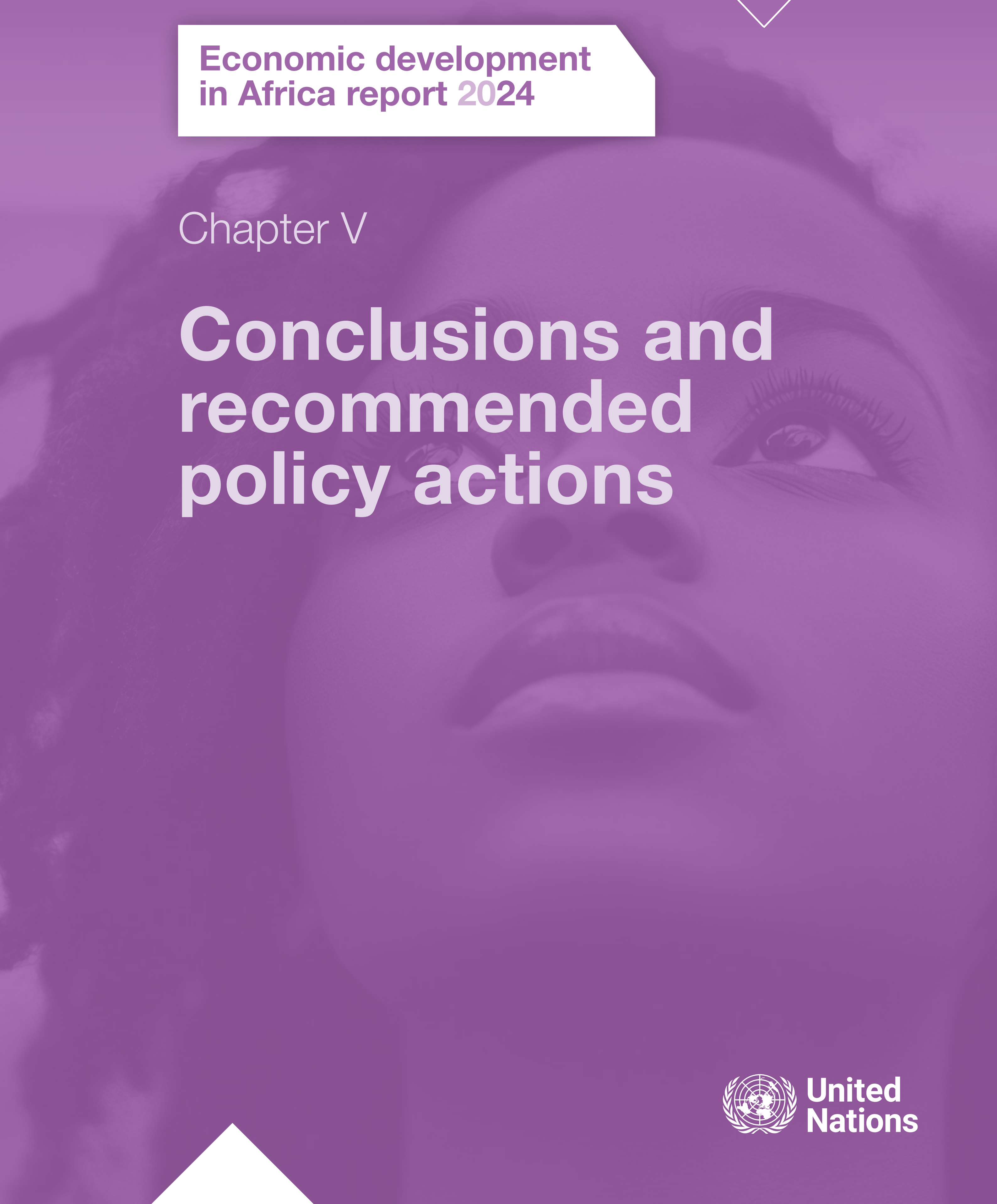
Economic development in Africa report 2024

Chapter V

Conclusions and recommended policy actions



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Introduction

The previous chapters emphasize that the simultaneous and interconnected global crises can significantly harm global prospects for growth, amplify economic and societal shocks and increase the vulnerability of African countries to volatile economic and trade conditions. Between 2012 and 2022, numerous covariate shocks and interconnected uncertainties had a major impact on the global economy, shifting the rhetoric on economic prosperity, financial stability, social cohesion and environmental sustainability. While market dynamics remain unpredictable, there are opportunities to be explored to harness the economic potential of domestic and regional markets in Africa. These include the African Continental Free Trade Area and subregional economic communities. To mitigate or recover from these crises, policymakers and businesses should collaborate closely to build resilient economic, trade and financial ecosystems that enable stronger crisis preparedness and response, encourage inclusive policies and enhance overall stability.

As outlined in chapter I, interconnected global crises exacerbate trade risks in Africa. Six categories of shock – political, economic, demographic, energy, technological and climate – pose significant threats to African trade and development. The differences among the vulnerability landscapes of African countries, particularly across the economic, governance, connectivity, social, energy and climate domains, will determine the extent to which they will be exposed to threats emanating from the polycrisis. Many African countries are highly vulnerable across the economic and connectivity domains, and their vulnerable economic and infrastructure systems increase their exposure to shocks. Hence the need for a multidimensional approach to risk management in Africa that addresses specific vulnerabilities across domains to build resilience against a complex and interconnected global risk landscape. Moreover, the importance of collaborative, resilient and adaptive policies to protect and advance economic and social development in Africa and help strengthen its resilience to the polycrisis cannot be overstated.

