Financing Development and Democracy in Africa

The AfDB and its Origins of Financing Development in Africa: Locating Money Finance within Industrial Policy

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Introduction

The recent crisis at the African Development Bank (AfDB) may be alluded as characteristic of the deficient institutional environment on the continent. But such crises are not unique to the AfDB. A crisis of transparency has in the past arisen at the European Investment Bank, with objections raised by local communities and international organisations around some of its projects. However, it is remarkable that the quest for transparency at the AfDB was externally driven and unflinchingly pitched against internal interests, calling to question the sovereignty of the bank to pursue domestic interests within a constellation of external influences. Undoubtedly, such externally motivated drive for transparency does reinforce a pattern of claims of an institutional deficiency on the African continent and, allegedly explanatory for its underdevelopment, while occasionally utilised to impose policies that undermine development, as demonstrated in the Structural Adjustment Programmes.

Within the AfDB itself, such contestation is not new but has been at its heart, since inception in 1964. In his biography, former Nigerian President, Shehu Shagari noted, that the initial condition which the Nigerian government, as the major shareholder, attached to funding the Bank was that 'under no condition should the bank's equity be offered to non-Africans in the future', citing the 'liberation of Africa from European economic domination and exploitation' as motivation for this conditionality. However, the circumstances became unsustainable by 1981 owing to financing constraint, which led 'the bank to seek its Board of Governors approval of non-African equity participation'. Nigeria, which initially vetoed the proposition for two years, succumbed to pressure from the other African governments, including the then President of the Bank, Mr. Mogamba of Zambia threatening to resign should Nigeria continue to maintain its position (Shagari 2001, 372). Today, the bank's authorised capital is held by 81 member countries, consisting of 54 African countries with 60 per cent shareholding and 27 non-African countries with 40 per cent shareholding.

The foregoing contextualises historically the so-called crisis of transparency, as it is the objective of the rest of this article to further broaden the discussion. Therefore, it unnerves a visceral of concerns around the role and significance of the bank for the future of the continent, while occasioning for a debate around the extent to which it is positioned for necessary bolder steps to innovatively finance development in Africa. Such debate allows for questioning the sufficiency of the current approach to financing development in Africa while exploring the possibility of an alternative approach by the AfDB and other continental financial institutions, extant or imminent. We argue that at the core of the crisis at the AfDB is Africa's dependence on the international community to finance its development. Development on the continent is here preferably located in the Agenda 2063 of the African Union (AU), as a most robust aspiration, built on a Pan African vision of an integrated, prosperous and peaceful Africa, driven by its own citizens, and representing a dynamic force in the international arena.

It may be necessary to further analyse the extent to which foreign interests may foster any re-alignment of the Bank's financing to meet Africa's development demands, not least where bolder initiatives may be proposed. The recent merger of the UK's Department for International Development (DfiD) and the Foreign and Commonwealth Office (FCO), which aims to link aid to foreign policy objectives is a case in point for countries' interests at the heart of foreign investments. Recipient countries must therefore navigate resulting underlying challenges in the politics of international investments.

Insufficient financing strategy of the AfDB

The AfDB is made up of 3 constituent institutions: The African Development Bank (AfDB), the African Development Fund (ADF) and The Nigerian Trust Fund (NTF). Its latest annual report shows that it's High 5 priorities have delivered electricity to 16 million people; provided 70 million people with food security through boosting agricultural technology; provided access to finance to 9 million people through private sector investee companies; improved access to transport services to 55 million people; and access to water and sanitation for 31 million people. Also, following the approval of the bank's shareholders to raise and additional capital of $115 in October 2019, the bank's capital more than doubled to a total of $208 billion (AfDB 2019). The bank called this feat a remarkable show of confidence on its leadership as it maintained a AAA rating from the four leading international rating agencies – Standard's and Poor's, Fitch, Moody's and Japan Credit Rating Agency – a reflection of its prudent financial management amongst other signals. But such confidence has been short-lived, called to question barely 3 months later.

Despite relying on foreign capital from 81 countries, the AfDB is still massively underfunded. About 90 per cent of its capital is callable (i.e. unpaid). This is notably not the case in other development banks. Such an arrangement is in part, due to African countries being unable to fully fund their shareholding, but also a reflection of poor creditors' commitments to financing, perhaps due to a governance structure that favours borrowing countries. A critical point of departure is to locate the so-called crisis of transparency within this inability of African countries to finance their development, owing to their low-income levels. We draw insight from the political settlements' literature, in which the functioning of institutions parallels the distribution of power in a society, itself deriving from existing income level or economic structure (Khan 2012). By implication, economic structures precede institutions (Reinert 2007) and the functioning of these institutions depends on the political settlement or existing social order. Here, existing relative power structure, domestic or external, need to be settled for institutions to function effectively. But the income for such settlement is largely deficient in Africa. As such, a more demanding issue than the crisis of transparency in the AfDB is to be located in its massive lack of income and underfunding of the bank leading to over-reliance on foreign capital.

