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OVERCOMING AFRICA'S ADDICTION TO FOREIGN AID: A LOOK AT SOME FINANCIAL ENGINEERING TO MOBILIZE OTHER RESOURCES

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OVERCOMING AFRICA'S ADDICTION TO FOREIGN AID: A LOOK AT SOME FINANCIAL ENGINEERING TO MOBILIZE OTHER RESOURCES

Abstract

The paper points out that African countries have become addicted to foreign aid. This has not, however, entirely helped their development because not only has aid been inadequate but it has also increased Africa's indebtedness with considerable servicing costs. Moreover, aid volatility, bureaucracy, and "tying" have curtailed and frustrated African budgets. The paper calls on African countries to explore alternative means of mobilizing resources to avoid the pitfalls of aid and foster the continent's development. Among the vehicles to this end proposed by the paper are: the budget; domestic capital markets; remittances; other Diasporean capital; future foreign exchange flows; and "reverse capital flight."

by DR. J. K. KWAKYE [1]

Dr. Kwakye worked with the Bank of Ghana for several years until 2000 and rose to the position of Assistant Director. He then joined the International Monetary Fund in Washington, D.C., as Advisor to the Executive Director Responsible for Ghana until 2010. Dr. Kwakye is currently a Senior Economist at the Institute of Economic Affairs, (IEA) Ghana.

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Further information may be obtained from;

The Institute of Economic Affairs,
P.O. Box OS1936, Osu, Accra, Ghana.
Tel:+233- 302244716 / 307010714
Fax:+233- 302- 222313
Email: iea@ieagh.org
Website: www.ieagh.org

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Preface

African countries have long depended on foreign aid. The aid has been used to finance development projects, finance technical assistance, or import critical commodities. As developing countries without enough resources of their own, African countries inevitably need additional aid resources. Africa's long reliance on foreign aid has emanated in part from the advice of its development partners.

Africa's dependence on foreign aid, however, comes with costs. Aid resources have not matched Africa's vast development needs, particularly relating to building physical and human capital. Aid has increased the continent's indebtedness whose high servicing costs have diverted resources away from development and social projects. Bureaucracy and volatility in aid delivery have often curtailed or frustrated African development budgets. Further, aid "tying" in the form of forced purchases from supplying countries and imposition of policy conditionalities, has often not served the interests of African countries.

Africa's long dependence on foreign aid has created moral hazard by breeding complacency and apathy in seeking alternative sources of mobilizing development resources. It is time Africa broke this aid addiction, given its costs. Some financial engineering is all that is needed to seek alternative resources.

The first vehicle is the budget itself. The budget offers scope for augmenting the resource envelope. This requires both revenue and expenditure measures. On the revenue side, there is room to broaden the tax base by roping into the tax net informal operators and the self-employed, reducing exemptions, and enforcing compliance. On the expenditure side, there is a need for prioritization by curtailing non-essential spending to create space for priority spending.

The second vehicle is the domestic capital market. The domestic capital market can provide long-term funds for the budget and other developmental activities in the key sectors of the economy. Bonds could be issued by government, municipalities and the private sector. In this regard, it will be necessary to develop the necessary institutional infrastructure and legal framework. A stable macroeconomic and political environment will also be conducive for the market.

Preface

The third vehicle is remittances. Remittances have a vast potential as a source of development financing. Measures required to tap remittances fully for development include: offering terms that make it more attractive to route them through formal rather that informal channels; reducing remittance costs by improving the financial infrastructure and regulatory framework; and courting remittances through reciprocal bilateral arrangements.

The fourth vehicle is Diaspora Bonds. This can be used to tap resources from Africa's Diaspora populations. While allowing them to earn some return, they will also be contributing to the development of the continent. Diaspora bonds can be used to tap into the wealth of the African Diaspora and a return of flight capital held abroad by Africa's residents.

The fifth vehicle is future foreign exchange flows. This entails bringing these flows forward for today's development through securitisation. Such flows include export receivables, tourism receipts and remittances. In this case, African countries would pledge their future foreign-currency receivables as collateral to raise funds for today's development. It is important, however, that the resources are used prudently and, to the extent possible, for productive activities and not for consumption purposes.

The sixth vehicle is "reverse capital flight". This has two sides. The first is to stem capital outflows; the second is to recover stolen wealth hidden abroad. The first requires strengthening anti-corruption institutions to check financial abuse by political leaders and to institute strong punitive measures for offenders. The second calls for using vehicles established by international bodies working to recover countries' stolen assets, including the Stolen Assets Recovery (STAR) initiative of The World Bank and the United Nations Office on Drugs and Crime (UNODC). The STAR initiative also helps countries establish institutions that can detect and deter illegal flow of funds.

Africa has long cried about lack of money to undertake its development. But the continent should look beyond donors to explore alternative sources in order to increase the resource envelope available for its development and to reduce the continent's vulnerability to foreign aid.

1. Introduction

African countries have long relied on foreign aid to support their development, as they lack enough resources of their own. Aid has been used to finance development projects, finance technical assistance, or import critical commodities, including food.

The term 'aid' may, however, be a misnomer to the extent that it may suggest something that is free. But, aid can be free or not free. Free aid comes in the form of a grant; whereas non-free aid comes in the form of a loan. When aid comes as a loan, it can be concessional or non-concessional, depending on its terms. Most 'aid' to Africa has actually been in the form of loans.

Foreign aid to Africa has not matched the continent's development needs. Aid has also come with costs, including crippling debt and imposition of conditions that may not always favour Africa's long-term development interests. Furthermore, prolonged use of foreign aid has led to addiction from which Africa has found it difficult to wean itself. Also, aid has created moral hazard to the extent that it has bred complacency and apathy especially in seeking alternatives.

This paper's key hypothesis is that Africa's overreliance on aid is not entirely helpful and that the continent can and must seek alternative sources of financing its development. All that is needed is some financial engineering to exploit these alternatives.

The paper is structured as follows. Following this introduction, Section 2 looks at some of the problems associated with foreign aid that limit its effectiveness as a development tool and why it is necessary for Africa to wean itself from it. After that, Section 3 elaborates alternative vehicles for mobilising resources to support Africa's development. Section 4 concludes the paper.

2. Problems with Overreliance on Foreign Aid

There are varying problems associated with Africa's prolonged use of aid. Aid has not only been inadequate for Africa's development needs, but it has also been unpredictable and volatile, frustrating African countries' budgets. Aid has created large indebtedness for Africa, the servicing of which has entailed considerable costs. Aid has been costly in terms of being plagued by bureaucracy and fragmentation. Further, aid tying in the form of purchases from donor countries and imposition of policy conditionalities has not always served Africa's interests.

2.1 Aid Inadequacy and Volatility

Aid to Africa has generally been inadequate in relation to the continent's development needs. Large deficits have persisted particularly in physical and human capital, which have stifled the continent's development. Aid has also been subject to considerable uncertainty and volatility. This has curtailed African budgets, subjected the budgets to considerable uncertainties, and retarded important fiscal projects and programs.

The United Nations has set a minimum threshold of 0.7 percent of Gross National Income (GNI) for Overseas Development Assistance (ODA) providers. By 2004, only a handful of ODA providers had reached this threshold. They were: Denmark, Luxembourg, The Netherlands, Norway and Sweden. Notably, the G-7 countries, the world's largest economies, all substantially fell short of the UN target. Were these countries to come up to the target, Africa would have a large boost in its ODA, which would give a big push to its development. It must be recalled that the US single-handedly funded the Marshall Plan that raised Western Europe up from the destruction of the Second World War. The US also contributed substantially to Japan's recovery after the War. It is that scale of assistance that can transform Africa.

