome challenges in funding projects that mitigate and reduce carbon emissions. Abor calls for the mainstreaming of climate finance into DFIs' operational activities and mechanisms, while also encouraging DFIs to engage with shareholders to increase their capital base.

Komlan Kadagali and Sampawende Tapsoba, of the University of Togo and the African Export-Import Bank (Afreximbank) respectively, discuss the relationship between public and private investment and economic growth over the short and long term. While acknowledging the importance of public investment, they assert that private sector investments have a more potent impact on driving long-term economic growth. The authors call for a reassessment of

development strategies aimed at harnessing the synergies between public and private investment.

Anthony Oyeyemi, Kyereboah-Coleman, Kale, Raymond Boumbouya, and Mercy Marimo, all from Afreximbank, question the methodologies used by the three leading credit rating agencies—S&P, Moody's, and Fitch—in assessing African countries. Their paper argues that these methodologies fail to adequately reflect the unique economic, political, and social realities of African nations. The authors advocate for a revision of these methodologies to better account for Africa's distinct economic, political, and social environments to avoid discouraging investment and constraining access to development finance.

Abel Osuji, of Afreximbank, explores the historical evolution of sustainable finance practices and their underlying conceptual frameworks. He contends that the principles of sustainable finance are primarily rooted in Western modernist philosophy, which often marginalises the values and experiences of developing countries. Osuji calls for a reconceptualization of sustainable finance models that incorporate culturally specific variations relevant to Africa.

Lukman A. Lasisi, Isaiah Adisa, and Ihunanya N. Erundu, of the Lagos Business School, Pan Atlantic University, focus on the challenges associated with geopolitical

instability in Africa and its effects on regional trade integration efforts. They attribute the low levels of intra-regional trade to political unrest, poor governance, and security issues. To fully realise the potential of the African Continental Free Trade Area (AfCFTA), the authors suggest that African governments and regional bodies should prioritise peace promotion, political stability, and good governance.

Kanayo Awani, of Afreximbank, highlights the significance of the AfCFTA in achieving Africa's development objectives. Awani discusses the role of sub-sovereign governments, through the African Sovereign Governments Network, in supporting the aspirations of the AfCFTA. She emphasises the importance of aligning national and local trade policies and developing trade-enabling infrastructure.

Oyeyemi Kale, of Afreximbank, examines the unique development challenges faced by Northern Nigeria, including poor infrastructure, inadequate healthcare services, and political instability. Kale explores how technology can be leveraged to accelerate economic growth in the region and identifies education, skills development, and public-private partnerships as critical enablers of development. He also stresses the importance of fostering security and stability to create the conditions necessary for sustained economic growth in Northern Nigeria.

While climate finance continues to engage the attention of policymakers and financiers in the context of the ongoing debate about energy transition, the lens on Africa's perennial financing deficit, which undermines its development aspirations, should not be blurred. Innovative financing mechanisms that recognise the delicate balance between the challenges of climate change and Africa's development imperatives are increasingly becoming a non-negotiable path toward equity and a just transition for the continent. The papers in this issue of CIAT, which underscore the multifaceted nature of the causative elements of the region's funding constraints, provide valuable policy suggestions for addressing some of the challenges hindering Africa's progress in finance, trade, and economic development. I highly recommend this volume of CIAT to policymakers, development practitioners, scholars, and all those interested in the continent's growth and development.



Professor Benedict Okey Oramah
President and Chairman
of the Board of Directors,
African Export-Import Bank

Africa's Industrial and Trade Infrastructure: Mobilising Development and Trade Finance

Andreas Klasen

Abstract: Africa's industrial and trade infrastructure is critical to fostering sustainable economic development, increasing competitiveness and integrating the continent into global value chains. However, significant infrastructure gaps remain due to underinvestment and a complex mix of political, economic and regulatory challenges. This policy insight examines the critical role of African multilateral development banks (MDBs), export credit agencies (ECAs) and export-import banks (EXIMs) in mobilising trade and development finance for Africa's industrial and trade infrastructure. It looks at the opportunities offered by these institutions, the constraints they face, and examples of innovative financing mechanisms being used to bridge the financing gap. The policy insight also considers the rising debt levels in several African countries and their implications for MDBs, ECAs and EXIMs in the context of infrastructure development. The article concludes with policy recommendations to optimise the role of public financing institutions in supporting sustainable development and trade expansion.

Keywords: Multilateral development bank, export credit agency, development finance, trade finance, bonds, infrastructure, sustainability

JEL Classification: B17, F13, F34, R11, Q56

Introduction

The trade landscape in Africa is undergoing a significant transformation: Various sectors such as renewable energy and health tech attract increasing local and foreign investments. In addition to services trade, sectors driven by innovation and technology, including machinery and equipment, play a vital role in Africa's economic development

and growth (David, 2019; Fiorini, Hoekman and Quinn, 2022). The continent is also witnessing the emergence of its own unique form of economic integration. The African Continental Free Trade Area (AfCFTA) aims at boosting trade within the continent by 25% to 30% in the next decade. However, unlocking this potential depends on a robust and modernised infrastructure base. Appropriate infrastructure is of

critical importance for people and businesses, raising the supply-side capacity of economies which also benefit directly through job creation. Infrastructure creates fundamental impacts regarding an inflow of firms and individuals, creating dynamic effects that may amplify or attenuate an initial growth impetus (Dang and Pheng, 2015; Grimes, 2014). Inadequate infrastructure, whether transport, energy, telecommunications or logistics, continues to hinder the continent's growth trajectory, limiting its ability to fully engage with global markets (Geda and Yimer, 2022; Gumedé, 2021; Sibanda, 2021).

Infrastructure projects promise tremendous opportunities for investors, contractors, operators and suppliers. However, the financing perspective is critical. Domestic public finance for publicly owned infrastructure comes from different sources such as taxation and public borrowing. Significant amounts of financing are also expected to be provided in the future by the private sector (Bannert, 2020; Regan, 2018). Furthermore, MDBs, bilateral development finance institutions (DFIs), official development assistance (ODA), ECAs and EXIMs are highly relevant financing source for infrastructure projects in Africa. Demand encompasses both funded and non-funded products (AfDB, 2017; AfDB and Afreximbank, 2020; Oramah, 2020). This article examines the roles, challenges and

opportunities facing African MDBs, as well as African and non-African ECAs and EXIMs in financing the continent's industrial and trade infrastructure. It also analyses selected mechanisms and discusses the rising debt levels that threaten Africa's financial stability. Finally, the paper offers policy lessons aimed at enhancing the effectiveness in mobilising development and trade finance for future growth.

African Multilateral Development Banks and Infrastructure Financing

Africa's multilateral development banks are central to supporting the continent's infrastructure development. These institutions, such as the African Development Bank (AfDB), address infrastructure deficit through long-term capital investment. Their mission is to promote economic development, poverty reduction and regional integration, all of which depend on adequate industrial and commercial infrastructure (Gurara, Presbitero and Sarmiento, 2020; Park, 2023). For example, AfDB's approvals for infrastructure amounted to US\$ 3.5 billion in 2023 (AfDB, 2024). Enabling access to trade-related infrastructure is also a key topic for the African Export-Import Bank (Afreximbank) (Afreximbank, 2024). Multilateral institutions thus play a critical role in bridging the financing gap by providing a range of financial products. These include sovereign loans to African governments,

non-sovereign loans to private sector entities, or guarantees that mitigate risk for private investors. MDBs also contribute to early-stage project preparation. By providing concessional finance and matching it with private capital, MDBs reduce the risk associated with infrastructure investment, particularly in politically and economically volatile regions (Gurara, Presbitero and Sarmiento, 2020; Humphrey and Michaelowa, 2019). De-risking mechanisms are crucial for attracting foreign direct investment (FDI) in large infrastructure projects, which might otherwise struggle to secure financing (Protopsaltis, 2019).

Despite their important role, African MDBs face several challenges. One of the most important is limited capitalisation. Compared to other MDBs outside Africa, institutions on the continent have smaller balance sheets, which limits their ability to finance large infrastructure projects independently. This limitation often forces them to rely on co-financing arrangements with a broad range of international partners, which can slow down project implementation and increase complexity (Arvanitis, Stampini and Vencatachellum, 2015; Humphrey, 2014; Park, 2023). Infrastructure projects require long-term stability to ensure a return on investment, however, this is often lacking in countries where governance is weak or prone to change. African MDBs thus can face delays and disruptions due

to political unrest or changes in government priorities. In addition, differences in legal frameworks, investment policies and regulatory standards make it challenging to implement large-scale projects that span multiple countries. In such environments, financing becomes more expensive and the risk of project failure increases.

While African MDBs face challenges, they also have opportunities to play an even greater role in mobilising finance. A key opportunity lies in expanding their use of innovative financing instruments, such as blended finance, public-private partnerships (PPPs) and project-related bonds. These instruments allow MDBs to leverage private sector investment while maintaining a focus on social and development outcomes. Another opportunity is the growing emphasis on green infrastructure projects. As Africa grapples with the impact of climate change, MDBs have an opportunity to take the lead in financing climate-resilient infrastructure, such as renewable energy, sustainable transport systems and climate adaptation projects. By focusing on green infrastructure, MDBs can access new sources of finance such as climate funds while promoting sustainable development across the continent. MDBs could also expand their partnerships with non-African MDBs and bilateral development finance institutions (DFIs). Further strengthening these partnerships will

be critical to scaling up infrastructure financing.

ECAs and Infrastructure Financing

Export credit agencies and export-import banks are playing an increasingly important role in financing industrial and trade infrastructure across Africa. The rationale for public interventions in several areas of trade finance and export credits can be summarised as follows: Addressing information asymmetry, providing financial support, and mitigating risk to promote trade and help to create or secure jobs in the domestic economy (Chatterjee et al., 2020; Kim, 2020; Klasen and Schedler, 2024; Turguttopbas, 2013). African ECAs and EXIMs, such as South Africa's Export Credit Insurance Corporation (ECIC) and Nigeria's Export-Import Bank (NEXIM), are working with multilateral entities and private sector financiers to mobilise capital for large-scale infrastructure investments. The same applies for the African Export-Import Bank (Afreximbank), a critical actor on the continent for development and trade finance (Oramah, 2020). African Trade & Investment Development Insurance (ATIDI, formerly ATI) is another multilateral ECA on the continent.

African ECAs and EXIMs

African ECAs and EXIMs often facilitate trade finance by providing guarantees and insurance that protect exporters from risks such

as non-payment and political instability. These guarantees de-risk transactions, making it easier for African companies to access international markets and secure financing for export-related projects. As a pan-African institution, Afreximbank has a broad product portfolio, offering a wide range of financial solutions, including trade finance, project finance and advisory services. Its focus spans multiple sectors with the aim of promoting intra-African trade and economic development. As a multilateral EXIM, the bank is particularly effective in financing large-scale infrastructure projects, such as ports, railways and power plants, which are critical to improving Africa's trade competitiveness. By providing insurance against political and commercial risks, other actors such as ATIDI and ECIC also encourage private sector investment in high-risk environments where traditional financiers may be reluctant to engage

However, national African ECAs and EXIMs face challenges that limit their effectiveness in supporting infrastructure and trade projects. One of the most pressing challenges is limited capitalisation. Entities are often undercapitalised compared to their international counterparts, which limits their ability to underwrite large projects or provide substantial support. The same applies if there is no full government support through so-called full faith and credit of the state (Klasen and Janus, 2023).

Another challenge is the limited depth of African financial markets, which can make it difficult for ECAs and EXIMs to crowd-in private financing. This constraint often forces African governments to seek support from non-African ECAs, which can lead to dependence on external sources of finance. African ECAs and EXIMs also face the same political and regulatory risks as MDBs.

Despite these challenges, there are significant opportunities for African ECAs and EXIMs to expand their role in infrastructure finance. One key opportunity is to strengthen their cooperation with MDBs and international financial institutions. By working together, ECAs, EXIMs and MDBs can pool their resources, share risks and co-finance larger projects. This approach allows African institutions to leverage the financial strength of other players while maintaining their focus on supporting export-oriented infrastructure. By focusing on green infrastructure, African ECAs and EXIMs can tap into the growing demand for climate finance and attract investment in renewable energy and climate-resilient infrastructure projects.

Non-African ECAs and EXIMs

Non-African ECAs and EXIMs are playing an increasingly important role in financing Africa's infrastructure projects. Institutions such as UK Export Finance (UKEF), the Export-Import Bank of the United States (US EXIM) or China's

Sinosure provide significant levels of financing, insurance and guarantees, particularly for large-scale projects that require international expertise and technology. Non-African ECAs and EXIMs have been particularly active in financing energy, transport and telecommunications infrastructure. One of the main advantages of non-African entities is their ability to provide long-term financing and large guarantees, which African institutions may find difficult to provide due to their smaller size. In addition, non-African ECAs and EXIMs often bring technical expertise and global experience in infrastructure development, helping to ensure that projects are implemented effectively and meet international standards (Klasen et al., 2022; Lundquist, 2022; Peterson and Downie, 2024).

Several ECAs and EXIMs have adopted specific strategies or take a proactive approach towards Africa. For example, China, Italy, the Netherlands, the United Kingdom and the United States pursue a regional strategic approach for the continent. Some institutions, such as SACE and SIMEST in Italy, UKEF, or Chinese institutions including Sinosure and China EXIM have adopted a "trade creator" approach, which involves extensive marketing, offices or representatives in Africa, as well as a broad product portfolio (Klasen et al., 2024). Proactive behaviour often involves close collaboration with multilateral institutions on the

continent, such as Afreximbank and ATIDI. Furthermore, some countries demonstrate great flexibility concerning national economic interest. Financing the green transition is another key priority, for example for members of the UN-convened Net-Zero Export Credit Agencies Alliance (NZECA).

Financing Mechanisms and Instruments

Financing Africa's industrial and trade infrastructure requires a mix of financial instruments and mechanisms that address the specific risks and challenges of the continent. Financing comes from a variety of financial channels, such as taxation, general government borrowing, or budget deficits. However, traditional methods of infrastructure financing are often insufficient to address the scale of the financing gap. With fiscal constraints limiting the ability to finance large-scale projects, governments are forced to explore alternative means of financing essential imports (Klasen, 2022; Regan, 2018). As a result, MDBs, ECAs and EXIMs have used various financing mechanisms to attract private investment, reduce risk and ensure the bankability of infrastructure projects. Examples for more advanced approaches are shown below:

Blended Finance

Blended finance can be an effective tool for mobilising private capital in high-risk environments. By

combining concessional financing from public sources, such as MDBs, with commercial financing from private investors or philanthropies, blended finance reduces the overall risk of projects, making them more attractive for private sector participation (Jung, 2020). MDBs play a crucial role in structuring these deals, often using their balance sheets to provide guarantees, first loss provisions or concessional loans. Blended finance is particularly suited to Africa's infrastructure challenges, where many projects face high political and economic risks. By reducing the perceived risk for private investors, blended finance can unlock additional capital for sectors such as renewable energy, transport and digital infrastructure.

PPPs

Public-private partnerships (PPPs) can be another important instrument for financing infrastructure projects. PPPs involve public sector entities, such as governments or MDBs, working with private companies to finance, build and operate infrastructure projects. This approach allows governments to tap into the expertise and financial resources of the private sector, while sharing the risks and rewards associated with large infrastructure investments. PPPs have been successfully implemented in sectors such as transport, energy and telecommunications, where private companies bring technical expertise, operational efficiency and

capital investment (Awuku et al., 2021; Darko et al., 2023). In return, governments provide regulatory support, concessions and long-term contracts that ensure stable revenue streams for the private sector. For African countries, PPPs offer a viable solution to address their infrastructure financing gap without overburdening public finances. By fostering greater collaboration between the public and private sectors, PPPs can accelerate project implementation, improve service delivery and create jobs, all of which contribute to economic growth. PPPs are often highly leveraged with bond issues or project finance.

Bonds

Sovereign bonds have traditionally been an important tool for governments to raise capital for infrastructure development. African countries have increasingly turned to the international bond market to finance large-scale infrastructure projects. While sovereign bonds provide governments with access to significant capital, they also carry risks, particularly in terms of debt sustainability and repayment pressures. In response to these challenges, African MDBs have worked to promote the use of infrastructure bonds specifically designed to finance infrastructure projects. These bonds are typically structured to meet the long-term financing needs of infrastructure development, offering more favourable repayment terms and reducing the burden on public

finances (Kodongo, Mukoki and Ojah, 2023). MDBs, ECAs and EXIMs can provide the necessary risk mitigation and credit enhancements to make infrastructure bonds more attractive to investors, ensuring that African countries can raise the capital needed for infrastructure without compromising fiscal sustainability.

Green bonds and sustainable finance instruments have gained prominence as tools for financing infrastructure projects that promote environmental sustainability and climate resilience. Green bonds are debt instruments used to raise capital for projects with clear environmental benefits, such as renewable energy, sustainable transport and climate adaptation infrastructure. For African countries, green bonds offer a way to access international capital markets while aligning infrastructure development with global climate goals (Ngwenya & Simatele, 2020). MDBs, ECAs and EXIMs can play a critical role in supporting the issuance of green bonds by providing technical assistance, guarantees and credit enhancements that make these instruments more attractive to investors. Green bonds also open up new opportunities for African countries to tap into global climate finance, which is increasingly directed towards projects that mitigate climate risks. Sustainable finance, which includes green bonds and other forms of green investment, offers African governments a way to build infrastructure that is not only

resilient but also socially inclusive. Again, the activities of NZECA members can be particularly useful to foster a just green transition on the continent.

Combining Different Instruments: An Example

The Italian company Tozzi Green developed a hydroelectric power plant located on the Ikopa River in Madagascar. The aim was to provide access to supply energy to the capital Antananarivo. Tozzi Green and the foreign buyer benefited from a combination of two Italian public export promotion instruments: The project was supported through a dual operation of the CDP Group's "Export and Internationalisation" hub. The contractual parties were thus able to leverage two different instruments provided by the Italian government: The Italian ECA SACE guaranteed a loan of EUR 10 million granted by Crédit Agricole with its buyer credit insurance product. SIMEST took a 49% stake in the Malagasy subsidiary with its equity product.

Debt Levels, African Multilateral Financial Institutions and ECAs

African countries have seen a significant increase in their external debt since 2008, reaching US\$ 1.2 trillion and accounting for almost 60% of the region's total public debt stock in 2023 (Afreximbank, 2024). This has had a direct impact on African countries' ability to secure new financing for infrastructure projects. High debt levels have

led to credit rating downgrades, increased borrowing costs and reduced investor confidence. For MDBs, ECAs and EXIMs, this creates a more difficult environment in which to operate, as the financial risks associated with lending to highly indebted countries are increased. The rising debt levels also limits the fiscal space available to African governments, reducing their ability to co-finance infrastructure projects or provide the necessary guarantees to attract private sector investment. As a result, infrastructure projects face delays or cancellations, and the continent's infrastructure financing gap might continue to widen.

On the other hand, MDBs are well placed to provide concessional financing, which offers more favourable terms than commercial borrowing, and to structure debt relief initiatives that alleviate the immediate fiscal pressures on African governments. MDBs, ECAs and EXIMs are also key advocates for debt restructuring and renegotiation efforts. By working with international financial institutions and bilateral creditors, African entities can help facilitate restructurings that reduce the debt burden on African countries while ensuring that infrastructure development can continue. In addition, African MDBs, ECAs and EXIMs might promote greater use of innovative financial instruments such as debt-for-development swaps, where debt is cancelled in exchange for commitments to

invest in infrastructure and other development priorities. These mechanisms could help reduce the overall debt burden while ensuring that essential infrastructure projects are not abandoned.

Summary and Policy Recommendations

MDBs, ECAs and EXIMs have a critical role to play in ensuring that infrastructure financing on the continent can continue in a sustainable manner. To increase the effectiveness of public financial institutions in financing Africa's infrastructure, these entities must continue to explore innovative financial instruments such as blended finance, PPPs and green bonds. By leveraging private sector investment and promoting sustainability, MDBs, ECAs and EXIMs can address Africa's infrastructure needs while ensuring that projects contribute to long-term economic development. MDBs on the continent should focus on broadening their capital base and increasing their capacity to co-finance projects with private investors. This will enable them to take on larger and more complex projects, particularly in regional infrastructure development. At the same time, MDBs, ECAs and EXIMs need to work closely with African governments to further harmonise regulatory frameworks and create a more conducive environment for infrastructure investment. ECAs, both African and non-African, should strengthen their cooperation

with multilateral and bilateral development financial institutions. By pooling resources and sharing risks, ECAs and EXIMs can scale up their operations and support larger infrastructure projects. African ECAs and EXIMs should explore opportunities to strengthen their financial capacity, possibly through partnerships with non-African ECAs or international financial institutions.

African MDBs, ECAs and EXIMs must also focus on addressing the rising debt levels on the continent, which threatens to undermine the progress made in infrastructure financing. To mitigate the effects of the debt crisis, these institutions should advocate for debt restructuring and other mechanisms that reduce the fiscal burden on African countries. Innovative solutions can provide a means of reducing debt while investing in critical infrastructure. MDBs, ECAs and EXIMs should also work to improve the financial sustainability of infrastructure projects. By promoting projects that have strong economic returns and are aligned with long-term development goals, public development banks and export finance institutions can ensure that infrastructure investment contributes to economic growth, making it easier for African governments to service their debt.

Given Africa's interconnected economies, regional infrastructure projects are essential to facilitate trade and industrial development. MDBs, ECAs and EXIMs should give

priority to financing cross-border projects that promote regional integration, such as transport corridors, energy networks and digital infrastructure. Regional projects offer economies of scale and can generate wider economic benefits across national borders. The African Continental Free Trade Area provides an ideal platform for promoting regional infrastructure, and MDBs, ECAs and EXIMs should align their activities with the objectives of the AfCFTA to ensure that infrastructure investments support intra-African trade and economic integration.

One of the key challenges in financing Africa's infrastructure is leveraging private sector investment. While MDBs, ECAs and EXIMs have made progress in de-risking projects, more needs to be done to attract private capital. PPPs provide a valuable mechanism for engaging the private sector in infrastructure development, and MDBs should continue to promote PPPs as a means of sharing risks and leveraging private sector expertise. In addition, African governments must work to create a more conducive business environment for private investors. This includes improving regulatory transparency, streamlining approval processes and reducing red tape. By creating a predictable and supportive environment, African countries can attract more private sector investment in infrastructure projects.

Finally, MDBs, ECAs and EXIMs

should embrace innovation in infrastructure financing. The rise of green bonds, climate finance and digital financial instruments offers new opportunities to finance infrastructure projects that are in line with global sustainability goals. By adopting these instruments, multilateral institutions and national export finance agencies can tap new sources of capital and promote infrastructure projects that are both economically viable and environmentally sustainable. Digital technologies also offer opportunities to improve the efficiency and transparency of infrastructure financing. Fintech platforms can facilitate access to finance for small and medium-sized enterprises involved in infrastructure projects, helping to promote inclusive economic growth.

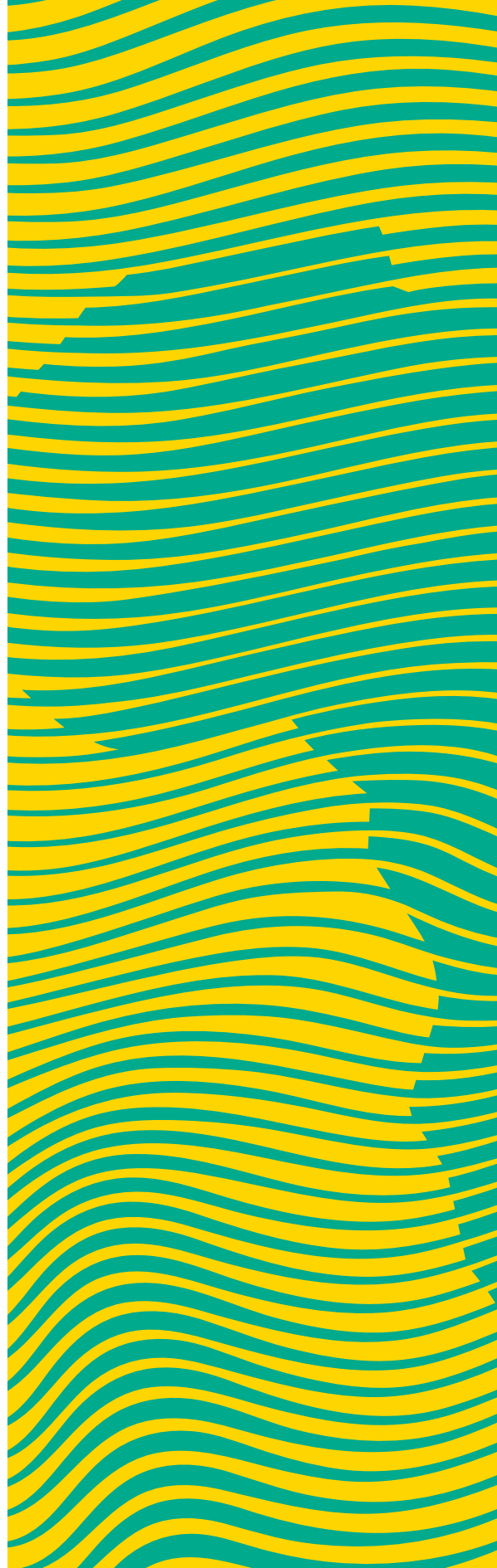
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Scaling Up Climate Finance: What is the Role of Development Finance Institutions?

Joshua Yindenaba Abor

Professor of Finance, University of Ghana Business School

Abstract: The impact of climate change on economic performance and businesses is of critical concern across the globe. Addressing it requires the provision of appropriate financing and participation of development finance institutions (DFIs). This paper examines the role of DFIs in interacting with government agencies, managing resources, influencing policy, and supporting the scaling up of climate finance. To minimize the level of risk, DFIs combine small projects through a portfolio approach and streamline the application cycle to limit credit evaluation and transaction costs, thereby ensuring the participation of local private financial institutions in climate finance. Apart from addressing market failures, DFIs help to make and shape the market, which in turn improves investor confidence to engage in climate finance. This paper recognises that climate finance has not entirely mobilised adequate private funds due to barriers, risk, and low incentives. Therefore, DFIs use their knowledge and the strength of their long-term relationships with the private sector to attract increased funding.

