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*The findings of this Brief reflect the opinions of the authors and not those of the African Development Bank, its Board of Directors or the countries they represent.*

#### **Mthuli Ncube**

Chief Economist and Vice President  
ECON  
[m.ncube@afdb.org](mailto:m.ncube@afdb.org)  
+216 7110 2062

#### **Charles Boamah**

Vice-President  
FNVP  
[c.boamah@afdb.org](mailto:c.boamah@afdb.org)  
+216 7110 2003

#### **Charles Leyeka Lufumpa**

Director  
Statistics Department  
ESTA  
[c.lufumpa@afdb.org](mailto:c.lufumpa@afdb.org)  
+216 7110 2175

#### **Steve Kayizzi-Mugerwa**

Director  
Development Research Department  
EDRE  
[s.kayizzi-mugerwa@afdb.org](mailto:s.kayizzi-mugerwa@afdb.org)  
+216 7110 2064

#### **Victor Murinde**

Director  
African Development Institute  
EADI  
[v.murinde@afdb.org](mailto:v.murinde@afdb.org)  
+216 7110 2075

#### **Pierre Van Peteghem**

Director  
FTRY  
[p.vanpeteghem@afdb.org](mailto:p.vanpeteghem@afdb.org)  
+216 7110 2028

## Diaspora Bonds: Some Lessons for African Countries

Seliatou Kayode-Anglade and Nana Spio-Garbrah<sup>1</sup>

### Abstract

This economic brief draws out lessons from the most publicized Diaspora bond issuances globally – that of Israel, India and Ethiopia with the aim of exploring their applicability to the African context. It intends to provide insight to potential African issuers on what aspects to ponder prior to issuance. This economic brief concludes that Diaspora bonds are an important fundraising vehicle but that critical to their success in Africa are both soft and hard factors: intensive marketing based on disaggregated data on the Diaspora and credit enhancement to entice investors and reduce risk perception. In this regard, development finance institutions such as the African Development Bank have a critical role to play in providing statistical data, advisory services and risk mitigating financial instruments to help African countries realize their aspirations to issue.

### 1 Introduction

#### Context

#### Nearly 140 million Africans are living outside the continent...

The size of the African Diaspora is huge. An estimated 30 million Africans have joined the western hemisphere in recent years while keeping strong ties to their homeland. It is estimated that Diaspora Africans are saving up to \$53 billion in the destination countries every year.

#### ...But migration generally happens within Africa.

Surprisingly though, countries within Africa are still the primary destination of most African migrants, especially the poorest ones, including refugees. Intra-regional migration is more important in Sub Saharan Africa (SSA) than in

any other developing region. Although intra-regional remittances are estimated to be much lower than remittances from outside the continent due to the lower income levels of migrants from within Africa compared to those in the Diaspora, this migration trend does show the potential for resource mobilization of the Diaspora within Africa.

#### Remittances are the largest source of net foreign inflows after foreign direct investment (FDI), ranking higher than official development aid (ODA)...

Despite the cost of sending remittances to SSA<sup>2</sup> and the impact of the recent financial crisis, “remittance inflows to Africa quadrupled in the 20 years since 1990, reaching nearly \$40 billion (2.6% of GDP) in 2010”. Very often, it is remittances that represent a lifeline to the poor.

<sup>1</sup> \* Seliatou Kayode-Anglade and Nana Spio-Garbrah are staff of the Financial Technical Services Division of the Treasury Department. The authors are grateful to peer reviewers Cédric Achille Mbeng Mezui, Patrick Giraud, Densil Magume, John Afele, Nadège Yaméogo, Sandeep Jain, Nontle Kabanyane, Habib Attia, John Anyanwu and the dedicated team from the Financial Technical Services Division under the leadership of its Manager, Olivier Eweck. The authors are grateful for the constructive suggestions and comments received. This brief—a product of the Financial Technical Services Division of the Treasury Department—is part of a larger effort in the department to analyze innovative financial instruments that African countries can utilize for domestic resource mobilization. The authors may be contacted at [ftfy4@afdb.org](mailto:ftfy4@afdb.org).

**...but the source of remittances, although relatively diverse, is primarily industrialized nations....**

Remittances come to SSA from various regions including Europe (41%), United States (28%), Africa (13%), the Gulf Cooperation Council States (9%), and other high income countries (8%).

A 2010 Bank study found that the 16 million African migrants living in Middle East and OECD countries could “potentially save approximately \$10 billion annually which, under the right conditions, could be invested in Diaspora bonds. This figure would be much higher if concerted effort is made to appeal to the 140 million-strong African Diaspora who currently lives in the western hemisphere”.

**...which introduces some recent volatility reflecting the economic environment in those countries, although more stable than ODA...**

Remittances did decrease by 3% for SSA and by 11% for Northern Africa in 2009 following the financial crisis but, because of the diversified locations of SSA mi-

grants, remittances to the continent as a whole remained somewhat stable.

This brief seeks to summarize the experiences of Diaspora bonds in three countries – Israel, India and Ethiopia and apply them to the African context. After highlighting the case for Diaspora bonds generally in Section 2, the major lessons learnt for Africa from the case study countries are outlined in Section 3. The brief will then summarize in Section 4, considerations for issuing countries on the continent. Finally, in Section 5 the brief elaborates on the ways in which the Bank and other multilateral institutions can assist in addressing the constraints to the continent to issue Diaspora bonds. The brief concludes in Section 6.