Table 1: OECD Countries ODA, 2001-04 (%GDP)

Country	2001	2002	2003	2004
Australia	0.25	0.25	0.25	0.25
Austria	0.25	0.23	0.20	0.24
Belgium	0.37	0.42	0.61	0.41
Canada	0.23	0.28	0.26	0.26
Denmark	1.01	0.96	0.84	0.84
Finland	0.33	0.35	0.34	0.35
France	0.34	0.36	0.41	0.42
Germany	0.27	0.27	0.28	0.28
Greece	0.19	0.22	0.21	0.23
Ireland	0.33	0.41	0.41	0.39
Italy	0.14	0.20	0.16	0.15

Japan	0.23	0.23	0.20	0.19
Luxembourg	0.80	0.78	0.80	0.85
The Netherlands	0.82	0.82	0.81	0.74
New Zealand	0.25	0.23	0.23	0.23
Norway	0.83	0.91	0.92	0.87
Portugal	0.25	0.24	0.21	0.63
Spain	0.30	0.25	0.25	0.26
Sweden	0.76	0.74	0.70	0.77
Switzerland	0.34	0.32	0.38	0.37
UK	0.32	0.30	0.34	0.36
US	0.11	0.12	0.14	0.16

Source: OECD

Aid to Africa has never matched the continent's need. Moreover, aid does not always go where development demand would naturally draw it. Aid may not even be correlated with human development, the way that it is expected to. A plot of aid per capita against the human development index (HDI) was found to be a random scatter rather than correlated (see Browne, 2006). Aid does not appear to be correlated with income levels either. In fact, Low Income Countries (LICs), those with GDP per head of less than US$ 735, account for three-quarters of people living in poverty, but receive only 40 per cent of total aid. Sub-Saharan Africa (SSA), with the largest number of LICs and where poverty is most widespread, reportedly receives only one-third of total aid.

Apart from its inadequacy, aid to Africa is subject to considerable uncertainty and volatility. This is due to the cumbersome legal and administrative procedures in ODA-giving countries and the need to meet varying requirements in recipient countries, including relating to purchases and policies, as described in detail in Section 2.3 below.

The volatility of aid is further demonstrated by the fickleness of aggregate aid data. While ODA rose quite steadily for 4 decades after 1950, it began to fall away sharply after 1992 following geopolitical shifts. (See Section 2.3 below).

Aid uncertainty and volatility impart similar unpredictability to African budgets. This has often frustrated the implementation of important projects and programs in Africa. There have been several instances whereby roads, schools, health, water and energy projects have stalled in Africa because some promised aid was not delivered for a variety of reasons. This has caused economic dislocations and has sometimes led to social upheavals.

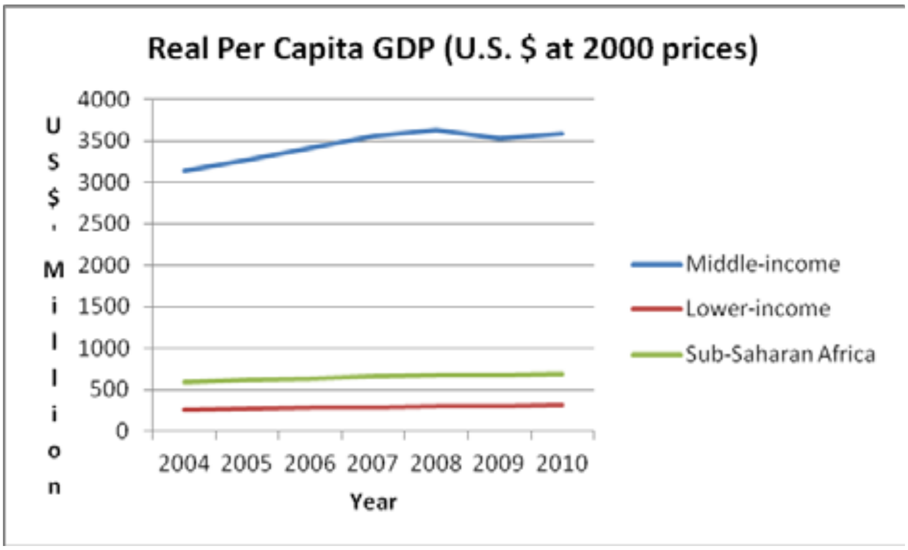
2.2 Vicious Cycle of Debt

Many African countries have low incomes. For the lower-income (LI) group, real GDP per capita is of the order of US$ 300. (See Table 2). The subsequent tables indicate the consequences of these low incomes in terms of the countries' capacity to save and invest, their fiscal and external positions and their indebtedness.

Table 2 and Chart 1: Real Per Capita GDP ($US at 2000 prices)

	2004-08	2004	2005	2006	2007	2008	2009	2010
Middle-income	3,399	3,140.9	3,262.6	3,406.5	3,557.6	3,625.1	3,525.4	3,592.7
Lower-income	278.0	259.4	268.8	277.9	287.5	297.1	302.8	310.6
Sub-Saharan Africa	635.0	593.4	612.7	633.9	659.2	676	673.9	688.4

Source: Regional Economic Outlook, IMF, April 2011

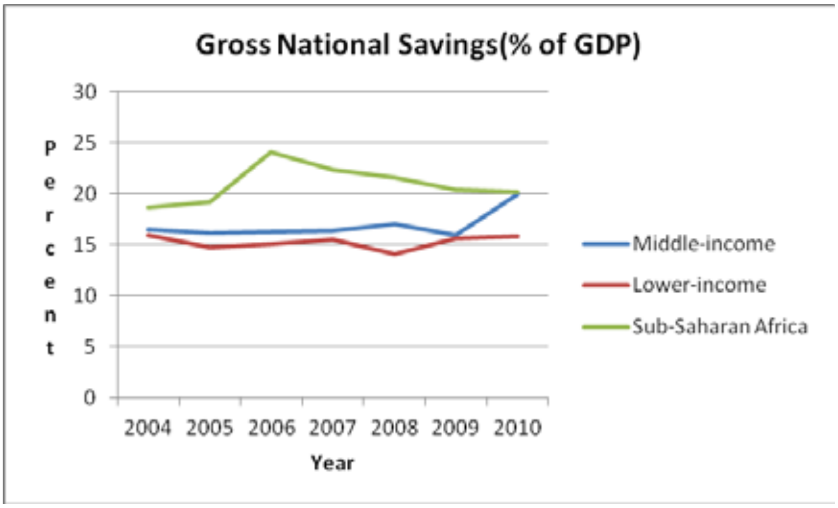


As a consequence of African countries' low incomes, they have low levels of savings that cannot support significant levels of investment. As expected, the LIs are at the bottom of this scale. (See Table 3 and Chart 2 below).