Clearly, greater commitment is required from African leaders and institutions to achieve the original mandate of the newly independent African states of the 1960s; to finance development through more sustainable means than foreign capital. The bank comes short of this mandate. Not only is the AfDB underfunded and unable to meet the financing requirement of the continent, it is also more specifically incapable of responding to the call of the AU to lead the Agenda 2063. The AU Commission has made it clear that its Agenda 2063 needs to be supported by the AfDB, and the New Partnership for Africa's Development (NEPAD), Planning and Coordinating Agency (NPCA) and the UN Economic Commission for Africa (UNECA). Among the flagship programmes in its First Ten Year Implementation Plan are the establishment of an integrated high-speed train network, structural transformation of its commodity-based production and integration into higher levels of the GVC, the implementation of the GrandIngaDam power project, the Pan-African e-Network, a single air transport market, a common African passport, the establishment of African financial institutions and the Africa Continental Free Trade Area (AfCFTA) amongst others.

The AfCFTA is considered the most pursued and aims to significantly increase intra-African trade while strengthening the continent's voice and policy space within global trade negotiations. Despite aims to establish African financial institutions for accelerating integration and socio-economic development in the Agenda 2063, there is currently lack of a detailed plan to achieve this, how such financial institutions would emerge or even funded. Since these proposed financial institutions have not emerged, not least in the timeframes within which they were planned, the onus rests on the AfDB to lead on financing the Agenda 2063.

The need for money financing development in Africa

Increasingly, it is clear that the current model of financing development for Africa is insufficient to transform it structurally. But the sustainability of private debt and its impact on fiscal sustainability of Low Income and Developing Countries (LIDC) is found to be increasingly challenged by fluctuations in global financial markets. Despite low borrowing cost in global financial markets, low-income countries still borrow at relatively higher average interest rates of more than 7 per cent and as high as 10.75 per cent, with refinancing needs projected to rise by 2024 in addition to the difficulties in restructuring such debt (Bonizzi et al. 2019). Deteriorating conditions in global liquidity such as the surge in borrowing cost in the face of the current Covid-19 crisis have further exacerbated borrowing conditions. As such, African countries must look inwards for more sustainable debt options, instead of the impromptu constituting of special envoys to supplicate external benevolence with each crisis.

Therefore, the need for the AfDB and other proposed continental financial institutions to money finance, through issuing their own debt domestically, cannot be overemphasised. There remains the question of whether the AfDB is well placed to lead the call for money financing on the continent, given its systematic role as development bank or whether another financial institution or a Central Bank ought to pursue this initiative. Nevertheless, there is growing consensus that a currency-issuing country can raise as much debt as possible in its currency, as long as it has its central bank and sets interest rates (monetary policy) and does not issue debt in foreign currency (Mitchell et al. 2019). While there is largely, consensus on the foregoing for closed economies, open economies face a Balance of Payments (BOP) constraint and oftentimes the willingness to hold domestic securities like central bank bonds (Vernengo et al. 2019; Bonizzi et al. 2020), including underdevelopment of domestic capital markets. The import-dependent economic structures of African countries, amidst these constraints, mean money financing could lead to higher external debt.

However, money financing can be pursued for real investment located within strategically crafted industrial policy. The cost of domestic input including wages can be paid for through money finance. The central bank could then sterilise by selling bills to manage the exchange rate. This frees up more capital for imports in the short-term, while aiming to transform the structures of these economies in the long-term. In addition, the callable capital which already exists at the AfDB – in which there is a huge unrealised margin for borrowing simply guaranteed by sovereign states – can be used to money finance through issuing debt domestically. In this case, the callable capital for African countries can be realised while also giving room to the non-African shareholders to increase their capital, as such, increasing the total paid-up capital of the bank. What this means is that money financing can be pursued to a measured extent in Africa, but would require more strategic forward-thinking from Africa's financial institutions.

AfCFTA and the Surplus Recycling Mechanism

Achieving the potential of the AfCFTA further underlines the need for alternative financing approach to development in Africa. To begin, the AfCFTA ought to be better teased out beyond trade agreements, to concrete integration of economic and productive structures of its member countries, to avoid the uneven development that could emerge. As such, instead of funding pockets of country projects, the AfDB could focus on projects that cut across countries like the Desert to Power Program for solar projects in the Sahel signed in May 2018, promoting greater integration of production on the continent. One only needs to look at the European Union to comprehend the looming spatial deficit, where periphery economies are seen as liability to the core, with emergent political backlash. A worse situation is likely to emerge on the African continent with a union on the back of different levels of competitiveness and production capabilities. So-called xenophobic attacks in South Africa are an indication. Within a trade area, the problem of adjusting external surplus and deficit is bound to emerge, as obtains in any open economy, irrespective of whether it is facilitated via single or multicurrency.

Therefore, a concrete arrangement ought to be in place to correct the inflationary impact of current account deficit and deflationary impact of current account surplus that would emerge between African countries when the FTA is operational. One proposal for how the continent may address this problem is through a central clearing system, as put forward by Keynes in 1941, in what he called a Surplus Recycling Mechanism (SRM). Here, the burden of adjustment would be on the countries with a trade surplus to fund countries with deficit based on the simple banking principle in order to manage the noninflationary growth of the continent (Krimpas 2010). This fiscal approach to financing countries' surplus and deficits promises to be lower than the market cost.

