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7

Looking Beyond Aid to Fund Africa's Development

John Kwabena Kwakye

LOOKING BEYOND AID TO FUND AFRICA's DEVELOPMENT

Southern Voice Occasional Paper 7

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Preface

The *Southern Voice on Post-MDG International Development Goals* was born in the spirit of collaboration, participation and broad academic inquiry. It is a network of 48 think tanks from Africa, Latin America and South Asia which has identified a unique space to contribute to the post-2015 dialogue. By providing quality data, evidence and analyses derived from research in the countries of the global South, these think tanks seek to inform the discussion on the post-2015 framework, goals and targets, and to help to shape the debate itself.

With these goals in mind, *Southern Voice* launched a call for papers among its members to inform the global debate based on the research they have already carried out, to strengthen national or regional policy discussions. The objective of the call was to maximise the impact of the knowledge that already exists in the global South, but which may have not reached the international arena.

In response to the call, we received numerous proposals which were reviewed by *Southern Voice* members. The research papers were also peer reviewed, and the revised drafts were later validated by the reviewer.

The resulting collection of ten papers highlights some of the most pressing concerns for the countries of the global South. In doing so, they explore a variety of topics including social, governance, economic and environmental concerns. Each paper demonstrates the challenges of building an international agenda which responds to the specificities of each country, while also being internationally relevant. It is by acknowledging and analysing these challenges that the research from the global South supports the objective of a meaningful post-2015 agenda.

In connection with the ongoing debates on post-2015 international development goals, **Looking Beyond Aid to Fund Africa's Development** by *Dr John Kwabena Kwakye* (Senior Economist) at the Institute of Economic Affairs, Ghana, focuses on development finance and aid. Given the several pitfalls associated with aid regime, the paper argues how Africa must seek alternative resources to successfully support its growth and development objectives.

I would like to gratefully acknowledge the contributions of *Ms Andrea Ordóñez* (Research Coordinator of the initiative) and *Ms Mahenaw Ummul Wara* (Research Associate, Centre for Policy Dialogue (CPD) and Focal Point at the *Southern Voice* Secretariat) in managing and organising the smooth implementation of the research programme.

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I would like to take this opportunity to recognise the support of Think Tank Initiative (TTI) towards *Southern Voice*, particularly that of *Dr Peter Taylor*, Programme Leader, TTI.

I hope the engaged readership will find the paper stimulating.

Dhaka, Bangladesh
May 2014

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Abstract

This paper argues that Africa's dependence on aid comes with costs, including aid inadequacy, indebtedness, the effects of volatility, bureaucracy, 'tying', addiction, moral hazard and stigma. Moreover, aid has had limited effectiveness in Africa to the extent that it has not enabled adequate progress to be made towards the Millennium Development Goals (MDGs) in many countries. The paper calls on African countries to explore more intensely supplementary vehicles of development finance, including the national budget, domestic capital markets, remittances, other diasporean capital, foreign direct investment (FDI), future foreign exchange flows, and 'reverse capital flight'. This call is in consonance with the High Level Panel's reminder to donors to honour their aid pledges while also emphasising that developing countries should mostly finance their own development. The paper also makes the point that the post-2015 agenda goes beyond long-term finance, and that more importantly, it embraces a new global partnership and international cooperation.

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Executive Summary

Africa has long been, and remains, dependent on foreign aid to support its development. However, aid dependency is problematic and cannot be a panacea for Africa's long-term development. Africa must seek alternative resources to supplement aid, while seeking to attain eventual self-sufficiency.

This paper proposes supplementary resource vehicles beyond aid to accelerate Africa's growth and development and to enable the continent to eventually achieve self-sufficiency. The pitfalls associated with aid are highlighted as a backdrop to the proposed alternatives.

Aid to Africa has generally been inadequate in relation to the continent's development needs. Because of other non-economic motives for aid, it does not always correlate with individual country needs. More developed countries may in fact receive more aid than less developed ones. Aid inadequacy leaves large deficits in African physical and human capital, stifling the continent's growth and development. While the overall quantity of aid has not been adequate, allocation to basic social services such as education, primary healthcare, malnutrition, safe water and sanitation similarly falls short. Most African countries are therefore struggling to meet the core relevant Millennium Development Goal 8 (MDG 8) targets, highlighting the limited effectiveness of aid in Africa.

Aid is also subject to considerable uncertainty and volatility. In particular, basic social services do not receive adequate attention, contrary to MDG 8. Often, African budgets are constrained and subjected to considerable uncertainties, thereby retarding important fiscal projects and programmes.