In particular, economic resilience should be reinforced to alleviate potential exposure to shocks stemming from the polycrisis. This requires the adoption of sound, stable macroeconomic stability policies that consider the different dynamics of African countries in terms of economic and trade structure and institutional systems. African economies remain largely undiversified and heavily reliant on primary commodity exports, making them particularly susceptible to external economic disturbances and price volatility. For those countries dependent on fuels, minerals and metals, this involves reinforcing the use of fiscal and monetary policies to incentivize diversification away from the fuel and mining sectors into other economic sectors. Countries dependent on agricultural exports should renew policies and invest in technology, skills and sustainable practices to enhance resilience against economic, financial, social and environmental shocks. Additionally, improving public financial management and adhering to fiscal targets can boost financial stability and revenues, helping countries recover from shocks without excessive borrowing and debt risk (chapter II).

The potential of regional economic integration in setting the pace of industrial growth and development in Africa should be taken into account. It is important to broaden the capabilities of African countries to effectively leverage the opportunities accorded by regional trade agreements, such as the Agreement Establishing the African Continental Free Trade Area.

To mitigate or recover from crises, policymakers and businesses should collaborate closely to build resilient economic, trade and financial ecosystems **that enable stronger crisis preparedness and response, encourage inclusive policies and enhance overall stability**

However, infrastructure gaps raise the cost of production and trade, undermining industrial productivity in the process, and eroding the competitiveness of African exports and the ability to develop viable value chains. While countries continue to prioritize their own economic infrastructure development, it is also important to further strengthen regional infrastructure development programmes. A balanced approach to infrastructure development remains essential for the sustainable development of intra-African value and supply chains. The current regional market dynamics in Africa signal a broader narrative about the opportunities to foster stronger trade networks aimed at promoting value added production and the supply of goods and services, and to enhance trade risk defence capabilities. Moreover, greater efforts and capabilities towards a coordinated continental approach to tackle infrastructure gaps, streamline trade procedures and foster deeper integration through the African Continental Free Trade Area are necessary if Africa is to build resilient, diversified and competitive trade networks, enabling it to better withstand global shocks and drive sustainable economic growth across the continent (chapter III).

Some businesses prosper amid the polycrisis, maintaining consistency and success. However, many African businesses, particularly SMEs, are faced with high trade costs, limited infrastructure and regulatory complexities that are worsened by weak energy infrastructure and limited financial support systems, which challenge their ability to manage risks effectively. To navigate the complex challenges posed by structural vulnerabilities, polycrisis shocks and global market fluctuations, there is an urgent need for SMEs in Africa to mitigate financial, operational and regulatory risks to bolster resilience and capitalize on opportunities in an increasingly competitive environment. For instance, access to financial instruments, such as derivatives and risk-management tools at the enterprise level, is essential for African firms to manage risks effectively and enhance their stability in volatile market conditions. Enterprise risk management can guarantee a safer and more reliable future for SMEs in Africa. Dealing with firm-related risks and opportunities calls for systemic, policy-driven efforts to equip African firms with the resilience required to thrive amid global uncertainties and unlock their full economic potential within regional and global markets (chapter IV).

Considerations for policy guidance

UNCTAD concludes its 2024 edition of the *Economic Development in Africa Report* by proposing short-, medium- and long-term actionable policy recommendations for key stakeholders – Governments, private sector trading partners and international organizations. In particular, Governments are encouraged to adopt policy measures that help enhance crisis preparedness and foster resilience to polycrisis shocks. Private firms are invited to develop stronger productive and trade capabilities by leveraging cost-effective risk-management strategies and other useful mechanisms that reduce their potential vulnerability in navigating the waters of uncertain economic environments. Trading partners and international organizations are urged to support and share knowledge about best practices to foster resilience to shocks emanating from the polycrisis. These proposed policy actions could enhance macroeconomic stability in African countries, optimize the resilience potential of regional trade markets, strengthen financial markets to facilitate hedging instruments and encourage SMEs to manage risk and improve performance in a proactive manner.

Enhancing macroeconomic stability to lower economic vulnerability to shocks

In a polycrisis environment beset with successive severe shocks, policymakers face multiple challenges. In the short term, prioritizing actions such as limiting economic losses, reducing inflation or rebuilding monetary and fiscal buffers is a difficult undertaking. This complexity arises when responding to a single supply-side shock, such as an energy sector commodity price shock, with measures such as inflation targeting, monetary tightening or foreign exchange intervention.

Optimal policy responses to multiple lingering shocks with spillover effects should focus on restoring macroeconomic stability, enhancing productive capacity and promoting sustainable consumption, savings and investment. Fiscal and monetary policies are useful for achieving objectives such as ensuring economic stability, wealth redistribution and revenue collection, and warding off harmful activities. For example, fiscal policy can stimulate economic growth, particularly during periods of shocks.

