

Michael, Bryane

Conference Paper — Manuscript Version (Preprint)

The Prospects and Problems of an IGAD Regional Development Bank

Suggested Citation: Michael, Bryane (2016) : The Prospects and Problems of an IGAD Regional Development Bank, ZBW - Leibniz Information Centre for Economics, Kiel, Hamburg

This Version is available at:

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The Prospects and Problems of an IGAD Regional Development Bank

Bryane Michael, University of Oxford*

Executive Summary:

A multilateral development finance institution for the Inter-Governmental Authority on Development (IGAD) region represents the chance to create a strong pro-developmental actor – and energize the IGAD itself. Yet, the IGAD senior officials will need to look beyond the traditional development banking model if they hope to make an impact of the scale needed to drag these poorest of countries out of their poverty. In this paper, we argue for the design of a development bank modelled after successful role models – like the China Development Bank – instead of proven failures. A mix of government and private sector participation, a widely disbursed capital base, and a temporary base in London, will help ensure the proposed IGAD Communities Development Bank acts as bridge and vector of pro-developmental capitalism in the IGAD region.

Keywords: IGAD, Inter-Governmental Authority on Development, Multilateral Development Banks, China Development Bank, mixed model development.

JEL Codes: O19, F63, N17

* **Acknowledgements:** This working paper has been commissioned and funded by the Horn Economic and Social Policy Institute (HESPI) as an input into other work. This working paper reflects the author's views only.

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The Prospects and Problems of an IGAD Regional Development Bank

Bryane Michael, University of Oxford

The Horn of Africa hardly seems like the place to invest. Several countries in the region have fairly recently come out of civil war, and all have per capita incomes well below the emerging market economies. Yet, we know that even the very small returns the IGAD can offer – in absolute terms – could result in significant returns (as measured by returns on assets). We also know that special economic zones and unions offer benefits which attract investment.¹ East Africa provides those frontier economies offering investors – both at home and abroad – potentially higher yields than the moribund yields offered in OECD economies. Could the disadvantages of the region represent the basis for profitable investment in the years to come?

In this paper, we find that the benefits of regional development finance institution in the IGAD region outweigh the costs – if the Bank has a particular structure and operation which we describe in this paper.² This development finance institution (which we refer to as a bank in this paper) should have an initial capitalization of \$40 billion and focus on a mix of projects aimed at promoting the development of the region and offering returns to governments and investors alike.³ We argue for a new structure – completely unlike previous structures -- focused on the private sector and operated outside the region in the short to medium term. The Bank will focus on maximising returns in the longer-run by internalising positive externalities usually passed over by private banks. The Bank will also promote development by extending the “knowledge bank” concept pioneered by the Bretton Woods institutions 30-40 years ago.⁴

The structure of this paper is as follows. In the first section, we review the lessons of previous attempts at operating national and regional development banks. We show the many failures – and crystallize lessons from this experience for the IGAD Communities Development Bank. The second section describes the aspects of the IGAD economies requiring a development finance institution different from previous, established (and poorly performing) models. The third section reviews the likely areas of investment for such a bank – looking at the areas of potential economic growth which Bank lending/invest could foster. We also provide back-of-the-envelope estimates as the benefits provided by such a bank. The fourth section looks at the potential size and structure of the Bank – with a focus on matching investment opportunities to Bank operations. The fifth section describes how the

¹ See Thomas Farole, Deborah Brautigam, and Xiaoyang Tang. China’s Investment in African Special Economic Zones: Prospects, Challenges, and Opportunities. *World Bank Economic Premise* 5, 2010.

² The Intergovernmental Authority on Development (IGAD) is an eight-country trade bloc in Africa. Member countries include Djibouti, Ethiopia, Somalia, Eritrea, Sudan, South Sudan, Kenya, and Uganda. For readers completely unfamiliar with the region, see Solomon Dersso, East Africa and the Intergovernmental Authority on Development, *IPI Working Paper: Mapping Multilateralism in Transition* 4, 2014, available [online](#).

³ References to a bank follow the established practice of referring to broker-deals as banks -- such as Morgan Stanley, Goldman Sachs, etc. Broadly speaking, a bank brings savers and investors together. Thus, we follow this practice, referring to the broker-dealer we propose to create as a bank.

⁴ We capitalize Bank when we refer to the specific bank we propose to create. Banks referred to in lower case represent such banks in general. Thus, our choices of capitalisation reflect deliberate references rather than random chance.

Bank will raise capital and generate profits. That section also looks at the risks which could threaten such profitability. The sixth and final section looks at political and operational issues. We describe the likely effect on elites and provide a possible timetable for moving the Bank forward.

We should highlight several caveats before starting our analysis. First, this paper most emphatically DOES NOT represent the views of the IGAD. To preserve our objectivity, we have written this paper without any communication with the IGAD, its member governments, or other bodies. Second, we adopt a “world as it should be” (positive) rather than “world as it is” (normative) approach. Many of our proposals may seem unrealistic for the region. However, we think it’s best to start from the best possible base and comprise, instead of start with a pessimistic view and try to improve the Bank from there. Third, some readers might see our paper as critical and/or flippant. In our view, we need to illustrate the problems we hope to fix by candidly and directly describing them. We write in a (hopefully) engaging way in order to keep the reader’s interest. For readers taking umbrage, we apologize in advance. Fourth, and not least, much of the analysis seems heartless. We do not talk about investment to address pressing needs like internally displaced persons, the challenges of health and education, and other social difficulties. We focus our analysis on areas of interest to a commercially successful development bank – leaving these social issues for other studies.

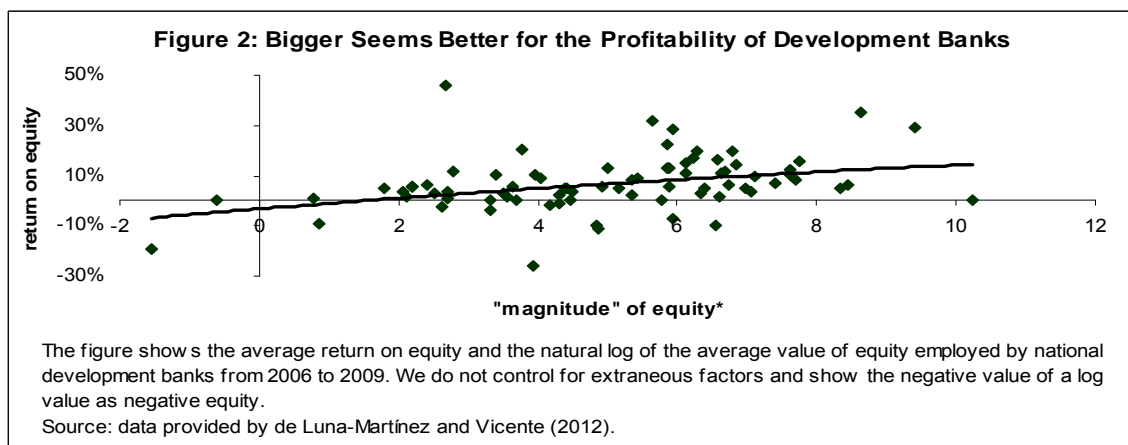
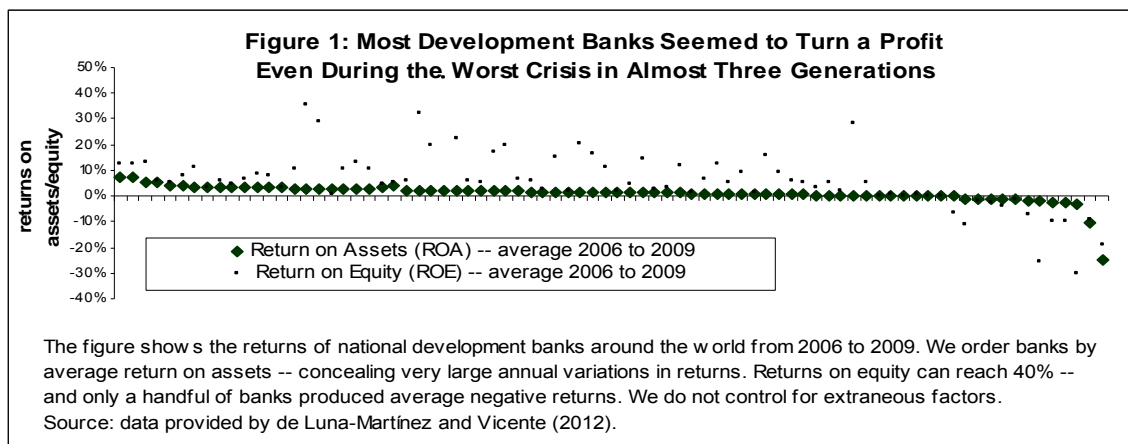
What Works (and Doesn’t) in Development Banking?

A look at the average development bank

At first glance, creating a regional development bank makes perfect sense. Figure 1 shows that – even during one of the worst financial crises in generations – most development banks in developing countries made a positive return on the assets they employed. Returns on equity look even more impressive. In many cases, even during this contractionary period, many development banks made more than 20% on average on their shareholders’ equity.⁵ Figure 2 shows the relationship between the value of equity employed by these banks (their size) and their returns. Before controlling for extraneous factors (like where they put the money, market factors, and so forth), bigger development banks seemed more profitable.⁶

⁵ These data disguise significant variation around these averages. Many banks showed negative returns (lost money) in at least one of the years in the 4 year period. Yet, as a longer term investment, these variations concern us less than the patterns in the data.

⁶ We do not control for these variables through regression analysis, as we do not wish to dwell on the size question here. The IGAD region differs so dramatically from these other countries that extending any argument about them beyond a casual reference, would give a false impression of the likely relationship between bank size and profitability. We discuss the optimal size of the Bank later in this paper.



Indeed, a lot of theory suggests that development banking should help a region like the IGAD develop quickly. Academics like Armendariz show – using theoretical models – that such banks should help develop the longer-term competencies needed for particular types of lending (like in infrastructure or a specialized industrial sector).⁷ Once such a locomotor bank raises the funds needed for large-scale finance and develops the competencies needed for engaging in such investment, economic development should proceed apace. Moreover, by having a bank owned by the countries themselves – rather than by disbursed private, corporate shareholders out of London or New York – the projects chosen could better reflect the borrowers' needs (and incorporate better local knowledge).⁸

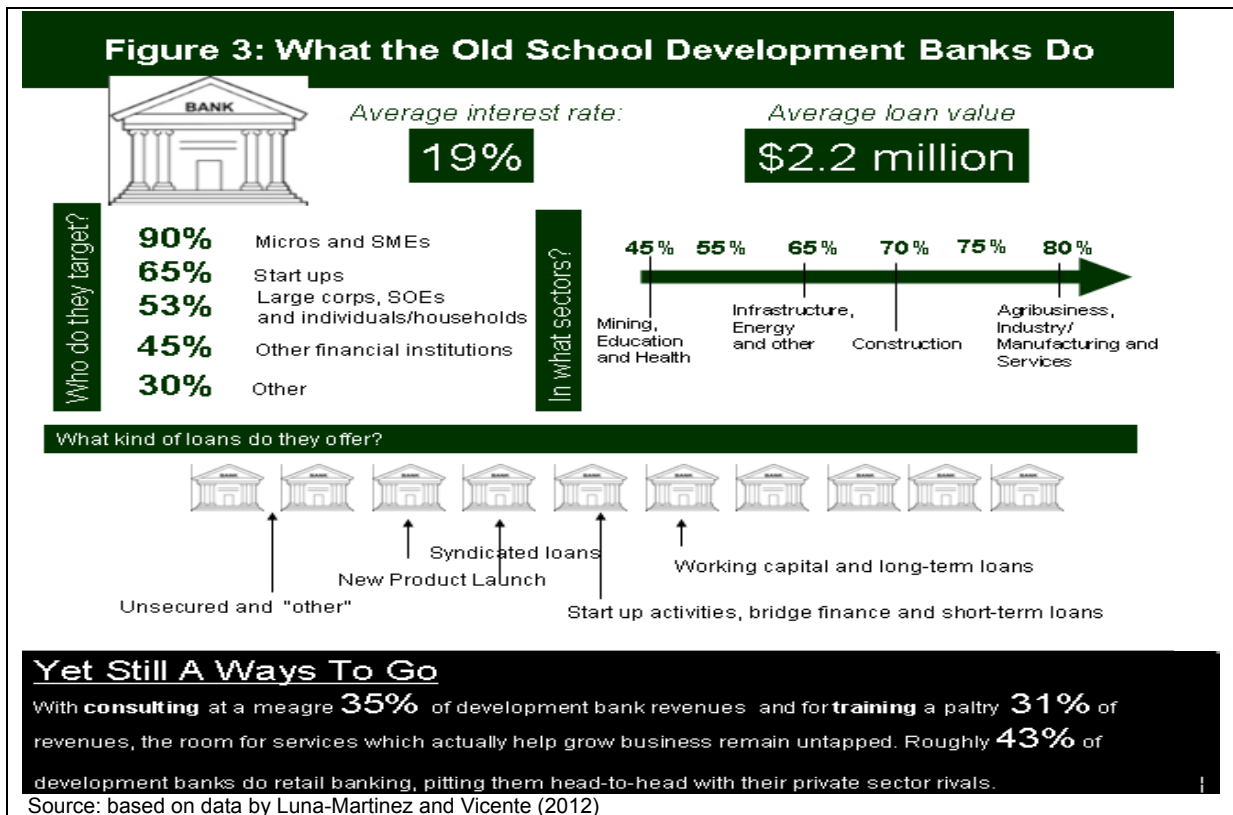
Even a cursory glance at the data though suggests that development banks represent an inefficient form of their private sector bigger brothers. Figure 3 shows salient data about national development banks (before we talk about their multilateral peers).⁹ As shown, the average development bank – at least from 2006-2009 – charged an average interest rate well

⁷ See Beatriz Armendariz de Aghion, Development banking, *Journal of Development Economics* 58 (1), 1999.

⁸ For data, see Chris Humphrey and Katarina Michaelova, Shopping for Development: Multilateral Lending, Shareholder Composition and Borrower Preferences, *World Development* 44, 2013.

⁹ For the source of these data, see Jose De Luna-Martínez and Carlos Leonardo Vicente, Global Survey of Development Banks, *World Bank Policy Research Working Paper* 5969, 2012, available [online](#).