Keywords: Climate finance, development finance institutions, multilateral development banks

JEL Classification: Q54; F65

Introduction

Ensuring sustainable finance for climate action is a topical issue in the policy space as countries across the globe realise the urgency to combat climate change and adapt to its consequences. Although many countries have ratified the Paris Agreement, efforts to achieve the goals of global climate action remain inadequate. Greenhouse gas

emissions continue to increase, and many governments are concerned that insufficient climate policies could reduce economic growth, which will not augur well for the already struggling global economy. Taking firm action does not only suggest good environmental stewardship, but is also seen as sound economic policy, considering that the costs of inaction and delayed efforts will exceed the costs of taking immediate

and timely action. Actions include promoting low carbon emissions, developing resilient infrastructure, drawing on untapped economic potential, driving exciting new technological developments, and building more inclusive societies. Focusing attention on smart, clean, and green initiatives in agriculture, energy, and infrastructure comes with unique benefits that can spur growth (World Bank, 2022).

Developing countries are the most vulnerable to the adverse impacts of climate change, and without definite action, these could render more than 100 million people poor by 2030 (Hallegatte et al. 2016). Moreover, an estimated 143 million people in Latin America, South Africa, and sub-Saharan Africa could be forced to move out of their own countries (Rigaud et al. 2018). Therefore, it is paramount for the more vulnerable countries to transition toward climate-compatible development paths. In as much as improving “hard” infrastructure such as roads, power plants, and water supply systems is critical, dealing with “soft” infrastructure such as governance and financial systems, institutions, and the agriculture and forestry sectors is equally paramount.

Financial resources and sound investments are needed to lessen emissions, encourage adaptation, build resilience, with the benefits of these efforts significantly outweighing any upfront costs. Several studies indicate that

investments in climate action would go a long way to build a sustainable global economy. For example, the World Bank (2019) argues that an investment of US\$90 trillion is needed in infrastructure by 2030. Transitioning to a green economy can unlock new economic opportunities and create employment, thus helping to recoup these funds. On average, investing US\$1 returns US\$4 in benefits (United Nations undated).

Development finance institutions (DFIs) have been identified as critical actors in addressing climate change and sustainable development, serving as key financial intermediaries for channelling long-term finance (Dickinson n.d.; Abor, Adjasi, and Lensink 2020; Abor 2023). These institutions can leverage finance from capital markets given their strong credit ratings and the backing of their shareholder governments. This paper examines the role of DFIs in scaling up climate finance.

Overview of Climate Finance

Climate change can be addressed through climate finance, described as local, national, or transnational financing that seeks to support the mitigation and adaptation of actions that will deal with climate, where funds are pooled from public, private, and other sources. Most countries around the world work together to fund climate change. Understandably, governments alone cannot provide all the financing. However, there are few in the private

sector engaged in this area due to lack of transparency, and high-risk levels among other challenges, due to economic inefficiency and underinvestment. This creates an opportunity to involve DFIs (Montero 2017).

The idea of climate finance started in 1994 at the United Nations Framework Convention on Climate Change (UNFCCC). The goal was to ensure that developed countries reduce greenhouse gas concentrations to levels that prevent adverse human-induced risks associated with climate systems. With this convention, industrialised nations were tasked to provide financial support to developing economies to fight climate change. Grants and loans were overseen by the Global Environment Facility. In 1997, the UNFCCC adopted the Kyoto Protocol, which was not operationalised until 2005. Unlike the convention, which only permits countries to adopt policies to mitigate climate change, the Kyoto Protocol commits its parties by setting internationally binding emission reduction targets. Currently, the Protocol has 192 parties and an adaptation fund to increase resilience to the impacts. Among the various UNFCCC's summits—which are referred to as conference of parties (COP)—COP 16 established the Green Climate Fund, which was appointed as the financial mechanism operator in 2011. The COP sets the policy priorities and criteria for financing the financial

mechanism, whilst the financial mechanism is accountable to the COP. The parties also established two special funds, the Special Climate Change Fund and the Least Developed Countries Fund, subject to the UNFCCC's Global Environment Facility and the Kyoto Protocol's Adaptation Fund.

Due to persistent concerns raised by world leaders, multilateral agencies also established the Climate Investment Funds—one of the world's largest multilateral finance mechanisms for developing countries—to enhance low carbon and climate resilient development. The fund was launched in 2008 in partnership with the public sector, private sector, civil society, neighbourhood networks, and six major multilateral development banks (MDBs), including the African Development Bank (AfDB), Asian Development Bank (ADB), European Bank for Reconstruction and Development (EBRD), Inter-American Development Bank (IDB), International Finance Corporation, and World Bank. Currently, Climate Investment Funds has US\$62.8 billion in contributions (US\$19.5 billion from private capital, US\$8 billion from governments, US\$15.4 billion from bilateral and other agencies, US\$17.9 billion from MDBs, and US\$2 billion from the Group of Seven).

To strengthen efforts to limit the global temperature rise, the UNFCCC parties reached the Paris Agreement in 2015. This agreement provided a

common goal for all parties (i.e., to limit global warming to well below 2 or 1.5 degrees Celsius) as well as funding to finance it (i.e., developed countries should take the lead to financially support developing economies). To achieve this goal, the parties agreed to submit their commitments—referred to as nationally determined contributions—by the end of 2020. The operating entities (i.e., Global Environment Facility and Adaptation Fund) of the financial mechanism and the special funding (Special Climate Change Fund and Least Developed Countries Fund) would serve the Paris Agreement.

In addition, the Sustainable Development Goals, based on decades of work by individual countries and the United Nations, has allowed for private, public, and charitable cooperation. On a global level, the Integrated National Financing Frameworks, which the United Nations established in 80 countries, is a coordinated effort to finance the Sustainable Development Goals through reforms in budget, taxes, public–private partnership, and access to finance and capital markets. In 2021, there was an investment of US\$1.45 billion through 59 blended finance packages in 34 countries. At the regional level, Africa—one of the continents facing some of the worst climate change consequences—has initiated Agenda 2063 (i.e., The Africa We Want). Goal 7 of Agenda 2063 seeks to promote

environmentally sustainable and climate-resilient economies and communities, calling for partnership with various investors to finance the policy.

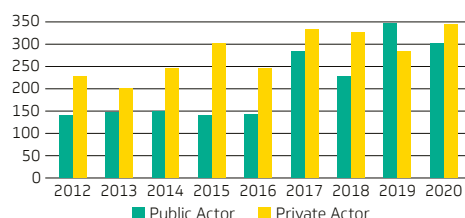
Important questions remain, however. How can actors mobilise private investment in climate change action? How do countries design risk and return arrangements to attract public and private investment? How do countries provide incentives for public and private investment? In this sense, climate finance can act as a catalyst.

Sources, Channels, and Mechanisms of Climate Finance

Sources of climate finance can be classified broadly as public and private sources. Public sources include DFIs, climate funds, government budgets, and government agencies. Private sources comprise commercial financial institutions, households, venture capital, private equity, and infrastructure funds.¹ For more than a decade, global climate finance has been on the rise and, despite its limited data on sources, channels and mechanisms, Climate Policy Initiative has provided some global data on climate finance as shown in Figure 1. Global climate finance has been increasing significantly; for instance, the least inflow of climate finance was US\$342 billion in 2013 whilst the highest inflow was US\$640 in 2020 (Figure 1). Also, from 2016, the inflow increased progressively.

1. <https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2019/>

Figure 1: Global Climate Finance by Sector, 2012–2020 (in billion dollars)



Source: Climate Policy Initiative Report, 2021.

The private sector has been contributing more funds to global climate finance than the public sector (Figure 1). For example, in 2012 the private sector contributed US\$224 billion whereas public contributions were US\$136 billion. In 2015, climate finance reached a peak (US\$437 billion) and fell by US\$54 billion in 2016. Although the

private sector contributes more, in 2019 public finance (US\$343 billion) outweighed private finance (US\$280 billion). Multilateral, bilateral, and national DFIs are the fundamental instruments that work with Overseas Development Agency (ODA) streams including climate finance (Table 2). In 2018, DFIs contributed US\$178 billion compared with US\$246 billion in 2019. During the Covid-19 pandemic, DFIs provided more funds (US\$193 billion in 2020) than any other source of climate finance. Of the DFIs, national development banks provided the most funding between 2012 and 2020 (44.3 percent of total public sources), peaking in 2017 (60.6 percent) (Table 1).

Table 1: Public Source of Climate Finance in US\$ Billions

Year	NDBs (in percent)	Other public sources	Total public sources
2012	60 (44.1)	76	136
2013	70 (49.0)	73	143
2014	64 (42.4)	87	151
2015	69 (50.0)	69	138
2016	56 (39.7)	85	141
2017	171 (60.6)	111	282
2018	94 (42.0)	130	224
2019	137 (39.9)	206	343
2020	103 (34.3)	197	300
Total	824 (44.3)	1,034	1,858

Source: Climate Policy Initiative Report (2021).

Table 2: Climate Finance Channels and Mechanisms

Types	Mechanism	Description	Instrument	Uses
<i>Public finance</i>				
Governments and agencies	State of Connecticut (USA) Republic of Fiji Tokyo Metropolitan Government (Japan) City of Gothenburg (Sweden) New York MTA (USA) Federal Government of Nigeria	Raise funds to finance climate change	Green bond, grant, loan, government budget	Adaptation
Multilateral DFIs	World Bank Asian Development Bank European Bank for Reconstruction and Development International Finance Corporation African Development Bank Inter-American Development Bank	Distribute finance and credit locally or globally	Grants, loans, soft loans, guarantees, bond issuance, carbon funds	Dual benefit, adaptation
Bilateral DFIs	British International Investment Swedfund (Sweden) International Development Finance Corporation (United States)	Provide finance to tasks and borrowers in different locales characterised by their legitimate status as banks inside characterised public and extraterritorial purviews	Grants, lending and concessional lending, and carbon funds	Dual benefit, adaptation, mitigation
National DFIs	China Development Bank KfW Banking Group (Germany) Export-Import Bank of India Lower Austria Guarantees and Investments, Buenos Aires Guarantee Fund, Rio de Janeiro Development Agency	Authorised to get associations together with private sector to give value speculations and obligation-based finance, and will often distribute or loan finance mainly to organisations inside their locale	Donations, PPP, project-level market rate debt	Dual benefit, adaptation, mitigation
Climate funds	United Nations Framework Convention on Climate Change Adaptation Fund Green Climate Fund Least-Developed Countries Fund Climate Investment Funds Global Environment Facility United Nations Development Programme Low Emission Capacity Building Programme United Nations Environment Programme Enlighten Energy Efficiency Initiatives Indonesia Climate Change Trust Fund UK International Climate Fund International Climate Initiative (Germany)	Aim to support investment programmes for the implementation of countries' low carbon development strategies, with the SCF providing three targeted programmes on renewable energy, forests, and climate resilience	Project-level market rate debt, grant	Dual benefit, adaptation, mitigation
<i>Private finance</i>				
Commercial financial institutions	BNP Paribas Bank of America Bank of China Morgan Stanley	Invest in climate change	Balance sheet financing	Mitigation, dual uses
Corporations	Canadian Solar Tesla Energy Beijing Enterprises Water Group	Help to minimise carbon emissions	Equity	Mitigation, dual uses, adaptation
Household/individual	Bill Gates	Finance climate change initiatives	Project level equity	Mitigation, dual uses
Philanthropy	Rockefeller Foundation Bloomberg Philanthropies Energy Foundation Ford Foundation	Induces policy change through advocacy, communication campaigns, and education	Project level equity, debts	Mitigation, dual uses, adaptation
Private equity, venture capital, infrastructure funds, institutional investors	Fannie Mae Crédit Agricole Corporate and Investment Bank Toyota	Interested in asset-based security	Project level equity	Mitigation, dual uses

Sources: Climate Policy Initiative (2021); Bracking and Leffel (2021).

The Role of Development Finance Institutions in Scaling Up Climate Finance

As mentioned earlier, DFIs have an important role in promoting environmental sustainability through scaling up or increasing their level of capital—mostly provided by governments—as well as mobilizing and leveraging private finance toward low-carbon and climate-resilient investments (Griffith-Jones, Attridge, and Gouett, 2020). To do so, annual investment in mitigating projects to address the challenges of climate change in developing countries must be increased. Climate funds alone have not been effective in significantly scaling up and promoting programmatic approaches to influence private predictions (Tirpak, Brown, Ronquillo-Ballesteros 2014).

DFIs are public sector or government-sponsored entities (Lundsgaard, Dupuy, and Persson 2018) that interact with government agencies, manage resources, influence policy. For instance, the China Development Bank educates the government on what policies to implement to attract more climate investment (Zhang 2022). Moreover, NDBs can attract both domestic and international funding through their broad partnerships. All DFIs can apply techniques such as project incubators, innovation, and impetus financial instruments to urge the private sector to partake in financing climate resilience projects despite

their hesitance due to genuine or perceived barriers and risks. Another way to scale up climate finance is to limit the level of risk by combining small projects through a portfolio approach and streamlining the application cycle to limit credit evaluation and transaction costs, thereby ensuring the participation of local private financial institutions (Smallridge et al. 2012).

DFIs not only address market failures but also make and shape the market, which is vital for development (Mazzucato and Penna 2016). These institutions are seen as specialised banks that help in sensitizing commercial banks on the risk involved in renewable energy investment (Geddes, Schmidt, and Steffen 2018; Zhang 2020). For example, the China Development Bank co-issued a financial support scheme, creating innovative financial models to pilot and showcase fruitful financing structures to boost commercial financing (Zhang 2022). They can certainly capitalise on this opportunity to scale up climate finance.

The Conditions for Effectively Scaling up Climate Finance

Two main conditions are needed to effectively scale up climate finance: a pre-investment phase (or pre-construction phase) and an investment phase (Smallridge et al. 2012; Griffith-Jones, Attridge, and Gouett 2020).

Pre-Construction Phase

Pre-investment meets three main needs: regulatory development/enabling environment, national dialogue, demand generation and feasibility study (Smallridge et al. 2012; Griffith-Jones, Attridge, and Gouett 2020). Since the private sector and other stakeholders are more risk averse than DFIs, the latter should provide the necessary incentives and assurance to attract and enable these investors. In addition, DFIs should educate stakeholders about the benefits, risk factors, and duration of the projects. Lastly, DFIs could provide feasibility studies for large ventures and investment plans for smaller tasks. For instance, the Development Bank of Southern Africa created a Project Preparation Fund, which is used to build an enabling environment for infrastructure project implementation, assist with costs to reach a financial close, and help in conducting pre-feasibility and bankable feasibility studies (DBSA, 2013).

Construction Phase

This phase involves the preparation of instrument needed to source funding for the project. National development banks will need to determine the financing structure, either source of debt on market terms, sources of equity on market terms, and (or) both sources of capital (Smallridge et al. 2012; Griffith-Jones, Attridge, and Gouett 2020). DFIs often combine funding

from investors, governments, international organisations, and/or donors with government grants and international sources to attract private investment. Because they are privileged, they can regulate various economic actors, from public administrations to private lenders and financiers. It is important that the instruments are broad enough to match the development levels of the country and depth of the stock market. It is useful to introduce new devices as well as rely on proven and successful mechanisms.

How Development Finance Institutions Leverage Private Finance

DFIs have a knowledgeable and long-term relationship with the private sector, helping them to better appreciate the local barriers to investment (Morgado et al. 2019) and allowing them to provide large-scale financial services to better meet their needs. This role is necessary because most private sector players are only willing to bear a limited level of risk (Smallridge et al. 2012).

In addition, information on activity- and country-specific barriers is limited to areas that affect the return profile of private sector actors. Therefore, DFIs can play an important role in conveying climate finance or attracting private investment in a straightforward manner. For example, the Green Finance LAC (GFL), with more than 40 DFIs in Latin America and the Caribbean,

has financed more than US\$2 billion in credit-line programmes and has mobilised more than US\$6 billion in private green investments to date.

Furthermore, most private actors cannot consider environmental externalities and integrate them into their investment decision, as they are not reflected in market costs (Griffith-Jones, Attridge, and Gouett 2020). DFIs are in a better situation to leverage private finance since they can provide assurance, thus offering extra motivation for the private actors to construct the investment. Consequently, they are more productive than commercial banks and investment funds in taking risks that stimulate long-term investment.

Additionally, since there are fewer incentives for participation, it is more difficult to attract the private sector into climate finance (Smallridge et al. 2012). DFIs can create financial instruments based on appropriate terms and conditions, helping private actors and domestic financial institutions to understand and address the financial risks and barriers that keep them from engaging in green and climate-versatile projects. For example, the Development Bank of Southern Africa's Climate Finance Facility is the first climate finance fund in Africa to use the green bank model. It is targeted at de-risking and increasing the bankability of climate projects to crowd-in significant investments from commercial banks and projects sponsors.

The China Development Bank assisted in designing policies to attract private investment in renewable energy (solar) and provided significant initial funding, making China one of the major global promoters of solar power. In Mexico, the Nacional Financiera S.N.C. leveraged the local financial market along with several multilateral and international financial institutions and developed a scheme to finance the first wind farm in the country. It also engaged in the issuance of bonds, further attracting investors to finance eligible wind energy generation projects.

Conclusions and Policy Implications

Immediate action is needed on a global level to combat climate change and adapt to its consequences. Many countries have ratified the Paris Agreement. However, efforts to achieve global climate goals remain inadequate. Significant financial resources and investments are required to reduce emissions, promote adaptation, and build resilience. While different players have important roles in the regard, DFIs in particular play a critical role in educating and attracting investors. They interact with government agencies, manage resources, influence policy, and support the scaling up of climate finance by limiting the level of risk, thereby ensuring the participation of local private financial institutions. Apart from addressing market failures, DFIs help in making and shaping the market, which is vital for development. This paper

recognises that climate finance has not entirely mobilised adequate private funds for climate finance projects due to barriers, risk, and low incentives, among other issues. DFIs can leverage their knowledge and long-term relationships with the private sector to push through these bottlenecks.

DFIs, especially multilateral development banks, can raise significant capital at lower rates, considering their strong credit ratings and the backing of their shareholder governments. Therefore, they should focus on important areas, such as smart agriculture, clean energy, and green infrastructure. This paper makes several other recommendations for policy consideration:

- Mainstream climate finance into DFI operations, activities, and financing mechanisms: Climate finance is needed to mobilise additional funding, develop relevant and effective policy frameworks, and implement green projects. Introducing climate mitigation and adaptation measures that are compatible with the Sustainable Development Goals and Paris Agreement and placing them at the core of operations is essential in maximising impact on sustainability.
- Introduce adaptive and sustainable technologies: DFIs should consider the incorporation of sustainable environmental externalities and adaptive technologies, such as

renewable energy, even if the short-term returns are minimal or non-existent.

- Promote collaborative efforts: Multilateral and national development banks that have contextual knowledge to on-lend to the target entities should collaborate. This requires implementing the necessary safeguards and risk management framework as well as applying appropriate pricing models.
- Engage shareholders: DFIs should encourage shareholders to increase capital, especially to multilateral and national development banks, as well as develop new or appropriate financing models (e.g., adaptation finance). International organisations should be part of the policy dialogue.
- Increase and leverage private investment: Major private sector investors such as pension funds, life insurance companies, investment firms, and impact investors should work with their asset managers and investee companies to support climate action and decarbonisation efforts and align with net zero transition targets. With their knowledge, expertise, and partnerships with the private sector, DFIs can help derisk climate-related projects to motivate private sector participation.

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A Quest for Private Investment-Led Growth in Africa: Striking the Right Balance

Komlan Kadagali¹ and Jules Tapsoba²

Abstract: Africa faces significant challenges in securing investment for development. This paper discusses how public and private investment affects economic growth across the continent. The authors posit that causality flows between both forms of investment, significantly improving long-term growth. Promoting economic growth in Africa requires a shift in policy set-up from public to private sector-led growth models. Shifting the growth model requires reassessing development strategies among African policymakers, enhancing complementarities between private and public investment, strengthening the business climate, addressing project and macroeconomic risks, and exploring new private investment sources. Development finance institutions play a crucial role here since they bridge the gap between sectors with a model designed to provide finance or capital in areas and countries where the private sector would otherwise not have access.

Keywords: Private investment, public investment, economic growth, Africa

JEL Classification: O40, R11, R42, R53

Introduction

African countries need substantial investments in education, healthcare, and infrastructure to sustain post-COVID-19 economic recovery efforts. The success of these initiatives hinges on mobilizing significant funding in the context of strained public finances. Gaspar et al. (2019) estimate that meeting the United Nations Sustainable Development Goals (SDGs) by 2030

would require an additional annual expenditure of US\$0.5 trillion for low-income developing countries and US\$2.1 trillion for emerging market economies. The African continent, which has some of the most pressing needs compared to other areas, requires both public and private investments.

Public investment involves government spending on infrastructure, education,

1. Economist and Senior Officer at Association of Large Companies of Togo (AGET); Research Fellow at the Research and Training Center in Economic and Management Sciences (CERFEG), University of Lomé (Togo). E-mail: kkadagali@gmail.com.

2. Deputy Chief Economist, Director Data Management & Model Development at AfreximBank Group. Senior Research Fellow at FERDI. E-mail: stapsoba@afreximbank.com.

healthcare, and other public goods. It enables governments to allocate resources to areas vital for long-term growth, even if these may not yield immediate profitability. It can stimulate economic activity by creating jobs and increasing the demand for goods and services. Indirectly, it promotes growth by enhancing productivity and attracting private investment, and it can help stabilize the economy during downturns by sustaining demand. However, overreliance on public finance can lead to unsustainable debt levels, potential inefficiencies, and mismanagement of public projects (Barbiero and Darvas, 2014; Erden and Holcombe, 2006; Ramirez and Nazmi, 2003).

Private investment refers to the expenditure made by businesses and individuals on capital goods, such as machinery, equipment, and buildings. Such investment plays a direct role in job creation and increased demand, as well as enhancing productivity and innovation, which is vital for long-term growth (Dreger and Reimers, 2014; Coenen et al., 2013; Nguyen and Trinh, 2018). In Africa, the private sector has the potential to redefine the economic landscape significantly, but despite increased input from private investment, Africa trails behind other developing regions. For instance, drawing on sub-Saharan data from between 1990 and 2017, the average ratio of private investment to GDP in the region rose from 10.4 to 13.5 percent, which is still lower than in regions such as Asia, which reached 16.7 percent in 2017. Private investment is generally more financially sustainable than

public investment and helps diversify investment sources, thus reducing the financial burden on governments (Devine et al., 2021).

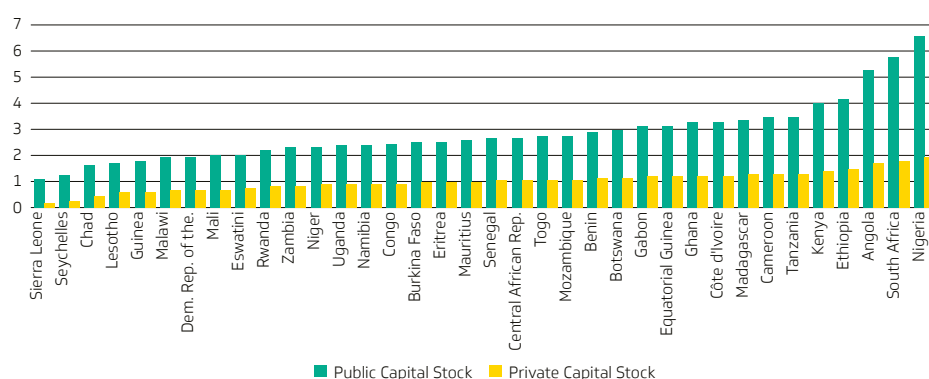
In recent years, Africa has seen increases in private and public capital stocks, though these remain lower than in other developing regions. For instance, between 1990 and 2019, Nigeria's public capital stock grew by an average of US\$ 6.4 billion per year, while its private capital stock grew by US\$1.8 billion annually (Figure 1). Similarly, South Africa attracted an average of US\$6.7 billion per year in public-private partnership (PPP) contracts from 1990 to 2019, surpassing other African countries such as Nigeria, Kenya, and Côte d'Ivoire (Figure 2). The interplay between public and private investment in Africa is crucial for economic growth; on one hand, public investment in infrastructure and human capital development to create an environment conducive to private sector activity, and on the other hand, private investment to drive capital accumulation and technological advancement, foster economic growth and generate tax revenues to fund further public investment. PPPs can enhance efficiency and distribute risk, leveraging private capital for public projects. A balance and leveraging of strengths between the two will allow Africa to overcome development challenges and unlock its economic potential.

This paper discusses the link between public and private investment and short-term and long-term growth, where short-term investment boosts

demand and productivity, and long-term investment drives innovation and human capital development (Santiago et al., 2020). While the balance between public and private investments is vitally important, pursuing a growth strategy led by the

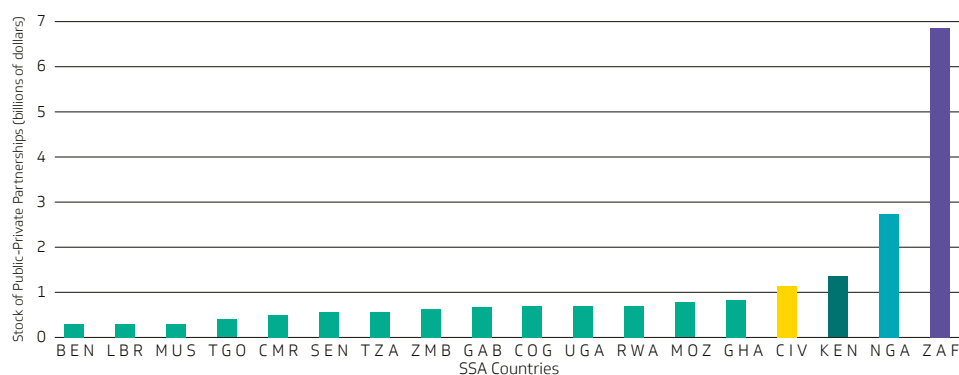
private sector is particularly important; empirical estimates show that private investment has a more significant impact on long-term economic growth than public investment, suggesting that a paradigm shift is needed. This would entail reassessing development

Figure 1: Public and Private Capital Stock in Constant Billions of U.S. Dollars (average over 1990-2019)



Source: IMF (2022).