For this type of current account adjustment to be feasible, a central monetary union may be necessary, which may fall outside the purview of the AfDB. However, the foregoing depicts what is necessary to ensure the AfCFTA works effectively for member countries. At the same time, it prompts the AfDB to reinvent its role to facilitate the emergence of a monetary union while setting the financing trend on what is possible for the AfCFTA. Another option is for the AfDB to reinvent itself into a lender of first resort, as such a fiscal authority on commercial – through directing external surpluses in one country into productive profit-yielding investment in another – rather than distributional criteria (see Krimpas 2010).

Matters arising

Statements cautioning debt on the basis of output on the continent have been too simplistic, as can be recently credited to the World Bank and IMF. Oftentimes, these statements ignore the complexity of sovereign debt, its source, the direction of funding and potential long-term returns. The issuance of debt is about fiscal policy, as such the constraints are not monetary but real. The problem only arises where the supply of money is out of sync with the supply capacity of the economy. But where there is large unused capacity or unemployment in the economy, there is scope for money financing via a Central Bank.

This subject has gathered significant interest in the wake of the Covid-19 pandemic. Such growing consensus endorses fiscal deficit as opposed to concerns around rising debt levels, growing budget deficit and cost of servicing debt, as demand has to be stimulated during downturns, in line with Keynesian countercyclical fiscal policy. As such, governments in high-income economies have raised an unprecedented scale of debt to sustain firms and households, notably without a priori matching output or repayment capacity to debt. The evidence that it is possible for governments to spend more than it generates in taxes or earns at any given time, is an auspicious start to the conversation.

Perhaps, African countries can take a cue by raising debt domestically to tackle the output and infrastructural gap for structural transformation on the continent. Even inflation causing wealth effect is curtailed through financing real investment, while at the same time guaranteeing exports in the long-run. Raising debt for infrastructure spending – transport, power, communication, etc – has a high multiplier effect on demand. It increases demand, creates jobs and productive capability. Fiscal spending (and credit) increase the size of the multiplier, and the persistently high growth rate in African countries over the last 20 years indicates a high multiplier effect from fiscal spending. As such, the multiplier on deficit money financing would be significantly high enough to cushion the effect of a future debt burden. Indeed, most African countries import even the most basic consumables, in which case the de-localisation of cheap consumer goods from the continent will necessarily be part of any country's or continent-wide industrial policy.

The call for money financing is reinforced by the fact that public debt through the capital market has the tendency to crowd out private investment. With a fixed exchange rate, money financing will lead to higher interest rates and can potentially crowd out the private sector. On the other hand, with a flexible exchange, money financing may lead to a depreciation of the exchange rate and raise the cost of key imported capital goods, which can also induce a crowding out. While a carefully managed float (as described above) and inflation-induced tax increase is recommended, the direction of money financing towards real investment and infrastructure has the potential to minimise these negative effects.

The foregoing shows that it is more difficult for governments that operate a fixed exchange rate and surrender their currency sovereignty to another to money finance, as characteristic of Francophone African countries. This allows for touching upon the political elements of the level of money finance necessary for development, considered in some cases to be as deterministic of outcomes as much as the economic fundamentals discussed above. The negative effects of money finance can be curtailed with political will, and strategic international cooperation for developing countries. In the same vein, history shows that debt driven hyperinflation is more a function of politics, domestic and external, than perceived market forces.

Therefore, regional and political contestation such as currently within the AfDB could deter efforts by Africa's financial institutions from addressing more pressing problems of development. Too many interests with voting rights can undermine decision-making processes, especially where significant risks are involved. Having to seek external approval makes it near impossible to achieve bold initiatives, such as recommended here. With already stringent lending conditionality to African countries, representative Central Bank governors are expected to think these proposals too ambitious, more so in Africa where there is no deficit of cautionary tales deriving from the fragility of its economic structure. So, embedded institutional structures for development can of themselves be the hinderance to necessary initiatives for achieving such.

Questions immediately arise around revisiting the linkages African financial systems have with the rest of the world, not least as it relates to the short-term nature of capital flows, the well-known undesirable impact of aid, to mention a few. Not disregarding the hollow case of Francophone African countries' recent calls for delinking the CFA Franc from the French Franc and ultimately Euro. These limiting relations comprise the present reality of Africa's financial system, of which the crisis at the AfDB is only the lesser manifestation of a considerably broader challenge.

Concluding remarks

It is obvious that the current institutional financing arrangement on the continent, adopted largely by the AfDB, is unable to deliver development. As such, African countries need to re-visit the financial (and oftentimes intellectual) dependency and innovate their way out of underdevelopment. This would include restrictions on capital flows while pushing the boundaries of domestic debt. There is the possibility of money financing domestic real investments within industrial policy. Afterall, the African character is ambitious. And the bank was founded on the mandate of realising that ambition. It is necessary to achieve that, through a robust continent-wide industrial policy, uninhibited by the current approach of financing development. Adopting the recommended SRM framework above would ensure effective functioning of a union, trade or monetary.

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