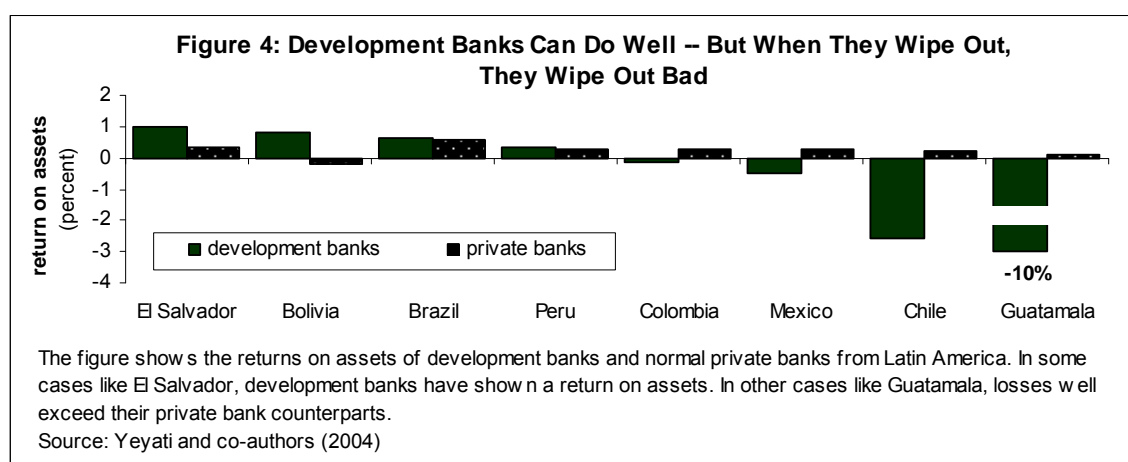
above international borrowing rates -- at around 19% per year.¹⁰ At such an interest rate, a 30 year borrower of \$1 million would end up paying \$5,720,096.49 (and we report the cents for dramatic flair). Of this amount, roughly \$4.7 million of this amount represents interest. With average loan amounts of \$2.2 million, one questions whether these projects truly make vast amounts of money available for large, development-causing projects.



Other factors jump out of the data – suggesting that traditional development banks do not mobilize the money they should to light the fires of big bang development. As also shown in Figure 3, much lending goes to speculative micro-enterprises and small and medium enterprises (which account for the bulk of most voters who elect the officials they banks serve). Roughly 53% of development banks lend to large corporate clients – but roughly the same amount lend to the state-owned enterprises with close ties to the same governments that fund them. Roughly 6 out of 10 development banks provide working capital and long-term loans, while only small proportions provide unsecured loans (10%) and syndicated loans (30%). Indeed, if development banking hopes to crowd-in other finance, such lending patterns bode ill.

¹⁰ We do not try to discount this rate for risks assumed (as part of these interest rates likely reflect risk premia and/or inflationary expectations). Because these banks pass risks onto the broader society, charging high interest rates to compensate governments for bearing these risks seems paradoxical. These high rates could also reflect high marginal productivities of capital (as lenders lend to the highest yielding projects first). Whatever the reason, these high rates seem troubling at best and predatory at worst.

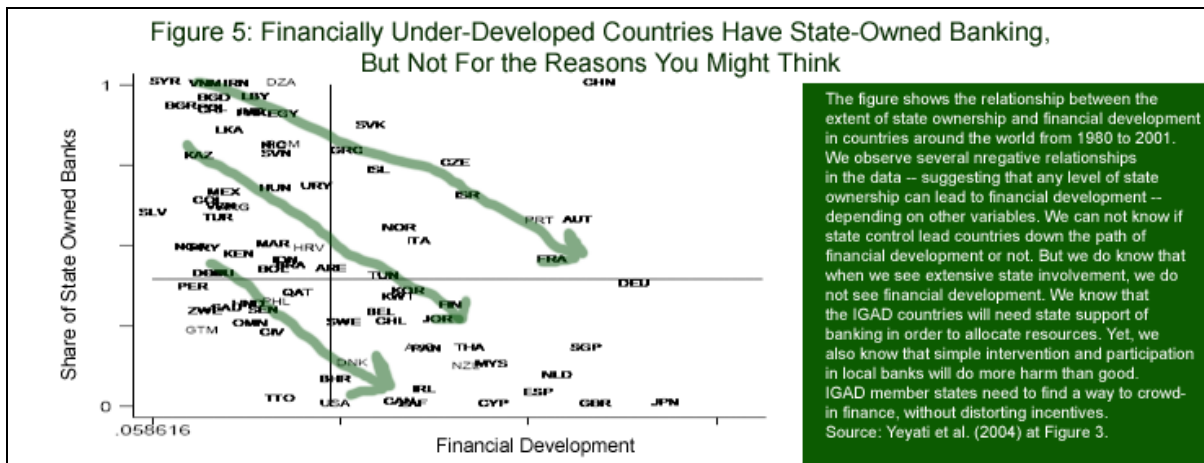
Indeed, the case for government involvement in providing finance for development remains far from clear. Figure 4 illustrates a pattern which reoccurs across the world.¹¹ Development banks – when they do well – tend to do okay-ish job of turning profits. When they succeed, their returns tend to be far more muted than the returns to commercial banks. As shown in the figure, with average returns of around 1% per year, these banks double investors' money in 70 years. When they do badly, they can lose 10% or more of the government's investment. The risk-return calculus thus looks far less favourable than in the private sector.



What about development and state-owned banks which “prime the pump” of banking and financial development more generally? Figure 5 shows the very tortured relationship between state participation in banking and the extent of financial sector development in a country. Countries’ tend to develop their financial systems over time – seeing the withdrawal of the state. A large amount of writing claims that development banks are successful.¹² **Yet, the data show that government participation in banking (for development or other reasons) tends to choke the domestic banking sector and harm long term development.**

¹¹ Gutierrez and co-authors do an okay job reviewing the experience of development banks in promoting development. Thus we do not repeat their exposition. As we argue throughout this paper, the basic premise of their work however is flawed. Instead of seeking to improve a dysfunctional approach to development finance, such banks would should focus on other ways of making money – like the approaches we review in this paper. See Eva Gutierrez, Heinz Rudolph, Theodore Homa and Enrique Blanco Beneit, Development Banks: Role and Mechanisms to Increase their Efficiency, *World Bank Policy Research Working Paper 5729*, 2012.

¹² Thorne (2011) represents one of many examples of the qualitative literature – long on suppositions and abstract admonitions, and short on hard proof. See Janine Thorne, A framework for successful development banks, *Development Planning Division Working Paper Series No. 25*, available [online](#).



Part of the reason for development banks' controversial (read "poor") performance lies in the use of development banks to distribute political patronage. For example, Sergio Lazzarini and co-authors, in their Harvard Business School Working Paper article titled *What Do Development Banks Do?* find that they allocate funds to the politically connected.¹³ Gutierrez and co-authors, also highlight the problems of politicisation – as development bank lending focuses more on generating positive media reports rather than actually providing goods and services for consumers and citizens. For their part, they argue for greater technocratic control over development banks – encouraging greater focus, client targeting and reviews of performance.¹⁴ Yet, despite the advice of so-called development bank pundits on improving the performance of these banks, recent studies find that many of these development banks needed to be privatized due to their poor performance.¹⁵ **The traditional development bank would remain a vector for importing inefficiency and corruption into the IGAD region.**

Traditional government to government lending wouldn't work well for the IGAD

Maybe the multilateral model would work better than the national model.¹⁶ After all, isn't it better to tackle the regional problems preventing economic and social development in the IGAD on a systemic, comprehensive basis?¹⁷ Indeed, most IGAD members have their own development banks anyway.¹⁸ Figure 5 shows these development banks – as well as the

¹³ In fairness, they find that funding decisions also reflect abilities to repay loans – just like any commercial bank would require. See Sergio Lazzarini, Aldo Musacchio, Rodrigo Bandeira-de-Mello, and Rosilene Marcon, *What Do Development Banks Do? Evidence from Brazil, 2002-2009*, *HBS Working Paper 12-047*, 2011, available [online](#).

¹⁴ See Eva Gutierrez, Heinz Rudolph, Theodore Homa and Enrique Blanco Beneit, *Development Banks: Role and Mechanisms to Increase their Efficiency*, *Policy Research Working Paper 5729*, 2011.

¹⁵ Julian Serre, *Rethinking the Role of National Development Banks*, *Background document for the UN Ad Hoc Expert Group Meeting on "Rethinking the Role of National Development Banks"*, New York, 1-2 December, 2005.

¹⁶ Some econometric evidence suggests that multilaterals may perform better – especially in areas like infrastructure. See Isabella Massa, *The Impact of Multilateral Development Finance Institutions on Economic Growth*, *Overseas Development Institute*, 2011, available [online](#).

¹⁷ For an analysis, see World Bank, *Regional Initiative In Support Of The Horn Of Africa*, *World Bank Regional Integration Department Africa Region*, 2014.

¹⁸ The World Bank database shows two development banks for the IGAD region – the Kenya Tourist Development Corporation (KTDC) and IDB Capital Ltd. We found the Development Bank of Kenya separately.

regional strategies already in place at the multilateral development banks covering the IGAD region. As shown, the IGAD Member States already have a surfeit of strategies and action plans. Maybe if we just find a way to “enhance the role of [these] regional development banks” – the IGAD will eventually find the funding needed pay economic and social development.¹⁹ With two new development banks slated for creation in the upcoming months, the prospects for regional development banking never looked brighter.²⁰

Figure 6: Development Banks in the IGAD Region and their Country Assistance Strategies

Country	Name	Link	AfDB	WB
Somalia	Somali Reconstruction and Development Bank	*	*	*
Uganda	Uganda Development Bank	*	*	*
Eritrea	Eritrean Investment and Development Bank (EIDB)	N/A	*	N/A
Kenya	Development Bank of Kenya	*	*	*
Djibouti	N/A	N/A	*	*
Sudan	Industrial Development Bank of Sudan	*	N/A	*
S. Sudan	N/A	N/A	N/A	*
Ethiopia	Development Bank of Ethiopia	*	*	*

A Regional Integration Strategy Paper serves as a key strategic document for several of the countries without their own specific African Development Bank country strategy.

* South Sudan’s strategy paper extends to 2014 – thus no AfDB strategy currently covers the country.

Yet, the data suggest that no amount of traditional development banking will help the region. Even banks like the African Development Bank note the difficulties of working in this region.²¹ Figure 7 shows the extent to which previous World Bank projects have succeeded in the IGAD region -- according to the World Bank’s own evaluation criteria.²² As shown, the relationship between the Bank-staff’s self-assessed extent of the “development outcome” and their evaluation of the Bank’s own performance during the project remains far from clear.²³ For the IGAD countries taken as whole (without dividing the data into countries-specific groupings), we observe a very slight tendency for “self” assessed development

¹⁹ We refer to the title of a recent UN publication on the subject. See Stephany Griffith-Jones, David Griffith-Jones and Dagmar Hertova, Enhancing the Role of Regional Development Banks, *G-24 Discussion Paper Series*, 2008, available [online](#).

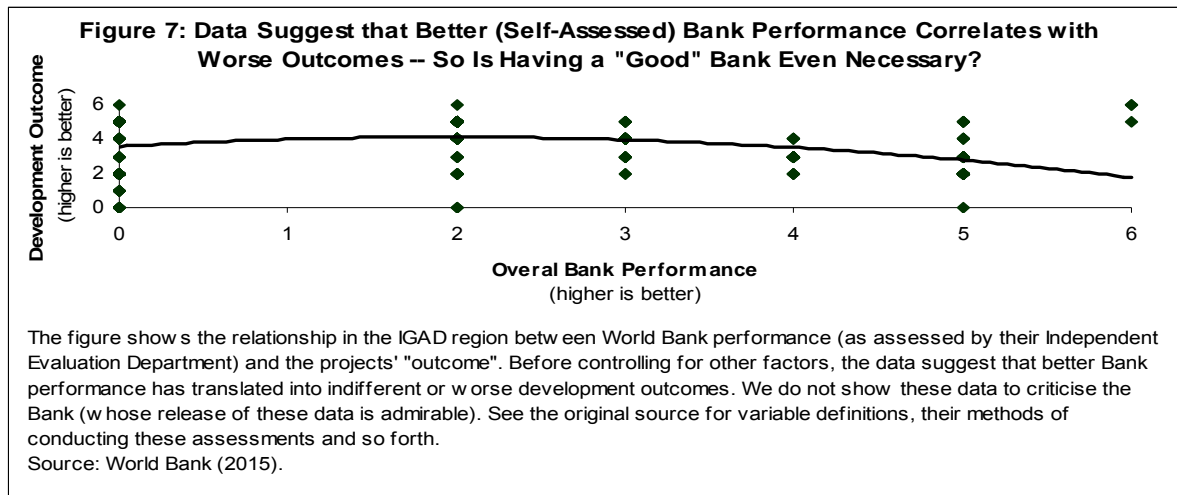
²⁰ See UNCTAD, A BRICS Development Bank: A Dream Coming True? *Working Paper 215*, 2014, available [online](#).

²¹ African Development Bank and the African Development Fund, *Eastern Africa Regional Integration Strategy Paper 2011 – 2015*, 2011, available [online](#).