Figure 2: Stock of Public-Private Partnerships Capital in Constant Billions of U.S. Dollars (average over 1990-2019)



Source: IMF (2022).

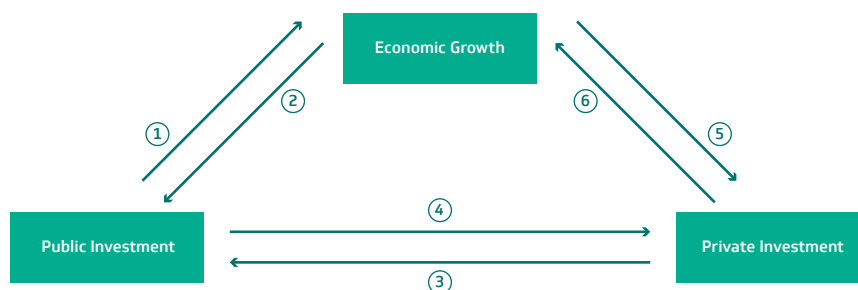
strategies for promoting private and public investment synergies, managing risks, and identifying new opportunities. Development finance institutions (DFIs) are vital for driving private investment funding in Africa, bridging the gap between the public and private sectors, and providing capital where the private sector lacks access.

Contemplating a Framework: Public Investment, Private Investment, and Growth

The interplay between public and private investment is crucial for economic growth, and its impact hinges on various factors. The relationship between public investment, private investment, and growth is complex, with cross-feedback loops (Santiago et al. 2020; Ramirez and Nazmi 2003). Figure 3 illustrates the interplay of these causality channels, with descriptive text to follow.

- Channel 1: Public investment to economic growth. Investing in public infrastructure and human capital development, such as transportation and education, boosts economic growth. Government spending on education, healthcare, and social services increases workforce skills and productivity. Public funding supports macroeconomic stability and creates an environment favorable to private sector endeavours, strengthening economic resilience.
- Channel 2: Private investment to economic growth. Private investment drives capital accumulation and technological advancement. Increased investment in research and development leads to the creation of innovative technologies, thereby enhancing productivity and fostering entrepreneurial activities. This generates employment opportunities, diversifies markets, and stimulates demand, ultimately bolstering

Figure 3: Causality Channel Interplay



Source: Authors' elaboration.

economic growth while impacting public finance through tax revenues.

- Channel 3: Private investment to public investment. Private investment can stimulate public investment; for example, a PPP arrangement can strengthen the government's financial capabilities by facilitating funds allocation for infrastructure and services. PPPs leverage private capital for public projects, enhancing efficiency, spreading risk across sectors, and prompting additional public investment to support private-sector activities, bolstering overall public funding.
- Channel 4: Public investment to private investment. The allocation of public investment impacts private investment by incentivizing it through subsidies, tax breaks, and grants and by enhancing market accessibility for private businesses. Public investment tools such as credit guarantees and development banks mitigate financial risks for private entities, fostering an increase in private investment.
- Channel 5: Economic growth to private investment. As the economy expands, it creates new investment opportunities, leading to increased private investment; sustained economic growth improves access to finance and encourages saving, resulting in a larger pool of funds for private investment. This decrease in credit risk premiums allows financial institutions to offer more credit, supporting business expansion and new entrepreneurial ventures.
- Channel 6: Economic growth to public

investment. Economic growth leads to higher tax revenues, enabling increasing government investment and reducing deficit spending. This results in a lower debt-to-GDP ratio and more spending on infrastructure and services, thereby stimulating overall economic activity and growth.

Understanding these relationships enables policymakers to design effective strategies for promoting economic growth, striking the right balance between them to ensure efficient and productive investments. Public investment should create a conducive environment for private businesses to thrive, while private investment should aim for long-term productivity and innovation.

Literature Review

The prevailing body of literature predominantly delves into the potential risk of public investment displacing private investment financing and explores the synergies between these two investment forms.

Public and Private Investment to Drive Economic Growth

Eberts (1986), Aschauer (1989a, 1989b), and Munnell (1990) conducted influential empirical studies that sparked significant interest in the relationship between government investment in infrastructure and economic growth. Aschauer (1989) demonstrated that public non-defense expenditures significantly influence productive capacity more than defense or non-defense spending. The defense budget shows minimal impact

on production capacity, whereas infrastructure significantly impacts productivity. Barro (1990) revealed that public investment has positive and substantial effects on growth. However, he cautioned that public investment could distort the market, emphasizing that, for a robust economy, it should not be a long-term solution. Cullison (1993) contended that government expenditure on education and labour training profoundly affects future economic growth and that expenditure on education, civilian safety, and labour training directly impacts human capital rather than physical capital. The consistent findings of these authors demonstrate a statistically significant positive correlation between public investment and growth.

Subsequent research continued to unveil a positive impact of public investment on growth. Khan and Kumar (1997) examined empirical findings from 95 developing countries spanning 1970 to 1990, revealing that private investment influences growth more significantly than public investment. The analysis of net returns indicated an increasing trend of net returns to private capital over time. Moreover, the study highlighted variations in the effectiveness of public and private investment and growth across different regions. Meanwhile, Ramirez and Nazmi (2003) analyzed cross-country data from nine major Latin American countries from 1983 to 1993 and argued that public and private investments contribute to economic growth. However, they found that

all government spending negatively impacts private investment and growth. Notably, public expenditure on education and health was observed to have a positive and statistically significant influence on the formation of private capital and long-term economic growth. Using a Cobb-Douglas function for Bangladesh, Haque (2013) found that public and private investments directly impact long-term economic development.

Potential Crowding Out and Crowding In Effects

Several academic studies have investigated the crowding-out effect of public investment on private investment, as outlined in the IS-LM model.³ Assuming constancy in monetary policy, heightened government expenditure may prompt a concomitant shift in the IS curve, precipitating a short-term surge in prices and interest rates, which could adversely affect private investment (Buiter, 1977; Sundararajan and Thakur 1980; Ram, 1986). Nazmi and Ramirez (1997) contended that while public investment bolstered output expansion, it manifested a perceptible crowding-out effect on private investment. Huzayran, Al-Nawab, and Mustafa (2021) unearthed evidence of the crowding-out effect of total public investment on private investment in the short run, observing no momentous effect of public infrastructure investment in the long run. Heightened taxation diminishes private investment post-tax, prompting economic agents

3. The IS-LM model represents the intersection of two economic curves: the investment-saving (IS) curve and the liquidity preference-money supply (LM) curve. It analyzes how changes in market preferences affect GDP and market interest rates.

to curtail their investment decisions.

Employing an Autoregressive Distributed Lag (ARDL) modeling, Bukhari, Ali, and Saddaqt (2007) illustrated that the crowding-out effect of private investment has obstructed growth in East Asian nations from 1971 to 2000. Their study implies that the dynamics of public investment and the restructuring of public expenditure could favor growth. Swaby (2007) used the vector error correction model (VECM) to scrutinize the interrelation between public investment and economic growth in Jamaica. The findings implied that while public investment positively influences GDP, the effect is not statistically substantive; additionally, public investment precipitates a crowding-out effect on net private investment, culminating in an amplification in domestic private investment but a drop in foreign investment. In their study of 11 Eastern European countries from 1991 to 2009, Gjini and Kukeli (2012) observed that public investment did not crowd out private investment. Using the weighted least squares method, their analysis indicated that the marginal effects of public investment on private investment were positive.

Investing public funds in infrastructure development and providing public goods and services has the potential to stimulate private investment. This type of investment helps establish a stable macroeconomic environment, making it more appealing for investment capital and reducing costs for the private sector. Government-driven demand for goods and services

can enhance revenue and profit expectations, encouraging private investment. Ramirez and Nazmi (2003) demonstrated that public investment in economy-boosting infrastructure, such as new highways or expanded power plants, can catalyze private investment. Public spending has been shown to have a positive and widespread impact, increasing overall productivity and paving the way for private investment to flourish. Blejer and Khan (1984) demonstrated that substantial investment fosters economic growth, especially in developing nations. Cruz and Teixeira (1999) employed the ARDL model to examine public investment's influence on the Brazilian economy's private investment between 1947 and 1990. Their analysis revealed a long-term complementary relationship between private investment and public investment.

African Perspectives

Few papers have focused on the interplay between public investment, private investment, and growth in African countries, mostly due to a lack of data. Kumo (2012) utilized the ARDL model in empirical research for South Africa from 1960 to 2009. The findings of the study revealed a causal relationship between infrastructure investment and GDP growth, signifying the crucial role of infrastructure in long-term economic development in South Africa. Additionally, it was observed that economic development has a negative impact on infrastructure investment. Using a VAR approach, Kollamparambil and Nicolaou (2011) demonstrated that public investment

in South Africa does not directly crowd out or complement private investment; instead, it indirectly influences private investment through acceleration effects.

In a recent study, Kadagali and Tapsoba (forthcoming) analyzed data from 43 African countries from 1990 to 2019. Their research reveals that private investment significantly influences short-term economic growth, while the impact of public investment is comparatively less pronounced. Through Granger causality testing, the study establishes a bi-directional causality between economic growth and private investment, with causality from economic growth to public investment and vice versa. Their findings imply that economic growth stimulates public and private investment in the short term, with private investment playing a more direct role in propelling economic growth. Additionally, the empirical analysis indicates that in the long term, both public and private investment positively impact long-term economic growth, with private investment demonstrating a more substantial effect.

Over the long term, Kadagali and Tapsoba (forthcoming) document that a 1 percent increase in public investment improves the economic growth rate by a range between 0.3 and 0.5 percent, while a 1 percent rise in private investment results in an increase between 0.5 and 0.6 percent in economic growth. This implies that while public investment is pivotal, private investment is more substantial in driving long-term

growth. The authors argued that a positive long-term impact of public investment on growth is attributed to its complementary role to private investment. Public investment in infrastructure and services can enhance the business environment, rendering private investment more appealing and feasible. Hence, in the long run, public and private investments can mutually reinforce each other, contributing to sustainable economic growth.

Policy Recommendations

Current research and extant literature posit that both public and private investments contribute to long-term economic growth in African countries. Furthermore, the influence of private investment on growth surpasses that of public investment in magnitude (Kadagali and Tapsoba, forthcoming). Based on this postulate, the following recommendations aim to guide the formulation of growth-enhancing policies on the continent. Such policies should target public investment to complement private investment and improve the business climate and macroeconomic stability, which can further encourage private investment; improving the business environment and addressing the risks of private investment can attract more private finance. Below is a discussion of the dimensions to be taken into account.

General Considerations

African policymakers need to create frameworks that promote a business-friendly environment while establishing long-term policies and strategies to provide a solid foundation for growth.

- Reassessing development strategies. Due to the challenging economic environment, Africa must rethink its development strategies. Reliance on public investment has led to a significant increase in public debt, which is unsustainable without changes in national resource mobilization. Shifting toward private sector-focused growth and investment models could benefit most countries in the region, considering demographics and the need to generate employment opportunities.
- Enhancing the business environment. Private investment plays a pivotal role in Africa's development. Countries must sharply reduce the risks associated with private investment. The low level of private investment in development sectors in the region indicates that the risk/return profile is often insufficiently attractive for investors. Risks, including institutional framework, market size and liquidity, and macroeconomic volatility, are higher in Africa. Most infrastructure projects are currently carried out and funded by the public sector.
- Addressing project, macroeconomic, and exit risks. To attract private financial investors, projects must be viable. Macroeconomic instability is a significant concern for financial investors and is a crucial aspect of their risk/return assessment. High inflation can introduce volatility in relative prices, making investment decisions riskier and less predictable. Policies enhancing macroeconomic stability can encourage private and foreign direct investment (FDI). Exit risk is another primary concern for international investors. The ability and range of options to exit an investment are pivotal in building a private investor ecosystem.
- New sources of private investment. African countries could tap into untapped private funding sources, such as foreign institutional investors and domestic private investment. Mobilizing additional private funds for development will require innovative solutions to enhance the project risk/return profile.
- Mobilizing domestic resources. Mobilizing domestic resources is key to financing public infrastructure and fostering growth. Efforts should focus on improving tax administration, enhancing land registries, strengthening tax auditing and customs administration, and overseeing tax compliance by significant taxpayers. Reforms aimed at broadening the tax base, including limiting exemptions—such as reducing tax exemptions, excise taxes, and property taxes—are essential.

Role of Development Finance Institutions

DFIs bridge the gap between the public and private sectors as a model designed to provide finance or capital in areas and countries where the private sector would otherwise not have access (von Mehren, 2019). This ensures a significant and sustainable impact, given that they provide a range of financial instruments and technical assistance to support projects that could be considered too

risky or unprofitable for the traditional commercially oriented financial sector. These institutions can boost private sector investment in Africa by collaborating with stakeholders and forming partnerships; bilateral and multilateral development institutions are the primary international investors in PPPs in Africa. This encompasses, but is not limited to, the following:

- Capital mobilization: DFIs are key in securing funding for private investment in Africa from various sources.
- Risk mitigation: DFIs can use strategies to reduce risk aversion among private investors, potentially lowering the cost of borrowing and encouraging participation in high-risk projects.
- Sustainability focus: DFIs prioritize investing in projects with positive social and environmental impacts, such as renewable energy and climate change mitigation.
- Bankable projects: DFIs offer support to enhance the operational capacity of local financial institutions and businesses, improving project readiness for private investment.

The recently created African Multilateral Financial Institutions (AMFIs) have a pivotal role to play.⁴ To strengthen Africa's position within the evolving global financial framework, an alliance of AMFIs, the Alliance of African Multilateral Financial Institutions

(AAMFI), also called the Africa Club, was formed.⁵ This initiative—inaugurated with support from the African Union Commission in February of 2024—is designed to promote collaboration, cooperation, and coordination among the participating institutions. The primary focus of the Africa Club is to provide financial support for private investment that yields substantial social dividends. As traditional concessional financing directed to the African region decreases, AMFIs are essential allies to African nations, offering strategic financial assistance to the private sector while delivering capacity building. With assets surpassing US\$62 billion as of 2022, AMFIs have attained a critical mass capable of influencing the financial landscape on the continent.

Conclusion

Balancing public and private investments is crucial for sustainable economic growth in Africa. Public investment is essential for infrastructure and human capital development, while private investment drives technological advancement and capital accumulation. There is a need to rethink growth models across the continent, shifting away from the traditional public sector-led model.

Many African economies rely heavily on the public sector, often constrained by adverse financing terms, frequent debt crises, and low domestic revenue mobilization. Africa must reassess its

4. AMFIs are financial institutions (co)-owned by multiple African countries. They act as strategic partners, providing financial resources and expertise to support investment, trade, and sustainable growth throughout Africa

5. AAMFI's founding members include the Africa Finance Corporation (AFC), the African Export-Import Bank (Afreximbank), the Trade and Development Bank Group (TDB Group), the African Reinsurance Corporation (Africa Re), the African Trade and Investment Development Insurance (ATIDI), Shelter Afrique Development Bank (SHAFDB), and ZEP—RE (PTA Reinsurance Co.).

development approaches, given that reliance on public investment has led to a significant rise in public debt, which cannot be sustained without changes in how national resources are gathered.

To address these challenges, countries in the region should prioritize growth and investment strategies that leverage the private sector and create job opportunities. However, attracting private investment presents challenges due to heightened risks and relatively unappealing risk/return profiles. Policies should improve macroeconomic stability, expand the tax base, and reduce exemptions. Innovative solutions are needed to enhance project risk/return profiles and encourage growth through mobilizing domestic and international private funding sources.

To attract both domestic and foreign private investment, it is imperative to establish a conducive business environment through reforms that prioritize transparency, streamline bureaucracy, and enhance legal security. Finally, future research should consider including the capital stock in PPPs, which are gaining momentum on the continent. Policymakers should focus on creating a conducive business environment, reducing risks for private investors, leveraging DFIs to facilitate PPPs, and fostering collaboration between the public and private sectors for sustainable and inclusive economic growth in African countries.



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Existing Credit Rating Methodologies and African Sovereigns: The Missing Link

Anthony Kyereboah-Coleman, Oyeyemi Kale, Raymond Boumbouya, and Mercy Marimo

Abstract: Credit rating agencies are critical to promote sovereign access to global financial markets, as is the process to achieving that goal. In Africa, as a major component to determine a country's economic stability and creditworthiness, as well as the applicable cost of borrowing, the application of existing sovereign credit rating frameworks amplifies the inherent weakness. However, these methodologies often fail to recognize the peculiarities of African sovereigns, as well as the underlying operating environment and associated risk assessment. This anomaly contributes to high-risk perception, leading to poor sovereign credit ratings and associated premiums for African issuances, thereby limiting access to sustainable finance for development across the continent. This paper examines existing credit rating frameworks that rating agencies in Africa use and their implications for sovereigns, highlighting their inherent weakness in appropriately assessing risk. To better serve the needs across the continent in determining sovereign credit ratings, the paper recommends alternative methodologies that better reflect the underlining operating environment.

Keywords: Sovereign credit ratings, economic development, Africa

JEL Classification: G20, L13, N27, O55

Introduction

In recent decades, with the integration of the global financial and economic landscape, sovereign credit ratings have become a critical tool to promote sovereign access to capital markets. International financial integration allows surplus units to lend globally. However, to protect investor interests and address asymmetric information on the part of deficit units, it is necessary to involve credit rating agencies (CRAs). According to Mattarocci (2014),

CRAs attempt to eliminate this information asymmetry, benefitting both borrowers and creditors. They assess borrowers' creditworthiness, which some market participants lack the means to do, thereby promoting market confidence and influencing the direction of global capital flows. Banks and the larger market participants rely heavily on credit ratings, especially where non-public information significantly influences credit ratings. CRAs also play a crucial

monitoring role, issuing warnings of potential downgrades when necessary to encourage borrowers to take corrective measures.

Despite the significant influence of CRAs in developed markets, African sovereign credit ratings experienced a downturn in the first half of 2023, with five economies facing downgrades and several rating actions contested. The negative trend can be partly attributed to shortcomings in existing sovereign credit rating methodologies, which often inadequately address the unique characteristics of Africa's financial landscape, marked by smaller, less developed financial systems that rely heavily on banks, with few stock markets offering sufficient liquidity and a weak contractual savings industry in many countries (Maimbo, Faye, and Triki 2011). According to Fofack (2021), "unless fairer financing rules are implemented, historical biases will continue to sabotage sustainable development in the region." Nkhalamba et al. (2023) highlight that Kenya and Nigeria rejected their ratings due to agencies' insufficient understanding of the local context. African policymakers have expressed growing concern over the reluctance of the "Big Three"—namely Fitch Ratings (Fitch), Moody's Investors Service (Moody's), and Standard & Poor's (S&P)—to reform their methodologies, viewing these changes as essential for a more equitable and accurate assessment within the global financial architecture. However, 2024 has seen positive changes in outlook and rating

upgrades. Specifically, eight countries had their credit rating outlook upgraded from either negative to stable or stable to positive.

This paper examines CRA methodologies and their applicability to sovereigns in Africa, given the nature and peculiarities of the continent's operating environment. The next section reviews current methodologies, followed by a discussion of potential bias against African countries and the impact of poor ratings on African economies in Section 3. Section 4 examines the African sovereign environments, and Section 5 highlights inherent weaknesses of existing CRA methodologies and advocacy for alternative approaches. Section 6 concludes.

Overview of Sovereign Credit Rating Methodologies

In 1994, South Africa was the first African country to receive a sovereign credit rating. By 1995, its local currency debt rating had improved to investment grade. The expansion across the continent accelerated over the next decade—facilitated by initiatives such as the African Sovereign Credit Rating Initiative, a collaboration between the United Nations Development Programme (UNDP) and S&P—with 13 African nations receiving ratings by 2004. By 2023, the number rose to 32. Despite this progress, African countries continue to face challenges related to the methodologies of the Big Three. Criticisms of these agencies include their over-reliance on per capita gross

domestic product (GDP), inadequate consideration of debt sustainability, lack of transparency, and conflicts of interest (Haspolat, 2015). These issues have spurred calls for reform and contributed to the ongoing push for a pan-African CRA that better addresses the unique economic and social contexts of the continent.

Fitch, Moody's, and S&P employ relatively similar methodologies to evaluate sovereign creditworthiness, beginning by estimating an initial score based on four pillars: (i) economic structure and growth outlook, (ii) fiscal policy and debt burden, (iii) institutional efficiency, and (iv) external balance. This preliminary score is then refined through adjustments with additional variables. The final rating range is determined by combining the scores from each dimension according to a predefined weighting system. Each agency utilizes a framework that blends quantitative and qualitative factors, though the specific approach and weightings differs (Table 1).

Economic structure and growth outlook: CRAs assess economic structure and growth by analyzing different aspects of economic performance. S&P evaluates income levels (GDP per capita), growth prospects, economic diversity, and volatility to determine economic resilience and debt-bearing capacity. Fitch considers structural features like financial sector risks, political risk, governance, and macroeconomic performance, along with growth prospects and economic stability.

Moody's assesses economic strength through growth dynamics (real GDP growth), the scale of the economy (nominal GDP), and national income (GDP per capita, PPP). These variables measure economic expansion, stability, and the breadth of economic diversification.

Fiscal policy and debt burden: This involves evaluating fiscal deficits, public debt, and interest payments. S&P focuses on fiscal sustainability, including fiscal flexibility, long-term trends, debt structure, funding access, and risks from contingent liabilities through a segmented analysis. Fitch examines public foreign currency debt, money supply, and structural features like government effectiveness and reserve currency status. Moody's reviews debt burden (government debt to GDP and revenue) and debt affordability (interest payments relative to revenue and GDP). These variables assess the government's fiscal health, debt levels, and the sustainability of its debt management practices.

Institutional efficiency: The quality of a country's institutions, including its legal system, regulatory framework, and monetary authorities, is a critical factor. S&P evaluates the effectiveness of government institutions and policymaking, focusing on their ability to maintain sustainable public finances, promote balanced growth, and respond to economic or political shocks, along with transparency and accountability. Fitch uses indicators such as government effectiveness and reserve currency status to

gauge institutional strength. Moody's evaluates institutional strength through the quality of institutions, policy effectiveness (fiscal and monetary), and the government's default history or track record of arrears. Strong institutions are crucial for sustaining long-term economic growth and stability.

External balance: Agencies analyze external balance through metrics like net external debt, current account balance, and foreign direct investment, assessing external financial stability and the economy's exposure to global market fluctuations. S&P evaluates the sovereign's currency status in international transactions, external liquidity, and the external position of the country's assets and liabilities relative to the rest of the world. Fitch focuses on commodity dependence, forex reserves, and external finances, including the sustainability of current account balances and the level and structure of external debt. Moody's assesses susceptibility to event risk by analyzing political risk, government liquidity risk, banking sector risk, and external vulnerability risk, with an emphasis on refinancing.

All of the Big Three CRAs aim to evaluate economic structure, fiscal policies, institutional quality, and external balance to assess a country's creditworthiness. There are some distinctions, however. For example, Moody's combines macroeconomic and institutional strengths into a unified score, adjusting for fiscal strength and event risks, while also assessing external risks and political

stability. S&P calibrates separate averages for macroeconomic and institutional dimensions, adjusting for fiscal performance, external balance, and monetary policy, with an emphasis on monetary policy flexibility and effectiveness. While Fitch generally aligns with S&P and Moody's, it places a greater emphasis on structural and external financial indicators. Each agency has its strengths and weaknesses, but they all aim to accurately reflect a sovereign's ability to honour debt repayment obligations when due.

Challenges in Applying Existing Methodologies to African Sovereigns

With their diverse and complex socio-economic landscapes, African economies often face challenges in applying existing credit rating methodologies designed for more developed economies.

Economic structure: A primary challenge in applying existing credit rating methodologies to African sovereigns is that the economic structure of African countries is significantly different from that of developed economies. Many African economies are characterized by large informal sectors that contribute significantly to GDP and employment but are often underreported in official statistics. As a result, vital economic indicators, such as GDP and fiscal deficit—may only partially capture the economic reality of these countries.

Overemphasis on short-term risks:

Existing credit rating methodologies often place significant weight on short-term economic indicators, such as fiscal deficits, inflation rates, and current account balances. Although essential, these indicators can overshadow the view toward long-term structural development and sustainable growth. For instance, infrastructure, education, and healthcare investments are essential for long-term development but may take longer to improve short-term economic indicators. As a result, African countries making significant progress in these areas may still perform poorly on credit ratings due to a perceived short-term economic weakness.

Overestimation of political risk: Although political risk is a critical factor in sovereign credit ratings and a legitimate concern, existing methodologies often fail to differentiate between short-term political turbulence and long-term systemic risks. African countries often experience political changes as part of their democratic processes, which CRAs sometimes misinterpret as signs of instability. These changes can lead to overly pessimistic ratings that do not accurately reflect the underlying political environment or the resilience of democratic institutions in these countries. Moreover, the methodologies do not account for the capacity of African governments to manage political risks and maintain policy continuity despite leadership changes. This overemphasis results in higher perceived risks and, consequently, higher borrowing costs

for African sovereigns.

