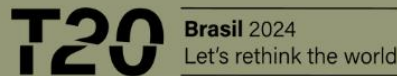
T20 Policy Brief



Task Force 03
REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

From Crisis to Reform: How the G20 Can Support the Reform of the International Financial Architecture to Unlock Private Capital for Low-Income, Resource-Rich Economies in Africa

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Abstract

This policy brief proposes ways the G20 can help African LIRR countries become properly resourced to meet climate needs, capitalize on public-private partnerships (PPPs), and restructure the global financial architecture to work for Africa. In particular, it highlights the crucial role of the G20 in providing de-risking vehicles that spur private investment in Africa, especially through provision of technical assistance and expanding public information on mineral reserves. Furthermore, this brief recommends measures to improve the Common Framework for debt treatment and enhance coordination among creditors and climate financiers for efficient debt resolution, and hence free up resources for development imperatives (e.g., health and education). Finally, it underscores how the G20 can assist African LIRR countries to develop financial resilience via financial entrepreneurship and the promotion of financial market development and regional integration.

Diagnosis of the issue

Introduction: Challenges and Opportunities

In the post-pandemic world, Africa has found itself with limited options to finance key development projects. A rapid rise in debt levels over the last decade has left African economies with little fiscal space to finance development. The financial outlook for Africa's low-income resource-rich (LIRR) countries, which are characterized by the central role commodities play in their economies, is especially dim.[1] Collectively, these countries have not had success converting their resource wealth into economic development apart from a China-driven commodity super cycle from 2002 to 2012. Real GDP per capita in these countries has declined since 2015 (Figure 1). In particular, the international financial architecture has not worked for them. The financial system's underlying foundation of financial intermediation consists of institutions, information, technology, rules, and standards (Miller, Mylenko & Sankaranarayanan, 2009). In this context, elevated global interest rates have dramatically increased the cost of borrowing across the developing world, especially in Africa (AfDB, 2024). Moreover, uncertainty in global financial markets has introduced a risk premium that has effectively shut African LIRR countries out of some credit markets (Landers & Martinez, 2024).

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[1] This brief adopts the definition of resource rich used by the following paper:

International Monetary Fund. "Macroeconomic policy frameworks for resource-rich developing countries." (2012).

