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AFRICA CAN AND MUST OVERCOME ITS ADDICTION TO FOREIGN AID

by

Dr. J.K. Kwakye*

Summary

This Legislative Alert draws attention to African countries' addiction to foreign aid. It points out that this has not entirely helped the continent's development because aid has been inadequate and has increased Africa's indebtedness with considerable servicing costs. Further, aid volatility, bureaucracy, and "tying" have often curtailed and frustrated African budgets. The paper encourages African countries to explore alternative means of mobilizing resources to avoid the pitfalls of aid and better foster the continent's development. Among the vehicles suggested to this end are: the budget; domestic capital markets; remittances; other Diasporean capital; future foreign exchange flows; and "reverse capital flight."

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The Editor, The Institute of Economic Affairs, P.O. Box OS 1936, Accra.
Tel. +233-302 244716/226333/226359/226388, 0307010713/4.
Fax:+233-302-222313. Email:iea@ieagh.org. Website:www.ieagh.org

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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 with insufficient resources of their own, African countries inevitably need additional aid resources. Africa's long reliance on foreign aid has also been encouraged by its development partners.

The 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. Most ODA givers, including the G-7 countries - the world's largest economies - provide aid that falls substantially short of the UN minimum threshold of 0.7 per cent of Gross National Income (GNI). While it would be unfathomable to expect aid to Africa anywhere near the scale of the Marshall Plan, the trickling in of aid has left large deficits in the key assests of human capital, which has stifled the continent's development.

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. Aid uncertainty and volatility has curtailed African budgets, subjected the budgets to considerable uncertainties, and retarded important fiscal projects and programmes.

Aid has increased the continent's indebtedness, the high servicing costs of which have diverted resources away from development and social projects. While some aid is in the form of grants, the bulk comes in the form of loans. This has escalated the external debt burden of African countries, with high servicing obligations that have denied the execution of important projects and programmes. The problem is exacerbated by the fact that loans are not always channeled fully into the most productive projects, for which they may be intended and which could generate enough returns for future repayments.

Further, aid "tying" in the form of forced purchases from supplying countries and imposition of policy conditionalities, has not always served the best interests of African countries.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 of a lack of choice which compels the recipient country to accept goods and services that may not be appropriate to their needs. By tying aid to purchases from, and awards of contracts to, 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. Aid - particularly those routed through the Washington-based Bretton Woods Institutions(BWIs) - has also often been subject to demanding policy conditions. The policy conditions often entail macroeconomic retrenchment and economic liberalization policies that inhibit the growth of African economies.

Aid to Africa 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 receipients, African countries have faced innumerable

requirements relating to design, approval and reporting-requirements that vary from donor to donor.

The involment of too many agencies delivering aid to Africa using too many systems and processes leads to fragmentation, discordination, and disharmony. As such, Aid has often not been properly channeled to national development priorities, undermining its effectiveness.

Along with the foregoing problems, Africa's long dependence on foreign aid has created moral hazard by breeding complacency and apathy, including in seeking alternative development resources. It is time the continent broke free of this addiction, given the high costs involved. All it will need is some financial engineering geared to exploring alternative resources.

The first alternative 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, enforcing compliance, and reducing corruption. More attention also needs to be paid to direct taxes, including property taxes, which tend to be proportionally low in African countries.

On the expenditure side, there is a need for prioritization by curtailing non-essential spending to create space for priority spending. There is often room to trim administrative and public wage budgets especially.

This should go hand in hand with public sector reforms. Improved efficiency of expenditure will also allow resources to go a long way while delivering better value for money.

The second vehicle is the domestic capital market. This can provide long term funds for the budget and other development activities in key sectors of the economy. It helps to reduce the risks of monetary financing. The capital market contributes to the development of a culture of domestic saving that can be used for investment. Bonds could be issued by Government, Municipalities, and the private sector.

In this regard, it will be essential to develop the necessary institutional infrastructure and legal framework. A stable macroeconomic and political environment will also be conducive for the market.

The third vehicle is remittances. Large African populations not residing in their countries of origin constitute a vast potential source of financing for development. It will require deliberate measures to tap fully into remittances for development. These include: offering terms that make it more attractive to route remittances through formal rather than informal channels; reducing remittance costs by improving the financial infrastructure and regulatory framework; and courting remittances through greater publicity and reciprocal bilateral arrangements.

The fourth vehicle is diaspora bonds- a type of debt instrument issued by a country to raise finances from its overseas diaspora. This can be used to tap resources from Africa's large diasporean population. While allowing them to earn some return, they will also be contributing to the development of the continent, a desire that many of the diaspora usually harbor.

Diaspora bonds can be used to tap into the wealth of the African diaspora and as a return of 'flight capital' held abroad by Africa's residents. Major institutional reforms would

be required to effectively tap into the diaspora resource pool, including relating to legal systems for contract enforcement; national banks and other institutions in the destination countries which can facilitate the marketing of the bonds; and related regulations in the host countries.

The fifth vehicle is future foreign exchange flows. This entails bringing these flows forward for development through securitization. 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 development.

Securitization will be facilitated by, among others, a sufficiently developed financial sector, low cost of legal and investment banking services, strong protection of creditor rights, and a stable macroeconomic environment.

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 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 UNODC. The STAR Initiative also aims to help countries establish institutions that can detect and deter illegal flow of funds. The scale of misappropriation of Africa's national wealth is huge. There is, therefore, a huge potential to tap into it for the continent's development.

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 addiction and vulnerability to foreign aid.

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*Dr. J. K. Kwakye is a Senior Economist at The Institute of Economic Affairs (IEA) and a former Advisor to the Executive Director in charge of Ghana at the International Monetary Fund (IMF), Washington DC, USA.