External vulnerabilities and commodity dependence: Many African economies rely heavily on commodity exports, making them vulnerable to fluctuations in global commodity prices. Existing methodologies often view this dependence as a significant risk factor, leading to lower credit ratings for countries with high exposure to commodity markets. However, this approach fails to consider the steps the countries must take to diversify their economies and manage these vulnerabilities. For instance, some African countries have implemented policies to stabilize revenues from commodity exports, such as establishing sovereign wealth funds or hedging against price fluctuations. However, these efforts are only sometimes fully recognized in the credit rating process, leading to a distorted assessment of economic resilience.

Institutional quality and governance assessments: The assessment of institutional quality and governance is another area where existing methodologies may need to capture the realities of African sovereigns. While the strength of institutions is critical in determining a country's creditworthiness, the methodologies often rely on broad indicators that may not accurately reflect the specific institutional context of a given country. For example, the perception of corruption is frequently used as a proxy for institutional quality, but this measure can be influenced by stereotypes or

incomplete information. Furthermore, improvements in governance and institutional reforms may take time to manifest in the indicators that CRAs use, leading to a lag in recognition of these positive developments.

Lack of contextual understanding: The economic, social, and historical contexts of African countries are unique, but existing credit rating methodologies often apply a one-size-fits-all approach. This lack of contextual understanding can lead to ratings that do not accurately reflect the creditworthiness of African sovereigns. For example, the impact of external debt is often evaluated similarly across different regions without considering the historical and economic contexts that have shaped how African countries manage and repay their debts. Countries that are able to effectively manage external debt may still be penalized under existing methodologies due to the high debt-to-GDP ratios common in emerging markets.

Biased credit ratings: There is a perception that existing credit rating methodologies are biased in favour of developed economies, which benefit from more vital institutions, diversified economies, and increased access to capital markets. This can result in a structural disadvantage for African sovereigns, often rated lower than their economic fundamentals suggest. The bias stems partly from the fact that these methodologies were developed primarily within the context of advanced economies, where economic and political

conditions are more stable and predictable. When applied to African sovereigns, they may only partially account for different risk factors and opportunities.

Methodological Bias and the Impact of Poor Ratings on African Economies

African policymakers are concerned about the potential bias in the CRA methodologies discussed above and the negative impact it has on their ratings. Griffith-Jones and Kraemer (2021) and Gbohoui, Ouedraogo, and Some (2023) present evidence in this regard and Nkhalamba et al. (2023) call for reforms to address flaws in the global financial architecture.

Despite elevated global interest, African countries face unjustifiably high borrowing costs and inflated perceived risk, largely due to inherent biases in credit ratings and market perceptions (Chirikure, Abimbola, and Chelwa 2022; Griffith-Jones and Kraemer 2021). For instance, in 2021, African Eurobonds yielded over 5 percent, compared to just 1 percent for advanced economies, and Angola paid over 9 percent for bonds despite no defaults since 2002, while Argentina issued a 100-year bond at 7 percent despite a history of defaults. Gbohoui, Ouedraogo, and Some (2023) reveal that the high premiums often stem from structural issues rather than actual risk levels. When accounting for factors such as transparency, the informal sector, financial development, and quality of public institutions, the excess premium usually associated

with countries in Africa diminishes, indicating that perceived premiums are linked to market risks influenced by rating methodologies that may not fully reflect accurate economic conditions. Addressing these biases and incorporating a more nuanced understanding of country-specific factors into credit rating methodologies could help align borrowing costs more closely with actual market risks.

The COVID-19 pandemic further exposed a procyclical bias in CRAs. Despite Africa's relative resilience to the shock and milder economic impact than that of advanced economies, countries in the continent faced harsher downgrades. Between January 31, 2020 and February 28, 2021, ratings for 41 percent of countries in Sub-Saharan Africa were downgraded, while advanced economies experienced minimal changes. This suggests inherent bias and unfair treatment, thereby constraining access to capital for development.

Governance issues within CRAs also contribute to these biases. Credit rating agencies, predominantly based in the United States and operating in markets dominated by advanced economies, often exhibit a cautious approach to downgrading advanced economies due to stringent regulatory oversight and reputational risks. In contrast, emerging and developing economies such as in Africa face less regulatory pressure and oversight, leading to harsher and more frequent downgrades. This "home bias"

among analysts and lack of balanced oversight result in disproportionately severe ratings for African countries, thereby increasing borrowing costs and constricting access to international capital markets.

Additionally, CRAs often overlook long-term climate risks, focusing instead on short-term factors. Africa is highly vulnerable to climate impacts and could potentially face further downgrades as global economies shift to low-carbon alternatives. Research indicates that climate inaction could lead to significant downgrades globally, highlighting the need to integrate long-term climate risk into CRA methodologies (Breitenstein, Ciummo, and Walch 2022; Griffith-Jones and Kraemer 2021; Klusak et al. 2023).

Credit rating agencies have had a profound and multifaceted impact on African economies. Their practices have exacerbated financial challenges, leading to an extensive dampening effect on growth and economic development across the continent.

High borrowing costs: CRAs procyclical downgrades have disproportionately impacted rated African sovereigns. Over 56 percent have experienced downgrades, compared to a global average of 31.8 percent, leading to significantly higher borrowing costs. Analysis of African Eurobond issuances reveals a clear negative correlation between credit ratings and borrowing costs, with lower ratings resulting in higher yields (Assa and Gevorkyan 2023). Angola's 10.60 percent yield bond (US\$1.75 billion,

maturing in 2032); Nigeria's 12.65 percent yield bond (US\$1.25 billion, maturing in 2029); and South Africa's 7.59 percent (US\$1.4 billion, maturing in 2032) and 8.74 percent (US\$1.6 billion, maturing in 2052) illustrate this trend. Despite macroeconomic fundamentals and current ratings, African countries face a borrowing cost premium of 2.9 percentage points, amounting to an estimated US\$2.2 billion in additional coupon payments (Assa and Gevorkyan 2023).

Cliff effects and investment grade losses: The impact of CRAs is particularly stark in the case of African countries losing their investment-grade status. Notably, Morocco and South Africa were downgraded to junk status during the COVID-19 pandemic. This development had severe financial repercussions, including sharp increases in bond yields and substantial capital outflows. The downgrade often results in a further rise in borrowing costs, straining fiscal space and undermining economic stability.

Spread premiums and economic challenges: African Eurobonds have traded at a significant premium, with spreads increasing dramatically. In June 2020, spreads were over 1,000 basis points above U.S. Treasury bonds and 400 basis points above the emerging market bonds composite index average. The rippling effect of these spreads could be disastrous, as seen in Ghana, where interest expenses in 2020 exceeded the country's health budget, limiting its

capacity to address the pandemic effectively. Similarly, Zambia experienced a dramatic rise in interest payments, which adversely impacted its fiscal stability.

Structural transformation deficit: The inflated cost of borrowing and deterrent effect of perception premiums have constrained capital investment, thereby discouraging investment in infrastructure and other critical areas needed to drive sustainable development. This has perpetuated an unhealthy dependence on commodity cycles and undermined long-term economic progress and poverty alleviation efforts.

Addressing Inherent Weaknesses in Existing Credit Rating Methodologies

Credit rating agencies play a critical role in the global financial system by assessing issuer's creditworthiness. Despite their importance, current CRA methodologies exhibit several inherent weaknesses that impact the accuracy and reliability of the ratings. These deficiencies affect the quality of credit assessments and have broader implications for financial stability and economic development, as discussed. In Africa, in particular, they increase the perceived risk and result in lower credit ratings for African Eurobonds.

Oligopolistic Market Structure

As discussed above, the credit rating industry is dominated by the Big Three, creating an oligopolistic market structure. This concentration limits

competition and stifles innovation and objectivity (Eijffinger 2012), perpetuating a cycle of inadequate and generalized credit assessments. For African countries, this often leads to ratings that do not fully account for their unique economic conditions, challenges, and risks.

Lack of Transparency and Conflicts of Interest

Lack of transparency is a critical weakness in current CRA methodologies. Rating agencies often guard their methodologies as proprietary, restricting external scrutiny and impeding constructive criticism required for improvement (Eijffinger 2012). The secrecy, coupled with potential conflicts of interest—where CRAs are remunerated by the entities they rate—raises concerns about impartiality and accuracy. The opacity of CRAs and inherent conflicts of interest were starkly highlighted during the 2008 global financial crisis, revealing serious flaws in risk assessment models and ability to predict systemic risks. The proprietary nature of these methodologies undermines their reliability and representation, especially for African countries with peculiar economic fundamentals compared to advanced economies.

Inconsistencies, Biases, and Discounting Practices

Eijffinger (2012) criticizes CRA methodologies for inconsistencies and potential biases, such as downgrades of economically strong countries like Germany. This in turn

undermines confidence in credit ratings and affects global financial markets. Additionally, the inadequate incorporation of discounting practices in financial analysis impairs the reliability of comparisons between revenues and debt obligations, compromising the accuracy of the ratings. Moreover, the methodologies rely mainly on the formal sector, undermining their relevance to African economies, where the informal sector is largely dominant, and the reliability of their assessment outcomes.

Dividend Policies and Leverage

Existing methodologies often inadequately address dividend policies and leverage. While the stability of dividend payouts is considered, there is insufficient assessment of the reasonableness of these policies in terms of equity capital cost. Moreover, these methodologies frequently focus narrowly on leverage from a bankruptcy risk perspective, neglecting its broader impact on financial indicators such as the cost of equity capital and overall capitalization.

Taxation Effects and Industry Specificity

The impact of taxation on financial performance and investment effectiveness is frequently disregarded in existing methodologies, leading to incomplete assessments of financial health. Reasons for such omission in advanced economies do not always resonate in the African setting, where taxation does have a significant impact.

Additionally, existing methodologies fail to consider the unique risks and characteristics of different regions, countries, and industries, resulting in ratings that may not fully reflect region-, country-, or sector-specific challenges and opportunities.

Credit Default Swaps

Credit default swaps highlight critical issues in the credit rating ecosystem, particularly for African sovereigns. Their private and non-transparent nature and role in worsening the 2008 financial crisis underscores the need for more regulated and transparent mechanisms (Pirdal 2017). The interaction between credit default swaps and ratings complicates risk assessment and stresses the need for improved market transparency and more tailored approaches.

Tailored Approach

A fundamental shift toward more robust and transparent methodologies is needed to address the weaknesses detailed above and reflect the realities of African economies. Several alternative approaches have been proposed.

Independent and global rating agencies: Establishing independent credit rating agencies, free from conflicts of interest, legacy, and national biases can enhance objectivity. Additionally, creating a global rating agency could contribute to standardizing and ensuring that ratings across regions are impartial (Eijffinger, 2012).

Standardized discounting and comprehensive analysis: Adopting standardized discounting models that reflect the time value of money and adjusting for economic conditions will improve assessment accuracy and relevance. Integrating frameworks—such as the business financial optimization theory—into dividend policy assessments and adopting a holistic approach to leverage evaluation can enhance financial stability assessments.

Country and industry-specific methodologies and taxation effects: Developing country and industry-specific rating methodologies and incorporating taxation effects into assessment will ensure that ratings better reflect country and sector-specific risks as well as economic and financial fundamentals. It is important to clarify the selection and interpretation of financial ratios with the view to reducing ambiguities and provide a more accurate assessment of an issuer's financial condition. These combined reforms—focusing on independent and global agencies, enhanced transparency, standardized practices, and tailored adjustments—can improve accuracy and reliability. Methodologies should reflect the following:

- Long-term development prospects, including investment in infrastructure.
- The informal economy, to better capture the full scope of economic activity in most African countries, relying on metrics or models that estimate its contribution.

- Political risk assessment refinement by distinguishing between political events and differentiating between short-term turbulence and long-term systemic risks; greater weight to the resilience of democratic institutions and the capacity for peaceful transitions of power, which are often underappreciated in existing methodologies.
- Contextualization of external debt through in-country evaluation considering economic structure, historical experience with debt management, and access to concessional financing; notwithstanding high debt-to-GDP ratios, African countries with vital track records in managing their debt should be recognized for their capacity to service their obligations under challenging conditions.
- Addressing structural biases by recalibrating the weight of key metrics and indicators to reflect their relevance to the fundamentals of emerging and frontier markets, including those in Africa.

Conclusions and Recommendations

While CRAs have become major players in the international financial space, there are growing concerns regarding current sovereign credit rating methodologies, which do not fully capture the unique economic, political, and social realities of developing economies. This misalignment leads to skewed risk assessments and, consequently, to ratings that are not reflective of the actual creditworthiness, potentially

limiting access to international capital markets and unjustly increasing borrowing costs. This paper highlights the inherent weaknesses of these methodologies and the need for reforms.

Addressing the shortcomings of existing sovereign credit rating methodologies in Africa involves the development of alternative frameworks that reflect the unique economic, political, and social environments of its nations and that consider the long-term development prospects, role of the informal economy, nuanced political risk assessments, and specific context of external debt. In this regard, crucial steps include establishing independent global rating agencies, enhancing transparency and regulatory oversight, and adopting industry-specific methodologies. Further, integrating long-term climate risks and refining financial analysis contribute to fairer assessments.

A clear case has been made for more robust and transparent rating frameworks to mitigate biases, promote access to sustainable finance, and support greater economic stability and development across Africa. These reforms are vital to creating a more fair and robust sovereign credit rating system that accurately assesses the continent's unique risks and opportunities.



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Evolution of Sustainable Finance and the Ontological Imperatives for an Afrocentric Model

Abel A. Osuji

Internal Audit Department, Afreximbank

Abstract: From its inception, sustainable finance (SF) has accommodated a variety of practices that reflect the doctrinal interpretations and ethos of different groups. It was originally driven by efforts to replicate religious tenets in banking and business conduct developed in the 16th century. Starting in 1980, state and institutional involvement in articulating the principles and dimensions of business sustainability, codifying corporate social responsibility (CSR) requirements, and nurturing sustainability-oriented alliances have helped foster the emergence and deployment of universal SF models. This paper explains how the expansion of the globalized, uniform SF market rooted in the dominant Western perspective has negated the ontological views of sustainability in other places that conceive responsibility differently, enabling powerful global corporates to promote SF models that are not relevant in developing societies. The paper recommends adopting a more pragmatic SF approach that recognises the pluriverse of the essence of sustainability across cultures and accommodates diverse meanings of responsibility. Accordingly, it recommends that Africa and other emerging societies develop and/or adapt balanced SF models that align with their cultural sense of responsibility and that could promote the optimal use of their resource endowments to support their developmental aspirations.

Introduction

The concept of sustainable finance (SF) is fluidly defined from different perspectives to suit different contexts. It encompasses nonfinancial environmental and social activities as well as corporate activities. The expanding nomenclatures of business sustainability, including corporate social responsibility

(CSR), triple-bottom-line, sustainable development, green economy, extra-financial activities, and environmental, social, and governance (ESG) practices, all share a commonality in firms' objectives to integrate economic, environmental, and social concerns into their core strategies (Paula-Carmen and

Dorin-Paul 2019; Qureshi et al. 2021; Sustainable Stock Exchange [SSE 2015]; Tóth et al. 2021). The SF concept is used interchangeably with sustainable banking, socially responsible investment (SRI), impact investing, green bonds, green and climate finance, social finance or banking, and responsible investment (Rabia et al. 2021 Tóth et al. 2021). The relatively narrower “green banking” concept applies the broader business climate sustainability model to the banking sector (Soumya 2019). SF incorporates ESG criteria into banks and other financial institutions’ product and service designs and offerings to customers (Paiva et al. 2021; Rabia et al. 2021; Tóth et al. 2021).

With respect to financial intermediation, SF dimensions support both in-house operations and the credit and investment decisions (Buallay et al. 2021). The benefits derivable from SF include capital accessibility, productivity, and cost improvements; enhanced risk management, operational resilience, and revenue from new market penetration and premium pricing; customer loyalty, brand equity, and image improvement; and enhanced employee engagement and retention (SSE 2015). SF could promote the social benefits of financial inclusion and equality and generate ecological advantages (Zahid et al. 2021). SF and the related taxonomies interchangeably describe financial players’ concurrent multifaceted strategic focus on profit and non-financial objectives. SF involves

the application of sustainability considerations within banking or the broader financial sector value chains.

The purpose of this paper is to explore the evolution of the conceptualization and practice of SF. Historically, SF accommodated various practices across groups and places, and the emerging trend of globalized SF standards has alienated the responsibility and the worldviews of stakeholders in developing societies while emphasizing Western modernist philosophy. Hence, there is an argument for a reframing of the SF model to allow for culturally contextual variations. The rest of the paper contains the following sub-topics: evolution of SF, ontological perspectives of SF, and conclusion.

Evolution of Sustainable Finance

Origin

The origin of SF can be traced to the historical efforts of economic actors to incorporate the ethos of organized religions into business conduct. Corporate adoption of SRI principles dates to 16th-century considerations of religious ethics by Italian banks in their business decisions (Zimmermann 2019). Dziawgo (2019) traced the foundation of sustainability in finance to the 18th century, when some Quakers and Methodists were inspired to apply their religious tenets in business strategy. The Quakers forbade members from trading in enslaved people. The founder of the Methodist Church, John Wesley, enjoined Methodist faithful to adopt responsible business culture and avoid

industries and products considered profane and dangerous to their beliefs and human society, including alcohol, tobacco, and gambling (Dziawgo 2019). The motivations for the business decisions of those religious adherents went beyond profit considerations and encompassed the upholding of spiritual mores and norms. The differing interpretations and observance of religious morals by the congregations led to variations in their ethical business conduct.

CSR became an essential part of the business ethics lexicon in the 1960s. It was used during this period to canvass the view of corporate citizenship, advocating that businesses contribute to the welfare of their operating environment (Dziawgo 2019). The emerging CSR perspective supported business investments driven by social values (Mendez and Houghton 2020). The idea's popularity in France and the Netherlands facilitated the introduction of environmental reports in Europe. In the 1970s, along with increasing recognition in the United States of additional social roles of corporates beyond profit maximization, the growing advocacy for sustainable business practices received an impetus from the maiden launch of Earth Day in April 1970 (Paula-Carmen and Dorin-Paul 2019). In 1971, Pax World Fund, an SRI-oriented mutual fund, was established as the first private equity firm with formalized CSR objectives (Mendez and Houghton 2020). SF practices in the 1960s and 1970s were mainly voluntary organizational gestures driven by external pressure

from civil society. During this period, the actors' conceptions of business sustainability were fragmented and inconsistent; hence, the disparity in organizational conduct and domain prioritizing, coupled with scant adoption.

Institutional and government interventions in articulating SF principles for corporate adoption took hold starting in 1980. The Brandt Commission Report on measures to facilitate closer collaboration between the global North and South, titled *North-South: A Program for Survival*, was published in 1980 by the Independent Commission on International Development Issues headed by Willy Brandt (World Bank 1980). It recommended incorporating environmental impact assessment when determining project viability and called on multilateral development banks (MDBs) to apply ecological values in their interventions in developing regions by supporting government borrowing from private lenders for compliant projects using guarantees and direct concessionary lending (Mendez and Houghton 2020).

In 1987, the United Nations World Commission on Environment and Development (WCED) published the Brundtland Report entitled *Our Common Future* (WCED 1987). It recommended forming financing alliances through private, public, and public-private partnerships to support development funding and for MDBs to assume more significant roles in supporting SF practices (Mendez

and Houghton 2020). The Brundtland Report pioneered the use of the sustainable development concept in the SRI lexicon and its formal definition (Dziawgo 2019; Mendez and Houghton 2020). The report emphasized mutual preservation of the environment, people, and resources while pursuing economic development and a sustainable development approach that enables present needs to be met without jeopardizing the potential of future generations to meet their needs (Dziawgo 2019). The Brundtland Report promoted the notion of comprehensive sustainability, comprising economic, social, and environmental considerations (Paula-Carmen and Dorin-Paul 2019). During the 1980s, the critical dimensions of the SF concept were clarified. The advocacy and participation of public sector institutions promoted the adoption of the evolving SF principles into mainstream business models.

The heightened sustainability-oriented activities in the subsequent periods to 1990 buttressed the roles of the Brandt and the Brundtland Reports in entrenching SF. Mendez and Houghton (2020) noted that the reports generated interest in sustainable banking and gave impetus to several enabling international and inter-governmental mechanisms, including:

- The Global Environmental Facility, 1991, supporting governments, IGOs/NGOs, and business alliances to tackle environmental risks.
- The UN Environmental Programme

Financial Initiative (UNEP FI), 1992, an alliance of global private lenders mobilizing capital for sustainable development and the sponsor of the annual UNEP FI Global Roundtables to discuss issues relating to the green activities of financial markets.

- The UN Conference on Environment and Development (UNCED) - Earth Summit, 1992, advocated increased aid and MDBs' lending to sustainable development projects in emerging economies.

Further, the Agenda 21 document, issued at the 1992 Earth Summit in Rio de Janeiro, emphasized the urgency of amending global consumption trends, controlling ecological degradation, and sustainably applying financial resources (UNSD 1992). Interventions and inter-governmental partnerships by public institutions with sparse private sector participation characterized SF in the early 1990s. The discussions on banking sustainability concentrated on MDBs' roles in directly financing and attracting private lenders to sustainable projects.

The catalytic role of the United Nations and governments in fostering sustainability practices continued into the late 1990s. Finland enacted the pioneering law on mandatory sustainability reporting (SR) for state-owned enterprises in 1997, followed by Australia and several other countries in Europe, Asia, and North America (Paula-Carmen and Dorin-Paul 2019). Some private lenders introduced sustainability-oriented products to exploit opportunities in supporting

business eco-efficiencies (Mendez and Houghton 2020). The involvement of private players culminated in the New York Stock Exchange's 1991 debut of the first sustainability-oriented market index—the Dow Jones Sustainability Index—to track listed companies' sustainable performance (Mendez and Houghton 2020). Other later-introduced sustainability indices include, FTSE4Good by the Financial Times Stock Exchange, 2001; BSE Values by Johannesburg Stock Exchange, 2003; and BM&FBOVESPA's Corporate Sustainability Index, 2005 (Paula-Carmen and Dorin-Paul 2019). The UN's Sustainable Stock Exchanges initiative was established in 2009 as the global multi-stakeholder platform for promoting responsible investment and supporting exchanges in improving ESG outcomes through research, technical aids, and advisory services and fostering consensus-building and collaboration (UN SSE 2023). The turn of the 21st century was defined by the emergence of sustainability-oriented private lenders, sustainability market performance metrics, and SR regulations. The emergence of sustainability-related market indices was a key milestone for global businesses and provided a basis for competition among private players.

To promote private sector SR, listed businesses are required to implement ESG disclosures by 2030 (SSE 2015). A partnership between UNEP and Ceres, Global Sustainability Standards Board (GSSB), published the maiden edition of the Global Reporting Initiative (GRI) in 2000, providing SR

guidelines for firms' comprehensive ESG activities (Paula-Carmen and Dorin-Paul 2019). Paula-Carmen and Dorin-Paul (2019) identified other SR frameworks developed after the GRI. These include:

1. Commission Guidance Regarding Disclosure Related to Climatic Changes, issued by the US Securities Exchange Commission (SEC) in 2010, requiring quoted companies to report their global climatic change-related risks.
2. International Standards Organization (ISO) 2600 Guidelines published in 2010 for social responsibility reporting, detailing the importance of CSR disclosures for internal and external communication.
3. SR Guidance issued by the Singapore Stock Exchange (SGX) in 2011, mandating quoted companies to disclose their sustainability performance.

Although GRI is the most widely recognized standard for SR and risk measurement (Antoncic 2021; Elalfy et al. 2021; Journeault et al. 2021), other frameworks, listed below, have been adopted across global markets:

- Prince of Wales Accounting for Sustainability Project, International Integrated Reporting Committee (IIRC), Sustainability Accounting Standards Board (SASB), and Carbon Disclosure Project (CDP)/Carbon Accounting (Journeault et al. 2021; LeBlanc et al. 2021).
- DJSI, Business in The Community

(BiTC), Business Ethics 100, Accountability rating, and Global Framework for Climatic Risk Disclosures (GFCRD; Aifuwa 2020).

- Kinder Lydenberg Domini, Ethical Investment Research and Information Service, Sustainable Asset Management, Asian Sustainability Rating, Morgan Stanley Capital International (MSCI ESG indices), FTSE4Good index, Bloomberg ESG Disclosure Scores, and Trucost (Buallay 2019).
- Global Core Indicators (GCI, Antoncic, 2021).
- Forestry Stewardship Council, Roundtable on Sustainable Palm Oil, Deloitte's Carbon Neutrality Standard, Science Based Targets Initiative (Ehrnström-Fuentes and Böhm 2023).

The SR requirements are not standardized, and the application of SR standards differs between organizations and jurisdictions because of variations in local statutory, social, and economic realities that affect ESG implementation. This poses practical challenges for businesses in developing SR protocols that simultaneously meet international and local needs (Buallay 2019; KPMG 2024). For instance, the GRI is a general principles-based SR framework applicable to all companies, whereas SASB provides industry- and sector-specific guidelines for climate-intensive companies' reports on the financial materiality of their sustainable activities (Parikka 2023; Vela Sustainability Technologies

2022). Specifically, the two standards differ on how they measure greenhouse gas emissions, water usage, and human rights indicators (Vela Sustainability Technologies 2022).

The rapidly evolving ESG practices and regulations made sustainability-oriented strategies increasingly crucial in the financial sector for purposes of compliance and exploiting emerging opportunities (Paula-Carmen and Dorin-Paul 2019). However, with the growing adoption of sustainable activities and reporting, greenwashing through misleading products and services labeling or misrepresenting noncompliant activities as sustainable emerged as negative sustainability practices (Dziawgo 2019). The involvement of private lenders and the widespread enactment of regulatory guidelines provided a fillip to corporate adoption of ESG practices beyond the financial sector. The emergence of deviant greenwashing tendencies among the competing players intensified the need for harmonization and standardization of corporate sustainability practices.