Table 3 and Chart 2: Gross National Savings (% of GDP)

	2004	2005	2006	2007	2008	2009	2010
Middle-income	16.5	16.2	16.3	16.4	17.0	15.9	20.0
Lower-income	15.9	14.7	15.1	15.5	14.1	15.6	15.8
Sub-Saharan Africa	18.6	19.2	24.1	22.3	21.6	20.4	20.2

Source: Regional Economic Outlook, IMF, April 2011

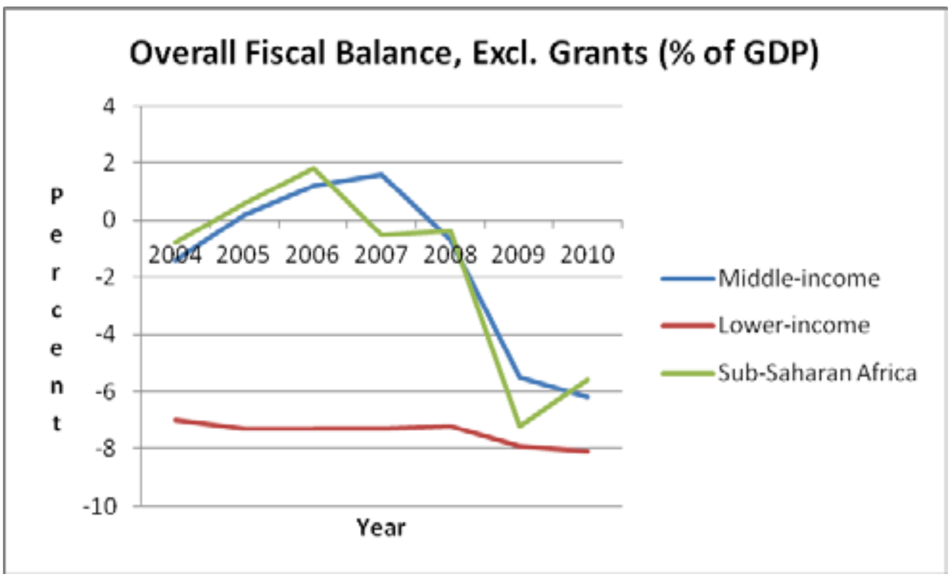


Partly because of their low incomes, many African countries do not collect enough revenue to fund their even constrained spending. Thus, they have budget deficits that, expectedly, are higher for the LIs (Table 4 and Chart 3).

Table 4 and Chart 3: Overall Fiscal Balance, Excluding Grants (% of GDP)

	2004-08	2004	2005	2006	2007	2008	2009	2010
Middle-income	0.2	-1.4	0.2	1.2	1.6	-0.7	-5.5	-6.2
Lower-income	-7.2	-7	-7.3	-7.3	-7.3	-7.2	-7.9	-8.1
Sub-Saharan Africa	0.1	-0.8	0.6	1.8	-0.5	-0.4	-7.2	-5.6

Source: Regional Economic Outlook, IMF, April 2011



Many African countries have persistent trade (Table 5 and Chart 4) and current account (Table 6 and Chart 5) deficits because they do not earn enough from external transactions to meet their needs. As expected, the deficits are higher for the LIs. The SSA figures are masked by the oil-exporting countries that have high earnings from oil exports.

Table 5 and Chart 4: Trade Balance (% of GDP)

	2004-08	2004	2005	2006	2007	2008	2009	2010
Middle-income	-1.5	-0.5	-0.4	-1.7	-2.2	-2.7	-1.5	-0.4
Lower-income	-8.6	-6.1	-8.5	-7.9	-9.1	-11.4	-9.6	-8.8
Sub-Saharan Africa	7.1	4.9	6.6	8.0	7.6	8.3	3.1	4.8

Source: Regional Economic Outlook, IMF, April 2011

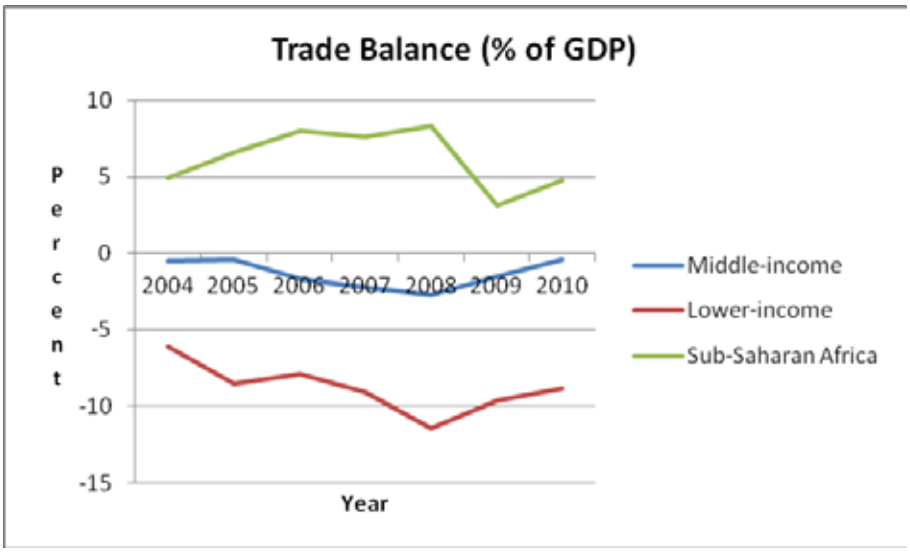
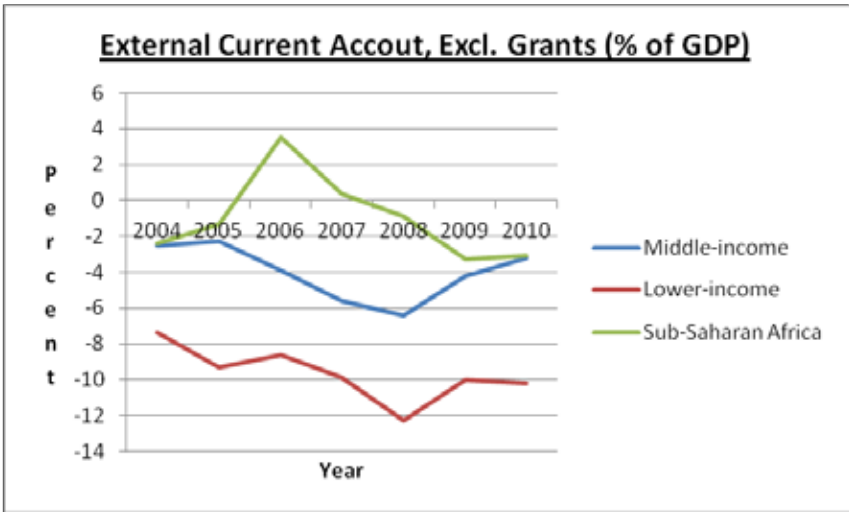


Table 6 and Chart 5: External Current Account, Excl. Grants (% of GDP)

	2004-08	2004	2005	2006	2007	2008	2009	2010
Middle-income	-4.1	-2.5	-2.3	-3.9	-5.6	-6.4	-4.2	-3.2
Lower-income	-9.5	-7.4	-9.3	-8.6	-9.9	-12.3	-10	-10.2
Sub-Saharan Africa	-0.1	-2.4	-1.3	3.5	0.4	-0.9	-3.3	-3.1

Source: Regional Economic Outlook, IMF, April 2011



Since many African countries do not have enough resources to fund their development, they have to rely on foreign aid. As we have noted above, while some aid is in the form of grants, the bulk comes in the form of loans. This has escalated the external debt burdens of African countries, with high service obligations that have denied the execution of important projects and programs. The tables and charts below illustrate the relative debt burden of Sub-Sahara Africa in terms of debts to official creditors (Table 7 and Chart 6) and as a percentage of GDP (Table 8 and Chart 7).

