THE SHIFT OF VALUE IN DEVELOPMENT FINANCE: IMPLICATIONS FOR DEVELOPING COUNTRIES AND POLICY TRENDS IN SUB SAHARAN AFRICA. A CASE OF UGANDA

By

Dr. Stephen Robert Isabalija

1.0 Background to the study

The subject matter of Financing Developing Countries (FDC) is said to have evolved along roughly the following lines: Initially, traditional western financing centers (IMF, EU, WB) would choose from which country to receive development finance in form of loans and grants, but with the emerging financial hubs (BRICS countries), the trend has changed. Also, these growing economies have become increasingly important players in the global economy, especially with their share of the global cross-border flows of financial assets also rising. Because of their strong growth prospects and opportunities, developing economies have attracted foreign financing (loans & grants) and investments (FDI) in order to improve their infrastructure for which China currently takes a lead, in anticipation of higher returns through getting market for their products, especially at a time of very low interest rates in advanced economies e.g.US, a reason as to why they are rushing to invest in Africa (Karolyi et., al, 2013). This has resulted in recent dislocation in the financing model to African countries from the traditional Western Financing centers such as IMF, WB to the growing financial hubs such as the BRICS (Brazil, Russia, India, China and South Africa) which has reshaped the financial services landscape and has provided a severe reminder of the countries intensely evolutionally nature.

Africa and Sub Saharan African countries (SSA) in particular have a large financing gap, not only to sustain its current rapid rate of economic growth but also fund its transformation (Amadu, 2014). The continent’s infrastructure spending needs alone stand at about $93 billion per year. The WB group in the process of reducing this gap committed a record breaking investment of $ 15.3 billion to SSA`s development in 2014 supporting shared prosperity in the region and focusing on increased efforts to reduce poverty (Diop – WB vice president for African region, 2014). Over the last decade, the flow of external financing to Africa; an important supplement to fiscal revenues has increased and the relative importance of its components has changed from peasantry to processing and manufacturing for some countries. Private capital flows to SSA driven by investment from the BRICS (Brazil, Russia, India, China and South Africa) countries especially China and India and portfolio flows as well as remittances have overtaken aid flows; a reason why the USA is crying foul to the extent of the US president calling for an African heads of state summit to re-partner for business (August, 2014). As a result, it is important to explore policy options to ensure that these external flows and trade dealings are efficiently sought of and then utilized to achieve economic, social and environmental sustainable development.

The growth in external resources has the potential to complement domestic resources to achieve SSA countries ambitious of transformational strategy. Deepening domestic financial sectors and developing local capital markets remain high on the policy agenda but seem far from being achieved (UNCTAD 2007). SSA countries need to continue making more efficient use of their existing financial systems and improve their mobilization and allocation of resources to growth-enhancing investments. One benefit of deeper financial sectors and more developed local capital markets is that they use them strengthen the tenuous link between external financial flows and macroeconomic growth, thus open up to their local people for cheaper capital. One important starting point is to continue building an appropriate financial infrastructure including the payments and accountability systems, and the legal and regulatory framework for financial services and promote financial literacy. Raising the necessary fiscal revenues together with appropriate macroeconomic policies remains a priority in order to move away from budget support. Sequencing the liberalization of the capital account, ensuring debt sustainability, and appropriately managing sovereign debt and external flows should also be a part of the policy instrument.

BRICS countries are playing an important role in SSA ongoing integration in the global economy and according to ADB (2013) data indicate the share of BRICS countries in Africa’s total value of green field projects as the main mode of investment in Africa rising to more than 25 percent in 2012 from 19 percent in 2003. Four of the BRICS (South Africa, China, India and Russia) are now among the top investing countries in Africa tending to overpower the traditional western financial centers (IMF, WB) because of their stringent policies accompanying their aid that most SSA countries are not interested in. Thus, one policy priority for SSA countries will be to find ways to attract investment in the primary sector as well as in services and manufacturing sectors cheaply and free from stringent conditions (Easterly 2005). To this however, majority of SSA countries are focusing to the emerging financial hubs to overcome their financial deficit leaving aside the famous financiers (WB, IMF) whose financial commitments has been tasted and of recent granting SSA countries a zero interest credits and grants for international development association (IDA); the WB`s fund for the poorest countries (Diop, 2014).

