THE HORN OF AFRICA INITIATIVE

SUPPORTING RECOVERY THROUGH DEEPENING ECONOMIC INTEGRATION AND PROMOTING REGIONAL COOPERATION

PRIVATE SECTOR MOBILIZATION

A ROADMAP FOR A GOVERNMENT-ENABLED, PRIVATE SECTOR LED GREEN GROWTH IN THE HORN OF AFRICA

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Djibouti, Ethiopia, Eritrea, Kenya, Somalia, Sudan, South Sudan

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EXECUTIVE SUMMARY

Escalating debt to GDP ratios in the Horn of Africa limits the available space for governments to finance the priority projects and programs including those under the Horn of Africa investment package. High debt levels in the Horn of Africa region are driven by arrears accumulation, fiscal deficits, exchange rate depreciations, and worsened by the impacts of COVID-19 on revenues. For East Africa as a whole, the average total public debt-to-GDP ratio reached 87 percent in 2021 up from 79 percent in 2020, significantly higher than IMF's recommended threshold of 40 percent for developing countries.

The limitations on government fiscal flexibility and high borrowing costs make it clear there are limits to traditional sources financing available for countries in Africa. Governments and development partners cannot adequately fill the financing gap which highlights the key question of how the Horn of Africa countries can adapt to these trends, and at the same time, identify new drivers for growth and find innovative solutions to complement traditional public investments.

Private sector engagement can play a critical role in closing the financing gaps necessary for private sector development (PSD) in the region, particularly, given the complex fiscal scenario post-COVID-19. The starting point for implementation of the PSD approach will be through private sector engagement to leverage the strengths and capabilities of the private sector to drive economic growth, job creation, and poverty reduction, while also addressing social and environmental challenges. The collaboration between government and the private sector in shaping policy will be fundamental since reforms implemented through a process of private sector engagement tend to have greater sustainability over time and higher levels of legitimacy.

The COVID-19 pandemic has had a significant impact on private sector and global supply chains, including in the HoA region, which further deteriorated due to the conflict in Ukraine. In order to ensure broad-based African economic recovery and resilience, private sector development policies and investments should aim to accelerate inclusive and green growth, and the structural transformation and diversification of the productive base. This involves policies targeting industrialization, human capital development, promoting jobs in high-productivity sectors, facilitating intra African trade and regional supply chains and leveraging the African Continental Free Trade Area (AfCFTA). Governments and development partners must continue to support infrastructure investments, including, through the HoAI to advance fourth industrial revolution technologies, and intensifying cross cutting and sectoral reforms to unlock opportunities for the private sector.

While it is true that risks and challenges for private sector development exist in Africa, there are various risk mitigating solutions put in place by various actors to support private sector programs and projects. Development partners in cooperation with Horn of Africa governments will strive to use the full range of financing instruments available including equity, loans and loan syndication, asset recycling and asset refinancing, risk mitigation and credit enhancement mechanisms (including guarantees), and technical assistance grants.

To complement these instruments, blended finance capital structures will be mobilized to crowd-in private capital for high-impact projects, which will in turn alleviate the perception of high risks that discourage private investors. Furthermore, to mobilize co-financing, technical assistance, and the capacity building needed for implementing cross-cutting and enabling business environment reforms and to implement projects under the HoAI, the full range of partnerships will be mobilized, including, other multilateral development banks (MDBs) and development finance institutions (DFIs), bilateral development partners, private sector, civil society organizations, and philanthropic foundations.

The Roadmap for a Government-Enabled, Private Sector led Green growth in the Horn of Africa includes four pillars. **Pillar 1** will address **enhancing Cross-Cutting and sector-specific business environment to unlock opportunities for private sector green growth**. This will be achieved through (1) supporting trade and investment facilitation reforms to accelerate private sector-led structural transformation and green industrialisation in the Horn of Africa; (2) supporting the identification and implementation of landmark sector specific reforms in high-growth regional value chains to unlock private sector green investment opportunities; (3) supporting the development of public-private partnerships (PPPs) in HoA countries to encourage private investments in the development of critical economic and social infrastructure; and (4) empowering private sector through building the capacity of local private sector representatives to conduct public private dialogue and partnering with governments. **Pillar 2** will address **facilitating access to integrated green and digital infrastructure to accelerate industrialization and implementation of AfCFTA**. **Pillar 3** is focused on **promoting small and medium enterprises (SME) participation in regional green value chains**, and **Pillar 4** targets the **development of youth entrepreneurship ecosystems and strengthening youth digital skills**.

The Road Ahead for Private Sector Engagement in the Horn of Africa

- Map on-going private sector engagement programmes at national and regional levels, assess gaps in private sector mobilization, and determine how to close these gaps.
- Identify potential business opportunities at the regional level in areas aligned with the Horn of Africa Initiative Pillars with potential for private sector participation.
- Establish regional public-private dialogue platforms to engage the private sector on the way forward, potentially through organizing regional business forums that crowd-in private sector. Identify challenges impeding trade and investment, advocate for reforms and promote a conducive business climate, promote regional linkages amongst private companies, and develop an implementation plan for private sector development and engagement initiatives.
- Launch regional initiatives and programs to implement the four pillars of the private sector development approach presented earlier.
- Engage additional development partners and promote the potential of HoA countries with the objective of mobilizing DFIs financing, guarantees, grants, and technical assistance for the HoA initiative.

- Identify programs and initiatives to advance economic integration within existing trade agreements such as IGAD and the Tripartite Free Trade Area Agreement (TFTA).

AFRICA'S MACRO BACKDROP: PANDEMIC, UKRAINE, AND THE DEBT SUSTAINBILITY CHALLENGE

COVID-19 Pandemic

The AfDB's 2020 *African Economic Outlook* estimated that in 2020, Africa's GDP suffered losses of between USD145.5 – USD189.7 billion from pre-COVID-19 levels. African countries debt accumulation has been driven mainly by depreciating exchange rates, growing interest expenses, and high primary deficits. Currencies have depreciated significantly, particularly in frontier market economies, partially because of disruptions in external financial flows such as remittances, foreign direct investment, portfolio investments, and official development assistance. The report calculated that about 30 million Africans were pushed into extreme poverty in 2020 because of the pandemic and estimated that about 39 million Africans could fall into extreme poverty in 2021. Inequality was also set to rise because of the pandemic's disproportionate impact on vulnerable groups like women, youth, and low-skilled workers in the informal sector.

The on-going conflict in Ukraine

The war in Ukraine elevated risk aversion among international investors which raised the cost of external financing for "high risk" countries. This is in addition to the US Fed tapering, rising interest rates, and a stronger US dollar. Raising interest rates in African countries as a response to inflation weighs on growth outlooks and slows fiscal consolidation and debt stabilization or reduction, which are important rating sensitivities for many countries.

