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Financing Government Programmes during Economic Downturn: Policy Options

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"The Centre for Budget and Policy Priorities wants to explain a simple truth that a lot of people seem to have a hard time understanding. That simple truth is this: you don't cut government spending or raise taxes during a recession. Governments should run deficits during recessions to compensate for lack of private demand, and should then balance the budget during periods of strong economic growth and full employment. Right now, with 10 per cent unemployment and the economy still in a parlous state, insisting on short-term budget-balancing measures makes no sense". (The Economist, 2010)

I. The Concept of Economic Downturn/Recession

A downturn is a slowdown in economic activity leading to inflation and an increase in uncertainty, as rising costs and prices are difficult to predict. In order to control demand when inflation is high, the government can increase taxes. In addition to this, the central bank can raise interest rates. These actions encourage savings and discourage spending. The result is that economic activity begins to decline.

There is no "official definition" of recession, but there is a general recognition that the term refers to a period of decline in economic activity. It is also a business cycle contraction which results in a general slowdown in economic activity. A downturn can lead to a recession which can be defined as "two successive quarters of negative economic growth". Very short periods of decline are not considered as recessions.

During a recession, demand in the economy is low and markets shrink. There are pressures for businesses to reduce costs, which can lead to increased unemployment as companies lay off workers. The resulting higher unemployment lowers aggregate demand, thus contributing to the downturn in the economy. Some businesses may have to close down. Macroeconomic indicators such as GDP (gross domestic product), investment, capacity utilisation, household income, business profits, and inflation fall.

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Recessions generally occur when there is a widespread drop in spending (an adverse demand shock). This may be triggered by various events, such as a financial crisis, an external trade shock, an adverse supply shock or the bursting of an economic bubble. In a 1979 New York Times article, economic statistician Julius Shiskin suggested several rules of thumb for defining a recession, one of which was two consecutive quarterly declines in GDP. In time, the other rules of thumb were forgotten. Some economists prefer a definition of a 1.5-2 percentage points rise in unemployment within 12 months.

In the United States, the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) is generally, considered as the authority for dating US recessions. The NBER defines an economic recession as: "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales". Burns and Mitchell (1946,3) provide a somewhat vague but nonetheless useful description of a recession as a substontial prolonged decline in economic activity that occurs broadly across various sectors of the economy.

More recent working definitions used by business-cycle analysts refine these ideas and emphasise the "three Ds" for a slowdown to be a recession. It should be sufficiently long (duration), it should involve a substantial decline in economic activity (depth), and it should involve multiple sectors or all the sectors of the economy rather than simply reflecting an isolated decline in a single sector or region (diffusion).

II. Attributes of Economic Downturn

A recession has many attributes that can occur simultaneously and includes declines in component measures of economic activity (GDP) such as consumption, investment, government spending and, net export activity. These measures reflect underlying drivers such as employment levels and skills, household savings rates, corporate investment decisions, interest rates, demographics, and government policies.

A severe (GDP down by 10.0 per cent) or prolonged (three or four years) recession is referred to as an economic depression, although some scholars argue that their causes and cures can be different. As informal shorthand, economists sometimes refer to different recession shapes, such as V-shaped, U-shaped, L-shaped and W-shaped recessions. A focus on GDP alone is narrow, and it is often better to consider a wider set of measures of economic activity to determine whether a country is indeed, suffering from a recession.

Using other indicators can also provide a timelier gauge of the state of an economy.

Consistent with this definition, it is more appropriate to focus on a comprehensive set of measures including employment, income, sales, and industrial production to analyse the trends in economic activity. Although, an economy can show signs of weakening months before a recession begins, the process of determining whether a country is in a true recession or not often takes time. For example, it took the NBER Committee a year to announce that the U.S. recession started in December 2007.