## 2 The Case for Diaspora Bonds

A bond is a debt security instrument with an original maturity of more than 1 year, usually tradable in the financial markets. A Diaspora bond is a bond issued by a country to its own diaspora to tap into

their assets in the destination country. A Bank report defines it more broadly as “an alternative to borrowing from the international capital market, multilateral financial institutions or bilaterally from governments”<sup>3</sup>.

The idea of tapping into migrant wealth is not new. The practice of issuing Diaspora bonds goes back to the early 1930s with the first issuers being Japan and China, followed in the 1950s by Israel and later by India. The State of Israel Bond stands out as the most successful example of a Diaspora bond issuance, mobilizing close to \$25 billion over the course of the last 30 years. From 1983 to 2003, Diaspora bonds represented 20-35% of Israel’s outstanding external debt. The annual borrowing policy of the country is actually defined by the Ministry of Finance according to the government’s foreign exchange requirements and systematically includes Diaspora bond issuance.

Table 1 below summarizes the main features of select Diaspora bonds in Ethiopia, India and Israel.

**Table 1 Key Features of Diaspora Bonds: Ethiopia, India and Israel**

	Date of Issuance	Amount and currency	Maturity (type and value)	Interest rate	Special features
India	2000	\$5.5bn USD – EUR – GBP	5 years	Fixed: 8.5%	For the Indian Diaspora in the USA
Ethiopia (Millennium Corporate Bond)	2008	Amount unknown USD – EUR – other convertible currency	5, 7 and 10 years	Fixed: 4%, 4.5% and 5% depending on tenor	Limited to Ethiopians with access to foreign exchange
Israel	2010	€1.5bn	10 years	Fixed: 4.625%	Not specific to the Diaspora. Regular issuances.
Ethiopia (Grand Renaissance Dam bond)	2011	Amount unknown but project cost \$4.8bn USD – EUR – GBP and Birr	Range of 5-10 years	Floating: 5y: Libor +1.25% 6-7y: Libor +1.5% 8-10y: Libor + 2%	Sovereign instrument

Sources: Development Corporation of Israel, State Bank of India, Ethiopian Ministry of Foreign Affairs.

<sup>2</sup> On average, the cost of sending \$200 is 10% if the destination country is in SSA, while it is less than 8% for other countries. According to the website, <http://www.envoidargent.fr/>, the traditional Money Transfer Operators (Western Union and Moneygram) charge 8% for transferring €100 from France to SSA (cash to cash immediate transfer).

<sup>3</sup> See the “Africa Economic Brief, Diaspora Bonds and Securitization of Remittances for Africa’s Development.” Vol.1, Issue 7, December 2010. African Development Bank Group.

Diaspora bonds are typically used as project financing tools for public sector, large-scale infrastructure development. Generally, they are to be used by a country to implement its development strategy.

African countries are highly reliant on external funds for financing their development. However, there is growing evidence that this needs to change. Firstly, ODA and FDI are not adapted in quantity and in quality to specific countries and their volumes have declined in recent years.<sup>4</sup> In addition, the 2008-2009 financial and economic crises, from which the world is still recovering, showed that traditional donor aid is likely to wane in the future as donor countries focus their resources internally. On the other hand, and somewhat counter intuitively remittance flows decreased by a much lower percentage than other capital flows and are generally perceived to be counter cyclical.<sup>5</sup> Of course, there are certain events or local circumstances which may temporarily change remittance behavior.<sup>6</sup> Thirdly, as a consequence of the impact of the crises, developing institutions are more interested in supporting new resource mobilization tools for development. In these respects, the African Diaspora represents a new frontier.

Modern communication tools and technology are critical to promoting the capture of Diaspora finance. This has been achieved in the past through the securitization of remittances mainly via money transfer operators (MTOs), where a securitized remittance bond is backed by the future flows of offshore remittances which would come into a trust account.<sup>7</sup> This is said to be possible because the transferred money temporarily belongs to the institution handling the transfer.

Securitized remittances have been used in Latin America since 1994 with relative success and African Export-Import Bank (Afreximbank) has, beginning in 1996, executed a few transactions securitizing receivables including remittances. It served as lead arranger for a Ghanaian transaction to borrow \$40 million from a development bank where the loan was backed by Western Union remittance receivables. In Nigeria, Afrximbank facilitated a loan of \$50 million against a flow of remittances through Moneygram.<sup>8</sup>

Africa could potentially raise \$17 billion a year<sup>9</sup> by using the future flows of receivables (exports, mainly fuel and travel services or remittances) as collateral. Securitization of remittances could be used to raise short to medium term financing by African banks.

Securitization of remittances is most valid for North African countries where transfers through banks are common. Moreover, North African banks have subsidiaries in Europe, where migrants are settled. However, the sophistication of this instrument coupled with the low penetration of banking institutions in SSA makes securitization a longer term prospect for the continent.

Section 3 therefore seeks to hone in on what other countries' experiences have taught governments about the factors of success in the issuance of Diaspora bonds.

