



# Contemporary Issues in African Trade and Trade Finance

## CIAT

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COVID-19  
SPECIAL  
ISSUE

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# Contemporary Issues in African Trade and Trade Finance

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## **CIAT**

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THE AFRICAN EXPORT-IMPORT BANK

# CONTEMPORARY ISSUES IN AFRICAN TRADE AND TRADE FINANCE (CIAT)

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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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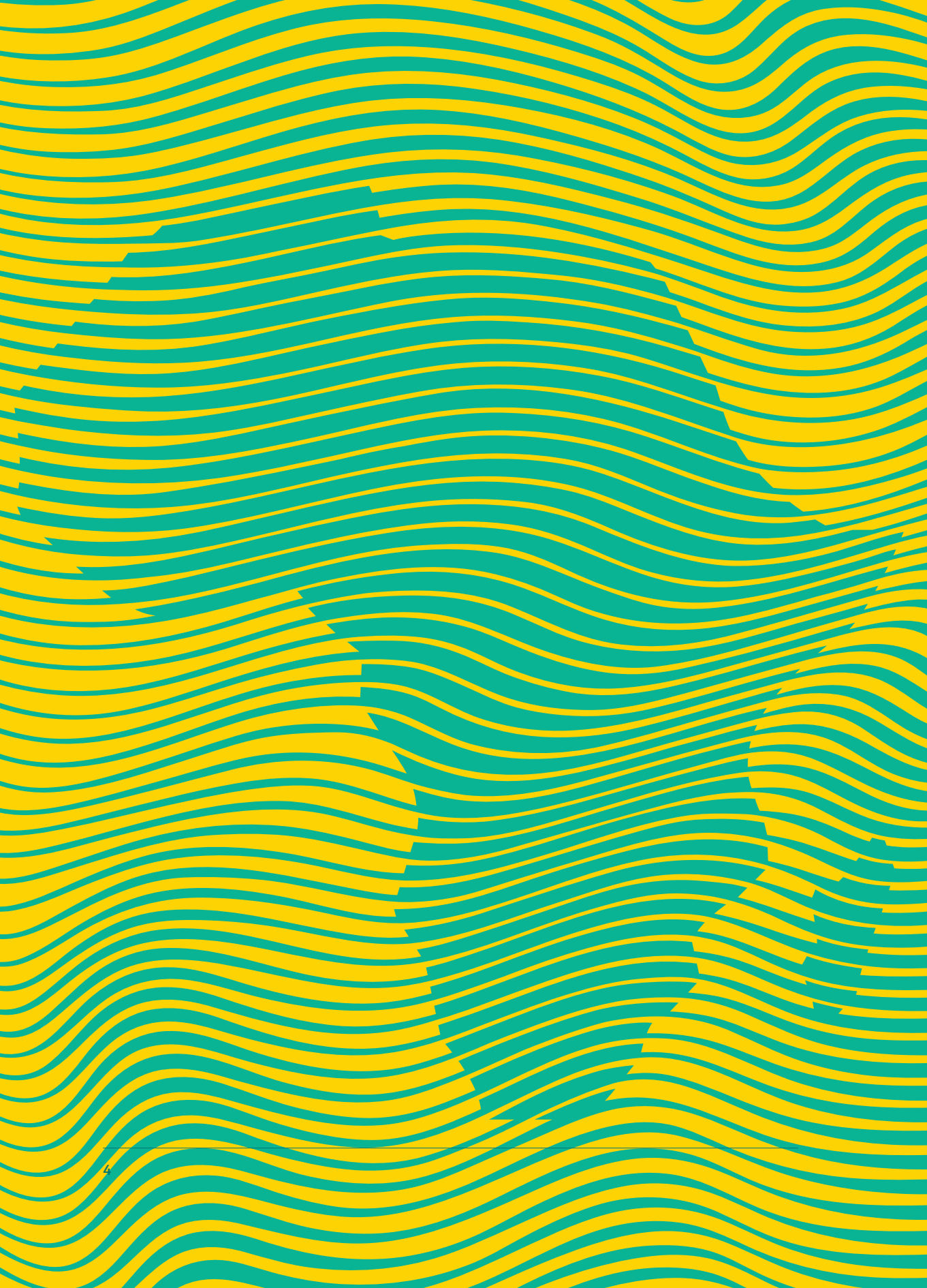
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## Foreword

COVID-19 has changed the world dramatically, inflicting high and still rising human costs, and setting the global economy on a path to synchronised recession. Africa's virus-related fatalities have been relatively low compared to others, but the pandemic's economic and social consequences have been substantial for a region that depends heavily on commodities for fiscal revenues and foreign exchange earnings.

The widespread adoption of strict virus-containment measures – including social distancing, lockdowns, curfews and border closures – disrupted global supply chains and froze the wheels of commerce as the virus raged since early 2020. The costs associated with the combined demand and supply shocks triggered by the pandemic were exacerbated by rising protectionism. The global nature of the crisis demanded a coordinated international response, but policymakers in several economies instead pursued self-preservation, banning the exports of food and drugs, and controlled essential supplies, including ventilators and personal protective equipment for healthcare workers.

On one hand, the sharp contraction of global growth and trade triggered by the pandemic underlined the limits of 'hyperglobalisation' and our over-

reliance on elaborate, international supply chains. On the other, it exposed, and in many instances, a widening of the inequality gap, to say nothing of pre-existing technological divides.

The crisis highlighted the vulnerability of countries with weak public healthcare systems and infrastructure, areas that in Africa have been neglected for decades. While those people engaged in formal employment could, in some cases, draw on digital connectivity to work from home and sustain their incomes and wellbeing, most Africans engaged in the informal sector saw their earnings plummet. Similarly, while advanced economies were able to extend fiscal stimuli and unemployment insurance to support businesses through the pandemic, this was simply not an option for most governments and corporations in the developing world, including Africa.

And yet the crisis, having touched every aspect of our lives – from our mental and physical health to the nature of work and the working environment, payments systems, education and accelerating digitalisation – also presents opportunities for African policy-makers to create the conditions for greater resilience post-COVID-19. In this issue of Contemporary Issues in African Trade and Trade Finance (CIAT), a diverse group of expert contributors share their perspectives on policies and reforms that could set the continent on the path to a more prosperous and secure future.

A key asset Africa has is the continuing relevance of the ‘extended family’, writes Emmanuel Akyeampong, a quality connected to the significance of community and spirituality on the continent. Dani Rodrik argues that the quest for greater resilience, made even more urgent by the market failures underscored by COVID-19, will accelerate the shift towards deglobalisation and a larger role for government. Eswar Prasad posits that digital technologies, beyond revolutionising payments systems, could herald a new era of financial inclusion. Andreas Klasen stresses that sustainably financing trade and development will be crucial for improved resilience in Africa, especially given that the pandemic will likely accelerate commercial bank balance sheet optimisation. Peter Lamptey weighs policy options for cultivating Africa’s healthcare

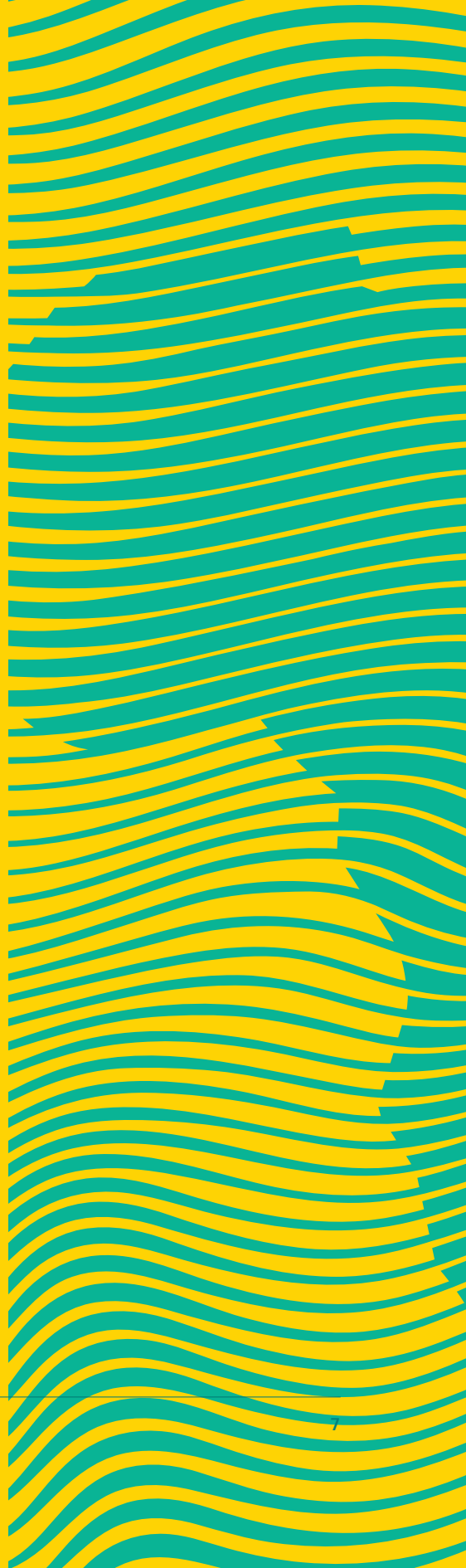
industry and preparing the region for future crises. Tayo Akinwande articulates the contours of a research and technological ecosystem that will put Africa on an irreversible road towards sustainable development.

In a second set of papers, Louise Fox and Landry Signé reflect on the future of work in Africa post-COVID-19. More than identifying employment prospects that may emerge, they propose effective strategies to expand formal opportunities. Gloria Li argues that synthetic local currency trade finance instruments can help mitigate liquidity constraints, as well as boost trade in a region where excess exposure to global volatility has been a source of recurrent balance of payment pressures. Kanayo Awani highlights the importance of factoring and supply-chain financing for economic development and reflects on how poor access to finance has constrained the growth of Africa’s small- and medium-sized enterprises.

Crisis and opportunity are two sides of the same coin. The COVID-19 pandemic is set to transform the world fundamentally, having simultaneously shone a light on the weaknesses of existing systems and revealed opportunities for advancement. The essays in this issue outline numerous policy options and reforms that could foster a more resilient Africa. They are timely and undoubtedly relevant to the development challenges we share, and I recommend them unreservedly to all of our astute and thoughtful readers.

**Professor Benedict Okey Oramah**

President and Chairman  
of the Board of Directors,  
The African Export-Import Bank



# Africa After COVID-19







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# Africa after COVID-19: Community, Spirituality and the Face of Hope



## **Emmanuel K. Akyeampong**

Ellen Gurney Professor of History and of African and African American Studies, and Oppenheimer Faculty Director, Harvard University Center for African Studies

Across the world, COVID-19 has laid bare the social and economic disparities both between countries and within countries. African nations took steps to secure personal protective equipment for healthcare workers, test kits and ventilators, but were outbid by wealthier regions and countries. And in those wealthier, developed countries, like the US, COVID-19 disproportionately impacted minority groups – African Americans, Hispanic Americans and Native Americans – in larger, crowded urban areas. In the early months of the pandemic, deaths among African Americans and Hispanic Americans in cities like New York and Chicago far outnumbered their representation in those cities’ populations. In early April, it was reported that while African Americans represented 32% of the population of Louisiana, they

accounted for 70% of COVID-19 deaths at that time.<sup>1</sup>

Weak health infrastructure compelled many African nations to close their borders and airports pre-emptively to avert the possible entry of visitors with coronavirus. According to a World Health Organization (WHO) survey from April in Africa, the 41 countries that responded had only 2,000 ventilators between them, with Somalia having none, the Central African Republic three, South Sudan four, Liberia five and Nigeria fewer than 100.<sup>2</sup> In the same month, a BBC News story noted how Nigeria’s early victims of coronavirus included the country’s political elite, prompting gibes about how everybody must now, with borders closed and the option of ‘medical tourism’ removed, utilise the country’s rundown hospitals.<sup>3</sup>

Under-resourced African nations like Tanzania that sought refuge

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1. Lois Parshley, “The Deadly Mix of COVID-19, Air Pollution, and Inequality, Explained” Vox, April 11, 2020. See also, Isaac Chotiner, “How Racism is Shaping the Coronavirus Pandemic” The New Yorker, May 7, 2020.

2. Max Bearak and Danielle Paquette, “Africa’s most vulnerable countries have few ventilators – or none at all” The Washington Post, April 18, 2020.

3. “Coronavirus: Why some Nigerians are gloating about COVID-19” BBC News, April 22, 2020 (bbc.com).



in spirituality, dismissing social distancing and face masks, soon realised – like in the US – that it was unwise to fly in the face of science.<sup>4</sup> Few African governments have the capacity to arrange the massive fiscal stimulus measures and financial bail-outs that advanced, industrialised countries have announced.

A virus that has led governments to mandate isolation, quarantine and social distancing has deepened individuals' appreciation for warm and nourishing social relations that many have previously taken for granted. Even in the more individualistic societies in the global north, where more focus is given to the 'nuclear family', families yearned to celebrate birthdays with grandparents and other, more distant, relations. When authorities began to permit gatherings of small social groups, people embraced the respite that even such modest get-togethers, of perhaps just 10 people, could offer from social isolation.

Thus far, Africa has borne relatively well the burden of COVID-19. The more dire predictions of international health experts are yet to manifest, though the continent cannot let down its guard. Some have pointed to how previous pandemics, such as HIV-Aids and Ebola, and the health protocols put in place in response have helped African policymakers and communities deal with coronavirus.

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A key asset Africa has is the strength of its community networks and the continuing relevance of the extended family.

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A key asset Africa has is the strength of its community networks and the continuing relevance of the extended family. This is a factor in African resilience that must be engaged explicitly as a coping mechanism. The importance of religion is another.

In the late 1960s, research claims about both set in motion debates that have persisted into the present. The WHO's International Pilot Study of Schizophrenia from 1968 covered nine countries, with Nigeria being the only African nation involved. For a disease then seen as progressively degenerative, early findings suggested more positive outcomes in developing countries like Nigeria, pointing to the possible contributory factors of family and community. Several subsequent studies have tested and revised these findings. Kinship in Africa, as a therapy-management group, has long been a research staple in medical anthropology.

In 1969, the Anglican priest and theologian John Mbiti published his landmark book, *African Religions and Philosophy*. He described Africans as

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4. Basillioh Mutahi, "Tanzania President John Magufuli: The Man who declared victory over Coronavirus" BBC News, November 2, 2020 (bbc.com).

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## As in previous viral epidemics, the strong norms around funeral and burial practices in Africa pose challenges during COVID-19.

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‘incurably religious’, an assertion that has sparked debates ever since.<sup>5</sup> In an era in which science has been elevated, people were not sure what to do with this description. At the same time, we admire how Japan has developed materially and technologically without shedding its culture and spirituality.

An important historical truth today is that Africa has become the continent with the largest population of Christians and Muslims. Africans will determine the face and the future of these two world religions. And it is incontestable that spirituality is part of Africa’s DNA. Long before Mbiti, the statesman and philosopher, Léopold Senghor, pointed to this reality in his theory ‘Négritude’, hinting at an intuitive African way of knowing that did not necessarily privilege the abstraction that Western logic celebrates.

But the social strengths that kinship, community and spirituality bring are not without complications. As in previous viral epidemics, the strong norms around funeral and burial practices in Africa pose challenges during COVID-19. Funerals in Africa

have two key functions: to transform the deceased into an ancestor, which the proper conduct of funeral and burial rites ensures; and to dramatise the deceased’s social standing and networks among the living. The first brings close relatives into physical contact with the deceased, and the second accounts for the more public face of funerals. Both are opportunities for contagion.

Across Africa one can witness elements of change, especially in urban environments, in the proliferation of private funeral homes and funeral insurance. The necessity for families to physically prepare their dead for burial is lessening in certain areas due to the presence of funeral homes, and the availability of funeral insurance could minimise the heavy debts families incur for funerals. COVID-19 may, in the short term, buttress the trend towards using funeral homes and discourage the large funeral gatherings. And if this engenders a ‘new normal’, the continent may see some long-term changes in the conduct of burials and funerals.