Nonetheless, caution should be observed when utilizing fiscal and monetary policy tools. For African Governments where equity should be a central objective, policies should be applied in such a way as to avoid the creation of uncertain environments or enable an unfair and uncompetitive environment that places other sectors or firms at a disadvantage. For instance, corporate taxes that remain higher for longer in one sector than another disadvantage firms and forge an unequal operational environment. Policy tools should be calibrated to strengthen diversification with sunset clauses. Fiscal and monetary policy regimes should aim for long-term application and consistency, as this ensures economic stability.

Optimal policy responses to multiple lingering shocks with spillover effects should focus on restoring macroeconomic stability, enhancing productive capacity and promoting sustainable consumption, savings and investment

For instance, open market operations supporting the agricultural sector should focus on implementation through a long-term development plan rather than one that brings frequent changes in the medium term.

Proposed policy actions to strengthen macroeconomic systems and achieve resilience

Based on the above, the following policy actions, aimed at strengthening macroeconomic systems to help build resilience across the economic domain, are presented to African policymakers and financial regulators for consideration:

- Optimize government spending and revenue through shock-sensitivity analysis.
- Apply a vulnerability lens to public financial management, monitoring and reporting.
- Facilitate optimal monetary policy by tailoring capital and liquidity requirements to risks and vulnerability to shocks.
- Increase institutional capacity for policy action and impact.

Improving public financial management and adhering to fiscal targets can boost financial stability and revenues, **helping countries recover from shocks without excessive borrowing and debt risk**

Optimize government spending and revenue through shock-sensitivity analysis

It is recommended that African Governments earmark expenditure for building infrastructure (physical and human capital) and essential public services that can help reduce business costs and support long-term economic benefits.

Short-term actions

It is recommended that African Governments identify and analyse revenue streams that can be used to sustainably finance the inputs and activities identified within the sectors allocated for diversification and resilience-strengthening.

Revenue could be generated from existing revenue streams, such as direct or indirect taxes. Such revenue could be earmarked for the activities and inputs identified for increasing economic resilience.

Conversely, revenue could be derived from deficit financing and borrowing (see medium-term actions below).

Medium-term actions

Detailed budgets should be drawn up, including the initial overall budget broken down into medium-term budgets. Budgets should be tied to specific objectives and to the inputs required. For instance, setting a target amount for infrastructure financing needs over a 5- or 10-year period can help Governments in Africa frame fiscal decision-making. Having this medium-term plan would not only help promote fiscal responsibility and sustainability; it would also help Governments perceive how changes due to shocks could affect the spending and revenue changes needed to reach specific infrastructure targets.

Deficit financing should be addressed, with details on where to borrow (internal or external) and the borrowing instruments and estimated borrowing terms. This would require African Governments to enhance debt management practices by improving debt reporting and reducing reliance on non-concessional borrowing. Seeking concessional financing (loans with favourable terms and lower interest rates) from multilateral institutions, such as the African Development Bank and the World Bank, can alleviate interest burdens and lengthen repayment periods, aiding in fiscal sustainability.

Moreover, it is recommended that African Governments establish comprehensive debt management frameworks that include caps on borrowing, regular assessments of debt sustainability and prudent terms for new loans. This is particularly relevant for countries that rely heavily on foreign debt, as seen in the case of Ghana (chapter II).

Effective debt management can prevent unexpected debt distress and improve credit ratings.

Apply a vulnerability lens to public financial management, monitoring and reporting

It is recommended that African Governments apply a vulnerability lens when designing and implementing fiscal policies to keep track of targets versus actuals for both government revenue and expenditure to ensure the fiscal sustainability of their development plans. By doing so, they can gain a better understanding of financial management issues and assess how their vulnerability to specific shocks or crises can affect their public finances and fiscal management processes.

Short-term actions

Applying a vulnerability lens to existing frameworks and tools used at the country level to assess the status of public financial management entails adding risk assessment criteria based on a country's vulnerability to global shocks when conducting public expenditure and financial accountability reviews. Two factors should be taken into account. First, most countries already have budget and financial accountability mechanisms in place, with some countries having conducted reviews of their budgeting and financial systems (see chapter II on fiscal policy). Second, although countries tend to score well in budget reliability, their scores in other areas are not as high.

Medium-term actions

Mechanisms to ensure appropriate monitoring, including regular audits and publication of documents, should be established. This is particularly relevant in a global polycrisis context where countries' vulnerability to shocks can have a bearing on the functions of their oversight institutions and the effectiveness of their public financial management and accounting practices.

Facilitate optimal monetary policy by tailoring capital and liquidity requirements to risks and vulnerability to shocks

It is recommended that African countries adopt financial stability tools to address stresses in the banking system while ensuring monetary policy stability.

Short-term actions

African Governments are encouraged to design a framework that promotes a resilient financial system in which banks can provide valuable credit, risk-management and liquidity services throughout the business and financial cycles, and in which financial regulation and supervision can lessen the probability of systemic risks and the potential costs of a shock hitting the financial system. A periodic review of such a framework should be undertaken to make sure that the regulatory and supervisory requirements deliver the same level of stability and/or resilience as new sources of risk emerge.