2.0 Financing trends – a policy perspective

African member states especially the Sub Saharan Countries have been the major beneficiaries of the international Aid, concessional finance and cheap loans reimbursed to them by European Union (EU), World Bank (WB), IMF, European Investment Bank (EIB) among others with a common vision of enabling them reach the Millennium Development Goals (MDGs). In addition to this, the western financiers since their formation have shown positive African development finance assistance and increased the debt relief.

The Concessional Finance (See Cotonou Agreement**)** mandates the EIB to provide reimbursable aid to developing countries through their commercial banks and central banks to undertake social development projects. Under the agreement, the bank allocated between 2003 – 2010 EUR 2.2 billion from the European Development Fund for the provision of concessional finance as follows: EUR 2.037 billion allocated to finance the Investment Facility, a risk-bearing revolving facility geared to foster private sector investment such as energy, water, transport and telecommunications; EUR 187 million as an interest rate subsidy appropriation. This was to be used for projects presenting strong social and/or environmental benefits or in order to increase loan concessionality for public sector infrastructure projects in countries subject to restrictive borrowing conditions under the Heavily Indebted Poor Countries Initiative (HIPC) or other similar schemes.

In addition, WB and IMF support is provided mainly through lending programmes to individual or groups of countries (regional projects). They provide considerable non-lending support through sponsorship and provision of technical assistance for analytical work and policy dialogue as well as support to enable different stakeholders to convene (e.g. governments, institutions, development partners, e.t.c) to address a common need. Furthermore, the World

Bank is increasingly providing general budget and sector support through the IDA (IDA, 2007). For example, WB has committed a handful of money at a low ($ 15.3 billion) and zero ($ 10.2 billion) interest rate which is the highest level of World Bank delivery by any region in the World history. But the key question policy makers and management thinkers need to address is why WB is doing this historical mark now yet African challenges have existed; may be because of China`s intervention. Is this fighting for supremacy or superiority, then who will be the winner and or the looser?

On the other hand, China is visibly financing developments in Africa mainly in many physical infrastructure developments and mining activities, it has challenged the approach that western countries emanating from the 'Washington Consensus'. The Washington Consensus imposes aid conditions, such as political and economic reforms. While China follows the principle of non-interference in a recipient country's internal affairs and sovereign integrity, a reason as to why many SSA countries are in bed with China because of their hidden non democratic tendencies but in quest for financial assistance. With its non-conditionality, the Beijing Consensus has gained favor in many developing African countries, but has come under fire from OECD circles. China's unconditional aid is seen as holding opaque political systems in place thereby allowing local leaders and elite groups to get away with poor governance (Tadem, 2007). Despite the criticisms, the Beijing Consensus is prompting serious change in the approach of those who follow the Washington Consensus. China is the world's second-largest economy, following the US. Competition for clients is becoming fierce and International Development Banks are acknowledging that they may have to start watering down the social and environmental conditions they attach to loans in Africa and elsewhere in order to minimize being undercut by Chinese lenders (Tadem, 2007). Today, China is on the verge of becoming the world`s largest economy but its voice at the IMF – wrapping up its annual meeting this weekend (17$^{th}$ October, 2014) in Washington DC remains that of a minor country and some worry this could undermine the IMF that estimates China`s economy at $ 17.63 trillion compared to the US at $ 17.42 trillion based on purchasing power parity standards by the end of this year (Batista, IMF representative of Brazil). The IMF, WB & the EU have a difficulty conforming to this new global power balance because China has 3.8% voting share not far from Italy which has an economy one-fifth the size of Chine and US with 16.7% yet China, is almost becoming the first economy. The risk for the IMF is that it will become less and less relevant and increasingly illegitimate (Lagarde IMF managing director, 2014). Thus, the exact extent to which the principles of the Washington Consensus will be adapted in response to the increasing pressure being imposed by the Beijing Consensus to SSA countries is/will become more apparent in the coming decade as South-South partnerships and the influence of the BRICS countries (Brazil, Russia, India, China, and South Africa) continues to grow.