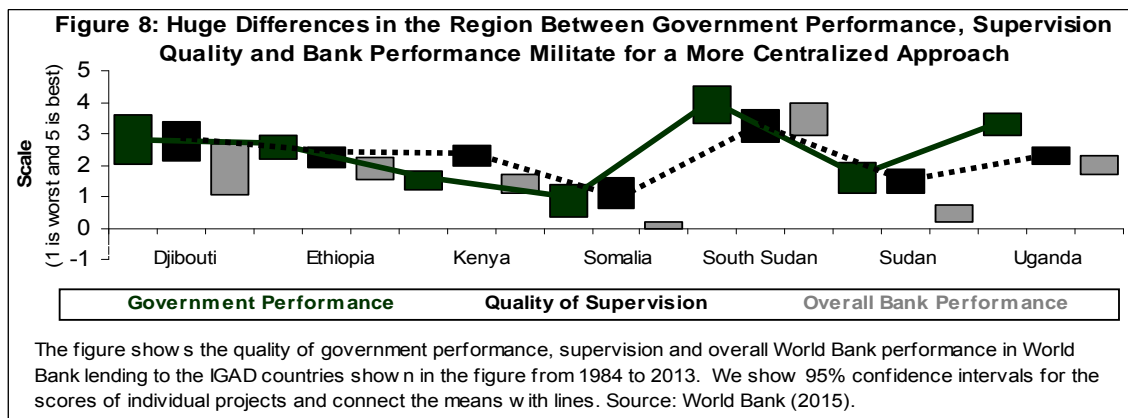
²² We refer to the World Bank in broad terms, rather than specific parts like the International Development Association (IDA) and other parts, to keep the exposition simple. We absolutely do not want to suggest the World Bank lending as “bad” in using these data. The World Bank laudably provides public access to this data – and we certainly do not want to penalize the Bank for sharing these data. We only wish to highlight that the traditional development banking relationship may not be right for the IGAD. For data, see <http://ieg.worldbank.org/ratings>

²³ These data come from the World Bank’s Independent Evaluation Department (IED). We could not work out the true extent of their independence – as most of the evaluations look far more optimistic than the grades reported by completely outside observers on similar projects. Yet, given likely negative biases on these outside observers, any attempt at assessing the true performance of these projects (without doing it ourselves) remains out of reach for now.

outcomes to get worse as the “self” assessed performance of the Bank improves.²⁴ In the best possible interpretation of these data, little relationship exists between this development’s performance and its development outcomes. **More troubling, the development outcomes seem to deteriorate as the development bank performs better!**



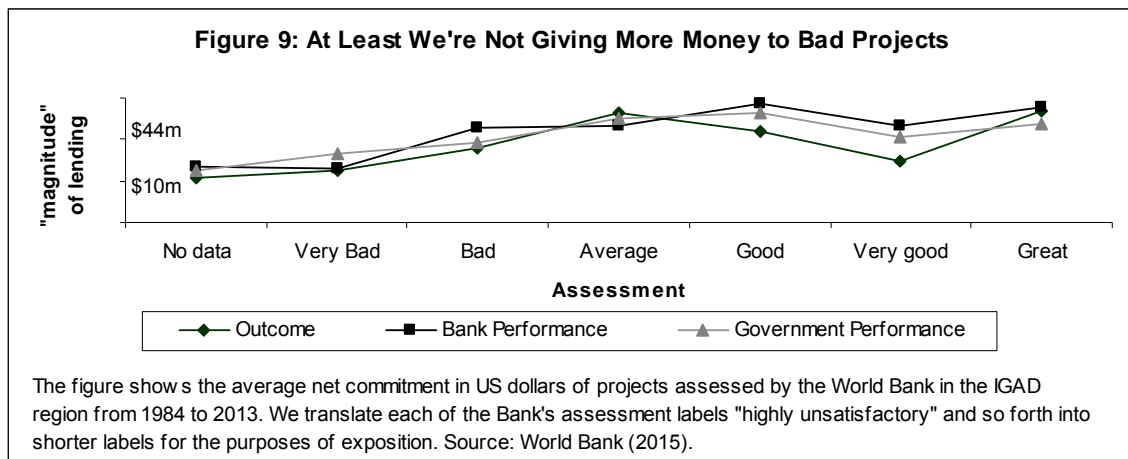
Yet, the data show a far more complex relationship between development banking and the way national governments interact with such lending. Figure 8 shows, for each IGAD member except Djibouti and Eritrea, ratings on roughly 566 projects from the region.²⁵ Estimated government performance actually excels in South Sudan and Uganda, and lags in Somalia and Kenya. Yet, World Bank performance collapses in the Sudan and Somalia. We also observe significant variations in the quality of project supervision across the IGAD region – with supervision excelling in Kenya and lagging in the South Sudan. **Variations in this development bank’s performance suggest that any multi-lateral approach to the region would benefit some countries at the expense of others.**



²⁴ We refer to these assessments as “self” assessments on the grounds that these evaluations are funded by the Bank and presumably the Bank exercises some degree of oversight of these evaluations.

²⁵ We exclude Eritrea as the Bank evaluation department provides data for only one project assessment from that jurisdiction. For only one project, the error band around the estimated mean for Eritrea remains so large, that omitting reporting remains a better tactic than reporting unreliable data.

The data also suggest that funds do not go where they can do the most good (or where they are best controlled).²⁶ Figure 9 shows the amount of World Bank lending or grant giving for each level of outcomes, bank performance and government performance. For example, the Bank gave (of course not on purpose!) far more money on average to projects with average outcomes than with very good ones. Very good government performance across the IGAD region correlated with lower project amounts than simply good performance. The broad trend – assuming these data reflect reality – points to larger projects associating with better performance by governments and the development bank in question (in this case the World Bank). **Yet, significant variations mean that traditional development banking can give more money to lower performing projects.**²⁷



What about African owned and led initiatives like the African Development Bank? Maybe an Africa-focused multi-lateral regional development bank would have better luck. The evidence looks hardly more promising. Scholars like Humphrey have analysed trends in the African Development Bank's lending, ownership and other data.²⁸ The African Development Bank has performed admirably in admittedly very difficult circumstances. Yet, concentration of the Bank's loan portfolio on certain countries like Tunisia and Egypt – and relatively low loan sizes continue to plague the organisation. Worse yet, some buds of evidence have started to emerge about the negative externalities that such lending may impose on borrowers (see Figure 10).²⁹ Admirably, the African Development Bank's share of lending to companies, rather than governments, remains one of the highest among multilateral development banks. But it doesn't go far enough. **IGAD Member States need a well funded opportunistic**

²⁶ We use the word "suggest" as none of the analyses we present use regression to control for outside factors. Despite our polemic presentation, readers should keep this limitation in mind.

²⁷ Not all aid is bad. Numerous studies show a positive relationship between aid flows (or specific targeted segments of aid) and outcomes such as GDP growth, health and educational outcomes and other indicators. To focus our paper, we must flatten a very rich and variegated literature into an easy-to-understand bottom line. For a discussion and some data showing the relatively positive impact of aid in the Sub-Saharan region, see John Loxley and Harry Sackey, *Aid Effectiveness in Africa*, *African Development Review* 20(2), 2008.

²⁸ See Christopher Humphrey, *The African Development Bank: Ready To Face The Challenges Of A Changing Africa?*, *Expert Group for International Assistance Analysis Working Paper* 2014/4, 2014.

²⁹ See L Pandolfelli and J. Shandra, *The African Development Bank, structural adjustment, and child mortality: a cross-national analysis of Sub-Saharan Africa*, *International Journal of Health Services* 43(2):337-61, 2013, available [online](#).

financial institution able to develop long-term market opportunities which strictly private sector organisations have little incentive to develop and exploit.

Figure 10: Will a Loan from the African Development Bank Kill Your Children?

An econometric study recently looked at the correlation between lending by the African Development Bank and child mortality in Sub-Saharan Africa. They find a statistically significant positive correlation – suggesting that the conditionalities imposed by such lending cause the significant contraction of spending and other socially adverse (and unintended!) outcomes. Maybe borrowing from the AfDB won't kill your children. But the study piles onto heaps of literature, showing the ineffectiveness of development lending -- and indeed sometimes the harms. If many praise the China Development Bank for its successes, few praise traditional development lending for its accomplishments.

China's challenge to development banking

China represents the role model – both for its ability to use development banking to promote rapid development as well as for the significant links already forged by China with the IGAD Member States. Figure 11 shows the extent of Chinese investment in the IGAD (and in Sub-Saharan Africa more generally).³⁰ As shown, much of China's investment in Africa concentrates in the IGAD region. The figure also shows some of the larger investments made by various Chinese companies – either with their own capital or with capital provided directly or indirectly by the government. As shown, many of these deal sizes far outstrip the loan amounts available by any multilateral lender. At the head of the silent revolution in Chinese lending and aid stands the China Development Bank.³¹

³⁰ Austin Strange, Bradley Parks, Michael Tierney, Andreas Fuchs, Axel Dreher, and Vijaya Ramachandran, *China's Development Finance to Africa: A Media-Based Approach to Data Collection*, *CID Working Paper 323*, 2013.

³¹ That sounds a bit more nostrum-esque than I intended. Prof. Woods has certainly referred to the new models coming out of places like China as a silent revolution in aid. Yet, Schiere and colleagues (2011) in their African Development Bank Working Paper, looks at relations between China and Africa in a more dispassionate way. See Ngaire Woods, *Whose Aid? Whose Influence? China, Emerging donors and the Silent Revolution in Development Assistance*, *International Affairs* 84(6), 2008. See also Richard Schiere, Leonce Ndikumana and Peter Walkenhorst, *China and Africa: An Emerging Partnership for Development?* *African Development Bank*, 2011, available [online](#).



Figure 12: Major Chinese Investments in the IGAD Region

Djibouti	China Railway Construction (\$510 m) and China Merchants Group (\$190m)
Eritrea	China Communications Construction (\$400m) ZTE, Huawei, and China Communications Construction (\$2.4b), Sinohydro (\$2.5b), Zhongmei Engineering (\$120m), Gezhouba (\$410m), China Communications Construction (\$610m), Jiangsu Yongyuan (\$410m), Dongfang Electric (\$500m), China Energy Engineering (\$120m), State Construction Engineering (\$130m), China Communications Construction (\$1.5b), State Grid (\$1b), Sinomach (\$650m), Huawei and ZTE (\$1.6b),
Ethiopia	China Railway Construction (\$3.3b), China Energy Engineering (\$480m) Sinohydro (\$140), Sinomach (\$560m), State Construction Engineering (\$1.7b), China Communications Construction (\$2.6b), Jiangxi Zhongmei Engineering (\$590m), AVIC (\$650m), China Communications
Kenya	Construction (\$480m), China Jiangxi Corporation for Int'l Econ. & Tech. Coop. (\$140m) Three Gorges (\$940m), Sinhydro and Three Gorges (\$400m), Sinohydro (\$220m), Genertec (\$270m), CNPC (\$260m), China Communications Construction (\$1.3b), China National Chemical Engineering (\$500m), Sinomach (\$320m)
Sudan	CNOOC (\$3.5b), Sinomach (\$200m), China Communications Construction (\$480m), Yunnan Copper-led consortium (\$180m), Three Gorges (\$500m), Guangzhou Dongsong Energy (\$560m), Power Construction
Uganda	Corp (\$1.7b)

Source: Heritage Foundation (2015).

At the heart of the “classical” China Development Bank model of development stands strong government financial institutions able to transfer the risks and rewards of development projects to the private sector.³² Figure 13 shows the model – whether rightly or wrongly portrayed in the popular press – in its simple form. Government makes assets available for government-controlled entities to securitise and resell in public or private markets.³³ By securitising land and large commercial real estate developments, the value of surrounding land rises and stores in the area generate rental leases and payments as well as taxes.³⁴ These

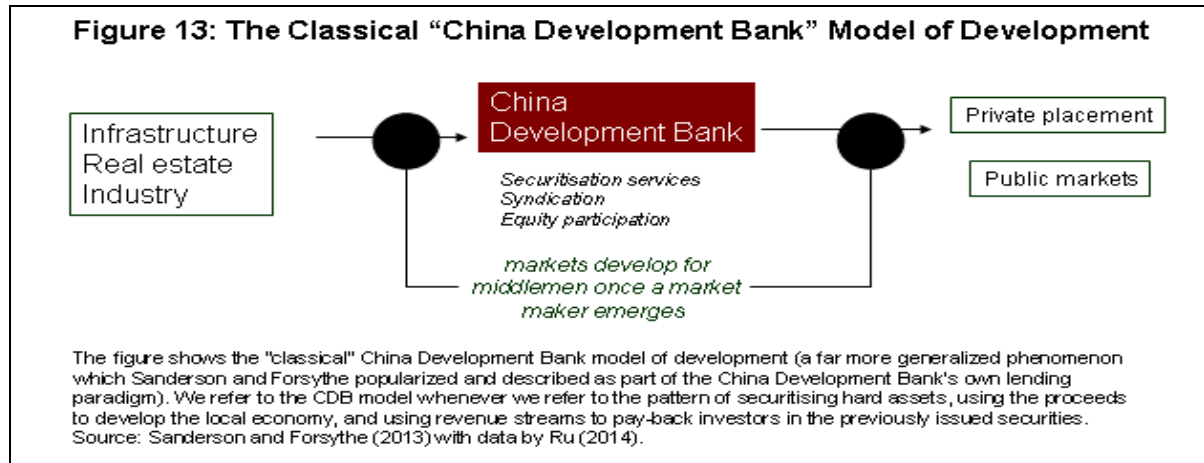
³² We refer to the “classical” model which Sanderson and Forsythe parody, as the China Development Bank was not the only bank to securitize and sell shares in various government owned investment vehicles. We choose the Sanderson and Forsythe account as it is far more simple and straightforward than the academic accounts.

³³ We purposely refer vaguely to “government” as these are often local governments or at times the central government acting through a particular department or ministry. Indeed, given the political sensitivities involved, we would also prefer to remain vague.

³⁴ For another account, see Yinqiu Lu and Tao Sun, Local Government Financing Platforms in China: A Fortune or Misfortune?, *IMF Working Paper WP/13/243*, 2013, available [online](#). See also Yuanyan, Sophia

payments, in turn, partly flow back to investors in the form of profits. Another part stays with the government while yet another part goes to public officials involved in these deals.³⁵

Monies raised on international capital markets can be used to fund projects even in the IGAD.



Naturally, several variations exist on this theme – including securitised loans backed by assets.³⁶ Since the early 2000s, commentators have noticed how Chinese banks – and particularly the China Export-Import Bank – have helped expand finance to Africa.³⁷ Yet, the Export-Import Bank works largely on the China Development Bank model.³⁸ Figure 14 shows how the China Export-Import Bank has extended credit as a way of encouraging (crowding in) other types of investment. Instead of securitising land or loans, they can securitize physical commodities. Such securitisation may allow foreigners will take ownership of 30% of the oil money flowing through Juba (for example) before any oil well rigging even starts to be assembled. But at least revenues will appear that would otherwise stay in the ground. **If IGAD Member States had the ability to help their customers buy their products and services on credit in the same way other countries' firms can (based**

Zhang and Steven Barnett, Fiscal Vulnerabilities and Risks from Local Government Finance in China, *IMF Working Paper 14/04*, 2014.