This is understandable, because the decision process involves establishing a broad decline in economic activity over on extended period of time, and which is done after compiling and sifting through many variables. In addition, different measures of activity may exhibit conflicting behavior, making it difficult to identify whether the country is indeed, suffering from a broad-based decline in economic activity. Recessions are infrequent but costly. Although each recession comes with unique features, there are common characteristics including:

- They typically last about a year and often result in a significant output cost. In particular, a recession is usually associated with a decline of 2 percent in GDP. In the case of severe recessions, the typical output cost is close to 5 percent;
- The fall in consumption is often small, but both industrial production and investment register much larger declines than that in GDP;
- They typically overlap with drops in international trade as exports and, especially, imports fall sharply during periods of slowdown;
- The unemployment rate almost always jumps and inflation falls slightly because overall demand for goods and services is curtailed; and
- Along with the erosion of home and equity values, recessions tend to be associated with turmoil in financial markets.

II.1 Key Pointers that the Nigerian Economy is In Recession

The Federal Government has confirmed recently that the country's economy was 'technically' in a recession. Nigeria's GDP growth contracted to -0.36 per cent in the first quarter of this year [2016], compared with 2.11 per cent in the fourth quarter of 2015. Several economists have already forecasted that the economy is likely to contract again in the second quarter of 2016.

The IMF has also stated that the Nigerian economy would now grow at a much slower pace than South Africa's, which is expected to grow at 0.1 percent in 2016. The IMF (2016) emphasised that the *Nigerian economy will contract for the first time in more than two decades* as the economy adjusts to foreign-currency shortages due to lower oil receipts, lower power generation and weaker investor confidence.

As the Nigerian economy slips further into recession, manufacturers in the country say their production level has dropped by 20.0 per cent, blaming dollar scarcity, declining purchasing power, fuel scarcity and infrastructure challenges for their woes. Key indicators that Nigeria's economy is in recession include:

- GDP Decline – Consecutive declines in quarterly real gross domestic product below zero. Year-on-Year GDP decline in 2015 was -15.3 per cent. South Africa overtakes Nigeria as Africa's biggest economy in dollar terms. The change in status of both countries was attributed to the appreciation of the rand and the devaluation of the naira;
- Decline in economic activity spread across the economy, in both the manufacturing and non-manufacturing sectors and lasting more than a few months. Capacity utilisation is now less than 20 per cent. The manufacturing sector is getting bleaker by the day as their earnings dim amidst the biting economic crunch. Recently, four major blue-chip Nigerian companies lost as much as ₦51.86 billion in the first half of 2016 as the economy continues to take a dip. Nestlé Nigeria Plc, Nigerian Breweries Plc, Dangote Cement Plc and Lafarge Africa all suffered combined profit losses to the tune of ₦ 51.86 billion in the first half of the year;
- Production level, business activity, new orders, employment level and raw material inventories have all declined at a faster rate ever.
- Decline in income and profits reported by businesses. Publicly quoted companies now mostly declare a drop in their revenues or profits;
- Dip in Government Revenue – We have seen government revenue dip so much that most states have to seek for a bailout to enable them pay for something as basic as salaries. Twenty-seven (27) states out of 36 cannot pay salaries of their staff. In spite of the bailout fund they received from the federal government, the states have failed to meet up with their obligations to their workers. The situation is so bad that some states are owing their workers up to a year and the state

governors have constantly reminded everyone that there is no where they can source for funds;

- Job lasses – There are massive layoffs as most companies cut cost to remain afloat. Since consumer and government spending has dropped, businesses can no longer produce at same level and, therefore, cut back to remain in business. There has been massive lay-off of workers in banks and financial institutions. The National Bureau of Statistics revealed a few months ago that over 600,000 jobs have so far been lost;
- Market capitalisation down to US$48.0 billion from US$84.0 billion in 2014;
- Foreign airlines exit the Nigerian aviation market. Fourteen (14) airlines have so far withdrawn their services from Nigeria due to low patronage. The airlines are among the 50 that operated the Nigerian routes some months ago. Some of those that have left are Spanish-owned Iberia Airlines, United Airlines and Air Gambia. Twenty Shipping firms are also confirmed to have left Nigeria over low businesses with 300 workers sacked; and
- Inflation rate gallops and is currently 16.5 per cent, the highest since 2005.