Central banks should implement clear inflation-targeting frameworks that maintain inflation within a defined range, such the 3 to 6 per cent target set by South Africa. These frameworks help stabilize prices, enhance investor confidence and mitigate the risks of imported inflation, particularly in countries with fixed exchange rates (see chapter II).

Medium-term actions

It would be advisable for central banks in Africa to support the capitalization growth and resilience of banks, which would contribute to lowering the risks of macroeconomic shocks. This would entail, for instance, the increasing use of tools, such as open market operations, to provide financial guarantees to commercial banks that lend at lower rates to businesses most vulnerable to shocks or to sectors identified for diversification.

Applying a vulnerability lens to public financial management entails adding risk assessment criteria based on a country's vulnerability to global shocks

Moreover, facilitating loan-targeting instruments that can expand private credit at favourable and sustainable rates will help diminish the vulnerabilities of households and businesses to shocks that have an impact on financial conditions.

Long-term actions

Regional development banks could have utility in financing long-term projects, for example, large-scale infrastructure projects and environmental projects that strengthen development. Investing in regional infrastructure projects, such as transport and energy networks, to facilitate cross-border trade and support the free movement of labour and capital within regional trading blocs, such as the African Continental Free Trade Area, will stimulate growth and stability in Africa.

Regional market dynamics in Africa signal a significant **opportunities to foster stronger trade networks** and enhance trade risk defence capabilities

Increase institutional capacity for policy action and impact

It is recommended that countries in Africa institutionalize better risk-informed public financial management processes by strengthening the capacity of public accountants, auditors and other relevant functions.

Short- to medium-term actions

The functions of audit offices can be reinforced or expanded with trained auditors who specialize in different functions related to line ministries whose purpose is to ensure comprehensive monitoring of existing frameworks. While African countries generally perform well in budgeting and planning areas, many lack efficient oversight institutions and often fall short in monitoring. Monitoring usually occurs through audits carried out by one office, with the office expected to audit all government functions, often with limited staff.

Within capacity-building frameworks, Governments should target the acquisition of longer-term technical skills and provide short courses and workshops to match each function. In addition, Governments should aim to ensure the availability of skill sets, such as geology expertise for ministries in charge of water resources or roads.

Long-term actions

African Governments should invest in the technical capacity of fiscal and economic planning institutions to improve long-term economic forecasting, debt analysis and fiscal policy implementation. Transparent and predictable fiscal policy processes, including publishing budget plans, debt statistics and economic performance reports, can improve accountability, reduce corruption and build confidence among investors and citizens.

Optimizing regional market opportunities to reduce trade-related risks

A dynamic network of value added exports and imports connecting businesses, suppliers and institutions across the various components of the supply chain, can enhance industry clustering and competitiveness. Such a network can boost efficiency, technological innovation, skills transfer, infrastructure development and regional economic growth, thereby strengthening the ability of African countries and regions to withstand shocks to trade and disruptions in supply chains. Opportunities to effectively leverage regional markets, such as the African Continental Free Trade Area, both in sourcing competitive inputs and in relocating production where necessary, will increase value addition in the exported products and reinforce existing and new trade networks at the subregional and continental levels, and thus help curb the cascading effects of trade risks and supply chain uncertainties.

As value added trade networks provide an appropriate route for improving the technical efficiency of African firms, their effective participation in such networks requires the upgrading of technical capacities to decrease inefficiencies and enhance the ability of firms to scale up production and exploit economies of scale.

The first step in this direction would be the development of an effective industrial ecosystem to support the growth and development of firms, including SMEs. This should be complemented by stable, consistent and credible macroeconomic and trade policies to ensure the predictability and stability of the business environment and lower risk and uncertainty when engaging in cross-border trade and financial activities. For now, infrastructure gaps remain a major obstacle to trade, raising investment, trade and marginal production costs; undermining industrial productivity; and eroding the competitiveness of African exports and the ability of countries in Africa to develop strong value chains. While these countries continue prioritizing the development of infrastructure that can support the growth of domestic economies, it is also important to focus on further reinforcing regional infrastructure development.

A balanced approach to infrastructure development remains essential for the sustainable development of intra-African value and supply chains. Similarly, investments in the energy sector are necessary to secure the seamless production of goods, particularly more complex manufactured goods. Energy security can help SMEs expand their production processes and diversify their goods, which in turn can help develop viable regional trade networks, while lowering production costs.

Proposed policy interventions to encourage participation in regional and global trade networks

To offset trade-related risks and enhance the participation of African countries in regional and global trade networks, the following policy intervention recommendations are put forth for consideration:

- Create more diversified regional trade networks through improved economic infrastructure and value addition.
- Strengthen regional mechanisms to manage cross-border trade-related risks and mitigate external demand shocks.
- Develop stronger capabilities to enhance industrial productivity, supply chains and resilient markets.

Leverage the African Continental Free Trade Area, to enhance regional trade networks and **reduce exposure to economic, governance and connectivity risks**

Create more diversified regional trade networks through improved economic infrastructure and value addition

It is recommended that African Governments and regional institutions improve value added production and trade networks by prioritizing investments in transport, ICT and energy infrastructure to strengthen connectivity across African economies. This prioritization should be aligned with existing continental initiatives such as the African Continental Free Trade Area and the Programme for Infrastructure Development in Africa, which focuses on the cross-border implementation of energy and transport corridors and regional Internet exchange networks.