In Africa, the notion of the extended family has survived the test of individualism and global onslaught of free market ideology. More importantly, even in poor families it has preserved some dignity through communal welfare.

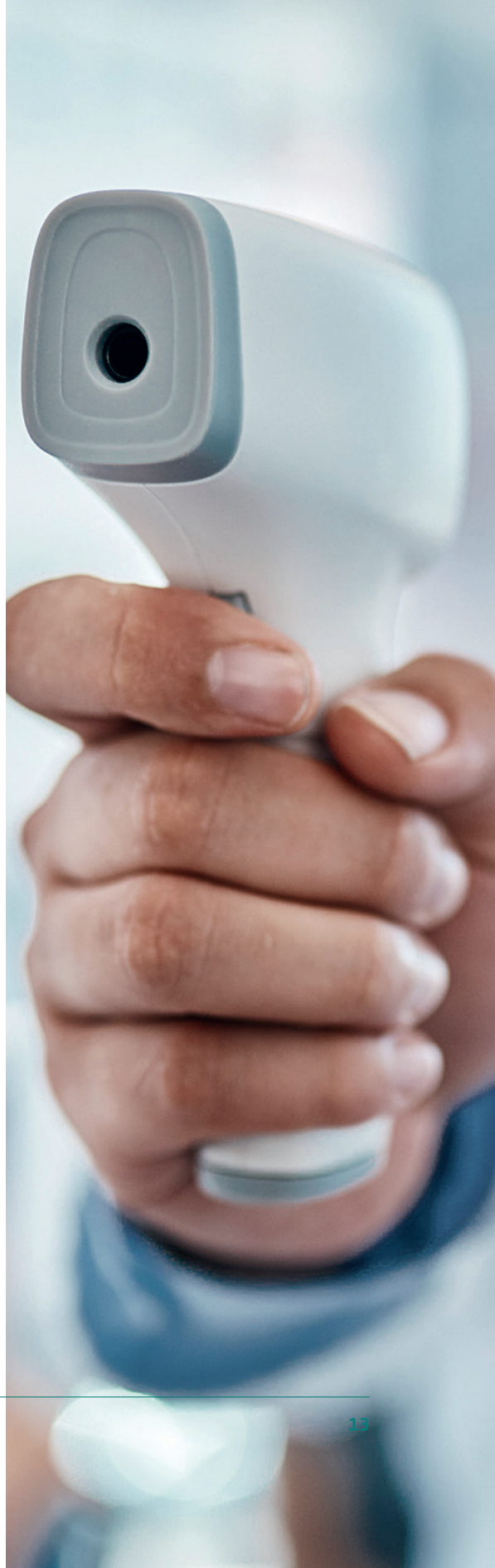
Kinship and community are two important pillars of Africa’s informal

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5. See, for examples, Jan Platvoet and Henk van Rinsum, “Is Africa Incurably Religious?”, *Exchange*, 32: 2 (2003), 123-153; and Frans Wijzen, “Are Africans Incurably Religious: Discursive Analysis of a Debate, Direction of a Discipline” *Exchange*, 46: 4 (2017), 370-397.

economy. COVID-19 poses an existential threat on a continent where a significant proportion of economic activity resides in the informal sector. The significance of this sector for Africa is undisputed, accounting in some countries for as much as 70% of economic activity. Just as COVID-19 has reconfigured the nature of formal work – deepening the digital economy, facilitating workplace meetings through virtual platforms, and affirming the ability to work from home – the pandemic may also prompt a reconfiguring of work in the informal sector, though the outlines of what this would look like are yet to be discerned. Its transformative potential cannot be understated, however, because of the informal economy’s commitment to family, kinship and community. In this, it has the capacity to touch more lives.

The fragility of our species in a time of heightened uncertainty triggered by the COVID-19 pandemic has strengthened the sense of community and kinship worldwide. Spirituality, family, the extended family – these qualities have sustained Africa and Africans for generations. Africans should be more deliberate in how they leverage these in their development visions for the rest of the century. The Muslim community of the faithful (the ummah) and the Christian Church (the assembly or ekklesia, to use the Greek term) are both communities of hope. With its demographic growth, where by 2050 one in every four individuals on Earth will hail from the continent, Africa is the face of hope in the world.



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# Africa after COVID-19: De-globalisation and Recalibrating Nations' Growth Prospects



**Dani Rodrik**

Ford Foundation Professor of International Political Economy at Harvard University's John F. Kennedy School of Government; Co-Director of the Economics for Inclusive Prosperity network; President-Elect of the International Economic Association

Three trends will shape the world economy in the post-COVID-19 era. First, we will see a rebalancing of the relationship between markets and the state, with a much stronger role for governments and public regulation. Second, there will be a parallel rebalancing away from hyper-globalisation and towards greater national sovereignty and autonomy. Third, we will be transitioning into an era with lower economic growth potential, in which political leaders and their publics will need to scale down their growth ambitions.

The pandemic has highlighted the inadequacy of our existing market arrangements in the face of challenges that demand collective action, as well as the importance of state capacity to respond to crises. It is leading nations to prioritise resilience and dependability in production over cost savings and efficiency through global outsourcing. The economic costs of

lockdowns, the associated supply shocks and the reduction in global trade have been felt particularly acutely in low-income countries, such as those in Africa, where living conditions were already precarious to begin with.

All three trends have been in place for some time. And while they could be viewed as posing significant dangers to human prosperity, they may instead be harbingers for a more sustainable, more inclusive global economy. The question is whether African leaders will be able to deploy the needed adjustments in policy and institutions.

First, consider the role of the state. The neoliberal-market fundamentalist consensus has been in retreat for some time. Designing a larger role for government in responding to inequality and economic insecurity has become a priority for economists and policymakers alike. In the advanced economies of North America and Western Europe, the trend is towards greater state responsibility. The

same will likely be true for developing nations – the question, then, is what form this will take?

While we cannot rule out a return to an old-style state dirigisme that achieves few of its intended results, it is possible that the move from market fundamentalism takes a genuinely inclusive form focused on a green economy, good jobs and the rebuilding of the middle class. Such a reorientation will need to be adapted to current economic and technological conditions, and not simply mimic interventionist policy instincts of an earlier era.

The return of the state will be attended by the renewed primacy of nation states. De-globalisation, decoupling, supply-chain repatriation, reducing dependence on foreign supplies and prioritising domestic production and finance have become recurring themes. The US and China, invariably, are the nations that set the tone. The retreat from hyper-globalisation can lead us down the path of trade wars and rising ethno-nationalism, damaging economic prospects for all. But it need not do so.

It is possible to envisage a more sensible, less intrusive model of economic globalisation that focuses on areas where international co-operation truly pays off – global public health, international environmental agreements, global tax havens and other beggar-thy-neighbour policies – but otherwise leaves

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Designing a larger role for government in responding to inequality and economic insecurity has become a priority for economists and policymakers alike.

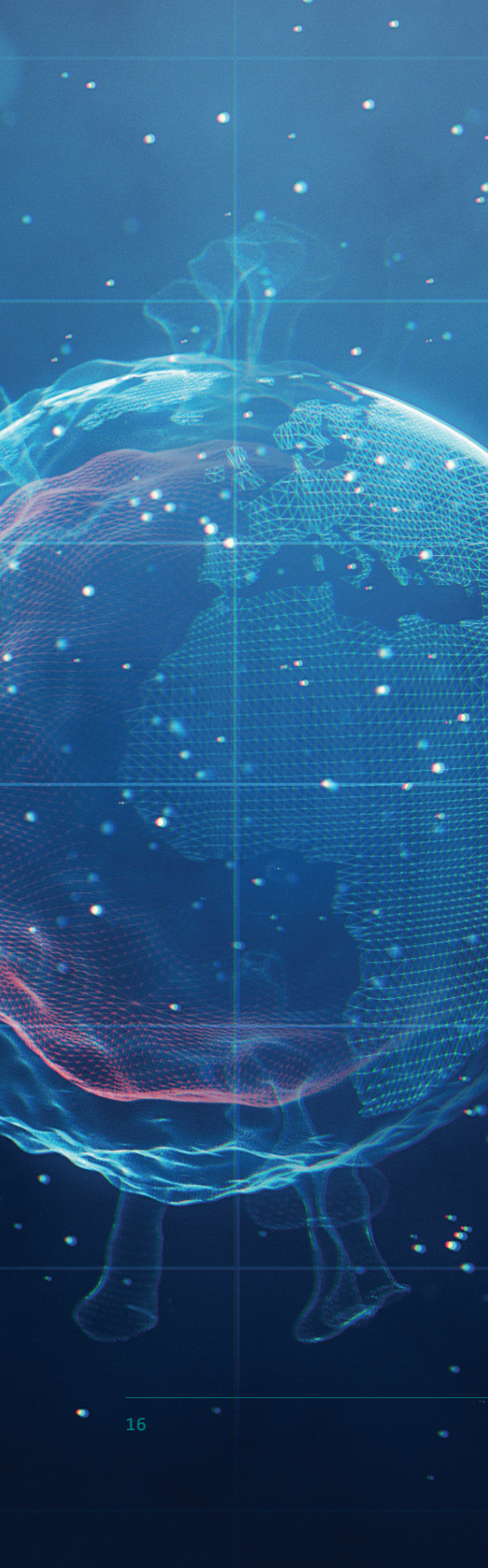
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nations unencumbered to prioritise their domestic economic and social problems. Such a global order would not be inimical to the expansion of world trade and investment. It might even facilitate it insofar as it opens space for restoring domestic social bargains in the advanced economies while enabling developing nations to craft their own, appropriate growth strategies.

For African nations, perhaps the most damaging medium-term prospect the world faces is a significant reduction in the possibilities of economic growth. On the whole, Africa had a few good years before the pandemic, with reductions in poverty and improvement in education, health and other social indicators. But much of this growth was based on unsustainable demand-side factors, in particular public-investment and natural-resource booms. COVID-19 accentuates a pre-existing growth problem.

The fundamental challenge is that export-oriented industrialisation, the most reliable vehicle for long-term development, has run its course. Employment in manufacturing peaks at much lower levels today than in





previous decades, due to a combination of demand shifts towards services, intensified global competition and skill-biased technological changes.

Certainly, some low-income countries still have a little headroom to expand manufacturing. A certain degree of import substitution, localisation of manufacturing and deeper regional integration within Africa can help somewhat. But the reality is that manufacturing will not be able to supply the bulk of the jobs that Africa's young, urban population desperately needs. Most African nations will have to rely on new growth models. The pandemic is a wake-up call to recalibrate growth prospects and stimulate the broader rethink that is needed.

Where will the jobs come from, if not from manufacturing? Non-traditional agriculture and traded services can help, but only so much. There are clearly unexploited opportunities in Africa's agricultural sector – the region contains more than 60% of the world's remaining arable land, yet spends billions of dollars annually on food imports. But it is hard to imagine a scenario whereby agriculture can continuously absorb the excess labour force. Where agricultural modernisation and the development of non-traditional export crops have been successful – as in Latin America – the process has not been labour-intensive. The same is true for natural resource-based growth spurts, which are unreliable and produce major economic imbalances. In all likelihood,

the new jobs will have to be created in urban areas to which young people still flock.

In services, Africa has had some successes. Mobile telephony and mobile banking are the examples that come immediately to mind. However, services traditionally have not acted as an escalator sector like manufacturing. The problem is that those services that have the capacity to act as productivity escalators tend to require relatively high skills. The classic case is information technology, which is a modern, tradeable service. Long years of education and institution building are required before farm workers can be transformed into programmers or even call centre operators. By contrast, little more than manual dexterity is required to turn a farmer into a production worker in garments or shoes, raising his/her productivity by a factor of two or three.

The bulk of productive jobs in Africa will have to come from less glamorous, mostly non-tradeable services such as retail, education, health and a variety of personal services that have the greatest potential to absorb the continent's relatively less-skilled labour force. That, in turn, will require an economic strategy much less fixated on international trade and foreign investment and much more focused on the health of domestic markets.

Governments must work both on the supply and demand sides of the internal market. On the one hand, they must enable the steady and broad-based accumulation of capabilities in human capital, institutions and governance that are critical to productivity. They must work with small- and medium-sized enterprises to facilitate both their employment growth and productive development. This will have to be a different kind of 'industrial policy' – focusing on services and on firms that serve the home market and draw on economies of scale associated with the African Continental Free Trade Area to boost productivity and competitiveness. And on the demand side, they must install tax and incomes policies that ensure sustained growth of the middle class. The focus on poverty reduction must be accompanied by policies oriented towards the middle class, which has long been neglected in developing countries.

We are unlikely to experience growth miracles in Africa. But moderate and steady growth, in the range of 2%-3% per capita, remains achievable. The key will be to reorient policies towards what matters: the creation, in sufficient quantities, of good jobs for Africa's labour force.

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The pandemic is a wake-up call to recalibrate growth prospects and stimulate the broader rethink that is needed.

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# Africa after COVID-19: Digital Technologies Herald the Democratisation of Finance



## Eswar Prasad

Tolani Senior Professor of Trade Policy and Professor of Economics at Cornell University, and Senior Fellow & New Century Chair in International Economics at the Brookings Institution

Even before the COVID-19 crisis, digitalisation was helping several emerging economies reach development objectives; post-pandemic, the impact of new technologies on financial inclusion could be further enhanced.

Advances in financial technology could have a tremendous impact on societies all over the world by supporting the democratisation of banking and finance. The lives of poorer households could be improved by enhancing their access to savings, credit and insurance products, while simultaneously alleviating liquidity constraints and the cost of trade in developing countries where access to hard currency has been a major obstacle to growth. Domestic and international payments will become cheaper and more efficient, benefitting consumers, businesses and economic migrants who send remittances to their home countries.

Mobile money and other digital

payments systems have already taken hold in many nations. New models of – mostly online – banking offer greater financial access to low-income and urban households. Cross-border remittance flows and payments, which are important for many African economies, are becoming cheaper and faster. The Pan-African Payment and Settlement System (PAPSS), developed by the African Export-Import Bank, will play a key role in promoting cross-border trade during the implementation of the African Continental Free Trade Area (AfCFTA) and save the continent billions of dollars in transfer charges.

However, new technologies are of course not necessarily risk-free. If poorly managed, these technologies could induce a degree of financial or macroeconomic instability. Such risks, were they to materialise, could end up being especially harmful to the economically underprivileged.

Regulators may struggle to keep up with rapid changes in financial



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## Mobile money and other digital payments systems have already taken hold in many nations.

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markets as novel technology-based platforms grow, threatening banks and other existing financial institutions. It falls to policymakers to choose how best to strike the balance between the potential benefits of financial innovation and the risks that such innovation may engender, while also bearing in mind the risks of stagnation and over-regulation.

African governments must make some crucial policy decisions. The first is to increase the availability of 'soft' infrastructure, especially access to the internet. While mobile phones provide an easy and cheap gateway, broader access to the internet gives users access to a much wider range of capabilities in managing their finances and strengthens institutional capacities in digital payments and settlements.

The second priority is to emphasise financial literacy and risk management in the digital era. While new products and services can offer many benefits, they can also be precarious when their modalities and details are not well understood by users. The advantages of improved access to formal finance will be limited unless households and businesses understand fully how they might benefit from that access. Equally, consumers must not be allowed to be

beguiled by sophisticated but possibly very risky products that they neither understand nor need.

The third priority is to improve the quality of regulatory oversight and public governance while also harmonising countries' regulatory frameworks to facilitate pan-African payments and settlements. A nimble framework that can adapt to evolving structures in financial markets and institutions is essential to mitigate risks that can arise from regulatory gaps and arbitrage by new entrants. Likewise, a stifling regulatory environment that stymies innovation is also undesirable.

Even central banks could play a direct role in adopting new financial technologies by considering the issuance of central bank digital currencies (CBDCs) in parallel with cash. Certain forms of CBDC are relatively easy to implement, as has been demonstrated in developing economies such as Uruguay and The Bahamas. CBDCs can help expand financial inclusion, bring more economic activity out of the shadows, broaden the tax base and reduce corruption intermediated through cash.