Aid is commonly plagued by bureaucracy. It is often subject to government regulations and procedures of benefactor countries. Bureaucracy not only breeds procedures and formalities, but may also entail other costs. As aid recipients, African countries face innumerable requirements relating to its design, approval and reporting. These requirements vary from donor to donor and can be quite conflicting. It is widely noted that using donor experts (not local people) to build, run and evaluate operations can act as a barrier to aid effectiveness.

An issue which has long affected aid is 'tying.' This is the requirement that aid recipients spend the funds in the donor country. Tying may also include conditions relating to the political and/or military interests of the benefactor, and demands for implementation of prescribed policies. Aid tying comes with high costs, not just because of monopolistic costing, but because a 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 routed through the Bretton Woods Institutions (BWIs) such as the World Bank, is often subject to demanding policy conditions which favour free markets and private enterprise. Such policies may, however, be associated with market failures that prevent maximum economic growth and optimum social welfare.

Most of the aid to Africa comes as loans rather than grants. As a result, it increases Africa's indebtedness, with high servicing costs that divert resources away from important development and social projects. After decades of dependence on aid, many African countries ran up high levels of debt. They had to be rescued from their debt burden through mechanisms such as Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI), which restored their debt to sustainable levels. However, African debt levels are rising again and many countries risk becoming burdened with unsustainable levels of debt.

Aid can be addictive for a nation, which breeds complacency and lethargy in mobilising recipients' own resources. Aid also creates moral hazard, encouraging recipient countries to take risks including undertaking lavish, and in many cases wasteful projects.

Given the pitfalls associated with aid, Africa must seek alternative resources to support its growth and development, and ultimately achieve self-sufficiency.

African budgets can serve as an important vehicle for augmenting development resources. This requires appropriate revenue and expenditure reforms. Revenue effort in Africa tends to be low and there is room for it to increase. This requires broadening the tax base, reducing exemptions, enforcing compliance and tackling corruption. Expenditure reforms are also needed, including through streamlining and prioritisation by curtailing non-essential spending, thereby creating space for priority development and social spending.

Domestic capital markets in Africa remain largely undeveloped, though large pools of potential resources exist. Capital markets can provide long-term funds for the national budget and other development activities in key sectors of the economy. To this end, government, municipalities and the private sector can issue bonds to access the pool of domestic resources. For the capital market to work effectively, it will be necessary to develop the requisite institutional infrastructure and legal framework to support it. A stable macroeconomic and political environment is also an important requirement for a well-functioning capital market.

Remittances sent by the African citizens residing abroad are playing increasing important role, and they support investment and consumption activities. Remittance flows can be further increased to support the continent's development if appropriate measures are implemented to that end. These measures include: offering terms which make it more attractive to route them through formal rather than informal channels; reducing remittance costs by improving the financial infrastructure and regulatory framework; and directly courting remittances through reciprocal bilateral arrangements.

Africa can access resources from its large diaspora populations. Africa can learn from China and India, who have been relatively successful in this regard. While the diaspora populations will be earning returns on their investments, they will also contribute to the development of the continent. Bonds can be issued to tap into the wealth of the African diaspora as well as to instigate return of flight capital held abroad. Success in this regard will require appropriate institutional reforms, including strengthening and increasing the transparency of legal systems for contract enforcement and clarifying regulations in the host countries that allow or constrain diaspora members from investing in bonds.

Lacking adequate domestic resources to invest and build its capital stock, Africa needs to utilise foreign savings in the form of foreign direct investment (FDI). Unfortunately, Africa's share of global FDI flows is minimal. According to the High Level Panel Report, "the most important source of long-term finance will be private capital." Africa's success in promoting growth and development depends on its ability to attract equity-based external capital. FDI is also important for African countries because it can help reduce risks associated with fluctuations in African export markets. Furthermore, FDI is a major source of managerial know-how and technology, which African countries urgently need. An advantage of FDI is that it brings capital and technology which are important ingredients for growth in Africa. In order to attract sufficient FDI, African countries must create business-friendly environments and conducive policy milieus. Economic integration will also facilitate the growth of domestic consumer markets, which is additionally conducive to FDI.

African countries anticipate future foreign exchange flows, including export receivables, tourism receipts and remittances. These flows can be brought forward for today's development of Africa through securitisation. In this case, African countries would pledge their future foreign currency receivables as collateral to raise funds for development. There is, of course, the risk that these future flows could suffer shocks. It is therefore important that the securitised resources are used prudently, in particular for productive activities which in principle should provide a better cushion against such shocks.