With Russia and Ukraine being major producers of critical commodities such as oil, gas, aluminum, palladium, nickel, fertilizer, wheat and corn, the sanctions and market concerns about the war, have disrupted supply chains and caused commodity prices to soar, albeit this has eased in recent months. The war has major implications for food security across the world and in the Africa given both countries' major roles in the global supply of food, inputs and Russia's prominence in global energy trade. The situation presented concerning challenges in the Horn of Africa. Somalia, for instance, had sourced over 90 percent of its wheat from Ukraine and Russia. The fallout out from the war compounded the economic and food security challenges brought on by the COVID-19 pandemic. At the same time, climate change and increased fragility pose persistent harm to Africa and the HoA region in particular. Rising input costs such as fertilizer prices along with supply chain disruptions have negative implications on food production and food security in African countries. The resultant increase in food prices and supply shocks could also fuel social tensions in many of the affected countries, especially those that are already fragile or affected by conflict.

Debt Sustainability in the Horn of Africa

Total debt levels in the Horn of Africa are high, driven by arrears accumulation, fiscal deficits, exchange rate depreciations, and worsened by the impacts of COVID-19 on revenues. For East Africa as a whole, the average total public debt-to-GDP ratio reached 87 percent in 2021, up from

79 percent in 2020. This is significantly higher than IMF's recommended threshold of 40% for developing countries.

High debt to GDP ratios limit the available headroom to finance the priority projects and programs including those under the Horn of Africa package. In Kenya, for example, the risk of debt distress changed from moderate to high in 2021, thereby making new loans more expensive and increasing the debt servicing obligations. Therefore, there is need to tap into innovative financing while carefully balancing the debt risks, including, from the private sector, to fill the financing gap for the Horn Africa initiative.

Limited Fiscal Flexibility Calls for Mobilizing Private Sector Financing Needed for Sustainable Development in the Horn of Africa

Limited government fiscal flexibility and high borrowing costs made it clear place limits on traditional sources financing available for countries in Africa as governments and development partners cannot fill the financing gap. The key question is how the Horn of Africa countries can adapt to these trends, and at the same time, identify new drivers for growth and find innovative solutions to complement traditional public investments.

Private sector-led growth is key to achieving the sustainable development goals and the African Union's 2063 development objectives**.** According to the International Finance Corporation's 2016 report on the private sector and jobs in Africa, the private sector accounts for 90 percent of jobs, 70 percent of gross domestic product (GDP), and 70 percent of all investment in Africa. The private sector can spur Africa's recovery and boost growth, by investing in both physical and social infrastructure. Innovation originating in the private sector is central to addressing challenges related to climate change adaptation, urbanization, financial inclusion, productivity, and the provision of goods and services that improve the quality of life of Africans.

The Maximizing Finance for Development approach (MFD) aims to help countries attract capital for national financing strategies. It is based on working with countries to crowd in private sector without pushing the public sector into unsustainable debt and contingent liabilities. This entails pursuing private sector solutions where they can help achieve development goals and reserving scarce public finance for where it is most needed.

Continental Challenges and Opportunities for the Private Sector Provide Lessons for the HoAI

The COVID-19 pandemic had a significant impact on the African private sector and global supply chains, which further deteriorated due to Russia's invasion of Ukraine. To ensure Africa's sustained economic recovery and enhance resilience, private sector development policies and investments should aim to accelerate inclusive and green growth and target structural transformation and diversification of African countries productive base. This requires policies that facilitate industrialization, human capital development, job creation, adoption of technologies to enhance productivity and sector competitiveness. Governments should also promote growth and development in Intra-African trade and regional supply chains, leveraging AfCFTA and various regional trade arrangements, enabling infrastructure investments, advancing fourth industrial revolution technologies, and intensifying cross-cutting and sectoral reforms to unlock opportunities for the private sector.

Challenges Facing Private Sector Development (PSD) in Africa

- While the business environment in African countries has improved over the past decade, institutional and regulatory obstacles continue to constrain private sector growth.
- While the structure of Africa's private sector has evolved noticeably over the past 10 years, informality is still a persisting challenge.
- Inadequacy of physical infrastructure across Africa continues to significantly inhibit private sector development, particularly in input sectors such as energy, water and transport.
- Entrepreneurs and SMEs face various development and growth constraints. These include barriers to regional and global markets, high costs of production, lack of adequate institutional and regulatory frameworks to support SME development, and limited access to finance.
- African human capital limitations also pose risks to PSD in the Fourth Industrial Revolution era.

Opportunities for Private Sector Development (PSD) in Africa

- The climate adaptation/green growth agenda represents a significant market opportunity for the private sector to develop new products and solutions, capitalizing on Africa's abundant and untapped resources of renewable energy.
- Rapid urbanization and rising African middle class with more purchasing power is expanding market opportunities. Middle-class Africans tripled over the last 30 years and currently stands at 313 million people, more than 34% of the continent's population.
- Africa's vast infrastructure deficit is an opportunity for significant new investment by the private sector to help leapfrog towards a new economic growth trajectory.
- The Fourth Industrial Revolution is already becoming reality in Africa with digital technologies and businesses models transforming every sector globally.
- The AfCFTA is expected to create larger and more integrated markets that can spur investment opportunities and intra-African trade as it connects 1.3 billion people across 55 countries with a combined GDP of USD 3.4 trillion.
- Fintech is extending access to financial services to the informal sector.

Roadmap for Private Sector led Green Growth in the Horn of Africa

The perception and the presumption of risk in African markets by the private sector investors are by far the biggest misunderstanding in pricing risk on the continent. The mismatch between this perception of risk and the on-ground reality usually leads some international investors who have yet to test the continent to seek a higher risk premium that is unparalleled for any other similar markets.

While it is true that risks still exist in parts of Africa, there are available solutions put in place by various actors to support private sector programs and projects. Development partners in cooperation with Horn of Africa governments will strive to use the full range of financing instruments available including equity, loans and loan syndication, asset recycling and asset refinancing, risk mitigation and credit enhancement mechanisms (including guarantees), and technical assistance grants.

To complement these instruments, blended finance capital structures will be mobilized to crowd-in private capital for high-impact projects, which will in turn alleviate the perception of risks that discourage private investors. Mobilization of innovative blended finance will follow the DFIs Principles for Blended Concessional Finance including assessing the economic rationale and the development impact for using blended concessional finance (financial and non-financial additionality), the need for crowding-in private sector financing with minimum concessionally, the commercial sustainability of the projects, the need to create new markets and promote competition, and adhering to high quality Environmental, Social and Governance (ESG) standards.

Furthermore, to mobilize co-financing, technical assistance, and the capacity building needed for implementing cross cutting and sectoral business environment reforms and to implement projects on the ground, the full range of partnerships will be mobilized including with other MDBs and DFIs, bilateral development partners, private sector, civil society organizations, and philanthropic foundations.