III. The Case for Increased Government Spending in times of Recession

Government expenditures [programmes] are financed primarily in three ways. These include Government revenue such as taxes and non-tax revenue (revenue from government-owned corporations, sovereign wealth funds, sales of assets, or seigniorage);Government borrowing; and money creation. How a government chooses to finance its activities/programmes can have significant effects on the distribution of income and wealth (income redistribution) and on the efficiency of markets.

During a recession, the private sector spending drops for a variety of reasons. Demand for goods and services drop. Private investors tend to restrict their investments. Factories tend to drop production and lay off workers. Eventually, more and more businesses will continue to lay off more because of lower demand.

Revenues of government at federal, state and local governments will also fall leading to higher unemployment, bankruptcies, hunger, homelessness, desperation, and crime. In addition, there will be social issues such as loss of personal dignity. If this downward spiral continues, we can expect serious consequences for everyone including corporations, the rich, the middle class, and the poor.

To prevent the downward spiral there has to be spending. If the ailing private sector cannot provide enough spending, we will need someone else to resuscitate the economy during a recession. Economists recommend injecting government funds into the economy without increasing taxes. Recession may be one of the few exceptions in which economists can justify deficit financing. In order to do this right, the spending should be big enough to make an impact. Ideally, spending should be in labour-intensive projects that would benefit the the society as a whole. It can include spending on construction, education, communication networks, massive power-generation, and other major infrastructure projects.

For example, during the Great depression of the 1930s, the Tennessee Valley Authority [TVA] was created in the US. This not only created jobs, but it also helped in addressing the economic depression speedily. It improved the quality of life by providing cheap and clean electricity for millions. Industries that were heavily dependent on large amounts of energy thrived. TVA also helped the US during the Second World War by providing a huge amount of electricity needed to build the atomic bomb that stopped the war with Japan.

With an effective stimulus package, such job creation will start very quickly. With workers now having money, they will be able to create a demand for goods and services. Businesses with capital will now begin to invest in goods and services. This, in turn, creates more jobs and more demand for goods and services. More small business such as retail shops and restaurants will sprout within many communities. There will be ample opportunities for the masses to rise above subsistence. Self-esteem and consumer confidence of the masses will improve. Human hardships, homelessness, crime and other social issues will decrease.

Eventually, as the positive ripple effect continues, the tax revenues naturally will go up and government's deficit financing will not be needed at some point. Eventually, tax revenues will automatically rise due to higher economic activity. This rise in revenues should now be used to reduce the budget deficit. The justification for a budget deficit will not be there anymore after the recession. Then taxes, fiscal policies, and interest-rates should be adjusted to maintain the health of the economy and keep government budgets balanced.

Deficit financing by the government is appropriate during recession or depression. This is also considered to be a textbook solution by many economists. It has been the practice in many countries including China, Japan and parts of Europe and Asia. Japan was one of the first nations to successfully use deficit financing to reduce the impact of the economic depression during the 1930s. It was so effective that they were out of that depression as early as 1933.

Fiscal deficit can be financed in two ways. Firstly, through domestic and external borrowing by the government from the market, and Secondly, by borrowing from the central bank which issues new notes against government securities. Thus, borrowing from the central bank results in expansion of high-powered money in the economy. It is in fact monetisation of fiscal deficit which may be inflationary.

There are four implications of fiscal deficit.

- Firstly, a good part of it is financed through borrowing from within and/or outside the country. This leads to increase in public debt and its burden;
- Secondly, if a part of fiscal deficit is financed through monetisation of fiscal deficits, it leads to the creation of new money and rise in prices or inflation. To check inflation and achieve price stability, the IMF and World Bank had recommended that fiscal deficit should not be more than 3.0 per cent of GDP;
- Thirdly, a large fiscal deficit adversely affects economic growth as a substantial part of borrowed funds is used to finance current consumption expenditure of the government; and
- Lastly, more borrowing by the government leaves fewer resources for private sector investment.