"Reverse capital flight" is a potential means of augmenting Africa's development resources. This vehicle 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 monitor financial abuse by political leaders and to institute strong punitive measures for offenders. The second requires vehicles established by international bodies to recover countries' stolen assets, including the Stolen Assets Recovery (STAR) initiative of the World Bank and the United Nations Office for Drugs and Crime (UNODC). The STAR initiative also helps countries establish institutions that can detect and deter illegal flows of funds. Recognising the impact of underground financial dealings on developing countries, the High Level Panel Report rightly calls on the international community "to implement a swift reduction in corruption, illicit financial flows, money laundering, tax evasion, and hidden ownership of assets."

Both the United Nations' Post-2015 Development Agenda and High Level Panel Report recognise the importance of aid after 2015, and call on donors to honour their obligations in that regard. They also call on developing countries to mostly finance their own development. This paper adds its voice to these sentiments, and in particular, urges African countries to explore other resources more actively to supplement aid.

But the post-2015 agenda is not just about aid or other forms of finance. More importantly, the HLPR calls for a "new global partnership", entailing "a new spirit of solidarity, cooperation, and mutual accountability." Further, the High Level Panel Report emphasises the need for a move from "vision to action" under the post-2015 agenda and suggests five "transformative shifts" in this regard, involving, in addition to forging a new global partnership, leaving no one behind; putting sustainable development at the core; transforming economies for jobs and inclusive growth; and building peace and effective, open and accountable institutions.

Specifically on the core MDG 8, while the High Level Panel Report recognises the importance of "stable, long-term finance" in achieving the specified targets, it again stresses the need to infuse global partnerships in addition to setting universal and quantified targets and monitorable priorities.

Acronyms

AfDB	African Development Bank
BWI	Bretton Woods Institute
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
G-7	Group of Seven
HDI	Human Development Index
HIPC	Heavily-Indebted Poor Countries
HLPR	High Level Panel Report
IDA	International Development Association
IEA	Institute of Economic Affairs
IMF	International Monetary Fund
LDC	Least Developed Country
LIC	Low-Income Country
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
MNC	Multinational Company
NGO	Non-Government Organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PDA	Post-2015 Development Agenda
STAR	Stolen Assets Recovery (Initiative)
UN	United Nations
UNODC	United Nations Office for Drugs and Crime

Looking Beyond Aid to Fund Africa's Development

John Kwabena Kwakye

1. Introduction

As a developing continent with limited resources of its own, Africa depends on foreign aid to finance its development. Aid is used to finance projects and technical assistance or import critical commodities. Aid has helped Africa achieve relatively high growth rates in a rather sluggish world economy. However, aid comes with costs and cannot be a panacea for long-term development. Moreover, while aid – both in quantity terms and in sectoral allocation – is an important pre-requisite for reaching the Millennium Development Goal (MDG) targets, many African countries are behind in this regard creates doubts about the overall effectiveness of aid.

The UN's Post-2015 Development Agenda (PDA) acknowledges the importance of "more and better long-term finance" in achieving the prescribed development goals and targets. Moreover, the PDA recognises that most of the money required to finance sustainable development "will come from domestic sources." The High Level Panel Report (HLPR) acknowledges that "developing countries have done much to finance their own development, and will be able to do more as incomes rise." While the HLPR recognises that developing countries will need, in addition to their own resources, substantial external funding, it notes that the main part of that funding "will not be aid from developing countries, although aid remains vital for LICs [Low Income Countries] and the promises made on aid must be kept."

This paper focuses on the finance pillar of the PDA. The paper recognises that Africa in particular will continue to require aid to support its development. However, it argues that the continent cannot do this indefinitely, and that it must, as of necessity, begin to take measures to reduce its reliance on aid. This is because aid comes with a price of its own for recipient nations. Moreover, aid resources available to Africa are going to dwindle as development takes hold on the continent. Aid will also fluctuate in line with the growing incidence of global financial crises.

The paper's key hypothesis is that Africa's reliance 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 proposes alternative resource vehicles beyond aid available to Africa to accelerate the continent's growth and development in the post-2015 era and to enable it to attain eventual self-sufficiency. The paper highlights the pitfalls associated with aid as a backdrop to proposing the alternatives.

Situating the paper in the context of the post-2015 debate, it is recognised that the debate goes beyond aid or other forms of development finance. The paper reiterates the call by the HLPR for a "new global partnership", entailing a "new spirit of solidarity, cooperation, and mutual accountability." It also notes the emphasis by the HLPR on the need for a move from "vision to action" under the post-2015 agenda in the context of five "transformative shifts", involving, in addition to forging a new global partnership, leaving no one behind; putting sustainable development at the core; transforming economies for jobs and inclusive growth; and building peace and effective, open and accountable institutions. Specifically on the core MDG 8, the HLPR also stresses the need to infuse global partnerships and to set universal and quantified targets in addition to the need for "stable, long-term finance."

