

The Brown Capital Management Africa Forum



Paper No. 12

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Reimagining Development Finance for a 21st Century Africa

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March 2023

Why has traditional development finance not worked for Africa over the past six decades? This gnawing question remains as we examine the trajectory of growth in Africa.

The roots of contemporary development practice reside in the immediate post-World War II era, when extraordinary efforts to provide temporary financial and technical assistance for European countries from the ravaging effects of the war helped to get back on track toward shared national and since then, the foundations of this approach became the cornerstone of development thinking. Bilateral and multilateral development institutions have devoted themselves to replicating Europe's experience with post-war reconstruction across the world. The approach is relatively simple. If countries received financial support during lean times, governments would invest in human capital and critical services in order to boost productivity in the medium term. To the extent that loans could be repaid, countries will enhance their development prospects. Since 1990, African countries received over \$1.3 trillion in development assistance; however, the continent's financial, societal, and political fabric remains fragile.¹ Furthermore, African economies appear to have become addicted to development assistance, despite repeated calls to reduce aid dependency.

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This publication was made possible by a grant from Brown Capital Management. The statements made and views expressed in this paper are solely the responsibility of the author and do not represent the views of the Wilson Center or Brown Capital Management.

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It is clear that business as usual will not deliver meaningful economic development in Africa. Development partners, like the United States, must continue to rethink their approach to development assistance in Africa. Just as in the immediate World War II era, African countries need some financial and technical assistance to become more competitive in global markets, more resilient to shocks, and less likely to remain ensnared in a self-perpetuating cycle of poverty. Framing and delivering requisite assistance has eluded the continent in recent decades, and aid-based support struggles to keep pace with Africa's growing and emerging needs. This paper makes a case for a fundamental rethink of development practice as it relates to Africa, analyzes the different approaches to development financing that will deliver development outcomes, and explains the role Africa's development partners could play in ensuring the long-overdue shift from perennial dependency to sustainable economic development that delivers shared prosperity, institutionalizes resilience, and protects the planet.

A Development Retrospective

The United States hosted the Bretton Woods Conference in 1944 as the victorious global powers sought to consolidate peace after concluding the Second World War.² The likelihood of an economic collapse in Europe was foremost in the mind of framers of the conference. The 730 representatives from the 44 allied nations attending this conference were aware that economic distress could destabilize the global economy and foment social disorder in parts of Europe and across the world. Against this backdrop, they created the International Monetary Fund (IMF) to monitor and oversee global financial stability and the International Bank for Reconstruction and Development (now known as the World Bank) to invest in reconstruction and economic development.³ Both institutions were predicated on two main ideas. The first is that global macroeconomic stability is paramount and development cannot happen without it. Thus, a precursor to development financing was deemed to be an unwavering commitment to macroeconomic stability. Countries were encouraged to demonstrate this commitment by agreeing to contain inflation, usually by maintaining a prudent fiscal balance. The second idea was that countries experiencing an adverse balance of trade could be nudged back on a path of macroeconomic stability and sustained economic growth via the provision of temporary financial inflows (this came to be known as development assistance or aid), which would do a couple of important things. It would provide recipient countries with much-needed fiscal space to purchase critical goods and services (like food and fuel), while also investing in productive capacity that would increase economic output in the outer years. In essence, the goal was to enable countries to cushion unexpected economic shocks and provide uninterrupted fiscal space to carry out the functioning of a government.

In this context, the United States designed the Marshall Plan for Europe, which aimed to provide fiscal relief for post-war Europe to prevent creeping inflation and a widespread shortage of essential commodities. Contrary to widespread belief, the \$13 billion provided by the United States under the Marshall Plan in 1948 did not rebuild Europe.⁴ By this time, the major European economies were already on the path to economic recovery. What the plan did was to help preserve macroeconomic stability in a time of great uncertainty and contain inflation by providing the beneficiaries with temporary financial assistance to facilitate the importation of food and essential supplies. The Marshall Plan had another objective. It also aimed to serve as a bulwark against the expansion of Soviet influence in Europe by creating a strong trading and political bloc between the United States and Europe.