Pillar 1: Enhancing the Cross-Cutting and Sector Specific Business Environment to Unlock Opportunities for Private Sector Green Growth

Supporting trade and investment facilitation reforms to accelerate private sector-led structural transformation and green industrialisation in the Horn of Africa. Private sector stakeholders' engagement and consultation will be the entry point for identifying the reforms needed. There is a need for the Horn of Africa countries to collaborate on improving the legal, regulatory, institutional, and digital environment for cross-border trade and investment. This involves addressing non-tariff barriers, harmonizing trade regulations and border procedures, harmonizing sanitary, phytosanitary, products standards and technical regulations. Implementation of trade facilitation measures is a critical enabler for private sector participation, for example, through support for customs modernization and automation, implementing one-stop border posts, integrated border management, Electronic Cargo Tracking System (ECTS), Authorized Economic Operator (AEO) frameworks, and small-scale trade regimes (STRs)), and promoting digital trade platforms. Additionally, there is a need for the development of institutional and regulatory frameworks for green industrial zones, agro-processing zones, and technology parks. The WBG has been proactive in this effort with various innovative tools such as the Country Private Sector Diagnostic (CPSD), where in each CPSD an assessment is made of the state of the private sector, identification of near-term opportunities for private sector engagement, and recommendations of reforms and policy actions to mobilize private investment and drive solutions to key development challenges. To date the WBG has completed CPSDs for both Ethiopia and Kenya and is currently preparing the CPSD for Somalia.

Supporting the identification and implementation of landmark sector-specific reforms in high-growth regional value chains to unlock private sector green investment opportunities. There is a need to create the conditions conducive to developing regional value chains in which private sector can participate across sectors such as industry, agribusiness, infrastructure and logistics, tourism, education and healthcare value chains. In Djibouti for example, IFC has designed a business-enabling environment project which aims to implement the regulatory reforms needed to increase access to finance facilitating private sector investment in the housing value chains. Private sector stakeholders' engagement and consultation will be the entry point for prioritising sectors, identifying the reforms needed to attract private investors in those sectors, and for promoting the participation of SMEs in regional value chains.

Supporting the development of PPPs in Horn of Africa countries to encourage private investments in the development of critical economic and social infrastructure. Three types of interventions could be envisioned: (i) the development of institutional and regulatory frameworks for PPPs; (ii) technical assistance for building public sector capacity to manage PPPs, including, developing the PPP pipeline and preparing bankable PPP transactions; (iii) mobilizing private sector, impact investors, and DFIs financing for green PPP projects in transport and ICT infrastructure and industrial, agro-processing, and technology parks. In Kenya, IFC has been closely supporting the National Treasury in developing the country's PPP unit's capacity, with technical assistance provided in a number of sectors such as Transport, Housing, Energy and Water.

Building the capacity of local private sector and governments to engage in public private dialogue and develop bankable projects. Enabling reforms are prerequisites to private sector development and attracting private investment in high growth sectors. Support is needed to build the capacity of private sector (industry associations, chambers of commerce, women business associations, and SME associations) and their government counterparts to jointly identify and co-operate in implementing reforms as part of a public-private dialogue platform, identification of investment opportunities, and promoting the development of regional value chains. In Somalia, IFC is also involved in supporting policy dialogue through Public Private Dialogue (PPDs) to build trust between the public and private sectors and develop the private sector policy agenda.

Supporting the development and implementation of e-government systems and cross border digital payments to promote transparency in economic governance and efficient delivery of public services to private sector companies and citizens. Private investors depend on the government in at least two important ways; the delivery of permits and licenses that allow them to operate and participation in public procurement, including PPP projects. Digitized processes and paperless transactions make it possible to cut lead times significantly, lower cost of services, and make public tenders for the procurement of goods and services more transparent. Agencies whose digitisation would particularly benefit the private sector include those in charge of investments, exports, SME development, and business registration. In addition, the World Bank Identification for Development (ID4D) initiative aims to streamline the movement of people, goods, services and capital across borders, lay a foundation for future digital economy integration, and enhance access to and the delivery of services.

Pillar 2: Digital Infrastructure to Facilitate Industralization and Implementation of the AfCFTA

Supporting the development of cross-border infrastructure in partnership with the private sector is essential to facilitate cross-border trade, accelerate industrialization and the implementation of AfCFTA, and usher in fourth industrial revolution innovation. Critical infrastructure includes energy, ICT and integrated transport connectivity, which includes ports, transport corridors, warehousing, cold chains, and logistics services. Aligned with this, IFC, through the implementation of its digital strategy in Africa, which aims to enable ubiquitous, reliable, and affordable connectivity, has supported several strategic partners such as Liquid Telecommunications, Africa's largest independent fibre, data centre and cloud technology provider and helped them to expand their digital infrastructure network across Africa (including in some countries in the Horn Africa). While this engagement was done through financing, many of these types of infrastructure will typically be supported through PPPs, leveraging the previously mentioned support to the development of PPPs institutional and regulatory environment and the support to the identification and preparation of viable PPP projects that can be taken to market. Additionally, private sector stakeholders' engagement and consultation will be the entry point for the identification of PPP institutional and regulatory environment reforms.

Pillar 3: Promoting SME Participation in Value Chains

Supporting SMEs participation in regional value chains of high-growth sectors through private sector engagement to identify reforms needed to attract private investors and to promote participation of SMEs in these value chains. This activity should also include supporting lead firms that have the potential to spur domestic and regional value chains and supporting supplier development programmes that make it possible for SMEs to participate in these regional value chains. For example, IFC invested in Twiga Foods in Kenya which is a platform that uses mobile phone technology to match supply and demand, aggregating market participants and finding buyers for farmers' produce. Twiga's m-commerce platform enables vendors to order fresh produce, as and when needed, from farmers across Kenya. Through the system farmers have guaranteed access to a fairly-priced, transparent, mobile marketplace, while vendors can consistently source high-quality produce, which is conveniently delivered for free to their doorstep by Twiga. By increasing efficiency in the supply chain, Twiga is able to reduce waste and ultimately reduce food prices for end consumers. Beyond examples such as these there is a need to support SMEs training, SMEs certification programmes, SMEs adoption of Fourth Industrial Revolution technologies, and other quality improvement programs that build SMEs capacity to meet the norms and standards required by large regional and foreign companies so that they can become part of these companies' supply chains. There is also a need for fostering strategic partnerships with buyers, SME support organisations, and financial institutions to promote linkages and increase SMEs' access to finance.