The respective promoters of the various sustainability standards and frameworks have revised them, over time, to improve and harmonize the guidelines. The International Organisation for Standardisation (ISO) has developed certifications for different aspects of organizational sustainability performance: ISO14001 for ecological management framework, ISO 14063 for climate

disclosures, and ISO 26000 for all-inclusive CSR achievements (Elalfy et al. 2021). The GSSB has published four generations of GRI: G1, G2, G3, and G4, with the latest version, the Standard, produced in 2017 (Elalfy et al. 2021). To achieve convergence, the SASB, IIRC, and GSSB group and CDP, GRI, SASB, and the Taskforce on Climate-related Financial Disclosures (TCFD), respectively, have undertaken collaborative projects to enhance the standards (Elalfy et al. 2021).

The United Nations continued to extend its institutional catalytic roles into the standardization of sustainable practices. In 2006, the NYSE adopted the UN-inspired Six Principles for Responsible Investment (PRI), emphasizing collaborative measures for the sustainability of investors, markets, and the environment, including incorporating ESG considerations in organizational investment decisions and equity and disclosure policies and cooperation in implementing sustainability principles (Dziawgo 2019). In 2015, the United Nations replaced the 2001 Millennium Development Goals with Sustainable Development Goals (SDGs), comprising 17 broad goals and 169 targets (UN 2015). Under the SDGs, countries and corporates are to promote enabling activities in the critical areas of people, planet, prosperity, peace, and partnership to address the identified systemic issues constraining global efforts towards achieving the SDG targets by 2030 (UN 2015). Implementation of some aspects of the SDGs is behind schedule, mainly because of capital

mobilization constraints, given that the estimated yearly global capital investment required to achieve the SDGs by 2030 is only \$7 trillion compared to \$23.3 trillion available in risk-averse private funds (Mendez and Houghton 2020). The prevailing SF models face the challenge and opportunity of mobilizing and judiciously allocating excess privately held funds to sustainable objectives without unduly increasing the owners' risk profile (Mendez and Houghton 2020). The SF paradigm holds latent prospects of future expansion and transformation from the standpoint of accommodating new entrants and headroom for current players' consolidation and innovation.

The European Union undertook significant institutional interventions impacting SF, though some affected all sectors. In 2013, the EU Parliament passed two resolutions: Corporate Social Responsibility: Accountable, Transparent, Responsible Business Behavior and Sustainable Growth and Corporate Social Responsibility: Promoting Society's Interests and a Route to Sustainable, Inclusive Recovery (Dziawgo 2019). In 2014, the European Union issued Directive 2014/95/EU, requiring large businesses with over 500 employees to provide enhanced environmental and social-related information, including on anti-corruption and bribery, in annual reports starting in 2017 (EU 2014) and introduced additional measures in 2018 and 2019 to promote SF within the member states (Dziawgo 2019). The 2018 initiatives include:

- Guidelines requiring institutional investors and fund managers to integrate sustainability criteria in investment decisions.
- Requirements for disclosing investment instruments' carbon footprint to investors.
- Rules to include sustainability concerns in insurance and investment experts' services to clients.

The 2019 expert reports were:

- Supplemental guidelines on corporate sustainability disclosures.
- A taxonomy for climatic-compliant commercial activities to support the transition to a carbon-neutral economy.
- EU Green Bond Standard, defining common criteria for green bond issues for comparability, ecologically eligible economic activities for EU green bond financing support and standardized taxonomy.
- EU climate and ESG benchmark information on acceptable approach and technical conditions to mitigate greenwashing risks and comprehensive SR requirements.

The EU measures instituted a conducive regulatory framework, provided technical support, and harmonized the bloc's SF practices.

The African Union (AU) launched Agenda 2063 in May 2013 as the strategic framework for achieving inclusive growth and sustainable development in Africa within 50 years,

covering seven aspirations, 20 goals, and 39 priorities (AUC undated). Agenda 2063 implementation follows five ten-year plans with The First Ten-Year Implementation Plan (TFTYIP) starting from 2014 designed to achieve continental political, socio-economic, and technological transformations (Mo Ibrahim Foundation 2019).

Corporate SF strategies have evolved from avoidance to comprehensive ESG considerations. Soumya (2019) identified four maturity stages of banking sustainability:

1. The defensive stage, when banks deem sustainable activities as largely expendable and superfluous to their core objectives and tend to resist emerging regulations. At this phase, banks adopt avoidance strategies, involving strict adherence to specified exclusion lists.
2. Preventive, when banks become more receptive and readily yield to legal or societal pressures to incorporate ESG considerations in their strategies. Accordingly, banks only comply with the minimal expected sustainability requirements.
3. Offensive, involving significant adoption of sustainable banking practices, such as investing in climate-friendly projects, creating funds targeting sustainable assets, and SR.
4. Sustainable, aligning all operations to defined sustainability criteria, avoiding deficient projects, and replacing economic-maximizing

objectives with comprehensive sustainability value-adding goals.

Kumar and Prakash (2019) and Mendez and Houghton (2020) traced the evolutionary stages of sustainable banking as:

1. Social banking, reflecting banks' involvement in charity-related activities.
2. Ethical banking, integrating defined non-economic values into banks' routine decisions.
3. Green banking, focused on achieving defined ecological objectives through conditional lending or avoidance.

Sustainable banking, incorporating the comprehensive ESG criteria into the bank's strategy and applying specific measures to mitigate the likely anti-sustainability impacts of its activities.

The sustainability evolutionary idea also applies to banking investment activities. Dziawgo (2019) identified the maturity trajectory of sustainable investing:

- negative screening phase: forbidding investments in identified industries or products, such as narcotics, weapons, or named jurisdictions.
- norms-based screening: a variant of negative screening applied to identify investment options that breach certain guidelines.
- positive or best-in-class screening: identifying acceptable ESG-compliant industries or markets to deal in.

- sustainability-themed investing: strategically investing in identified sustainability-oriented assets.

- positive impact investing: focusing on projects with specific sustainable objectives.

- shareholder advocacy: using shareholder position to influence investee firm's sustainability-oriented behavior.

- ESG integration: incorporating comprehensive ESG criteria in routine investment decisions and risk management.

The various evolutionary classifications of SF reflect divergent emphasis on the triggers, responses, and decision criteria underlying adopted sustainability models but also show important areas of overlap. A player's sustainability practices may not necessarily evolve chronologically through the phases.

Banks improved and diversified their products and services along with the SF maturity phases. Rabia et al. (2021) noted non-chronological sustainable financing innovations and instruments:

- responsible investment: a financing decision-making model incorporating ESG factors that concurrently yield long-term superior returns and social benefits.

- green bonds: fixed-income instruments, which proceeds are strictly applied to climate-friendly projects.

- SRI: consideration of specific social

criteria in investment decisions to achieve defined social-value objectives.

- social impact bonds: instruments, which proceeds are applied to socially oriented projects, with fixed income yields payable on achieving defined outcomes.

Banking technology has evolved from “brick and mortar to click and mortar” (Forcadell et al. 2019: 3). Soumya (2019) identified banking products, services, and operations that conformed to green banking principles:

- online and mobile banking services: online bill payment and funds transfer, mobile banking, remote cash deposit and withdrawal through ATM.
- green checking accounts: enabling bank customers to obtain information through ATM or touchscreen computer, including virtual access to their account statements.
- green loans: banks’ financing to projects that met specified environmental criteria, such as concessionary mortgages to green buildings.
- green credit cards: schemes for replacing currency notes with more resilient plastic money requiring less frequent replacement.
- sustainable banking operations: entails using renewable energy sources and power-saving office equipment.

The emerging branchless banking innovations, involving rendering regular banking services outside of bank branches through mobile phones and online computer services, ATMs, and agency banking by third parties, could generate significant sustainability value (Zahid et al. 2021).

MDBs have made industry leadership interventions in developing SF and promoting its adoption. Mendez and Houghton (2020) identified some pioneering endeavors of MDBs in championing and developing the sustainable banking agenda:

- Incorporating sustainability criteria into credit risk management. For example, the European Bank for Reconstruction and Development (EBRD) started applying sustainable lending principles in 1990. This was more than a decade before the 2003 Equator Principles, a framework for evaluating the sustainability risks underlying project financing adopted by up to 101 financial institutions across 38 countries by 2019.
- Using innovative financing solutions, such as guarantees, equity investments, loan syndications, and green bonds, to attract conventional financing to seeming economically unviable but socially impactful projects.
- Leveraging blended financing arrangements to sustain public-private partnerships by providing concessionary loans for projects, thereby de-risking the borrower for private investors’ participation.

These arrangements include using equity and long-tenured loans to assist weak markets in attracting foreign direct investment.

- Developing solutions for transparency and uniformity in reporting sustainable financial flows, a project which private lenders may not find sufficiently cost-effective to undertake.
- Innovatively co-opting commercial banks into sustainable project financing, using green bond instruments, pioneered by the European Investment Bank's (EIB) 2007 Climate Awareness Bond for clean energy ventures; blended finance; non-recourse financing; and structured trade finance.

Some MDBs established donor-contributed trust funds to mobilize and provide aid or grants to qualifying beneficiary projects designed to achieve defined sustainability values (Michaelowa et al. 2020). The credentials of SF programmes may cover the three ESG domains or narrowly focus on specific social or environmental agenda, thus underlining the acceptable flexibility in SF products and funding scope. The sustainability mixes and depth an organisation deployed in routine operations and product offerings could reflect its sustainability capability and maturity credentials.

The sustainability-oriented financial market has shown consistent growth in the past decade. Following the 2008 financial downturn, stakeholders in the financial industry

now increasingly require banks to reform their business models to de-emphasize profit maximization and deliver increased sustainable values (Rabia et al. 2021). One hundred and thirty banks, managing 33 percent of global banking assets, have signed the UN Environmental Finance Initiative Principle for Responsible Banking, committing to adopting ESG-oriented models (SIA, 2020). A 2019 survey indicated investors' rising interest in ESG, from 71 percent in 2015 to 85 percent in 2019 (SIA 2020). Over 2400 companies with assets under management above \$80 trillion were signatories to the PRI in 2019, compared to fewer than 500 companies with total assets below \$10 trillion in 2006; and by 2020, 50 financial institutions had joined the Science-based Targets Initiative, a project encouraging firms to adopt specific voluntary emission reduction targets (SIA 2020). Global sustainability-oriented assets under professional management increased to \$30.68 trillion in 2018 from \$18.28 trillion in 2014, with Europe accounting for \$14.08 trillion (46 percent), followed by the United States, with \$12 trillion, translating to 39 percent (Dziawgo 2019). Europe's dominance of global sustainable assets compared to other regions could be attributable to the increased measures and regulations enacted by the European Union in 2013. ETFs and mutual funds generated a sustainable investment value of \$288 billion globally within 11 months in 2020, representing a 96 percent increase over the 2019 performance (LeBlanc et al. 2021).

The 2020 result is instructive when viewed against the prevailing general investor apathy and bearish market outlook amid COVID-19-induced market disruptions and uncertainties.

Ontological Perspectives of Sustainable Finance

Despite the plethora of avowed direct and spin-off benefits of sustainable business models, some global players remain pessimistic about the subject, its impacts, and prospects (Mussell 2016), especially in emerging markets where regulations appear relatively lax or nonexistent and voluntary adoption is limited because of the economic actors' reservations. The drivers of the SF controversy include its multidimensional and multistakeholder essence (Sorsa and Fougère 2021), ambiguities surrounding stakeholders' varying conceptualization and interpretations of corporate sustainability, and arguments about the relevance of the predominant ontological perspective underlying the prevailing sustainability models to all stakeholders affected by corporate actions (Journéault et al. 2021). The differential understandings of sustainability potentially pose diverse implementation challenges.

Ontology refers to the perception of reality within a locality, the inter-relations between the constituent human and non-human entities, and the assumptions and beliefs underpinning the understanding of that reality (Cleaver et al. 2021; Journéault et al. 2021; Mussell 2016; Sorsa and Fougère 2021; Sullivan

2017). The ontological sustainability perspective recognizes location-specific CSR variants that reflect divergent or even contradictory perceptions by people and their relationship to nature in different places (Ehrnström-Fuentes and Böhm 2023). The ontological views underlying subsisting SF models include the following:

- Descola's ontology identified four dimensions that portray the understanding of the human-nature interaction across different cultures—naturalism, totemism, animism, and analogism (Descola 2014). According to Descola (2014), analogism, the inference that natural entities are independent, distinct beings for which minute similarities could be drawn to make the sense of an organised world, are common in West Africa, among Mesoamerican natives, and in the Andes, whereas animism obtains in South and North America, Siberia, and Southeast Asia. The African traditional totemic practices of preserving and caring for affiliated objects have ecological and economic significance, fostering environmental protection by conserving plant and animal species and maintaining eco-diversity as well as generating tourism-related economic value (Moahi 2022; Ndubisi 2018). For instance, over 100 animal and plant species are treated as totems among the Ugandan Batooro, Banyoro, and Baganda tribes, similar to the tribes in the Democratic Republic of Congo and the Central African Republic (Moahi 2022). The global adoption of the GRI

sustainability model, underpinned by the Western naturalist worldview, invariably excludes other ontological perspectives relevant to non-Western cultures in the prevailing ideas and practices about sustainability (Journeault et al. 2021).

- Political ontology recognizes the existence of a pluriverse, comprising capitalist modernity espoused by global businesses and other worlds of Indigenous peoples whose relationship to land transcends economic considerations (Ehrnström-Fuentes and Böhm 2023). Local groups' understanding and relationships with nature translate to notions of responsibility that are different from the global corporates' mainstream approach (Ehrnström-Fuentes and Böhm 2023). Political ontology depicts the power-play to elevate global corporates' modernist One-World view to dominate other views and the resistance struggles against modernity ontology (Escobar 2016). The modernist One-World view emphasizes the duality represented in human-nonhuman and culture-nature dichotomies, supporting market-based ESG mechanisms, such as environmental degradation for economic gain, whereas the pluriverse of multiple worlds and responsibility sense-making accommodates a relational view of life (Escobar 2016; DePuy et al. 2022), such as Muntu and Ubuntu in some areas of Africa (Escobar 2016).

The legitimacy instrumentation and community views are two dialectical dimensions of SF political ontology. Ehrnström-Fuentes and Böhm (2023: 247) viewed CSR as a mechanism to secure global corporates' legitimacy and greenwashing by burnishing their reputation while hiding the continuing exploitative dispossession of land-dependent indigenous communities in the Global South. Ehrnström-Fuentes and Böhm described the community or material worldview as emphasizing inter-human exchanges and responsibly conducting human and non-human interactions in an evolving dynamic, accentuating the experience of the local people affected through business sustainability activities. The modernist sustainability perspective that reinforces prevailing SF practices and supports land resource exploitation while suppressing Indigenous people's views of responsibility in places (Ehrnström-Fuentes and Böhm 2023) aligns with the legitimacy ontology.

- Neo-Gramscian ontology: a philosophy of power politics in which the economically superior class leverages their position to create and influence a hegemonic group (Sorsa and Fougère, 2021). From the neo-Gramscian perspective, CSR represents the framing of the economically dominant global corporates' interests instead of the general concerns of a multistakeholder hegemony (Sorsa and Fougère 2021). Communities whose daily lives are entwined with

land are threatened by the extractive ventures of industries, creating conflicts between relatively weak local people and global businesses. This is more manifest in places where natural phenomena, such as forests and hills, hold strong cultural appeal and represent sacred values, and are not just perceived as exploitable resources (Ehrnström-Fuentes and Böhm 2023). The African Maasai pastoralists treat land and the natural elements of the landscape as community endowments rather than isolatable resources for individual appropriation and exploitation, using access to expansive water bodies and forage to support livestock and natural vegetation regrowth (DePuy et al. 2022). The Kenyan Maasai's traditional activities that foster biodiversity include using pastoral livestock rearing to create glades rich in species and facilitating interactions between domestic cattle and wild ungulates (DePuy et al. 2022).

- Relational social ontology: business sustainability is driven by a corporate empathy or caring mission and relational considerations, essentially using superfluous business undertakings to address the needs of members of society overlooked by the market and the State (Mussell 2016). In this respect, CSR consists of corporate philanthropic gestures. African traditional philanthropy, driven by a deep-seated sense of collective responsibility, resilience, and communal solidarity, is based on informal generosity and reciprocal support, which fosters inclusiveness

and sustainable development within societies (Corps Africa 2024; Giving Tuesday 2023; Mahomed 2023; Moyo and Ramsamy 2024). Although modern philanthropy emphasises monetary donations, diverse African philanthropy models, such as Ubuntu, are driven by undocumented practices, traditions, and narratives that portray the underlying values of cross-generational care, kinship solidarity, and interdependencies, which form the bedrock of society's growth (Giving Tuesday 2023; Moyo and Ramsamy 2024). Noting that philanthropy is embedded in daily African practices, usually dispensed in kind, and not necessarily from abundance, Mahomed (2023) identified instances of African traditional philanthropy not captured in dominant narratives. These include communal contributions during festivals, emergencies, and death; lending agricultural facilities without receiving financial compensation; pooling local labour for infrastructure development; contributing to community grain savings projects; elderly women taking turns to bathe new babies; volunteers supporting mourners and washing rituals for dead bodies or caring for ill community members; and diaspora residents and migrants from communities forming hometown associations in host countries for mutual support and helping extended families and home communities.

Despite the trajectories of the divergent ontological perspectives of responsibility, SF practices are

coalescing into universal frameworks anchored in one dominant paradigm. Sustainability has evolved into the exclusive dictate of powerful Western global institutions, fostering their values of technical, business, and human advancement and accommodating their systemic weaknesses while overlooking local challenges (Sorsa and Fougère 2021). Globalization and colonialism served as tools for propagating a singular SF paradigm predicated on Western ideas of modernity and their diffusion to far-flung cultures (DePuy et al. 2022; Ehrnström-Fuentes and Böhm 2023). Over time, CSR transmuted to a place-capture instrument by fostering value congruence through shaping local communities realities and world perception to align with those of corporate stakeholders (Ehrnström-Fuentes and Böhm 2023). The single worldview of sustainability anchored in Western cultural values and perceptions of inter-human and human-nature relations fostered the prevalent notion shaping business sustainability views and practices. Similarly, emergent SF construct reflected the naturalist ontological underpinning, suppressing other cultures' notions and ways of making sense of responsibility.

Another complication, related to the multifaceted and multi-stakeholder attribute of business sustainability, is the quest for standardization and harmonization to facilitate corporate adoption and comparability and checkmate greenwashing tendencies. Standardizing and certifying sustainability practices

and institutionalizing SR templates tended to moderate or eliminate divergent notions of sustainability (Ehrnström-Fuentes and Böhm 2023). Codifying and quantifying sustainable practices, leveraging the ideology of numbers view, resulted in a reductive paradigm, narrowly framing the boundaries that circumscribe sustainable activities (Journeault et al. 2021). In implementing modernity-oriented sustainability, objectively determinate facts substituted character, and responsibility was interpreted as complying with a set of rules reflecting the dominant institutional values of technological, commercial, and human civilizations, without much emphasis on internalizing the values (Arrigoni 2019).

Modernity-driven CSR emphasized empirically quantifiable parameters, such as social investments in health, education, and carbon-reduction, while consciously obliterating other nuanced but equally important elements, such as human relations and communities' ecosystems distortions by corporate extractive activities, ancestral land deprivations, value-swapping, and cultural reframing (Ehrnström-Fuentes and Böhm 2023; Journeault et al. 2021). For example, proliferation of industrial-scale shrimp farming projects and agro-fuel-producing palm oil plantations across global tropical areas created disadvantages for the original mangrove and forest-dependent cultures (Escobar 2016). Similarly, contemporary governance mechanisms for regulating the land

market, such as state-approved exclusive individual rights, facilitated cheap transfer of land resources to the most powerful users (state, businesses, and international organisations) but negated customary collective land ownership, which should reinforce inclusion and participation of vulnerable indigenes of traditional societies as important land stakeholders (DePuy et al. 2022). By de-emphasizing local realities and perceptions of nature and excluding the legitimate concerns of the weaker native stakeholders, latent in the nuanced trade-off of indigenous environmental concerns and culture for infrastructure, the emergent universally applicable SF models appear to lack the critical sustainability criteria of concurrent accommodation of all stakeholders and fostering value co-creation.

It has become imperative to rethink the prevailing SF model. Rather than limiting the conceptualization of sustainability to the dominant Western ontological interpretation, a progressive approach should be considered that addresses SF from the meaning of responsibility within the target society or culture, to reflect the model of the affected people's traditional practices, local technology and skills, understanding of the local ecosystem, and place of humans in nature (Dei 1993; Journeault et al. 2021). African relational values and financial psychology require reframing its SF model to elevate mutual accommodation, reciprocity, and collective welfare over individual benefits. In this model, human

actions are viewed not just from the prism of economic utility but based on the implications for other natural elements in a connected web and the potential to reinforce group solidarity (Dia 1991; DePuy et al. 2022). An African-oriented sustainable model should recognise collective ownership and control of productive resources obtained in traditional practices, rather than privatising and commercialising common lands and absolute individual resource ownership and appropriation (Dei 1993; DePuy et al. 2022). Another attribute of an African-focused SF approach is the recognition of the culture of accepting loan collateral for the intrinsic symbolic rather than its commercial value, such that the mercantile value of the pledged object need not be commensurate with the amount borrowed (Dia 1991). To buttress the efficacy of traditional African social guarantees and commitment, Dia (1991) observed the sharp contrast between that the high rate of loan repayment in the traditional financial system in sub-Saharan Africa and the high proportion of delinquent loans in the formal banking system. Other cultural practices that could be incorporated into an African-oriented SF model include the use of consensus and arbitration to settle disputes and traditional savings and investment schemes such as rotating and savings associations (Dia 1991). SF solutions for Africa should empower people, address social inequities, and create a balance between financing food production for domestic consumption

and cash crops for export (Dei 1993).

The agnostic ontological CSR paradigm involves pragmatic situational development of views and counterviews, in which each adversarial stakeholder group accepts the others' views as valid and requiring negotiation to find mutually acceptable common ground (Sorsa and Fougère 2021). Viewing sustainability as an interactive construct entailing inter-human and human-nonhuman exchanges that produce multiple legitimate realities across places recalibrates existing CSR practices to recognize other possible realities and perceptions of man-nature relations in places (Cleaver et al. 2021; Ehrnström-Fuentes and Böhm 2023). The emergent approach should engender a reinvention and redefinition of sustainability risks, stakeholders, and climate, focused on support for biodiversity and ecosystems in places, rearticulation of acceptable dimensions of sustainable trade and financing models, and recognition of other solutions and responsible activities reflecting the pluriverse of SF ontological worldviews (Ehrnström-Fuentes and Böhm 2023). From this perspective, framing CSR represents dynamic and sensitive multi-stakeholder considerations (Sorsa and Fougère 2021). Existing universally applicable SF models do not reflect the interpretation and meaning of sustainability across all societies, which could cause sub-optimal results in outlier cultures. Regional financial actors in African

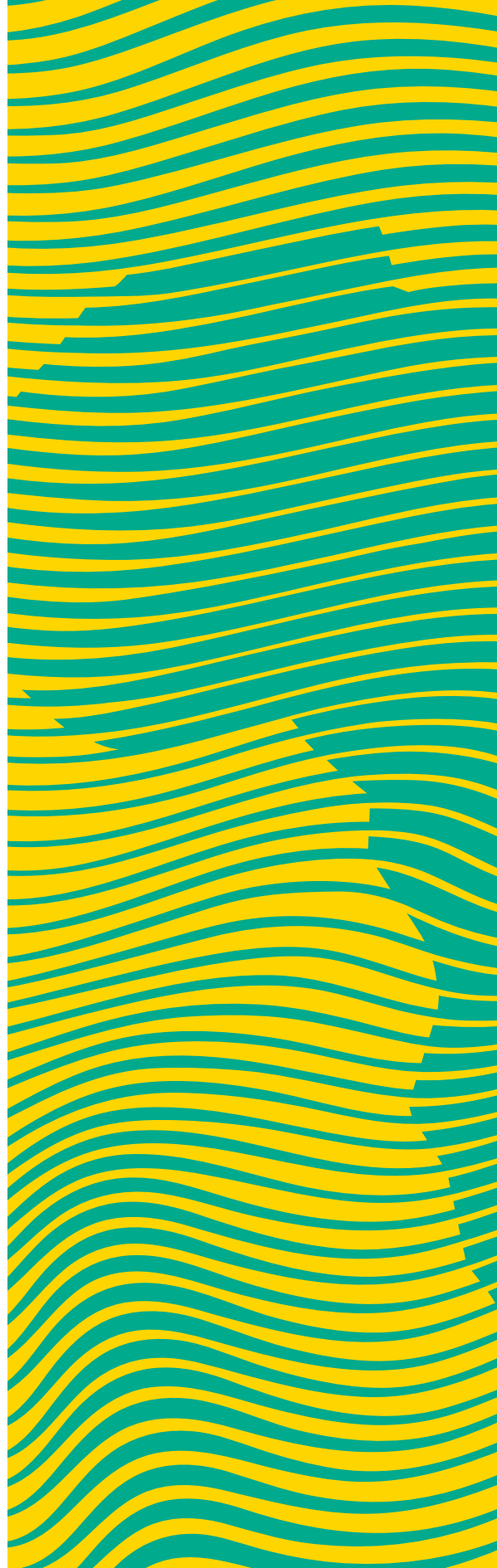
and other emerging economies should deploy suitable SF models that reflect the indigenous perception of responsibility and optimally support people's meaningful developmental aspirations.

Conclusion

The centuries-old SF concept and practices have evolved from replication of religious ethos in business conduct to a set of codified international standards and jurisdictional legalities, encompassing corporate ESG considerations. Historically, SF boundaries have been fluid and dynamic, emphasizing the prevailing non-financial concerns in the context and reflecting divergence in historic, organizational, and regional practices. Existing SF models are influenced by the dominant Western cultural philosophies to the exclusion of other cultural approaches to responsibility and values. The upshot is the growing development of universally applicable SF models with no consideration for differences in the reality of sustainable practices across cultures.

