WORLD ECONOMY UPDATE

November 14, 2014 | Vol. 4 No. 35

The Role of International Development Finance Institutions in Financing Infrastructure in Africa and Its Implications for Korea

ISSN 2233-9140

Youngho Park Research Fellow, Africa and the Middle East Team, Department of Europe, Americas and Eurasia (parkyh@kiep.go.kr)
YoungKee Kim Director General, Nuclear Power Plant Finance Office, Korea EximBank (youngkkim@koreaexim.go.kr)
Jong-Moon Jang Researcher, Africa and the Middle East Team, Department of Europe, Americas and Eurasia (jmjang@kiep.go.kr)
Hyelin Jeon Senior Researcher, Africa and the Middle East Team, Department of Europe, Americas and Eurasia (hljeon@kiep.go.kr)

1. Background and Purpose of Study

Africa, once a "continent in crisis", is emerging as a "market of opportunity". With internal conflicts that had hampered Africa's development decreasing, and the continuing boom in natural resources and infrastructure sectors, the continent has experienced a remarkable 5% average annual growth from 2000 to 2013, meaning Africa is now at a turning point. Perspectives on Africa are changing greatly: 'The Economist' called Africa "The Hopeless Continent" on its cover in 2000; but Africa reappeared on the cover of the Economist in 2011 under the title "Africa rising", and "A Hopeful Continent" in 2013, a visible sign of change in perceptions of Africa.

African nations entering the initial stages of economic development are focusing on renovation of their extremely decrepit infrastructure and industrial base, setting off a building boom across the continent. It is no exaggeration to say that the sound of bulldozers and hammers are fast replacing the sound of guns on the continent, where demand for construction is growing explosively.

The natural resource boom is expected to further expedite Africa's infrastructure development including the construction of railway lines, sea ports, plants, and the like. A substantial part of Africa's natural resources remain undeveloped as a result of longstanding internal conflicts and poor infrastructure. Therefore, once development proceeds in earnest, it is expected that there will be a jump in the demand for high value added plants, such as gas and oil pipelines, power facilities, etc. Consulting companies, including KPMG and Ernst & Young, view Africa as one of the most promising emerging construction markets in the world.

Accordingly, the Korean government and construction industry are becoming increasingly interested in Africa. The growing interest in Africa are evident in recent surveys of construction companies in Korea, which was conducted by the Korean Chamber of Commerce and Federation of Korean Industries. The respondents' interest in Africa was much higher than that in either the Middle East or Asia. In line with this, however, the fragile business environment and political instability still prevalent throughout Africa make Korean corporations reluctant to enter the African market. Furthermore, these risks limit the amount of financial support that Korean export credit agencies (ECAs) provide. One way to overcome this challenge is to foster financial cooperation with international policy financing bodies such as development finance institutions (DFIs).

Against this backdrop, this study surveys the types and amount of financial resources that multilateral and bilateral DFIs provide for Africa, and makes an in-depth analysis of major projects in Africa financed by them. Moreover, this study explores how Korean ECAs and investors collaborate with international financial institutions to provide increased funding for Africa's infrastructure development projects.

2. African Risks and Financing Environment

Africa's political conditions are unstable and uncertain compared to those of other emerging countries. Country risks including contract breach, expropriation, civil disturbance, foreign exchange control, etc are very much visible around the continent. Africa's country risk stems primarily from the political atmosphere such as internal conflicts, coup d'etats and acts of terrorism. Of the 47 fragile states of the world selected by the OECD (as of 2012) 25 were African. African nations that gained independence in the late 1950s or early 1960s have experienced more than 200 coup d'etats from 1960 to 2012. More than a half occurred in West Africa, which was related to power struggle over its territorial natural resources.

The financing environment is also very poor. With the exception of a few countries such as South Africa, local financing for development projects is limited. Credit ratings are extremely low, making it very difficult for African countries to access financial support from international financial institutions. Among the 54 countries in Africa, only five have an investment grade credit rating.

3. MDB Financial Supports for African Infrastructure Development

MDBs such as the World Bank, African Development Bank (AfDB) and European Investment Bank (EIB) are taking central roles in supporting African infrastructure development through pioneering investments and risk mitigation. The World Bank(the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), for instance, allocated 20% or more of all loans it provided in 2012 to Africa, which was largely spent on infrastructure development projects including plant construction, roads, bridges, water resources, and wireless communication networks. Because of the fact that most African countries are poor with low credit ratings, the ratio of loans from the IDA is 90%, whereas IBRD only accounts for 10%. It is expected that many non-African IDA beneficiary countries will graduate from its program within 15 years, hence prompting IDA focus its support on Africa.

International Financial Corporation (IFC), which has traditionally focused on Central Asia and Latin America, has also been increasing its financial assistance to Africa in recent years. Whereas IFC's assistance for Africa stood at USD 278 million in 2002, it multiplied by over 13 times to reach USD 3.7 billion by 2012. Much of IFC's investments and loans for Africa concerns infrastructure development, amounting to over USD 1 billion in 2012. The Multilateral Investment Guarantee Agency (MIGA), providing guarantee services for promotion of foreign direct investment into developing countries, has played a pivotal role in African infrastructure development. MIGA's attention has recently been focused on supporting postwar reconstruction projects in conflict-stricken countries. In 2012, 34% of projects guaranteed by MIGA was allocated to sub-Saharan Africa, representing 24% of the total value of investments the agency guaranteed.