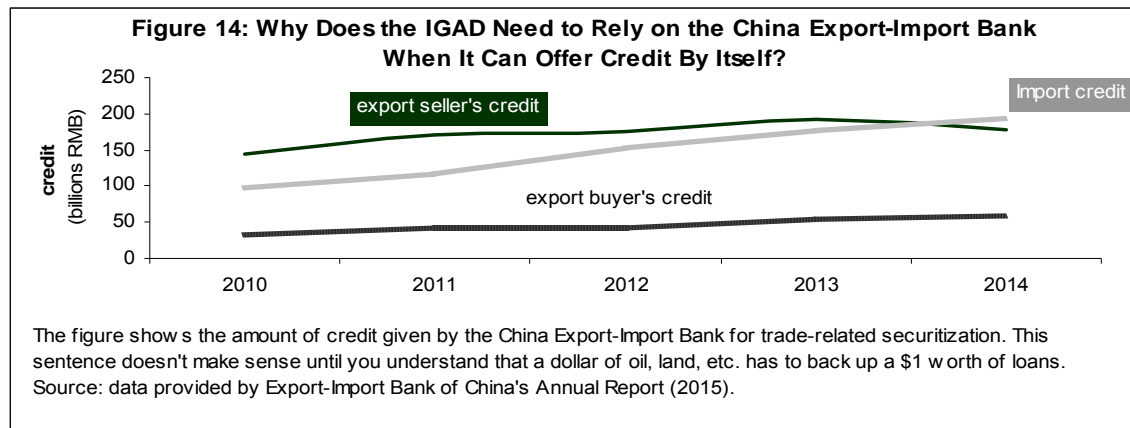
³⁵ In a highly corrupt environment like the IGAD, structuring LEGAL payments to officials in exchange for their cooperation represents a key challenge. We later argue that IGAD officials should have enough ownership rights in order to receive the longer-term personal pay-offs that they would receive in status quo bribes.

³⁶ While commentators focus on asset securitisations in China, few look at the repackaging of cash-streams generated by commercial or household debt into investment vehicles. For markets like the US, such securitisation represents a bulwark of securitised finance. See Nicolas Faleris, Cross-Border Securitized Transactions: The Missing Link in Establishing a Viable Chinese Securitization Market, *Northwestern Journal of International Law and Business* 26(201), 2006.

³⁷ See Todd Moss and Sarah Rose, China ExIm Bank and Africa: New Lending, New Challenges, *Centre for Global Development Notes*, 2006, available [online](#).

³⁸ Naturally, and unlike in the IGAD region, policymakers may force well capitalized domestic financial institutions to explicitly fund policy objectives. See Alicia Garcia-Herrero, Sergio Gavila, and Daniel Santabarbara, What Explains the Low Profitability of Chinese Banks? Banco de Espana Working Paper No. 0910, 2009, available [online](#).

on transfers of ownership rights of future revenue streams), such credit could help promote regional development.



Where are the Chinese investments in Africa? We can not observe the “pieces” of African equity and debt wrapped up into publicly and privately traded securities. Yet, if Chinese FDI is wrapped up in traded investment – as shares of CNOOC and in bonds of the China Construction Bank or the Industrial and Commercial Bank of China -- we can figure out how much African investment Chinese firms and banks are indirectly securitising.³⁹ Sources such as Mayer Brown place Chinese investment in the Africa region varying between \$2 billion and \$18 billion (depending on the year).⁴⁰ Kaplinsky and Morris, in a first tracking exercise looking at the source of Chinese investment in Africa, note that stock market investment has fuelled much of the investment in Africa.⁴¹ Meaning whoever buys shares of those large Chinese companies indirectly already holds “shares” (literally proportional parts) of the African assets they have invested in.

Successful development banking actually hasn't been tied to a bank

Yet, the China Development Bank model represents just one flavour of a model long shown to promote development. The grouping of large holding companies owned and/or controlled by persons with close ties to the government has a long history. Most scholars now accept that large conglomerates – often structured around a large bank – help overcome missing markets and mobilize vast resources in their industries.⁴² Figure 16 shows some recent

³⁹ For readers not familiar with finance, consider the following. Investors can buy IGAD assets directly, or they can buy shares in companies which invest in IGAD assets. They can buy shares privately, shares listed on exchanges or buy shares in banks holding loans used to finance the purchase of IGAD assets. In any case, they receive access to the risks and returns inherent in these assets.

⁴⁰ Mayer Brown, *Playing the Long Game: China's Investment in Africa*, 2014, available [online](#).

⁴¹ See Raphael Kaplinsky and Mike Morris, Chinese FDI in Sub-Saharan Africa: Engaging with Large Dragons, *European Journal of Development Research* 21, 2009.

Raphael Kaplinsky and Mike Morris

⁴² See J. Ramachandran, K.S. Manikandan, and Anirvan Pant, Why Conglomerates Thrive (Outside the U.S.), *Harvard Business Review*, December, 2013, available [online](#).

examples of these groupings.⁴³ Turks call their groups the holding companies, while the Russians refer to them as financial-industrial groups.⁴⁴ Singaporean development finance revolved partially around its sovereign wealth fund -- Temasek.⁴⁵ While not so much in vogue these days, development gurus used to hold up the old-style keiretsu and chaebol as role models for development.⁴⁶ Even the Ukraine has its experience with these large bank-centred groups.⁴⁷ **In these cases, the sharing of risks and returns tie in political elites in a way that simple debt can not.**

Newer flavours of this development model revolve around private equity.⁴⁸ Several commentators have noted the way that private equity houses like the Carlyle Group uses high-level political connections to secure large-scale investments.⁴⁹ Senior politicians in countries like the United Arab Emirates and Saudi Arabia have used sovereign wealth funds like private equity arms of the government – enriching the elite and the population in general.⁵⁰ **Massive government funded investment firms which take equity positions in companies at home and abroad have helped link frontier regions like the IGAD with global financial markets – encouraging economic development through the transmission of trade relationships and knowledge.**⁵¹

⁴³ Readers interested in the topic in general should see, Alex Fernandez Jilberto and Barbara Hogenboom, Big Business and Economic Development: Conglomerates and Economic Groups in Developing Countries and Transition Economies under Globalisation, *The Developing Economies* 46(4), 2008.

⁴⁴ See KPMG, *Turkish multinationals steady on their course despite crisis, survey finds*, available [online](#). See also Tatiana Popova, Financial-Industrial Groups (FIGs) and Their Roles in the Russian Economy, *Review of Economies in Transition* 7, 1998, available [online](#).

⁴⁵ The Government Investment Corporation (GIC) also played no small role in such integrated development. See Dag Detter and Stefan Folster, Hands-On But Independent Governance: The Innovator From Singapore, In *The Public Wealth of Nations: How Management of Public Assets Can Boost or Bust Economic Growth*, 2015. For a less academic description, see Angela Cummine, How Temasek has driven Singapore's development, *East Asia Forum* 6(4), 2015.

⁴⁶ For a discussion and comparison, see Seung-Rok Park and Ky-hyang Yuhn, Has the Korean chaebol model succeeded?, *Journal of Economic Studies* 39(2), 2012.

⁴⁷ Alexander Kostyuk, Konstantin Tchernyshov, and Helen Kostyuk, Financial-Industrial Groups at the Markets for Corporate Control and Investments: The Case Of Ukraine, *Corporate Ownership and Control* 2(2), 2004, available [online](#).

⁴⁸ For evidence see Mara Faccio and Hung-Chia Hsu, *Politically Connected Private Equity and Employment*, available [online](#). See also Jordan Siegel, Contingent Political Capital and International Alliances: Evidence from South Korea, *Administrative Science Quarterly* 52(4), 2007.

⁴⁹ See Dan Briody, *The Iron Triangle: Inside the Secret World of the Carlyle Group*, 2003.

⁵⁰ See I Bremmer, State Capitalism Comes of Age, *Foreign Affairs*, 2009, available [online](#). See also Nimrod Raphaeli and Bianca Gersten, Sovereign Wealth Funds: Investment Vehicles for the Persian Gulf Countries, *Middle East Quarterly* 15(2), 2008.

⁵¹ See Roland Beck and Michael Fidora, The Impact of Sovereign Wealth Funds on Global Financial Markets, *European Central Bank Occasional Paper Series* 91, 2008, available [online](#). See also Surendranath Jory, Mark Perry, and Thomas Hemphill, The Role of Sovereign Wealth Funds in Global Financial Intermediation, *Thunderbird International Business Review* 52(6), 2010, available [online](#).

**Figure 16: The Flavours of Financial Industrial
Conglomerate Holding Companies**

Example country	Description
Traditional	
Turkey	The holding companies represent large-scale conglomerates. Those like Sabanci and Koç have banks which provide funding to other enterprises inside and outside the group.
Russia	The financial industrial groups like Oneximbank Group, Menatep, Alfa and Most revolve explicitly around a bank. Gazprom and the other conglomerates still had close ties with close banks.
Japan	Many have written on the role of the <i>keiretsu</i> , the Japanese conglomerates often with a bank at their centre.
Korea	The Korean <i>chaebol</i> represent Korean-flavoured <i>keiretsu</i> . Firms like Samsung and Hyundai have helped promote economic development through intimate ties with senior politicians.
Ukraine	The Finance-and-Credit group, Privat-Invest, and UkrSibBank represents just a few conglomerates among the panoply of large financial industrial groups that helped develop Ukraine before the crisis.
Singapore	A slightly more diffuse model of state-led finance, <i>Temasek</i> has played an important role in setting up and increasing the competitiveness of many large Singaporean companies. The organisation acts more like a conglomerate than the sovereign wealth funds we describe below.
New Economy	
Carlyle Group	Often linked with conservatives in the UK and US, Carlyle represents the archetype of the private equity fund supposedly using its influence to develop large-scale projects.
Saudi Arabian Monetary Agency	Like many other sovereign wealth funds (for example in the UAE and Brunei), these funds invest in private and public companies at home and abroad (to diversify their holdings). Profits are usually used to enrich the sovereigns and pay for politically popular social programmes. They take a more hands-off approach than <i>Temasek</i> and their private equity peers.

These examples suggest three things of interest to a potential IGAD development bank. First, the bank can not simply conduct arms-length transactions. It must participate actively in these economies – profiting and failing as the marginal productivity of capital results in profits or in failure.⁵² Second, the institution must have political as well as economic clout to succeed.⁵³ In places without functioning markets, firms can conduct transactions using bureaucratic procedures, as market relationships can not yet exist.⁵⁴ Third, even though

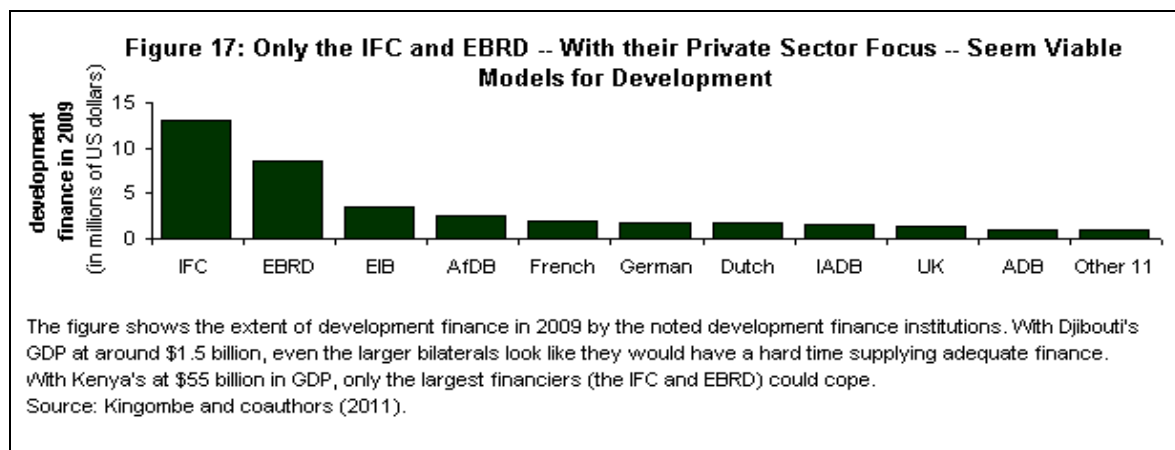
⁵² Not everyone believes that large scale investment needs to take place to jump-start lagging economies like the IGADs' economies. Caselli and Feyrer argue that large capital flows have not resulted in increasing marginal productivities of capital in Africa and other developing regions. See Francesco Caselli and James Feyrer, The Marginal Product of Capital, *Quarterly Journal of Economics* 122(2), 2007.

⁵³ In the African context, authors like Dixon and Monk find simply having access to large amounts of sovereign wealth does not help a country without good governance. Connections with *government* will serve as a sine qua non for *governance* in the IGAD region. See Adam Dixon and Ashby Monk, What Role for Sovereign Wealth Funds in Africa's Development?, *CGD Oil-to-Cash Initiative Background Paper*, October 2011, available [online](#).

⁵⁴ The can not exist because the costs of establishing and using these markets exceed the private benefits. With its focus on social welfare, government and large conglomerates have stronger incentives to create missing markets. For a discussion in the Chinese context, see Hong-bin Li, Ling-sheng Meng, Qian Wang, Li-An Zhou, Political Connections, Financing and Firm Performance: Evidence from Chinese Private Firms, *Journal of Development Economics* 87(2), 2008.

donors have traditionally used debt to finance development, it is equity that will align funders, government officials' and companies' interests. Each group needs to get their share of the benefits in order for any scheme to succeed – without entrenching intransigent politicians.⁵⁵ The most successful cases of development banking – bringing resources together to fund projects – come from outside the world of multilateral lenders.

Similarly, when governments get involved in development finance, they fail (or at least do not pull in the profits and deal sizes seen in the private sector). Figure 17 shows the funding available by various development finance institutions in 2009 (admittedly a while ago).⁵⁶ As shown, only the IFC and EBRD have mobilized the kinds of resources that a place like the IGAD might need in order to finance development. The EBRD represents a particularly interesting role model – given its private sector focus and its headquarter's physical location outside the area it serves.⁵⁷ These organisations attempt to replicate the financial conglomerate-cum-financial industrial group approach to development. But their lack of sufficient penetration of their borrowers' economies make them a distant second-best.