Furthermore, for SSA countries to grow and prosper, they need to build a strong productive capacity, which involves increasing the competitiveness of the production and private sector. Private sector development is actively pursued since "it is businesses and not governments that trade" and can produce development results in this arena (WTO and OECD, 2010). Better still, public-private partnerships are strongly encouraged so that policy and practice are aligned (WTO and OECD, 2009). They thus need to address the challenges the private sector faces stemming from the cost and inadequacy in financing castigated by;

- Lack of close working relations with different financiers
- Financing agencies (commercial banks) seeking financing from capital markets which is itself expensive and not reliable.
- Many development banks including Uganda development bank financing social infrastructure at a cheaper cost at the expense business that spar growth.
- Another trend worth noting that has posed a challenge is that ODA terms have generally become increasingly concessional with almost 90% of bilateral Official Development Assistance (ODA) being in the form of grants and China too favors this approach (IDA, 2007; IOSC China, 2011). Far noting is that most SSA countries are running to China which favors a similar model with that of the western countries.

Because of the above challenges, development finance in the perspective of the private business sector especially in SSA countries remains invisible.

3.0 A case of Uganda and Motivation for the study

The capital inflow has been especially utilized to boost infrastructure and the industrial sector. Infrastructure that ultimately ushers in services sector has since early 2000s gained a significant share of Uganda's GDP growth and in 2009/2010 contributed 49 percent to GDP and to its growth by 13 percent. According to Cali et al. (2008) services constitute over 50 percent in low-income countries and accounted for 47 percent of economic growth in SSA over the period 2000-2005 while industry contributed 37 percent and agriculture 16 percent in the same period. This implies that growth in Africa and indeed in Uganda relies as much on services and industrial development as on natural resources or agriculture, in spite of those countries benefiting from trade preferences in primary and secondary goods (Nkundabanyanga et., al 2013). This has been so because of the value shift and provision of infrastructure; roads, and electricity which has been so because of the capital inflows from the major western financiers (IMF, EIB, EU & WB) and also China.

These sectors (services & industrial sectors) could therefore if better improved provide important benefits to the Ugandan economy. For example, employment might adjust to the changes and people would get jobs, improve on GDP, utilization of redundant resources and improved par capital in the long run. This benefits the poor countries in particular and represents a net increase in employment. As the SSA financing remains the block with the highest demonstrated potential; the importance of its un tapped resources earmarked by emerging economies creates much interest by their government and other players especially with regard to policy and development and the extent to which theses emerging markets can exert their influence on SSA economy to boost their capital gains in addition to making SSA countries get out of poverty to achieve the MDGs. But this can be jeopardized because of the conflict of interest most SSA countries play. For instance, remarks from the finance ministers with the WB & IMF officials in Khartoum (September, 2014), "African states have made bold demands for quick deliberate action from WB and IMF in supporting Africa`s growth plans". On the other hand the SSA countries are underneath in "love" with China for capital development and debt extension to finance infrastructure. For instance, 90 percent of Uganda`s contracts have been given to the Chine`s contractors at a helm of their own loan repayable by Uganda at a high interest rate bigger than that of IMF, WB, EIB e.t.c. This is because China does not impose political and economic consensus which the former does. We argue that this kind of direct investment and proceeds may not spur economic growth because their loans and grants are indirectly conditioned by either party. For example the recent contract sag single handedly given to China Harbour Engineering (CHEC) to construct a standard railway gauge is to cost Uganda $ 8 billion which will be directly financed by the Chinese bank. Such a development loan of that magnitude should have been channeled through development bank like Uganda Development Bank (UDB) and then finds its way to the rightfully selected contractor. The challenge now facing Development banks is why do they exist, what is their mandate if foreign banks can deal directly with either individuals or contractors, is this type of financing sustainable and developmental to the recipient country