Table 7 and Chart 6: External Debt to Official Creditors (% of GDP)

	2004-08	2004	2005	2006	2007	2008	2009	2010
Middle-income	2.8	3.4	2.8	2.7	2.5	2.5	2.9	2.9
Lower-income	46.4	70.0	59.7	42.0	32.2	27.9	28.0	23.7
Sub-Saharan Africa	18.2	31.4	22.7	14.2	11.8	10.6	11.3	9.0

Source: Regional Economic Outlook, IMF, April 2011

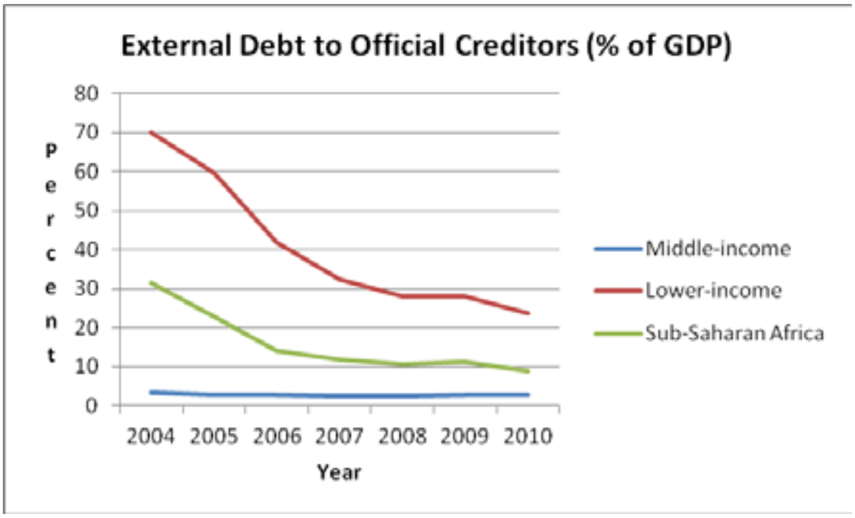
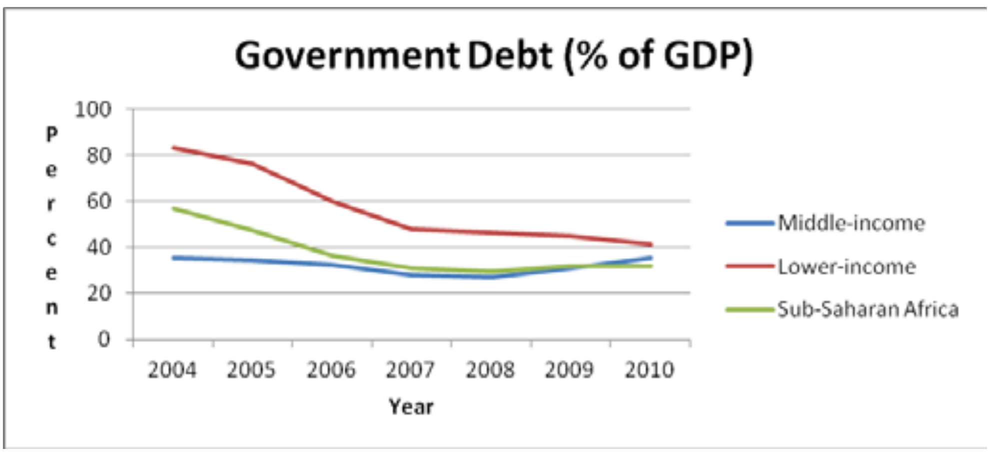


Table 8 and Chart 7: Government Debt (% of GDP)

	2004-08	2004	2005	2006	2007	2008	2009	2010
Middle-income	31.4	35.4	34.2	32.2	28.0	27.0	31.1	35.3
Lower-income	62.8	83.5	76.3	60.1	47.8	46.3	44.9	41.2
Sub-Saharan Africa	40.3	57.0	47.6	36.4	30.9	29.5	31.7	31.7

Source: Regional Economic Outlook, IMF, April 2011



Africa's overall external indebtedness worsened steadily over the post-independence periods. Therefore, while 'aid' is indispensable to Africa, given that the continent lacks its own resources to finance its development, it has resulted in high indebtedness of which servicing costs have been high and slowed down the continent's development.

The Tables above show that the LIs, as expected, have become the most indebted. The offer of debt relief to many LIs in 2006 under the Multilateral Debt Relief Initiative—following earlier relief under the Highly Indebted Poor Countries (HIPC) initiative—lowered their debt levels significantly. But they may well rise again in the future because the fundamental problems that led to accumulation of high debts have not gone away.

2.3 Aid "Tying"

One of the oldest problems that have bedeviled aid is 'tying.' Traditionally, aid tying involves requiring that aid recipients spend the funds in the donor country. In this paper, we extend the definition to include conditions relating to the political and/or military interests of the benefactor, and demand for implementation of prescribed policies.

When tying involves purchases from a donor country, it is like the givers of aid trying to derive commensurate benefit from it. It is like exacting value for money given. With aid tied to its sources, it finances capital and consumer goods and the range of training and consultancy services available from the aid giver. Aid tying comes with high costs, not just because of monopolistic costing, but more especially because lack of choice compels the recipient country to accept goods and services that may not be appropriate to their needs. By tying aid to purchases from and award of contracts to firms in donor countries, aid recipients are denied opportunities to benefit from competition in supplies and contracts. This denial undermines efficiency. Aid may also be linked to political and/or military interests of the benefactor. A look at the pattern of US aid amplifies this assertion.

Table 9: Top 10 Recipients of US Aid, 1960-2002

	1960	1970	1980	1990	1995	2000	2001	2002	2003
1	India	India	Egypt	Egypt	Egypt	Russia	Pakistan	Russia	Iraq
2	Korea	Vietnam	Israel	Israel	Haiti	Israel	Russia	Egypt	DR Congo
3	Pakistan	Pakistan	Turkey	Poland	Israel	Egypt	Egypt	Israel	Jordan
4	Vietnam	Indonesia	Bangladesh	Philippines	Russia	Ukraine	Colombia	Serbia	Colombia
5	Egypt	Korea	Indonesia	El Salvador	Iraq	Jordan	Ukraine	Afghanistan	Russia
6	Taiwan	Brazil	N. Marianas	Honduras	Palau	Indonesia	Serbia	Colombia	Ethiopia
7	Turkey	Colombia	India	Bangladesh	El Salvador	Ethiopia	Honduras	Jordan	Afghanistan
8	Jordan	Turkey	Nicaragua	Pakistan	Philippines	Bulgaria	Israel	Ukraine	Israel
9	Morocco	Laos	Somalia	Sudan	S. Africa	Mozambique	Peru	Indonesia	Egypt
10	Tunisia	N. Marianas	Sudan	Jamaica	Jordan	Honduras	Jordan	Pakistan	Bolivia

Source: Browne (2006)

The pattern of US aid over forty years from 1960 was influenced to a large extent by Cold War considerations and shifts in geopolitical factors. It can be seen that even for Africa, the US picked its aid recipients on the basis of Cold War considerations or other political or military interests.

As noted above, global ODA has been quite volatile, rising quite steadily for 4 decades after 1950, and falling away sharply after 1992. The fall was in large part because of the geopolitical rationale related to the Cold War, which had been a dominant donor motivation for aid, but had suddenly been removed. The 1990s saw a distinct switch in the direction of (reduced) aid away from Africa towards Europe, as donors sought to build influence with Eastern Europe and the newly independent states of the former Soviet Union.