Three main characteristics of the Marshall Plan offer valuable lessons for development assistance and development finance today. The first relates to the tension between capital infusions and macroeconomic stability. Should restrictive macroeconomic targets limit capital inflows in recipient countries? Should more attention be paid to addressing structural economic transitions? Second, what role should trade play in ensuring the efficacy of aid? Post-war Europe benefitted from development assistance because concomitant efforts were made to firmly embed recipient countries in emerging global value chains, particularly manufacturing and finance. The framers of the Marshall Plan understood that success was contingent upon recipient nations being able to trade their way out of poverty. This ensured they earned enough in the medium term to wean themselves off aid. A third lesson relates to the political nature of development assistance, which is why the oversight and administration of aid in most donor countries is domiciled in the State Department or Foreign Ministry. The politicization of aid in donor and recipient countries has been shown to be counterproductive.

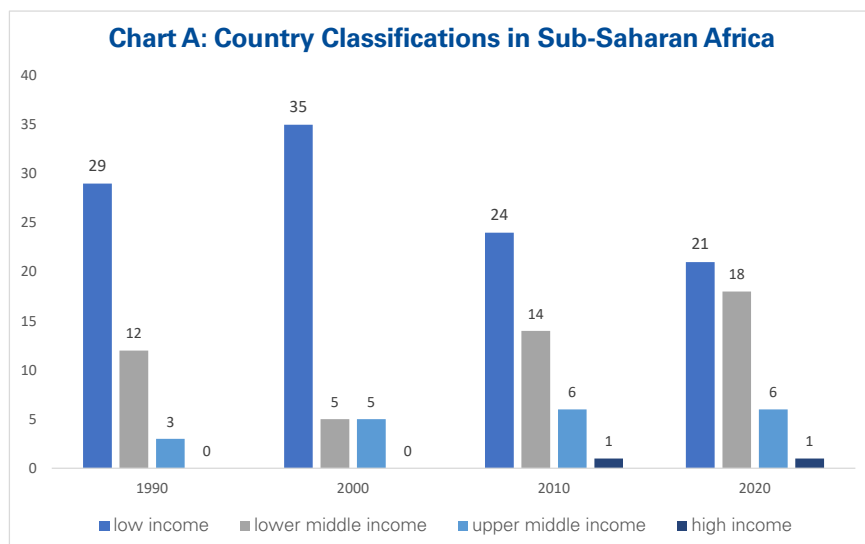


These three lessons still resonate across Africa today. Restrictive macroeconomic targets bode well for economic stability but could make it difficult for countries to finance much-needed infrastructure, technology, institutions, and skills that will prepare African nations for necessary green economic transitions and employment creation. The seemingly exclusive reliance on development aid to trigger transformative economic growth in Africa remains problematic. Without scaled-up efforts to boost trade and increase value-addition, it is unreasonable to expect African countries to exit cycles of aid dependency and inter-generational poverty. Also, the politicization of development assistance has had deleterious impacts on aid efficiency when donor countries overlook economic governance fundamentals because of higher level geostrategic goals.