The paper is structured as follows. After this introductory section, Section 2 looks at some of the problems associated with foreign aid that limit its effectiveness as a development tool. Section 3 then elaborates alternative vehicles for mobilising resources to support Africa's development. Finally, Section 4 concludes the paper.

2. Problems with Reliance on Foreign Aid

There are varying problems associated with Africa's prolonged use of aid. Aid is not only inadequate for Africa's development needs, it is also unpredictable and volatile, frustrating African countries' budgets. Aid creates indebtedness for Africa, the servicing of which entails considerable costs, and is costly as it can be plagued by bureaucracy and fragmentation. Aid tying in the form of purchases from donor countries and imposition of policy conditionalities does not always serve Africa's interests. Aid also breeds addiction, complacency and lethargy in mobilising personal resources. Finally, aid creates moral hazard, encouraging risk-taking in the form of lavish and wasteful projects and programmes, for example.

2.1 Aid Inadequacy and Volatility

MDG 8 envisages aid (along with trade and debt relief) as a vehicle for developing a global partnership for development. However, aid to Africa has generally been inadequate in relation to the continent's development needs. Large deficits persist particularly in physical and human capital, which have stifled African development. Aid is also subject to considerable uncertainty and volatility. This curtails African budgets, subjects the budgets to considerable uncertainties, and retards important fiscal projects and programmes.

The United Nations (UN) has set a minimum threshold of 0.7 per cent of gross national income (GNI) for official development assistance (ODA) givers. But only a handful of ODA providers – mainly Scandinavian countries – have reached this threshold. Notably, the Group of Seven (G-7) countries (the world's largest economies) with the exception of the UK that met the target recently, all substantially fall short of the UN target. Were these countries to meet this target, Africa would experience a significant boost to its ODA and consequently its development. Launching the 2013 MDG Gap Task Force Report, the UN Secretary General Ban Ki-moon noted the reductions in ODA for two consecutive years for the first time in many years. ODA reportedly declined 4 per cent in 2012, mainly due to fiscal austerity measures by countries in the European Union (EU). Ban Ki-moon urged donor countries to continue to strive for, or surpass, the ODA target of 0.7 per cent of GNI, particularly to the least developed countries (LDCs). The HLPR adds its voice to this call by agreeing to push donor countries "to fulfill their side of the bargain by honouring their aid commitments."

It is important to remember that the US-funded Marshall Plan provided substantial aid to Western Europe after the Second World War, quickening its reconstruction. The US also contributed significantly to Japan's recovery after the War. It is that scale of assistance that can transform Africa.

Currently, aid to Africa does not match the continent's need. Moreover, aid does not always go where development demand would naturally draw it. Most aid does not actually go to the poorest who need it the most. Aid amounts are in fact dwarfed by protectionism in rich nations that denies market access for poor country products, while the rich nations use aid as a lever to open markets in poor countries to their products.

Aid may not even be correlated with human development, the way it is expected to be. A plot of aid per capita against the Human Development Index (HDI) is found to be a random scatter rather than correlated (Browne, 2006). Aid does not appear to be correlated with income levels either. In fact, LICs (with GDP (gross development product) per capita of less than USD 735) account for three-quarters of people living in poverty, but receive only 40 per cent of total aid. Sub-Saharan Africa, with the largest number of LICs and where poverty is most widespread, reportedly receives only one-third of total aid.

While the overall quantity of aid has not been adequate, allocation to basic social services – education, primary healthcare, malnutrition, safe water and sanitation – which collectively form the core of the MDGs, similarly falls short. Thus, most African countries are far behind in meeting the targets set for these services under MDG 8. This serious shortcoming raises doubts about the overall effectiveness of aid.

This paper and the HLPR recognise that aid remains an important component of the Post-2015 Development Agenda. However, the Agenda is not just about aid. In fact, the HLPR contains other critical non-aid elements for propagating and ensuring the success of the development agenda beyond 2015.

More importantly, the HLPR calls for "a new global partnership" that was not apparent in the MDGs era, and which probably undermined the achievement of the stipulated goals. Further, the HLPR emphasises the need to move from "vision to action" under the post-2015 agenda, recommending "five transformative shifts":

1. Leave no one behind, irrespective of ethnicity, gender, geography, disability, race or other status;
2. Put sustainable development at the core, embracing the social, economic and environmental dimensions;
3. Transform economies for jobs and inclusive growth;
4. Build peace and effective, open and accountable institutions for all;

and finally, but most importantly,

5. Forge a new global partnership, entailing a "new spirit of solidarity, cooperation, and mutual accountability."

On the overriding MDG 8, the HLPR recognises that progress was made in some areas, but notes shortcomings in several others including a lack of progress on trade openness, in still highly-indebted or financially-exposed countries, and a widespread lack of access to essential medicines. The HLPR acknowledges the importance of "stable, long-term finance" in achieving the specified targets. Beyond finance, however, it again stresses the need to infuse global partnerships. Further, the HLPR recommends key changes to MDG 8, including developing universal targets; quantifying targets to the extent possible; the need for more stable long-term finance; and signaling monitorable priorities that go beyond aid.