The 2016 national budget was expansionary, anchored on a deficit of ₦2.2 trillion. The entire capital component of the budget was ₦1.8 trillion. Thus, without borrowing and even if the 2016 revenue projections were fully achieved, the implementation of the capital expenditure component of the budget would be impossible. Indeed, less than ₦400 billion has so far been released for capital projects. In the light of this and with economy already contracting at a GDP of -0.36 per cent in the first quarter of 2016 and unemployment rate of 12.1 per cent, government would need to act fast in negotiating loans to support critical sectors that will reflate the economy and pull it out of recession and stagflation.

Deficit financing is the right thing to do given that our debt- to- GDP ratio is very low. What is important is optimum utilisation of the resources borrowed to ensure we do not unduly overburden future generations with debts.

Need to broaden the tax base

Value Added Tax (VAT) can be broadened by the Federal Government especially, against the backdrop that it is among the lowest in the world and, well below the rates in other ECOWAS member countries. Thus, some increment should be considered.

CBN Monetary Tools

The Central Bank of Nigeria in collaboration with other stakeholders has effective tools to reverse the current recession. The Bank's special interventions, including funds targeting lending to SMEs, agriculture, power and non-oil exports are important. Section 3.2.12(h) of the CBN Monetary Policy Circular No. 38 for 2010/2011 fiscal year noted that infrastructure development remains grossly inadequate relative to the nation's requirements due to lack of funds. As part of efforts to address this challenge, the Central Bank of Nigeria established the Infrastructure Finance Office on March 01, 2010 with a mandate to, among others, evolve a sustainable financing framework to stimulate long-term financing for infrastructure development in the country. A few of the interventions are as follows:

The N300 billion Power and Aviation Intervention Fund (PAIF)

The Bank provided ₦300 billion facility for investment in debentures to be issued by the Bank of Industry (BOI) in accordance with Section 31 of the CBN Act 2007, for investment in power and aviation projects. The funds were channeled through the BOI for on-lending to Deposit Money Banks [DMBs] at a maximum interest rate of 1.0 per cent for disbursement at concessionary interest rate of not more than 7.0 per cent and a tenor of 10 -15 years. The African Finance Corporation [AFC] served as technical adviser to the Fund.

Review of the Prudential Guidelines to recognise the peculiarities of Long-Term Financing

As part of measures by the CBN to further encourage banks to lend to the real sector of the economy, particularly SMEs, infrastructure and agriculture, the Bank approved the amendment of the prudential guidelines on loan loss provisioning, and rules and regulations on margin lending. The objective is to take cognisance of the current dynamics in the industry and provide guidance on the recognition and measurement of loans, establishment of loan loss allowances, credit risk disclosure and related matters. The reviewed prudential guidelines recognises the use of a time-based approach for specialised loans which established longer time lines for measuring asset quality, based on the gestation periods for projects in the target sectors.

In Nigeria, not much can be achieved by relying solely on traditional sources of revenue to finance its programmes in these times of grave economic crisis. The focus should be on innovative financing and that is the focus of the rest part of this paper.

IV. Innovative Financing: The Way out for Nigeria

The term 'innovative financing for development' was coined in the early 2000s and since then, its use has become commonplace in development discourse. As the UN Secretary-General's 2009 Progress Report on Innovative Sources of Finance for Development noted, "the concept of innovations now extends to such diverse forms as thematic global trust funds, public guarantees and insurance mechanisms, equity investments, growth-indexed bonds, countercyclical loans, distribution schemes for global environmental services, microfinance and mesofinance, and so on". (UN,2009 pp. 5)

The World Bank defines innovative financing for development as "those that depart from traditional approaches to mobilising development finance —that is, through budget outlays from established sovereign donors or bonds issued by multilateral and national development banks exclusively to achieve funding objectives". (UNDP, 2012 pp. 11)

Some of the innovative financing options that Nigeria could use to finance government programmes include the following:

IV.1 Public-Private–Partnership Option

In the face of budgetary constraints, government can turn to the private sector as an alternative source of funding to meet the funding gap to deliver new and improved infrastructure projects from transport (roads, railways, bridges); education (schools and universities); healthcare (hospitals, clinics and treatment centres); waste management (collection, disposal, waste to energy plants); water (collection, treatment, distribution), government accommodation and defence.