⁵⁵ For examples of the way finance can entrench and distort incentives, see Richard Auty, The Political Economy of Resource-Driven Growth, *European Economic Review* 45(6), 2001. For empirics, see Shang-Jin Wei, Domestic Crony Capitalism and International Fickle Capital: Is There a Connection?, *International Finance* 4(1), 2001.

⁵⁶ Christian Kingombe, Isabella Massa and Dirk Willem te Velde, *Comparing Development Finance Institutions: Literature Review*, 2011, available [online](#).

⁵⁷ We spend a fair amount of this working paper arguing that any IGAD development bank should be located outside the IGAD region in the short to medium term.

Why Does the IGAD Communities Bank Need a Special Design?

How big is the development bank challenge?

The IGAD region would need extremely large money flows in order to dent its growth prospects.⁵⁸ Total GDP probably comes to around \$100 billion (including under-counted parts of the region's GDP). Thus, mobilising investments at even 1% of the region's GDP would come to flows of \$1 billion per year. Figure 18 shows GDP levels per capita in the region, as well as growth rates. These growth rates show the potential rewards for investors. **Investors with a portfolio representing the region's GDP today can expect a 14 fold return on their investment – putting an investment in the IGAD on par with an investment in Microsoft in 1994 or three times the return in Facebook to date!**⁵⁹

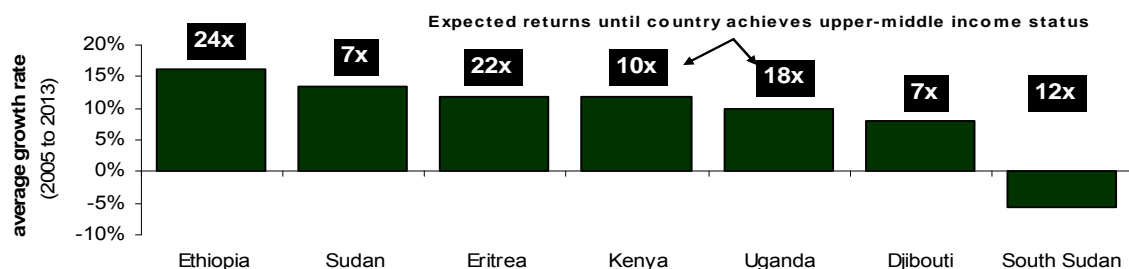
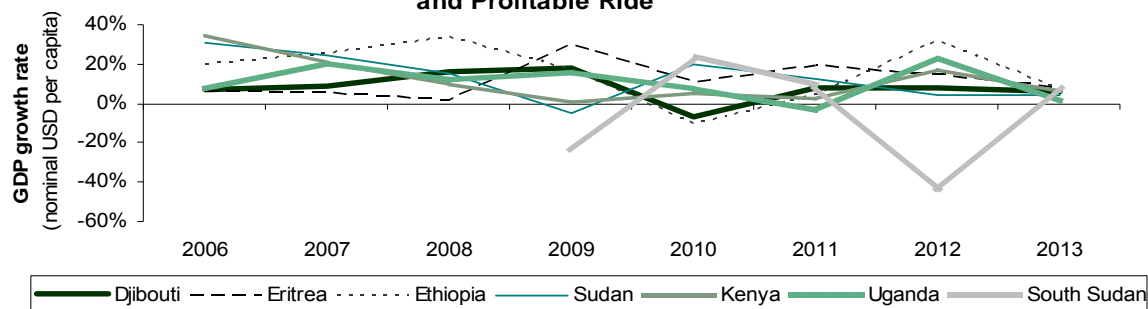
Even though we observe fast GDP growth, we must ask what the GDP growth rate would have been without finance constraints. As we saw in Figure 17, only the largest regional multilateral finance institutions like the IFC and particularly the EBRD could mobilize such funding. Yet, Figure 19 shows the approximate investment needs of each country – known as the financing gap – taking into account the likely production of new investment opportunities given demographic, economic and other changes. As shown, the region will generate about \$38.8 billion in investment opportunities – already taking into account existing financing.⁶⁰

⁵⁸ Few writers on the topic find areas where African financial institutions can mobilize sufficient funding. Calice finds (even though he does not dare say it directly in his ADB sponsored paper) that local financial institutions could never provide enough funding. Triki and Faye find that even sovereign wealth funds, seen as a panacea for many of Africa's funding woes, would come up far short. See African Development Finance Institutions: Unlocking the Potential, *Africa Development Bank Working Paper Series 174*, 2013, available [online](#). See also Thouraya Triki and Issa Faye, Africa's Quest for Development: Can Sovereign Wealth Funds help? *Working Paper No. 142*, 2011, available [online](#).

⁵⁹ Holding the value of that IGAD GDP today, and selling it when the IGAD attains development levels of struggling European countries provides one with big returns. Professional economists will see the snags in the exact quantification we have done – but almost certainly accept the underlying logic of the exercise itself.

⁶⁰ We show later in the paper that this amount would absorb almost the entire amount of foreign investment going to emerging markets writ large!

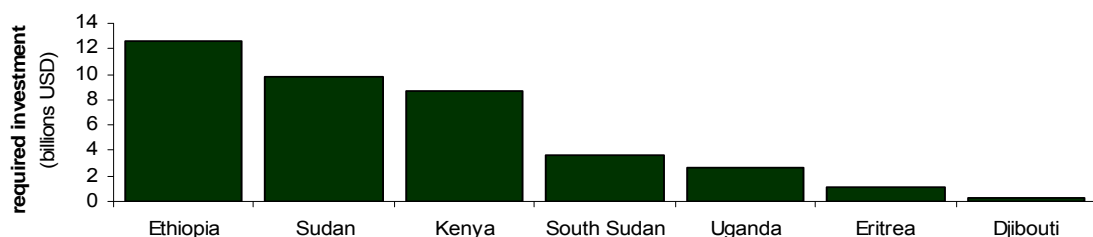
Figure 18: If IGAD Securities Track GDP, Investors Can Expect a Bumpy and Profitable Ride



The figure shows GDP growth rates (in nominal US dollar terms) from 2005 to 2013 for the IGAD countries shown. The upper graph simply shows these past growth rates. The lower graph shows average growth over the period. The black boxes show the expected rate of return if an investor invests average GDP per capita at their 2013 level, and cashes out when the country reaches upper-middle income status (at \$12,000).

Source: Data from World Bank (2015)

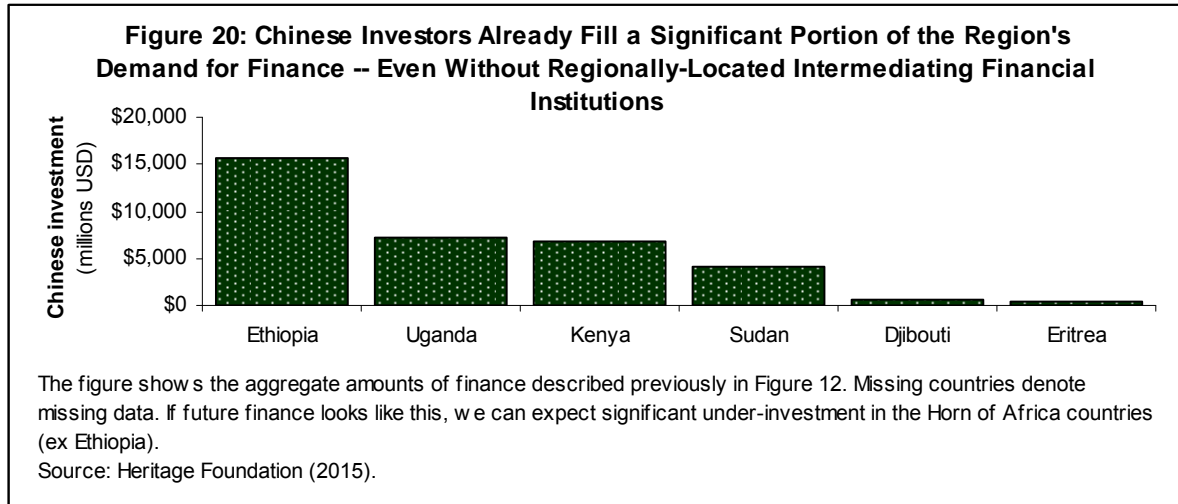
Figure 19: The IGAD Needs About \$38.8 billion on its Optimal Growth Path



The figure shows the investment required for each IGAD member country on its optimal growth path. We exclude Somalia as no data exists at all for the country. We calculated these figures as follows (with Appendix II providing a formal description). First, we started with GDP in US dollar terms for the last year available (2013). Second, we found the extent to which each country under-invests (by taking the average gross capital formation as a share of GDP of rapidly growing economies (of roughly 30%) and subtracting current gross capital formation (as a percent of GDP) from that "optimal" investment. Third, we assumed that gross capital formation would grow at the rate of GDP (shading that figure up or down given recent growth in gross capital formation). Fourth, we found the value of this investment 5 years from now (at the time when such investment would likely take place, taking a realistic view of the speed with which the Bank would get up and running).

Source: Data from World Bank (2015).

Generating this kind of extra funding represents a daunting task without the efforts of a large institution able to gather large amounts of funding for redistribution. Figure 20 shows the amounts of recent Chinese investment again in aggregate – and the extent to which a single financial institution might “serve up” such investments. These investments come to only about half of the region’s annual, optimal demand for resources.⁶¹ Yet, Chinese financial institutions benefit from providing this finance. Why can’t an IGAD focused financial institution profit instead? Why can’t this institution aggregate the supply of, and demand for, funds – and clear the market through large-scale intermediation?⁶²



Other proposals have been made – yet none would likely generate enough funds to make a difference. Many like Allen and co-authors point to particular successes (in their case the Kenyan Equity Bank).⁶³ Other authors like Elhiraika and Abu-Ismaïl, looking at countries like the Sudan, just hope and pray that better banking comes to the region.⁶⁴ Yabara gives fantasy advice on creating integrated capital markets in the region which seems light-years away from reality.⁶⁵ Many pundits pin their hopes on microcredit as a way of scrapping

⁶¹ Our estimate of investment needs requires about 40% of present GDP. Yet, we do not expect to raise such finance every year – as many projects may be too costly or risky to invest in during the upcoming 5 year period.

⁶² Those familiar with financial markets will recognise this as a central (counterparty) clearinghouse. Kenya has already made efforts to establish such a clearinghouse under its jurisdiction. Yet, that effort clearly won’t have the scale sufficient to provide for the region’s investment needs. See Duncan Miriri, Africa Investment - Kenya Aims to Host Africa's First Yuan Clearing House, *Reuters Markets*, Sept. 18, 2013, available [online](#). See also Samuel Onyuma, Regional Integration of Stock Exchanges in Africa, *African Review of Money Finance and Banking*, 2006.

⁶³ Franklin Allen, Elena Carletti, Robert Cull, Jun Qian, Lemma Senbet, and Patricio Valenzuela, Resolving the African Financial Development Gap: Cross-Country Comparisons and a Within-Country Study of Kenya, in S. Edwards, S. Johnson, and D. Weil (Eds.), *NBER Volume on African Economic Successes*, 2012.

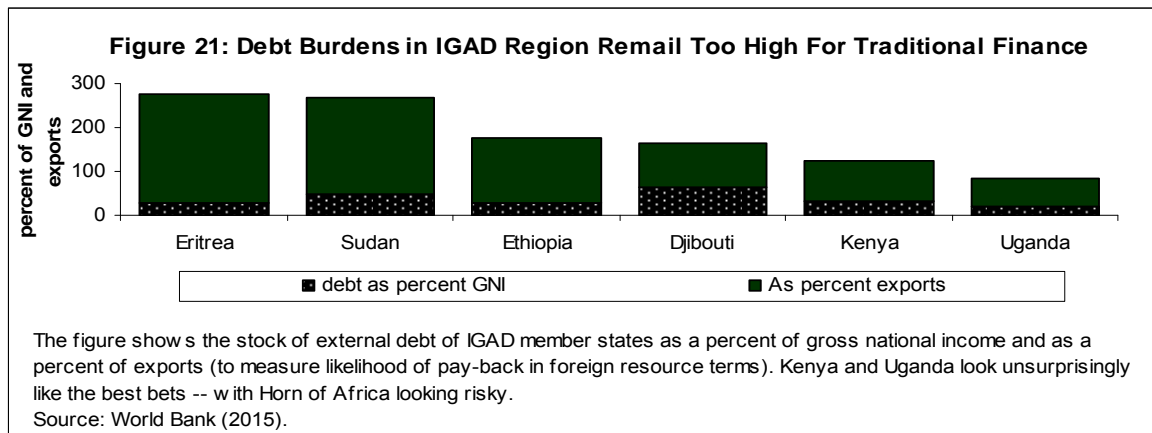
⁶⁴ See Adam Elhiraika and Khalid Abu Ismaïl, Financial Sector Policy and Poverty Reduction in Sudan, *Working Paper 0411*, available [online](#).

⁶⁵ See Masafumi Yabara, Capital Market Integration: Progress Ahead of the East African Community Monetary Union, *IMF Working Paper No. 12/18*, 2012, available [online](#).

together enough money to finance larger developmental ventures.⁶⁶ Yet, rigorous assessments of these approaches generally show they don't work – leading to disillusionment.⁶⁷ **If microcredit doesn't really work – and we know most development banks focus on promoting microcredit – we need an approach already shown to work.**

Why won't the usual model of development banking work in the IGAD region?

The IGAD region is drowning in debt – and more lending simply won't provide the growth needed. Figure 21 shows the debt burdens – as a percent of gross national income and as a percent of exports – for the region. Even for the least indebted Uganda, current debt loads come to almost 100% of exports. Figure 22 provides a slightly more nuanced view of debt and investment in the region. We see that lending to the weaker IGAD states has almost come to a halt in the post-crisis period – and both lending and investment in these countries has decelerated. Kenya, Uganda and to a lesser extent Ethiopia will represent the motors of this region. **Yet, setting up a development bank to give even more loans to the region just doesn't make sense.**⁶⁸

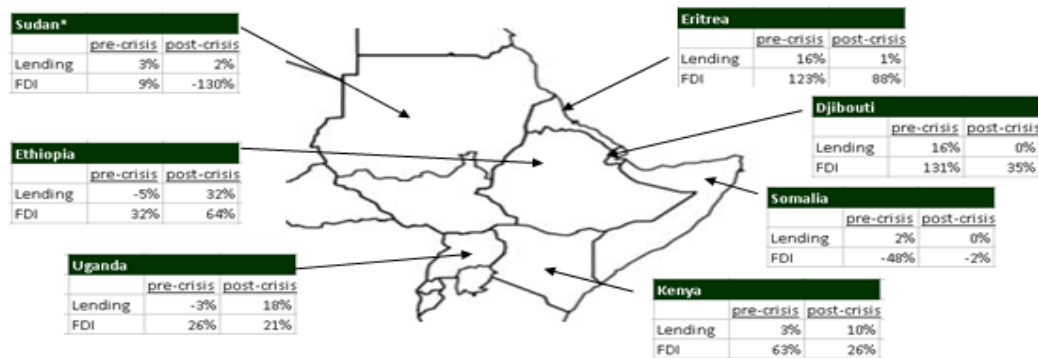


⁶⁶ See Finance for the Poor: Microfinance Development Strategy, available [online](#). See also Michael Mahmoud, Microfinance in Africa: Overview and Suggestions for Action by Stakeholders, *UN Office of Special Advisor on Africa*, 2013, available [online](#).