Short-term actions

Regional trade agreements offer opportunities for African businesses to scale up their operations and increase production capacities for goods and services that would otherwise be imported. Offering incentives that aim to promote industrialization and local manufacturing and sourcing (or supply) of goods and services targeted at regional markets is therefore recommended. For instance, African Governments could offer reduced corporate tax rates for companies that invest in manufacturing or industrial projects, while financial institutions could offer low-interest loans or credits on income tax for capital investments in machinery, technology and facilities that boost production capacity. These incentives would enhance productivity and value addition, reduce the dependence on exporting unprocessed raw materials (for example, crude oil or minerals) to global markets, where prices are volatile, and help stabilize export revenues.

Moreover, it is recommended that African regulators introduce risked-based investment regulations with clearly defined standards of accountability for the fiduciaries of institutional investors and investment managers, which would allow such funds to diversify their portfolios while controlling risks. Such regulations are more appropriate for investing in alternative assets, including infrastructure and other long-term assets. Given the energy potential of Africa, investments in renewable energy sources and regional power-sharing mechanisms are necessary. Improving energy infrastructure reduces production costs and increases the competitiveness of African industries.

Medium-term actions

The African Continental Free Trade Area could be leveraged to mobilize investment in infrastructure through the liberalization of services and the Protocol on Investment to the Agreement Establishing the African Continental Free Trade Area. The provisions for trade in services can provide opportunities for businesses in the infrastructure sector that could reduce investment costs and increase return on investment. By addressing the fragmentation of investment regulations, the Protocol is designed to be the single standard for investments in Africa, which should provide a more predictable governance regime for investments and a more positive investor experience. Further, the Protocol has established the Pan-African Trade and Investment Agency to assist investors in mobilizing financial resources and provide technical and business support.

Regional and international financial organizations and institutional investors could work closely with African Governments to set up co-investment programmes for financing subregional infrastructure networks. In the form of equity (for example, the Pan-African Infrastructure Development Fund) or debt (for example, the Managed Co-Lending Portfolio Programme of the International Finance Corporation), these co-investment vehicles could help leverage the credibility, expertise and experience of regional and international organizations to mobilize additional private capital to finance infrastructure projects in Africa.

Development partners, such as UNCTAD, are encouraged to support countries in reinforcing their investment regulation, building human capacity to promote standards of accountability and diversifying their investment portfolios. This could help improve market and regulatory conditions and thus facilitate safety in the investment decisions of institutional investors in co-investment platforms for regional and cross-border infrastructure financing. Broadening investment opportunities in regional connectivity infrastructure would help bring down logistical and trade costs, enhance connectivity and raise trade efficiency.

Strengthen regional mechanisms to manage cross-border trade-related risks and mitigate external demand shocks in Africa

It is recommended that African Governments and trading partners take steps to leverage regional markets, such as the African Continental Free Trade Area, to enhance regional trade networks and reduce exposure to economic, governance and connectivity risks. Regional trade agreements can shield African economies from external demand shocks by building stronger, more diversified intra-African trade relationships, reducing reliance on external markets and fostering regional production and value addition.

Short-term actions

It is important to promote the alignment of national strategies with regional integration goals through the use of uniform or compatible mapping and assessment standards. This allows for harmonized customs procedures for a more active participation of the private sector in interconnected value and supply chains and streamlined border processes for rapid and efficient response mechanisms to sudden external demand shocks.

African Governments and domestic, regional and multilateral financial institutions are encouraged to set up emergency or crisis-response trade finance and supply chain finance facilities to support African businesses affected by global demand shocks, helping them pivot to regional markets. Such financing can stabilize businesses that depend on exports and prevent job losses in key industries.

Medium-term actions

The establishment of an efficient management system and associated capacity-building for the harmonization of standards relating to regional production and trade networks would lead the way to better regional connectivity. Potential financing solutions could include setting up a regional fund or pooling public and private resources to help implement African Continental Free Trade Area strategies, build early warning systems, develop contingency plans and provide insurance to manage trade-related risks and challenges.

Development partners such as UNCTAD could provide support for customs departments to simplify procedures and reduce time and costs for businesses. This encourages trading countries to recognize their respective clearance forms, thereby helping to resolve time and compliance issues faced by entrepreneurs (see https://asycuda.org).

Long-term actions

African countries and regional institutions are encouraged to establish regional trade hubs and industrial parks that specialize in high-demand sectors such as agriculture, pharmaceuticals and technology. Regional trade hubs can attract investment and promote manufacturing within Africa, making the continent more self-reliant and capable of responding to global demand fluctuations.

Developing or expanding regional financial markets that offer options for financial integration and currency stability for intra-African trade would help increase the ability of African businesses to grow within the continent, stabilize exports and build resilience to external economic conditions.

Set up emergency or crisis-response trade finance and supply chain finance facilities to support African businesses affected by global demand shocks, **helping them pivot to regional markets**

When exporting or sourcing goods, more stable currencies can lessen inflationary pressures from currency fluctuations, particularly during external economic turbulence. The creation of regional payment systems, such as the Pan-African Payment and Settlement System, would allow African businesses to transact across borders without relying on international currencies, reducing their exposure to exchange rate risks and external financial market volatility.