4.0 Global situation at glance

Economic growth in sub-Saharan Africa (SSA) remains robust and is expected to pick up in 2014 after expanding by 4.9 percent in 2013, output looks set to expand by about 5½ percent this year. The region's recent strong period of economic performance thus looks set to be sustained, supported by stronger global economic activity spurred by the improved outlook for the advanced economies. Importantly, the projections assume that the impact on the region of the expected growth slowdown in emerging markets (Ems) and tightening global monetary conditions will be limited (World Economic & Financial Survey, 2014). For more than two decades, Ems have generated some of the most exciting investment opportunities globally. However, they today present a very difficult investment proposition, having established themselves as major players in the global economy. Many Ems are better resourced, have stronger balance sheets and with a young workforce to save and provide development finance to SSA countries at a low interest rate compared to the famous Western countries and Western financial centers like IMF & WB (IMF-World economic outlook, 2011). They however, have turned exploitative in a way that they have extended their labour to SSA countries in areas where there given contracts instead of employing the local. This has in addition resulted in profit repatriation and making Africans unemployed. For example, because of this and not accepting technical expertise from WB & IMF; SSA countries have chosen silent countries such as China to finance their huge financial undertakings because of its non conditionality on its loans, grants and other aid flows

Emanating from African financial stricken situation, their challenges are twofold and characterised by two important debates.

Firstly, SSA has been said to be caught into a 'poverty trap': its growth path would diverge from those of other parts of the world, e.g. East Asia or Latin America. A great number of studies question whether this suggests the existence of features that would be specific to SSA, in particular initial endowments that would have a negative impact on long-term growth and state capacities. Economic historians have thus highlighted the negative effects of specific land-skills ratios or types of agricultural modes of production because they want to do the job themselves instead of using the local labour force. The argument that SSA is caught into a poverty trap, however, remains controversial and has continued to hinder development financing by the international financial institutions (e.g., the World Bank). The international financial institutions argue that the culprits are African states' poor economic policies and insufficient trade liberalisation, while UNCTAD considers, on the contrary, that the reduction of state intervention during the era of adjustment programmes explains the continent's stagnation (Sindzingre, 2008).

Secondly, the impacts of globalisation which often refers in fact to trade openness policies, is the subject of intense debate, as to whether it is beneficial or detrimental, appropriate to low-income countries and particularly those in SSA, given the continent's endowments and post-colonial market structures characterized by the exports of primary/raw commodities. In this context, the impact of globalisation on states and public institutions has been viewed as intensifying their weakening and increasing already high inequalities. This debate has become recently crucial for SSA because the continent's exports are subject to an unexpected increase in global demand due to emerging countries primarily China. This phenomenon if it lasts, destabilises some past development theories, such as the decline in the terms of trade and the 'curse' on countries that exhibit market structures based on the export of commodities (the 'natural resources' curse'): endowments in natural resources and commodity dependence might not be intrinsically a curse, and it may be possible to grow from natural resources (Sindzingre, 2008). Nigeria, Niger are a victim to the curse at the hands of their natural resource (oil), corruption is at its highest and insecurity brought about by the Boko Haram. Increased global demand in commodities may today have consequences that differ from the negative effects of the windfall gains of the 1970s (e.g. oil) on economies and state capacity in SSA, because of a larger room for manoeuvre regarding International Financial Institutional (IFI) policies and financial resources. Prospects, however, are highly uncertain, as these windfall gains and room for manoeuvre regarding fiscal capacities and redistributive choices may have negative impacts on states and create economic and institutional traps. In addition, Asian 'developmental states' in the 1980s, and now China, suggest a model of growth that highlights the key role of strong state intervention.

5.0 Current Developments IN SSA

Despite the global economic slowdown in 2012, growth in SSA remained robust supported by resilient domestic demand and still high commodity prices attributable to high cost of capital SSA countries use to finance their undertakings (World Bank, 2013). In 2012, the region's growth was estimated at 4.7 percent. Excluding South Africa, the region's largest economy, the remaining economies grew at a robust 5.8 percent higher than the developing country average of 4.9 percent. About a quarter of countries in the region grew at 7 percent or better, and several African countries are among the fastest growing in the world. Medium-term growth prospects remain strong and should be supported by a pick-up in the global economy, high commodity prices, and investment in the productive capacity of the region's economies. Overall, the region is forecast to grow at more than 5 percent on average over the 2013-15 period: 4.9 percent in 2013, gradually strengthening to 5.2 percent by 2015.