One option is to leverage on public-private partnerships (PPPs) which are contracts between private sector entities and a government body, usually with the former expected to deliver desired services and assume the associated risks. The government is relieved of the financial and administrative burden of providing the service, but retains an important role in regulating and monitoring the performance of the private partner.

Employing PPP as a tool for meeting its obligations to citizens, governments have been able to avail themselves of the state of the art technology and private sector expertise, while avoiding excessive strains on already limited budgets.

Some of the objectives of a PPP programme are to:

- Increase financing available for infrastructure by making use of private sector investment resources;
- improve value for money in infrastructure projects by creating incentives for best-practice design, timely completion, and efficient operation by sharing project risk with the private sector;
- encourage innovation in the provision of infrastructure;
- improve the sustainability of infrastructure and infrastructure service;
- improve accountability in public expenditure If a government intends to increase the use of PPPs to provide infrastructure, then the main aim of developing the PPP framework is to make this happen.

Benefits of PPPs

- Infrastructure created through PPP can improve the quality and quantity of basic infrastructure such as the provision of water and its treatment, energy supply and transportation. In addition, the process can be widely applied to a variety of public services such as hospitals, schools, prisons and government accommodation;
- PPPs can assist the government develop a more disciplined and commercial approach to infrastructure development whilst allowing them to retain strategic control of the overall project and service;
- Under PPP arrangements, the risk of performance is transferred to the private sector. The private sector only realises its investment if the asset performs according to the contractual obligations. As the private sector will not receive payment until the facility is available for use, the PPP structure encourages efficient completion on budget without defects;
- There is evidence of better quality in design and construction than under traditional procurement. PPP focuses on the whole life cost of the project not simply on its initial construction cost. It identifies the long-term cost and assesses the sustainability of the project;
- The expertise and experience of the private sector encourages innovation, resulting in shorter delivery times and improvements in the

construction and facility management processes. Developing these processes leads to best practice and adds value;
- The process helps to reduce government debt and to free up public capital to spend on other government services;
- The tax payer benefits by avoiding paying higher taxes to finance infrastructure investment development;
- The PPP process requires a full analysis of projects risks at the outset. This fuller examination of risks by both the government and lenders means that cost estimates are robust and investment decisions are based on better information; and
- PPPs create efficient and productive working relationships between the public and private sector.

Potential Risks of Public-Private-Partnerships
- Development, bidding and ongoing costs in PPP projects are likely to be greater than for traditional government procurement processes. The government should, therefore, determine whether the greater costs involved are justified. A number of the PPP and implementation units around the world have developed methods for analysing these costs and looking at value for money;
- Some projects may be more politically or socially challenging to introduce and implement than others, particularly, if there is an existing public sector workforce that fears being transferred to the private sector, if significant tariff increase is required to make the project viable, if there are signficant land or resettlement issues, etc.;
- There is no unlimited risk bearing – private firms (and their lenders) will be cautious about accepting major risks beyond their control, such as exchange rate risks/risk of existing assets. If they bear these risks, their price for the service will reflect these;
- Private firms will also want to know that the rules of the game are to be respected by government as regards undertakings to increase tariffs/fair regulation, etc. The Private sector will also expect a significant level of control over operations if it is to accept significant risks;
- The Private sector will do what it is paid to do and no more than that. Therefore, incentives and performance requirements need to be clearly set out in the contract. Focus should be on performance requirements that are out-put based and relatively easy to monitor;
- The private sector is likely to have more expertise and after a short time, have an advantage in the data relating to the project. It is important to ensure that there are clear and detailed reporting requirements imposed on the private operator to reduce this potential imbalance;

- Given the long-term nature of these projects and the complexity associated, it is difficult to identify all possible contingencies during project development. Events and issues may arise that were not anticipated in the documents or by the parties at the time of the contract. It is more likely than not that the parties will need to renegotiate the contract to accommodate these contingencies.