⁶⁷ Niels Hermes and Robert Lensink, The Empirics of Microfinance: What Do We Know? *The Economic Journal* 117(517), F1–F10, 2007. See also C. van Rooyen, R. Stewart and T. de Wet, The Impact of Microfinance in Sub-Saharan Africa: A Systematic Review of the Evidence, *World Development* 40(11), 2012. For a broader overview, see also Kathleen Odell, Measuring the Impact of Microfinance: Taking Another Look, *Grameen Foundation Publication Series*, 2010, available [online](#).

⁶⁸ Businesses in many IGAD countries also avail themselves of loans from organisations like the European Investment Bank (EIB). The EIB has recently supposedly made €40 million available to Ugandan banks to relend as microcredits. See EIB, EIB to increase support for Ugandan small businesses through EUR 40m loan to local banks, 2014, available [online](#).

Figure 22: Further Lending Unlikely in Region where Uganda and Kenya are Motors of a Potential IGAD Free Trade Area

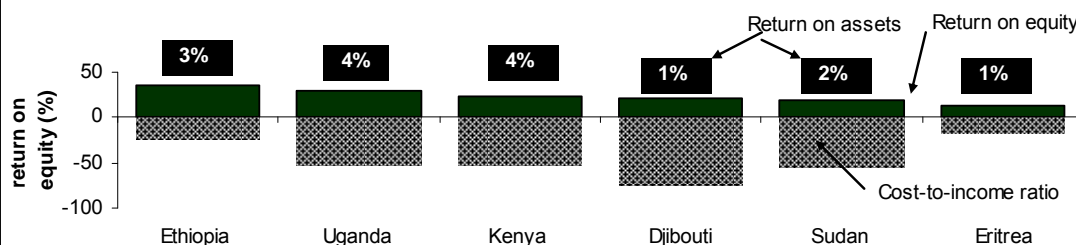


The figure shows the way that lending and foreign direct investment has changed in the IGAD Member States before and after the financial crisis. Specifically, we show the average annual growth rate of total external debt stocks (in US dollars) and net foreign direct investment inflows as reported by these IGAD members themselves. The pre-crisis period includes 2000 to 2006 whereas the post-crisis period includes 2007 to 2013. In general, Uganda and Kenya are doing fine – while the other members represent the financial and economic hinterland. The hinterland won't probably get anymore loans – but will get investment. As such, a financial institution focused on investments makes sense.

Source: data provided by World Bank (2015).

The IGAD needs better -- rather than more -- banking. Figure 23 shows the return on banks' assets and equity – as a measure of the extent to which banks (and thus the rest of us) can turn a profit in the region. We know that if banks' fail to make money, the marginal returns on the capital they purvey may not warrant further expansion. We clearly see bank over-capitalisation. The amount of money IGAD region banks make – as a percent of the money their investors put in – well exceeds investments in the OECD. Yet, as a percent of assets (total capital deployed), returns barely enter positive territory. Cost-to-income ratios show the reason why. IGAD region banks use much of their revenue in order to keep their doors open. **The IGAD region doesn't need to add another costly, over-capitalized bank to the group.**

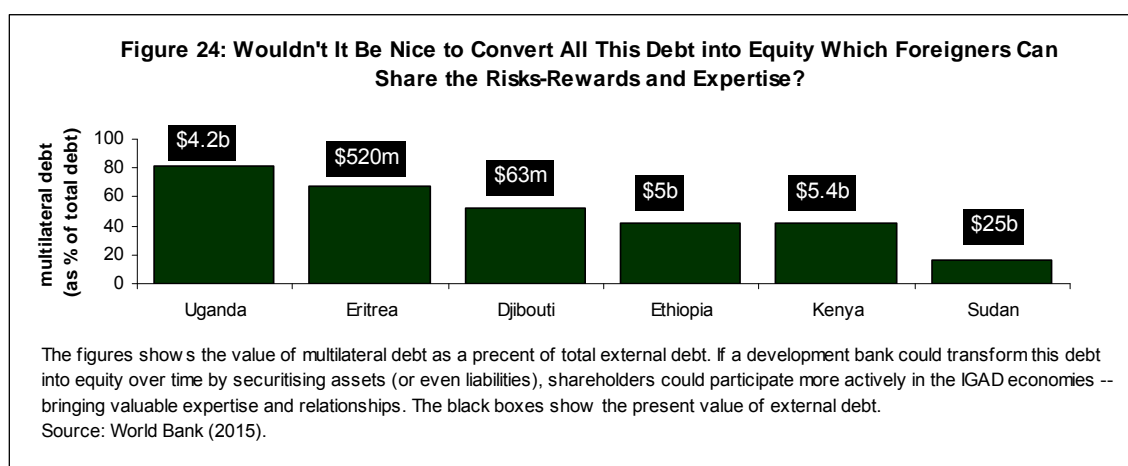
Figure 23: IGAD Region Doesn't Need Another Bank, they Need Better Banking In General



The figure shows returns on banking equity and assets in the IGAD region as well as cost-to-income ratios. IGAD banks return an awesome average return on equity -- but a poor return on assets, suggesting they are over-leveraged already. We see much of their income eaten up in banking costs -- suggesting that the IGAD does not need more bigger, inefficient banking. Source: World Bank (2015).

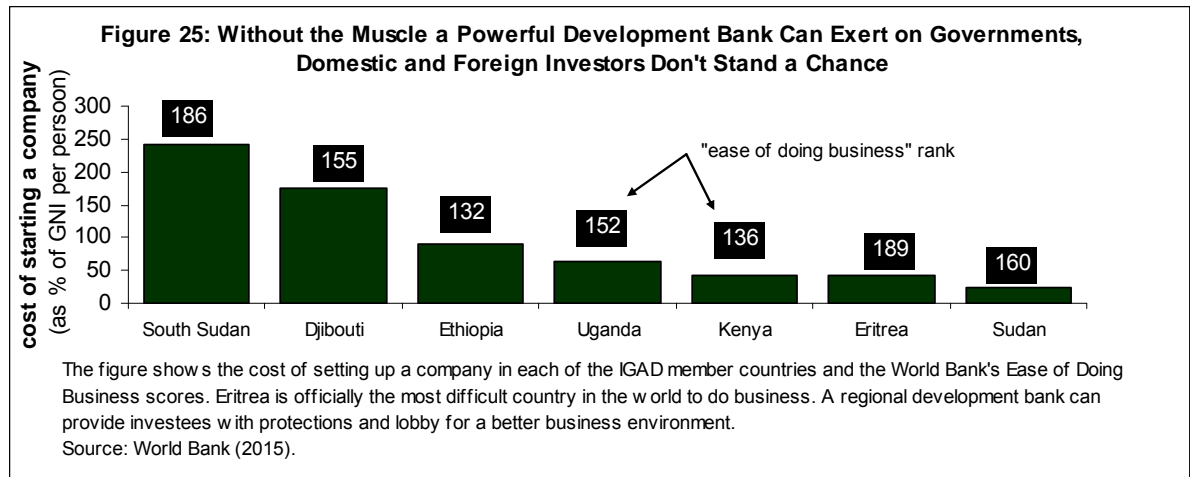
The IGAD region needs pure-play equity much more than debt. Figure 24 shows the extent of indebtedness in the region – and the value of such indebtedness. Instead of loans, imagine these values consisted of securities (or securitized instruments) which gave investors rights (and obligations) over the stuff the loans were supposed to buy in the first place. What if you

and I held \$63 million in “papers” which let us own stakes in Djibouti shipping? Or \$5 billion in Kenyan flower exporters? The World Bank Group and African Development Bank should resell pieces of their debt to clever investors who would re-price it (and probably demand equity stakes in place of “odious” debt).⁶⁹ **The IGAD governments must work with their foreign counterparts to restructure the existing nature of obligations for past and future profits through a muscular institution if the IGAD hopes to develop in the next 50 years.**



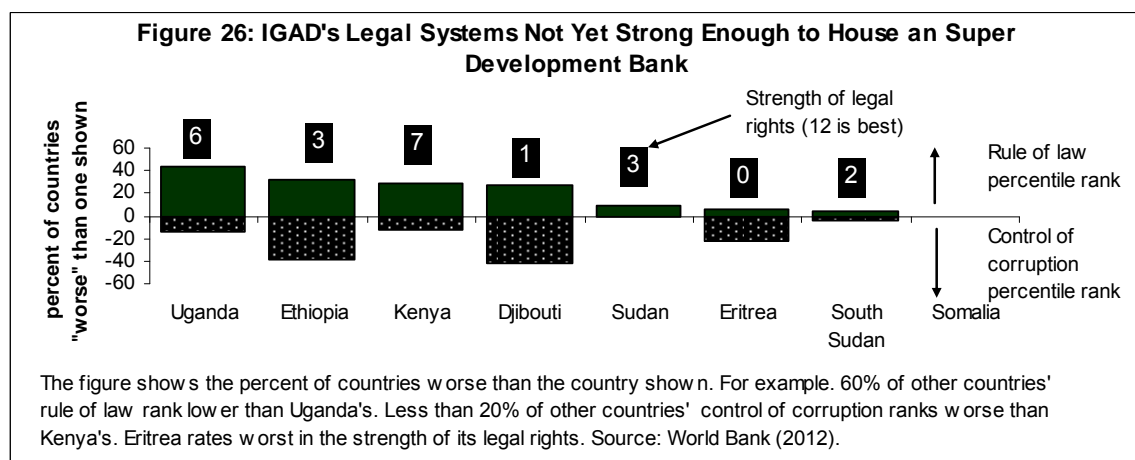
If the IGAD needs an economic institution strong enough to deal collectively with previous donors, it also needs an institution strong enough to politic for pro-investment policy changes at home. Figure 25 shows the cost of starting a business in the IGAD region, and the “ease of doing business” ranking (which you have undoubtedly seen before). The simple fact that the cost of starting a business can be expressed in terms of citizens’ annual income shows how anti-business laws and policies are across the region. Two IGAD members (Eritrea and South Sudan) represent the worst-of-the-worst for ease of doing business. What would be Sinopec’s “ease of doing business” (or the World Bank’s for that matter!)? Their size and political influence make their ease-of-doing-business in a class by itself. What if other investors could have the same rights as their large investors? What if investors pooled their resources into a body with the political, economic and diplomatic clout needed to encourage these governments to do the right thing? **What the region needs more than anything consists of an organisation with the political and economic power needed to open up markets of all kinds in the IGAD region.**

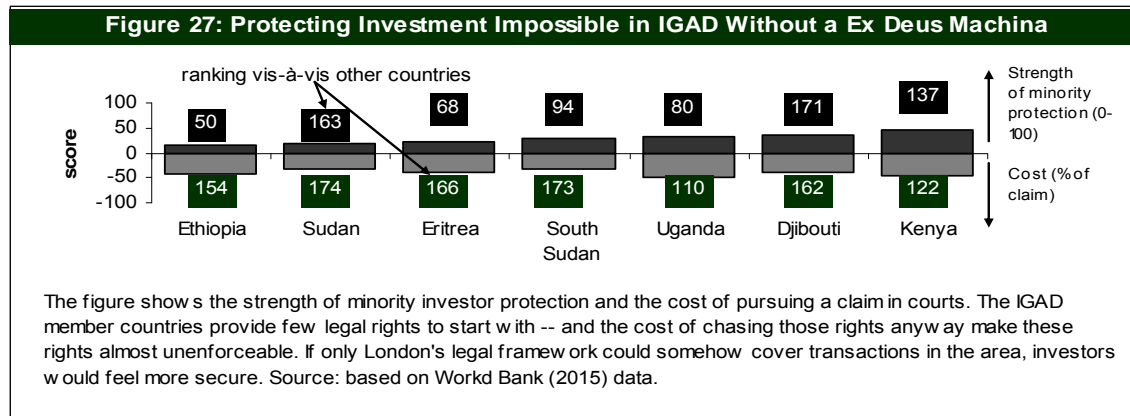
⁶⁹ The term “odious debt” refers to the social costs imposed by the failure of multilateral lenders to write down or write off loans which would have already been resolved in the private sector. The odious part comes from the fact that debt service and overhang stop productive investment (as no rational businessman will start a factory knowing he/she must give up 60% of its value one day in future expected taxes)? For more analysis of the effects of debt reduction on investment, see Pernilla Johansson, Debt Relief, Investment and Growth, *World Development* 38(9), 2010. For data on these “odious debts”, see James Boyce and Leonce Ndikumana, *Africa's Odious Debts: How Foreign Loans and Capital Flight Bled a Continent*, 2011.



What prevents a development bank from working in the region itself?