Develop stronger capabilities to enhance industrial productivity, supply chains and resilient markets

It is recommended that African countries design industry-tailored training and capacity-building programmes to improve labour skills and encourage technology and innovation that can boost firm-level specialization and competitiveness in regional production and trade networks.

Short- to medium-term actions

Strengthening the institutions responsible for trade and industrialization policies is necessary to identify gaps and opportunities and thus improve industry competitiveness and ensure compliance with international standards.

Regularly assessing and monitoring productive capacities in key industries and sectors is useful to evaluate and mitigate the impact of macroeconomic shocks and trade policies on value added production demand linkages. For instance, UNCTAD assessments of national productive capacities gaps can help African countries identify and address their limitations and exploit opportunities to reinforce microeconomic and macroeconomic fundamentals for industrial growth and integration into value added trade networks.

Medium- to long-term actions

It is important to provide support for the institutional capacity-building of regional trade organizations, such as the African Continental Free Trade Area, by expanding cooperation in regulatory frameworks, quality standards and trade dispute mechanisms. Strengthening African regional trade agreements would contribute to the development of resilient regional value and supply chains and increase trade volume within the continent, making economies in Africa less vulnerable to external demand shocks.

Strengthening institutional and organizational settings to mitigate risks to cross-border transactions

Access to financial instruments, such as derivatives and risk-management tools, is essential for the management of currency and interest rate risks, **enhancing the stability of African firms amid volatile market conditions**

To facilitate more effective leveraging of intra-African trade opportunities and the potential for regional trade agreements to create buffers against global market shifts, African businesses would need to address foundational challenges, such as regulatory inconsistencies, infrastructure deficits and financial market limitations. Access to financial instruments, such as derivatives and risk-management tools, is essential for the management of currency and interest rate risks, enhancing the stability of African firms amid volatile market conditions. For instance, the use of financial derivatives, such as forward, future, option and swap contracts, can help traders and investors manage or trade, that is, transfer a specific financial risk[1] when engaging in a cross-border business or financial activity. However, the structuring, valuation and settlement of financial derivatives contracts, which are either traded within organized exchange markets, such as stock market or commodity exchanges, or processed over the counter, require sound financial infrastructures and institutional settings, including sophisticated exchange markets and robust clearinghouse systems that provide a safe and regulated trading platform for these risk-mitigating financial instruments.

[1] Either interest rate risk, currency risk, commodity price risk, equity and credit risk.

To guarantee that financial instruments serve their intended purposes to hedge against risk,[2] boost trade opportunities and empower a larger group of market participants[3] to access capital, a supportive legal and regulatory framework should be put in place.

However, underdeveloped financial markets and limited access to sophisticated instruments hinder African businesses from fully utilizing these instruments. Many advantages can be gained by developing and strengthening financial markets in Africa, primarily enabling traders and investors to manage their price risks more effectively, but also boosting linkages between trade and finance, improving the marketing of goods and services manufactured and traded across Africa and making African industries and regional markets more efficient and competitive. Furthermore, the success of these financial markets would also require sound risk management strategies and frameworks, as well as regulatory enhancement that can protect financial institutions and non-financial participants[4] alike and safeguard domestic financial stability.

Proposed policy measures to mitigate risks to cross-border transactions

In view of these opportunities and the potential to reduce the adverse effects of the polycrisis on cross-border trade in Africa, a more effective partnership and collaborative approach is recommended to promote the development of viable markets and tools that can serve the needs of African businesses in mitigating risks to cross-border transactions. In particular, there is a need to:

- Create a supportive environment for the use of sophisticated financial instruments and stability in cross-border financial transactions
- Enhance financial risk-management practices and culture
- Institutionalize enterprise risk management practices.

Create a supportive environment for the use of sophisticated financial instruments and stability in cross-border financial transactions

Short- to medium-term actions

In countries with existing exchanges, it is recommended that African Governments and regulatory authorities assess the current laws and regulations governing the exchanges and their operations to identify potential institutional and operational vulnerability to shocks and propose supportive actions through which derivatives and other risk-mitigation financial instruments can be best deployed and used by traders and investors when engaging in cross-border activities in Africa.

It is important to enhance the effectiveness of African regulators in supervising exchanges and their operations by increasing the adoption and use of supervisory and regulatory technology and tools. The use of emerging technologies, such as artificial intelligence and machine learning, could facilitate greater and better processing of regulatory data and improve supervision.

In some countries in Africa, this would require setting up innovation and/or digital technology units within a regulatory authority, such as a central bank, which could contribute to the design, testing, adoption and monitoring of supervisory and regulatory solutions.

[2] Including cross-border transaction risks emanating from internal and external shocks.
[3] For example, buyers and sellers in derivative contracts, exporters, importers, brokers and clearing banks.
[4] For example, firms engaged in trading financial derivatives and other risk-mitigating financial instruments.