IV.2 The Pension Funds Option

Pension funds are a fast-growing and useful asset pool for funding infrastructure projects. The National Pension Commission (PENCOM) recently announced that the asset pool of contributor's funds and managed by Pension Fund Administrators (PFAs), is currently at N5.3 trillion. It has been suggested that the Federal Government of Nigeria (FGN) could use the pension funds to finance budget deficit.

The use of pension funds to finance infrastructure projects became more prominent in the past two decades. This was largely as a result of mandatory pension schemes to fund pay-as-you-go systems particularly, in the private sector to guarantee pensions. This trend was further fueled by the need to diversify risk and match assets to the liabilities of pension fund schemes. Infrastructure asset is a suitable vehicle that delivers strong long-term economic inflation-linked returns at an acceptable level of risk, while matching asset to liability tenor of pension schemes. Thus, it has attracted significant funding from pension schemes. Within the Organisation for Economic Co-operation and Development (OECD), key institutional investors held US$65 trillion in assets as at 2009, which is expected to continue rising as coverage increases and workforce ages.

The following section looks at the experiences of some countries regarding the evolution of their pension fund market and the contribution of same to infrastructure investment. Pension fund has helped provide alternative source of funding for financing infrastructure in several countries and there has been no report of default that has resulted in erosion or misplacement of pension funds in the course of its use to finance infrastructure projects.

Challenges

The major challenge would be the initial resistance to use pension funds for infrastructure development given past history of incomplete or abandoned infrastructure projects, project delays and cost overruns. Pension fund managers may be averse to investing in such projects as they may jeopardise the returns on their assets and ultimately, the realisation of retirement benefits of their benefactors.

There is an absence of a framework to leverage on pension assets to fund infrastructure projects. Furthermore, there is an absence of an effective public awareness campaign to enlighten pensioners and pension fund managers on the potential benefits of using pension funds to finance infrastructure projects. There is also lack of experience of pension funds and fund managers in PPP and project finance.

The general weak capacity in the area of infrastructure building and funding, currently hinders the investment of pension assets in infrastructure finance. Nigeria's long-term financing market is underdeveloped, shallow and offers limited investment opportunity. Lack of the appropriate capacity in the area of infrastructure building and funding often results in the weak participation of local institutions in funding infrastructure projects.

IV.3 The Bond Financing Option - Eurobond

The operational phase of infrastructure projects is distinctively different from the initial phases. As the infrastructure project is starting to generate positive cash flows, default risks subside rapidly over time, on average, even below those of other highly rated debt securities. Infrastructure projects often represent (quasi-) monopolies, hence, cash flows are relatively secure as the price-setting power of infrastructure operations is high.

With stable underlying cash flows in the operational phase, infrastructure projects are akin to fixed income securities, therefore, bond financing is a natural and economically appropriate financing instrument. A key question is how infrastructure bonds can be promoted, especially in emerging markets such as Nigeria. The development of the local bond markets is a prerequisite for issuing infrastructure bonds.

One option is to issue infrastructure bonds off-shore to tap from the international capital markets. In this context, several issues regarding legal and disclosure frameworks arise. Policy actions are important. Short-term policy actions must continue to focus on achieving macroeconomic stability, maintaining debt sustainability, ensuring adequate use of proceeds from financing and investment in projects with high economic "multipliers". Others are avoiding the build-up of balance sheet vulnerabilities from currency and maturity mismatches, and managing the risk of significant slow-down or reversal.

Second, long-term policy actions should focus on developing domestic capital markets and institutions, and, adequately sequencing the liberalisation of capital accounts.

IV.4 Export Credit Agencies Option

A financing source of growing importance in emerging markets are export credit agencies (ECAs). Their involvement has become more prominent in emerging markets. In Asia, ECAs have become more involved in large infrastructure projects. For instance, the Japan Bank for International Cooperation and the Korea Export-Import Bank are large players. In Africa, the China Development Bank (CDB) has become a major player in the infrastructure market.