Aside from its inadequacy, aid to Africa is subject to considerable uncertainty and volatility. This is due to cumbersome legal and administrative procedures in ODA-giving countries, and the need to meet varying requirements in recipient countries, including those related to purchases and policies as described in detail in Section 2.3 below. The volatility of aid is further demonstrated by the fluctuations in aggregate aid data. While ODA rose quite steadily for four decades after 1950, it began to fall away sharply after 1992 following geopolitical shifts. Aid uncertainty and volatility impart similar unpredictability to African budgets. This often frustrates the implementation of important projects and programmes. There have been several instances where roads, schools, health, water and energy projects have stalled in Africa because promised aid was not delivered. This causes economic dislocations and even social upheavals.

2.2 Vicious Cycle of Debt

While African countries were benefiting from aid they ran up high levels of debt, and by the 1990s many became unsustainable. As such, most of those in receipt of aid were declared Heavily Indebted Poor Countries (HIPC). The fact that most African countries became heavily indebted while benefiting from aid suggests that aid was heavily skewed towards loans rather than grants. Indeed, the word aid seems a misnomer because it seems to suggest something that is entirely free, when in reality it is not.

The HIPCs benefited from relief of largely multilateral and bilateral debt in order to bring their debt levels to what was determined to be sustainable levels. In 2006, eligible countries – being those that had reached the completion point under the HIPC initiated and were thus eligible for irrevocable debt relief – benefited from a further round of debt relief under the Multilateral Debt Relief Initiative (MDRI). The MDRI cancelled all debts owed to the International Monetary Fund (IMF), the International Development Association (IDA) of the World Bank Group and the African Development Bank (AfDB).

Both the HIPC and MDRI reliefs, while helping the eligible countries reduce their debts to sustainable levels, were also meant to assist them to achieve the MDGs. While in principle the first objective was mostly achieved by 2006, as we know several of the MDGs remain unachievable for many countries. Even post-HIPC and MDRI debt levels have been rising again in many African countries as they continue to borrow to finance their development. Given the high service cost of debt, achievement of the MDGs is going to be more challenging. This is why the Post-2015 Development Agenda is important in rekindling international efforts and enthusiasm towards the socio-economic goals and targets.

2.3 Aid "Tying"

Aid has long been dogged by the issue of 'tying.' Traditionally, aid tying involves the requirement that recipients spend the funds in the donor country. The definition may be extended to include conditions relating to the political and/or military interests of the benefactor and demands for implementation of prescribed policies.

When tying involves purchases from the donor country, it is like the givers of aid trying to derive commensurate benefit from it. It is like extracting 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 because a 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 is often wasted on conditions that the recipient must use overpriced goods and services from donor countries. Aid may also be linked to political and/or military interests of the benefactor.

The pattern of US aid over 40 years from 1960 was influenced to a significant degree by Cold War considerations and shifts in geopolitical factors. 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 somewhat volatile, rising quite steadily for four decades after 1950, then 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 known that donors including France and the United Kingdom tend to give more aid to their former colonies 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 that routed through the Washington-based Bretton Woods Institutions (BWIs) of the IMF and World Bank has also often been subject to demanding policy conditions. The BWIs have become big aid agencies, disbursing large amounts of financial assistance contributed by their Western paymasters. The BWIs' financial assistance is invariably subject to implementation of policies that reflect the "neo-liberal tradition", which favours free markets and private enterprise and frowns upon economic controls and restrictions as well salient roles for the state. Implementation of free market policies is, however, not without costs. Associated market failures may inhibit maximum economic growth 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 plagued by bureaucracy, 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 conflicting.

As 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 more than 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 during which targets were set for 2015. Midway through the period, a follow-up meeting was held in Accra, Ghana. A key 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 non-government organisations (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 observed that using donor experts (not local people) to build, run and evaluate operations acts as a barrier to 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 Paris Declaration encouraged aid-recipient governments to publish development programmes that aid agencies could use. Yet, aid continues to be directed to areas that were at variance with national priorities.