It is worth mentioning another initiative that IFC led with key stakeholders from 2018 to 2022 to improve Senegal's previously threatened mango access to the EU market. In this country, there was a vibrant but nascent private sector working in the mango space, with 10 big mango exporters. The advisory work provided by IFC supported Senegal's mango sector to launch an innovative digital platform, known as Commango, to facilitate the buying and selling of mangoes and it reduced mango container rejections in Europe by 75 percent by helping to reduce pest infestation and other types of contamination. The advisory work also enabled the investment team to identify an investment pipeline of over $87 million in Senegal's agricultural sector. The success of this innovative project has made it worth replicating and expanding elsewhere, and the lessons-learned might find application in the Horn of Africa region.

Pillar 4: Developing Youth Entrepreneurship Ecosystems and Youth Digital Skills

There is a need for supporting high-growth, scalable entrepreneurs deploying digitally enabled and/or green business models to translate ideas into marketable products and services. There is a need to catalyse global support for developing Africa entrepreneurship ecosystems through multi-stakeholder partnerships that provide youth entrepreneurs with angel and venture capital funding, access to digital entrepreneurial skills, mentorship, experience-sharing, regional business partnerships and alliances, information hubs, online networking and transacting platforms that link entrepreneurs across the Horn of Africa and the wider continent. To realize such objectives, there is also a need to engage the private sector in establishing new schools and strengthening existing ones, including, TVET, and universities that are relevant to labor market demands, and delivering upskilling programs that are relevant to the private sector future skills needs. IFC has several engagements in other regions of the continent which it could look to replicate in the HoA such as the IFC's "Start-up Maghreb program" which aims to build a strong knowledge base around entrepreneurship in North Africa with the goal of supporting more investments in VC-funds and start-ups. Lessons learned from this initiative could be adapted to the situation in the HoA to produce similar results.

The Starting Point: Implementation Through Private Sector Engagement

Private sector engagement calls for involving private sector actors in development activities to harness their expertise, resources, and innovation to help achieve development objectives. Private sector engagement can take various forms. These include partnerships, investments, technical assistance, and policy dialogue.

The goal of private sector engagement is to leverage the strengths and capabilities of the private sector to drive economic growth, job creation, and poverty reduction, while also addressing social and environmental challenges often with community involvement**.**

The collaboration between government and the private sector in shaping policy is fundamental for fostering a supportive business environment that promotes sustainable and inclusive growth. Reforms that are implemented through a process of private sector engagement tend to have greater sustainability over time and higher levels of legitimacy.

Private sector engagement can play a critical role in closing the financing gaps necessary for private sector development in the region, particularly, given the complex fiscal scenario post-COVID-19. For example, Public-Private Partnerships (PPPs) are a critical tool for leveraging private sector resources to achieve policy objectives.

The private sector across the Horn of Africa (HoA) displays differing degrees of sophistication and challenges, highlighting the need for enhanced engagement efforts and opportunities for improvement. It is also important to align the Horn of Africa Initiative (HoAI) within COMESA, EAC, IGAD and other regional integration initiatives relevant existing trade frameworks and promoting greater private sector engagement are necessary for realizing the full potential of the AfCFTA to accelerate regional economic development.

To operationalize a Private Sector Strategy (PSE) in the HoA, the following features could be considered:

1. **Actionable Agenda:** This includes identifying barriers and interventions to support regional value chains with the highest potential, addressing specific national issues per country, identifying pathways to complement existing Regional Economic Communities (RECs), and balancing engagement with mature private sectors in one country and unorganized private sectors in another.

2. **Audience:** It is crucial to identify and establish partnerships that are cross-sectoral and tailored to the local context, treating the private sector as both a stakeholder and a source of expertise. Prioritizing engagement with stakeholders that have high influence and impact is essential to concentrate resources and support the integration of the HoA.

3. **Strategy:** A plan should be developed based on context and lessons learned for private sector engagement. These include developing a customized and sequenced strategy

based on sound diagnostics, prioritizing assistance programs tailored to specific country conditions, supporting local and foreign private sector activities during all stages of reconstruction, identifying and utilizing synergies and linkages across relevant actors and sectors, and developing interventions targeted towards migrants and diaspora communities where appropriate.

4. **Engage:** Pursuing diverse strategies and pinpointing priorities crucial to businesses may foster sustainable results, emphasizing market-oriented approaches when feasible. The choice of alternatives for each engagement would hinge on the objective, context/sector related to the specific intervention, market malfunction, policy reaction, and the ongoing policy dialogue mechanism for sustainability and monitoring (Figure 5). For instance, in cooperation with development partners, authorities might arrange regional forums with private sector representatives to promote a systematic public-private dialogue at the regional level, addressing regional issues such as value chain integration, trade, and investment facilitation.

The Road Ahead for Private Sector Engagement in The Horn of Africa

- Map ongoing private sector engagement programmes at national and regional levels, assess gaps in private sector mobilization and determine how to close these gaps.
- Identify potential business opportunities at the regional level in areas aligned with the Horn of Africa Initiative Pillars wherewith potential for private sector participation.
- Establish regional public-private dialogue platforms to engage the private sector on the way forward, potentially through organizing regional business forums that crowd-in private sector, identify challenges impeding trade and investment, advocate for reforms and promote a conducive business climate, promote regional linkages amongst private companies, and develop an implementation plan for private sector development and engagement initiatives.
- Launch regional initiatives and programs to implement the four pillars of the private sector development approach presented earlier.
- Engage additional development partners and promote the potential of HoA countries with the objective of mobilizing DFIs financing, guarantees, grants, and technical assistance for the HoA initiative.
- Identify programs and initiatives to advance economic integration within existing trade agreements such as IGAD and the Tripartite Free Trade Area Agreement (TFTA).

Appendix 1: East Africa Debt Burden

The table below presents the latest available data on public debt in the HoA region.

HoAI Country	Deby/GDP ratio (%)		Aggravating factors
	2020	***2021***	
Djibouti	70.1	74.4	
Ethiopia	50.5	52.95	High public expenditures for infrastructure
Eritrea	185	175.6	The historically high debt-GDP-ratio decreased due to government efforts to accelerate payments
Kenya	63	68	Primary deficit, exchange rate depreciation, expensive commercial debt whose maturities are falling due
Somalia		74.4	Historically high debt levels. Somalia will be able to access international financing once it secures full debt relief as expected by 2024.
South Sudan		41.7 (2019)	Impact of civil conflict, a large fall in oil prices, and high levels of fiscal spending
Sudan	135	143	Governance challenges, arrears and exchange rate depreciation leading to an increase in interest payments from 400 million to 14,800 million Sudanese Pounds

Sources: *East African Economic Outlook (2022), Ethiopia Public Debt: A policy note (2022); Country Diagnostic Notes (Djibouti (2022)), IMF data mapper*

Appendix 2: Achieving Sustainable Development Requires the Mobilization of Private Sector Financing

The Sustainable Development Agenda requires financing on a massive scale. The UN Commission on Trade and Development (UNCTAD) in its annual World Investment Report, 2014 estimated that US$5 trillion to US$7 trillion of investment is needed globally per year in order to achieve the SDGs. On the demand side, total annual investment needs in developing countries in key SDG sectors from 2015 to 2030 were estimated at between US$3.3 to US$4.5 trillion with a midpoint of US$3.9 trillion. This leaves an annual investment gap of between US$1.9 and US$3.1 trillion over current investment levels with a mid-point of US$2.5 trillion annual investment gap. Only private sector capital can avail such large funding by allocating capital to meet SDGs.