A globalized approach to SF may reinforce uniformity of practices and comparison of performance. However, such an approach could create SF models that are alien to local communities and detached from the cultural philosophies of responsibility in other regions, particularly developing regions. A pragmatic approach that models SF practices to align with institutionalized ontological

perspectives of responsibility in different places and reflects their entrenched cultural beliefs and sense-making of human-nature relations would make SF more practically meaningful and less rhetorical to local stakeholders, and in this way create a greater potential for their adoption across places. More critically, such a realistic approach could enable players in Africa and other emerging societies to strike an appropriate balance in adopting affordable SF models that align with their developmental goals. Moreover, emerging societies' SF perspective should accommodate optimal and sensible utilization of their resource endowments to enhance their peoples' growth and living conditions



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Geopolitical Instability and its Impact on Trade Integration in Africa

Lukman A. Lasisi^{1*}, Isaiah Adisa¹, Ihunanya N. Erundu¹

Abstract: This study examines the complex relationship between trade integration in Africa and geopolitical instability. Despite efforts to promote intra-regional trade through initiatives such as the African Continental Free Trade Area (AfCFTA), Africa continues to face significant challenges stemming from geopolitical instability, economic constraints, and political unrest. In this context, the study aims to assess the effectiveness of trade integration policies in Africa, particularly in the context of the AfCFTA, and their implications considering prevailing geopolitical instability. The study analyses historical trade data and recent geopolitical events, unpacks the impact of instability on regional trade dynamics, and offers insights into the potential pathways for overcoming these challenges. The study found that the impact of instability in Africa includes limited access to financial markets, fragmented markets, and hindrance of trade liberalisation policies, leading to a decline in intra-African trade. Military coups, conflicts, and terrorism have created barriers to regional integration and pan-African cohesion. It is crucial for African governments to prioritise efforts to promote peace, stability, and good governance to unleash the full potential of the AfCFTA and foster sustainable economic development.

Keywords: Trade integration, AfCFTA, Geopolitical instability, Africa, Military Coup, Terrorism

JEL Classification: F52, F130, F150

Introduction

Intra-regional trade among African countries is the lowest globally. According to UNCTADstat (2024), only 13.6 percent of Africa's total trade in 2022 was with other African countries. In other words, Africa rarely buys from Africa (Olney 2022). Unfortunately, there are significant challenges with trading in Africa.

First, most African countries produce similar products—mostly crude and agricultural—making it difficult to establish the basis for trade. Inability of African countries to process commodities beyond the primary level deprives them of much-needed value and makes them unattractive on the international market (Union and

1. Research Unit, Lagos Business School, Pan Atlantic University

*Corresponding Author, Email: abisoyelasisi2002@gmail.com, llasisi@lbs.edu.ng

Africana 2012). For instance, Africa's share of manufacturing exports accounts for only 1.3 percent of global exports (African Export-Import Bank 2022). Second, markets in Africa are often small, fractured, and lack proper integration (Gnimassoun 2019). About 80 percent of firms in Africa are small and medium enterprises, with limited experience and a minimal industrial base, and are often found operating in the informal sector (Kere and Zongo 2023). Despite considerable digital penetration recorded in Sub-Saharan Africa and internet users projected to exceed 85 percent by 2025, e-commerce remains unfamiliar in most markets, making it difficult to participate in international trade (GSMA 2022). Third and perhaps the most severe, is geopolitical instability; Africa is not safe. The success of trade integration in Africa is severely hampered by geopolitical instability (Amponsah 2002; Jung 2017; Pasara 2020).

The AfCFTA was created in 2018 to address this anomaly of low intra-regional trade by enhancing economic integration, economic diversification, and industrialization in Africa. The AfCFTA represents the largest free trade area on the globe with 1.3 billion people (16.3 percent of the world population). With the youngest population in the world and a total GDP of US\$ 3 trillion, Africa has the potential to become a significant force in global trade (World Bank 2020). However, Africa grapples with significant economic challenges that could undermine the aspirations of AfCFTA. The continent continues to

struggle with poverty and there are still wide development gaps between African countries and the world's developed countries. As of 2019, Africa's share in global trade was a meagre 2.6 percent (UNCTADstat 2024), the lowest in the world.

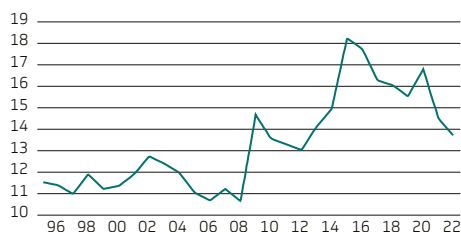
The continent hopes to leverage opportunities from the AfCFTA to address some of its problems. However, trade and investment constraints brought forth by instability—frequently the result of political unrest and poor governance—have made markets tiny and dispersed (Pasara 2020) and continuously threaten the potential advantages of regional trade agreements such as increased trade, peace and security, and economic growth (Amponsah 2002). Political instability and limited access to financial markets have a significant impact on the effects of trade liberalisation policies in Africa (Jung 2017). Increased political will to fight instability is required to reap the benefits of trade agreements.

The “Arab spring” that swept across North Africa and the Middle East in the 2010s led to the destabilisation of some African countries such as Egypt (in part), Libya, and Sudan. According to the 2023 Global Peace Index, the Sahel region of Africa (together with the Middle East) is the least peaceful region in the world. Other parts of Africa, such as West Africa have also experienced waves of violence in recent times. The free flow of arms across Sahara and into West Africa, where armed terrorist groups and non-state actors such as

Boko Haram, the Islamic State in the West African Province, and criminal nomads known as the “Bandits” hold sway and have taken advantage of the availability and affordability of these weapons of war to visit terror on local communities in Cameroon, Chad, Mali, Niger, and Nigeria.

Most recently, there has been a surge in military coups in Africa. In the past four years, the continent has witnessed eight military coups in seven countries: Burkina Faso, Chad, Gabon, Guinea, Mali, Niger, and Sudan. These coups have constituted serious threats to regional integration and pan-African cohesion, have strained relations with neighbouring countries, and created tensions in the region. As a result, some of these countries (Burkina Faso, Mali and Niger) have severed ties and have withdrawn from ECOWAS. Peace deteriorated in Mali after French troops were withdrawn from the country. Of the 12 least peaceful countries globally in 2023, 4 of them are in Africa. The impact of instability and geopolitical risk has been grave for intra-Africa trade, an already historically low occurrence in Africa. Some modest improvement was recorded in the last decade with trade reaching an all-time peak of 18.2 percent in 2015, but this declined to 13.3 percent in 2022. This decline is not unrelated to the events mentioned above.

Figure 1: Percentage intra-African trade (1995–2022)



Source: UNCTADstat 2024.

In this study, we attempt to tease out the effectiveness of trade integration in Africa in relation to geopolitical instability. We start by understanding trade integration policies in Africa in the context of the AfCFTA. Next, we discuss some of the challenges of geopolitical instability in Africa and its consequences for trade development. We then we review the effectiveness of trade in Africa given geopolitical instability. Finally, we draw conclusions from our findings and make some recommendations.

Examining Trade Integration in Africa: A Deep Dive into the AfCFTA Policy

Promoting intra-African trade for the continent’s development has been a topical issue since the 1960s (ElGanainy et al. 2023). Despite several initiatives by regional governments to promote and enhance trade integration in Africa, the challenge of tariffs and non-tariffs remains unabated (ElGanainy et al. 2023). However, agreement on the AfCFTA by African

leaders has demonstrated efforts to promote trade integration amongst African countries (World Bank 2020). Through the AfCFTA, African leaders have shown the potential to transform regional trade, driving social and economic development in Africa that will significantly improve the livelihoods of citizens across the continent (ElGanainy et al. 2023). Understanding what the AfCFTA portends for Africa's development agenda and the challenges that will likely arise is therefore crucial for the success of the policy.

The AfCFTA is an agreement binding all African nations. It was signed on 21 March 2018 in Kigali, Rwanda and entered into force on 30 May 2019. Trading under the AfCFTA agreement commenced on 1 January 2021. Although a key component of the African Union's Agenda 2063, the AfCFTA goes beyond economic development with these key objectives:

- (a) create a single market for goods, services, facilitated by movement of persons in order to deepen the economic integration of the African continent and in accordance with the Pan African Vision of "An integrated, prosperous and peaceful Africa" enshrined in Agenda 2063;
- (b) create a liberalised market for goods and services through successive rounds of negotiations;
- (c) contribute to the movement of capital and natural persons and facilitate investments building on

the initiatives and developments in the State Parties and Regional Economic Communities;

- (d) lay the foundation for the establishment of a Continental Customs Union at a later stage;
- (e) promote and attain sustainable and inclusive socio-economic development, gender equality and structural transformation of the State Parties;
- (f) enhance the competitiveness of the economies of State Parties within the continent and the global market;
- (g) promote industrial development through diversification and regional value chain development, agricultural development and food security; and
- (h) resolve the challenges of multiple and overlapping memberships and expedite the regional and continental integration processes.

Despite the potential benefits of implementing these objectives, numerous challenges have been identified. Kassa, Ediju, and Zeufack (2022) acknowledge that success of the AfCFTA is threatened by geographical and political fragmentation, and thick borders whereby complex tariff and non-tariff restrictions slow trade along borders, increasing the cost of moving goods across borders. De Melo and Twum (2021) examined what AfCFTA has meant for supply chain practices in Africa. They argued that regional economic communities in Sub-

Saharan Africa have participated primarily in non-regional value chains, focusing more on forward rather than backward activities. The authors noted that this contrasts with comparator groups where supply chain trade has veered toward regional value chains. Obeng-Odoom (2020) on the other hand, observed that AfCFTA's exclusive focus on Africa limits its effectiveness. Additionally, the author noted that the AfCFTA has shown a disinterestedness in systemic redistribution, encouraging private appropriation of socially created land rents that prevent AfCFTA from achieving its goals. In fact, AfCFTA might foster inequality alongside of poverty and in so doing, undermine the very essence of this trade regime.

Leshoele (2023) argues that almost all of these regional integration efforts and agreements have disproportionately focused on trade and economic integration, with limited attention to political unification, a crucial element in the quest for economic progress. For AfCFTA to succeed, political activism needs to be combined with a continental industrial strategy that includes continental protection for infant industries in tandem with this continental liberalisation.

Considering the challenges highlighted in existing literature, Kassa, Edigu, and Zeufack (2022) suggested that, for AfCFTA to succeed, there is a need to strengthen integration by, for example, improving physical integration, strengthening political cooperation, and facilitating business

integration. Additionally, they suggested that these efforts must be accompanied by the harmonisation of rule, regulation, and the enforcement of regulatory co-operation amongst member nations. Aniche (2023) noted that the significant challenges of the AfCFTA agreement could be overcome through strict implementation and enforcement of its agenda. Additionally, the author acknowledges that the AfCFTA plans align with Agenda 2063 and that strict implementation will also drive the achievement of that agenda.

There is no doubt that the AfCFTA has great potential for Africa's social and economic development. However, evidence from the literature shows that there are still challenges that must be addressed to ensure success.

Challenges of Geopolitical Instability in Africa

The increasing forces of globalisation have deeply increased interdependence among the economies and societies of the world, highlighting the growing complexity of geopolitical instability in recent years. The intertwined networks promoted by globalisation that cut over national boundaries have replaced the traditional obstacles of border delineations. As such, the need to consider the effects of geopolitical events is increasingly critical for companies operating in many industries. Events that can have a significant impact at a regional or global level are unstable government systems, armed wars, terrorist acts, and natural disasters. Through their

effects on commodity prices, trade routes, and financial markets, these geopolitical changes have a ripple effect that affects every aspect of the global economy (Kaya 2024).

Wujie (2023) argues that geopolitical uncertainty is a crucial factor that greatly affects how countries interact in international politics. The geographical makeup of a country significantly influences its geopolitical dynamics, impacting interactions with various actors beyond bilateral relations. A nuanced understanding of how geopolitics affects multiple fields equips stakeholders with the necessary knowledge to navigate the complexities of an evolving global landscape. Such insights can be very helpful to businesses in countries trying to negotiate the complex and volatile world of geopolitics and enables them to exploit fresh opportunities and minimise risks. Popularisation of the notion of the “end of history” by political philosopher Francis Fukuyama in 1992 has given way to a fresh wave of historical instability worldwide. With this backdrop, Africa, which after the so-called “end of history” momentarily experienced peace and development, is again in danger of greater unrest. Various wars, insurgencies, and governmental shifts demonstrate how prone the continent is to hostilities (Nwanze 2024).

Through conflicts taking place in other regions of the world, Africa’s journey is linked to more significant geopolitical, economic, environmental, and

strategic shifts. Significant powers with a presence in these regions add to the already unstable geopolitical environment in Africa, often causing anarchy in Africa. These problems interact with one another as seen by the complex sociopolitical situation in the Maghreb region, which includes the long-lasting conflict in Western Sahara, the internationalised civil war in Libya, and the dynamics of the G5 Sahel countries, which include France and the struggling governments of the Sahel. Similar tensions affecting the Horn of Africa demonstrate how Africa is linked to more extensive international conflicts (Mthembu and Kornegay 2020).

From an African perspective, these intricate dynamics highlight the need of the region to participate actively in creating the new world order. Most academic accounts of Africa portray it as a watchful participant to developments in world politics. Conversely, this point of view emphasises the significance and influence of African nations in current world affairs. Strategically positioned as a centre of geopolitical analysis, Africa requires a basic reassessment of research approaches in geopolitics. This need results from the meeting point of changing population patterns and technology developments, which together increase the importance of the continent on the international scene. The region has benefited greatly from economic integration programs, especially those formed with rising partners such as China. But they have also created reliance on imports, which leaves African

economies vulnerable to external shocks. With possible effects spanning several industries, the current increase of trade restrictions resulting from the Ukraine conflict provides a moving example of this vulnerability (Mthembu and Kornegay 2020). For additional context, the Ukraine war has seriously disrupted the world's food distribution network. Both Russia and Ukraine are major exporters of important agricultural products such as wheat, corn, and sunflower oil. One of the top grain exporters in the world, Ukraine has struggled to keep its agricultural output and transportation capacity intact in the face of the war (Lin et al. 2023). The Ukraine conflict has resulted in significant increases in global food prices. Particularly in areas such as North Africa and the Middle East, where food security is already delicate, this disturbance has shown the vulnerability of nations mostly dependent on grain shipments from Russia and Ukraine. Global food prices have been raised by trade restrictions, rising transportation costs, and insurance premiums resulting from the conflict, therefore aggravating poverty and hunger in impacted areas (Lin et al. 2023).

Should geopolitical tensions worsen, African countries may suffer greatly, with negative impacts on import costs and export markets. Under such conditions, empirical studies highlight the vulnerability of about one-half of the region's foreign trade value (Zhang and Reyes 2023). Furthermore, there may be major economic consequences from the break in financial flows

between trade blocs brought on by geopolitical tensions. The possible economic losses are highlighted by a retrospective analysis covering 2017–19, which projects a startling US\$ 10 billion drop in Official Development Assistance and Foreign Direct Investment (FDI) inflows, or about 0.5 percent of GDP annually. Such declines in FDI jeopardise long-term technology transfer in addition to short-term economic stability (Zhang and Reyes 2023).

Beyond purely security issues, terrorism affects important commercial routes in the Lake Chad Basin as well as in countries such as Benin, Niger, and Togo. Furthermore, a number of countries in East, Central, North and West Africa—Algeria, Côte d'Ivoire, the Democratic Republic of Congo, Kenya, Mali, Mozambique, Somalia, Tanzania, and Uganda—face the danger of having their economic resilience undermined by terrorist threats. Maintaining trade routes and border integrity becomes, therefore, essential to preventing instability in the region.

One of the main concerns in geopolitics in recent years has been the spread of foreign military bases and forces around the Horn of Africa. The African Union Peace and Security Council highlighted the challenges brought about by the creation and expansion of foreign military facilities in several African nations. The Council is concerned because member states are thought to be unable to effectively track the flow of weapons to and from these locations. Such foreign military

operations are primarily focused on defending strategic interests, supporting friendly regimes, influencing in the face of intensifying international competition, and reducing threats to international peace and security, especially those originating from terrorist groups and maritime piracy.

Geopolitical Instability and Trade Policies in Africa

The literature is replete with recommendations to improve intra-African trade, with much of the attention on trade policy reforms such as reducing tariffs, enhancing transport and communication infrastructure, and access to finance. Less attention has been given to domestic and cross-border security (Njinku and Fosso 2006; Union and Africana 2012; Gnimassoun 2019; Songwe 2019 and Olney 2022). In fact, it has recently been proposed that the focus of the Economic Commission for Africa Conference of Ministers planned for March 2025 in Ethiopia should be on advancing implementation of the AfCFTA². The conference will address, among other issues, the challenges associated with regulatory reforms as it concerns non-tariff barriers to trade, the high cost of doing business, political impediments, and connectivity challenges. Still, geopolitical issues have been kept in the background.

According to Caldara and Iacoviello (2022), geopolitics is a multidimensional term generally used to describe the struggle for

control and territorial dominance between states, although more recently, this has included struggle for trade and politics and not just between states but corporations, non-state actors, and political groups. Research has shown that an increase in geopolitical risk crowds out FDI (Caldara and Iacoviello 2022; Salisu et al. 2022). According to OECD (2002), FDI is important for economic growth, especially in environments where domestic savings are not sufficient to support the needed domestic investment. Geopolitical instability creates uncertainty and deters FDI. This is crucial for Africa's development, as FDI brings not just capital but also technology transfer and expertise. Aiyar et al. (2023) insists that geopolitical tensions negatively impact cross-border trade, restricting the free flow of goods, services, capital, labour, and technologies. Heightened geopolitical tensions often lead to countries imposing protectionist trade policies.

The global economy is an intricately connected system in which changes in one part most likely lead to changes in other parts of the world. Economic interdependence through demand and supply of goods and services has created a distribution network that extends to other parts of the world (Papadopoulos et al. 2023). Tensions in world geopolitics have elevated concerns around global economic and financial integration. Ongoing trade tensions between the China and the U.S., the Ukraine conflict and the war between Israel and the Palestinian

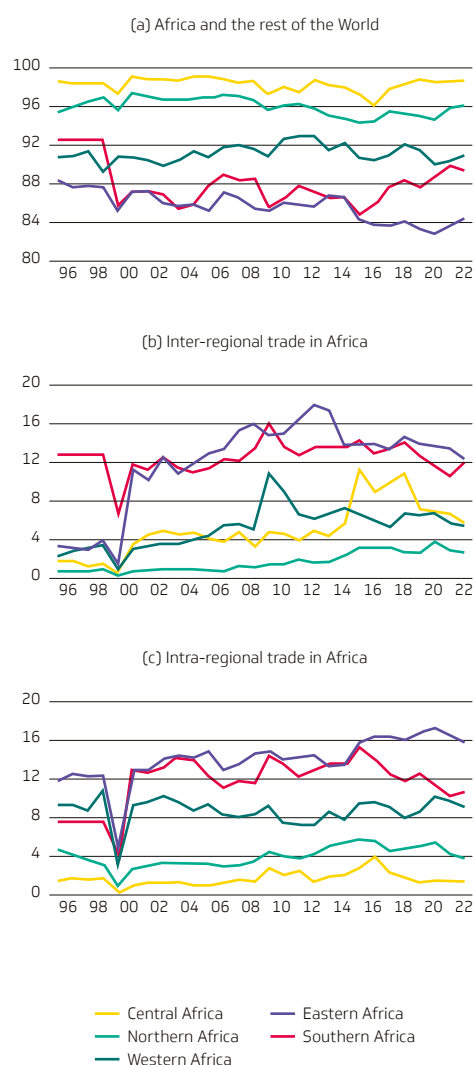
2. Experts propose advancing AfCFTA implementation as the theme of the next Conference of Ministers | United Nations Economic Commission for Africa (uneca.org)

militant group Hamas in Gaza are a few examples that have serious implications for global trade relations. The larger trend of global geopolitical competition between major powers such as China and the U.S. can lead to a fracturing of the global trading system. Such “decoupling” would force African nations to choose sides, hindering efforts to create a unified African market (Catalán and Tsuruga 2023).

Meanwhile, recent trading patterns in Africa have shown significant prospects for intra-continental trade, although this increase is gradual. Nonetheless, more than 80 percent of trade has been with partners outside the continent (figure 2a), with China responsible for approximately 15 to 20 percent of this trade (Munyati 2024). The Central Africa region has the smallest trade share in Africa and the largest outside of Africa, followed by North and West Africa. Intra-regional trade is also the lowest in these regions (figure 2c). Interestingly, these areas are also some of the most unstable regions on the continent. East and Southern Africa, with minimal geopolitical instability, have shown the highest potential for both inter- and intra-regional trade in Africa (figures 2b and 2c). Since the signing of AfCFTA in 2018, there has been a clear decline in trading with non-African partners and inter-regional trading, while there has been a considerable surge in intra-regional trading in Africa. However, with the COVID-19 pandemic in 2020, these gains were soon lost, further underscoring the challenges of policy

resilience and sustainability in the face of instability.

Figure 2: Trade patterns in Africa (1995–2022)



Source: UNCTADstat 2024.

Conclusion and Policy Recommendations

It is evident that geopolitical instability significantly impacts the effectiveness of trade integration in Africa. The low levels of intra-regional trade within the continent can be attributed to the challenges posed by political unrest, poor governance, and security issues. The AfCFTA represents a significant effort to address the lack of economic integration and diversification, but the potential benefits of this agreement are continuously threatened by various forms of instability.

The impact of instability can be seen in the form of limited access to financial markets, fragmented and tiny markets, and the hindrance of trade liberalisation policies. The resulting decline in the percentage of intra-African trade further underscores the adverse effects of geopolitical instability on trade integration within Africa. The prevalence of military coups, conflicts, and terrorism in various African regions have created significant barriers to regional integration and pan-African cohesion. The withdrawal of countries from regional organisations and the closure of borders have disrupted the flow of people and commerce, further exacerbating the challenges of trade integration.

Moreover, the events in North Africa and the Sahel region, coupled with the surge in military coups and political unrest, have contributed to the decline in intra-African trade, as evident from the data shown in figure 2(c). The decline in trade integration

reflects the grave impact of instability and geopolitical risk on the continent's trade dynamics. Although the AfCFTA presents opportunities to address some of Africa's economic challenges, realising its potential benefits will require a concerted effort to address political unrest, improve governance, and foster peace and security. The success of trade integration in Africa hinges on the ability of African nations to mitigate geopolitical instability and create conducive environments for trade and investment.

Considering these findings, it is imperative for African governments and regional bodies to prioritise efforts aimed at promoting peace, stability, and good governance. Addressing the root causes of instability and conflict will be crucial to unleash the full potential of the AfCFTA and to foster sustainable economic development across the continent. Only through concerted political will and collaborative actions can Africa overcome the hurdles posed by geopolitical instability and pave the way for enhanced trade integration and economic growth.

Analysing the limiting effects of geopolitical instability on the efficiency of trade integration in Africa shows important consequences for trade policy, frequently leading to higher trade barriers. Potentially impacting up to 50 percent of the region's foreign trade value, these obstacles show up as increased import costs or limited access to important export markets. Geopolitical instability may also aggravate the consequences

by cutting off cash movements between nations that trade. Given these obstacles, support for the AfCFTA's ongoing progress in regional integration is essential. Successful implementation of the AfCFTA requires a number of strategic steps to negotiate and lessen the difficulties brought about by geopolitical instability. Among these are improving trade governance, removing non-tariff obstacles, increasing customs efficiency, increased use of digitalization, and filling infrastructural shortages.

Hence, the importance of realizing the AfCFTA's full potential will need time, a significant commitment of resources, and international support (Tralac 2023). However, AfCFTA is an enormous step toward African economic unification, creating the biggest free trade zone in the world by combining 54 countries into a single marketplace for products and services. This historic accord seeks to stimulate intra-African trade by removing tariffs on a wide range of commodities, enabling capital and human resource mobility, and creating the foundation for a continental customs union.

Again, within the African economy, the AfCFTA has enormous potential to transform. Reducing trade barriers and standardising rules could significantly increase intra-African trade, promote economic expansion, and lift millions out of poverty. By giving access to a single market that includes more than 1.3 billion people, the AfCFTA further strengthens Africa's position

in international trade and investment. This vast market is well-positioned to draw in international capital, promote industrialization, and spur creativity throughout the continent (Santosh 2021).

Moreover, policymakers can manage higher geopolitical risks by enacting subsidised tariffs for importers and exporters. Lower interest rate trade credits can be a useful policy tool to lessen the detrimental effects on trade flows (Gupta et al. 2019). Finally, as a vital policy step, given the growing geopolitical concerns, the introduction of tax breaks and benefits for exporting and importing companies is crucial for addressing geopolitical instability



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The African Sub-Sovereign Governments Network (AfSNET) as a Catalyst for the AfCFTA

Kanayo Awani

Abstract: This paper explores the potential transformative impact of the African Sub-Sovereign Governments Network (AfSNET) in the context of African Continental Free Trade Area (AfCFTA) implementation. It posits that, if armed with abundant local knowledge, sub-sovereign governments are strategically positioned through AfSNET to align national and local trade policies to meet the needs of local economies. The paper proposes a roadmap and recommendations for leveraging AfSNET to overcome existing barriers and unlock significant economic opportunities at the local and regional levels, to promote greater integration and facilitate cross-border trade.

Keywords: African Sub-Sovereigns, AfCFTA, Economic Integration, Intra-African Trade Promotion

JEL Classification: D02, F18, N77

Introduction

The historic African Continental Free Trade Area (AfCFTA), the world's largest free trade area, seeks to reduce trade barriers, promote regional economic integration, and drive economic growth across the continent (World Bank 2020). It covers 54 countries with a population of about 1.4 billion and a combined GDP in excess of US\$3 trillion. However, its success depends not only on national governments, but also on sub-sovereign entities such as states, provinces, and local authorities. These entities are crucial for implementing trade policies at the local level, where alignment with national strategies

is needed to achieve broader continental objectives. The African Export-Import Bank (Afreximbank)'s African Sub-Sovereign Governments Network (AfSNET) has the potential to bridge this gap by facilitating the participation of sub-sovereign entities to ensure that trade policies are better integrated across different levels of government and are responsive to local realities.