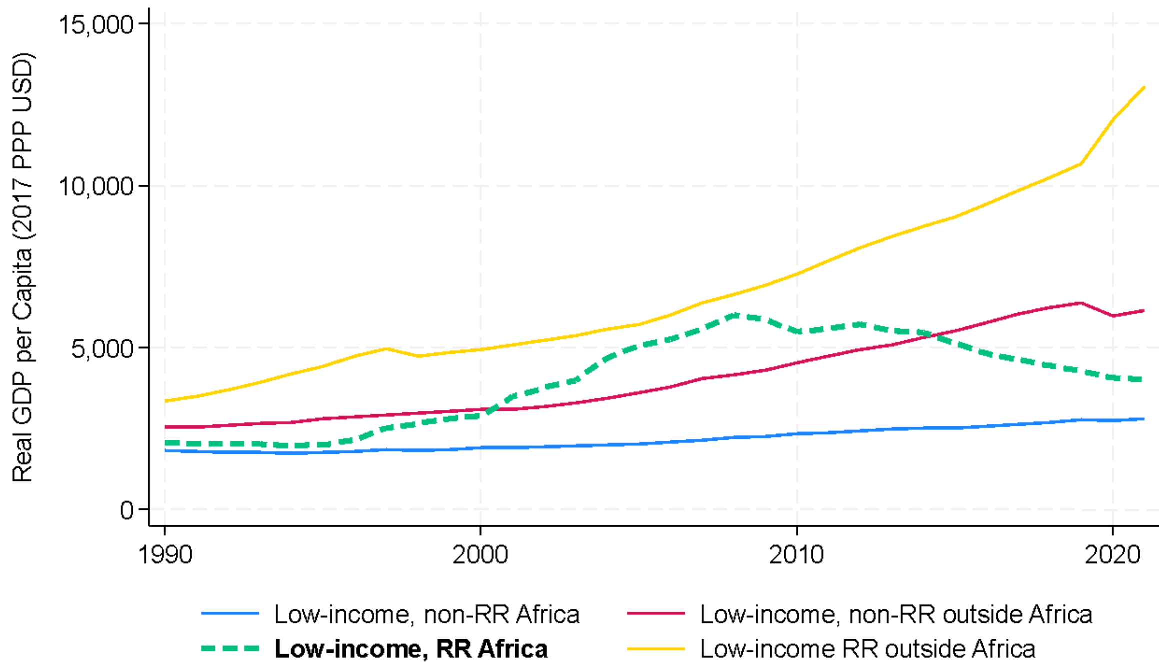


FIGURE 1. GDP per capita in African low-income resource-rich countries has fallen in recent years. *Source:* Authors calculations using the World Development Indicators. *Note:* China is omitted from the "Low-income, non-RR outside Africa" group.

In addition to limited access to development finance, African LIRR countries are particularly vulnerable to climate disasters despite contributing very little to global emissions. According to Notre Dame's GAIN index, five of the top 10 countries most affected by climate change are African LIRR countries. One of these countries, the Democratic Republic of the Congo (DRC), grapples with rising variability in rainfall that causes both droughts and flooding. Ironically, the DRC is home to roughly half of the world's proven cobalt reserves (Chen, Laws & Valckx, 2024) and hosts the Congo Basin, the largest carbon dioxide (CO_2) absorption mechanism on the planet (World Bank, 2022).

Thus, African LIRR countries are in the strange position of not being able to mobilize private capital at scale despite their abundant endowment of resources critical to resolving the climate crisis by which they are most affected but of which they are largely not responsible. Their predicament, nonetheless, presents a unique opportunity for the G20 to partner with these countries to help alter the functioning of the international financial architecture to translate their resource endowments to sustainable development and financial resilience.

A natural partner in the G20

The G20, which accounts for 80 percent of the world's greenhouse gas emissions, has set an ambitious goal of achieving net zero emissions (IMF, 2021; Baskaran, Ekeruche, Heitzig, Ordu & Senbet, 2023). African LIRR countries are key partners in resolving the climate change crisis prioritized by G20 members for many reasons, including their endowment of key minerals needed to manufacture the technologies that will be used to power the green transition. African LIRR countries need financing to create a value chain and commercialize critical minerals that are vital to the G20's goal of net zero emissions. However, the current international financial infrastructure is grossly inadequate in helping mobilize such financing. Therefore, for the G20 to successfully and sustainably realize its objective, it is important that they not only help accelerate the value creation and commercialization of critical minerals in African LIRR countries, but also help them develop the financial self-reliance needed to participate in the global economy for years to come.

The last few years have seen an explosion of interest in minerals central to the green transitions, chip fabrication, and high-skilled manufacturing (Figure 2). Governments, including the United States, the United Kingdom, and China, have articulated critical

minerals strategies and launched critical minerals-oriented programs at a large scale that synergize with ongoing infrastructure development efforts like China's Belt and Road Initiative (BRI), and the EU's Global Gateway (GG). Given the prominent role of critical minerals in the global political economy, it is natural to ask a question central to this policy brief: How can the G20 help refine the international financial architecture to help LIRR African economies translate the renewed global interest in strategic minerals into fiscal space, industrialization, and financial self-reliance?