In fact, it has been noted that aid does not always follow the often-claimed developmental objectives of donors. On the other hand, aid often serves as a means of influence that may be related to factors of commercial, geopolitical, strategic/security, or historical importance to donors. For example, patterns of aid allocation have been skewed by former colonial ties. It is of course a known fact that donors tend to give more aid to their former colonies—for example, France to Francophone countries, Britain to Anglophone countries, Portugal to Lusophone countries—which is a signification of the political economy of aid. Thus, despite all the talk of supporting democracy and economic openness, the former colonial powers still give about twice as much aid to their former colonies that are undemocratic or have closed economic systems.

Aid—particularly those routed through the Washington-based Bretton Woods Institutions (BWIs)—the International Monetary Fund (IMF) and the World Bank (WB)—has also often been subject to demanding policy conditions. The BWIs have become big aid agencies, disbursing large amounts of financial assistance contributed by the Western paymasters. The BWIs' financial assistance is invariably subject to implementation of policies that reflect the "neo-liberal tradition," which favors free markets and private enterprise and frowns upon economic controls and restrictions as well as a big role for the state. Implementation of free market policies is, however, not without costs. Associated market failures may inhibit maximum economic expansion and optimum social welfare. Direct government interventions are necessary to mitigate the pitfalls associated with free market policies.

2.4 Aid Bureaucracy and Fragmentation

Aid is seriously plagued by bureaucracy. It is often subject to government regulations and procedures of each supplying country. Bureaucracy not only breeds procedures and formalities but may also be costly. As aid recipients, African countries have faced innumerable requirements relating to design, approval and reporting. These requirements vary from donor to donor and can be quite disharmonious.

As we have noted above, aid is commonly routed through big development agencies, but this adds layers of bureaucracy, which undermines its effectiveness. In 2003, there were reportedly over 80 aid agencies administering over 35,000 separate projects in recipient countries. In addition to their complex procedures and working practices, aid agencies develop their own agendas in line with requirements by their ministries of finance and parliaments. Each bilateral donor has at least one agency to administer its aid programs.

Lack of aid effectiveness has long been a source of concern and emanates from various factors.

In 2005, an international accord on making aid more effective was reached in Paris under the Paris Declaration (PD) during which targets were set for 2015. Midway through the period, a follow-up meeting was held in Accra, Ghana. A major problem identified was that aid was fragmenting to the extent that there were too many agencies, financing too many projects, and using too many procedures. In fact, the number of aid projects financed by a multitude of bilateral donors had reportedly skyrocketed. While NGOs that were managing aid had become more numerous, their explosion was responsible for much of aid's fragmentation. Fragmentation was swamping poor countries, given their limited administrative and institutional capacities.

It has been widely noted that using donor experts (not local people) to build, run, and evaluate operations stands in the way of aid effectiveness. It is important to cut the use of such parallel systems dramatically. Oxfam has, rightly, noted that aid should strengthen local capacities "rather than spawn parallel aid empires".

One problem associated with too many aid agencies is lack of coordination or harmony. The best way of coping with fragmentation of aid in this sense would be for recipient countries to lay down a set of national development priorities and ask donors to fit in with their plans. The PD encouraged aid-recipient governments to publish development programs that aid agencies could use. Yet still, aid is being directed to areas that were at variance with national priorities.

3. Alternative Vehicles for Resource Mobilization

Given that reliance on external resources has landed African countries into so much debt, and given the other problems associated with aid enumerated above, Africa should begin to look beyond aid and explore other avenues to tap resources for its development. Some financial engineering is necessary to exploit other sources for mobilizing development resources and reducing reliance on foreign aid. This paper identifies the following vehicles for mobilizing such resources: the budget; domestic capital markets; remittances; other Diasporean capital; future foreign exchange flows; and "reverse capital flight." These options have mostly been overlooked to the detriment of Africa's development. The lack of African initiatives in exploring these options has been compounded by external advice, including from donors and other financiers like the World Bank and the IMF, that encourage African countries to continue to use external loans and other foreign aid to support the continent's development.

3.1 Resource Mobilization through the Budget

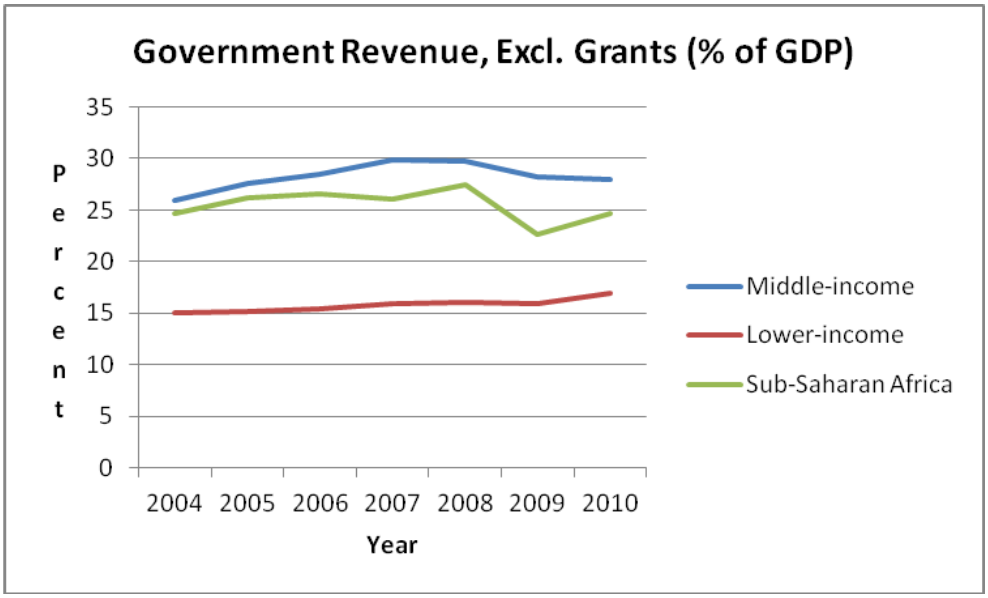
The budget itself is as an important vehicle for augmenting internal resources for development. This can be achieved by exploring both revenue and expenditure options. The import of this vehicle as a source of resource mobilization is often overlooked.

As can be seen from Table 10, the revenue effort of particularly LIs is low. There is considerable room for increasing this effort.

Table 10 and Chart 8: Government Revenue, Excl. Grants (% of GDP)

	2004-08	2004	2005	2006	2007	2008	2009	2010
Middle-income	28.4	25.9	27.6	28.5	29.9	29.8	28.2	28.0
Lower-income	15.5	15	15.1	15.4	15.9	16.0	15.9	16.9
Sub-Saharan Africa	26.2	24.7	26.2	26.6	26.1	27.5	22.6	24.7

Source: Regional Economic Outlook, IMF, April 2011



A strong mobilization effort can significantly increase Africa's resource envelope to support development. African revenue systems lack robustness, in part due to the narrow tax base, spate of tax exemptions, tax evasion, administrative inefficiencies and corruption.