ECAs usually demand that materials, machines and sometimes, even labour for infrastructure projects are bought from their home jurisdictions. This can potentially raise costs. However, ECAs often allow repayment of debt in local currency, at least in part. ECAs are also seen as a potential insurer against political risks, hence they help reassure other lenders such as local commercial banks, which often do not have the necessary expertise and monitoring capabilities. As we all know, the Federal Government has decided to fund part of the 2016 budget through borrowing from foreign investors using bonds which would be infrastructure project-specific.

Project-specific bonds have been used in many countries for greenfield and brownfield projects. Canada is said to be the country that mostly relies on the capital markets to finance infrastructure projects. Specifically, the Government is expected to raise US$1billion through Eurobond for capital expenditure this year to augment domestic resources. Nigeria's low debt to GDP ratio means the country can borrow more to fund budget, infrastructure and other essential projects that will stimulate the economy and create jobs for the citisenry.

Nigeria's debt-to-GDP ratio is among the lowest in emerging markets at 10.0 per cent, with just US$8 billion in sovereign debt outstanding in hard currency which is an indication that it should be preferred by investors. The ratio for Kenya and South Africa is over 40.0 per cent.

The 2016 budget has a deficit-financing gap of ₦1.84 trillion for capital expenditure, which can be funded through borrowing from local and international markets. The Eurobond, therefore, is a welcome decision if indeed, it will be applied appropriately to drive the macroeconomy.

IV.5 Diaspora flows Option

Worldwide, African diaspora members save an estimated US$53 billion annually. If one in every 10 members of the diaspora could be persuaded to invest US$1,000 in his or her country of origin, Africa could raise US$3 billion a year for development financing. Mobilisation of diaspora funds is possible through the issuance of a diaspora bond, a retail saving instrument marketed to diaspora members. The money raised through diaspora issuances could be used to finance projects that interest overseas migrants - such as; housing, schools, hospitals, and infrastructure projects that have a concrete benefit to their families or the community back home.

Diaspora bonds can tap into the emotional ties, the desire to give back—of the diaspora and potentially help lower the cost of financing for development projects back home. Because the diaspora savings are held mostly as cash under the mattress or in low-yielding bank accounts in the countries of destination, offering a premium on diaspora bonds could be attractive. Diaspora investors can be a more stable source of funds than other foreign investors because their familiarity with the home country often gives them a lower perception of risk. In particular, diaspora members generally are less concerned with currency devaluation risk because they are more likely to have a use for local currency.

Partial guarantees by multilateral development banks could enhance the creditworthiness of many diaspora bonds. Surveys of diaspora groups' income and investment characteristics and political risk perception would help with the pricing and marketing of diaspora bonds. Embassies and consulates overseas can play a major role in marketing such bonds. Still, there are some dangers to the origin countries. Large foreign currency inflows after a bond issuance, and potential outflows when the bond matures, require careful macroeconomic management, especially of the exchange rate. Even if the bond is issued in local currency, Nigeria must pay attention to exchange rate management and prudential debt management.

The pioneers of diaspora bonds, Israel and India, have leveraged them over time to raise more than US$25 billion and US$11 billion, respectively. For sub-Saharan African countries, the World Bank has estimated that these instruments could raise as much as US$5 billion to US$10 billion annually (World Bank 2010 pp. 331).

V. Concluding Remarks and Key Recommendations

There are typically three ways of financing government spending: taxes, debt and money creation. Some governments also charge for the use of certain services. User fees for national parks, road tolls, and charging for public transportation are also used. However, they tend to be vastly dominated by taxes, bonds, and money.

Government debt is not necessarily a bad thing. Typically, a family that wants to buy a house cannot simply pay for it all at once, but must borrow much of the purchase price and then gradually pay it back over time. The same is true for governments. In these times of recession, the government of Nigeria should leverage more on innovative financing with less emphasis on traditional methods of funding programmes/projects.

That is the way to go.

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