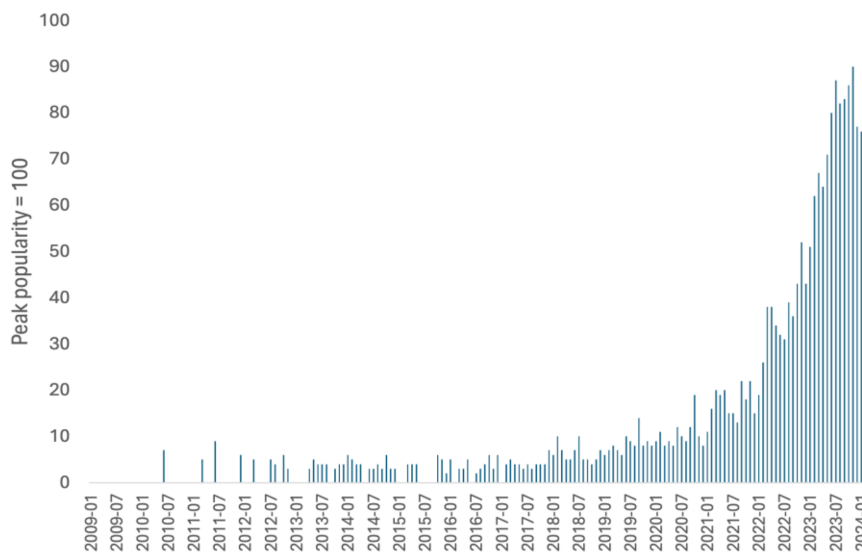


FIGURE 2. Exponential increase in Google searches for the term "Critical Minerals"

Source: Google Trends

This policy brief argues that the G20 is in a unique position to help LIRR African economies achieve this objective in three key ways. First, it can improve the Common Framework through modest reforms to how we understand preferred creditor status and the terms under which sovereign bonds are issued. Second, it can finance or transfer technical expertise to facilitate geological surveying in Africa. Third, the G20 can support

LIRR African economies to develop their own internal solutions for self-reliance and financial resilience.

Recommended G20 interventions

Accelerate deployment of the Common Framework to expand African LIRR countries' fiscal space

Expanding African LIRR countries' fiscal space will help them make local investments that engender a virtuous cycle of additional investments, de-risking of private sector engagement, and deepening trust with private sector partners. A helpful point of entry for G20 involvement is adapting the Common Framework. The Common Framework, while operable, is not streamlined. There are several courses of action that the G20 may consider to accelerate its deployment. First, Multilateral Development Banks (MDBs), whose major shareholders are mainly G20 countries, could exercise their preferred creditor status more flexibly. This will incentivize private creditors and non-G20 members to provide debt treatment on comparable terms. As specified by the Bridgetown agenda, without shareholders' putting in additional finance, MDBs can boost their lending capacity by including the callable capital of US$1 trillion into their risk framework.

Second, to protect themselves from future shocks, the G20 could strongly encourage African LIRR countries to adopt collective action clauses (CACs) in their debt instruments. With CACs, bondholders agree upfront to be bound by the terms of a restructuring if a specified supermajority of bondholders (75 to 85%) approves of the terms proposed by the issuer. It is often perceived as one of the best tools available to sovereigns to preempt a restructuring or minimize the cost and economic disruption of debt restructurings.

Finally, to resolve the China-private creditors dispute, Africa's LIRR countries could be encouraged to adopt the most-favored nation (MFN) clause, which stipulates that the borrowing country will treat a particular lender no worse or no less favorable than all other lenders. It is usually present in trade and investment agreements and is recently being adopted in sovereign debt agreements as in the case of Sri Lanka. MFN treatment is essentially a means of providing for non-discrimination between one creditor and other creditors and therefore can be seen as a reflection of the principle of equality.

The G20 can help unlock private capital at scale by helping LIRR economies expand geological surveying

Renewed global interest in Africa's minerals has potential to unlock private sector capital at scale, particularly for infrastructure related to resource extraction, resource transportation and export, digitalization of logistics, and electricity to carry out these activities. So far, Africa's LIRR economies, similar to African countries in general, have struggled to unlock private capital at scale (Lashitew, Ross & Werker, 2021). While there are many reasons for the lack of private capital inflows, we focus here on just one. At present, there is a coordination problem engendered by incomplete information among the various stakeholders, both public and private, involved in mineral extraction in Africa. Mining companies are reluctant to invest in more intensive geological sampling and new mines unless they know the transport and energy infrastructure is in place. On the other hand, private infrastructure developers do not want to invest in road and rail infrastructure unless they are confident that they will be profitably used for many years. The same goes for energy providers. Non-debt financing from international markets is scarce for these companies, and elevated global interest rates have made debt financing costly (Seeger, 2019).