Usually, personal income and company tax rates tend to be high, but because of the narrow base and other problems mentioned above, the direct tax effort is low. The informal and self-employment sectors have a vast tax potential, but remain largely outside the tax net in many African countries. There is a need to find innovative ways to rope these operators into the tax net. By broadening and deepening revenue collection, the high rates on income tax, indirect taxes, and petroleum taxes in many African countries could be accordingly reduced. While reducing tax rates would increase compliance, it would reduce Africa's high production costs that undermine the continent's international competitiveness.

Indirect taxes tend to contribute a disproportionately larger share of total tax receipts in African countries. The overreliance on indirect taxes stems from the fact that they are easier to levy and collect. As a result, indirect tax rates have been relatively high in many African countries, with VAT rates, for example, going up to 17 ½ percent and beyond in many countries. In many countries, the petroleum sector, for example, is heavily taxed to the extent that fuel prices are as high as and may, in some cases, even exceed those prevailing in America and Europe.

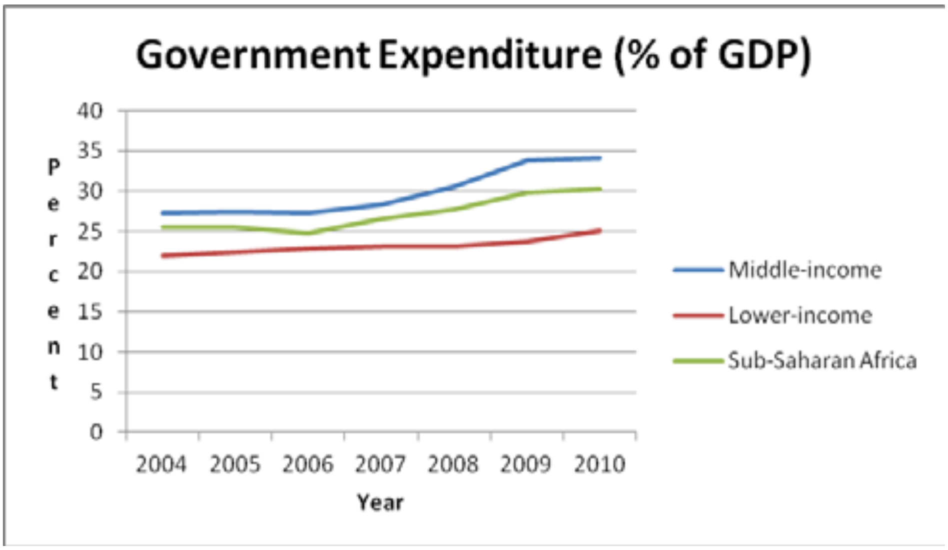
There is the need to expand the direct tax base in African countries to rope in potential taxpayers, including, as we have mentioned above, the self-employed and those engaged in informal activities and who consequently remain outside the tax net. In the case of Ghana, as is probably the case in many other African countries, property tax makes minimal contribution to the budget, although it has a huge potential, given the numerous sprawling mansions in the main cities and other urban areas.

There is generally no effective system for collection of property and rent income taxes, which are more progressive. These taxes tend to be the responsibility of local governments. But as an incentive for their collection, they could be tied to transfers from the central governments to local governments for other purposes. It has been suggested that lack of effort in this area may reflect a reluctance of the political elite, many of whom own these properties, not to pay their due share of taxes. Increasing the revenue effort also requires strengthening tax administration, reducing the spate of rebates and exemptions, and enforcing compliance.

Africa's expenditure budgets tend to be constrained by low revenues. Table 11 (and Chart 9) below shows that LIs have the lowest levels of expenditure because they have the lowest levels of revenue.

Table 11 and Chart 9: Government Expenditure (% of GDP)

	2004-08	2004	2005	2006	2007	2008	2009	2010
Middle-income	28.2	27.3	27.4	27.3	28.3	30.6	33.8	34.2
Lower-income	22.7	22.0	22.4	22.8	23.1	23.2	23.8	25.1
Sub-Saharan Africa	26.1	25.5	25.6	24.8	26.6	27.8	29.8	30.3



But even within the low expenditure envelope, they can create some space and get better value for money through prioritization and higher efficiency. Reducing non-essential spending would create room for priority spending. There is often plenty of room to reduce administrative budgets and other nonessential spending in favor of development and social spending. What is often lacking is the political will to do this. Africa cannot develop until it spends sizable budgets on development of its physical and human capital, just as the SEAs did. Table 12 shows the composition of Ghana's expenditure budget for 2007-10. It shows the disproportionate share of recurrent expenditure vis-à-vis capital expenditure. Within recurrent expenditure, wages & salaries have a commanding and growing share. Transfers also have a significant share of recurrent expenditure. A feature of Ghana's expenditure budget that is not discernible in the Table is the dominance of "statutory expenditure," defined to include wages & salaries, pensions, and payments to statutory funds, including the GETFUND, DACF, NHIF. The high level of earmarked statutory expenditure virtually holds the budget hostage as it leaves no room to maneuver in addressing other priorities.

Table 12: Ghana. Composition of Government Expenditure (% of GDP) (VERSION 2)

	2007	2008	2009	2010
Recurrent Expenditure	23.00	25.40	22.30	27.30
- Wages & Salaries	10.10	11.30	11.30	13.20
- Transfers	4.40	5.00	2.70	5.50
- Other recurrent expenditure	8.50	9.10	8.30	8.60
Capital Expenditure	14.40	15.70	11.90	10.80
Total Expenditure	**37.30**	**41.00**	**34.20**	**38.10**

Source: IMF Staff Report on Ghana's 1st and 2nd ECF Review, May 17, 2010.
Note: 2010 is projection.

African countries generally have large public sectors that consume a disproportionate share of tax revenue. Here also, the necessary political will should be mustered to undertake needed reforms that will ensure leaner, more productive, and better-remunerated public sectors. These measures should go hand in hand with others geared to reducing waste and increasing efficiency in public spending. Often, announced expenditures on some sectors do not elicit expected results and outcomes, suggesting misapplication of funds and spending inefficiencies.

3.2 Resource Mobilization Through the Domestic Capital Market

African countries are invariably encouraged to use foreign resources for development. Because of perceived high political and economic risks, FDI flows to Africa have been relatively low. As we have noted above, in addition to grants, Africa relies on concessional and non-concessional loans from the BWIs and other multilateral and bilateral sources for aid. A major failing of dependence on aid has been the lack of focus on the development of African domestic capital markets as potential sources of financing for the continent's development. Africa can mobilize resources for its development through domestic capital/ bond markets. Capital markets link issuers with long-term financing needs with investors willing to place funds in long-term, interest-bearing securities. A bond market offers opportunities for funding the government and private sector. Government bonds tend to dominate domestic securities markets. A government bond market provides several benefits. It provides an avenue for domestic funding of budget deficits other than that provided by the central bank and, thereby, can reduce the need for direct and potentially damaging monetary financing. It also avoids a build-up of foreign debt.

Capital mobilization by the non-government public sectors could also be promoted. There is potential for capital mobilization through bond issues by the energy, roads, ports, railways and telecommunications sectors. Adequate guarantees will, however, have to be provided to make the bonds attractive to investors. The idea of the capital market is to develop a culture of domestic savings to provide long-term funds for investment and development.

The absence of a sound market infrastructure, the paucity of (domestic) institutional investors, low savings rates and lack of interest from international investors can hold back capital market development. Further, political instability, economic instability, often fed by expansionary fiscal and monetary policies and exchange rate instability can weaken investor confidence and increase the risk associated with development of bond markets. These are the areas in which some work has to be done to foster domestic capital development.