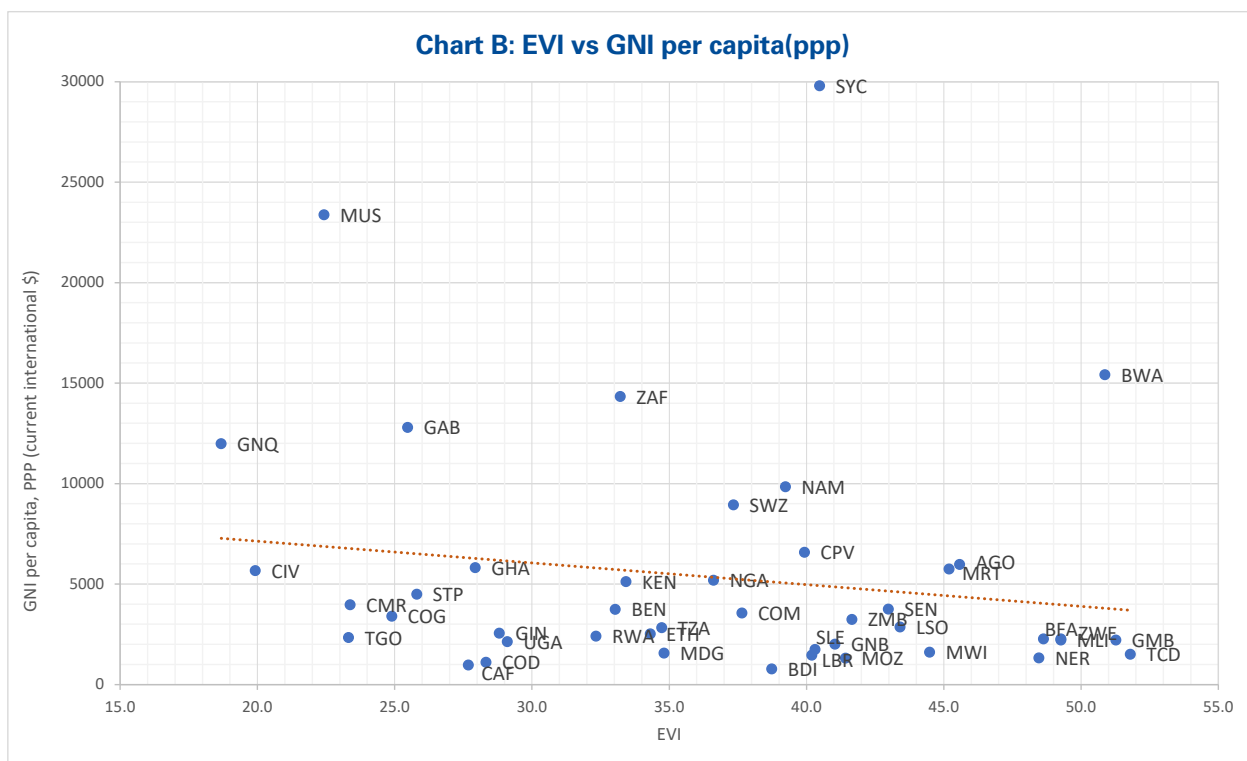
Reconsidering Development Theory

Perverse development assistance in Africa during the Cold War years undermined political and economic stability and facilitated waste and mismanagement. Addressing these issues necessitates a reconsideration of development theory and development financing. As mentioned earlier, the notion that development financing is primarily a gap-filling exercise has taken hold over the ages. Taking its cue from the Bretton Woods conference, development thinking in Africa has focused on addressing shortfalls in government savings (arising from weak economic management or external shocks—like commodity price slumps or natural disasters). The expectation is that infusions of foreign aid or development assistance would give countries some breathing space to make productive expenditures that would boost future economic output and, hopefully, make the countries more self-reliant and competitive. On this basis, African countries have routinely paid more attention to closing their savings-investment gap in financial programming exercised, than to prioritizing strategic investments that could trigger and sustain structural economic transformations that would move economics from subsistence and survival to higher value industrialization and sustainable growth. Consciously or unconsciously, this notion has influenced development financing provided by both multilateral institutions and bilateral agencies.

The African continent is very different from post-World War II Europe in several important ways. First, the challenges faced by African countries are persistent and structural, not temporary. African countries are at the bottom of global value chains and cannot trade their way out of poverty easily. The perennial failure to address the structural rigidities that have kept African economies exporters of unprocessed raw materials means that the continent’s trade and fiscal challenges are much more entrenched. Second, African countries are not competitive in the global trading system and do not have easy market access. The framers of the Marshall Plan ensured that concomitant steps were taken to ensure that Europe has accelerated access to high-value trade. The same was true of Japan and Korea. Extraordinary efforts to enhance trade are vital if development assistance efforts are to succeed. In Africa’s case, low value-added trade constrained the ability of African countries to repay concessional loans while also saving enough for necessary strategic investments.