Even so, financial technologies are not always benign. Private 'stablecoins', such as Facebook's Libra, which are backed by reserves of hard currency assets, could ultimately displace central bank money in countries whose monetary authorities

have limited credibility. This could accentuate the process of 'dollarisation' that many emerging economies are already subject to, precipitating the loss of monetary sovereignty. Moreover, new channels for cross-border capital flows could exacerbate the exchange rate and capital flow volatility with which many developing countries are already contending.

Coordination at the regional level could be helpful in sharing knowledge and developing a co-operative approach to these issues. This might help tie in broader objectives, such as financial market development and financial integration, at both the national and regional levels to support the deepening of economic integration and trade under the AfCFTA. Regional institutions that are familiar with local economic and financial market circumstances could be valuable catalysts in synthesising the small but growing body of research on these topics, as well as in incorporating lessons from experiences of other countries that are farther along in these areas.

African policymakers must develop a proactive strategy to harness the benefits of new financial technologies. Such a strategy should include measures to improve financial literacy, among both households and small businesses. Some caution is warranted in opening up to new financial technologies, in light of the economic and political constraints that many governments face. Still, an active, hands-on approach could help improve the benefit-risk trade-offs; passivity could only increase longer-term risks and delay the potential benefits that African economies stand to enjoy.

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African policymakers must develop a proactive strategy to harness the benefits of new financial technologies.

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# Africa after COVID-19: Reshaping Regional Trade Finance



## Andreas Klasen

Professor of International Business and Director of the Institute for Trade and Innovation at Offenburg University, Germany; Honorary Fellow in the School of Government and International Affairs at Durham University, UK

The COVID-19 pandemic has created an enormous economic shock and triggered a deep global recession. Many African economies have been hit hard by the coronavirus crisis, with economic activity greatly disrupted and countless jobs destroyed. The International Monetary Fund estimates a 4.8% decline in world market-weighted GDP in 2020, while the World Trade Organisation is forecasting a 9.2% decline in merchandise trade this year. This downturn is far worse than that sparked by the 2008 financial crisis, and comparable only to the 1930s Great Depression.

Global policy uncertainty has created further challenges for African industry. Companies must deal with rising multipolarity, growing fragmentation and policy-induced shocks, such as trade wars. Approaches promoting national trade grow outside existing multilateral frameworks, leading to institutional inertia. Furthermore, after decades of rapid expansion, global value chains have stalled over the past 10 years.

The exchange of goods and services is almost always beneficial when countries trade with one another. Exports lead to efficiencies of large-scale production, enabling economies to specialise in producing narrower ranges of goods. Consequently, cross-border trade can propel economic growth first through global demand and then by facilitating knowledge and technology diffusion.

Global trade and foreign investments are key drivers for African economic growth. Emerging and developing markets are shouldering increasingly important roles as engines of global growth and trade. South-South trade – that is, trade among growth markets, mostly in the southern hemisphere – is becoming increasingly relevant and will receive a major boost from programmes such as China’s Belt and Road Initiative and the African Continental Free Trade Area (AfCFTA).

In recent decades, international trade has been supported significantly by the expansion of export credits and trade finance. Because only a small part of foreign trade is paid in advance, there is a substantial need





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## The ongoing trend of commercial bank balance sheet optimisation will be accelerated by the pandemic.

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to facilitate financing for goods or services. Consequently, exporters in Africa and around the world require sufficient liquidity to buy raw materials, finance labour and inventory, and produce goods to process export transactions and extend open account terms to importers. In many economies, structural problems appear in the supply of finance for exporters. Information asymmetries make it difficult for banks to value investments, and a lack of collateral qualification for context-specific transactions presents further problems. Major challenges appear for small- and medium-sized enterprises (SMEs) when exporting goods, and a lack of access to finance is the single most significant constraint for SME exporters in Africa.

The ongoing trend of commercial bank balance sheet optimisation will be accelerated by the pandemic. Compliance and regulatory issues, such as Basel III/IV, are additional impediments for the provision of export, development and innovation financing. Offerings made available by commercial financial institutions often mismatch to exporters' requirements with regard to size and maturity.

Consequently, export-import banks (exim-banks), export credit agencies (ECAs) and development finance

institutions step into finance and insure trade. They usually operate according to three core principles: additionality, catalysing investments from private entities and acting sustainably. In highly industrialised countries, strong exim-bank and ECA COVID-19 measures for exporters significantly supported trade performance.

Despite the challenges posed by the coronavirus crisis and rising policy uncertainty, there are significant opportunities for internationally-oriented businesses in Africa. The continent has tremendous economic potential, buoyed by several factors, including: a burgeoning middle class, rapid urbanisation, large infrastructure needs, accelerating digitalisation, agricultural innovation, and the rise of manufacturing industries with favourable returns. These developments also facilitate shifts in major economic powers' core interests, integrating innovative African companies into their value chains.

Another crucial factor in building economic resilience and propelling growth is the AfCFTA. If the free trade agreement is implemented in a fast and ambitious manner, it will not only bolster the post-COVID-19 recovery, but also help reposition Africa, as improved regional value chains will reduce the negative impact of future economic and financial crises. The AfCFTA has the potential to become a model of effective governance and harmonised trade regulation. The pandemic affords policymakers a

unique opportunity to further develop common guiding principles for African trade as well as forward-looking coordination of national trade policies.

These steps must be accompanied by new activities aimed at securing sufficient trade finance and export risk mitigation instruments. Although several multilateral institutions, including the African Export-Import Bank (Afreximbank) and the Trade and Development Bank, already help facilitate interregional and intra-African trade, a package of new actions might be required.

In addition to COVID-19-related measures, such as Afreximbank's Pandemic Trade Impact Mitigation Facility, joint efforts on the part of African and non-African multilateral institutions for financing trade around common goals and norms can generate supplementary benefits. Relatedly, closer collaboration on the continent between multilateral institutions, national development banks and ECAs can boost exports and imports. Innovative initiatives to mobilise domestic institutions for co-operation in a joint regulatory framework for an African 'level playing field' are also required. Like the initiative of the new ECA Export Egypt, this raises the possibility that African governments will intervene strategically to diversify their economies and mobilise additional trade finance and risk mitigation solutions for exporters.

With fast urbanisation, surging infrastructure investments, digitalisation and the rise of manufacturing industries, there are significant opportunities for exporters on the continent. These prospects can be better realised by capitalising on the potential of the AfCFTA, strengthening regional value chains post-pandemic.

Financing trade and development sustainably will be crucial for Africa. Enhanced collaboration between multilateral development banks, development finance institutions and ECAs could greatly enhance intra-regional trade. Furthermore, setting up a 'level playing field' on the continent will allow governments to make strategic interventions for successful export credits and trade finance solutions, fostering growth through trade.

African trade is already showing signs of rebounding from the coronavirus-induced recession. Through concerted, co-operative and continent-wide efforts, drawing on the knowledge and resources of all types of institutions and policy experts, Africa will continue to grow confidently and quickly into its increasingly important role as an engine of economic growth and global trade.

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The AfCFTA has the potential to become a model of effective governance and harmonised trade regulation.

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# The Future of Health in Africa

## Post-COVID-19



### **Peter R. Lamptey**

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A vision for a healthy Africa must not be limited to meeting the basic needs of the population; we should instead strive to attain a vastly improved quality of health consistent with global best practice standards.

According to the latest World Population Prospects published by the United Nations, Africa's population could increase more than threefold by the end of the century to reach 4.3 billion. If this prediction holds, healthcare in Africa will have to improve dramatically in both quality and coverage to meet the expected growth in demand.

For this to happen, the region will need to enhance substantially its current healthcare systems to: (i) deliver high-quality universal healthcare; (ii) address major health challenges such as infectious diseases, non-communicable diseases (NCDs), HIV and COVID-19; (iii) plan and be ready for other emerging diseases; (iv) adopt new technologies such as telemedicine and digital programmes to enhance healthcare responses;

and (v) establish world-class national and regional centres of excellence, as well as stimulate globally-competitive medical industries.

Despite the relative improvement in life expectancy, Africa still compares unfavourably against other parts of the world. The five leading causes of death in Africa continue to be preventable and treatable diseases such as lower respiratory infections, HIV/AIDS, diarrhoeal diseases, malaria and NCDs.

NCDs pose one of the greatest threats to Africa's health. This has been driven by changes in lifestyles and standards of living, which have increased the prevalence of cardiovascular disease, cancer, mental illness, diabetes and chronic respiratory diseases. These trends are likely to continue in the light of increasing urbanisation and shifts in diet and lifestyle, and could be exacerbated post-COVID-19. The World Health Organization estimates that Africa will experience a 27% increase in NCDs, which could lead to 28 million additional deaths.

The HIV epidemic, which has claimed the lives of 33 million people



worldwide, mostly in Africa, illustrates the difficulties the region faces. Despite massive investment, the AIDS crisis is far from over and the Joint UN Programme on HIV/AIDS (UNAIDS) estimates that \$26.2 billion will be required globally in 2020 to support the current level of efforts to treat and control the epidemic.

The COVID-19 pandemic may be a preview of what the world will face in future. An early and sustained regional response has been credited as one of the reasons for the relatively less devastating health impact of the pandemic in Africa compared to other parts of the world. But more research is needed to ascertain the full extent of the COVID-19 crisis on the continent. However, judging from its experience with HIV, Africa's fragile economies, limited disposable resources and competing health priorities could be more severely impacted by future pandemics. Africa needs a reliable early warning system that will detect new epidemics, in addition to mobilising and coordinating regional and national responses.

The current successes in health improvements in Africa have come as a result of the combined efforts of national health agencies, their international counterparts and external donor support. Unfortunately, donors may also, unintentionally, have had a negative influence on healthcare delivery, due to the creation of well-funded parallel – and often unsustainable – health programmes, and making

African governments dependent on external funding.

Attempts by the international community to fill the gap in healthcare delivery through stopgap measures may have created a new set of challenges, potentially causing African countries to fall into the aid-dependency trap. The promotion by the US Agency for International Development (USAID) of what it calls the 'Journey To Self-Reliance', with the aim of strengthening African nations' ownership of health programmes and infrastructures, may be painful but necessary.

### **Technological advances and digital healthcare**

For this transition to be successful, African governments must: increase public allocation of resources for universal healthcare significantly, improve accountability, use public sector health resources more efficiently, balance the roles and resources of the public and private sectors, and expand the role of the community in healthcare delivery.

In most places in Africa, multiple healthcare options exist. This practice of 'medical pluralism' comprises Western or allopathic medicine, traditional healthcare and faith-based healers, as well as self-prescribed medical care, often with poor-quality drugs.

Medical pluralism exists in part because of the prevalence of both modern and traditional beliefs in disease causation, poor coverage



of modern medical care and poor governance. But medical pluralism also poses a challenge in an industry where malpractice has grave human costs. Examples range from claims of fake cures for diseases by misguided political leaders, often unproven traditional therapies and the peddling of fake drugs by street vendors. These competing, often ineffective and sometimes harmful, interventions must be addressed to improve the quality and reliability of healthcare across the continent.

Developing regional medical centres of excellence, including state-of-the-art hospitals, is a sustainable solution to both the prohibitively high cost of medical tourism and to rising inequality in access to healthcare. It will also stem the brain drain in the medical and research profession, laying a more robust foundation for a framework that inspires organic growth and effective interaction between research and treatment.

But ensuring universal access to quality healthcare or treating access to excellent healthcare as a basic human right requires striking the proper balance between public and private provision of these essential services. This will be the main challenge facing policy-makers as the African healthcare industry modernises.

Experiences from advanced economies, some of which have become a magnet for medical tourism, show that quality has been achieved

at the expense of universal coverage in countries where private provision has been the main healthcare conduit. In contrast, healthcare delivery has been more cost-effective in advanced economies that have adopted universal single-payer models.

At the same time, countries must invest in technologies that can improve access to and quality of care, as well as reduce costs. These include digital health, telemedicine and digital self-care to improve services for patients and the community overall. Digital health and telemedicine could be applied to several areas of medicine and public health, including data management and the provision of remote services and health information through mobile telephony, in addition to health knowledge management and distance learning for healthcare providers.

These technology solutions can play a critical role in expanding and enhancing the role of community-based health workers in the delivery of clinical services, as well as in empowering patients to improve personal health. Digital self-care – especially the use of smartphones by individuals to self-monitor disease indicators (such as blood sugar and blood pressure) and manage various aspects of their health – is a rapidly growing industry in developed countries that will be valuable in Africa. The benefits of digital self-care include education of patients and enabling individuals to take charge of their health, reducing the

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Developing regional medical centres of excellence, including state-of-the-art hospitals, is a sustainable solution to both the prohibitively high cost of medical tourism and to rising inequality in access to healthcare.

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frequency of clinic visits, enhancing the confidentiality of testing and improving the efficiency of the healthcare system overall.

However, access to these technologies remains limited in a region where the cost of internet access remains relatively high and the urban/rural digital divide is significant. Increasing medical coverage and access through technology will require bold and sustained investment to expand internet capacity within the region and propel Africa into the digital world post-COVID-19.

### **Fostering Africa's research and medical industries**

Over the past few decades, global concern about the disproportionate burden of disease and mortality in low-income countries, especially in Africa, has led to a substantial influx of funding by many donor and research agencies. This investment has energised in-country research and advanced the discovery of new treatments for diseases that are the leading causes of deaths. It has also stimulated new research strategies

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## There is a great potential for the development of scientific research in Africa driven by African health priorities.

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for the prevention and control of these and other diseases. However, there is concern that Africa's health research agenda has often been driven (if not exclusively then at least largely) by these funding sources.

In terms of publications, for example, the contribution of African medical scientists and researchers to the global body of medical knowledge remains marginal. The absence of medical research and infrastructure in the region has led to a massive exodus of experts and to the rise of medical tourism, which is costing Africa billions of dollars annually. There is a great potential for the development of scientific research in Africa driven by African health priorities. There is an urgent need to bolster research training, national and regional research infrastructures, career development programmes and funding for African researchers on the continent.

Africa's medical industry is similarly underdeveloped. The severe global shortage of medical products early in the COVID-19 pandemic – including personal protective equipment, drugs, ventilators and other commodities – should be a wake-up call for Africa to invest in regional and national industries. A

related challenge will arise in respect of supplies of COVID-19 vaccine, since industrialised countries have already committed to purchasing hundreds of millions of doses prior to the approval of these products. It is time for Africa to develop a regional response to avert shortages of essential drugs and medical products, build regional and national stockpiles, and invest in a continental medical industry.

An equally compelling reason is the rapid growth of the African pharmaceutical industry, which was forecast to grow in value to \$65 billion in 2020. Beyond saving billions of dollars of foreign reserves, Africa's pharmaceutical industry could be a major driver of growth and job creation in a part of the world where more than 17 million young graduates are entering the labour market each year.

Africa faces multiple challenges in improving the quality and coverage of its healthcare. The COVID-19 crisis has been an admonition for policymakers all over the world. Countries are reorganising supply chains and embracing technology to improve the resilience of their healthcare industries. Now is the time for Africa to enter a new era of higher-quality medical self-reliance, with the inauguration of the African Export-Import Bank's Medical Centre of Excellence in Abuja undoubtedly a step in the right direction.





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# Africa after COVID-19: Refurbishing Research Systems to Solve Homegrown Challenges



## Tayo Akinwande

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Despite the warnings levied by public health officials after previous viral disease outbreaks such as Ebola and the H1N1 flu, the coronavirus still managed to wrong-foot governments the world over, hastening the rapid, globe-encircling spread of COVID-19. The proliferation of infections led nations to pause economic activity and industrial production, and put untold stress on global supply chains. Critical goods, especially medical supplies, had to be rationed, even in the developed world. Even vital medical treatments had to be suspended and rationed in many instances, to say nothing of those people who could not be diagnosed and treated for other illnesses while healthcare systems were overrun with COVID-19.

The pandemic has laid bare African countries' weaknesses in protecting their citizens. Beyond healthcare, the COVID-19 crisis has unmasked, too, the fragility of Africa's security,

infrastructure and financial systems. And while infection and mortality rates have been less pronounced in the region than in, for example, the US or Western Europe, the pandemic's impact cannot be understated.