A number of factors have constrained Africa's economic progress, despite decades of regional integration efforts. The low level of intra-African trade, which compares unfavorably with other regions, is driven by factors

such as persistent trade barriers, underdeveloped infrastructure, inefficient trade facilitation mechanisms, and a lack of industrial diversification (Brookings Institution 2019; IGAD 2023; OECD 2021). Inadequate transportation networks and deficit of energy further impede trade and sustainable economic development across the continent (Hanson 2016). Recent reports from Afreximbank and the African Development Bank highlight the continued impact of infrastructure deficits on production and trade costs, which ultimately constrains intra-African trade (Afreximbank 2023; African Development Bank 2023). Another significant barrier is the misalignment of development strategies with Africa's needs. Moyo (2015) argues that many development policies have failed because they do not adequately consider Africa's socioeconomic realities. Development interventions like the AfCFTA, which are tailored to the continent's unique circumstances, are essential to unlocking sustainable growth.

The AfCFTA, launched in 2018, is a transformative step toward economic integration. Its goal is to create a unified market for goods and services across Africa (Kuhlmann and Agutu 2019). However, effective implementation requires active participation from sub-sovereign entities, which play a pivotal role in aligning local initiatives and aspirations with the AfCFTA's broader objectives. AfSNET is instrumental in facilitating this alignment. The AfCFTA's success depends on inclusive governance

models that integrate sub-sovereigns into decision-making processes.

The multilevel governance theory underscores the importance of involving sub-sovereign entities, which possess the local knowledge needed to adapt broad policies to specific regional contexts (Heidtmann and Selck 2024). Similarly, principal-agent theory underscores the importance of objective alignment between national governments and sub-sovereign actors, ensuring that they pursue common objectives and avoid misaligned strategies that could hamper the AfCFTA's success (Yan and Hyman 2024).

The Role of Sub-Sovereigns in Economic Development and Trade

Sub-sovereign entities, including states, provinces, and local governments, play a critical role in economic development and the implementation of trade policies. In many global trade agreements, sub-sovereigns are key players in localising and implementing national policies, ensuring that trade initiatives are responsive to local needs. Their role in driving regional innovation, supporting the development of trade-related infrastructure, and promoting cross-border cooperation is essential for sustainable economic growth.

Empirical evidence supports the effectiveness of sub-sovereign involvement in governance. Sandström et al. (2020) highlight how polycentric governance models with strong sub-sovereign participation promote greater adaptability and

policy responsiveness, which are essential for achieving AfCFTA's goals. For instance, in China, coastal provinces like Guangdong and Shanghai have shaped foreign economic policy by directly engaging in international activities, aligning regional and national objectives (Wong 2018). In Africa, the role of sub-sovereigns in addressing infrastructure deficits—such as transportation and digital connectivity—will be critical to the AfCFTA's success. Odiadi (2021) notes that foreign investment, especially in infrastructure, is necessary for sustainable development. Engaging sub-sovereign governments in infrastructure development will ensure that investments align with both local and national priorities, improving the AfCFTA's overall implementation.

A prime example of this type of alignment can be found in the Canada-European Union Comprehensive Economic and Trade Agreement (CETA). Canadian provinces were actively involved in negotiations, particularly on public procurement and labor standards. This ensured that regional priorities were reflected in national trade policies (Government of Canada, 2017; Omiunu, 2018). Similarly, in the United States-Mexico-Canada Agreement (USMCA), the governments in U.S. states such as Texas and California have strengthened cross-border partnerships with Mexican states to enhance regional trade, infrastructure, and education. These partnerships underscore the importance of sub-sovereign participation in facilitating

regional economic integration and promoting localised economic growth (Schiavon and Fernández de Castro 2023).

In Africa, sub-sovereign entities face unique challenges when engaging in trade agreements. The low level of intra-African trade—despite decades of regional integration efforts—can be attributed, in part, to the limited involvement of these entities in trade-related decision-making. Sub-sovereign governments are often closer to local economies and are better equipped to address local challenges such as infrastructure deficits and regulatory inconsistencies (Afreximbank 2021). For instance, the challenges faced by Africa's 16 landlocked countries highlight the importance of local solutions to transportation and logistics barriers (Afreximbank 2021). These challenges highlight the important role of Afreximbank's AfSNET in facilitating sub-sovereign entities' participation to promote integration and intra-African trade.

AfSNET's Role in Facilitating Sub-Sovereign Participation

Afreximbank established AfSNET to address the challenge of limited participation of sub-sovereigns in critical decision-making, including on trade policies, to promote integration and harmony between governments and sub-sovereigns. It created a platform to facilitate greater engagement for sub-sovereign governments in intra-African trade promotion. The platform will facilitate policy alignment between local and

national governments, promoting the development of trade-enabling infrastructure and cultivating and nurturing strategic partnerships to enhance cross-border trade. AfSNET's activities align with Agenda 2063, the African Union's strategic framework for socio-economic transformation, which emphasises the importance of building capacity at all levels of governance (African Union Commission 2021).

Since its inception, AfSNET's activities have centred on advocacy through conferences aimed at enhancing sub-sovereign participation in AfCFTA implementation. The first conference, held in 2021 in Durban, South Africa, focused on the vital need for sub-sovereign involvement in the AfCFTA's implementation. It explored strategies to support the development of trade-related infrastructure while encouraging discussions around policy alignment between local governments and national trade strategies (Afreximbank 2021). The 2022 conference, held in Abuja, Nigeria, built upon these efforts by institutionalising AfSNET's role as a platform for sub-sovereign governments, with discussions focusing on strengthening partnerships and securing investments for infrastructure development. The 2023 conference, held in Cairo, Egypt, expanded the scope of the previous ones by emphasising financial deal-making, business-to-business matching, business-to-government engagements, and government-to-government, while positioning

sub-sovereigns as key players in the AfCFTA's broader objectives.

The 2024 conference, to be held in Kisumu, Kenya, will focus on accelerating AfCFTA implementation and expanding the network's influence in intra-African trade promotion. AfSNET has also facilitated strategic partnerships, such as its collaboration with United Cities and Local Governments of Africa to support infrastructure development and capacity-building initiatives at the local level. These efforts have contributed to creating crucial building blocks to facilitate meaningful dialogue on how sub-sovereign entities can actively contribute to the implementation of the AfCFTA. Accordingly, AfSNET is providing a platform for sub-sovereigns to assume more prominent role in advancing intra-African trade and promoting regional economic integration through these conversations and collaborations.

Despite these efforts, AfSNET has not yet achieved its full potential. Institutionalising AfSNET would allow sub-sovereign governments to play a direct role in trade policy formulation, ensuring that local economic priorities are reflected in continental, bilateral, and multilateral trade agreements. This would also facilitate better coordination in critical areas such as infrastructure development, where local governments are pivotal in improving transportation and logistics networks essential for cross-border trade promotion (Afreximbank 2021).

Learning from Others

The lessons learned from CETA, USMCA, and other such agreements provide valuable insights into the potential role of AfSNET as it seeks to enhance sub-sovereigns' participation in Africa's trade agreements. In CETA, Canadian provinces ensure that national trade policies are aligned with regional needs, while U.S. states in USMCA form cross-border partnerships to drive regional economic development. These examples show that sub-sovereign governments, when empowered to do so, can play a catalytic role in economic integration. For AfSNET, this means building capacity, promoting partnerships, and formalising the role of sub-sovereigns in AfCFTA decision-making processes. By leveraging these global best practices, AfSNET can ensure that Africa's diverse regional economies are adequately represented in AfCFTA. However, to fully realise this potential, AfSNET must address its current limitations by institutionalising its efforts and securing long-term sustainability to solidify its role as a driver of sub-sovereign participation and create enduring frameworks that facilitate trade and regional development.

Sub-Sovereign Participation in AfCFTA: Key Challenges

The successful implementation of the AfCFTA requires the active participation of sub-sovereign entities. However, these entities face a range of challenges that hinder their effective involvement. Addressing these barriers is essential

for enabling sub-sovereigns to contribute meaningfully to AfCFTA's goals of economic integration, industrialisation, and inclusive growth.

a. Coordination and Governance Issues

A significant challenge is the **misalignment between national and local policies**, which can lead to inefficiencies in implementing AfCFTA's broader goals (Ezugwu and Duruji 2023; Hagos 2023). Sub-sovereign entities operate in diverse governance frameworks with varying degrees of power, autonomy, and capacity. For example, some have limited authority to regulate trade policies or build infrastructure, complicating efforts to align their initiatives with national trade strategies.

By providing a platform for dialogue between national governments and sub-sovereign entities, AfSNET can play a vital role in addressing these governance challenges. With a focus on facilitating policy alignment and cooperation, AfSNET can ensure that local governments are not only included in decision-making processes but also empowered to implement AfCFTA policies that reflect regional and local needs.

b. Defining Sub-Sovereigns: Diversity in Nomenclature and Structure

Another challenge that AfSNET faces is the **lack of a clear, consistent definition of sub-sovereign entities**. In Africa, the

structure and nomenclature of sub-sovereign governments vary widely, complicating efforts to standardise their roles in AfCFTA implementation. Afreximbank defines an African sub-sovereign government as a subordinate authority to a sovereign state, designated as a region, state, province, or local authority with delineated governance powers. They include districts, islands, governorates, states, counties, provinces, and semi-autonomous regions.

Each type of sub-sovereign government holds different degrees of power, autonomy, and responsibility, which complicates the coordination of their roles in AfCFTA. For example, governorates in some countries may have more autonomy over trade policy than districts or provinces. In Ghana, metropolitan, municipal, and district assemblies are essential to local governance under a decentralised system. They lead development efforts within their jurisdictions and facilitate resident participation in the decision-making process. However, their autonomy is constrained by central government control, funding shortages, and political interference, which affect their ability to effectively implement infrastructure and development projects (Hackman, Osei, and Gyasi 2021; Sulemana, Musah-Surugu, and Adams 2018).

In Nigeria, the 36 states along with the Federal Capital Territory enjoy considerable autonomy, particularly with respect to taxation, resource

management, and economic development, although they remain dependent on the federal government for certain policy directives (Suberu 2009). Meanwhile, semi-autonomous regions, such as Zanzibar in Tanzania, hold unique powers that distinguish them from other sub-sovereign entities (Cameron 2018). These variations underscore the need for AfSNET to establish clear definitions and guidelines for sub-sovereign participation, ensuring that all entities can effectively contribute to AfCFTA goals regardless of their structure or nomenclature.

c. Capacity and Resource Gaps

Many sub-sovereign entities across Africa lack the **technical, financial, and human resources** needed to engage fully in AfCFTA initiatives. These resource gaps often leave sub-sovereign governments ill-equipped to implement trade policies, negotiate investment deals, or develop the infrastructure required to support cross-border trade.

AfSNET could help sub-sovereign entities overcome these limitations by facilitating access to training, capacity-building programmes, and investment opportunities. For example, partnerships with development banks and international donors could provide the necessary funding and technical assistance to bridge these capacity gaps. Moreover, peer learning initiatives and knowledge-sharing platforms within AfSNET could enable sub-sovereign entities to learn from one another's successes and challenges.

d. Infrastructure Deficits

One of the most pressing barriers to sub-sovereign participation in AfCFTA is the **lack of adequate infrastructure**. Poorly developed transportation networks, inadequate logistics systems, and limited information and communication technology (ICT) infrastructure prevent many sub-sovereign governments from engaging in cross-border trade (Azolibe and Okonkwo 2020; Calderón and Servén 2010). These deficits increase production and transaction costs, making it difficult for local economies to integrate into regional and global value chains.

Strategic investments in infrastructure—especially in transportation, logistics, and ICT—are crucial to supporting sub-sovereign participation in AfCFTA. AfsNET can play a pivotal role in identifying priority infrastructure projects, securing investment for these projects with multilateral agencies and development banks, and coordinating efforts across multiple sub-sovereign regions to ensure that they align with AfCFTA objectives. For instance, a collaborative approach to building trade-enabling infrastructure across sub-sovereign entities could reduce duplication of effort and bring about a more efficient use of resources (Afreximbank 2021).

e. Policy and Legal Barriers

Finally, **regulatory inconsistencies across different regions** are another major obstacle (Ezugwu and Duruji 2023). In many cases, sub-sovereign

entities operate under different legal frameworks that do not align with national or continental trade policies. These inconsistencies hinder the seamless flow of goods and services across borders, complicating efforts to implement AfCFTA.

AfsNET can help harmonise policies and legal frameworks across sub-sovereign entities. Through advocacy for the standardisation of trade regulations and procedures, AfsNET can facilitate more efficient trade flows and ensure that sub-sovereigns are not constrained by obsolete or conflicting legal systems. Furthermore, AfsNET can offer a platform to help sub-sovereign entities understand and navigate the AfCFTA's complex legal landscape, thereby enabling their full participation in its initiatives.

f. Trade Barriers

Trade barriers, such as non-tariff barriers, customs delays, and inconsistent regulatory frameworks, constitute a significant challenge to participation in the AfCFTA (Omi and Da Silva 2021), particularly sub-sovereign participation. These barriers impede the seamless movement of goods and services across borders, thereby limiting the capacity of sub-sovereign entities to fully engage in cross-border trade and economic integration efforts. Surmounting these barriers will require the harmonisation of regulations, simplification of customs procedures, and ensuring that sub-sovereign entities possess the requisite capacity and resources

to comply with AfCFTA's trade facilitation measures (Ezugwu and Duruji 2023). AfSNET could address these trade barriers by collaborating with sub-sovereign entities to streamline trade procedures and advocate for the elimination of non-tariff barriers. Furthermore, facilitating dialogue between national and sub-sovereign governments can educate local entities about the necessary compliance standards help them implement trade policies that align with AfCFTA's objectives.

If these challenges are adequately addressed, AfSNET has the potential to unlock the full economic capacity of sub-sovereign governments across Africa. Through strategic partnerships, infrastructure development, capacity-building programmes, and policy harmonization, AfSNET can advocate for the requisite conditions for sub-sovereign governments to thrive within an integrated African market.

AfSNET as Catalyst: Strategies for Enhancing Sub-Sovereign Participation in AfCFTA

The AfSNET can be a critical catalyst in the success of the AfCFTA by facilitating sub-sovereign participation in trade, investment, and development activities. This section outlines the roadmap and strategies necessary to maximise AfSNET's impact and ensure that sub-sovereign entities play a meaningful role in AfCFTA's implementation

Key Strategies for Enhancing Sub-Sovereign Participation:

To fully unlock the potential of sub-sovereign governments within AfCFTA, AfSNET must first be institutionalized as a formidable body with well-defined structures and membership criteria. Efforts should also ensure broad representation across Africa, addressing gaps in participation. For instance, past conferences have predominantly included representatives from West and Eastern Africa, with limited attendance from other regions. AfSNET should prioritize key strategies to promote meaningful engagement and promote integration, ensuring all regions contribute to and benefit from AfCFTA's objectives

Roadmap for Sub-Sovereign Participation in AfCFTA

To fully unlock the potential of sub-sovereign governments within AfCFTA, AfSNET must first be institutionalised as a formidable body with well-defined structures and membership criteria. This should include concerted efforts to ensure broad representation across Africa, addressing gaps in participation. For instance, past conferences have predominantly included representatives from West and Eastern Africa, with limited attendance from other regions. AfSNET should promote meaningful engagement and integration, ensuring that all regions contribute to and benefit from AfCFTA's objectives (table 1).

The following steps provide a comprehensive outline of this process:

Institutionalizing Sub-Sovereign Participation:

AfSNET must advocate for the formalisation and embedding of sub-sovereign entities into AfCFTA's governance structures, and vice versa, such as sub-sovereign also having structures, parastatals that are focused on AfCFTA participation. This requires establishing clear channels of representation for local governments at both the national

and continental levels. By creating formalised mechanisms for sub-sovereigns to participate in AfCFTA's decision-making processes, AfSNET will ensure that their interests, needs, and regional priorities are reflected in trade policies and broader economic strategies. This step also involves developing frameworks to recognise sub-sovereign entities as critical stakeholders in trade agreements, which will help build local ownership of AfCFTA initiatives.

Table 1: Key Strategies for Enhancing Sub-Sovereign Participation in AfCFTA

Strategy	Details
1. Capacity Building and Technical Assistance	Organise training programs, workshops, and conferences to build the capacity of sub-sovereign governments. Focus on trade facilitation, infrastructure development, and legal frameworks to help local entities implement AfCFTA policies effectively and promote cross-border trade.
2. Infrastructure Development	Collaborate with sub-sovereign governments to identify and finance critical infrastructure projects, such as transportation, logistics hubs, and ICT systems. Work with development institutions like the Afreximbank and African Development Bank (AfDB) to ensure projects align with AfCFTA's objectives and enhance connectivity.
3. Policy Advocacy and Representation	Advocate for sub-sovereign interests in AfCFTA negotiations. Ensure sub-sovereign governments are represented in trade policy discussions to influence decisions on trade tariffs, investment incentives, and regulatory frameworks.
4. Regional Cooperation and Integration	Promote cross-border collaboration between sub-sovereign entities to create regional value chains, shared infrastructure projects, and joint trade initiatives. Strengthen regional competitiveness and support inclusive economic growth.
5. Innovative Financing Mechanisms	Explore financing solutions like public-private partnerships (PPPs) and development financing options to mobilise resources for sub-sovereign projects. Collaborate with international donors, development banks, and private investors to ensure sufficient funding for trade-related projects.
6. Digitalisation for Trade Facilitation	Support the adoption of digital trade facilitation tools (e-commerce platforms, digital customs processes, ICT systems) to reduce costs, improve access to markets, and streamline cross-border transactions.
7. Monitoring and Evaluation (M&E)	Establish a monitoring and evaluation framework to assess the progress of AfSNET initiatives. Regular evaluations will allow for adjustments in strategies to meet the evolving needs of local governments.

Table 2: Roadmap for Enhancing Sub-Sovereign Participation in AfCFTA

Step	Description
1. Institutionalizing Sub-Sovereign Participation	Formalizing the role of sub-sovereign entities in AfCFTA governance structures.
2. Strengthening Representation in Decision-Making	Advocating for direct representation of sub-sovereign governments in decision-making processes.
3. Prioritising Infrastructure and Connectivity	Identifying and prioritising infrastructure projects to boost connectivity and integration.
4. Ensuring Capacity Building and Knowledge Transfer	Promoting ongoing training and partnerships to empower sub-sovereigns.
5. Facilitating Public-Private Partnerships and Innovative Financing	Promoting private-sector investment and exploring innovative financing options.
6. Embracing Digital Transformation	Encouraging the adoption of digital solutions for trade facilitation.
7. Diaspora Engagement	Leveraging the financial, intellectual, and entrepreneurial capital of the African diaspora.
8. Monitoring and Evaluation for Continuous Improvement	Implementing a robust system to assess and refine participation efforts.

Strengthening Representation in Decision-Making:

Direct representation of sub-sovereign governments in AfCFTA's key decision-making forums is essential to ensure that local perspectives influence regional and continental trade policies. AfSNET can facilitate this by advocating for sub-sovereign inclusion in national trade delegations and AfCFTA negotiations. Additionally, AfSNET should establish regular consultative platforms that allow sub-sovereign leaders to provide input on trade negotiations, investment policies, and infrastructure development, ensuring that these policies address local economic realities. This will also help streamline coordination

between national and sub-sovereign governments.

Prioritising Infrastructure and Connectivity:

Infrastructure development is a cornerstone for enhancing sub-sovereign participation in AfCFTA. AfSNET should collaborate with sub-sovereign entities to identify and prioritise high-impact infrastructure projects that cater to local and regional needs. These projects should focus on improving transportation networks, logistics hubs, border infrastructure, and ICT systems, which are critical for facilitating trade and boosting local economies. Furthermore, AfSNET should engage development partners like Afreximbank and

African Development Bank to secure financing for these projects. Through the alignment of infrastructure development with AfCFTA's objectives, sub-sovereign entities can enhance their connectivity and achieve greater integration into regional and continental value chains.

Ensuring Capacity Building and Knowledge Transfer:

AfSNET should encourage ongoing capacity building and knowledge transfer to empower sub-sovereign governments with the tools and expertise required for active participation in the AfCFTA. This involves creating partnerships with international organisations, universities, and development agencies to provide technical assistance and training. The training programmes should focus on trade facilitation, economic planning, legal frameworks, and infrastructure development. Additionally, AfSNET should establish peer-learning platforms where sub-sovereign entities can share best practices and success stories, helping them adapt and respond to emerging challenges.

Facilitating Public-Private Partnerships and Innovative Financing:

A key component of the roadmap should include innovative financing solutions to support sub-sovereign projects. AfSNET should facilitate PPPs to attract private investment for infrastructure development, trade facilitation, and capacity-building initiatives. Working with financial institutions like Afreximbank, AfSNET

can also explore mechanisms such as municipal bonds, regional investment funds, and concessional financing to ensure sustainable funding for sub-sovereign initiatives under AfCFTA.

Embracing Digital Transformation:

AfSNET should encourage sub-sovereign entities to adopt digital solutions, such as e-commerce platforms and digital customs processes, to facilitate trade and enhance efficiency. Integrating ICT systems across sub-sovereign regions will enable faster cross-border transactions and provide local businesses with access to global markets.

Diaspora Engagement:

The African diaspora plays a crucial role in enhancing sub-sovereign participation in AfCFTA. In 2021, diaspora remittances reached US\$95.6 billion, surpassing official development assistance to Africa (African Development Bank 2022). The significant financial contributions of the diaspora can be harnessed to support infrastructure development and local economies. Beyond remittances, the diaspora contributes valuable skills, expertise, and investment opportunities that can benefit sub-sovereign governments.

AfSNET should actively engage the diaspora through structured initiatives such as investment platforms, trade advisory councils, and diaspora bonds. These mechanisms will enable sub-sovereign entities to unlock new opportunities for cross-border investments, entrepreneurship, and

economic collaboration in support of AfCFTA's goals.

Conduct Monitoring and Evaluation for Continuous Improvement

AfSNET should establish a robust monitoring and evaluation system to assess the progress of sub-sovereign participation in AfCFTA regularly. This system would track key performance indicators related to infrastructure development, trade facilitation, and economic growth at the local level. Regular evaluations will assist AfSNET in adjusting its strategies to align with evolving regional needs, ensuring that the initiatives remain relevant and effective. The insights gained from monitoring and evaluation processes can also guide policy refinement and strengthen future projects.

Policy Recommendations

Based on the challenges and strategies discussed throughout this paper, the following policy recommendations are proposed to enhance the role of sub-sovereign entities in AfCFTA's implementation through AfSNET:

Reform institutions

AfSNET should advocate for the formal inclusion of sub-sovereign entities in AfCFTA's institutional framework. Institutionalising their participation will ensure that local and regional governments have a clearly defined role in both the formulation and execution of trade policies, which is crucial for aligning local initiatives with broader continental objectives.

Build capacity

National governments and international partners must prioritise investment in building the capacity of sub-sovereign entities. This includes providing technical training, funding, and policy support to equip local governments with the skills necessary to contribute meaningfully to AfCFTA's implementation. Programmes should focus on trade facilitation, legal frameworks, and infrastructure development to maximise sub-sovereign impact.

Invest in infrastructure

Increased investment in regional and local infrastructure is essential for supporting sub-sovereign participation in AfCFTA. AfSNET should facilitate partnerships between sub-sovereign entities, development banks, and private investors to secure the necessary funding for critical infrastructure projects. These partnerships would focus on improving transportation, logistics, and ICT systems to enable seamless trade flows and economic integration.

Harmonise policies

For AfCFTA to function effectively, it is crucial that policies at the national and sub-sovereign levels are harmonised. AfSNET should work towards aligning trade regulations and standards across regions to prevent fragmentation and ensure that local entities can engage in cross-border trade without unnecessary regulatory barriers.

Promote public-private collaboration

Encourage partnerships between sub-sovereign governments and private actors to drive infrastructure and trade facilitation projects. Through this collaboration with private enterprises, sub-sovereigns can leverage private sector innovation and capital, which will enhance their ability to implement AfCFTA initiatives. These collaborations could focus on areas like technology adoption, financing, and capacity building, ensuring that sub-sovereign entities are better equipped to participate in cross-border trade and economic integration.

Clarify the definition and role of sub-sovereign entities

AfSNET should work to establish clear definitions of sub-sovereign entities, considering the diversity in their governance structures and roles across Africa. This would help clarify their responsibilities and powers in relation to national governments, especially in trade policy formulation and implementation. Standardising the recognition of sub-sovereign governments would ensure that their contribution to AfCFTA is properly aligned and coordinated across different regions.

Through the incorporation of innovative financing mechanisms, digitalisation initiatives, trade, investment, and cultural exchanges, and a robust monitoring and evaluation framework, AfSNET has the potential to play a transformative

role in enhancing sub-sovereign participation in AfCFTA. This approach is poised to not only deepen Africa's economic integration but also ensure that the benefits of AfCFTA reach all regions, thus promoting inclusive growth and sustainable development across the continent. Addressing key structural challenges, AfSNET can serve as a catalyst for equitable economic progress under AfCFTA.

Conclusion

This paper highlights the strategic significance of sub-sovereign participation in the efficacious implementation of the AfCFTA. AfSNET serves a crucial function in bridging the gap between national trade policies and local implementation. Through an emphasis on capacity building, infrastructure development, and policy advocacy, AfSNET can contribute to sustainable economic growth and enhance intra-African trade and investment.

To fully achieve this objective, it is imperative that AfSNET be institutionalised to formalise the representation of sub-sovereign entities within AfCFTA governance structures. This would enable local and regional governments to contribute effectively to the formulation of trade policies and decision-making processes at both the national and continental levels. AfSNET's role in facilitating innovative financing models, such as PPPs and regional investment funds, is critical in addressing the infrastructure and development needs of sub-sovereign entities.