This chicken-and-egg coordination problem is not easily solved, but there are opportunities to fill information gaps that serve as a hindrance to the companies involved. Many African countries still have significant gaps in geological surveying. Zambia, for instance, has surveyed only 61 percent of its land (Kasumba & Chifwepa, 2016). There is therefore an opportunity for the G20 to assist Africa's LIRR economies in expanding their geological surveying, both broad surveying and more intrusive surveying at strategic mineral deposits.[2] They can do this in three primary ways. First, they can directly finance geological surveying in LIRR economies. Second, the geological services in these countries can offer technical assistance to counterparts in LIRR economies. Third, they can raise additional capital for surveying and feasibility studies by playing a more central role in shepherding the fragmented donor landscape for LIRR economies.

These actions will open the door for public-private partnerships where partners are equipped with more complete information. These partnerships ideally offer pathways for infrastructure development and for accelerating mineral refining in the long run, the latter of which will be important in increasing export receipts.

The G20 can support African economies to develop their internal solutions for self-reliance and financial resilience

In addition to the recommendations pertaining to the G20 partnership in mobilizing resources externally, including debt resolution, it is imperative that African economies, including LIRR economies, put proactive measures in place to achieve self-reliance and resilience. Sub-Saharan African countries generate tax revenues as a share of GDP to the

[2] Strategic deposits include, for example, those that have impressive results from high-level surveying but whose connecting infrastructure dampens incentive for investment.

tune of 14.7 percent of GDP (Table 1).[3] For LIRR African economies, this has been just 11 percent in recent years, far below low-income peers. Expanding revenue capacity can be achieved without raising tax rates, or even imposing new taxes, which could be distortionary or counterproductive. Instead, more efficient public finance management, improved audits and compliance should be in place with speed. G20 partnership in building the capacity of tax administration and investments in digitization of systems would be vital.

TABLE 1. Revenue generating capacity by country grouping

Country grouping	Tax revenue (% of GDP)		
	2019	*2020*	*2021*
Low-income, non-RR Africa	14.7	14.1	14.4
Low-income, RR Africa	**10.7**	**11.0**	**10.8**
Low-income, RR outside Africa	16.1	14.6	13.9
Low-income, non-RR outside Africa	16.6	15.6	16.8
Sub-Saharan Africa average	*15.0*	*14.6*	*14.7*
World average	*23.6*	*23.1*	*23.3*

Source: OECD's Global Revenue Statistics Database.

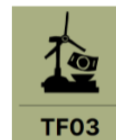
Furthermore, a major challenge is that the stock exchanges in Africa (except South Africa) are thin and illiquid (Trimble & Bryant, 2019). There are close to 30 stock exchanges, and they suffer from low market capitalization and low trading activity. They need to be integrated and consolidated. The African Continental Free Trade Area Agreement (AfCFTA) offers a distinct opportunity to help integrate these exchanges. The

[3] Authors' calculations using the OECD's Global Revenue Statistics Database. Data retrieved on 1 April 2024. Available: https://stats.oecd.org/Index.aspx?DataSetCode=RS_GBL#

G20 partnership, in terms of providing technical assistance and capacity building, can accelerate the implementation of this continental trade initiative – and help integrate the markets.

Another low hanging fruit is the emergence of technology-enabled startups for financial services in Africa**.** This new and remarkable movement needs to be accelerated and scaled up to mobilize mass market access to a menu of digital financial services in payments, savings, credit, and insurance (Senbet, 2024). Strengthening fintech requires developing an enabling policy environment involving financial regulators and inclusive digitization. The G20 lending its technical expertise in digital transformation and developing talented financial manpower is vital here.