In the short-term, the business environment in the IGAD is so dysfunctional that even a development institution should not locate there. Conversely, to function well, any development bank would probably need to sit physically outside of the IGAD region (at least for now). Figure 26 shows three measures of the institutional quality in the IGAD countries. Even for Uganda (the highest ranked country for its “rule of law”) – roughly 60% of other countries rank better. Even for this relative role model, almost 85% of countries do a better job at controlling corruption. Its “strength of legal rights” ranks roughly half as good as the best countries like the UK – with a score of 6 out of 12. **Laws in the region simply do not provide enough protection to a development bank in order to provide for the types of contracts and legal arrangements needed for massive investment.**





So how to do the Chinese do it? Chinese economic diplomacy serves the role we propose for an IGAD development bank in this working paper. Large Chinese investors can operate outside of markets – exercising considerable leverage over investee governments and companies.⁷⁰ Yet, Uganda public officials and businessmen can not exercise the same role in Eritrea.⁷¹ South Sudanese investors can never engage in the kinds of diplomacy and wield economic power the way Chinese businessmen and officials do.⁷² **Only through the establishment of a powerful IGAD development bank can these officials hope to one day wield the same power in their region that the Chinese do today.**

Thus, in order to attract funds on the scale necessary to deal with the region's large-scale development challenges – as well as provide incentives to adopt development-friendly policies, the development bank should be located outside the region. The idea of locating the institution outside the IGAD may seem strange. Yet, the idea of development finance operating outside the area it serves has a long and venerable tradition. The Economic Cooperation Administration (ECA) – which gave Marshall Aid money to Europe after World War II -- sat in the US.⁷³ The European Bank for Reconstruction and Development (which serves as private sector development bank to Central and Eastern Europe) sits in London.

Indeed, many development organisations already serving African countries sit in Europe. Many EU member states have development banks (or more specifically development finance institutions) which provide funding to various African (or other emerging) countries. Figure 28 shows some of these investment organisations and their Africa – or other emerging

⁷⁰ See Ian Taylor, Unpacking China's Resource Diplomacy in Africa, *HKUST Center on China's Transnational Relations Working Paper No. 19*, 2007, available [online](#). See also Zhiqun Zhu, *China's New Diplomacy: Rationale, Strategies and Significance*, 2010.

⁷¹ For the state of intra-community trade and investment in Africa and among IGAD Member States (or the lack of such trade and investment), see Habiba Ben Barka, Border Posts, Checkpoints, and Intra-African Trade: Challenges and Solutions, *AfDB Working Paper*, 2012, available [online](#).

⁷² Policymakers have theorized about such trade and investment links for years. Despite years and pages of abstract diagrams, investment between IGAD Members remains muted. For an example of one of the many heralds of intra-community investment, see Terence McNamee, Mark Pearson, Wiebe Boer, *Africans Investing in Africa: Understanding Business and Trade, Sector by Sector*, 2015.

⁷³ Many of the reasons policymakers gave for setting up the Administration outside of the area it gave money to are still relevant for the IGAD today. For a discussion of these reasons, see Herbert Simon, Birth of an Organization: The Economic Cooperation Administration, *Public Administration Review* 13(4), 1953.

market – investments.⁷⁴ As shown, these institutions have not shied away from taking direct stakes in productive African ventures. For its part, the China-Africa Development Fund (with an estimated \$3 billion in funding) already represents the closest thing to the Bank we propose – and it is located in Beijing!⁷⁵ Nothing requires that a development bank simply give loans. Nothing also requires an African development organisation to actually sit in Africa.

Figure 28: Some African Focused Development Banks Located Outside of Africa

Country's Development Financial Organisation	Extent of participation in Africa
Belgium	participates in a corporate vehicle investing in SMEs in Rwanda and another company set up to invest in three state-owned agro-industrial companies in Gabon (palm oil, rubber and cattle raising).
UK	participates in several equity funds (\$5 million for the African Lion II fund, which specializes in junior gold, base metals, coal, industrial minerals and diamond mines). Another fund invests in a Ugandan electricity distribution company.
Spain	lent to a Spanish company money to provide explosives for mining works in Kazakhstan.
Germany	participates as a shareholder in Industrial Promotion Services Kenya Ltd. (IPSK), funds expansion to Tanzania and Uganda, as well as helps determine policies and select projects.
Finland	has lent money and taken equity positions in firms in St Petersburg (Russia)
Netherlands	participated in a loan of €40 million to the Ghana Water Company.
Denmark	Participated as equity investor in a beer brewery and infant milk formula producer in China.
Sweden	Invested in a Nicaraguan state telephone company and covered credits made to a Swedish company.
Italy	Invested almost €4 million in a Chinese packing company.
Norway	Lent €400k to a Norwegian power company to invest in a Nepalese power company.
France	Invested in a Club Med in Mauritius

The figure shows the extent to which European development finance institutions participate in African equity (or debt) and equities from other developing markets. We show these investments in non-African countries, as these prior investments may signal increased willingness (and risk appetite) in the future to invest in Africa. Source: Storey and Williams (2006)

Other worries – like crowding out and politics – also militate for an IGAD finance institution located outside the region in the short to medium term. A development bank can crowd-out domestic banking.⁷⁶ Much evidence shows that development banks distort capital markets in the countries in which they operate – as governments use these banks to allocate money to friends or politically visible projects.⁷⁷ Even for the multilateral banks, recent empirical

⁷⁴ See Andy Storey and Simon Williams, *An Irish Development Bank? Centre for Development Studies Working Paper*, 2006, available [online](#)

⁷⁵ See Martyn Davies, *How China delivers development assistance to Africa, Centre for Chinese Studies*, 2008, available [online](#).

⁷⁶ For evidence and empirics, see Shahe Emran and Subika Farazi, *Lazy Banks? Government Borrowing and Private Credit in Developing Countries, Institute for International Economic Policy Working Paper Series IIEP-WP-2009-9*, 2009, available [online](#).

⁷⁷ Even the China Development Bank, a role model for the IGAD financial institution we propose in this paper, suffers from these problems. If the Bank were located outside of China, its capital allocation decisions would

analysis shows that donor interests trump project impacts or client needs as motivations for lending.⁷⁸ Intra-Board politics can exert a deleterious effect on portfolio performance.⁷⁹ Instead, development banks should crowd in private investment when political risk is high.⁸⁰ **As such, we must find a design which keeps IGAD members from exercising too much harmful influence over the Bank – while preserving their interests to cooperate with the institution.**

Securitising the IGAD Member States' Assets and Liabilities

In markets without broad domestic equity markets and needing to shy away from debt, securitisation represents the only option left. Securitisation means finding profitable assets, selling shares of pieces of those assets directly, and using revenues from those shares to pay-off investors.⁸¹ Indeed, the EU increasingly stresses the role of securitisation as a means of deepening the common market – whereby citizens from one part of the Union can participate in the risks/returns of assets in another part.⁸²

If the IGAD region's foreign investors securitised its foreign direct investment (or sold rights over revenues through stocks, bonds, etc.), they would have raised almost \$60 billion. Figure 29 shows the value which the securitisation of foreign investment could have raised. The figure shows roughly the value of assets created as the IGAD Member States grow if they follow their past history in the way growth translates into investment demand. We see Sudan generating a large value of securitisation (and we do not yet have data divided by Sudan and South Sudan). Uganda represents another pent-up economy – which would be able to raise a large amount of finance if its asset stock grows. Ethiopia would generate a moderate amount of business, compared with others in the IGAD region. **We can thus see that securitisation**

probably suffer less from non-productive politics (though benefits of links to government may also be reduced). Brazil – as seen through the eyes of Lazzarini and coauthors as well as de Bolle -- shows far more clearly the harms of development banking. See Hong Ru Government Credit, a Double-Edged Sword: Evidence from the China Development Bank, *MIT Working Paper*, 2014, available [online](#). See also Sergio Lazzarini, Aldo Musacchio, Rodrigo Bandeira-de-Mello, and Rosilene Marcon, What Do State-Owned Development Banks Do? Evidence from BNDES, 2002–09, *World Development* 66(1), 2015. See also Monica de Bolle, Do Public Development Banks Hurt Growth? Evidence from Brazil, *PIIE Policy Brief PB15-16*, available [online](#).

⁷⁸ Ben-Artzi illustrates the link between donors' interests and multilateral development bank lending (as does Humphreys whom we previously cited). See Ruth Ben-Artzi, *Political Aid: Is Multilateral Lending Strategic?*, 2005, available [online](#).

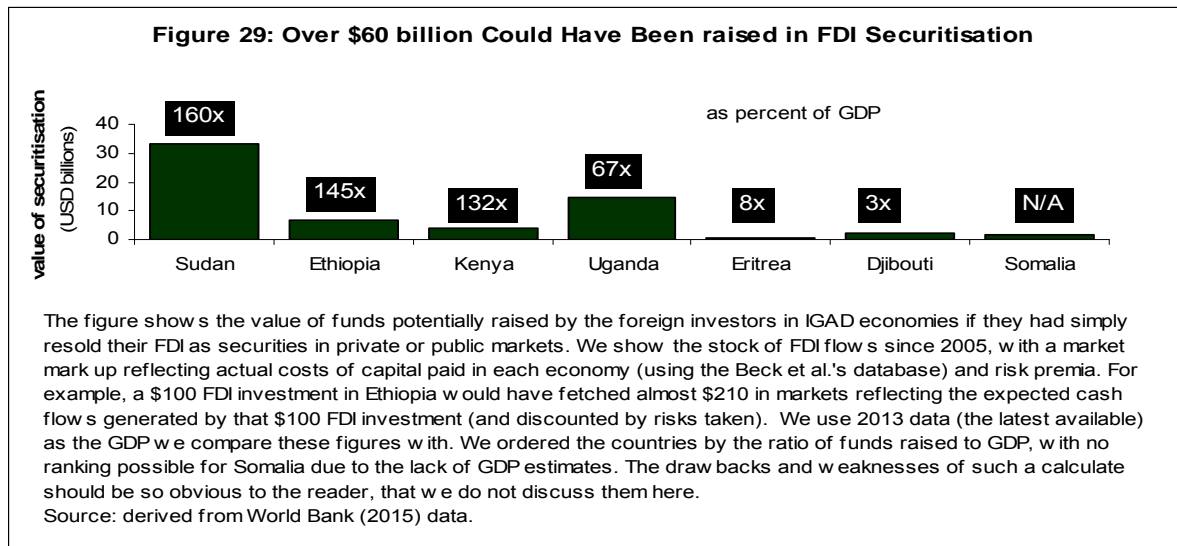
⁷⁹ Many have documented the presence and nature of such politics in multilateral financial institutions. For a recent analysis in the Asian context, see Christopher Kilby, Donor influence in multilateral development banks: The case of the Asian Development Bank, *The Review of International Organizations* 1(2), 2006.

⁸⁰ Hainz and Kleimeier talk about such crowding-in in the context of lending (an activity which should take a back seat to equity participation). Yet, the main arguments remain the same. See Christa Hainz and Stefanie Kleimeier, *Political Risk, Development Banks and the Choice of Recourse in Syndicated Lending*, 2012, available [online](#).

⁸¹ For an overview, see Lakshman Alles, Asset Securitization and Structured Financing: Future Prospects and Challenges for Emerging Market Countries, *IMF Working Paper* 01/147, 2001, available [online](#).

⁸² For an analysis of the issues, see EU DG-FISMA, *Consultation Document: An EU Framework for Simple, Transparent and Standardised Securitisation*, 2015, available [online](#).

represents one of the only ways of marshalling sufficient funds needed for the IGAD's enormous development challenges.⁸³



What does it mean to securitise IGAD countries' assets? Figure 30 shows the way that investments of some of the IGAD's larger companies could be securitised – creating larger conglomerates able to deal with a multilateral bank as a major financier. Some of the larger conglomerates probably already have access to a large investment bank that plays the role of the proposed IGAD Bank. Yet, the revenue streams from these large companies show that viable securitizable assets exist in the IGAD, and some owners may want to sell out to reduce their risks or free up capital. The largest companies in Ethiopia alone produce revenues coming close to \$900 million.⁸⁴

What about the long-tail of the company distribution (namely smaller companies)? The following two figures make the argument that a regional development bank might be able to provide asset-based finance directly – rather than going through the 19th century invention of stocks and bonds. Figure 31 shows the assets that would be available for securitisation by IGAD member state if they had the optimal amount of investment.⁸⁵ We see significant assets available outside of the largest companies. Roughly \$2.5 billion would be required by new companies, if IGAD economies had the better policy environment of other poor countries. To provide the “stock” of companies which would have been created in the past 15 years requires close to our previous estimate of required investment – about \$40 billion (in this case \$37 billion). Figure 32 shows the reason why the IGAD would need mass

⁸³ In other words, securitising FDI to the region since 2005 would meet the region's financing needs for one year only (albeit in the short-term more focused on Kenya, Uganda and to a lesser extent Ethiopia and South Sudan).

⁸⁴ These companies include MIDROC Ethiopia (which makes up more than half of this group's total revenues), Sunshine Investment Group, Messobo Cement, Dashen Bank, Awash Bank, East Africa Holding, DH Geda Trade & Industry, East Africa Bottling (Coca Cola), Addis-Mojo Edible Oil Complex SC and Dashen Beer.

⁸⁵ We would argue that showing the value of these companies' assets without credit constraints – rather than showing assets as they presently lie – provides a better portrait of smaller companies' investment needs. Yet, even shading down these estimates by 30%-50% still shows a large stock of assets available for securitisation.

securitisation, instead of trying to copy the US or other countries in selling company shares of bank loans. All countries in the IGAD have relatively low proportions of companies registered as limited liability companies (meaning the sole owners and partners take person risks and use their own limited funds). Concentration among the largest owners seems to confirm the failure of local institutions to encourage wider groups of people to invest together in common endeavour. **By bundling and reselling dollops of assets, a development bank could completely bypass inefficient banks and stock exchanges (encouraging them to up-their-game).**

Figure 30: Securitising the IGAD's Companies May Open Up Cheap and Plentiful Funding, Pulling in Foreign Partners in the Process
(please see disclaimers)



MIDROC (ETH)
Revenue: app. \$670m

Would Sheikh Mohammed Al-Amoudi want to shift risks/liabilities for the assets generating \$670m to others? Saudi funders probably already serve the role we propose for the Bank – providing low-cost external funding, contacts, and advice.



DAL Group (SUD)
Revenue: app. \$1b

Could Osama Abdul Latif use 20 times his current assets? China already serves as a major provider of finance in the sanction-ridden region.



Port de Djibouti
Revenue: \$90m

The Port and terminal assets represent an obvious attraction for investors. Asset heavy, revenue rich and in a sector well known on public markets.



Sameer Group (KYA)
Revenue: app. \$38m

Listed on the stock exchange, which doesn't help most of us outside Kenya to invest in this Group. The Group probably has foreign lenders, and can dip into Kenya's deeper equities and banking markets.