The effectiveness of AfSNET in empowering sub-sovereigns will depend on stakeholder collaboration, partnerships, advocacy, digitalisation, robust capacity-building programmes, sustainability initiatives, and the establishment of a monitoring and evaluation framework to track progress and refine strategies. Promoting inter-regional cooperation will harmonise policies and reduce barriers to intra-African trade, while financial partnerships with institutions such as Afreximbank, the African Development Bank, and the World Bank will increase the resources available to sub-sovereign governments. These partnerships will be essential for sharing technical expertise and mobilising the capital required for large-scale infrastructure projects, ensuring that sub-sovereign entities can effectively meet the challenges of regional trade integration.

Finally, further research is required to assess the long-term impact of sub-sovereign participation in AfCFTA and to explore innovative financial tools, digital technology integration, and capacity-building approaches. These efforts will be critical in accelerating the successful implementation of AfCFTA's objectives, ensuring a more integrated and economically resilient Africa.

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Technology and Innovation as Catalysts for Increased Productivity and Economic Development in Northern Nigeria

Oyeyemi Kale

Abstract: Despite its abundant natural, human, and cultural resources, Northern Nigeria compares unfavorably with other regions of the country in terms of growth and socioeconomic development. Major challenges include inadequate physical and soft infrastructure, low agricultural productivity and industrial capacity, security issues, and low levels of trade. This paper explores how innovation and technology could be leveraged to unlock the region's growth and development potential. It provides evidence-based recommendations for policy interventions and stresses how harnessing technology and innovation could transform Northern Nigeria's economy

Keywords: Agricultural productivity, economic development, innovation, technology

JEL Classification: O13, O31, O33

Introduction

Northern Nigeria, which consists of 19 states and the Federal Capital Territory (FCT), spans a large part of Nigeria. Despite its vast landmass, large population, and rich cultural and historical heritage, the region has historically faced significant socioeconomic challenges. It lags behind other regions of the country in infrastructure, industrial development, and trade expansion, which translate into high poverty rates, insecurity, and unemployment. Several of the region's socioeconomic indicators reveal deep-rooted problems that stymie development in Northern Nigeria. Poverty rates

are higher than the national average of around 39 percent, with many states in the North struggling with poverty rates exceeding 60 percent. Educational attainment and literacy are also lower in the region, as access to quality education is limited, especially for women. These factors, combined with poor infrastructure, inadequate healthcare services, and political instability, have constrained the realization of the region's economic potential.

Northern Nigeria accounts for over half of the country's landmass. More than 70 percent of the population is employed in agriculture. Major

agricultural activities include cultivating crops such as maize, millet, sorghum, rice, and groundnuts. The region also produces a significant portion of the country's livestock, including cattle, goats, sheep, and poultry. Nonetheless, the region's overall agricultural output remains far below its potential due largely to outdated farming practices, limited access to modern technology, inadequate infrastructure, and insecure land tenure systems.

The region has some strengths. Kano, the largest city of Northern Nigeria, is known for its historical role as a trade centre, particularly for textiles and agricultural commodities. Kaduna, another important city in the region, serves as an industrial hub. Nevertheless, the northern economy is constrained by several structural challenges that limit its ability to scale up production and trade, especially in international markets. The region's exports consist predominantly of raw agricultural goods and livestock and less value-added, while over-reliance on imports weakens local industries, with dampening effects on revenues.

Limited and/or poor infrastructure is one of the most significant constraints to the region's growth and economic development. Poor road networks, insufficient rail lines, and inadequate energy supply contribute to high costs of production and trade, limiting the region's competitiveness. Farmers often struggle to transport their produce to markets due to bad roads, leading to post-harvest losses.

Despite these challenges, Northern Nigeria holds substantial economic potential, particularly in agriculture, commerce, and services. In a region where traditional practices dominate agriculture, the key to unlocking its potential lies in applying innovation and technology to drive growth and economic development.

Northern Nigeria's strategic location offers significant opportunities for regional and international trade expansion. The region shares borders with several West and Central African countries, including Niger, Chad, and Cameroon, providing access to a broader regional market. Historically, Northern Nigeria has been a critical player in trans-Saharan trade routes, with trade in agricultural products, textiles, and livestock forming the backbone of its economy. However, in recent decades, Northern Nigeria's trade potential has been constrained by poor infrastructure, limited access to financing, inefficient regulatory systems, and poor logistical capacity especially related to warehousing, storage facilities, and processing infrastructure. These constraints have further reduced the competitiveness of local products in regional and international markets.

For Northern Nigeria to enhance its trade competitiveness, innovative solutions are needed. Technology can play a transformative role in enhancing trade logistics, improving market access, and increasing the efficiency of cross-border trade. Globally, innovation and technology have been

central to driving economic growth and improving living conditions. The digital revolution, in particular, has created new opportunities for developing countries to leapfrog traditional stages of industrialisation and tap into global value chains. The integration of technology into key sectors such as agriculture, manufacturing, and trade can catalyze growth and structural transformation of the regional economy.

Technology has the potential to improve agricultural productivity by providing farmers with access to critical information such as weather forecasts, market prices, and best practices for farming techniques (FAO 2017). Mobile platforms and digital services can connect farmers to buyers and suppliers, reducing transaction costs, and improving market efficiency (Kim, J. et al. 2017). Similarly, technological innovations in logistics and supply chain management can help reduce bottlenecks in the movement of goods across the region, enhancing the competitiveness of Northern Nigeria's trade.

The advent of digital financial services offers new opportunities for financial inclusion, particularly in remote and underserved communities. Mobile banking, digital payment platforms, and blockchain technology can enable small and medium enterprises (SMEs) to access finance, streamline transactions, and expand their businesses. By leveraging these technological innovations, Northern

Nigeria can create a more inclusive and dynamic economy that supports entrepreneurship and fosters sustainable growth, with far-reaching positive implications for the country's overall economy. This paper explores how technology and innovation could be deployed to enhance efficiency and productivity in agriculture and improve trade competitiveness, which would catalyse growth and economic development in the Northern region.

Promoting Agriculture and Trade for Economic Development: The Role of Innovation and Technology

Innovation and technology are critical for economic transformation. Northern Nigeria's historically low industrialization, inadequate infrastructure, and limited market access can be overcome with strategic investments in technology and innovation. In this regard, innovation can be leveraged to enhance agricultural efficiency and productivity, improve digital infrastructure, foster entrepreneurship, and expand trade.

Innovation in Agriculture

Agriculture remains the backbone of most developing economies, including that of Northern Nigeria. It employs the majority of the population and contributes significantly to both regional and national GDP. However, the agriculture sector faces challenges such as low productivity, inefficiency, and limited market access. Innovations in agriculture that are designed to improve crop yields and reduce waste

will potentially increase local farmers' competitiveness in national and international markets.

Precision Farming Technologies

Adopting precision farming technologies offers a pathway to increasing agricultural productivity significantly. Precision farming involves the use of technologies such as GPS-guided equipment, drones, and sensors to monitor crops, manage resources, and optimise field-level management of farming practices. These technologies help farmers make informed decisions about planting, fertilisation, irrigation, and pest control, thereby reducing waste and increasing yields (World Bank 2021). Drones equipped with sensors can provide real-time data on soil quality, moisture levels, and crop growth, enabling farmers to apply water, fertilisers, and pesticides more efficiently (Ehui 2024). Satellite imagery can help farmers monitor large tracts of land, identify areas of poor crop performance, and take corrective action (FAO 2017). While the adoption of precision farming technologies is still in its infancy in Northern Nigeria, successful experiences from other parts of Africa suggest that sustained investment in these technologies will significantly increase productivity and profitability in the region's agriculture sector.

Digital Platforms for Market Access

Another significant barrier facing farmers in Northern Nigeria is limited access to markets. Many farmers

rely on local intermediaries who offer low prices for their produce, reducing their income and limiting their ability to reinvest in their farms. Digital platforms can help address this challenge by connecting farmers directly with buyers, both domestically and internationally. E-commerce platforms for agriculture, such as Farmcrowdy and Thrive Agric, have already demonstrated success in Nigeria by providing farmers with access to broader markets and enabling them to sell their products at competitive prices (Ecofin Agency 2023). These platforms allow farmers to list their produce online, set prices, and negotiate directly with buyers. They also provide transparency in pricing, helping farmers make more informed decisions about when and where to sell their products.

Moreover, digital platforms can be used to provide farmers with real-time market information, such as commodity prices, demand trends, and buyer requirements (Ehui 2024). This helps farmers decide what crops to grow, when to harvest, and how to negotiate with buyers. (World Bank 2021). By improving market access and price transparency, these platforms can increase farmers' incomes and contribute to the expansion of the agricultural sector in Northern Nigeria.

Mobile Finance and Insurance Services

Access to finance is critical for smallholder farmers in Northern Nigeria. Traditional banks are often reluctant to lend to farmers due to

the perceived risks, and they require farmers to provide more collateral to secure loans. Mobile financial services are helping overcome this constraint by providing farmers with access to credit, savings, and insurance products through their mobile phones (Kim et al. 2017).

Mobile money services like Paga and MoMo allow farmers to save money, transfer funds, and make payments without needing a bank account. These services are particularly useful in rural areas, where access to formal banking is limited. In addition, mobile-based credit platforms, such as Paylater and Carbon, offer short-term loans to farmers (Ecofin Agency 2023), enabling them to purchase inputs such as seeds, fertilisers, and equipment.

Agricultural insurance is another area where innovation can make a significant impact. Index-based insurance products, which use weather data to trigger payouts in the event of crop failure, can help mitigate the risks associated with farming (Kim et al. 2017). These insurance products provide farmers with financial security, allowing them to invest in their farms confidently. By increasing access to finance and insurance, mobile services can help farmers improve their productivity and resilience, thereby contributing to the overall growth of the agriculture sector (Ehui 2024).

Innovation for Trade Expansion

Trade is a crucial driver of economic growth, but Northern Nigeria has

yet to capitalise on its full potential for regional and international trade. Innovation and technology offer several avenues to expand trade, from improving logistics and supply chains to facilitating cross-border trade and connecting local businesses to global markets.

E-Commerce Platforms for Trade

One of the most effective ways to expand trade in Northern Nigeria is through e-commerce platforms that connect local producers with international buyers. E-commerce has revolutionised global trade (Ehui 2024) by reducing the need for physical storefronts and allowing businesses to reach customers worldwide. Platforms such as Alibaba, Jumia, and Konga have demonstrated the potential of e-commerce in Africa, providing businesses access to larger markets and reducing transaction costs (Ecofin Agency 2023). The African Export-Import Bank (Afreximbank)'s Pan-African Payment and Settlement System is another essential e-commerce and digital trade enabler designed to facilitate instant cross-border payments in local currencies across African countries.

In Northern Nigeria, e-commerce platforms can promote locally produced goods, such as agricultural products, textiles, and crafts, in domestic and international markets. These platforms allow small businesses to reach a global customer base without expensive infrastructure (Ehui 2024). By integrating digital

payment systems, logistics services, and marketing tools, e-commerce platforms can streamline online selling and help businesses scale up (Ecofin Agency, 2023).

Blockchain for Supply Chain Transparency

Blockchain technology offers an innovative solution to some of the challenges facing trade in Northern Nigeria, particularly regarding supply chain transparency and efficiency. Blockchain can be used to create immutable records of transactions, ensuring that goods are tracked from production to delivery (Kim et al. 2017). This reduces the risk of fraud, improves accountability, and increases trust among buyers and sellers. In the agriculture sector, blockchain can track the origin and quality of products, assuring buyers that they are purchasing authentic goods (Ehui 2024). This is particularly important for export markets, which often require traceability and certification. By improving transparency and efficiency in the supply chain, blockchain can help Northern Nigerian businesses access new markets and increase their competitiveness.

Digital Platforms for Cross-Border Trade

Cross-border trade is a significant source of income for many businesses in Northern Nigeria, particularly those located near the borders of Niger, Chad, and Cameroon. However, complex customs procedures, inefficient logistics, and security

concerns often hinder cross-border trade. Digital platforms can streamline cross-border trade by providing businesses with access to information on tariffs, regulations, and logistics services (Ehui 2024). For instance, TradeNet, a digital platform developed by the Economic Community of West African States, provides traders with information on cross-border procedures and regulations, which reduces the time and cost of moving goods across borders (Ecofin Agency, 2023). Similar platforms can be developed for Northern Nigeria to facilitate trade with neighbouring countries and promote regional integration.

Developing Digital Infrastructure

Digital infrastructure is a critical enabler of innovation and economic growth. Northern Nigeria lags the rest of the country in internet penetration and digital connectivity, with many rural areas still lacking broadband access. Improving digital infrastructure enables innovation, fosters entrepreneurship, expands trade, and drives development (Akintaro and Akintaro, 2024).

Expanding Internet Penetration

One of the critical challenges facing Northern Nigeria is the digital divide. According to recent data, internet penetration in Northern Nigeria is significantly lower than in the South. This disparity limits access to information, digital services, and online markets, particularly in rural areas. Expanding internet access by deploying fibre optic cables,

satellite broadband, and mobile broadband networks is critical to closing this gap. The Nigerian Communications Commission has taken steps to improve broadband access by implementing the National Broadband Plan, which aims to increase broadband penetration to 70 percent by 2025 (Akintaro and Akintaro 2024). However, more must be done to ensure that Northern Nigeria benefits from this initiative. Public-private partnerships (PPPs) can be crucial in expanding digital infrastructure, particularly in underserved areas. In collaboration with government agencies, telecom companies can invest in building the necessary infrastructure, while the government can provide incentives such as tax breaks and subsidies to encourage investment (Kim et al. 2017).

Establishing Digital Hubs

Digital hubs and innovation centres have become vital components of the technology ecosystem in many countries, providing entrepreneurs with the resources, mentorship, and networks they need to succeed. Northern Nigeria, however, has seen limited investment in such hubs, in part due to insecurity and the lack of digital infrastructure.

Establishing digital hubs in cities such as Kano, Kaduna, and Maiduguri could catalyse innovation and entrepreneurship. These hubs can provide access to high-speed internet, co-working spaces, training programs, and networking events, helping to build a community of

tech entrepreneurs in the region. In addition, they can serve as incubators for startups, offering mentorship and access to funding (Eko iCentre 2024). Successful digital hubs in other parts of Nigeria, such as the Co-Creation Hub in Lagos and Roar Nigeria Hub in Enugu, provide models that can be replicated in Northern Nigeria.

Case Studies: Successful Tech Hubs in Africa

Several African countries have successfully developed digital hubs that have fostered innovation and entrepreneurship. For example, Kenya's iHub in Nairobi has become a centre of excellence for tech startups, supporting entrepreneurs and creating a thriving ecosystem for innovation. Similarly, the Kigali Innovation City in Rwanda has attracted global tech companies and investors, positioning Rwanda as a leader in digital transformation in Africa (Eko iCentre 2024).

Northern Nigeria can learn from these examples by building innovation hubs that cater to the region's specific needs. For instance, hubs focused on agricultural technology (agritech) could help develop solutions tailored to the challenges faced by Northern Nigerian farmers, while financial technology (fintech) hubs could help improve financial inclusion in the region. By fostering innovation through digital hubs, Northern Nigeria can create an enabling environment for startups and entrepreneurs, driving economic growth and job creation.

Education and Skill Development

One of Northern Nigeria's most critical factors in fostering innovation and economic growth is improving education and skill development, particularly in science, technology, engineering, and mathematics (STEM) fields. Northern Nigeria's educational system faces longstanding challenges, including low enrollment rates, inadequate infrastructure, and a shortage of qualified teachers. These issues have resulted in a significant skills gap, particularly in the digital and technological sectors essential for driving innovation and entrepreneurship.

Strengthening Primary and Secondary Education

Improving education in Northern Nigeria must address fundamental issues in primary and secondary schooling. According to UNICEF, Northern Nigeria has some of the lowest literacy rates in the country, particularly among girls. This is primarily due to socioeconomic barriers, cultural factors, and insecurity. It is vital to create a conducive environment for education by improving access to schools, training teachers, and providing adequate learning resources.

Government policies should prioritise expanding access to education, particularly in rural areas, by building more schools and hiring qualified teachers. There should also be a strong focus on encouraging female education by addressing cultural barriers, such as early marriage and

gender norms that limit educational opportunities for girls. Programs like the Girl Child Education Project in Sokoto State have shown positive results and could be scaled up across the region.

Investing in digital education platforms that provide remote learning opportunities can also help bridge the educational gap. Northern Nigeria can enhance access to quality education by utilizing e-learning platforms to supplement traditional classroom education, particularly in areas with a shortage of teachers, as demonstrated by mobile education initiatives like Eneza Education in Kenya.

Expanding STEM Education

Building a workforce that can participate in and drive the digital economy requires focusing on STEM education. Northern Nigeria must invest heavily in equipping students with the skills needed for technology, innovation, and industrial jobs.

Curriculum Development and Teacher Training

A significant barrier to expanding STEM education in Northern Nigeria is the outdated curriculum and lack of teacher training in modern subjects such as coding, robotics, artificial intelligence, and data science. Updating the curriculum to reflect the needs of a digital economy is crucial to preparing students for future employment. Teacher training programs should be introduced and scaled up to provide educators with

the knowledge and tools to teach STEM subjects effectively. Initiatives such as Africa Code Week, which provides coding workshops for teachers and students across the continent, could be expanded to Northern Nigeria to build capacity in STEM education. Similarly, partnerships between local universities and international organizations can help train teachers in advanced fields like computer science and engineering.

STEM Scholarship and Mentorship Programs

Scholarship programs to increase enrollment in STEM fields should be a priority in Northern Nigeria. These programs should focus on providing opportunities for women and underrepresented groups to pursue STEM careers. For instance, the SheCodes program, which provides scholarships for women to learn coding, could serve as a model for similar initiatives in Northern Nigeria. Mentorship programs also play an essential role in encouraging young people to pursue STEM careers. It is essential to partner with tech companies, universities, and innovation hubs to connect students with mentors who can guide them through their educational and professional journeys (Kim et al. 2017). By fostering an environment of support and encouragement, Northern Nigeria can build a talent pipeline ready to contribute to the region's innovation ecosystem.

Vocational and Technical Training

While higher education is essential for developing advanced technological skills, vocational and technical training is equally critical for equipping the workforce with practical skills that are in demand in the market. The informal economy in Northern Nigeria is significant, and many people rely on trade related to tailoring, carpentry, and mechanics for their livelihoods. However, these trades often suffer from low productivity due to a lack of training and access to modern tools.

Vocational Schools and Apprenticeship Programs

To address these challenges, the government should invest in establishing vocational schools that offer training in skills relevant to traditional trades and new technologies, such as renewable energy, automotive technology, and digital marketing. These schools should collaborate with local industries to ensure that the training they offer meets market demand.

Apprenticeship programs can also help bridge the skills gap by providing hands-on experience in various trades. For example, Germany's dual education system, combining classroom learning with apprenticeships in industries such as manufacturing and information and communication technology (ICT) (Kim et al. 2017), could be a model for similar programs in Northern Nigeria. By linking education with practical training, these programs could help create a skilled workforce capable of contributing to the region's economic development.

University-Industry Collaboration

Universities in Northern Nigeria can play a crucial role in driving innovation by partnering with industry to conduct research, develop new technologies, and train students in fields critical for economic growth. Unfortunately, many regional universities lack the funding and resources to fulfil this role effectively.

Building Innovation Centres in Universities

One way to address this issue is by establishing innovation centres within universities focusing on research and development in critical sectors such as agriculture, manufacturing, and ICT (Kim, J. et al., 2017). These centres can serve as hubs for collaboration between academia and industry, providing a platform for students and researchers to work on real-world problems and develop innovative solutions (Ehui 2024). The University of Lagos and Covenant University, in Southern Nigeria, have partnered with tech companies to support research and innovation. Similar initiatives should be pursued in Northern Nigeria. By creating links between universities and industries, Northern Nigeria can ensure that its higher education institutions are aligned with the economy's needs, thus contributing to the region's innovation ecosystem.

Public-Private Partnerships

PPPs are a powerful mechanism for driving innovation, building infrastructure, and expanding trade.

By collaborating with the private sector, the government of Northern Nigeria can mobilise additional resources, expertise, and technology to accelerate growth and economic development. This section explores the potential for PPPs in agriculture, infrastructure, and technology.

PPPs in Agriculture

Northern Nigeria's agriculture sector offers numerous opportunities for PPPs. PPPs could help to raise the funding needed for investment in innovation to improve productivity and scale up agro-industrial capacity with increased value-added in the sector.

Agri-Tech Partnerships

PPPs can be particularly effective in developing and deploying agri-tech partnerships between government agencies, private tech companies, and international organizations to bring cutting-edge technologies to farmers in Northern Nigeria. For instance, PPPs can support the development of digital platforms that connect farmers with buyers, provide access to weather data, and offer financial services such as micro-loans and insurance (Kim et al. 2017). In addition, PPPs can help scale up precision agriculture technologies, such as drones, sensors, and satellite imaging, by providing farmers with access to these tools at affordable prices. In Ethiopia, the government partnered with private companies to deploy drones to monitor crop health and optimise irrigation, resulting in increased yields and reduced water

usage (Kim et al. 2017). A similar model could be implemented in Northern Nigeria to drive innovation in agriculture.

Infrastructure Development for Agriculture

PPPs can also be critical in developing the infrastructure needed to support agriculture. Investments in irrigation systems, cold storage facilities, and processing plants can help reduce post-harvest losses, increase value-added production, and improve the competitiveness of Northern Nigerian agriculture. For example, constructing a PPP-financed cold storage facility in Kano State could help preserve perishable crops such as tomatoes, onions, and peppers, allowing farmers to sell their produce at higher prices. Developing digital infrastructure in Northern Nigeria will require significant investment, particularly in underserved rural areas. PPPs offer a mechanism for mobilising private capital to build the necessary infrastructure, such as broadband networks, data centres, and digital hubs (Akintaro and Akintaro 2024).

Several African countries have successfully used PPPs to expand broadband access. The Rwanda government partnered with private companies to roll out fibre optic networks nationwide, increasing internet penetration and improving digital connectivity. A similar approach could be taken in Northern Nigeria, with the government incentivising private telecom companies to invest in broadband infrastructure. PPPs

can also support the development of tech hubs and innovation centres in Northern Nigeria. These hubs can serve as incubators for startups, offering mentorship, training, and access to funding (Ehui 2024). For instance, the Kigali Innovation City in Rwanda, a PPP-driven initiative, has attracted tech companies and created thousands of jobs (Eko iCentre 2024). A similar project in Northern Nigeria could help build a vibrant tech ecosystem and attract regional investment.

Industrial Development PPPs

The development of manufacturing and industrial sectors is essential for Northern Nigeria's economic diversification and job creation. PPPs can help build industrial parks, processing facilities, and critical infrastructure logistics for scaling up regional industries.

Special Economic Zones

Special economic zones (SEZs) have been used successfully in China, India, and Ethiopia to attract foreign investment and stimulate industrial development (Kim et al. 2017). SEZs offer businesses tax incentives, simplified regulatory processes, and access to infrastructure. In Northern Nigeria, PPPs can be used to develop SEZs catering to agriculture, textiles, and manufacturing. For instance, an SEZ focused on agro-processing in Kano could attract investment in value-added industries such as food processing and packaging.

Logistics and Transport PPPs

The movement of goods within Northern Nigeria and across borders could be improved with better transport infrastructure. PPPs can be used to develop logistics hubs, road networks, and rail lines that facilitate trade and improve market access. For instance, constructing a PPP-financed rail line connecting Kano to Lagos could reduce supply chain bottlenecks and transportation costs and increase the competitiveness of Northern Nigerian products in national and international markets.

Conclusion

Empowering innovation and technology to expand agricultural output and trade, economic growth, and development in Northern Nigeria requires a multifaceted approach that addresses the region's unique challenges and opportunities. By investing in digital infrastructure, promoting education and skill development, fostering PPPs, and ensuring security and stability, Northern Nigeria can unlock its economic potential and improve its people's livelihoods. Government policies, private sector investment, and international partnerships all will be crucial in driving this transformation. By harnessing the power of innovation and technology, Northern Nigeria can achieve sustainable economic growth, create jobs, and expand trade—both within Nigeria and across international borders

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African Export-Import Bank Banque Africaine d'Import-Export

Headquarters – Cairo

72B El-Maahad El-Eshteraky Street
Roxy, Heliopolis, Cairo 11341, Egypt

info@afreximbank.com
T+(202) 2456 4100/1/2/3/4

Abuja Branch

No. 2 Gnassingbe Eyadema Street
Off Yakubu Gowon Crescent
Asokoro, Abuja, Nigeria

PMB 601 Garki, Abuja, Nigeria

abuja@afreximbank.com
T+(234) 9 460 3160

Abidjan Branch

3ème Etage, Immeuble CRRAE-UMOA,
Angle Boulevard Botreau Roussel –
Rue Privée CRRAE-UMOA
Abidjan, Côte d'Ivoire

abidjan@afreximbank.com
T+(225) 2030 7300

Harare Branch

Eastgate Building, 3rd Floor
(North Wing), Sam Nujoma Street
Harare, Zimbabwe

P.O. Box CY 1600
Causeway, Harare, Zimbabwe

harare@afreximbank.com
T+(263) 24 2 700 904/941

Kampala Branch

Rwenzori Towers,
3rd Floor Wing A
Plot 6 Nakasero

P.O. Box 28412
Kampala, Uganda

kampala@afreximbank.com
T+(256) 417 892 700
+(256) 312 423 700

Yaoundé Branch

National Social Insurance Fund (NSIF)
Headquarters Building Town Hall,
Independence Square

P.O. Box 405
Yaoundé, Cameroon

yaoundebranch@afreximbank.com

Caribbean Office

Trident Insurance Financial center
Hastings, Christ Church, Highway 7,
Bridgetown, Barbados BB5156

info@afreximbank.com
T +1 246 833 4636

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