African banks and financial institutions to make basic financial hedging tools, such as derivatives, **more affordable and accessible to SMEs**

Financial infrastructure, such as a clearing and settlement infrastructure, is important for the good functioning of domestic markets, including the money market, interbank market and bond market. Such infrastructure would also be essential in strengthening the ability to hedge currency risk and mitigate credit risk in response to future crises. For instance, it is recommended that African countries set up a strong clearinghouse that complies with international standards and can manage payment flows that are associated with the clearing and settlement of derivatives, including cross-border transactions, and create the necessary conditions for attracting domestic and international investors and market participants to trade derivatives on the domestic exchange.

Medium- to long-term actions

It is necessary for African countries to comply with all Basel standards and, in particular, ensure full implementation of the Basel risk-based capital standards, which would lower financial institutions' exposure to financial shocks and safeguard stability in cross-border capital flows. An assessment by the Basel Committee on Banking Supervision (Bank for International Settlements, 2023) found South Africa to be compliant with the Committee's large exposures framework. This means that the exposure of South African banks to a single counterparty or to a group of connected counterparties was within the required limit of 25 per cent of the banks' tier 1 capital, and hence an indication of their capacity to manage systemic risks.

It is further recommended that African countries (mainly regulators) and standard-setting bodies at the domestic or international level, such as the Basel-based committees, design tailored training programmes that focus on the components of the Basel standards that address key risks in the banking sector or help mitigate a particular vulnerability to shocks that affect the financial sector. Customized training programmes would help African regulatory experts better understand the benefits of the Basel standards and hence contribute to the effective implementation of international standards towards more resilient economic and financial environments.

Moreover, close coordination and interaction between regulators, policymakers and the private sector would help regulators better understand the specific challenges, needs and interests of market participants (in this case, both public and private investors) and thereby remove unnecessary obstacles to the participation of investors and market users in those exchanges. This would entail, for example, joint research on the policy, legal and regulatory determinants of derivates markets or market and risk assessments on financial markets, financial instruments and digital financial services that can further financial stability and financial inclusion.

A practical example of UNCTAD technical cooperation that aims to help countries manage financial risk more effectively and raise investment through enhanced regulation and stock exchange development is the Sustainable Stock Exchanges Initiative. This is a United Nations partnership programme that includes UNCTAD, the United Nations Global Compact and the United Nations Environment Programme. Its purpose is to provide a global platform for exploring how exchanges, in collaboration with investors, companies (issuers), regulators, policymakers and international organizations, can strengthen performance in dealing with environmental, social and corporate governance issues and encourage sustainable investment. The Sustainable Stock Exchanges Initiative seeks to achieve this by conducting evidence-based policy analysis, facilitating a network and forum for multi-stakeholder consensus-building and providing technical guidelines, advisory services and training.[5]

[5] See https://sseinitiative.org.

Enhance financial risk-management practices and culture

In addition to building the necessary skills of the regulators and supervisors who have the authority to set the conditions and rules of derivatives activity, review risk-management and governance processes, and track risk exposures, it is important that market participants[6] understand and appreciate the role and potential of derivatives markets in managing risks and strengthening the resilience of the economy.

Short-term actions

It is recommended that African Governments and the private sector promote basic financial risk awareness by providing training programmes to improve awareness and understanding of financial risk management for SMEs, including introductory training on simple financial risk tools and operational risk.

In addition, it is important to encourage African banks and financial institutions to make basic financial hedging tools, such as derivatives, more affordable and accessible to SMEs. This could be accomplished by launching pilot programmes in sectors exposed to currency volatility, for example, export-oriented industries, and simplifying the process for SMEs to access currency hedging and other basic instruments by reducing regulatory hurdles and transaction costs. Other recommendations are to establish public–private support platforms that can facilitate the access of African businesses to risk-management resources, including guides on mitigating cross-border financial risks, and to support the implementation of credit-guarantee schemes that encourage banks to lend to SMEs. These credit-guarantee schemes can help mitigate the risk for banks and encourage them to offer financing options that SMEs can use to manage financial risks more effectively.

Medium-term actions

It is recommended that African countries develop and deepen derivatives markets in key regional financial hubs, for example, Kenya, Nigeria and South Africa, which can provide firms across the continent with access to more advanced risk-management products, such as currency options, swaps and futures (chapter IV). The development of such markets would require stronger partnerships with regional institutions (for instance, development financial institutions) and established international markets to build the necessary technical capacity and expertise for managing and regulating derivatives markets effectively.

Fostering partnerships with regional banks and financial institutions in developing risk-management products and focusing on currency stability and transaction cost reduction, can be achieved under the Protocol on Investment to the Agreement Establishing the African Continental Free Trade Area (chapter IV), the Pan-African Payment and Settlement System and similar regional initiatives to improve financing opportunities in intra-African trade and lower currency risk when engaging in cross-border transactions.

A strong and well-functioning derivatives market or exchange also calls for the development of capacity-building and training programmes to strengthen the skills of financial market experts in structuring, pricing, trading, leveraging, settling and safeguarding financial derivatives and other financing models. Such institutional capacity-building are a necessity for both policymakers (regulators) and the private sector (investors and market users).