The consequences have been especially devastating in terms of public finance and welfare. Africa's technology gap with the rest of the world is widening, and the region depends excessively on primary commodities and natural resources for fiscal revenues and foreign exchange earnings. Both of these factors have been major drivers of persistent intergenerational poverty and recurrent balance of payments crises.

At the time of writing, vaccines are beginning slowly to be distributed in some parts of the world, and there is light, however dim, at the end of the tunnel. But COVID-19 continues to rage in most places, and it is important to raise questions about what comes next and how African countries should plan for the post-pandemic era.

Those questions must certainly include the following:

- How long will it take African national economies to recover?
- How long will it take for Africa’s public healthcare systems to convalesce?
- What must be done to prepare African countries better for future pandemics?
- How do African countries use the lessons from this crisis as a platform for innovation and to stimulate dynamic, competitive economies?

### **Resourceful, ingenious, local solutions**

Despite the magnitude of the challenges posed by the pandemic, African researchers were able to respond and innovate effectively, developing local solutions to the technical trials and tribulations of monitoring and treating COVID-19.

In the later stages of infection, symptoms often include severe respiratory distress, which frequently requires putting a patient on a ventilator. At the height of the pandemic, there was a global shortage of ventilators, and it was unclear whether Africa was ever going to get access to sufficient supplies to treat patients in intensive care units. There besides, it wasn’t always clear whether the ventilators available on the open market would suit African hospitals, which must often deal with inconsistent power supplies

and a scarcity of trained personnel. Many ventilators on the open market are ‘overdesigned’ and necessitate specialised training for staff.

The response from researchers and engineers in African universities was ingenious. First, they focused on developing a fundamental understanding of the mechanism involved in helping a patient with respiratory distress breathe. From that point, they were able to propose solutions using readily available local materials. A team from Nigeria’s Bayero University Kano designed a ventilator that was based on an emergency ventilator (‘e-Vent’) concept devised at MIT, but which included several important and creative alterations. Rather than relying on expensive and difficult-to-procure motors used in commercial ventilators, the BUK team was able to adapt windshield-wiper motors to their design, as well as rewrite from scratch the e-Vent’s control algorithms. The engineers and medical experts at the university were able to complete the project, from the initial concept design to demonstration of the prototype, in just one month.

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African researchers were able to respond and innovate effectively, developing local solutions to the technical trials and tribulations of monitoring and treating COVID-19.

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In addition to BUK, four further Nigerian universities were responsible for several other ventilator solutions that make use of local materials. This is extremely encouraging, as it demonstrates the capacity of African research scientists and engineers to develop solutions to the unique problems confronting the continent while leveraging global resources.

Another area that the pandemic has helped crystallise is telemedicine, especially the remote monitoring of patients with COVID-19 but who are not sick enough to require hospitalisation, while keeping them away from patients who do not have the disease. It quickly became apparent that employing a simple electronic device that monitors temperature, pulse and blood oxygenation levels, and which can be connected to a patient's mobile phone via Bluetooth, would be effective when allocating scarce healthcare resources. Using practically ubiquitous mobile telephone technology, healthcare workers are able to simultaneously collect data and communicate securely with their patients.

Designing these telemedicine systems went a lot further than just providing hardware; researchers in Africa were also able to incorporate artificial intelligence. They explored machine learning algorithms to monitor patients' progress and trained a deep neural network using data gathered from local hospitals and other sources. This architecture

could drastically reduce the cost of healthcare delivery in both Africa's urban centres and its rural areas.

A third area in which innovation has shined through is education. Some private universities have migrated their classroom instruction into online domains, with professors able to conduct lectures and tutorials remotely. Perhaps what was most innovative was the introduction of hands-on experiences and classroom demonstrations through the use of videos that often were prepared by institutions in Europe and North America. This also helped expand students' horizons, as they could access online materials prepared by those institutions. It also led to experimentation with the 'flipped' classroom concept, in which students watch pre-recorded lectures before coming to class for further discussions.

The steps taken in these three areas – ventilators, telemedicine and education – illustrate beyond a doubt the capacity of African research scientists and engineers to conduct multi-disciplinary, mission-oriented research that addresses urgent, complex problems. The experience of the COVID-19 crisis and the spotlight shone on African innovators should enable us to identify the areas that require and are most deserving of increased investment. If this process is conducted effectively, universities and research institutions throughout the continent could grow into engines of innovation and entrepreneurship,

creating value and dynamic national economies that can compete in a globalised world.

### **Reorienting education and emboldening research**

Three components are necessary to create African innovation engines: first, there must be a platform that encourages and supports mission-oriented, multi-disciplinary research; second, specialists must be trained in Africa who can create, execute and deliver on these research programmes; and third, there must be infrastructure in place for efficient technology transfers, from research laboratories into the hands of consumers, with a keen focus on achieving success for the overall public good.

In order to cultivate the necessary personnel, our education systems must be reoriented from simply information transfer to a focus on critical thinking and innovation. This must include new approaches to assessing student competence – the current model, that of evaluating what students are able to remember (or rather to regurgitate) through annual examinations, is no longer suitable. Though it would necessitate serious curriculum reforms, schools should incorporate independent projects about real-world problems that bring together all the elements a student has learned in the classroom into their appraisals.

This reorientation must occur at all levels, beginning, I would argue, with

tertiary education, the objective of which is to promote the development of critical thinking and open-ended problem-solving. Practical reforms can then be propagated at the secondary and primary education levels.

At the research level, the agendas that African scientists, engineers and designers pursue should be motivated to resolve the greatest challenges facing societies throughout the region. To delineate what exactly those challenges are, we must paint a picture of the type of Africa that we want to live and work in 10 years from now and in the distant future. There are myriad projects to aspire towards, from universal health coverage and energy ubiquity, to building a green economy and supporting environmental protection. Having goals like these in mind will spur developments in cutting-edge technologies, including biotechnology, nanotechnology and artificial intelligence, among others.

It is important, too, that graduate students, while working on problems relevant to African societies, are competitive globally and remain in close contact with their peers in other parts of the world, be that through publishing in top journals or participating in conferences. Enabling researchers to spend extended periods of time in top laboratories in Western Europe, North America, Japan, South Korea and China would also prove invaluable for cross-border knowledge transfer.

On the issue of knowledge and especially transfer in Africa, the most important issue is to provide adequate access to capital intended to promote a culture of innovation and entrepreneurship. Simultaneously, university graduates and researchers must be emboldened to take the plunge and bring their products and innovation to market. Encouraging corporate involvement in education, particularly in research through industry mentorship of students, could open new and exciting avenues for graduates. Within the academic realm, insights and guidance provided members of the African diaspora who hold research positions in reputed, overseas universities and corporate laboratories would prove doubly beneficial and relevant to Africa's up-and-coming innovators.

Practically speaking, it would behoove African policymakers to encourage industry to invest more resources in research and development, perhaps through mechanisms such as tax credits or the matching of grants to pay for precompetitive research. Equally important will be the building of a robust intellectual property infrastructure – modelled, for instance, on the European Patent Organisation – including the legal framework that will make intellectual property accessible throughout the continent. Likewise, universities and research institutes in Africa must be encouraged to develop a culture of technology transfers, including the establishment of technology licensing offices.

The COVID-19 pandemic has illustrated plainly the challenges Africa faces and illuminated the fault lines in its existing socio-economic infrastructure. But Africans' response to the crisis has revealed, too, their incredible capacity for ingenuity and innovation. The work done by researchers, engineers and designers to transcend various constraints is deeply admirable. They have demonstrated definitively how deserving they are of greater support.

If Africa is to harness the creativity of its scientists and engineers to devise sustainable solutions to local problems, it is critical that we create and incentivise an effective and globally competitive research ecosystem. The alternative scenario – wherein the COVID-19 crisis is just one manifestation of Africa's existential challenges, from healthcare to industrial development and widening inequality – does not bear thinking about.

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University graduates  
and researchers must be  
emboldened to take the plunge  
and bring their products and  
innovation to market.

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# Building a Better Future of Work for Resilience and Growth in Post-COVID-19 Africa



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**Abstract:** The COVID-19 global pandemic has brought unprecedented disruptions to the global economy and is already having a tremendous impact on welfare and livelihoods in Africa, reducing earnings and increasing poverty. As stabilisation begins to take hold, economic leaders are developing strategies to ‘build back better’. While all African countries’ economic development strategies in the past have focused on transformation as the key to sustained and inclusive growth, COVID-19 has placed a new spotlight on resilience as an equally important economic outcome. Strategies are necessarily context-specific, but we identify two important approaches to increasing resilience: encouraging the entrance of new, large firms in order to accelerate the creation of new stable formal employment opportunities, and developing the agricultural sector and the AFS in order to increase earnings and resiliency in the informal sector. Success in both approaches would improve employment opportunities across Africa.

**Keywords:** Future of work, COVID-19, employment, agriculture, resiliency, transformation

## **1. Introduction**

The COVID-19 global pandemic has caused an unprecedented disruption in the global economy, which is

already having a tremendous impact on welfare and livelihoods in Africa, resulting in Africa’s first recession

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in 25 years. Businesses survival is threatened, and households have already experienced reduced earnings and increased poverty and food insecurity. The impact differs among countries and sectors, but the main labour market effect in low-income countries (LICs) and lower-middle income countries (LMICs) has been a decrease in earnings (income) and an increase in underemployment (reduced hours) rather than outright unemployment. Only in the richer middle-income countries (UMICs, e.g. South Africa, Tunisia) has open unemployment increased substantially.

During the Great Recession that followed the global financial crisis of 2007, to the surprise of many, African low and lower-middle income economies did not suffer the decline that other regions did (Filmer and Fox, 2014). While economic growth in all developing countries averaged 1% in 2009, for the LICs and the LMICs in Africa, average economic growth was about 4.5%, and rose to 6.5% in 2009. Earnings and consumption continued to rise after 2009, and the share of the population in extreme poverty continued its slow decline. Several factors explain this result, including higher prices and continued demand from China for Africa's commodity exports, as well as fiscal space following debt forgiveness in the early 2000s. Africa's large informal economy represented a strong point in the response to the recession, as household farms and firms continued to supply the domestic market in

the face of higher food prices and increased domestic demand.

Africa has not been as fortunate this time – the pain is evident. African governments have already taken steps to limit the economic repercussions from the global economic and health shocks; now the discussion is around how to 'build back better'. What does this mean for African livelihoods – for employment opportunities and the livelihoods of the large and young working population? In this article we argue that African leaders need to move the focus of their economic policy beyond the traditional objectives of macroeconomic stability, growth and continued economic transformation to building up resiliency – the capacity to rapidly return to an earlier trajectory after a shock. In the future, African countries are likely to face an even riskier external and internal environment. The probability that there will be shocks with major social and economic impacts requires a nimbler economic policy apparatus, one that not only sets development targets but plans for future shocks (be they weather shocks, a pandemic, or an external economic event) and equips key economic actors to navigate them when they arrive. Often, resiliency implies the capacity to adapt to the 'new normal' and to develop new approaches to mitigate the impact of future shocks.

The measures countries should undertake to improve employment opportunities within a more resilient

economy are context-specific. In this paper, we highlight two strategies relevant to the continent as a whole: (a) using deregulation to create more formal wage employment opportunities by encouraging the development of medium and particularly large, exporting firms, and (b) supporting informal livelihoods – a source of resilience during the previous global recession – through investment in agriculture and in the agro-food system for export and domestic consumption. Both strategies would be enhanced by accelerated progress on the African Continental Free Trade Agreement (AfCFTA).

Our paper is organised as follows. First, we review the macroeconomic and welfare impact of the COVID-19 shock in Africa, highlighting differences among countries in terms of the initial impact and policy response. Next, we discuss the evidence to date of the impact of the shock on employment and earnings. We then discuss the opportunities COVID-19 brings for a ‘better livelihoods’ scenario in Africa, focusing on why the twin objectives of returning to the economic transformation path and increasing resiliency matter. Finally, we highlight some strategies that could be pursued to enhance resilience and speed up transformation, leading to improved income earning opportunities for all.

## **2. The macroeconomic impact of COVID-19 in Africa**

As the COVID-19 pandemic spread globally, African countries faced both a public health crisis and an

economic shock. To curb the spread of the pandemic, in March 2020, African countries followed the lead of Asian, European and North American countries and imposed lockdowns, movement restrictions and social distancing requirements, which caused major declines in economic activity (Teachout and Zipfel, 2020). Meanwhile, negative external shocks were increasing. The COVID-19 pandemic disrupted global supply chains and overall global demand for goods and services dropped precipitously. Global trade declined by 3.5% during the first half of 2020; this was mostly due to the immediate shock from the global travel restrictions instituted by various countries in efforts to curb the spread of COVID-19 (IMF, 2020 a-b).

The consequences have been grave. The World Bank projections for SSA released in October 2020 anticipated a 3.3% contraction of GDP in 2020 for the subcontinent, with over 40 million people who could be forced into poverty (World Bank, 2020). For North Africa, the African Development Bank estimated a loss of 5.2% in 2020, compared to pre-COVID-19 projections (African Development Bank, 2020). The tourism industry in Africa is among the hardest-hit sectors. The AU Commissioner for Infrastructure and Energy reported that as of July 2020, all of Africa had lost almost \$55 billion in travel and tourism revenues (Reuters, 2020), putting the 24.3 million jobs



supported by the tourism industry at risk, including jobs ranging from hotels and catering to handicrafts and excursions (Signé and Gurib-Fakim, 2020). While African carriers are starting to resume the domestic and intra-African flights that were suspended in March, international travel arrivals remain limited.

Most countries are facing fiscal challenges. The downward spiral of economic activity led to a drastic decline in domestic demand for goods and services, especially in sectors such as transportation and manufacturing for local markets (e.g. food and beverage) (Teachout and Zipfel, 2020), causing revenues from indirect taxes to fall. Prices of hydrocarbons, basic metals and other commodities have also declined, reducing export earnings. As a result, many African countries have experienced a decline in tax revenue, and 2020 fiscal deficits in SSA almost doubled, going from -4% in 2019 to about -8% (IMF, 2020b). The countries that experienced the largest increase in fiscal deficits were resource-intensive countries and tourism-dependent countries (IMF, 2020b). Though African countries were initially projected to start experiencing a decline in public debt levels due to fiscal consolidation, the COVID-19 pandemic has resulted in an increase in public debt levels from around 55% to 65% of total GDP in Sub-Saharan Africa (IMF, 2020b). Mozambique, a country that was already struggling with a debt-to-GDP ratio of 100% in

2018, experienced an increase and reached a debt-to-GDP ratio of 130%, which is clearly unsustainable; Angola, Congo, Egypt, Cabo Verde, Congo and Djibouti also have external debt-to-GDP ratios over 100%, which makes controlling their fiscal deficits during the pandemic almost impossible (Sallent Mickaël, UN, 2020). Additional financial constraints were created by a decline in foreign direct investment (FDI) inflows and in remittances – a critical source of financing for many African countries.

With the exception of South Africa, Africa has experienced lower cases of COVID-19 infections and death than other regions. Evidence has trickled in that outside of capital cities, movement restrictions were implemented sporadically; few markets actually closed, although transit slowed substantially. Some African countries were more successful than others in implementing health sector responses. For example, Nigeria was the first African country to discover the genetic sequence of the SARS-COV-2 virus, while countries like Senegal, Ghana and Kenya made progress in researching potential solutions to the virus (Youssef and Mare, 2020). Overall, Africa's health systems are poorly equipped to handle the pandemic, but countries like South Africa managed to respond quickly with projects to improve the capacity of its public health care system through collaboration between the public and private sectors (McKinsey,



2020). Cooperation among various African leaders, the Africa Centres for Disease Control, and other AU agencies resulted in a substantial increase in COVID-19 testing and in the coordination of policies to fight the spread of the virus (Signé et al., 2020).

A resurgence of cases in many developed countries continues to threaten African economies (IMF, 2020b). Uncertainty regarding economic recovery remains, and African governments lack funding to adopt expansionary fiscal policies. Despite emergency financial assistance from international financial institutions, securing financial resources to stop the contraction and improve employment and earnings remains one of the biggest challenges facing the continent.