The European Investment Bank (EIB) is another major source of finance for development projects in Africa. The EU-Africa Infrastructure Trust Fund (ITF) which the bank established in 2007, has been crucial to the expansion of infrastructure in Africa. EIB actively supports infrastructure projects that the African Union(AU) deems either as high developmental priorities or contributes to regional integration.

The African Development Bank (AfDB) shows a similar interest in developing infrastructure, which claimed almost half of all loans and grant aids the bank provided in 2012. The AfDB's goal is to promote market integration across the African continent and it prioritizes trans-Africa infrastructure projects that involve multiple African countries.

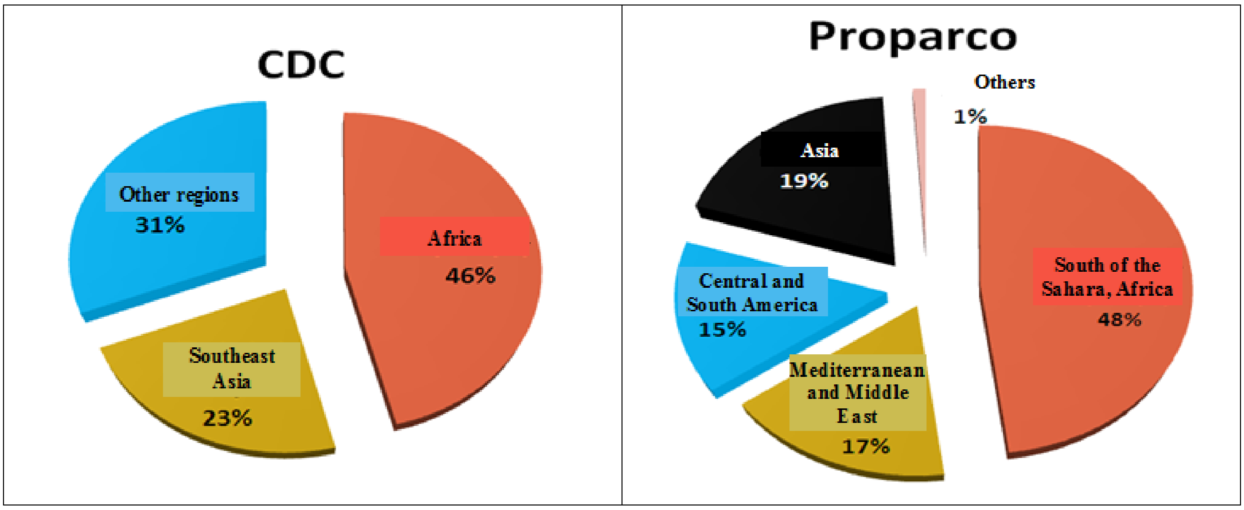
4. Financing of Africa's Infrastructure Projects by European Development Finance Institutions

European Development Finance Institutions, especially CDC (UK), Proparco (France), and DEG (Germany) are actively participating in African infrastructure development projects with strong experience in terms of operating in the region. They occupy the middle space between public aid and private investment, playing a critical role in financing African infrastructure projects, often viewed as too risky by private sources of financing. Distinct from aid agencies in their focuses on profitable investment according to market rules, they ultimately pursue sustainable development through initiating or developing projects in industrial fields where commercial banks or investors are reluctant to invest. These DFIs, having a high risk tolerance and a longer investment horizon, play the role of a catalyst in mobilizing the participation of other investors or financing institutions. They provide financial services such as equity participation, loans or guarantees in risky private sectors. This approach has been successful as both the development impact and financial returns were realized. This is made possible through the extensive experience and know-how that European DFIs have accumulated through years of project exploration and feasibility evaluation in Africa.

CDC has been participating in a broad array of development projects in Africa, making use of UK-Africa relations that go back to the colonial days. Having decided to concentrate investments in Africa in 2011, CDC is rapidly increasing its presence on the continent. Its operating policy today requires that 75% of all new investments be made in low-income countries (i.e., countries with a GDP per capita of USD 905 or less), and that 50% of those investments be made in sub-Saharan Africa. Thanks to this change in policy, Africa claimed the majority of investments that CDC made in 2012. Most of these investments have gone into former British colonies, such as Kenya, Nigeria, South Africa, Ghana, Uganda, and Tanzania.

Proparco is similarly active in Africa, with eight of its fourteen overseas offices located on the continent. Proparco's area of focus is sub-Saharan Africa, which accounts for almost half of all the investments that the company has made so far. On the contrary, Africa is relatively minor in the investment portfolio of DEG which has no comparable historical or colonial relations with Africa. Nevertheless, DEG has been steadily increasing its investments in Africa in recent years, especially in the form of co-financing with other DFIs.

Regional investments by CDC and Proparco (2012)



5. Participation in African Infrastructure Development through Co-financing

A diverse array of financial resources come together through co-financing schemes to form financial packages in African projects. The reason why many financing institutions are participating in individual projects in Africa is primarily to share risks, thereby mitigating them. Large-scale projects involving construction and plant development rely primarily on financial assistance provided by multilateral development banks (MDBs) and bilateral DFIs, with ECAs and commercial banks tending to participate in these projects as latecomers. African projects tend to involve multiple and diverse financial institutions, not only to mobilize sufficient financial resources, but also to reduce risks inherent to those projects. Africa still presents a wide range of unpredictable risks for project participants. Most African states have relatively low credit ratings, making it impossible for financial institutions to fund projects in the region either by themselves or in small groups. Case in point, the large copper-cobalt development project in Congo, a country with much internal political conflicts and extremely poor business environment, was made possible by the diverse financing supports from multiple financial institutions such as Congo ECA, AfDB and EIB. KIEP