2.5 Addiction, Moral Hazard and Stigma

Aid may become a long-term addiction. For many African countries aid has become a permanent and substantial part of their budgets. In effect, the budgets have become enslaved to aid and it has the potential to discourage efforts to mobilise resources. It is not surprising that tax systems in Africa tend to be ineffectual by international standards. They are riddled with shortcomings including narrow base, inefficiency, corruption and evasion or lack of enforcement. The availability of aid has been a disincentive to address these shortcomings.

Aid may create moral hazard. It may encourage recipient countries to take risks including embarking upon lavish expenditures. There are many examples in Africa of projects which languish after launching in anticipation of aid pledges that did not fully materialise.

Aid may also stigmatise a recipient country. In particular, loan-aid may create such indebtedness that it leads to a recipient country being labeled a HIPC or similar. Becoming a HIPC, as many African countries were so declared during the late 1990s, can have dire consequences including a high credit-risk rating. This will not only raise borrowing costs, but the country may also be shunned by investors because of its poor financial rating.

3. Alternative Vehicles for Mobilising Resources

Given the varied problems associated with aid, Africa should begin to look beyond aid and explore other avenues to access resources for its development. Some financial engineering is necessary to exploit other sources for mobilising development resources and reducing reliance on foreign aid.

This paper identifies the following vehicles for mobilising such resources: the national budget; domestic capital market; remittances; diasporean capital; foreign direct investment (FDI); future foreign exchange flows; and reverse capital flight. These options have 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, which encourage African countries to continue to use external loans and other foreign aid to support their development.

3.1 The National Budget

The budget itself is 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 mobilisation is often overlooked. In fact, the HLPR on the Post-2015 Development Agenda recognises the budget as a major contributor to development finance and urges countries "to continue efforts to invest in stronger tax systems and broaden their domestic tax base."

The revenue effort of LICs is relatively low. This could be partly the result of aid-induced complacency and lethargy. There is considerable room for increasing this effort.

A strong mobilisation effort can significantly increase the resource envelope to support development of LICs. African tax systems in particular lack robustness, in part due to the narrow base, spate of exemptions, 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 vast potential, but remain largely outside the tax net. There is a need to find innovative ways to incorporate these operators into the tax net. By broadening and deepening tax collection, the high rates on income tax, indirect taxes, and petroleum taxes in many African countries could be accordingly reduced. While reducing tax rates will increase compliance, it will reduce Africa's high production costs that erode the continent's competitiveness.

Indirect taxes tend to contribute a disproportionately larger share of total tax receipts in African countries. The reliance 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 17.5 per cent and beyond. 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 of America and Europe.

There is the need to expand the direct tax base in African countries to accommodate potential taxpayers, including, as we have mentioned above, the self-employed and those engaged in informal activities who remain outside the tax net. In the case of Ghana (and probably in many other African countries) property tax constitutes only a minimal proportion of 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 the 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 a 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. In fact LICs in general tend to have the lowest levels of expenditure because they have the lowest levels of revenue.

But even within the low expenditure envelope they can create some space and get better value for money through prioritisation 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 non-essential spending in favour of development and social expenditure. What is often lacking is the political will to do this. Africa cannot develop until it spends sizable amounts on the development of its physical and human capital, just as the South East Asian countries did.

Using Ghana as an example, the expenditure budget tends to be heavily skewed in favour of recurrent expenditure and against capital expenditure. Within recurrent expenditure, wages and salaries have a commanding and growing share. Transfers also have a significant share of recurrent expenditure. Ghana's expenditure budget is also dominated by "statutory expenditure", which includes wages and salaries, pensions, and payments to statutory funds. The high level of earmarked statutory expenditure virtually holds the budget hostage as it leaves no room to maneuver in addressing other priorities.

African countries generally have large public sectors that consume a disproportionate share of tax revenue. Here also, the necessary political will should be generated to undertake the needed reforms that will ensure leaner, more productive and better remunerated public sectors. These measures should complement 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 the misapplication of funds and spending inefficiencies.

3.2 Domestic Capital Markets

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 problem with dependency 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. The HLPR duly urges countries "to build local financial markets" to provide resources to finance their sustainable development.

Africa can mobilise resources for its development through domestic capital/bond markets. Capital markets link issuers with long-term financing needs and 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 can therefore reduce the need for direct and potentially damaging monetary financing. It also avoids a build-up of foreign debt.

Capital mobilisation by the non-government public sectors could also be promoted. There is potential for capital mobilisation 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 a 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 risks associated with development of bond markets. These are the areas in which work has to be done to foster domestic capital development.