Increased investment flows are supporting the region's growth performance, with investment-to-GDP ratios increasing by an average of 0.5 percentage points per annum over the past decade. In 2012, for instance, net private capital flows to the region increased by 3.3 percent to a record $54.5 billion, notwithstanding the 8.8 percent decline in capital flows to developing countries. Foreign direct investment flows tend to dominate capital inflows to the region, thanks to a wealth of extractive resources, but also because other forms of capital flows such as portfolio and bank lending to the region are limited by less developed capital markets and a banking sector that is less integrated with global financial markets (South Africa and Mauritius are exceptions). Foreign direct investment (FDI) to the region increased by 5.5 percent in 2012 to $37.7 billion, although for developing countries as an aggregate these flows fell by 6.6 percent. The resilience of FDI flows to the region in 2012 reflects, inter alia, still high commodity prices (even though prices softened during the year). In 2012, several mines were expanded or new ones constructed; prospecting yielded major gas discoveries along the east coast of Africa; new, commercially viable oil wells were drilled in West Africa and East Africa; and a number of countries discovered new mineral deposits including Uganda.

While both foreign and domestic-originating investments mainly in infrastructure have increased, the investment-to-GDP ratio of about 22 percent in SSA is the lowest among developing regions. The region's investment-to-GDP ratios are at levels observed in China in the early 1960's and India in the early 1980's both prior to their economic boom, suggesting increased scope for further expansion in productivity-enhancing investment in the region.

Besides increased private investment, governments in the region are focusing their attention on tackling the infrastructural weaknesses that are inhibiting the region's competitiveness and growth. For example, the spike in capital expenditure in Uganda in 2011 is linked to the construction of the Bujagali dam along river Nile, which has increased the provision of electricity for both domestic and commercial use financed by IMF & WB. This has generated from faster growing economies and higher commodity prices as well as from improving access to international capital markets and new sources of bilateral official financing. Continued investment in key infrastructure will be critical to maintaining and strengthening growth over the medium term.

Nonetheless, care must be exercised to ensure the long-term sustainability of public investment programs. For example, where high commodity prices have boosted government revenues, spending needs to be sufficiently flexible so as to be able to absorb what could be a significant revenue loss if commodity prices were to fall. World Bank simulations suggest that a 20 percent fall in industrial commodity prices would lead to a 1.6 percentage points of GDP decline in government balances over a three year period. Hence, countries will need to carefully balance a ramping up of priority investment spending with safeguarding fiscal flexibility should commodity prices and government revenues decline.

Overall, the region's general government balance as a share of GDP deteriorated in 2012, with some 40 percent of countries seeing their fiscal balance worsen by 1 percent or more of GDP. Public debt-to-GDP ratios in the region are relatively low in historical terms or in comparison with high-income countries. Yet, this ratio has increased from 31 percent in 2008 to 38 percent in 2012 for example Ghana, Niger, Senegal and Uganda are among countries that have seen a rapid increase in their debt levels over the past four years both from Western financiers (IMF, WB) and from financial hubs such as China among others. This contradiction in the financing model has resulted in competition for Africa for resources, investment and capital development moreover at a least cost of capital.

Methodology to be used to enrich the study

The study will be carried out in Uganda and will gather information from (Unit of Analysis) Bank of Uganda (BOU), Uganda Development bank (UDB), East African Development Bank (EADB), Commercial banks in Uganda that operate within Africa, World Bank country office, Embassy of China in Uganda, Ministry of finance and Planning & Economic Development (MFPED). The study will be cross sectional and quantitative research design. In addition, we shall interview at least 10 senior employees (Unit of inquiry) within the selected unit of analysis. The decision to accept a minimum of three respondents per entity was based on previous scholars such as Baer and Frese (2003) and Ngoma (2009). We chose to get information from respondents because reliable information could not be as easily achieved by collecting data from other stakeholders other than at senior management level and at the same time from those who work within those entities.

We chose the unit of analysis because by their established mandate, they are supposed to supervise, act as agents of disbursing funds and others oversee developments on behalf of their mother countries or organizations

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