3.3 Resource Mobilization Through Remittances

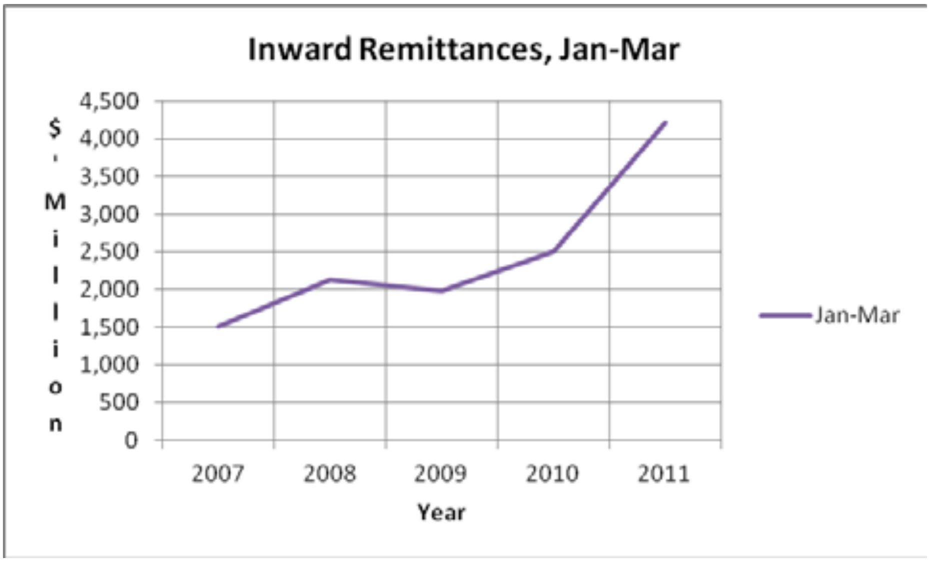
Remittances are assuming increasing importance as a source of finance flows to the developing world, including SSA. Large populations of African citizens are located in rich countries where they migrate to seek greener pastures. African expatriates have been remitting increasing amounts to their relations for consumption and investment purposes. Remittances also come from institutional sources, mainly the NGOs, and other private sources, like foundations that fund development projects and programs in Africa. "Recorded" personal remittance inflows to SSA are reported to have stood at some $10.3 billion in 2006 (See Go and Page). From World Bank sources, "unrecorded" flows through informal channels are even believed to be higher. Institutional remittances to SSA reportedly amounted to $5.3 billion in 2005, while private foundations are said to provide about $4.4 billion annually.

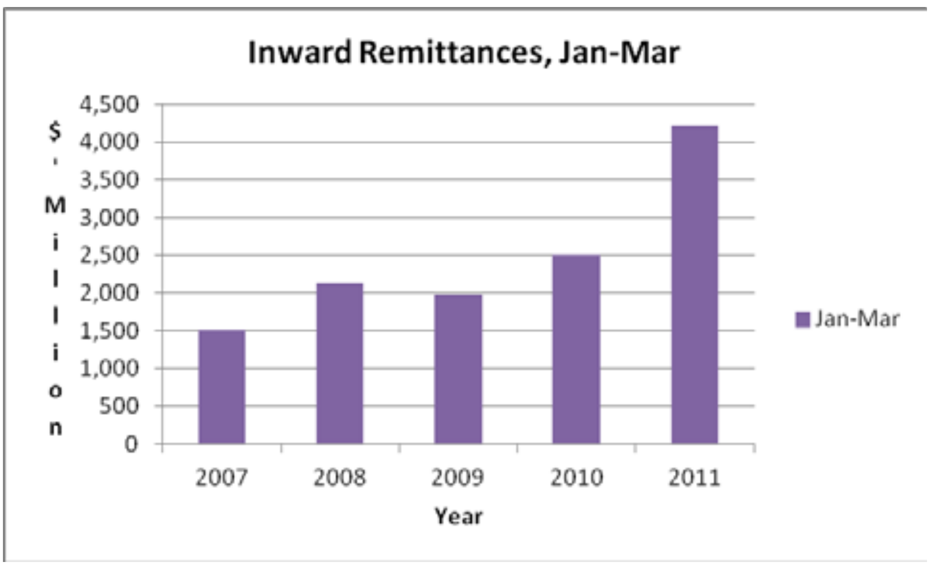
Ghana, for example, has a large and growing remittance potential that can be tapped for development. This potential is made clear in Table 13 (and Chart 10 and 11), where private inward transfers in the first quarter alone rose from $1.5 billion in 2007 to $4.2 billion in 2011.

Table 13 and Charts 10, 11: First-Quarter Remittances to Ghana ($US Million)

	Jan	Feb	Mar	Jan-Mar
2007	500	451	565	1,517
2008	655	785	693	2,132
2009	660	590	727	1,976
2010	822	767	913	2,500
2011	1,375	1,262	1,583	4,220

Source: Bank of Ghana





The issue is how remittance flows to Africa can be maximized for the development of the continent. First, the financial system has a role to play in providing channels for remittances. They should offer terms that make it more attractive to route funds through these formal channels rather than through informal ones. Second, governments should deliberately court these remittances. They can do this by publicizing the availability of channels and opportunities for utilizing them. Africa is believed to have the highest share of remittances flowing through informal channels among all regions. Reducing remittance fees would encourage remitters to send larger amounts and at greater frequencies. It would also encourage remittance senders to shift from informal to formal channels, making funds more readily available for intermediation by formal institutions.

Reducing remittance costs will bring a significant portion of "unrecorded remittances" into formal channels. This can be done through, among others, improving access to banking for remittance senders and recipients; strengthening competition in the remittance industry; avoiding overregulation; and adopting more efficient technologies, such as the use of internet and mobile phone technology. African governments can also increase remittance flows to their countries by entering into reciprocal bilateral arrangements with countries where their migrants predominantly reside, especially in America and Europe.

3.4 Resource Mobilization through Diaspora Bonds

An innovative mechanism for sourcing financing for African development is through "Diaspora bonds". The Diaspora bond is supposed to act as a debt instrument issued by a country to raise financing from its overseas Diaspora. China and India are believed to have raised tens of billions of dollars from their Diaspora through bond issues. Africa can learn from their example.

Diaspora bonds are usually issued in crisis and often at a "patriotic" discount. Unlike international investors, the Diaspora may be less averse to convertibility risk because they tend to have current and contingent liabilities in their home country. Further, the Diaspora usually have a strong desire to contribute to the development of their home country and are, therefore, more likely to purchase Diaspora bonds.

The stock (population) of SSA Diaspora is estimated at over 15 million, with over 5 million in high-income countries. It is projected that their annual savings could be more than $28 billion. (See Table 13 below). The bulk of the savings is presently invested outside Africa. African Governments and private corporations can potentially tap into these resources by issuing Diaspora bonds.

Diaspora bonds can also provide an instrument for repatriation of Africa's flight capital, estimated to be more than $170 billion. (See Section 3.6 below). Diaspora bonds could potentially raise $5-10 billion annually by tapping into the wealth of the African Diaspora abroad and the flight capital held abroad by its residents.