3.3 Remittances

Remittances are assuming increasing importance as a source of finance flows to the developing world, including Sub-Saharan Africa. Large populations of African citizens have immigrated to rich countries from where they send home increasing amounts to their relatives for consumption and investment purposes. Remittances also come from institutional sources, mainly NGOs and other private sources like foundations which fund development projects and programmes in Africa. "Recorded" personal remittance inflows to Sub-Saharan Africa stood at USD 10.3 billion in 2006 (Go and Page, 2008). From World Bank sources, "unrecorded" flows through informal channels are believed to be higher. Institutional remittances to Sub-Saharan Africa reportedly amounted to USD 5.3 billion in 2005, while private foundations are said to provide around USD 4.4 billion annually.

The issue is how remittance flows to Africa can be maximised for the development of the continent. First, the financial system has a role to play in providing channels for remittances. It 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 publicising the availability of channels and opportunities for utilising them. Africa is believed to have the highest share of remittances flow through informal channels among all regions. Reducing remittance transaction fees would encourage remitters to send larger amounts and at greater frequencies. It would also encourage 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 over-regulation; and adopting more efficient technologies such as the internet and mobile phones. African governments can also increase remittance flows to their countries by entering reciprocal bilateral arrangements with countries where their migrants predominantly reside, especially in North America and Europe.

3.4 Diaspora Capital

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 Sub-Saharan Africa's diaspora is estimated at over 15 million, with more than five million in high-income countries. It is projected that their annual savings could be more than USD 28 billion (see Annex Table 1). The bulk of the savings is presently invested outside Africa. African governments and private corporations can potentially access these resources by issuing diaspora bonds.

Diaspora bonds can also provide an instrument for the repatriation of Africa's flight capital, estimated to be more than USD 170 billion (see Section 3.7). They could potentially raise USD 5-10 billion annually by tapping into the wealth of the African diaspora abroad and the flight capital held by its residents.

Some hurdles need to be overcome, however, for successful diaspora bond issues. These include weak and non-transparent 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 utilise the large diaspora resource pool.

3.5 Foreign Direct Investment (FDI)

Lacking adequate domestic resources to invest and build its capital stock, Africa needs to access foreign savings in the form of foreign direct investment (FDI) or portfolio investment (PI), as an alternative to aid. According to the HLPR, "the most important source of long-term finance will be private capital." Wei and Balasubramanyam (2004), for instance, argue that Africa's success in promoting growth and development depends on its ability to attract equity-based as opposed to debt-based external capital. They stress that FDI constitutes the most significant component of external equity-based capital for African countries. FDI is important for African nations because it can help reduce risks of fluctuations in their export markets. Also, FDI is the major source of managerial know-how and technology, which countries in Sub-Saharan Africa urgently need. FDI essentially brings physical capital and technology, all of which are important ingredients for growth.

Africa's share of FDI has constituted a small proportion of the global total. Moreover, FDI is unevenly distributed across the continent. It tends to be concentrated in resource-rich countries. The stock of FDI in Sub-Saharan Africa accounts for a minute fraction of the stock of FDI in developing countries. While FDI flows to Africa have increased in recent years, Africa still accounts for a small fraction of world FDI flows. Thus, Africa's improved economic policy environment has not been matched by FDI flows to the continent.

Not only Africa receives inadequate capital inflows, but that it also suffers a great deal from capital export. Onimode (1988), for example, notes that Africa loses capital through several channels, including net capital exports by multinational companies (MNCs) through the repatriation of super profits, transfer pricing, unequal exchange and the poor terms and balance of trade of African countries, mark-up inflation, increasing interest charges on external debts, i.e. the rising burden of external debt service, technology rent from patents, trade-marks, copyright, etc. and inflated contracts.

In theory, FDI decisions are influenced by several factors, with an overriding bias towards economics or commerciality. Onimode (1988) identifies factors that influence the location decision of foreign firms to include the followings:

- Objectives of prospective investors;
- Policy framework of the host country; and
- Economic and business environment in the host country.

African countries individually lack sufficiently large domestic consumer markets, business-friendly environment, and conducive policy milieu that can attract FDI on large scales. To turn the situation around, African countries must address these challenges.

3.6 Future Foreign Exchange Flows

Another innovative idea that has been suggested for the Sub-Saharan Africa to mobilise financing is through issuing bonds based on the securitisation of future foreign exchange flows. These flows include, but are not limited to: export receivables, tourism receipts and remittances. In principle, securitising future hard currency receivables is a potential means of increasing Sub-Saharan 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 loans (see Annex Table 2 in the Annex for an estimated securitisation potential in the Sub-Saharan region).