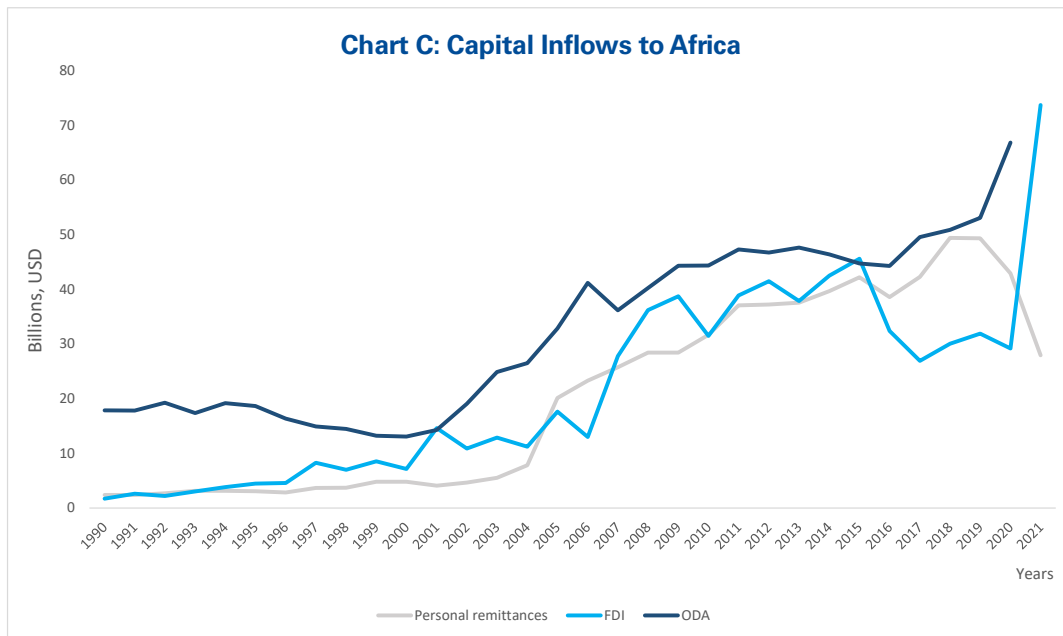
Third, Africa’s financial, economic, social, and political institutions are very fragile. This makes it harder to prevent fiscal diversion, financial leakages, and waste. In post-war Europe, it was relatively easier to reconstitute financial and economic institutions. In immediate post-independence Africa, these institutions were only just being built. Since the 1990s, when two-thirds of Sub-Saharan African countries were classified as “low income” by the World Bank, today half of the continent is classified either middle- or high-income, as shown in Chart A. While this calls for a more nuanced, country-specific approach to development assistance, it must be noted that some of the continent’s higher-income countries are still very susceptible to economic shocks, as shown in Chart B. Fourth, many African countries have experienced persistent political uncertainty and instability, coupled with episodes of violent conflict. This is largely due to the crisis of post-colonial legitimacy, the legacy of the Cold War, and the corrosive influence of zero-sum politics in many countries. A failure to reflect these peculiarities in the design, direction, timing, and quantum of development assistance Africa receives has been a recipe for disaster over the decades.



According to “Expensive Poverty” by Greg Mills, African countries received \$1.3 trillion in development assistance from 1990-2020. This is roughly equivalent to \$1,000 per capita. However, over this same period, average income per capita increased by just \$350 across the continent.⁵ Clearly, the return on investments in economic development has been less than stellar. The continent’s structural rigidities and weak economic governance are partly to blame, and the approach to development policy and practice share part of the blame.

Another reason why we must rethink the approach to development assistance is that Africa has changed significantly since the turn of the century. As Chart C illustrates—unlike the 1990s when development assistance accounted for roughly three-quarters of Africa’s capital inflows—by 2020, it accounted for less than 40%. Today, foreign direct investment and remittances account for most of the inflows. Non-concessional financing increases the fiscal cost of borrowing and exacerbates the debt burden for African countries. This adds another reason why savings rates are low in many African countries. Development assistance is trying to provide countries with a bandaid to address both the structural weaknesses and what is becoming persistent and deepening indebtedness. Furthermore, foreign direct investment has increased since 1990, but it is concentrated in a handful of countries.





Although the amount of concessional development assistance has decreased, the underlying development financing philosophy remained the same. Countries still overly focus on the savings-investment gap and are yet to find a way to prioritize strategic investments in their financial programming plans. The government of Ghana broke ranks in 2019 and became the vanguard for the “Africa Beyond Aid” narrative.⁶ This narrative echoed similar calls by pan-African leaders over the ages but differed from earlier analyses in a significant way.⁷ The Ghana model was not a philosophical objection to aid. It charted a progressive exit ramp from aid dependence to a more self-sufficient and accountable use of national resources. Moreover, development assistance has a role to play in this context. In reframing the development financing narrative, we must recognize that effective aid must be time-bound, and the framing must reflect equity, sustainability, and poverty reduction in a meaningful way. Development assistance must become an instrument to finance structural economic transformation and should focus less on funding individual projects.

In order to accomplish the goal of rethinking development assistance for 21st Century Africa, we must stop thinking about development assistance as a function of what donors are willing to provide and more about what Africa needs to finance critical infrastructure, technology, and human capacity development gaps.