Table 14: Potential Market for Diaspora Bonds

Country	Diaspora stock (thousands)	Potential diaspora saving ($'bn)
Mali	1,213	0.6
Ghana	907	1.7
Eritrea	849	0.6
Nigeria	837	2.8
Mozambique	803	0.6
Zimbabwe	761	1.3
South Africa	713	2.9
Sudan	587	1.0
Congo, DR	572	1.0
Angola	523	1.0
Senegal	463	1.3
Ethiopia	446	1.6
Somalia	441	1.6
Kenya	427	1.7
Cameroon	231	0.6
Tanzania	189	0.6
Cape Verde	181	0.7
Uganda	155	0.7
Madagascar	151	0.6
Mauritius	119	0.7
Other SSA	5,285	5.5
Total	**15,854**	**28.5**

Source: Go and Page (2008).

Some hurdles need to be overcome, however, for successful Diaspora bond issues. These include: weak and nontransparent legal systems for contract enforcement; lack of national banks and other institutions in destination countries, which can facilitate the marketing of the bonds; and lack of clarity on regulations in the host countries that allow or constrain Diaspora members from investing in bonds. This means that Africa needs significant institutional reforms to be able to effectively tap into the large Diaspora resource pool.

3.5 Resource Mobilization Through Securitization of Future Foreign Exchange Flows

Another innovative idea that has been suggested for SSA to mobilize financing is through issuing bonds based on securitization of future foreign exchange flows. These flows include, but are not limited to: export receivables, tourism receipts and remittances. In principle, securitization of future hard-currency receivables is a potential means of increasing SSA access to international capital markets. In a typical future-flow transaction, the borrower pledges its future foreign-currency receivables as collateral for a loan. The receivables are lodged in an account, which is used to service the loan.

Table 15: Securitization Potential in Sub-Saharan Africa (SSA)

	Sub-Saharan Africa (SSA)		**Low income (excl. India)**		**All developing countries**	
	Receiv-able($'bn)	Potential sec.($'bn)	Receiv-able($'bn)	Potential sec.($'bn)	Receiv-able($'bn)	Potential sec.($'bn)
Fuel exports	44.1	8.8	47.7	9.5	417.5	83.5
Agricultural raw material exports	5.7	1.1	4.4	0.9	46.3	9.3
Ores and metal exports	13.4	2.7	5.0	1.0	106.6	21.3
Travel services	12.4	2.5	4.8	1.0	168.5	33.7
Remittances	8.4	1.7	23.6	4.7	179.4	35.9
Total	**84.0**	**16.8**	**85.5**	**17.1**	**918.3**	**183.7**

Source: Go and Page (2008).

As always minimal institutional requirements will be needed for effective future-flow securitization in SSA. These include: domestic financial development; banking relationships with banks abroad; and low costs of legal and investment banking. Also, an appropriate legal infrastructure and strong protection of creditor rights, and a stable macroeconomic environment are essential prerequisites. In case of remittance securitization, in particular, extensive use of informal channels in SSA can reduce the flows through the formal financial system and thereby the size of potential securitization. Further on the negative side, securitization by poor countries carries significant risks—currency devaluation and, in the case of flexible-rate debt, unexpected increases in interest rates—that are associated with market-based foreign-currency debt.

Another downside of the mechanism relates to the potential volatility of receivables in SSA, increasing the risk of default. Furthermore, it has to be emphasized that there is no additionality of financing here to the extent that the mechanism only ensures upfront receipt of future receivables, which allows early implementation of development projects and programs. Yet still, this asset class can provide useful access to international capital markets, especially during liquidity crises. Moreover, for many developing countries, securitization backed by future flows of receivables may be the only way to begin accessing such markets.

Securitization of future flows may reduce the government's flexibility in managing its external payments and can conflict with the negative pledge provision included in multilateral agencies' loan and guarantee agreements, which prohibit the establishment of a priority for other debts over multilateral debts.

An example of securitization of future foreign exchange flows was the recent passage of legislation to collateralize Ghana's oil receipts. It is recalled that opinion was very much divided as to the rationality of this action. The fact is that if future receipts are brought forward to today and used for productive activities, then that is quite a sensible thing to do. It is only when they are used for consumption that it would be a most unwise decision.

3.6 Resource Mobilization through "Reverse Capital Flight"

Many African countries are endowed with natural-resource wealth dominated by oil and minerals. The record of using this wealth for the continent's development and the benefit of its populations has, however, been abysmal. Natural-resource wealth of several African countries has benefited a few political elite, their families and cohorts, while the majority of the people have continued to live in abject poverty. The injustice in oil wealth distribution has also generated several conflicts on the continent and retarded its development. The incidence of transferring African wealth outside the continent by political leaders has been particularly high and deprived the country of vast development resources.

The World Bank noted in a report on Africa that between 2000 and 2010, $200 billion in oil revenue would accrue to the continent. However, Africa had higher poverty rates, greater income inequality, less spending on health care, higher prevalence of child malnutrition and lower literacy and school enrollments than other countries at the same level of income. This is due to the high level of misappropriation of African wealth by the ruling class. In most cases Africa's wealth is stashed away in private bank accounts in Switzerland and other Western capitals.

From Nigeria to Congo DR to Angola to Equatorial Guinea, vast oil endowments have led to protracted conflicts and corruption that have impoverished the populations. One finds numerous examples of the large scale of abuse of African resources for the gain of a privileged few.

In fact, it is estimated that the cross-border flow of the global proceeds from criminal activities, corruption and tax evasion are estimated to be more than $1 trillion annually (quoting the United Nations Office of Drugs and Crime, UNODC and World Bank, 2007). Some $20 billion to $40 billion in assets acquired by corrupt leaders of poor countries, mostly in Africa, are kept overseas. This is the scale of misappropriation of African natural-resource wealth.

The approach to making sure that Africa's natural-resource wealth stays in Africa for use for the continent's development should be on two fronts: stemming its outflow and recovering stolen wealth.

In the first place, there is a need to strengthen anti-corruption institutions to check financial abuse by political leaders and institute strong punitive measures for offenders. The World Bank and the UNODC have launched the Stolen Assets Recovery (STAR) initiative to help countries recover their stolen assets. This initiative will also help countries establish institutions that can detect and deter illegal flow of funds, work with the Organization for Economic Cooperation and Development (OECD) countries in ratifying the Convention Against Corruption (CAC), and support and monitor the use of recovered funds for development activities. The recovered assets could provide financing for large social programs and infrastructure projects in Africa.

4. Conclusion

African countries have long depended on foreign aid to support their development. Foreign aid is inevitable for developing countries since by definition they do not have enough resources of their own.

The dependence on foreign aid is, however, not without costs. While aid has not matched Africa's development needs, it has increased the continent's indebtedness whose high servicing costs have further impoverished it. Moreover, bureaucracy and volatility in aid delivery have often curtailed or frustrated African development budgets. Added to this is aid tying in the form of forced purchases from supplying countries and imposition of policy conditionalities, which often do not serve the interests of African countries.

It is time Africa broke its addiction to foreign aid and explored alternative means of mobilizing development resources. Some financial engineering is all that is needed. Options to mobilise non-aid resources for Africa's development include: budget restructuring; development of domestic capital markets; increased mobilization of remittances; issuance of Diaspora Bonds; securitization of future foreign exchange flows; and "reverse capital flight". Exploring these alternative sources of development funds would help reduce Africa's vulnerability to foreign aid.

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P. O. BOX OSI936, Osu, Accra, Ghana. Tel: +233 -302-244716 / +233 0307 010714, Fax +233 302 222313
Email: iea@ieagh.org, ieaghana@yahoo.com
www.ieagh.org