### **3. Impact on the labour force – employment and earnings**

African labour markets and employment opportunities are as heterogeneous as the countries they belong to. Most of the labour force makes a living in household production – family-owned-and-operated farms and micro-enterprises, which rarely employ anyone outside the family (Filmer and Fox, 2014). For most, this represents a vulnerable form of employment, as the risk of low earnings or earning loss is high, even though income in the sector as a whole is less vulnerable to external shocks. While the share of employment outside this sector, earning a wage

or salary, has been growing as new formal (and semi-formal) firms are created in LICs and LMICs of Africa, wage employment is not an option for the majority of the labour force. Prior to the onset of the COVID recession, the share of employment in wage-earning jobs in Africa was:

- 15% employment in LICs;
- 20%-35% in SSA LMICs – the lower rate in mineral-rich countries;
- 50%-70% in North African LMICs (generally richer and more industrialised than SSA LMICs); and
- 65%-80% in SSA UMICs – the higher rate in South Africa.<sup>2</sup>

In LICs, the majority of time spent working in the informal (household production) economy is on farms, but as countries get richer, farm employment as a share of total hours worked in the informal sector declines in favour of non-farm employment in petty trade, food and beverage service, transport, other services, and craft manufacturing – small-scale agro-processing, furniture-making, etc. (Filmer and Fox, 2014). By contrast, in Africa’s UMICs and North African LMICs, especially the non-oil exporters, the private enterprise sector expanded over the last 50 years, offering new employment opportunities, while labour force growth slowed, allowing most of the labour force to secure wage employment and countries to reach upper-middle-income status.

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## African labor markets and employment opportunities are as heterogeneous as the countries they belong to.

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Rapid response surveys find that most households, regardless of their source of labour income, have been hit with some income loss (Capital Business, 2020). Data suggest that the losses were worst in the second quarter of 2020, and that by the third quarter employment and earnings had started to recover. For the continent as a whole, the ILO estimates that 10% of labour income was lost in the first three quarters of 2020; the highest rates of income loss were in Northern and Southern Africa, and were associated with a sharp jump in unemployment, not surprising given the high share of wage employment in these regions (ILO, 2020).

Employment status – farm, non-farm informal, or wage-earning – has affected the severity of income loss. Incomes earned in the non-farm informal sector have suffered the most, as these were highly affected by partial or total lockdowns in urban areas. Some estimates place second-quarter income losses among informal traders and service providers at 80%, although these incomes began to recover as movement restrictions were eased (Gates Foundation, 2020). Farm incomes suffered initially owing to an inability to access markets, but as transport patterns have recovered

2. Data from World Development Indicators, 2020.

farm incomes have also recovered. Many wage earners have been able to work from home, or, in the case of temporary factory closures, received partial pay. For example, one-quarter of wage earners in Ethiopia stated they suffered a temporary loss of pay by June 2020 but most did not lose their job outright (Weiser et al., 2020).

Tourism and tourism-related sectors (air transport, hospitality) suffered the highest job losses and are projected to continue to struggle at least through 2021. Construction has also been hard hit, as has the oil-exporting industry (although this is not a major employer) and retail trade. In every country, job and income losses have been higher among women. This reflects (i) their concentration in sectors such as tourism, retail and garment manufacture, where the drop in demand has been highest, and (ii) the need to reduce work hours to take care of children who are out of school and at home (ILO, 2020). Youth and older workers have been more likely to lose their jobs or part of their income. Youth entering the labour force in 2020 and 2021 are likely to suffer lifetime income losses. North African countries and South Africa both had extremely high youth unemployment rates (around 30%)

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Youth and older workers have been more likely to lose their jobs or part of their income.

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before the pandemic hit owing to formal job creation lagging behind the growth of the labour force, so youth were already very vulnerable (AfDB, 2018).

As a result of job and income losses, the African Development Bank estimates that 37.5 million additional people will enter extreme poverty in 2020, and this could reach 49.2 million by 2021 (AfDB, 2020). About 60% of the people newly entering extreme poverty are expected to live in West and Central Africa. Nigeria and the DRC are both expected to see large increases in this category, the former in part as a result of income losses caused by the decline in oil prices and demand.

Numerous countries have shown that there can be no full economic recovery until the pandemic is tamed. The most recent projections from the IMF, the World Bank and other sources all point to a recovery in 2021 for most of the continent (IMF, 2020 a-b; World Bank, 2020). Demand-induced falls in earnings and employment will recover as economies recover in 2021. The favourable outlook for the region is tempered by much weaker prospects for some countries and regions. Highly tourism-dependent countries, such as the island nations, and even moderately tourism-dependent countries such Ethiopia (air transit), Kenya, Morocco and South Africa will take longer to recover, as will oil-exporting countries, owing to expected continued soft demand and prices (e.g. Angola, Gabon, Nigeria,



Ghana, Republic of Congo, South Sudan). Conflict-affected countries such as Libya and South Sudan will struggle until a political settlement is reached. Countries whose economies were already weak in 2019, such as Tunisia and South Africa, may not see per capita income growth in 2021 either.

#### **4. The case for resilience and transformation**

As the global economic effects of the pandemic begin to wane in 2021, African governments can move beyond the exigencies of stabilization and attempt to return to their growth path. In doing so, they will inevitably face a post-pandemic ‘new normal’. The world over, countries are vowing to ‘build back better’. In Africa, this has to mean an inclusive development path focused on improving employment opportunities. Emphasis needs to be on raising productivity in the informal sector – especially in countries where wage employment is a low share of total employment – while increasing the pace of formal job creation. In this paper, we highlight the importance of the twin goals of transformation and resilience to improved economic outcomes, and two key focus areas – deregulation and investment to accelerate the entrance and growth of new large firms and thus to boost the growth of wage-earning employment opportunities, and the development of the agro-food system (AFS) – as levers in meeting the ‘build back better’ challenge. Efforts in both areas would be enhanced by, and

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The quality of employment opportunities in the post-COVID-19 era in African countries will depend on two key economic trends: the rate of economic transformation, and country resilience.

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benefit from, faster progress toward the AfCFTA.

The quality of employment opportunities in the post-COVID-19 era in African countries will depend on two key economic trends: the rate of economic transformation, and country resilience. Economic transformation refers to two linked development processes: structural transformation – the shift of workers and resources from low productivity sectors to higher productivity sectors through the more rapid entry and growth of firms in the higher productivity sectors – and sectoral transformation – the growth of productivity within sectors, especially the lower productivity ones. Economic transformation makes possible the growth of labour earnings in the economy as well as the transformation of employment from self- and family-employment in household farms and micro-businesses to wage employment in private firms (or the public sector). Economic transformation sustains economic growth (McMillan et al., 2017). Resilience refers to the capacity of the national economy, as well as

regional, community and household economies to dampen and recover from shocks, including by adapting to a 'new normal'. Resilient countries can grow and transform faster.

Economic and employment transformation have been key economic development policy goals in Africa since independence, with mixed success.

- North African countries and South Africa have realised the most extensive transformation. They have diverse economies, with a lower share of agriculture in GDP and higher productivity in the sector, as well as a higher share of manufacturing in output and employment, a more developed service sector, and more diverse exports. Consequently, the share of wage employment (formal and informal) in total employment is high, and productivity differences between sectors are lower. However, the pace of transformation in these economies has slowed over the last 15 years, which has reduced the growth of wage employment opportunities, especially for new entrants (mostly youth).
- Across the region, the LIC countries are the least transformed, with high informal employment rates, low productivity and large gaps in productivity between formal firms and the rest of the economy.
- The Sub-Saharan Africa low-middle-income countries

(SSALMIC) are in the midst of a nascent transformation process, built on rising agricultural output and productivity, which has supported the development of non-agricultural sector output and exports.

- Mineral exporters (oil, gas and hard minerals) have mostly reached LMIC status without significant transformation.

Creating better employment opportunities in the stalled transformers as well as the nascent LMIC transformers will require economic restructuring, and investments in resilience can help.

COVID-19 has placed a new spotlight on resilience as an equally important economic outcome. Risk is a feature of life, and when a negative risk materialises, the effects of the shock and its aftermath can be profound. The importance of resilience to sustained economic growth is depicted visually in *(Figure 1)*. During the 1980s and 90s, Sub-Saharan Africa (SSA) experienced declining per capita growth as struggles with macroeconomic management, governance and the debt overhang held back progress and caused growth to be highly volatile. During downswings, incomes and assets were reduced, and had to be built back up again once the economy was put back on track; downswings erased the gains of upswings. Since about 2000, per capita income has steadily increased despite population

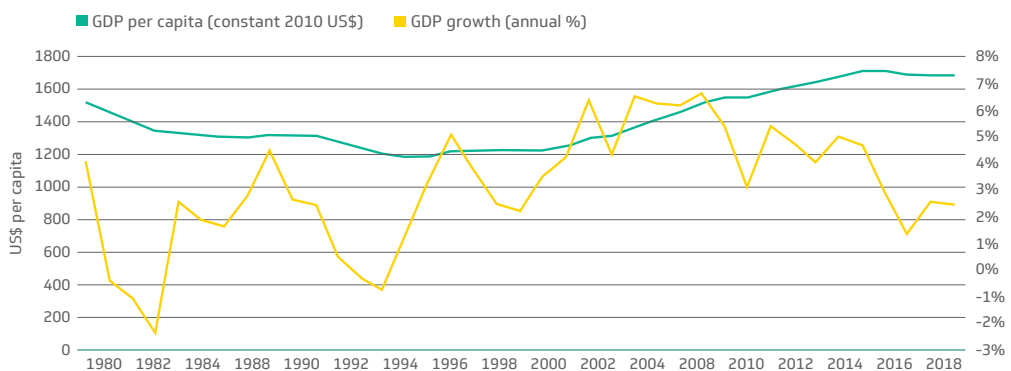
growth headwinds of about 2.8% per annum. SSA achieved and sustained this growth in part by becoming more resilient as downswings became less pronounced. Between 1982 and 1999, the annual growth rate fell below 2% seven times, but has done so only once since 2000 (in 2016).

By contrast, North Africa experienced consistent and positive per capita income growth from 1985 up until the 2007-8 financial crisis and global recession, allowing sustained increases in GDP per capita.<sup>3</sup> Subsequent to the recession, North Africa suffered from anemic growth, caused in part by the Arab Spring, until about 2015. The sustained economic decline between 2008 and 2014 in response to the global economic crisis and the political disruptions of the Arab Spring erased

some gains from the past. After that, until the pandemic hit, growth was on the upswing once again and incomes had started to recover (AfDB, 2018).

Economic historians have documented the importance of resilience (avoiding economic decline) in the amazing progress of the U.S. and Western Europe since the industrial revolution (Broadberry and Wallis, 2017) as well as in China's progress over the last 40 years (Fang et al., 2018). Several factors have been cited as critical for developing this resilience, including political stability (including avoiding civil conflict), economic diversification and transformation, and human capital development. However, an overarching factor is the quality of political and economic institutions. These don't have to be perfect (Rodrik, 2015) but they need

**Figure 1: Sub-Saharan Africa: Real GDP per capita (left axis) and GDP per capita growth (right axis), 1980–2018**



Source: WDI, 2020

<sup>3</sup> North Africa can reach positive per capita growth at lower levels of overall economic growth because of much slower population growth (about 1% in Morocco and Tunisia; almost 2% in Egypt).



to provide a clear set of 'rules of the road' and facilitate cooperation among interest groups so that when a shock arrives, solutions can be identified and pursued to allow a faster recovery, return to growth, and investments to mitigate the effects of future shocks. This matters not only for externally-induced shocks but also for national or regional ones such as a drought or flood, or a regional economic downturn.

Resilience facilitates transformation because structural and sector change requires innovators and new entrants – entrepreneurs who disrupt a market with new products or new, more efficient ways of making old products. Impersonal institutions as well as open and transparent regulations are needed to ensure that potential disrupters can get access to finance, land and the required government permits to move ahead with their plans. For example, mobile phone companies have been able to disrupt the slow, sleepy fixed-line telecommunications market-owned and occupied by legacy telecoms companies in Africa because they have been able to access the broadband spectrum and land for cellphone towers. Countries that have encouraged competition and new entrants in ICT while protecting consumers with inter-operability requirements and lifeline tariffs see lower prices and broader usage (Robb and Paelo, 2020). Likewise, the development and rapid spread of mobile money was facilitated by regulators' encouragement of



innovation, as opposed to their protecting the vested interests of established banks.

Post-COVID-19 economic development policy needs to focus more on resilience – on avoiding downswings – not only because of the harm downswings create, but because it is widely agreed that in the future, African economies will face growing exposure to external shocks. Exposure to climate shocks caused by global warming threatens the payoff from past economic development investments (Buhang et al., 2015), especially in rural areas (IFAD, 2019). COVID-19 is not the only zoonotic disease to affect African economies recently; the Ebola outbreak in 2016 caused significant economic damage. Increasing globalisation, urbanisation, and human-animal contact are all expected to increase the pandemic threat.<sup>4</sup> Civil conflict and decreased security stemming from simmering conflicts and domestic terrorism has been on the rise in Africa and has had far-ranging negative economic effects from all across the continent. Conflict and fragility erode existing social and economic infrastructure, raising the cost of doing business and fragmenting markets. Many shocks cannot be prevented; resilience helps households, communities and nations establish coping measures to minimise long-term effects and invest for future mitigation.

Building back better thus means supporting economic transformation

and the growth of new formal wage-earning opportunities, and developing the livelihoods of those who cannot gain formal wage jobs – that is, supporting and developing informal sector activities on and off the farm.

### **5. Two priorities: supporting the entrance of large firms and developing the agro-food system (AFS)**

The best way to increase good jobs (formal sector wage jobs) and a resilient economic transformation is to encourage the entrance and growth of large firms (Ciani et al., 2020). Large firms play an outsized role in economic transformation and employment creation since they tend to use newer technology, pay higher wages and are more likely to export. They push transformation forward and support resiliency because they are better able to weather economic storms. They often structure the market for medium and smaller firms operating in related sectors who will be their suppliers and retailers, thus helping to ensure their survival as well (for example, the large automakers in the U.S., Europe, Japan and Korea structure the auto parts supply market). Most large firms (those employing over 100) start off large, although a few start as medium-sized firms (20-50 employees) and grow (Ciani et al., 2020). Small firms do not grow large; a firm that starts with fewer than 20 employees has a less than 1% chance of growing to over

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4. <https://www.gavi.org/vaccineswork/5-reasons-why-pandemics-like-COVID-19-are-becoming-more-likely>

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Large firms play an outsized role in economic transformation and employment creation since they tend to use newer technology, pay higher wages, and are more likely to export.

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100 employees, even if it survives its first five years (which they most often don't). This raises questions about whether promoting 'youth entrepreneurship' is an effective employment strategy (Fox et al., 2020).

In developing countries, some large firms are started by wealthy domestic investors or investor families; others enter through foreign direct investment (FDI). What is important is that to play their dynamic role, large firms need to be kept on their toes through constant competitive pressures to innovate, either from inside the economy or from potential importers. Unfortunately, evidence suggests that this does not happen. Through political alliances between owners of large domestic firms and the government, African countries protect their large firms using regulation, application of excessive red tape to potential new entrants, exclusion from government promotion and procurement programmes, etc. As a result, analysis of enterprise survey data showed that after 35 years in operation, firms in Tunisia and Egypt barely increased their productivity, while firms in other

LMIC and UMIC countries doubled or tripled their productivity over the same period (Schiffbauer et al, 2015).

This protection of existing 'elephant' firms reduces good job creation (Schiffbauer et al., 2015), as well as resilience, because it stifles the innovation necessary to adapt to the changing world economy. Some policymakers worry that failure to protect domestic firms from competition from FDI will prevent a domestic entrepreneurial class from developing. However, this perception ignores the dynamic effect that a large foreign firm can play in an economy, by bringing in new technology and skills, as well as structuring suppliers' markets, encouraging the growth of new young firms in these areas. Less 'policy capture' by large firms – meaning less discretionary regulation, equal access to infrastructure and finance, equal and impartial treatment by the judiciary and tax authorities – would encourage the new firms Africa needs to grow good jobs. These new firms would be well-placed to take advantage of the scale opportunities and effective implementation that the AfCFTA would bring.