The UN Financing for Sustainable Development (2019) report highlighted the need for mobilizing private sector models and impact capital for sustainable development, while in the Development Commission, 2015 report "From Billions to Trillions: Transforming Development Finance", seven of the global multilateral organizations stressed that trillions of dollars are needed to close the funding gap for SDGs and affirmed their commitment to leveraging the current "billions" of development finance to "attract, leverage, and mobilize 'trillions' in investments of all kinds: public and private capital, particularly for infrastructure.

Therefore, development partners have adopted a Private Capital Mobilization (PCM) framework and methodology to leverage private sector financing critical for achieving SDGs across affordable clean energy, financial inclusion, zero hunger, decent work and economic growth, industry, innovation and infrastructure, and climate action.

It is worth noting that the potential for impact investing growth is tremendous and could have a considerable impact on achieving SDGs in Africa. The IFC report "Creating Impact: The Promise of Impact Investing" (2019) estimated the appetite for impact investment by private institutions at $5.1 trillion, while the appetite in public investment markets is at $21.4 trillion - assuming investments achieve market returns in both markets. Additionally, according to the Global Impact Investing Network (GIIN) Annual Impact Investor Surveys undertaken each year, impact investors worldwide have become energized at the prospect of contributing to these global goals and many have begun to align their portfolios to SDGs while others use SDGs as a mean to identify and develop impact investing strategies. The growing consideration of social and environmental factors in investing is a signal of a larger shift in the global financial markets.

Appendix 3: Challenges Facing Private Sector Development in Africa

While the business environment in African countries has improved over the past decade, though to varying degrees, institutional and regulatory obstacles continue to constrain private sector growth. The regulatory and institutional environment limits private sector development and is not robust enough to attract substantive levels of private investment. While several countries have implemented ambitious reforms, progress has not been even across the continent. More economy-wide and sector-specific reforms are necessary to enable private sector competitiveness. The constraints typically revolve around the institutional and regulatory challenges, a difficult operating environment and lack of an enabling environment, infrastructure availability, reliability and cost, persistent issues of economic governance and policies. Attracting domestic and foreign investments to high-growth sectors is a prerequisite for sustained private sector-led growth. While African countries vary significantly, the World Bank's Logistics Performance Index, the World Economic Forum's Global Competitiveness Index, and the Mo Ibrahim Index generally rank African countries among the world's least competitive places for private sector development and their ability to attract private investment. Given the history of conflict, the HoA region also lags behind the rest of the continent as an investment destination.

While the structure of Africa's private sector has evolved noticeably over the past 10 years, informality is a persisting challenge. In most Africa countries, historically the private sector comprised three broad components: (i) foreign multinationals operating across different sectors, (ii) a small group of formal local ecosystem made up of SMEs oligopoly and monopoly firms which might include state-owned enterprises competing with private sector or providing services such as transport, and (iii) a large, unstructured, informal group of MSMEs typically operating in trade and proximity services. However, over the past two decades, the structure of the private sector in Africa has been evolving. We have witnessed the emergence of locally bred African multinationals active in telecoms, finance, transport, and industry (collectively referred to as African Champions), and a solid block of medium-sized firms. This evolution was made possible by some institutional and regulatory changes that expanded market opportunities, made it easier to register a business, and broadened access to financial services. According to the IFC's (2016) report on the private sector and jobs in Africa, the informal sector accounts for up to 90% of private operators in most African countries.

Inadequacy of physical infrastructure across Africa continues to significantly inhibit private sector development, particularly in input sectors such as energy and transport. Adequate infrastructure is essential for private sector development. A recent study by the Economic Commission for Africa (ECA) revealed that the implementation of the Free Trade Area will lead to an increase in intra-African freight demand of around 28% by 2030, compared to a scenario without its implementation. These gains will only be optimized if the AfCFTA is accompanied by implementation of regional infrastructure projects.

Across the African continent roads predominate as a mode of land transport, although road density of 204 km per 1000 Km2 remains substantially lower compared to other developing regions with 944 km per 1000km2. The situation for rural access is worse as only 34 percent of the population are within two (2) kms of an all-weather road compared with 50% in other parts of the developing world. Africa's land transport has room to become more competitive by reducing high transaction costs that are as high as 40-70 percent compared to other developing countries. These costs arise mainly due to poor quality of infrastructure, absence or poor implementation of trade facilitation practices relating to aspects such as customs clearance and duties, delays, coordination issues, unpredictability, and informal payments.

In many countries, climate change is threatening agriculture and food security, urban water supply, and the supply of hydroelectricity. According to the African Climate Policy Centre, GDP in Africa's five regions is likely to decline significantly as temperatures rise. According to UNCTAD, for scenarios ranging from a 1°C to a 4°C increase over pre-industrial levels, the continent's GDP is expected to decrease by between 2.25% and 12.12% by 2030. The situation calls for new thinking from both government and private sector around possible solutions. The African Development Bank estimates that climate adaptation in Africa will require investments of about USD 3 trillion by 2030.

Entrepreneurs and SMEs face development and growth constraints. These include (i) competitiveness constraints such as limited access to domestic, regional and global markets, the high cost of production, inaccessibility of business development support mechanisms; (ii) institutional environment: lack of adequate institutional and regulatory frameworks to support entrepreneurship and SME development; (iii) financial constraints: access to finance through commercial banks is limited and prohibitive – most SMEs do not meet banks' requirements to access loans, investment funds (PE/VC) are typically not adapted to the critical mass of SMEs with low entry ticket, and are concentrated in very few countries.

Despite the growth in the banking sector, poor access to finance for MSMEs still blocks expansion. A 2019 study by IFC estimates the total financing gap for MSMEs at USD331 billion: 26 percent (USD86 billion) for micro businesses and 74 percent (USD245 billion) for small and medium enterprises.[1] Insufficient access to trade finance remains a major impediment to the development of Africa's trade sector and, more acutely, to intra-African trade. Access to finance is an important constraint to the development of enterprises of all sizes in Africa, but financing gaps are particularly significant for MSMEs.[2] Building an efficient financial system would require more robust monetary and fiscal policies, the review of financial regulations, new financing products, deeper local and regional capital markets, and better services for financial inclusion. In addition, African companies face crippling obstacles when they seek to tap into market opportunities, adopt technology, and access a skilled workforce. Business development services that could close MSMEs' capacity deficit are limited. Where they are available, most MSMEs find them unaffordable.