### 3 Lessons Learnt

This section highlights the main lessons learnt from Israel, India and Ethiopia

along with the findings of previous studies on migration related subjects.

#### Lesson 1: Diaspora bonds are a trustworthy source of finance for countries undergoing difficulty...

Israel, India and Ethiopia's experiences show that the Diaspora is often called upon when countries are having difficulty borrowing from other sources. Although Israel has been issuing Diaspora bonds regularly since 1951, it is noted that sales peak in difficult times:

- 1973, Yom Kippur war - annual sales were \$473 million whereas on average Diaspora bond sales amounted to \$322 million yearly during 1970-1979;
- 2001, 9/11 terrorist attacks - annual sales represented \$1.14 billion, in comparison to \$785 million in 2000<sup>10</sup>.

India's Diaspora bond issuances were more opportunistic and followed macroeconomic constraints on foreign exchange:

- 1991, balance of payments crisis – bonds were issued in the amount of \$1.6 billion;
- 1998, international sanctions following nuclear testing – bonds were issued in the amount of \$4.2 billion.

Ethiopia, as a new Diaspora bond issuer, issued its bond to address a critical national electricity crisis. The 2011 bond issuance was needed to allow the country to single-handedly build a 5,250MW dam on the Nile River with an estimated cost of \$4.8 billion. Traditional financing for this energy project was difficult to obtain due to:

<sup>4</sup> *ibid.*

<sup>5</sup> See "Remittances in Africa", p. 58. March 2012. World Bank and European Commission.

<sup>6</sup> As a counter example, remittances to Tunisia decreased during the first months following the January 2011 revolution that led to the departure of the former President. From discussions with "Epargnes sans Frontières". May 2011.

<sup>7</sup> Global Remittances Working Group Meetings, Spring Sessions, March 2011.

<sup>8</sup> See the "Africa Economic Brief, Diaspora Bonds and Securitization of Remittances for Africa's Development." Vol.1, Issue 7, December 2010. African Development Bank Group.

<sup>9</sup> *Ibid.*

<sup>10</sup> See "Fifty years of external finance via State of Israel Non-Negotiable Bonds." 2004. Bank of Israel.

**Box 1 Patriotic Ties to Diaspora Bond Issuance**

Excerpt from statement made by Prime Minister Meles Zenawi on the occasion of the inauguration of the Grand Renaissance Dam in April 2011:

“As we will be financing several other projects in our plan (GTP), the expense will be an additional and heavy burden on us. All our efforts to lighten this have been unsuccessful, leaving us with only two options. Either to abandon the project or do whatever we must to raise the required funds. I have no doubt which of these difficult choices the Ethiopian people will make. No matter how poor we are, in the Ethiopian traditions of resolve, the Ethiopian people will pay any sacrifice.”

Source: Ethiopian Ministry of Foreign Affairs.

- Bilateral tensions – Egypt, who depends on the Nile for its water needs, cited colonial treaties which restricted the use of the Nile, as an impediment to the dam’s construction. However, with the removal of former President Hosni Mubarak, relations have improved. In July 2012, newly elected President Mohamed Morsi visited Ethiopia for the first time by an Egyptian head of state in 17 years, for a two-day summit to promote inter-African trade. This action is highly expected to be the first in a series of diplomatic visits with the Nile basin neighbors.
- Lack of international financing - Financial institutions of all kinds shied away from the project wanting to see more detail on the project’s feasibility such as solid electricity off-take agreements with power companies in neighboring countries. Commercial viability was also questioned. A 2011 report claims the dam’s plant load factor – a measure of efficiency – would be only 33% versus

an average of 50%, which suggests that the dam is more costly than is necessary.<sup>11</sup> Some of this concern has been relieved since Ethiopia began exporting energy to Djibouti in May 2011. In addition, a feasibility study has been financed for a link to Kenya. Nonetheless, institutional support for the dam was also weak due to potential environmental impacts.

- External debt sustainability concerns - While GDP growth is estimated at a steady 10.7% for 2011 and beyond<sup>12</sup>, planned investments for the country’s Growth & Transformation Plan (GTP) in infrastructure could lead to an unsustainable debt burden. Diaspora bonds are considered local bonds by many Ethiopians despite being owned by non-resident nationals. Bonds unlike loans are issued at the discretion of the sovereign who may have a different perception of the amount of debt that can be reasonably accumulated. A Diaspora bond’s inclusion in external debt is debated as it is understood that the Ethiopian government reserves the right to repay its liabilities to bondholders in local currency in extenuating circumstances.

**Lesson 2: Open the sale to all, but market strategically to the few...**

One of the key takeaways from Diaspora issuances is the benefit from not restricting its access to specific categories of investors. Although this has been done, most successful Diaspora bonds are open to various investor classes. In the case of Israel, there was no particular restriction on the investor base for their issuances. However, the road shows, the features of the bond and especially the pricing - at the beginning, less than US Treasury bills - would mostly only attract Israeli nationals. Another example of where the bond design as opposed to regulation de facto targeted Diaspora

members relates to redemption criteria. In Israel, prior to maturity, redemption could only occur for the purpose of investment in Israel. Additionally, the 200 employees of the Development Corporation for Israel (DCI), the country’s bond issuer, created in 1951, have a clear mandate to market and sell the bonds to the Jewish community, although this is not necessarily a feature of the individual bond prospectus.