Another important facet of the Africa beyond aid narrative is the importance of using Africa’s resources for Africa’s development. Using a progressively increasing proportion of Africa’s natural resources and often-dormant financial resources will help promote both resilience and sustainability. The United Nations Conference on Trade and Development (UNCTAD) estimates that Africa loses almost \$90 billion in illicit financial flows (IFFs) annually because of bad natural resource contracts, weak economic governance, and corruption.⁸ This dwarfs the amount of development assistance that flows into Africa annually. Using aid to invest in systems and institutions that staunch the flow of IFFs is one way to boost homegrown development financing. The United Nations Development Programme (UNDP) partnered with the Organization for Economic Co-operation and Development (OECD) to establish Tax Inspectors Without Borders.⁹ This initiative promoted fair and transparent natural resource contracting by providing bespoke technical assistance to countries entering or managing complex natural resource contracts. Since its inception, the program has delivered \$1.7 billion in additional tax collected and \$3.9 billion in additional tax assessed to beneficiary developing countries. Scaling these efforts in Africa would be beneficial. Africa’s Sovereign Wealth Funds and pension/insurance funds have roughly half a trillion U.S. dollars in assets under management.¹⁰ Most of these assets are not invested within the continent. A strong case could be made to use some of these funds to either fund strategic investments and/or help de-risk additional foreign direct investment through joint ventures.



An Evolving U.S. Approach

Since the founding of the United States Agency for International Development (USAID) in 1961, the U.S. approach to development assistance has evolved significantly. A decade after the establishment of USAID in 1961,¹¹ the United States established the Overseas Private Investment Corporation (OPIC) in 1971 in recognition of the crucial role played by the private sector.¹² Established in 2004, the Millennium Challenge Corporation (MCC) introduced development compacts that linked development finance to good governance.¹³ OPIC was revamped and the Development Finance Corporation (DFC) was established in 2019 with “investing for development” as its tag line.¹⁴ The United States also experimented by establishing the Task Force for Business and Stability Operations in 2006, to finance economic development efforts in the aftermath of the Iraq and Afghanistan wars.¹⁵

This evolution reflects a recognition that Africa’s development landscape, and development needs, have changed over the years—with over 2021 over half of African countries classified as middle or high income by 2021. For most countries, development priorities shifted from poverty reduction to strategic investments (including infrastructure) that would boost productive capacity and foster both equity and sustainability. The introduction of OPIC and the DFC emphasized the contributions of the private sector in bolstering economic development, while the advent of the MCC highlighted the centrality of sound economic governance and strategic investments, including infrastructure. However, USAID remains the most important tool for the financing and delivery of development and humanitarian assistance.

According to the U.S. Congressional Research Service, Sub-Saharan Africa (SSA) has received an increasing share of overall U.S. development assistance from USAID and the State Department over the years, rising from 10% in 2001, to 31% in 2011 and an average of 36% more recently.¹⁶ Over the past decade, total disbursements to SSA from these sources has averaged some \$7 billion annually, with most of the resources going to health—primarily programs addressing HIV/AIDS, malaria and tuberculosis. The Biden Administration’s \$7.8 billion FY2023 budget request for State Department and USAID assistance for Africa included 75% for health programs, 12% for economic growth, 6% for peace and security, 4% for democracy, human rights, and governance, and 4% for education and social services.

Four main criticisms have been levied against the U.S. approach to development assistance, namely: its lopsided nature, the scale of the ambition, a need for enhanced coordination, and problems with tied aid. While it is clear that programs such as the President’s Emergency Plan for AIDS Relief (PEPFAR)¹⁷ and the President’s Malaria Initiative¹⁸ have made a difference in Africa’s health sector, many argue that concomitant progress in other sectors like economic growth, education, and governance is vital for both efficacy and sustainability across the continent. It could be argued that lopsided development assistance only provides a partial solution, which may not be sustainable. Concerns have also been raised about the focus on three health emergencies, as opposed to the delivery of support that would establish and strengthen a robust primary health sector in Africa. The catastrophic failure of the healthcare systems in West Africa to respond to the 2014-16 Ebola outbreak or the continent to address the COVID-19 pandemic makes a case for more comprehensive health sector support—and not just focusing on HIV/AIDS and malaria. Some studies have also documented a further weakening of primary health systems as staff from primary healthcare facilities move to aid-funded health projects.