Developing such knowledge and skills can be achieved by designing training and capacity-building programmes, ranging from hedge accounting and standardization certificate programmes to financial risk-management training workshops and management training on valuation and

> Facilitate the access of African businesses to risk-management resources, **including guides on mitigating cross-border financial risks**

[6] Including financial institutions, such as pension funds, asset managers, insurers and banks, as well as traders such as exporters and importers that hedge trade-related risks with derivatives.

information systems for measuring and reporting exposures at the firm level.

Long-term actions

It is recommended that African countries and partners expand investment in the building of a comprehensive financial market infrastructure that includes derivatives exchanges, clearinghouses and robust settlement systems across Africa. This would provide SMEs with secure, regulated platforms for managing financial risks. Strengthening regulatory frameworks would contribute to the good governance and trading of derivatives and other risk-management products, ensuring transparency, stability and accessibility for all businesses.

At the regional level, efforts towards harmonizing financial regulations across African countries to support the development of integrated financial markets are highly encouraged, as they would enhance liquidity and access to risk-management instruments. It is also recommended that intraregional banks and financial institutions develop specialized financial products for SMEs, such as currency swaps and risk-sharing facilities, that mitigate financial risks associated with cross-border trade.

Institutionalize enterprise risk-management practices

Many private sector businesses, particularly SMEs, operate in unfavourable business climates or in complex industry-specific risk environments and face risks arising from macroeconomic uncertainties or connectivity vulnerabilities. These conditions affect their business operations, production, trade of goods and services, and finance. Risk management strategies and practices are pivotal approaches that can help them ensure against market uncertainties. This entails, for instance, their ability to anticipate, minimize or mitigate risks from internal (domestic) or external (regional, global) sources of shocks or vulnerability.

Moreover, effective risk management would enable SMEs to make better strategic decisions relating to operational and financial performance.

It is therefore important to formulate policies and practical guidelines on enterprise risk management at the SME level, including the necessary processes, structures and reporting and monitoring systems relating to risks (for example, strategic, operational and financial).

Similarly, there is a need to set risk-management standards tailored to the African context and better adapted to the resource capacity of local SMEs. For instance, such standards could include processes by which risks are appraised and mitigated based on the level or type of vulnerability to shocks (for instance, vulnerability across domains identified in this report) or initiatives to align enterprise risk-management strategy and regulatory frameworks with regional trade agreements, such as the Agreement Establishing the African Continental Free Trade Area, to ensure that cross-border risks are adequately identified and managed.

Table V.1 presents a strategic approach to institutionalizing enterprise risk-management practices in African SMEs and outlines strategic steps and key actions adapted to the unique economic, cultural and regulatory environment in Africa.

By implementing the policies, practices and tools outlined in this chapter, all stakeholders in Africa – Governments, local businesses, trading partners and international organizations – stand to benefit from a more favourable environment in which complex and interconnected crises and risks are assessed and managed effectively to reduce exposure to potential shocks and disruptions, stimulate growth and further development on the continent.

Table V. 1

Strategic steps and key actions for institutionalizing enterprise risk-management practices in Africa

Strategic steps	Key actions
Understand the local regulatory environment and cultural context	Become familiar with the local regulations and cultural attitudes towards risk and decision-making and take them into account.
Promote enterprise risk-management training programmes and build awareness	Develop and offer enterprise risk-management training to SME owners and managers. Organize events to spread enterprise risk-management knowledge and share relevant case studies.
Set up a clear enterprise risk-management framework	Utilize established frameworks,[a] with local adaptations to adopt best practices. Also, the enterprise risk-management framework should be adapted to address specific local risks.
Integrate enterprise risk management into corporate governance	Design enterprise risk-management policies and procedures aligned with organizational strategy and national priorities. African enterprise risk-management practices should address emerging risks, focusing on scenario planning and resilience-building. Risk management should be integrated into strategic planning and decision-making processes of African firms.
Foster a culture of risk awareness	Apply risk management to operations and decision-making, while integrating enterprise risk management into the organizational culture. This requires training SME owners and employees to adopt and implement risk-management practices.
Draw up effective enterprise risk-management implementation processes	Determine risk identification and prioritization processes and develop strategies to mitigate identified risks, for example, diversification and infrastructure for climate-related risks. Each sector has a unique risk profile, and enterprise risk-management practices should be tailored to meet sector-specific needs.
Explore enterprise risk management and ICT tools for business growth	Utilize enterprise risk-management tools and software suitable for the local context. Implement data analytics to enhance risk identification and assessment.
Envisage monitoring, review and evaluation practices	Conduct regular audits and reviews to ensure enterprise risk-management processes remain effective.
Engage in enterprise risk-management learning platforms, networks and cooperation	Collaborate to share best practices on enterprise risk management with government, industry networks, universities, and international organizations for systemic risk management. Public–private partnerships are gaining recognition as an effective means to manage large-scale risks, particularly in infrastructure development.

Source: UNCTAD, adapted from Commonwealth Secretariat (2023); International Labour Organization (2023); KPMG (2021); Lungisa et al. (2023).
[a] For example, Enterprise risk-management framework of the Committee of Sponsoring Organizations of the Treadway Commission; standard 31000 of the International Organization for Standardization.

Risk management strategies and practices are pivotal approaches that can help African SMEs ensure against market uncertainties