In cases where restrictions on nationality are explicitly applied, the basis for doing so is made clear. Ketkar and Ratha (2007) studied the reasons why India decided to restrict the Resurgent India Bond (issued in 1998, 5 years, \$4.2 billion, available in US dollars, British pound, and Deutsche mark) and the India Millennium Deposit (issued in 2000, 5 years, \$5.5 billion, available in US dollar, British pound and euro) only to investors of Indian origin. While limiting the potential size of the market, the Indian authorities felt that they could better target their marketing towards the Indian Diaspora versus other investors. They also felt that Diaspora Indians, as opposed to investors of other nationalities, would be more understanding in the case of default and would not be disparaged to be paid in rupee instead of a hard currency.<sup>13</sup> Although the need to explicitly exclude foreign investors is debatable, experience shows that the marketing and design of the instrument are more strategically aligned to the end buyer.

In Africa, Ethiopia is the first country to have explicitly issued a Diaspora bond, although several countries are considering doing so including Cape Verde, Kenya<sup>14</sup> and Ghana. There have been regular bond issuances in African countries on the international market which were not restricted to a specific audience and could therefore be bought by the Diaspora, for example, the Moroccan issuance in 2010

<sup>11</sup> “How efficient is the Grand Ethiopian Renaissance Dam?” International Rivers, 20 July 2011.

<sup>12</sup> African Economic Outlook 2012, African Development Bank Group, p.198.

<sup>13</sup> Diaspora bonds often include a clause which states in the case of certain circumstance the issuer reserves the right to pay bondholders in local currency. This is often disadvantageous as the bonds are not inflation-indexed and are paid at the prevailing exchange rate at the time of maturity.

and Senegalese, Namibian, Nigerian and Zambian issuances in 2011 and 2012. In this case, in Africa, the jump from international bond to Diaspora bond is just one of targeted marketing.

**Lesson 3: Emotional affiliation does not eliminate the need to make a financial return...**

The Ethiopian experience in issuing Diaspora bonds is very instructive with regard to the concept of a patriotic discount – a benefit to the issuer. This term refers to a Diaspora bond coupon level that is lower than the benchmark, typically the 10-year US Treasury bond or other bonds floated by the same or comparable issuer. This means the purchase of the Diaspora bond will be at a premium that hinges on an emotional connection with the issuing country. Jewish investors buying an Israel Diaspora bond instead of a US Treasury note between 1970 and 1993 were showing their sense of patriotism up until the annual average rate on the fixed Diaspora bond finally exceeded the bench-

mark, thereby offering more interesting pricing to the investors.

This type of patriotic attachment should not be taken for granted in the African context. Several migration and Diaspora bond experts often refer to the patriotic discount on a risk adjusted basis indicating for example that the Diaspora have lower risk perception about their own country versus foreign investors and overall better information, hence the reduced yield requirement. However, this does not necessarily translate into active investment by nationals and foreign investors, exactly because of a less intimate connection, may be more inclined to invest in emerging markets such as Africa because they are looking dispassionately at the yield and at the high level macroeconomic situation versus personal memories which may not be positive.

The first Diaspora bond from Ethiopia in 2008, called the ‘Millennium Corporate Bond’, intended to finance the Ethiopian Electric Power Corporation (EEPCO) hy-

droelectric power project, Gilgel Gibe III. This bond issue did not meet revenue generation expectations for reasons ranging from lack of trust in (i) the ability of the utility to service the debt, (ii) the full faith and credit guarantee of the government and (iii) the overall political climate in Ethiopia. With fixed bond yields of 5%, similar to yields on certificate of deposits in the resident country of the migrants (i.e. US), and a lack of secondary markets which renders the investment highly illiquid, investors abroad did not express major interest.

The government tried again with a second bond issuance in 2011 to secure financing for the 5,250MW Grand Renaissance Dam project (issued to the Diaspora by the Ministry of Finance as opposed to a state utility). This issuance included several enhancements such as an improvement in the marketing campaign to Diaspora Ethiopians. Table 2 compares the two issuances. Many of the changes address the concerns of a more informed investor, not one driven by patriotism alone.

**Table 2 Ethiopia’s Diaspora Bond Issues**

	<b>EEPCO Millennium Corporate Bonds</b>	<b>Renaissance Dam Bond</b>
Purpose	Raising funds for the Ethiopian Electric Power Corporation	Financing the Grand Renaissance Dam
Currency	USD, Euro and Pound Sterling and other convertible currency, and Birr	USD, Euro and Pound Sterling or Birr
Minimum Denomination	USD 100 denominations but minimum purchase USD 500	USD, Euro and Pound Sterling, in denominations of 50
Maturity	5, 7 and 10 years	5 or between 5-10 years
Interest	4%, 4.5% and 5%	Non-interest bearing Option with interest: 5yr: Libor+1.25% 6-7yr = Libor+1.5% 8-10yr = Libor +2%
Payment of the Bond	At maturity, the bond holder can: i) receive the face value of the bond in foreign currency; ii) purchase another bond with the same face value; iii) deposit in a foreign currency or birr account; iv) pay for import commitments	At maturity
Payment of the Interest	Annually	Every six months
Repayment of the Interest	i) in birr in person; ii) deposit in a foreign currency or birr account; iii) transfer abroad; iv) repurchase additional bonds; v) pay for import commitments	Paid in the currency in which the bond was originally purchased
Transferability	Transferable to a second party	Transferable to up to three people
Taxes	Interest income from the bond free from any income tax	Revenue accrued will be free from any tax

Source: People Move, The World Bank Blog about migration, remittances and development.