At \$47.8 billion in 2021, the United States is by far the world leader in providing global development assistance in aggregate terms.¹⁹ However, when viewed in relative terms, the United States provides only 0.2% of gross national income (GNI), well below the OECD average of 0.33%. While noting that the United States also contributes significantly through its financial support to multilateral institutions, an argument could be made for raising the ambition of U.S. development assistance, in particular, and global targets in general. Development financing must reflect the magnitude of the development financing being faced. African countries require a number of strategic investments if they are to become more resilient, less dependent, and more democratic. For example, the continent is facing significant annual financing gaps, for example: infrastructure (\$90-110 billion), technology (\$40-50 billion), and green transitions (\$50 billion). Development assistance must scale up and be more ambitious and adopt a moon-shot approach to meet these gaps, rather than focus on arbitrary GNI targets.



A more balanced approach to U.S. development assistance in Africa would not only ensure that all sectors receive equal attention, but it will also facilitate coordination and consistency. The 2006 Governance and Economic Management Assistance Program (GEMAP) in Liberia illustrates this point.²⁰ USAID and the U.S. Treasury jointly led this development assistance initiative with support from regional organizations and multilateral partners. Support for rebuilding that war-torn country required the full complement of U.S. instruments of foreign assistance. Development assistance from USAID (both technical and financial) was able to re-start the Liberian economy and instill a measure of investor confidence, technical financial management support from the Treasury helped shore up economic management, and stability and security from the United States helped strengthen the commitment to democratic governance and prevent a resurgence of violence. Liberia needed this coordinated support for development assistance to be effective in that challenging context.

Studies have shown that “tied aid” increases the costs of development assistance by 15-30%.²¹ Development assistance models that require beneficiary countries to source goods and services from donor countries have been shown to cost more and, in some cases, deliver less. In many cases, tied aid also results in developing parallel delivery and monitoring mechanisms in beneficiary countries. This undermines development effectiveness by diluting national ownership of development programs, burdening domestic government institutions with multiple (and sometimes duplicative) reporting requirements, and often costing more to administer. Addressing and eliminating tied aid in U.S. development assistance must receive prompt attention.

The 2022 U.S.-Africa Leaders Summit

The U.S.-Africa Leaders Summit in December 2022 was an opportunity to review U.S. development assistance in the context of a more general reset of relations between the United States and African countries.²² Most African countries came to the summit with enhanced trade, technology transfers, and investment on their minds. They were wary that rising nationalism, weakening multilateralism, and the global impacts of the war in Ukraine could impact U.S.-Africa relations adversely. They sought new and equal partnerships that would help African countries become more prosperous, resilient, and predictable trading partners. The United States was anxious to unveil a bolder, more ambitious relationship that would herald an era of scaled-up investment and mutually beneficial partnerships, particularly in the areas of trade, governance, security, and diplomacy.

The forum highlighted a couple of notable shifts. First, the announcement of veteran U.S. diplomat Ambassador Johnnie Carson to oversee the implementation of the \$55 billion package was a welcome change. This signaled U.S. commitment to effective implementation and much better coordination within the U.S. interagency, as well as between the United States and Africa countries. If this new position is provided with the resources and political clout it deserves, it could be the fulcrum that would facilitate a sequenced and coordinated rollout of the various programs. More importantly, efforts should be made to help promote collaboration and not competition between this position and other U.S. agencies that provide development assistance. The second notable shift pertains to the new focus on regional investments like the Democratic Republic of the Congo and Zambia initiative to jointly refine and process lithium and cobalt. This spotlight on regional development assistance signals that the United States continues to believe that development assistance is as much about large-scale strategic investments in value addition, technology transfers, and manufacturing as it is about more community-focused poverty reduction projects. The regional approach also allows the United States to scale up its development ambitions across Africa by overcoming the “small market size” most African countries face at the national level.