[1] The study discussed shortfalls and opportunities related to the financing gap for micro, small, and medium enterprises in emerging markets.
[2] Less than 20% of firms use banks to finance investments, and domestic credit to the private sector is lower in African than elsewhere. Only in four countries (Mauritius, Morocco, Tunisia, and Zimbabwe) do more than 50% of firms finance investments through banks: in the other African countries, less than 25% on average do so (the World Bank).

Africa human capital limitations pose risks to private sector development in the Fourth Industrial Revolution (4IR) era. The private sector in Africa faces skills deficit and inadequate labor force which impair its competitiveness. The lack of suitable skills in the labor force indicates a large gap between educational outcomes and labor market needs. Africa's large young and dynamic labor force must be sufficiently equipped with the necessary education and skills needed to improve their productivity and prepare them for the challenges and opportunities offered by the 4IR and to facilitate their transition from low productivity sectors and jobs into new and emerging ones.

Africa's education system faces significant challenges in delivering the learning outcomes, skills, and competencies necessary for transitioning to the job market, let alone attending to the requirements of the 4IR. Private sector institutions have a role to play in education and skills development by providing students with modern education and digital and entrepreneurial skills that improve their employability and enhance their readiness and relevance for private sector jobs. It is important to partner with the private sector to establish new schools, TVET, and universities that are relevant to labor market demands. In addition, there should be work undertaken work on removing legal and regulatory barriers to private sector investments/PPPs in the education and skills development sector.

Opportunities for Private Sector Development in Africa

The climate adaptation/green growth agenda presents a significant market opportunity for the private sector to develop new products and solutions. The African continent has abundant and untapped resources of renewable energy which creates real opportunities to invest in off-grid and mini-grid energy access projects, large scale green baseload projects, battery storage systems and green hydrogen. In addition, climate resilient and digital agri- technologies will be key in developing the agribusiness sector in Africa which has 60% of the world's remaining un-tapped agricultural land and has massive potential to become a net exporter of food products.

Rapid urbanization and rising African middle class with more purchasing power is expanding market opportunities. Rapid urbanization offers private sector investment opportunities to address infrastructure deficits in digital and transport connectivity, and power generation and connectivity. There is no doubt that Africa holds strong potential with its 1.2 billion population, which is projected to double by 2050 with youth accounting for 40 percent of the population. The income per capita of African cities is more than double the continental average which make them attractive markets. This attractiveness is enhanced by the fact that Africa is on its way to be the fastest-urbanizing region globally which ensures sustained demand for goods and services; a demand that is already growing due to regional integration and the growth of middle-class African households.

Africa's vast infrastructure deficit is an opportunity for significant new investment by the private sector to help leapfrog towards a new economic growth trajectory. As a share of GDP, infrastructure investments in Africa have stagnated at around 3.5 percent per year since 2000. The McKinsey Global Institute estimated in 2016 that this figure would need to rise to 4.5 percent for the continent to close its infrastructure gap. This would mean doubling annual investments in African infrastructure between 2015 and 2025 to reach USD150 billion by 2025.

However, attracting infrastructure investments needs conducive PPP legal frameworks and sector specific regulatory reforms as some of Africa's legal, regulatory, and institutional frameworks are major constraints to attracting private capital in infrastructure. Clear, unambiguous laws, regulations and guidelines are needed to provide comfort to potential investors about the enforceability of their infrastructure contracts. It also needs strong support for infrastructure project preparation as fully preparing sustainable infrastructure projects to a level that can attract investment requires between 7 and 10% of the estimated investment cost. Therefore, enhancing support for regulatory reforms, capacity building, and quality project preparation will bring more viable and bankable projects to market, thus attracting private sector investment.

The Fourth Industrial Revolution is already becoming reality in Africa. Digital technologies and businesses models are transforming every sector globally and the Digital Economy is constantly disrupting itself. New industries and new markets will be formed even as older ones start to evolve and transform. With the blurring of sectoral and national boundaries in the digital realm, competition has been redefined globally. With new industries and markets being created, new jobs will be created while the entire typology of labour markets will be reshaped. In order to capitalize on the Fourth Industrial Revolution massive potential, the African private sector should leverage its existing core capabilities and heavily build new investment and innovation capabilities to move higher up the value chain of products and services.

The AfDB 2019 report "Unlocking the Potential of the Fourth Industrial Revolution in Africa", identified more than 6,500 technology startups operating in Africa, among which close to 712 startups or 10 percent of them working on 4IR related technologies. Internet of things (IoT) applications are emerging steadily and Fourth Industrial Revolution (4IR) technologies such as artificial intelligence, drones, big data, 3D printing, blockchain technologies, and additive manufacturing are expected to make Africa's private sector more competitive, with applications spanning all sectors. In the agriculture sector, applications span automatic plant management, plant breeding to speed varietal selection, intelligent robots that reduce inputs by over 90%, the identification of biological anomalies, spatial planning, and the analysis of soil and weather conditions for precision farming. In the energy sector, 4IR applications include smart grids and the sale of solar power as a utility/service through internet-enabled cookers and solar panels. In the industrial sector, applications include the development of sophisticated machine-learning algorithms to interpret and/or explore data—for example, to manage fleets—while advanced robots will eliminate the advantage of cheap labour but create more valuable, higher-skilled jobs in the long term. In the financial sector, 4IR applications are transformative for financial inclusion (e.g., micro-insurance, micro-savings), e-commerce, fintech, crypto-currency-based transactions, and blockchain-enabled financial transaction platforms and systems.

The World Economic Forum calculated in 2020 that if Africa were to increase its share of global trade from 2 to 3 percent, this one percentage point increase would generate approximately US$70 billion of additional income per annum for the continent. If successfully implemented, AfCFTA could generate a combined consumer and business spending of US$6.7 trillion by 2030.

It is clear that AfCFTA presents a major opportunity for African countries to lift 30 million people out of extreme poverty and to raise the incomes of 68 million others who live on less than USD 5.50 per day.

Markets and economies across the region will be reshaped leading to the creation of new industries and the expansion of key sectors. African countries are becoming more connected to the global economy through global value chains. However, they tend to operate at the lowest rung of the ladder in those chains, mainly supplying raw materials and other low-value manufactured outputs. Cooperation is needed between African SMEs and regional and global companies to build regional value chains and to improve the competitiveness of African industries in global markets.

Implementing the AfCFTA would help usher in the kinds of deep reforms necessary to enhance long-term growth in African countries. As the AfCFTA is implemented, trade facilitation measures that cut red tape and simplify customs and border procedures are expected to produce USD292–450 billion in potential income gains.