A second avenue towards increased resilience and transformation, most relevant for African countries, especially LIC and LMIC, is to focus on increasing agricultural productivity-led growth and the development of the agro-food system (AFS). African economic strategy and policy discourse tend to undervalue agriculture as a transformation

pathway, focusing instead on shifting employment and capital out of agriculture – the structural change part of economic transformation. However, ignoring gains from sectoral transformation in agriculture represents a missed opportunity because agricultural transformation through productivity-led growth gets the whole economy moving, especially for LIC and countries at the low end of the LMIC income group (Ivanic and Martin, 2018). It raises incomes in the sector where the poorest people work, increasing demand for goods and services throughout the economy (primarily those provided or sold by non-farm informal businesses) through the multiplier effect (Delgado, 1998). Producing more food lowers its price in urban areas, helping to keep labour costs competitive. Agricultural exports earn the foreign exchange needed to pay for technology and capital imports, especially if production shifts into higher value export crops. The important role of restructured and productive agriculture in the East Asia miracle is one of the most often overlooked aspects of these countries' success, as Joe Studwell explained in his influential book *How Asia Works* (Studwell, 2013).

As the world's population grows and gets richer, demand for food grows, especially for high-value crops and processed food and livestock products. Economic planners tend to focus on Engel's Law, which notes that demand for food is income

inelastic; this can lead to the mistaken conclusion that agriculture is not a key sector for development. But countervailing Engel is Bennett's Law, which notes that as people get richer, their demand for higher-value and processed food grows, as well as for animal proteins, which increases worldwide demand for feed crops, reducing the effect of Engel's Law on the incomes of agricultural producers if their farm systems respond (IFAD, 2019; Dolislager et al., 2020).

Africa's population is projected to double by 2050 and will account for over 80% of the world's population growth during this period. Rapid population growth, rising per capita incomes, and urbanisation are all fuelling a rapid rise in demand for higher-value agriculture products and processed food within Africa. Demand for food within Africa constitutes considerable untapped potential for intra-African trade. The proportion of African countries' food imports originating from other African countries remains very low, consistently averaging about 20% over the past several decades, with South Africa accounting for over a third of this intra-African food trade (Fox and Jayne, 2020). The African Continental Free Trade Agreement (AfCFTA) has great potential to enable African farmers and agro-food system firms to capitalise on the opportunities presented by Africa's rapidly rising demand for food.

Africa can also grow and transform by feeding the world. Available farmland

worldwide is diminishing due to urbanisation, even as population and demand for food continues to grow outside Africa. The animal feed market worldwide is growing rapidly as the growing global middle class consumes more animal proteins. Thailand's Northeast famously eradicated poverty and financed capital imports by exporting cassava chips to Europe for animal feed (Rambo, 2017). Africa could follow this example.

A surprisingly large share of the labour force in Africa still earns at least part of its income from farming, even in the more industrialised countries. For example, a quarter of the employed population in Egypt reports agriculture as their primary economic activity, while 35% in Morocco do, similar to the average in – SSALMIC countries (40%; WDI 2020). Raising incomes through increased labour productivity would thus benefit a large share of the employed population. It would increase household and community resilience to shocks in rural areas, reducing poverty traps and income inequality.

Cross-country evidence suggests that as agriculture becomes more

productive, using less labour, productive employment in the off-farm AFS – input supply, sale and rental of farm inputs and machinery, post-harvest transport and storage, food processing and sale, etc. – grows, fuelling structural and employment transformation (Dolislager et al., 2020). A productive and commercially-transformed family farming sector provides raw material for agro-processing industries, a segment of manufacturing where African countries could compete in world markets (Page, 2020), and also creates an active input supply sector (production and distribution). North Africa and RSA already export a variety of fresh fruits and vegetables to the Northern hemisphere. Agro-processing contributes substantially to GDP and exports; for example, Tunisia is one of the world's largest exporters of olive oil while South Africa exports processed fruits, nuts, juices and wine.

Achieving this goal will require African food value chains to become more internationally competitive, by raising on-farm productivity, lowering the costs of production and distribution to cities and small towns, facilitating



private investments in value-adding activities such as food processing, and most importantly, by reducing trade barriers between their own countries – a key requirement for success of the AfCFTA as well (Fofack, 2020). A range of public investments would support this process, including investments in transportation and logistics infrastructure to reduce costs of getting products off the farm and into markets. Investments in public agricultural research and development (R&D) are key to accelerating transformation, but Africa has fallen short in this area (Fuglie et al., 2019). Embracing new technology such as blockchain to enhance quality assurance and improve export logistics would help as well (AfDB, 2018).

## **6. Conclusion**

Africa's challenges in the post-COVID-19 era loom large. Restoring livelihoods and growing incomes is a key element of the 'build back better' agenda. We have argued that, in the past, both inclusive transformation and economic resilience increased African living standards, and they can do so once again. African

development strategies and policies have to pay attention to both parts of the economy – formal and informal livelihoods – along the dimensions of both transformation and resiliency. While all African countries' economic development strategies in the past have focused on transformation as a key outcome, COVID-19 has placed a new spotlight on resilience as an equally important economic outcome. Strategies to achieve these twin objectives will be context-specific. Two approaches highlighted here are encouraging the entrance of new, large firms in order to accelerate the creation of new stable formal employment opportunities and developing the agricultural sector and the AFS in order to increase earnings and resiliency in the informal sector. Success in both strategies would improve employment opportunities across Africa. Both strategies would be facilitated by regional and continental efforts to promote intra-African trade through the successful implementation of the AfCFTA (Signé and van der Ven, 2019; Fofack 2020). A successful AfCFTA could enhance continental resilience to future shocks and disruptions.

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# How Currency Risk Management Can Boost Access to Trade Finance in Africa



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**Abstract:** Access to trade finance is one of the most significant binding constraints to the growth of African trade. Across Africa, this constraint has been exacerbated by a shortage of US dollar liquidity, since the dollar remains the preeminent currency used to settle trade transactions. This paper argues that if development finance institutions increase the supply of synthetic local currency trade finance instruments, this could shield companies from risks associated with currency depreciation and boost both access to trade finance and economic growth in Africa.

**Keywords:** Currency risk management, local currency markets, synthetic local currency loans

## 1. Introduction

Access to trade finance has been one of the most significant constraints to trade in Africa. According to the World Economic Forum's 2015 Executive Opinion Survey, a representative sample survey of business leaders, lack of trade finance is the leading concern for top manufacturing-value-added countries such as Nigeria, Morocco, Algeria and Côte d'Ivoire.<sup>1</sup> The difficulties of financing trade in Africa have been exacerbated

by African entities' excessive reliance on foreign currency, especially the US dollar, which is used in more than 45% of trade transactions. In addition to liquidity constraints, which often are accentuated by recurrent balance of payment crises, the excess reliance on dollars exposes countries to foreign exchange risks.

This paper seeks to understand the role of foreign exchange risk in

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**1.** With the exception of Uganda, South Africa and Egypt, lack of trade financing is a top issue for exporters of commodities, natural resources, and manufactured goods. Among the 10 leading intra-African exporter countries that responded to the Executive Opinion Survey, access to trade finance is the top concern for Senegal, Lesotho, and Malawi and the no. 2 concern for Kenya, Namibia and Zimbabwe. The World Economic Forum's Enabling Global Trade reports in 2014 and 2016 rank access to trade financing as the most problematic factor for exporting for most African countries, followed by identifying potential markets, meeting quality/quantity requirements of buyers, access to imported inputs at competitive prices and high costs of domestic or international transportation.



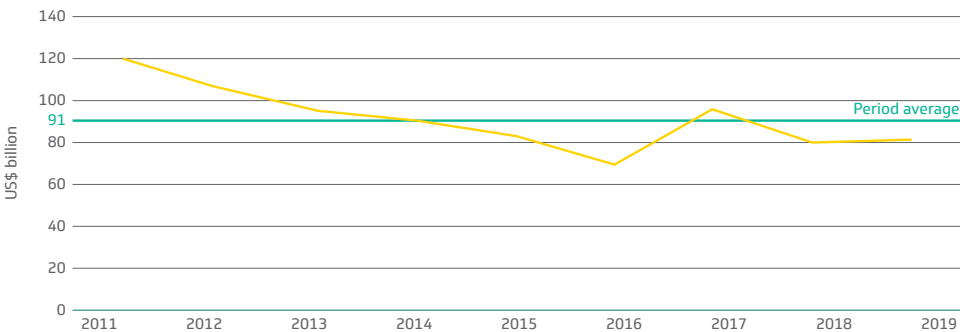
the availability of trade finance. It advocates that if development finance institutions (DFIs) increase the supply of synthetic local currency trade finance instruments, this could shield companies from risks associated with currency depreciation, and thus boost access to credit. The paper first discusses challenges to financing trade in Africa, such as liquidity constraints, currency risk, credit risks, and an overall perception of inflated risk. It next articulates a framework for addressing currency risks to boost trade finance in Africa and describes the benefits of synthetic local currency trade finance instruments. Lastly, it discusses the potential implications of these instruments, and their benefits for financing of trade across the region, for large and small companies alike.

## 2. Challenges to financing trade in Africa

As much as 80% of global trade is supported by some type of financing or credit insurance (World Trade Organization 2016). Banks and other financial institutions act as intermediaries between the buyer and seller, to manage various risks that arise from the gap between the payment for and the delivery of goods. Efficient and fair access to trade finance allows the seller to reduce payment risks and the buyer to reduce delivery risks during the shipment of goods.

Africa has a large trade finance gap that affects its companies' access to affordable trade finance and ability to integrate into global supply chains. In 2019, only one-third of the continent's total estimated US\$82

Figure 1: Trade finance gap by year



Source: Afrexim-AfDB, Trade Finance Survey 2020

billion in demand for trade finance was met (*Figure 1*). That year, across all regions of Africa, 71% of commercial banks participated in the trade finance market. African trade finance tends to be short-term, low-risk and high-collateral, with an average default rate that is much lower than banks' non-performing loans ratio. So, how can we explain the supply bottleneck for trade finance? Three explanatory factors must be explored – a shortage of foreign exchange liquidity, currency risk, credit risk – and an overall perception of inflated risk on the continent.

In terms of liquidity constraints, the share of US dollar trade invoicing across African countries far exceeds these countries' share of trade with the US for all emerging and developing countries. SWIFT data shows that exports are often invoiced in dollars, even when the destination is in Asia or other African countries. Therefore, any factor that disrupts hard currency liquidity can continue to “harm the prospects for the supply of trade finance in the very locations where the trade potential is greatest” (World Trade Organization 2016).

While hard currency liquidity is essential, domestic private companies in Africa lack access to foreign exchange liquidity and long-term deposits in their own currencies. Foreign exchange reserves should form an integral part of a country's self-insurance against currency depreciation, especially in low-income countries. However, according to the

Bank of International Settlements, the private sector in Africa holds few foreign assets or none that can be easily repatriated in hard times. The median share of foreign portfolio assets in gross domestic product is only 3% in Africa, compared with 11% for emerging markets outside Africa (Bank for International Settlements 2014). Even in non-pandemic times, 19% of African banks cite inadequate foreign exchange liquidity and 20% cite a lack of foreign correspondent banks as top constraints to increasing their supply of trade finance.

Macroeconomic instability, including political and sovereign risk, also tends to put downward pressure on local currencies against the value of hard currencies. With the current decline of foreign counterparties for almost every region in Africa, access to US dollars and dollar clearing is even more difficult.

In response to foreign exchange deficits, African government officials sometimes implement foreign exchange controls and rationing, deploying hard currency reserves for the trade of goods deemed essential to their economy, which pushes up the cost of other non-essential goods. When liquidity is low, both banks and governments favour larger clients or companies over small and medium enterprises and rationing further skews the provision of trade finance away from smaller companies.

The US dollar denomination of Africa's trade finance loans, in addition to

trade in foreign currencies, has also contributed to the continent's reliance on dollar credit conditions and its vulnerability to external shocks. Dollar credit conditions take on a central role in trade finance provision in Africa, because trade finance instruments such as letters of credit are typically invoiced in dollars. While companies operating in countries with developed financial markets can use those domestic banking systems to finance trade, African letters of credit issued by African commercial banks frequently require confirmation lines by global banks or institutions in destination countries. From 2011 through 2019, Commerzbank, Citibank, Standard Chartered Bank, Deutsche Bank, UBAF, Natixis, and Société Générale acted as confirming banks of one-third of all trade transactions originated by African issue banks (African Development Bank [AfDB] and African Export-Import Bank [Afreximbank] 2020). Most companies in Africa rely on these seven global banks for financing of trade.

Without adequate currency risk management, tight global credit

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Dollar credit conditions take on a central role in trade finance provision in Africa, because trade finance instruments such as letters of credit are typically invoiced in dollars.

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conditions combined with exchange rate fluctuations have significant adverse effects for the recipients of trade finance provided by global banks and their subsidiaries.

First, these conditions make existing loans more expensive due to local currency depreciation against the US dollar and rising floating interest rates. Convertibility and transfer risk kick in when the local currency can't be converted to another currency, due to changes in nominal value or capital and exchange rate controls. In addition to the primary credit risk caused by exposure to currency volatility, trading partners also face indirect credit risk from currency conversion when they agree on a future dollar transaction. While African exporters that obtain dollar loans and receive dollar revenue have a natural hedge on their balance sheets, importers that obtain dollar trade finance and local currency revenue retain a mismatch on their balance sheet. During global financial instability or exchange rate fluctuations, an importer could find it difficult to meet dollar-denominated payment obligations, due to a significant devaluation of the local currency against the dollar on liquidity constraints when access to dollars is rationed.

Second, adverse credit conditions combined with exchange rate fluctuations reduce the availability of new trade finance loans and increase financing costs. It has been shown that trade finance flow correlates negatively with the US dollar index

(Boissay et al. 2020). In times of stress associated with strong performance of the dollar, the ‘flight to safety’ effect leads banks and companies in importing countries to cut exposure and credit to particular countries that they perceive as riskier. Bruno and Shin (2015) found that a stronger dollar can reduce cross-border bank lending, such as trade finance, through its impact on the balance sheets of global banks. A stronger dollar also can tighten credit conditions; when currency mismatch is present on a borrower’s balance sheet, a stronger dollar inflates the value of dollar liabilities relative to other assets. From the bank creditor’s perspective, this increases credit risk on the borrower. Hence, exchange rate fluctuations against the dollar affect the lender’s risk-taking capability and the borrower’s access to credit.

Another important characteristic that feeds into the persistent trade financing gaps in Africa is inflated perception of risk as opposed to actual credit risk. Between 2013 and 2019, the average rejection rate of trade finance transactions globally was between zero and 10%, but in Africa was 15%. The most frequently reported reasons for rejections of African applications by public, foreign and local/private banks were client creditworthiness (36%), insufficient collateral (30%) and lack of foreign exchange liquidity (30%), if loan applications were made in US dollars (AfDB and Afreximbank 2020).

Selectivity in risk-taking and ‘flight to quality’ customers are also likely explanations for global banks’ decision to redirect offers of trade finance only to their largest customers in developed countries (Auboin and DiCaprio 2017). From 2015 to 2019, top correspondent banks servicing issuing banks in Africa (such as Commerzbank, Deutsche Bank and Standard Chartered Bank) reported lower shares of correspondent relationships than from 2011 to 2014. Central Africa and North Africa experienced the worst deterioration of confirming relationships with foreign banks. Global banks that provide liquidity and risk mitigation reduced correspondent banking networks for several reasons. First, prudential regulations for trade finance under the Basel III framework increased after the 2007–2008 global financial crisis, as trade finance flows were disrupted by contagion during the crisis. Second, non-prudential regulations (such as know-your-customer, anti-money laundering and sanction regulations) increased the cost of due diligence for small transactions. As a result, despite initiatives to avoid unintended consequences of prudential regulations, access to trade finance for developing countries became less affordable.