When it comes to bridging the development financing gap, this is an opportune time to stage the reversal of illicit flows and capital flight from Africa. The numbers are staggering. Recent estimates suggest Africa lost a combined US$2 trillion (in 2018 dollars) through capital flight from 1970-2018 (Ndikumana, 2022). Multinational corporations (MNCs), many of which are domiciled in the G20 countries, are the culprit, accounting for US$588 billion of the total capital flight. Capital flight can be even more pervasive in resource rich economies due to collusion among political elite, MNCs, and financial intermediaries (Ndikumana, 2022). The G20 is uniquely positioned to provide technical support in uncovering and curbing capital flight, beginning with a convening of a forum inclusive of multi-stakeholders and actors, including MNC leadership.



Scenario analysis of interventions

The recommendations offered in the previous section play out on different time horizons, operate at different stakes, and have varying consequences, if followed. This section discusses these variables in greater detail.

Possible outcomes of recommendation #1

With regard to the adoption of the afore-mentioned recommendations, one immediate challenge is the shortage of the required knowledge and skill-set among African LIRR countries. Financial and legal advisers, alongside other experts, typically spend considerable time and effort in structuring the sovereign bonds to ensure that they are contractually binding and protect the issuing country from future shocks. Hence, external support in the form of technical assistance and capacity building from G20 countries would be vital.

As MDBs are advised to take on more risks by taking haircuts, one potential challenge is that they could lose their AAA status. To avoid this, MDBs should deliberate with credit rating agencies to change their processes and modify the allowance they make for callable capital.

Possible outcomes of recommendation #2

There is a clear upside to the G20 facilitating access to information about potential mineral location, extent, and quality. It reduces the cost of information for companies, ministries, and partnering governments, who are constrained to varying degrees by the lack of information about mineral deposits and mineral quality in LIRR economies. Furthermore, it reduces the risk borne by private companies that make significant

investments in mine developments, infrastructure, power plants, and telecommunications infrastructure, the construction of which is often needed from scratch in African LIRR economies.

Companies proceeding with their investments in the absence of such information necessarily bear risk. One such risk is that the discovery of better mineral deposits (either higher grade, larger quantity, easier to extract, or more collocated to infrastructure, including refineries) will change future incentives for investments by governments and other firms that facilitate extraction and export of resources and downstream products. Importantly, this risk plays out not only at a national level but a regional level as well. A new mineral deposit discovery in DRC, for example, affects investment decisions in Zambia.

Possible outcomes of recommendation #3

African countries will reduce excessive dependence on debt and other global initiatives by building capacity for the development of internal solutions. On the strengthening of the financial sector, African financial systems have recently grown both in quantity and depth, but finance has not been inclusive. The G20 support and partnership for unlocking financial entrepreneurship will help promote inclusive finance. This will also help develop climate finance startups which have grown fast globally but have not yet ventured into Africa. Moreover, with the G20 support and partnership, home-grown initiatives like the AfCFTA and the Africa Exchange Linkage Project (AELP) will ensure African financial systems are destined to become well-integrated, deep, inclusive, and fit for the service of the green economy. Finally, considerable financial resources can be mobilized through international cooperation in the reversal of illicit flows and capital flight, with

G20 as the primary facilitator. This further reduces external dependency and promotes self-reliance and financial resilience.

Conclusion

This paper has reviewed the key challenges the international financial architecture poses for African LIRR countries, the opportunity presented by the renewal of global interest in minerals, and the role the G20 can play in converting this interest into measurable development outcomes like industrialization, and financial self-resilience. In particular, we recommended three ways the G20 can intervene to help African LIRR countries realize these outcomes: 1) Continue to reform the Common Framework to ensure that it is implementable in a timely and effective manner; 2) Unlock private capital by helping African LIRR economies expand geological surveying; 3) Support African LIRR economies to develop their own internal solutions for self-reliance and financial resilience.

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TF03

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