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

Another downside of the mechanism relates to the potential volatility of receivables in Sub-Saharan Africa, increasing the risk of default. Furthermore, it has to be emphasised 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 programmes. Yet still, this asset class can provide useful access to international capital markets, especially during liquidity crises. Moreover, for many developing countries, securitisation backed by future flows of receivables may be the only way to begin accessing such markets.

The securitisation of future flows may reduce governments' flexibility in managing their 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 securitisation of future foreign exchange flows was the recent passage of legislation to collateralise Ghana's oil receipts. Opinion was very much divided as to the rationality of this action. The fact is that if future receipts are brought forward 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 an unwise decision.

3.7 "Reverse Capital Flight"

Many African countries are endowed with natural resources 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. The natural resources of several African countries has benefited a few political elites, 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 has noted that between 2000 and 2010, USD 200 billion in oil revenue would accrue to Africa. However, Africa had higher poverty rates, greater income inequality, less spending on healthcare, 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 accumulates 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 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 USD 1 trillion annually (United Nations Office for Drugs and Crime (UNODC)); the World Bank. Some USD 20-40 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 ensuring that Africa's resource wealth remains for domestic development should be on two fronts: stemming its outflow and recovering stolen wealth.

First, 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 Organisation for Economic Co-operation and Development (OECD) countries in ratifying the Convention Against Corruption, and support and monitor the use of recovered funds for development activities. The recovered assets could provide financing for large social programmes and infrastructure projects in Africa.

Recognising the impact of underground financial dealings on developing countries, the HLPR could not have stated it more forcefully when it called on the international community "to implement a swift reduction in corruption, illicit financial flows, money laundering, tax evasion, and hidden ownership of assets."

4. Conclusion

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

Dependency on foreign aid is, however, not without costs. While aid does not match Africa's development needs, including the needs of basic social services as envisaged under MDG 8, it increases indebtedness, the servicing costs of which prevent attainment of the MDGs and further impoverishes the continent. Moreover, aid bureaucracy and volatility often curtail or frustrate African development budgets. Added to this is "tying" in the form of forced purchases from supplying countries and imposition of policy conditionalities, which often contradict the interests of African countries. Furthermore, aid dependence breeds addition, creates moral hazard, and stigmatises recipient countries.

It is time for Africa to break from its dependence on foreign aid and explore alternative means of mobilising development resources. Some financial engineering is all that is needed. Options to mobilise non-aid resources for the continent's development include: budget restructuring; development of domestic capital markets; increased mobilisation of remittances; issuance of diaspora bonds; attracting more FDIs; securitisation of future foreign exchange flows; and "reverse capital flight." Exploring these alternative sources of development funds would help reduce Africa's dependence on aid and accelerate its path to self-sufficiency.

Although a useful development tool, aid is not a panacea for Africa's development. Over reliance on aid may indeed undermine the continent's long-term development, given the numerous pitfalls associated with it. As African countries attain middle-income status, and given volatility of aid attendant to global financial crises, Africa's access to aid, especially the concessional component, is going to diminish and become less certain. It is therefore imperative that Africa looks beyond aid to explore alternative resources to accelerate the continent's development and its path to self-sufficiency.

Both the Post-2015 Development Agenda and the High Level Panel Report recognise the importance of aid after 2015 and call on donors to honour their obligations. But they also call on developing countries to mostly finance their own development. This paper adds its voice to these sentiments, and in particular, urges African countries to explore more actively other resources to supplement aid.

But the post-2015 agenda is not just about aid or other forms of finance. More importantly, the HLPR calls for a new global partnership, entailing a "new spirit of solidarity, cooperation, and mutual accountability." Further, the HLPR emphasises the need to move from "vision to action" under the post-2015 agenda and suggests five "transformative shifts" in this regard, involving, in addition to forging a new global partnership, leaving no one behind; putting sustainable development at the core; transforming economies for jobs and inclusive growth; and building peace and effective, open and accountable institutions.

Specifically on the core MDG 8, while the HLPR acknowledges the importance of "stable, long-term finance" in achieving the specified targets, it again stresses the need to infuse global partnerships in addition to setting universal and quantified targets and monitorable priorities.

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Annex

Annex Table 1: Potential Market for Diaspora Bonds: 2008

Country	Diaspora Stock ('000)	Potential Diaspora Saving (Billion USD)
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 Sub-Saharan African Countries	5,285	5.5
Total	**15,854**	**28.5**

Source: Go and Page (2008).

Annex Table 2: Securitisation Potential in Sub-Saharan Africa: 2008

(Billion USD)

Item	Sub-Saharan Africa		Low Income (excl. India)		All Developing Countries	
	Receivable	Potential	Receivable	Potential	Receivable	Potential
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).

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