During Ethiopia's first issue, despite the option to be paid in foreign currency and deposited in a foreign account abroad, in practice most bondholders received payments in birr (local currency). It was the emphasis and enforcement of repayment in convertible currency which made the 2011 bond more appealing to investors living in markets in the West.

Typically, analysts believed that Diaspora bonds even when presented at a discount would be found acceptable to investors because these have current or contingent liabilities in their home country and hence may not be averse to accumulating assets in local currency (i.e. financing the construction of a home). However, this view does not take into account the macroeconomic environment in the home country. The real exchange rate on foreign currency denominated bonds in Ethiopia, given local inflation in the 40% range as of August 2011, provides an underlying economic imperative for the foreign resident investor only when payments were indexed in hard currency.

The move from fixed returns to returns indexed to the London Interbank Offered Rate (Libor) also eliminated interest rate risk in the post-financial crisis environment. However, the overall rate of interest in the range of Libor+2% for maturity up to 10 years exhibits a significant discount to other international bonds issued by African countries in 2011: Namibia, rated Baa3/BBB- issued in October 2011 a 10-year bond at Libor +290bps; Senegal, rated B+ issued in May 2011 a 10-year bond at Libor+564bps while Nigeria, rated B+/BB- issued in January 2011 a 10-year bond at Libor+347bps. However, in the current low interest rate environment, the Diaspora bond with an average yield around 4% was offering better yields to the Ethiopian Diaspora than their saving accounts with less than 1% return.

The evolution of Israeli Diaspora bond yields over the years depicts a better alignment to market levels now than in the early 1950s. From 1951 to 1980, Israeli bonds yielded on average 4% against 6.8% for comparable US Government levels.<sup>14</sup> By May 2012, 10-year Israeli bonds were trading at around 200bps above the equivalent US Treasury notes. Similarly the various Indian Diaspora bonds issued in 1991, 1998 and 2000 hardly presented any discount to market prices. There was an evolution in the pricing approach.

In reality, the discounted 2011 issued Ethiopian Diaspora bond has mainly been sustained by local residents through various directives and governmental incentive building measures to promote bond purchase.<sup>15</sup> In fact, the head of the Public Mobilization Council and Communications Minister of Ethiopia, Bereket Simon, during a September 2011 interview with Bloomberg, indicated that, "the country is not raising funds from foreigners, in a bid to demonstrate its economic resurgence."<sup>16</sup> Thus far, the bond is noted to have been able to raise \$400 million but from the domestic market principally. Total amount raised to date has not been made public.

However overall, given the level of information available to any potential investor today, an African Diaspora bond issue would have better chance of success if it is priced in line with comparable international bond issues by African countries. Ultimately, creating a fixed or floating coupon depends on the market and the investors' preferences but the choice makes a difference to the intended audience and it is important for authorities to price the bond against other instruments available in the migrant's country of residence.

#### **Lesson 4: Transparency in the use of proceeds is critical...**

The proceeds of Diaspora bonds in Africa should be earmarked for projects appealing to the Diaspora such as infrastructure projects, housing and social amenities.

The Grand Renaissance Dam for example is very symbolic to Ethiopians as they have been clamoring for years to exploit their major national resource – the Nile River – which features in the earliest accounts of their national and cultural history.

Likewise the history of Israel, particularly the holocaust, played a great role in the decision of many Jewish people to invest in Diaspora bonds in the expectation of an eventual return to their home country. Israeli nationals have a shared vision to become a true "light unto nations," that is, a source of creativity benefiting millions throughout the world. The country has traditionally been a leader in the fields of science, medicine, environmental management, water and technology. The proceeds realized through the sale of Israel bonds has helped to cultivate the desert, build transportation networks, create new industries, resettle immigrants, increase export capability, and maximize the nation's overall economic potential. Thus, the end use of funds raised by the Diaspora is important and the issuing country must acknowledge that it is accountable to this group of investors, just as strongly as its own residents.

#### **Lesson 5: A lack of rating does not preclude issuance...**

Experience shows that many Diaspora bond issuances were not tied to a rating. Israel and Ethiopia for example, did not seek a credit rating from international

<sup>14</sup> See Ketkar and Radha (2007)

<sup>15</sup> A National Bank of Ethiopia (NBE) directive was issued in April 2011 compelling all commercial banks to buy government bonds equivalent to 27% of their loan book each month. State employees were also instructed to grant one month's salary to the bond.

<sup>16</sup> See "Ethiopia plans more bonds for \$4.7 billion hydropower dam," African Capital Markets News, September 30, 2011.