Fintech and mobile financial services are extending access to financial services to populations (especially the informal sector) unable to access those services through the traditional banking sector. Fintech affects market structures in Africa by reducing the costs of financial services, creating opportunities to access new market segments and customers, and making incumbents more competitive. Africa is the global leader in mobile money, which has become an important component of the continent's financial services landscape. However, mobile financial services have not achieved their full potential for a variety of reasons including regulatory obstacles. Mobile financial services range from payments and current accounts to savings, loans, investments, and insurance. Africa counts 100 million active mobile money accounts today. The unbanked market and potential remain significant.

Appendix 4: Private Sector Engagement

Private sector engagement is the process of involving private sector actors in development activities to harness their expertise, resources, and innovation to help achieve development objectives.

The private sector in the Horn of Africa (HoA) displays differing degrees of sophistication and challenges across countries, highlighting the need for enhanced engagement efforts and opportunities for improvement. For instance, in Kenya, the private sector is well-developed, accounting for 80% of GDP, and the market is large and diverse. However, challenges remain in the areas of competition policy, informality, and bureaucratic red tape. In contrast, in South Sudan, the private sector is largely underdeveloped due to conflict and instability, and challenges are foundational and include lack of access to finance and a weak regulatory environment.

Figure 1. Private Sector Snapshot- Horn of Africa (HoA)

Kenya	Somalia	South Sudan	Djibouti	Ethiopia
➢ **Status:** The private sector is well-developed (accounts for 80% of GDP) and the market is large and diverse. ➢ **Challenges:** competition policy, informality, and bureaucratic red tape. WEF Global Competitiveness rank 94.	➢ **Status:** The private sector is largely informal/large conglomerates control many sectors **Challenges:** lack of access to finance and a weak regulatory environment, including competition policy.	➢ **Status:** The private sector is largely underdeveloped due to conflict and instability. ➢ **Challenges:** lack of access to finance and a weak regulatory environment.	➢ **Status:** The private sector is relatively small and underdeveloped due to small population and a small market. Sales by SOEs is high 60-70% of GDP. ➢ **Challenges:** lack of access to finance and limited infrastructure (electricity, ICT).	➢ **Status:** The private sector is relatively small but growing. Largest FDI in SSA$3.6 billion in 2017. The country has a large population and a large market. ➢ **Challenges:** lack of access to finance and a complex regulatory environment.

Sources: World Bank Group (Forthcoming); AfDB (2022); World Bank Group (2019); and World Bank (2018).

The HoAI framework is built on four pillars: improving infrastructure such as transport, energy, and digital networks, promoting trade and economic integration, building resilience to shocks such as natural disasters, and strengthening human capital. As part of efforts to promote trade and regional integration, governments have adopted a *Regional Trade Facilitation Roadmap 2022-2025*. This three-year plan aims to reduce trade costs and facilitate the movement of goods and services across borders through coordinated policy actions and reforms. This is particularly critical for the Horn of Africa within COMESA and other relevant RECs given that intra-regional trade is the lowest in Africa, accounting for less than 6 percent of gross domestic product, compared with about 17 percent for the continent as a whole.[3].

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[3] United Nations. (2020). *Commodity Trade Statistics Database (UN Comtrade).* Djibouti, Ethiopia, Kenya, South Sudan, and Somalia intra-regional trade, 2020.

Private sector engagement is key in several areas within the HoAI trade facilitation roadmap, such as implementing an Electronic Cargo Tracking System (ECTS), adopting Authorized Economic Operator (AEO) frameworks, and establishing small-scale trade regimes (STRs). By prioritizing the implementation of these initiatives, HoA countries can reduce transaction costs, increase efficiency, and facilitate trade, thereby enhancing regional economic integration and promoting sustained economic growth. By promoting private sector engagement, countries can leverage the AfCFTA to unlock new opportunities, drive innovation, and create more and better jobs for people across the continent.

Private sector engagement is also crucial for investing in pastoral areas in the HoA. Efforts are underway to enhance the resilience of pastoralists through private sector investments that promote access to financial services and markets (World Bank's De-risking, Inclusion and Value Enhancement of Pastoral Economies in the Horn of Africa – DRIVE project [4]). Private financial institutions are encouraged to provide financial services and literacy to pastoralists, while also investing in their distribution networks. These services include savings accounts to cover minor shocks and daily struggles, drought insurance to protect against medium to major droughts, digital accounts for payment services, and financial literacy programs to improve the resilience of vulnerable rural communities. Additionally, quality infrastructure is being developed to strengthen standards and support the private sector in exporting higher value livestock and meat products, while trade facilitation efforts are underway to facilitate cross-border livestock trade, strengthen quarantine facilities, and linkages to ports to bring livestock trade into formal channels. Finally, de-risking investments are being made to link pastoralists to livestock processors and exporters, thus increasing their income and bolstering the resilience of their communities.