Even when liquidity is available, increased regulatory burdens and fixed costs per customer pushed banks to focus on bigger customers. On average, the 10 biggest trade



finance customers account for 58% of a bank’s total trade finance assets, while small and medium enterprises account for less than 30% (AfDB 2017). Even though these smaller businesses have seen improvements in the risk profile of their trade finance assets from 2011 to 2019, they still face higher rejection rates from banks (AfDB and Afreximbank 2020). Banks cite the inability by small and medium enterprises to provide appropriate documentation to meet regulatory standards (such as know-your-customer compliance and anti-money laundering requirements) as one reason for high rejection rates. Typically, small and medium enterprises are less profitable clients for banks and particularly

difficult to evaluate due to the lack of clear financial and know-your-customer records.

In addition, most companies with a rejected trade finance application do not seek alternative financing such as trade credit (AfDB 2017), due to lack of awareness. Even when companies do seek alternative trade financing, high spreads on trade credit – a reflection of the disconnect between perceived and actual commercial risk – acts as a deterrent. Accurate and comprehensive information about credit on African loans and bonds is difficult to access due to incomplete issuance knowledge. One report calculated that in 2014, local currency

**Table 1: Africa trade credit pricing (annual interest rate)**

Country	Price range, May 2011		Price range, April 2014	
	Low	High	Low	High
Angola	60%	65%	65%	70%
Cameroon	14%	20%	18%	24%
Congo	22%	26%	22%	27%
Democratic Republic of the Congo	16%	20%	22%	26%
Ghana	78%	82%	74%	78%
Kenya	39%	49%	39%	49%
Mozambique	20%	26%	20%	26%
Senegal	12%	16%	12%	16%
Sudan	15%	19%	9%	14%
Tanzania	10%	13%	25%	35%
Uganda	14%	16%	16%	18%
Zambia	13%	20%	13%	20%

Source: Omni Bridgeway. 2011, 2014. “Debt prices.” Omni Bridgeway News, May 2011, April 2014.

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## Developing national secondary currency markets will help de-risk foreign exchange transactions.

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interest rates on trade loans varied from 74% to 78% in Ghana and from 39% to 49% in Kenya (*Table 1*). In addition, common risk mitigation instruments, such as trade credit insurance or factoring, have only just started to be used widely.

### 3. Framework for addressing currency risks in trade finance

Addressing currency risk is crucial to both reducing the perception of risk and boosting access to trade finance for companies across Africa. There are several approaches to enhance the management of currency risk and the liquidity of trade finance.

First, deepening trade integration and financial integration will likely promote the use of local currencies and reduce the cost of borrowing. Second, developing national secondary currency markets will help de-risk foreign exchange transactions. Third, experimenting with innovative financial instruments – such as synthetic local currency trade finance instruments – can begin as trade integration deepens and local secondary markets develop.

Regional systems eliminate the use of an intermediary foreign correspondent bank so that payments are processed faster and with lower costs across borders. While the volume of transactions denominated in US dollars is still high, there is evidence that regional integration has led to a steady increase in local currency transactions and a decrease in hard currency transactions. SWIFT

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**Table 2: African foreign exchange market development, by country, 2017**

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State of market development	Low-income countries	Middle-income countries
No or negligible foreign exchange market	Angola, Benin, Burkina Faso, the Democratic Republic of the Congo, Ethiopia, Guinea, Madagascar, Malawi, Mali, Mauritania, Mozambique, Namibia, Niger, Rwanda, Senegal, Sierra Leone, Tanzania, Togo, Zambia	Algeria, Cameroon, Côte D'Ivoire, Gabon, Swaziland, Tunisia
Growing foreign exchange market	Uganda	Botswana, Egypt, Ghana, Kenya, Morocco, Nigeria
More developed foreign exchange market		South Africa

Source: Currency Exchange Fund (TCX).

Note: A lack of foreign exchange liquidity, a perception of high risk, a lack of appetite in African derivative markets and regulatory hurdles all contributed to the slow development of secondary markets. For example, the South African rand (ZAR) is the most liquid of all African currencies, but the US dollar/ZAR market turnover is only the equivalent of US\$5 billion to US\$7 billion daily. In comparison, the euro/dollar market turnover is more than US\$ 1 trillion daily.

data shows that African regions with strong integration saw increased use of local currencies and decreased use of hard currencies. The use of the West African franc by the eight countries in the West African Economic and Monetary Union has overtaken the South African rand and the British West African pound, accounting for 7.3% of payments in 2017, up from 4.4% in 2013. The 16-member Southern African Development Community (SADC) also saw increasing use of the rand and decreasing use of the dollar since the debut of the SADC Integrated Regional Electronic Settlement System. As of 2018, 60% of cross-border transactions in SADC were denominated in the dollar, while 35% were denominated in the rand.

This implies that boosting the use of local currencies will shield the African trade market from adverse global conditions associated with the performance of US dollars. However, further regional coordination is needed to build a continental payment system that encourages the use of local correspondent banks and local currencies in the financing of cross-border trade.

In addition to trade and financial integrations, African importers and exporters would benefit from currency risk management tools that reduce their exposure and convertibility risk. In large markets with established and liquid currencies, forward contracts are widely used to reduce uncertainty. They allow

investors to lock in fixed exchange rates at low costs, which then can be used to settle contracts with suppliers, make payments and remit profits. Cross-currency swaps are contracts in which two parties agree to exchange multiple fixed amounts (normally loan principal and interest payments) in two different currencies. Together, derivatives like these can help de-risk foreign exchange transactions.

Although these markets are nascent in Africa, there have been positive developments in the last few years. For example, Nigeria developed domestic hedging tools after the crash of its Naira currency. The Central Bank of Nigeria supported a naira-settled over-the-counter futures market with a flexible investors and exporters window rate and helped to mitigate exchange rate risk. Investors, banks and importers all have access to the over-the-counter market for hedging foreign currency loans, capital imports, dividend repatriations, remittances, letters of credit and provisioning for foreign currency loans. The size of this hedging market grew to \$4.4 billion in 2018.

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Boosting the use of local currencies will shield the African trade market from adverse global conditions associated with the performance of US dollars.

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However, in general, the development of onshore contracts in domestic derivative markets is difficult in Africa because of a combination of low liquidity levels, government regulation and aversion to risk. Limited currency risk markets are not generally accessible, and companies often lack the financial training and experience to make proper use of hedging instruments and other risk mitigation techniques. Only South Africa has a developed currency risk market (*Table 2*).

In the absence of an onshore hedging tool to mitigate foreign exchange risks, those that seek coverage can establish hedging with an offshore institution. This approach has been used in other parts of the world that are plagued by exchange rate volatility. For example, companies in many frontier market economies in the Association of Southeast Asian Nations use offshore derivative markets in Singapore – which has

extensive financial infrastructure and available liquidity – to establish hedging contracts when their domestic secondary markets are limited.

#### **4. Synthetic local currency instruments as a method of addressing currency risk**

The concept of using an offshore entity to mitigate currency risk and indirect credit risk also can be applied to the African trade finance market. In recent years, DFIs have stepped in to increase US dollar financing lines in Africa through trade finance programmes, with the goal of supporting the unmet demand caused by the flight of global banks. Programmes by several DFIs, including the International Finance Corporation, African Development Bank (AfDB) and African Export-Import Bank (Afreximbank), have expanded the scale of their financing, as well as their risk participation. By

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#### **Box: Cross-currency swaps**

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Cross-currency swaps are contracts under which two parties agree to exchange multiple fixed amounts (normally, loan principal and interest payments) in two different currencies.

For example, if a party has taken a foreign currency-denominated loan, it will have a set schedule for making interest and principal repayments in hard currency. It can use forward contracts or cross-currency swaps (basically, a series of foreign exchange forward contracts bundled together to mirror the cash flows needed to repay the loan interest and principal) to fix a foreign-exchange rate on these payments.

This gives the borrower certainty about the value of its payments in its local currency, reducing its risk and making investment more attractive.

TCX normally offers non-deliverable products in which all cash flows, despite being denominated in local currency, are settled in US dollars. It thus creates a synthetic local currency loan.

Source: Currency Exchange Fund (TCX)

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supporting the financing capabilities of participating commercial banks, the DFIs allow these banks to provide financing for clients who otherwise would have been rejected.

DFIs can take the further step of increasing the supply of synthetic local currency facilities to reduce credit risk and boost access to finance for African companies. This can be done by hedging US dollar funding exposure through a third or offshore institution. Shifting the currency risk to the third institution creates a synthetic local currency loan that can make macroeconomic risk more transparent and also improve the borrower's debt sustainability. It is often the only strategy to mitigate currency risk when local secondary markets are still nascent (Griffiths et al. 2020). (The term "synthetic" refers to the fact despite obligations being fixed in the local currency, all cash flows between the lender and borrower, including disbursements, interest payments and principal repayments, are settled in foreign currencies.)<sup>2</sup>

Synthetic local currency loans increasingly have been offered to private sector borrowers by DFIs, multilateral development banks, and microfinance funds. Another attractive feature of synthetic local currency is flexibility of financing terms. While the US dollar is dominant in trade finance (and in finance generally), financing terms do not

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Shifting the currency risk to the third institution creates a synthetic local currency loan that can make macroeconomic risk more transparent and also improve the borrower's debt sustainability.

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necessarily have to be denominated in dollars. A loan paid out and settled in dollars can still be synthetically denominated in local currency. A non-deliverable cross-currency swap can be used to preserve the original structure of dollar-denominated loans, because it can practically fix an exchange rate on interest and principal payments (see box opposite).

A good example of the development of this new approach is a risk partnership between the Afreximbank and the Currency Exchange Fund (TCX). TCX is a special purpose fund with a long experience of providing hedging instruments for currencies devoid of them in commercial markets (Hirschhofer 2019). It provides over-the-counter derivatives to hedge the currency and interest rate mismatch that is created in cross-border investments between international investors and local borrowers. TCX accepts foreign exchange exposure on transactions originated by regional development banks in hard currencies. It offers swaps and

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2. It is to be distinguished from a true local currency loan, which is paid and repaid in local currency units and the debt repayment conditions are fixed in local currency terms.



Figure 2



- A USD 10m equivalent bullet loan hedged by TCX
- The lender requires a return in USD terms of 5%
- The TCX swap rate is LCY 15% fixed versus USD 5% fixed
- At disbursement the LCY: USD rate is 10:1
- The LCY loan is therefore fixed at LCY 100m @ 15%
- At the repayment date the LCY: USD rate is 12.5:1

- The borrower must repay LCY 100m, but in USD, so USD 8m
- The lender incurs a FX loss on the loan of USD 2m
- TCX 'repays' LCY 100m on the LCY leg, so USD 8m
- The lender 'repays' USD 10m on the USD leg
- Only the difference of USD 2m is paid, by TCX to the lender
- TCX receives LCY interest and pays USD interest

Source: Currency Exchange Fund (TCX)

converts the exposure into domestic currencies for the beneficiaries at the same maturities. TCX's partnership with the Afreximbank, which makes use of local currency lending and guarantees, allows the bank to retain the credit risk of its trade finance operations, while the currency risk is transferred to TCX.

The function of the synthetic local currency trade instrument hedged with a non-deliverable swap through TCX is best presented in a flow diagram (Figure 2). While foreign exchange exposure is shifted to TCX, convertibility and transfer risks often remain with the borrower, which is required to convert the contractually specified local currency (LCY) amount into US dollars (or other hard currency) and settle the obligation via a transfer to an offshore account. The process is as follows: at disbursement or when the hedge is executed, the repayment obligation of the borrower is fixed in local currency at the prevailing local

currency/foreign currency rate. The lender disburses in foreign currency. On the repayment date, the borrower must satisfy the local currency repayment obligation as it was fixed at disbursement, but that obligation must be settled in foreign currency. The amount of foreign currency that the borrower must transfer is calculated by converting the local currency repayment obligation against the local currency/foreign currency exchange rate on the date of repayment.

If the local currency has depreciated, the lender will receive less foreign currency from the borrower than the amount it disbursed. In that case, TCX will cover the shortfall. If the local currency has appreciated, the lender will receive more foreign currency than the amount it disbursed, but it must pay the surplus to TCX. Either way, the lender is perfectly hedged, as a loss or gain on the loan will be precisely offset by an equal but

opposite loss or gain on the swap. The borrower has a fixed liability in local currency terms, which is unaffected by the appreciation or depreciation of local currency against foreign currency. TCX will always gain or lose, bearing the currency risk in full.

This synthetic loan structure has several advantages for trade finance in Africa. First, the synthetic instrument is useful in illiquid currency markets where hedging instruments are not widely available or where foreign exchange markets are shallow and volatile. Second, while the synthetic instrument provides access to much-needed hard currency, the borrower fixes the debt service in terms of its own revenues (which are typically in local currency). Payments in US dollars give the borrower certainty about the value of its payments in local currency, and also make the investment more attractive and less risky from the lender’s perspective. Most importantly, in case there is an external shock and a resulting currency depreciation, the borrower pays back a smaller hard-

currency amount. Hence, by shifting the currency risk from the borrower to the financier (*Table 3*), synthetic local currency trade loans can improve the repayment capacity of African importers and lower their risk of defaults.

## 5. Potential implications for financing trade in africa

The intervention of DFIs and multilateral institutions has become particularly relevant as African banks increasingly depend on their support for trade financing. In 2018, the International Chamber of Commerce’s Global Survey of trade finance found that 43% of banks headquartered in Africa expected the continent’s trade finance gap to widen and that the trade finance programmes provided by multilateral development banks would expand to close this gap. Recently, a global trade finance survey by BNY Mellon and the International Chamber of Commerce showed that most institutions would provide more trade finance to small and medium enterprises or in geographies with high levels of unmet demand for trade finance, if the visibility and efficiency

**Table 3**

Category	All cash flows in	Debt service contractually set in	Assumes currency risk
Plain US\$ loan	US\$	US\$	Importer
Plain LCY loan	LCY	LCY	Financier/exporter
Synthetic LCY loan	US\$	LCY	Financier/exporter

Note: LCY = local currency

of transaction processes were improved through risk reduction.

Currently, during the COVID-19 pandemic, shrinking global demand and drops in commodity prices and export revenues have tightened lending conditions and exacerbated existing constraints in Africa. The exposure to adverse global volatility and commodity price cycles have created recurrent balance of payments crises and liquidity constraints to remain in place without further condition despite the strong liquidity positions of most banks. In the short run, DFIs and multilateral institutions active in Africa can help mitigate this risk through partnerships such as the one between the Afreximbank and TCX. DFIs and multilateral institutions can increase the supply of local currency-denominated lending to local banks, to continue support programmes that target the private sector and smaller enterprises. These programmes will also shield borrowers from risks associated with currency depreciation and US dollar credit fluctuations. Furthermore, the support programmes can lower the risk and the cost of credit for companies that are struggling to obtain affordable financing.

In the long run, reducing foreign exchange risk is key to ensuring the stability of the trade finance market in Africa. DFIs and multilateral institutions will be expected to maintain a proper trade finance environment through innovative means of credit enhancement. These

institutions should expand the offer of local currency trade finance facilities beyond large corporate banks, to small and medium banks. Their effective currency risk management can help local banks safely expand trade credit and ease access to confirmation counterparties. This approach will not only ensure loss minimisation for companies, but it also will contribute significantly to boosting overall trade flows in Africa and to promoting the integration of more companies into intra-African trade.

## **6. Conclusion**

To facilitate trade integration and the development of industrial value chains in Africa, the continent's trade financing gap must be closed. Information asymmetries, an exaggerated perception of risk, and rising compliance costs affect companies across the continent. Denomination of trade finance loans in foreign currencies is not sustainable because it inflates credit risk during currency fluctuations and it is vulnerable to global shocks, such as the current pandemic-induced context of heightened global volatility in both currency and commodity markets. New financial products, including instruments for hedging risks, can address some of these underlying problems and widen access to trade finance for African companies.

Multilaterals and those dedicated to bridging the trade finance gap in Africa should take advantage of the

offshore derivative markets to split currency risk from credit risk, which will provide additional flexibility, risk management and liquidity. Better allocation and management of currency risks can give small and medium enterprises increased

access to local currency-denominated finance and can mitigate the impact of US dollar credit fluctuations. This will have the additional advantage of fully leveraging the benefits of trade integration underway on the continent.