<sup>17</sup> According to the study, "Leveraging Migration for Africa" (Table 2.3, page 64), household surveys show that remittances are mainly used for food, education or health. In some cases, (i.e. in Burkina Faso for remittances originating from outside Africa, in Kenya for remittances within Africa, in Nigeria for domestic remittances and those outside Africa), real estate expense rank first (land or construction).

credit agencies for their Diaspora bonds. However, following along with the strategy of opening sales to all investors, African countries' bond issuance on the international markets may require a credit rating to attract sophisticated investors. A bond rating typically gives foreign investors more confidence and helps to attract retail investors as well.

Conversely, there is an ongoing debate as to the direction of causality. A rating may improve the ability of a bond to attract investors; however, on the other hand, the ability to fundraise from the Diaspora could influence the sovereign credit rating perception of rating agencies. Standard & Poor's (S&P) stated in reports dating to 2009<sup>18</sup> that they did not generally find Israel to be fiscally stretched and that the country could easily sustain external financing to support its budget. Credit rating agencies felt that the ease at which Israel could tap into the worldwide Jewish community for funding undoubtedly supports its sovereign credit rating, although it may not have been the initial decisive factor.

A World Report states, "Israel's ability to issue diaspora bonds is now much more important in underpinning Israel's sovereign credit rating than it was in the 1980s, when the country had a much larger financing requirement."<sup>19</sup> The ability to issue a Diaspora bond can support sovereign credit ratings by demonstrating diversified resource mobilization avenues available to a country which ultimately can have a catalytic effect on investment. Even in the case of India where the country was downgraded in 1998 following the imposition of international sanctions, the success of Diaspora bond issuances in the same year and in 2000, was perceived as an attribute by Moody's and S&P.

## 4 Diaspora Bond Issurance

There are milestones that countries considering issuing a Diaspora bond must achieve before launching their bond if it is to be effective and cost efficient. For the three countries presented in this economic brief, Diaspora bonds were achieved over time through trial and error and in the case of some, such as Ethiopia, it is still unclear whether the classification of the instrument as a Diaspora bond is entirely justified. Generally, a government would need to ask itself a series of questions prior to preparing for issuance.

### *Is there a need for a Diaspora Bond specifically?*

A country must ask itself if the bond is sellable. Project-oriented Diaspora bonds have a good prospect of success as the outcome is tangible to bondholders and progress (use of proceeds) is verifiable even at a distance. However, it would require the disclosure of underlying feasibility studies to show economic viability and assurance of project revenues as it is this, rather than government guarantees which is likely to motivate African Diaspora investors versus local ones. The costs associated with such disclosures and transparency is behind the choice of India, for example not to opt for US Securities and Exchange Commission registration of their Diaspora bonds. Nonetheless, the existence of a project in line with historic sentiment or with the country's overall development agenda is likely to be best suited as in the case of Ethiopia. A project is a rallying point where there is an explicit shared vision among the population and potential investors.

A country must also ask itself if it makes sense to limit the bond issuance to just

the Diaspora in the first place as it might benefit from a generally positive sentiment with international investors. In the case where a patriotic discount can be applied, restriction to the Diaspora is plausible. However, in the case where pricing is reasonable compared to benchmarks on the market, if other options are available for bond issuance (i.e. sovereign bond) it might be prudent for those to be explored prior to incurring the marketing costs related to making an issuance restrictive.

### *Is there a Critical Mass of Solvent Diaspora?*

A country considering a bond issuance must do a mapping of its nationals abroad. Statistics on the number of Diaspora members is insufficient – there needs to be information on education levels, income, how these communities save their money, their investment patterns in each targeted country, among other studies. The issuing country may need to invest in conducting surveys in each destination country after determining a select number of countries/regions to target.

It is also not sufficient to study the Diaspora members but also the money transfer operators they prefer to use. The estimated remittances sent to SSA through formal channels represent 35-55% of total inflows.<sup>20</sup> In Kenya nearly two-thirds (62%) of domestic remittance transfers were conducted through mobile phones at the time of their household survey in late 2009.<sup>21</sup> Transfer fees to SSA can reach as high as 20% of transferred amount. MTOs inasmuch as they represent private sector partners are critical in the data gathering exercise and can later inform the design of the Diaspora bond. The Commercial Bank of Ethiopia for example, covered any remittance fees as-

<sup>18</sup> See Ketkar & Ratha, "Diaspora Bonds: Tapping the Diaspora during Difficult Times", Journal of International Commerce, Economics and Policy, Vol. 1, No. 2 (2010) pgs 251-263.

<sup>19</sup> Ibid.

<sup>20</sup> Ratha and Shaw (2007). It should be noted that this data reflects the surveys of remittance service providers (RSPs) implemented by country-based researchers and institutions between 2008 and 2009 only.

<sup>21</sup> Mohapatra and Ratha (2011).

sociated with the purchase of the Ethiopian Renaissance Dam bond.

### **Is the Diaspora reachable?**

How accessible is the Diaspora both physically and in terms of financial literacy? A country would need to identify established points of entry. Traditionally, these have been embassies however the past has shown that these may be insufficient and lacking in the required skill to execute the marketing strategy necessary to reach a critical mass of investment savvy Diaspora. An entire agency or department may need to be created such as Israel's DCI. The DCI underwrites the loans and maintains ties with Jewish communities abroad in order to have updated profiles of investor preferences. However, the entity does not need to be standalone. A unit or division could be created in the Ministry of Foreign Affairs for example. Additionally, the government may have to target churches, mosques, websites, media, student groups, cultural associations and other non-traditional access points for its nationals abroad.