Results Expected Through Private Sector Engagement

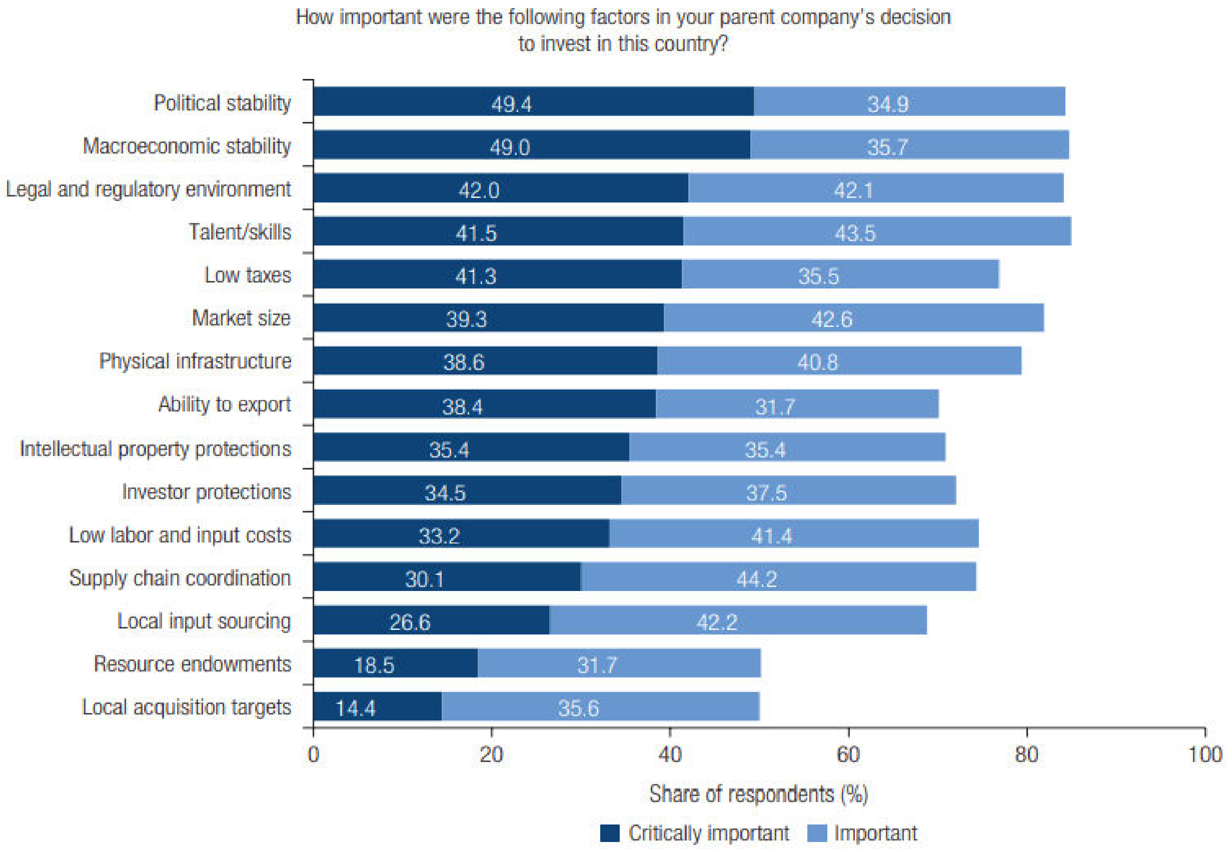
a) Better policy outcomes

The collaboration between government and the private sector in shaping policy is fundamental for fostering a supportive business environment that promotes sustainable and inclusive growth. Successful private sector engagement requires the adequate representation of relevant stakeholders, the establishment of effective feedback mechanisms, and the availability of a continuous dialogue platform. Such an engagement process can facilitate the identification of potential obstacles and enable stakeholders to work together to address them. The WBG's Global Investment Competitiveness Report 2019-2020 (GIC) surveyed more than 2,400 foreign investors in 10 large middle-income countries in 2019. Beyond macro-economic and political stability, the regulatory environment was cited as the most important factor driving investment decisions

[4] https://projects.worldbank.org/en/projects-operations/project-detail/P176517

(Figure 3) [5]. Research also demonstrates that the quality of institutions governing the business environment, including a strong private sector engagement platform, has a positive effect on FDI[6].

Figure 3. The Legal and Regulatory Environment Was among the Top Three Factors for FDI in 2019



Source: World Bank (2020)

Reforms that are implemented through a process of private sector engagement tend to have greater sustainability over time and higher levels of legitimacy. This is because the engagement process allows private sector stakeholders to take ownership of the reform process and ensures that the reforms are more responsive to their needs and preferences. Private sector engagement can provide valuable feedback and insights, which can help policymakers diagnose problems more accurately and develop more effective solutions[7]. The private sector can bring in knowledge, expertise, and experience that can help improve the design and implementation of reforms and make them more effective in achieving their intended goals.

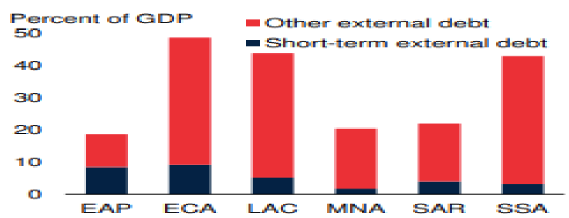
[5] World Bank Group. 2020. *Global Investment Competitiveness Report 2019-2020 (GIC).* Washington DC.
[6] Ali; et. al. 2010. *Do Institutions Matter for Foreign Direct Investment?* Open Economies Review, vol. 21, issue 2, 219 pages
[7] Herzberg, B; and Wright, A. 2006. *The public-private dialogue handbook: A toolkit for business environment reformers.* Washington, DC. DFID, World Bank, IFC, OECD Development Center.

b) *Support to close critical financial gaps*

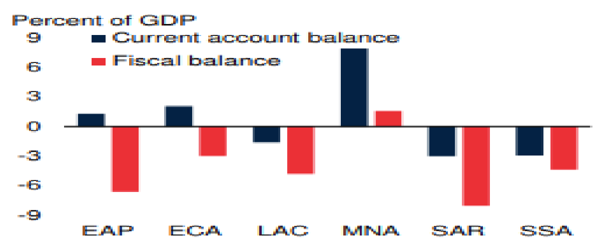
Private sector engagement can play a critical role in closing the financing gaps necessary for private sector development in the region, particularly given the complex fiscal scenario post-COVID-19 (Figure 4). This is particularly important in areas that are priorities under the HoAI framework, such as climate adaptation and mitigation, digital infrastructure, agribusiness, livestock value chains and trade facilitation. For instance, the estimated climate adaptation financing gap in Sub-Saharan Africa is around US$12.4 – US$13.1 billion[8]. Encouraging private capital mobilization (PCM) and private capital enabling (PCE) through investment climate improvements, partial risk guarantees, Public-Private Partnerships (PPPs), and different types of bonds can facilitate greater private sector investment in these areas. For example, the implementation of the AfCFTA's Protocol on Investment can help improve the investment climate, while the issuance of green bonds, such as Egypt's Inaugural Green Bond Issuance, can provide alternative financing options for climate-friendly projects under the Just Transtion. By leveraging private sector resources in this way, the region can make important strides towards achieving its development objectives.

Figure 4. Regional external debt, Current account and fiscal balances, by world region[9]

A. Regional external debt



B. Current account and fiscal balances



Source: World Bank (2023)

Public-Private Partnerships (PPPs) are a critical tool for leveraging private sector resources to achieve policy objectives. In the Economic Community of West African States (ECOWAS) region, a recent study highlighted the need for harmonization of national frameworks, fiscal management, and sector regulation to facilitate regional projects. To address these challenges, ECOWAS member countries agreed to harmonize legal and institutional frameworks. This process will culminate in an integrated regional PPP framework for governing PPPs. Over the next 25 years, the ECOWAS regional infrastructure masterplan includes 201 projects in connectivity, digital development, energy (including renewable energy), and transport (air, rail and maritime, shipping), with an estimated investment requirement of US$122 billion. Given the limited public

[8] Tall; et. al. 2021. *Enabling Private Investment in Climate Adaptation and Resilience: Current Status, Barriers to Investment and Blueprint for Action*. Washington, DC World Bank.

[9] EAP: East Asia and the Pacific; ECA: East and Central Europe; LAC: Latin America and the Caribbean; MNA: Middle East and Northern Africa: SAR: South Asia Region: SSA: South Saharan Africa.

financing capacity of the region, additional financial inflows will be required to bridge the infrastructure gap, making PPPs an essential tool to support regional development.