### Box: Overview of trade finance products

Trade finance is a collection of short-term instruments such as loans, letters of credit and guarantees that secure trade flows in a predictable manner, mitigate payment risks for companies and reduce cross-border transaction costs.

Trade finance includes the financing of import and export transactions through loans, letters of credit, factoring, and export credit and insurance. Banks' off-balance sheet commitments in trade finance include export and import letters of credit and bank guarantees. On-balance sheet exposure is loans for export or import.

The bank also can purchase the debt or invoice through factoring and forfeiting. Trade finance is not to be confused with trade credit, which involves no intermediation by financial companies. In trade credit, the exporter of goods provides the importer with a loan, so the buyer does not have to pay immediately at the point of purchase, but within an agreed period of time. The exporter also can take on trade credit insurance to protect against the risk of non-payment by the buyer.

Trade finance products (short-term) US\$	Export finance (medium- and long-term)
(Issued) import letters of credit (off-balance sheet)	Products for which an export credit agency has provided a state-backed guarantee or insurance to the trade finance market
(Confirmed) export letters of credit (off-balance sheet)	
Loans for import/export (on-balance sheet)	
Performance guarantees and standby letters of credit (off-balance sheet)	
Supply chain finance: receivables discounting, forfeiting, factoring, loan or advance against receivables, loan or advance against inventory, pre-shipment finance (between companies, not intermediated by banks)	

Source: International Chamber of Commerce, Trade Register Report 2019

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# Factoring: An Alternative SME Financing Instrument for Intra-African Trade Promotion



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**Abstract:** Small and medium enterprises (SMEs), which constitute the largest proportion of Africa's industrial fibre and are set to be key actors during the implementation of the African Continental Free Trade Agreement, continue to face major constraints in accessing financing. This paper highlights the development of factoring and supply chain financing (reverse factoring) as viable alternative financing instruments for the growth and development of SMEs at a time when closing trade financing gaps will be critical to the expansion of intra-African trade and effective implementation of the trade pact.

**Keywords:** AfCFTA, factoring, Intra-African trade, SME financing

## 1. Introduction

Small and medium enterprises (SMEs) contribute significantly to the economic fortunes of countries around the world, especially developing countries. They create jobs and contribute to the growth of gross domestic product and economic development.<sup>1</sup> SMEs account for 80% of firms in Africa and make up the largest proportion of the continent's industrial fibre. Notwithstanding the documented contribution of SMEs, limited access to financing is a major constraint to their growth and expansion. The challenge is

more pronounced in Africa, which is characterised by a significant financing gap across all sectors. Lack of access to financing could present a major challenge to the implementation of the African Continental Free Trade Agreement (AfCFTA).

Trading under the free trade agreement was expected to commence on July 1, 2020, but was postponed to January 1, 2021, because of the COVID-19 pandemic. Once trading commences, the agreement is projected to usher in a new era of African trade with

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1. In view of the frequently contextualized definition of SMEs, this paper approaches SMEs from a generic perspective.

the potential for greater exchange of value-added products, which would contribute significantly to unlocking Africa's economic potential. Availability of trade financing, especially for SMEs, will be the key lubricant to propel the agreement to realise its objectives. It is estimated that an additional US\$40 billion in trade financing will be required to meet the expected increase in demand for financing associated with expansion of intra-African trade under the new trade pact.

In view of the expected dominant role of SMEs in ensuring optimisation of the gains associated with the free trade agreement, access to financing will become even more critical. This paper discusses factoring as a viable alternative source of financing for SMEs. The rest of the paper is organised as follows: Section 2 discusses challenges with SMEs financing in Africa. Section 3 reviews factoring as a tool for SME growth in Africa. Section 4 discusses implications for intra-African trade, and Section 5 concludes.

## **2. Challenges with SME financing in Africa**

Trade financing is critical for the facilitation of cross-border trade because of its role in overcoming the challenges of information asymmetry, contract enforcement and liquidity constraints inherent in international trade transactions. Africa has a high

unmet demand for trade financing, with an estimated annual trade financing deficit of US\$81 billion (AfDB and Afreximbank, 2020). At less than 3%, Africa's share in global trade is dismally low, partly reflecting the constraints faced by SMEs in their growth and development. Limited access to financing, especially by SMEs to be able to meet their financial needs, undermines their ability to grow.

The withdrawal of major international banks from the African correspondent banking and trade finance landscape in a context of increasingly stringent regulatory environment and high costs associated with compliance and anti-money laundering (AML) issues has exacerbated the financing gap faced by African entities, especially SMEs. Although banks currently support one-third of Africa's trade, only 28% of banks' total trade finance portfolio benefits SMEs. The average rate of rejection of letters of credit, which is a key instrument used by banks to finance trade in Africa, is estimated at more than 6% (AfDB & Afreximbank, 2020; Gajigo et al., 2015; Bérenger, 2018).

Several factors account for the difficulty faced by SMEs in accessing trade finance. Financiers first and foremost cite the inability to assess the creditworthiness of SMEs as a key challenge in providing them with credit. Indeed, creditworthiness is one of the key elements of a bank's underwriting processes, but it is



difficult to ascertain especially where credit ratings are not standard. In advanced economies, the lender would usually expect the contract between seller and buyer to be enforced since reneging on such contracts would adversely affect buyer's credit rating. In the absence of such safeguards, trade finance for SMEs has an added element of uncertainty, even though trade finance on the continent is less risky than other types of lending. The default rate on trade finance in Africa is estimated at 5% compared to 12% for non-performing loans for all bank asset classes (AfDB, 2017).

Another obstacle is the informality of SME trade and the absence of structured bookkeeping processes. Most SMEs across the continent lack proper organisational structures and do not meet global standard on record keeping and bookkeeping. In this context, relevant information about them is usually scant and unreliable.

Inflexibility on the type of collateral required by lending institutions constitutes another barrier to trade finance for SMEs. Collateral requirements in Africa can be as high as 100% of loan value. In most cases, they are limited to cash, fixed assets and guarantees, among others. Most banks are not open to considering the goods traded or the receivables of the contracts financed as their collateral on a stand-alone basis. Hence, SMEs

that often pledge all their assets to one bank to receive a term loan or overdraft facility are then limited when applying for trade finance or working capital, as there are no more assets available to pledge. Furthermore, some small traders who lease warehouses do not have large assets to offer as collateral.

Another key factor is the constraint of single obligor limit often faced by local banks and other trade finance entities. However, SMEs often require large amounts of short-term liquidity to finance bulk purchases, especially when prices are low. Under such circumstances and from a balance sheet perspective, local banks face restrictions and are unable to provide sufficient liquidity to a stand-alone client.

Other factors that affect African SMEs and large corporations alike when seeking trade finance include the absence of credit insurance and de-risking mechanisms that exist elsewhere, political risk, which is exacerbated during cross-border transactions, and currency risk.<sup>2</sup> Furthermore, over-inflated risks preparation, as well as limited access to capital markets for the overwhelming majority of African SMEs, hinder their ability to draw on diverse sources of funding to expand African trade (see how currency risk management can boost access to trade finance in Africa in this issue

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2. Currency risk in trade finance relates to lenders' concerns about their funds getting stuck in a country where they do not operate, the fear of currency devaluation, or a shortage of foreign reserves, posing transferability and convertibility risks that may result in a lack of payment.

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Most SMEs often have no capacity for self-financing and therefore cannot finance the top of their balance sheets and working capital requirements.

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of CIAT).

All these factors contribute to SMEs' lack of access to traditional banks and other formal financing sources. Both supply and demand factors explain the limited use of banking services by SMEs. On the supply side, market imperfections, characterised by information asymmetry or weak creditor protection, make it difficult for financial intermediaries to assess the creditworthiness of SMEs, monitor their activities and enforce repayment. On the demand side, lack of creditworthiness makes it difficult for SMEs to access financing. In general, the supply side constraints are more prevalent.

Increasingly, banks are becoming more reluctant to provide loans to SMEs since they typically have very low levels of capitalisation, on the back of sluggishness in their economies. These factors impede SME development and operational performance, thereby limiting their ability to increase their capital. At the same time, most SMEs often have no capacity for self-financing and therefore cannot finance the top of their balance sheets and working capital requirements. In view of these constraints, they are hesitant

to approach banks for loans. In this context, factoring is seen as a viable alternative financing source for SMEs.

### **3. Factoring as a tool for SME growth in Africa**

Klapper (2006) and Vasilescu (2010) describe factoring as a financial service where an enterprise sells its accounts receivable (in the form of invoices) to a factor at a discount in exchange for immediate cash and a range of services, including credit protection, accounts receivable bookkeeping, collection services and financing. It is recognised as an alternative and globally well-established source of financing suitable for SMEs (Ivanovic, Baresa, & Bogdan, 2011; Vasilescu, 2010). Unlike traditional loans, factoring is particularly compelling and effective for SMEs, as underwriters place the risk mainly on the receivables (the financial asset) and the creditworthiness of the buyer rather than on the seller (usually SMEs) (Vasilescu, 2010).

In cases where the buyer is situated in a different country from the seller, two factors should be involved – one in each country. The correspondent factoring relationship anchored in Factors Chain International (FCI)'s two-factor system provides the necessary safeguards, as in the quadrant involving the following parties: the exporter, the importer, the export factor and the import factor. The two factors establish a contractual or correspondent relationship to service the buyer and

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A two-factor system, under the aegis of FCI, allows the national factor to grant financing, with the corresponding factor ensuring collection abroad.

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the seller, respectively. Therefore, to carry out import activities freely, the importer needs to sign a factoring contract which allows it to outsource the management of its transactions. It also helps to maintain business at a high level of performance while remaining credible with suppliers.

Once the goods are released, it becomes the responsibility of the factoring structure to ensure proper delivery of the order. It will therefore have to ensure the transport of the goods, insurance and the warehouse so that they are truly delivered to the end customer. A two-factor system, under the aegis of FCI, allows the national factor to grant financing, with the corresponding factor ensuring collection abroad. Factoring enables firms to have better solvency ratios, better supply chain reputations given the timely meeting of company obligations, and improved sales volume given an increased ability to offer trade credit (Ivanovic et al., 2011). Moreover, some firms may benefit from their fixed assets not being encumbered, better terms for export, reduced bad debt and exchange risk, improved profitability due to reduced credit risk, and reduced leverage and worries

associated with being over-leveraged (Ivanovic et al., 2011).

An international factoring mechanism involves an international trade contract with factoring activities between an import and an export factor (Vasilescu, 2010). The export factor benefits the factoring transaction by way of local market knowledge, local presence and local language skills (IFG, 2012). The parties to a domestic factoring – the client, the factor, and the debtor – are usually in the same jurisdiction (IFG, 2012).

There are two instances of factoring: recourse and non-recourse factoring. Non-recourse factoring offers a client full credit management service cover on approved debts against the eventuality of being unable to secure full payment of factored invoices (Vasilescu, 2010). Under recourse factoring, the factor takes responsibility for debt collection but retains the right to seek full recourse from the client for any bad debts (Vasilescu, 2010). There is also reverse factoring (supply chain financing) whereby a factor offers suppliers of a debtor the option to assign or sell their debtor-approved receivables. With a guarantee from the debtor while in invoice discounting, the financier purchases the sales ledger and advances funds against the approved debt but does not take on the responsibility for the debt collection (IFG, 2012).

The African Export-Import Bank (Afreximbank) recognises the

important role of SMEs on the continent in terms of industrial development and structural transformation, as a response to growing local demand for services, increased specialisation and support for large companies through backward and forward linkages. Given their contribution to the fortunes of developing economies, there is an urgent need to offer SMEs adequate solutions to optimise access to financing to enhance their participation in intra-African trade. Accordingly, Afreximbank has identified factoring as one of the most effective financing instruments to support SMEs. They can play the role of indirect exporters within logistic chains of export, with the hope that factoring will lower the cost of funds and allow small businesses in African countries to be more competitive through the use of open accounts other than letters of credit.

In view of this, the bank has designed and implemented a five-pillar strategy consisting of financial intervention, development of legal and regulatory frameworks, awareness creation and capacity building, services, and strategic partnerships. To support this strategy to facilitate an increased contribution of SMEs to integrated regional supply chains, the bank provides credit to factoring companies and directly (especially under reverse factoring schemes), organises learning and skill-building workshops, and offers legal and regulatory advice/consulting services and technical assistance to promote



good practices in Africa. In line with the aspirations of the free trade agreement regarding intra-African trade and also to integrate African SMEs into global value chains, factoring is imperative to close the trade financing gap.

Factoring enables SMEs to finance customer receivables and provides guarantees against unpaid invoices while securing the cash flow of the company. Moreover, factoring accompanies SMEs throughout the business cycle, allowing them to be financially supported at each phase of their development:

- at the inception phase, by lightening the burden and structuring the development of the company to benefit from financing;
- in the growth phase, by making it possible to inject liquidity, since factoring proves to be a cash accelerator;
- during difficult periods, by securing financing based on the quality of the customer base and billing.

The global factoring industry is flourishing, albeit at a suboptimal level of performance characterised by uneven concentration in different markets (IFG, 2013; 2014). Although still an insignificant player in the global factoring market, Africa has made great strides in the past decade with an average annual growth of 14.2%, from €5.86 billion in 2001 to €23.93 billion in 2012, exceeding the global

industry average growth rate of 8.6% (Oramah, 2013). In the current era of the COVID-19 pandemic, Mulroy (2020) predicts a significant rebound in 2021 and beyond as banks pull back credit facilities.

Several measures are required to harness the potential of factoring in Africa. Satta (2006) advocated for a conducive legal and regulatory environment, a strengthened credit information infrastructure, a favourable tax regime and growth in factoring associations. Timmermanns (2009) advocated for increased awareness and recognition of factoring, harmonisation of the legal and regulatory environment, knowledge sharing, best practices and information, and support to the establishment of factoring activities in new markets.

#### **4. Implications for intra-African trade**

As Africa moves toward greater economic integration in the context of the free trade agreement, it is important to address major obstacles to intra-regional trade, including financing, to fully maximise the benefits of regional integration. The free trade agreement seeks to de-fragment Africa and boost the continent's competitiveness and cross-border trade. Ultimately, removal of duties on 97% of tariff lines is expected to boost intra-African Trade by 52.3% by 2022 and to more than double within the first decade. This is especially likely if implementation of the agreement



is accompanied by robust trade facilitation measures, including tariff removal. If complemented by policies targeting non-tariff barriers, while improving trade logistics, and addressing poor infrastructure and deficit of trade finance, trade facilitation can be four times more effective in stimulating trade (Tajudeen, 2019).

While trade integration has the potential to boost productivity and growth and contribute to structural transformation in African economies, SMEs need access to trade finance on a sustainable basis to support their growth and expansion. In a continent where trade finance gaps remain a challenge and SMEs are the hardest hit, factoring has the potential to contribute to transforming SMEs into large companies while significantly expanding cross-border trade. Accordingly, factoring will provide the financing solution as the pivot around which a significant traction would be gained on intra-African trade promotion, as well as extra-African trade, under the free trade agreement.

To reiterate, sales on open account are expected to increase in the context of intra-African trade. With the support of FCI and other partners, banks and non-bank financial institutions interested in factoring are emerging across the continent. To address the risk issues associated with open account trade, these financial institutions can access FCI's two-

factor system and correspondent factoring network in the quadrant arrangement discussed above. An importer in an African country can easily transact business with an exporter in another African country. The exporter assigns the receivables due on the sale to the export factor and then to the import factor. The export factor provides finance and receivables ledger management while the import factor provides collection services and remittance of funds to the export factor.

## **5. Conclusion**

This paper introduced factoring as an important financing instrument in support of SME operations and development, to position the sector as a significant contributor to the promotion of intra-African trade, industrialisation and structural transformation of African economies during the implementation of the AfCFTA. Although there has been significant development in factoring around the continent, much more needs to be done, particularly in the policy, legal and regulatory space. More awareness of factoring as an alternative financing tool in support of SMEs is needed because SMEs disproportionately suffer exclusion from the services of traditional financiers. Significantly, factoring also has the potential to stimulate other financial services, especially credit insurance, that will permit de-risking of SME-related transactions.

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