Financial literacy is very often overlooked by those researching their Diaspora. Citizens that reside abroad may simply not understand fixed income and bond instruments as potential investment vehicles. Having a strong Diaspora that is wealthy does not equate to having a group of active investors capable of reading and analyzing a bond prospectus and other important documents containing financial terms. The marketing strategy must take into account the level of malaise Diaspora members may have with investing in general and redress these.

### **Can the Bond Issuance be Properly Managed?**

A particular macroeconomic and regulatory environment is necessary for suc-

cessful bond issuance of any kind, including Diaspora bonds. In particular, Diaspora investors will be keen to know the country's creditworthiness as well as its debt sustainability outlook. The extent and structure of its capital markets and the soundness of its legal framework for investors will also be considerations. A country issuing bonds must provide investors with extensive information, including regular reports during the entire time that the bond is outstanding.

Trust is probably the key factor in Diaspora bond issuance in Africa. Good governance, transparency and political stability are the foundations of success. Investors resident abroad, given their distance and in some cases, the underlying reason for their departure from the home country, must feel that the government has the capacity and goodwill to manage proceeds properly. This is why countries such as Morocco have been very successful in leveraging migrant resources.<sup>22</sup> In Ethiopia for instance, there is no capital market or bond law which governs issuances. This certainly dampened the comfort level of investors abroad, which in turn caused the Ethiopian government to focus more inward to local investors

The issuing country would wish to establish a benchmark in order to determine its Diaspora Bond pricing. Benchmarks used have included:

- International bonds in the country of origin.
- National bonds in the country of origin.
- International bonds from a country comparable to the country of origin (number of Diaspora, per capita income, etc.).
- National bonds in the country of issuance (i.e. US Treasury).
- Other Diaspora Bonds irrespective of location.

over which they had more direct influence.

### **How will it be structured?**

If a government can answer the preceding questions with a resounding yes, it would then have to consider how best the Diaspora bond should be structured to create the most international interest.

Generally, for Africa, pricing should be competitive compared to the benchmark to attract investors. Diaspora African investors are likely to be more concerned than local residents about inflation rates and the central bank benchmark interest rates when purchasing a bond. This is why for example, it may be important for the authorities to consider repayments in convertible currencies. Ultimately though, there needs to be alignment between the currency of the bond at issuance and at repayment, even if alternative local currency repayment may be offered.

Many options are available regarding tenor, amortization and whether yields should be based on floating or fixed rates. Most of the Diaspora bonds issued by India and Israel presented a standard bullet maturity. However, in the case of Africa the recommendation would be to offer early redemption triggers for specific events like a real estate investment in the country of origin. These features would require additional structuring (provision of a liquidity facility) and increase issuance costs but this flexibility would also increase significantly the attractiveness of the product to the Diaspora. In the case where the Diaspora bond will constitute a vehicle to mobilize project finance, many of these characteristics should reflect the underlying project's valuation. However in some cases, the choice of features will depend on the local market conditions. In terms of pricing, the country should consider incorporating certain advantages over other investment vehicles such as a

<sup>22</sup> In Morocco, remittances make up 637% of FDI and 452% of ODA. "Approach to African Migrant Remittances: The Migration and Development Initiative", African Development Bank (2009).



tax exemption. Obviously, market timing and marketing are also important. It would also be necessary to delineate investor categories (open vs. exclusive to Diaspora vs. exclusive to nationals only) and whether the issuance process, custodial facility and trading mechanisms should be similar to regular bond issuance. Redemption, the option to call and coupon frequency must also be assessed.

Given the multiple considerations that will be unique to each African country and each Diaspora bond issuance, the Bank and other development partners can offer different types of assistance to issuing countries. These are explored in the next section.

## 5 Going Forward

We believe the Bank and other agencies are in a prime position to foster the development of this critical resource mobilization tool through the following possible actions.

### *Improving Data Knowledge*

Currently, data on remittances varies depending on the reporting entity. For example, the Nigerian central bank reports \$20 billion of remittance inflows per year, which is double the estimate of the World Bank. Discrepancies also exist among different institutions in the same country (i.e. difference between government and central bank data on remittances in Ghana). In some countries data exist but are not published.

In order to appropriately market to the target group, there is a need for reliable and updated data on the Diaspora in general and remittances in particular. Detailed feasibility studies on Diaspora behavior in the destination and home countries must be developed and regu-

larly updated. The issuing government must understand where the Diaspora members are, their numbers, their earnings and preferences on how they manage their money. This will allow the government to build relevant strategies accordingly.

The African Statistics Fund, currently in the pipeline at the Partnerships and Cooperation Unit (ORRU) of the Bank or the Migration and Development Trust Fund<sup>23</sup> could be used, in addition to the issuing country's participation, to build a database of Diaspora demographics. This work could be supported by the use of modern communication tools (websites, blogs, social media) to allow for information gathering to be two-way – from the Diaspora to the government and vice versa.