Although the Summit’s \$55 billion commitment almost doubled the \$30 billion announced by the Japanese government at the 8th Tokyo International Conference on African Development (TICAD) in August 2022,²³ its outcomes are more focused than the pledges made by China at the Forum for China-Africa Cooperation (FOCAC) in December 2021,²⁴ the Summit left several questions unanswered. The first relates to the mandate and responsibilities of the coordinator. This must happen quickly if this



initiative is to succeed. Also necessary in this regard is the allocation of adequate financial and human resources to provide requisite support. Second, there still needs to be a shift in the narrative from what the United States can provide to what Africa needs—consistent with attaining sustainable development goals. This shift will not only help concentrate U.S. development assistance targeted impacts, as opposed to discrete outcomes, but it will also identify how the United States can leverage other development assistance resources to maximize development impacts. Third, there is a need to avoid becoming overly focused on humanitarian assistance at the expense of development. This is particularly important for Africa’s middle-income countries, which may have higher income per capita, but are still very vulnerable to global trade and environmental shocks. Fourth, the Summit did not go far enough in its support for raising/catalyzing additional development financing for Africa, particularly the speedy rechanneling of IMF Special Drawing Rights and affordable/innovative resources to expedite Africa’s green transitions.

A Roadmap for Enhanced U.S.-Africa Development Assistance

Despite multiple challenges, development assistance has been transformative across Africa.²⁵ Development partners, like the United States, have contributed greatly to the continent’s development strides—particularly over the last couple of decades. However, much more needs to be done. Studies have shown that there is a continuing appetite in the United States to support development assistance, with polls showing that a majority believes that much more is being spent on aid.²⁶ This suggests that some political space exists to raise U.S. development assistance ambitions. Scaling up U.S. development assistance to a minimum of 1% GNI before 2030 will signal unparalleled U.S. leadership and demonstrate a solid commitment to the prosperity and stability of the African continent. In addition, the United States can consider the following:

Policy Options and Recommendations

- 1. Elevate development assistance, particularly USAID, to cabinet level to make it much more effective.** Invigorating U.S. development financing could also involve establishing a coordinating mechanism similar to the role played by the National Security Council on defense and security matters. The appointment of a coordinator to oversee and coordinate U.S.-Africa Leaders’ Summit commitments is a step in the right direction.
- 2. Empower African initiatives that enable the continent to make fully utilize and maximize its natural and financial resources, including the half a trillion in reserves held by the continent’s pension funds, Sovereign Wealth Funds, and financial institutions.** Programs like Tax Inspectors Without Borders should be supported and prioritized.
- 3. Future-proof development financing by considering support for development financing instruments that cater to future needs.** Investments required for Africa’s green energy transitions and strategies to address climate change fall in this category. Such financing must be accessible and affordable for households and businesses. These include sustainability bonds, carbon trading, and diaspora bonds. Bespoke programs and initiatives could help close critical financing gaps.
- 4. Forge strategic partnerships with private finance and technology firms.** The United States could leverage its market position to be a catalyst and a de-risker. Creative solutions, including the provision of targeted and time-bound tax credits, could help incentivize U.S.-based firms to be part of such partnerships.
- 5. Intentionally invest in an exit ramp from the persistent cycle of aid to consistent and coordinated efforts to further reduce aid dependency.** The United States could commit the progressively scale up support for value chain reengineering in favor of African producers, and expand efforts to increase private partnerships and investment flows, as development assistance winds down in the outer years.



Conclusion

Rethinking economic development pathways and development financing in Africa must not mean trying to scale up what is already being done. African countries and their development partners must adopt a new development framework. One that is not entirely predicated upon development assistance. The new framework must also incorporate the realities and urgency of Africa's imminent green transitions, as well as the need to close the yawning infrastructure and technology gaps. This new framework must have trade at the center. As was the case during the Marshall Plan for Europe, success and sustainability must be measured by Africa's ability to generate income and create trade by repositioning its exports in global value chains. Regional trade should be energized to help ensure food and fuel security, as well as boost industrialization. Furthermore, meaningful development progress requires sustained strategic investments in infrastructure, technology and human capital. Development assistance is not designed to provide this. Aid is insufficient, often tardy and usually tied. African countries will have to seek external investment and financing to fill these gaps. These financing flows must be construed as development financing, which requires an element of concessionality. This is why innovative mechanisms to de-risk such investments and reduce the costs of borrowing must be part of Africa's development conversation. The current gradual increase in domestic resource mobilization in a number of African countries could be supercharged using fintech, and proceeds should be directed towards health, education and skills acquisition.

Viewing economic development in Africa as an investment proposition is bold and risky. However, this is the only way to make a meaningful dent in poverty, ensure viable green transitions, and enhance institutional resilience for prudent and accountable economic governance. Africa's development partners, like the United States, have an important role to play, and that must go beyond their traditional role as purveyors of development assistance.

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