The private sector can also facilitate this. Homestrings, an investment company which targets members of the Kenyan Diaspora, is said to have offered a diaspora investment option to Kenyans resident abroad on its platform. This act caused the number of registered Kenyans to the website to double.

The Bank can also leverage its investments in Higher Education, Science and Technology to ensure that financial literacy within the continent is such that non-institutional bond buyers can also benefit and contribute to their country's development.

### *Improving the Financial Structure and Competitiveness*

Multilateral organizations such as the Bank have the relevant instruments to help countries to improve the financial literacy and regulatory environment through technical assistance, reforms programs and institutional support. As of 2012, the Bank can cite the multi-donor

partnership, Making Finance Work for Africa (MFW4A), the Migration and Development Trust Fund and the Middle Income Trust Fund as examples of such instruments. A diagnosis of the regulatory environment and the financial sector will help to determine if a country is ready for an international bond issue and if not, to propose an action plan.

In terms of actual Diaspora bond design, the Bank can guarantee to cover the risk of default on coupon payments for Middle Income Countries. The Partial Credit Guarantee<sup>24</sup> can be applied to a portion of the aggregate amount issued, to cover the private bondholders against risk. This could prove to be a key success factor for the bond issue particularly since bond issuances seem to occur in times of economic or political turmoil.

In order to further enhance the confidence of Diaspora investors, the proceeds of Diaspora bonds should be earmarked for projects appealing to the Diaspora such as infrastructure projects, housing, education and other social amenities. Issuing a Diaspora bonds should not necessarily be associated with a simple need for money. It should be marketed as a need for well integrated and transformational projects.

To the extent possible, funds from Diaspora bonds should be formally ring-fenced from the general resources of the government. The Bank can assist in this by formalizing arrangements by which capital raised through the Diaspora bond will go toward co-financing Bank-approved and funded projects in the country. The Diaspora would have a strong incentive to invest in these bonds since the project would benefit from the Bank's "brand", and AAA credit rating. This will provide insurance that the project will be completed and ensure availability of project progress reports.

<sup>23</sup> See <http://www.fundsforafrica.org/> "The fund aims to promote and support local initiatives and those from the diaspora aimed at improving knowledge of remittances, reducing the costs of transfers, optimizing the use of the resources transferred, and supporting local development in migrant home countries."

<sup>24</sup> The Partial Credit Guarantee covers a portion of scheduled repayments of loans or bonds against the risk of non-payment by the obligor.

Again here private sector has a role to play. Large corporations like Ernst & Young are looking to structure country-specific private equity (PE) funds for countries like Ethiopia to raise retail financing from migrants in the US. In this case, the Diaspora interest would peak because the fund would specifically focus on sectors closed to foreign investors. The aim is to demonstrate that the amount of capital needed to invest in sectors like real estate should not necessarily exclude small investors from participating or only be within the reach of FDI. The Bank would be open to positioning itself as an institutional investor in such a PE fund.

### ***Leveraging Intra-continental Diaspora***

Total migrants from the West African Economic Monetary Union (WAEMU) region amounted to 5,797,700 people in 2010 and the top 3 destination countries were Nigeria, Côte d'Ivoire, and Burkina Faso. According to the study on regulatory frameworks and financial products for Morocco and Franc zone<sup>25</sup>, WAEMU has a positive balance regarding remittances, whereas the Economic Community of Central African States (ECCAS) for example, has a negative balance. According to this trend, it would be

interesting to look to the possibility of mobilizing the savings of the African Diaspora living in central Africa. Such a Diaspora bond could be critical to the financing of regional infrastructure projects.

To this end, the Bank can again apply credit enhancements to a Diaspora Bond issuance targeting migrants within the continent. It can use its convening power and partnerships with regional bodies such as Regional Economic Communities to assist in the marketing of such bonds over a wide geographic area, focusing on the promotion of financial literacy to increase the appetite of individual bond buyers.

## **6 Conclusion**

The Bank recognizes that by default and by design, traditional methods of raising finance domestically are losing influence. We have to conceive of new ways of financing development, and can no longer depend on a limited envelope. Given the shifting patterns in development finance and traditional donor funding, domestic resource mobilization efforts are getting renewed focus. There is a need to develop new instruments to ensure financing for growth enhancing projects on the continent. Diaspora bonds are one way in

which this can be achieved. In particular, these bonds can be used to underwrite infrastructure projects which will have the greatest transformational impact to the continent.

The experience of the major Diaspora bond issuers, namely Israel, India and Ethiopia provides many lessons to be learnt, some of which are applicable to African countries and some which instruct potential issuers on challenges to avoid. It is clear that African countries will need robust analytics on their Diaspora members, credit enhancements to entice overseas nationals to invest and trustworthy government institutions which protect the interest of the bondholders.

The Bank's currently available instruments including Trust Funds and Guarantees as well as its interest to co-finance physical projects or private equity funds are just a few of the ways the Bank can add to the momentum of leveraging African migrant resources for development.

Remittances are a powerful tool the African continent must use to expand the overall resources at its disposal. As such, the African Development Bank remains the continent's partner in accessing the benefits of Diaspora bond issuance.

<sup>25</sup> « Les envois d'argent : cadres réglementaires et produits financiers dédiés au Maroc et dans la zone Franc ». *Epargnes sans Frontières*, June 2011.

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