Mukwano Group
Revenue: app. \$230m

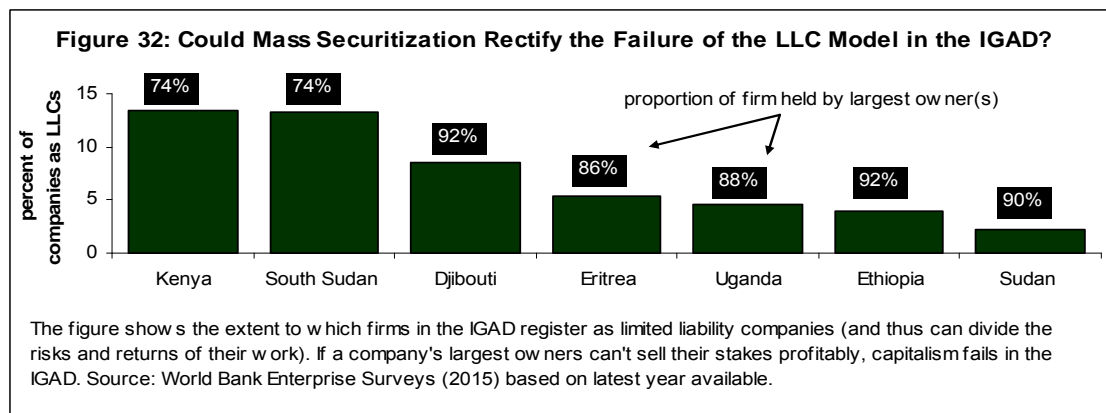
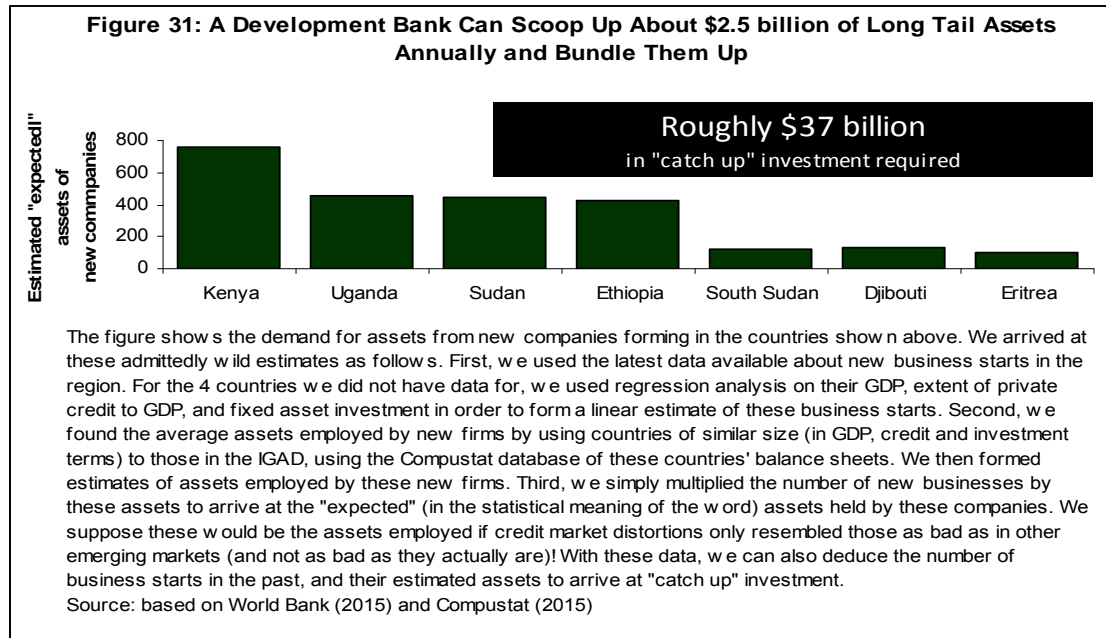
Amiral Karmali may not have the UK ties that the Madhvani family, but the Mukwano Group still has industrial assets in the consumer products space potentially of interest to many.



Somalia Petroleum Company
Rev. est. \$2b when ready

No one is talking about privatization – only the chance for the rest of us to share in the profits when oil prices recover. The UK SFO has already stepped in – showing foreign muscle can help police the region's economy.

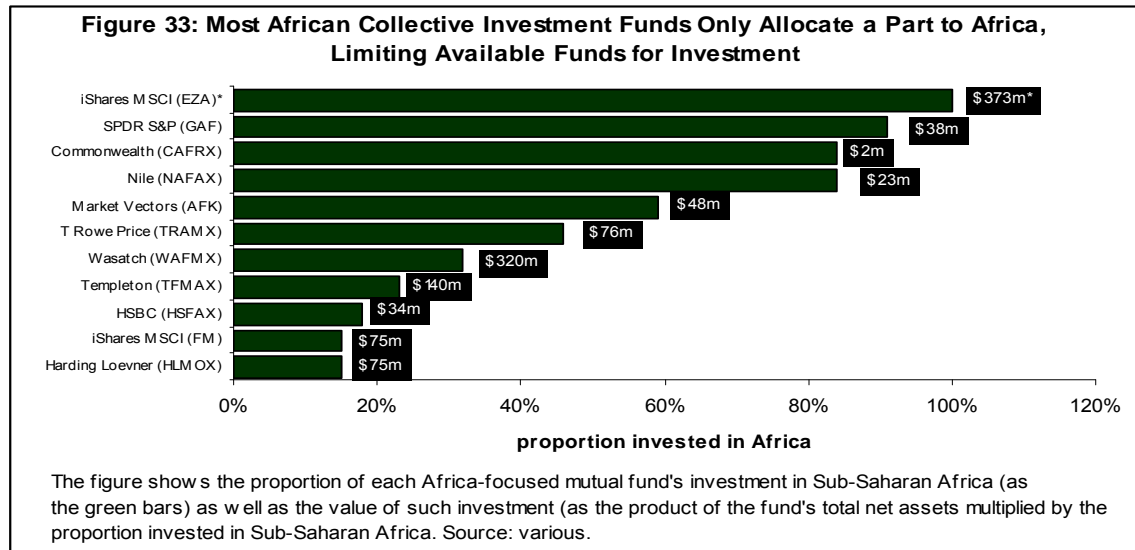
The examples used in the figure represent concrete illustrations of the way a non-odious debt development bank could help promote development in the IGAD region. We have not consulted with these companies (and they might well already have foreign private placement investment). We use their logos under “fair use” for intellectual, academic discussion. References to public figures from IGAD member states found in the public domain and used for illustrative purposes only. Revenues refer to latest publicly available figures from credible sources (including media sources).



Such securitisation would add a new range of risks and returns to African portfolio investments available to domestic and international investors. Figure 33 shows some of the better-known African undertakings for collective investment in transferable securities (in other words mutual funds) in the West. As shown, only iShares can find enough investments to invest all its capital into Sub-Saharan investments. Yet, the fund only focuses on South Africa – illustrating the lack of marketable investments from the rest of Sub-Saharan Africa!⁸⁶ **If any IGAD development bank could help increase the value of such offerings by only 5%, the amount of money raised would be enough to fund only a tiny fraction of the development projects we describe in this working paper.**⁸⁷

⁸⁶ Many of the funds we describe as targeting "Africa" allocate a far amount of money to Egypt and other countries in North Africa. Of investments south of the Sahara, Nigeria and Kenya remain the powerhouses of investment attraction.

⁸⁷ The total assets under management in Figure 33 only come to a couple of billions dollars. Thus simply adding 5% of the value of existing assets to the value of the funds specializing on African equities would not amount to very much. Without a paradigm shift which radically increases demand for African securities, the market will



Despite the promise of securitisation as a method of offering exposure to IGAD-related risks and returns which typical stocks and bonds can not provide, we accept the limitations of such securitisation.⁸⁸ First, we don't buy some of the popular press arguments arguing for the securitisation of contingent future resources like remittances, future aid flows or resources still in the ground.⁸⁹ Getting investors to buy pieces of already-existing assets would be hard enough for the IGAD region. Getting investors to buy future potential shares of money that might come seems unlikely, and indeed likely to reduce the flows of those monies/resources earmarked for investors in such securitization schemes.⁹⁰ Second, such securitisation might interfere with the development of normal banking systems, the domestic trading of shares and even the conduct of domestic monetary policy.⁹¹ Yet, as we argue in this working paper, securitisation can help to crowd-in more traditional finance markets (in equities and debt) by creating market demand for (and experience with) IGAD assets. Third, as we describe in a

likely remain limited. We argue that a credible development bank operating along unconventional lines might cause that paradigm shift.

⁸⁸ Confusion over the term "securitization" will trip up any reader interested in knowing more about securitisation in Africa. International relations, sociology and politics scholars have usurped the term to refer to promoting domestic security through military and law enforcement. For more on their discussion of the "securitization" of the IGAD region, see Jonathan Fisher and David Anderson, Authoritarianism and the Securitization of Development in Africa, *International Affairs* 91(1): 131–151, 2015. See also Thierry Balzacq, *Securitization Theory: How Security Problems Emerge and Dissolve*, 2010.

⁸⁹ See Suhas Ketkar, Aid Securitization: Beyond IFFIm, *DESA Working Paper No. 127*, 2012. See also Abebe Shimeles, Diaspora Bonds and Securitization of Remittances for Africa's Development, *AfDB Africa Economic Brief* 1(7), 2010.

⁹⁰ As an example, imagine that investors buy \$100 in "shares" in future aid worth \$200. Aid agencies, seeing their aid pre-promised, would likely refuse to give such aid (as it goes to investors' pockets rather than to social objectives). Indeed, if Africa countries could raise money on such vacuous promises, they would not need aid in the first place!

⁹¹ For more on the way that securitisation can interfere with monetary policy, see Mangal Goswami, Andreas Jobst, and Xin Long, An Investigation of Some Macro-Financial Linkages of Securitization, *IMF Working Paper WP/09/26*, 2009. For more on the links between banking sector development and securitisation, see Miguel Segoviano, Bradley Jones, Peter Lindner, and Johannes Blankenheim, Securitization: The Road Ahead, *IMF Staff Discussion Note SDN/15/01*, 2015.

later section, our proposals give foreigners (as well as local populations) a great deal of power and influence vis-a-vis current elites.⁹² The very critical among readers might see securitisation of the IGAD's assets as another "scramble for Africa."⁹³ Yet, as we argue in a later section, most of the developed world grew based on such openness to foreign trade and investment. As described in Figure 34, many people equate securitization with the 2007-8 financial crisis, making the development of securitisation markets unpalatable to many.⁹⁴ Yet, if the hyper-sensitive Communist Party of China can put aside its dislike of former colonial powers, and promote securitisation, maybe the IGAD member states can also?

Figure 34: Isn't Securitisation the Stuff that Caused the Financial Crisis?

Yes, and no. It's like saying the discovery of the atom caused the destruction of Hiroshima. Most scholars point to abusive securitisation practices and lack of oversight as the cause of the financial crisis – not securitisation itself (Levitin et al, 2009). Indeed, most academic and policy treatments highlight the positive roles that securitisation can play in a capital market (Loutskina, 2011). Stocks and bonds represent a very sloppy, dirty form of securitisation – where owners chop up pieces of fictional bodies that "hold" assets. Why not just chop up the assets directly with contracts? A focus on the "atoms" of finance themselves, rather than the sloppy molecules of joint stock companies and vehicles containing unsecured debt promises, could revolutionize the way we do finance in Africa. Let's make official what many promoters are already doing in Africa and elsewhere – where Africans rather than Wall Streeters earn the profits.

Where are the Opportunities for Investment in the IGAD Region?

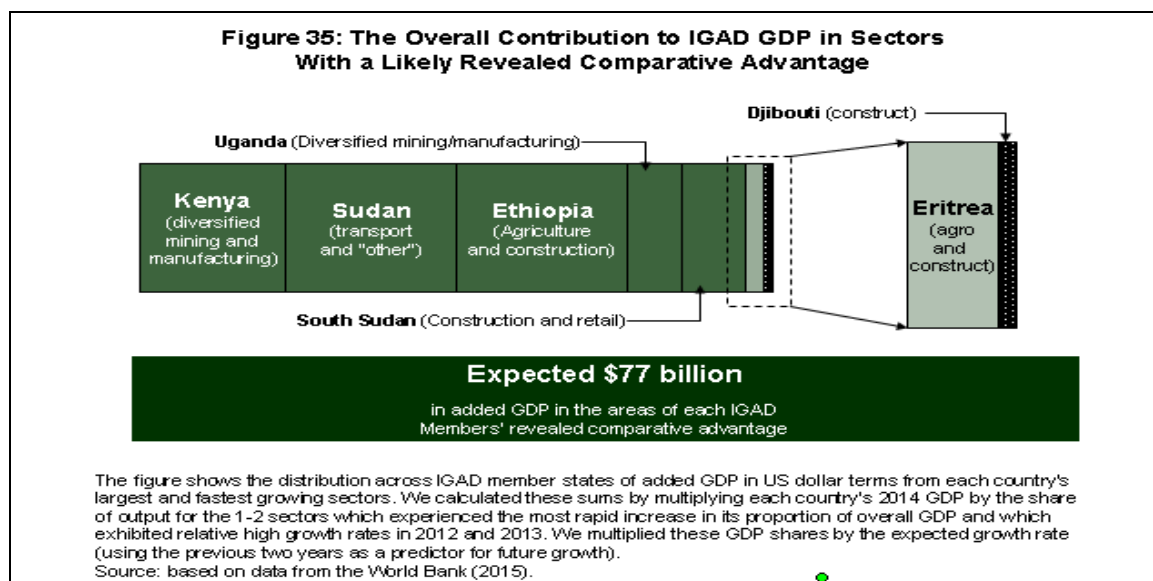
Potential growth in the IGAD economies

Judging by the current state of development of the IGAD members' economies, a development bank would have numerous investment opportunities. Figure 35 shows the expected value of output in major economic sectors (as broken down by International Standard Industrial Classification (or ISIC) categories over the next 5 years. As shown, Kenyan, Sudanese and Ethiopian growth sectors look poised to make the largest contributions of regional GDP (in absolute US dollar terms) in the next five years. **A development bank looking to fund large-scale profitable companies (or groups of companies) will likely deploy much of its capital in these sectors (Kenya's mining and manufacturing, Sudanese resource extraction and transport as well as Ethiopian agriculture and construction) in the first years of its existence.**

⁹² See Anupam Chander, *Odious Securitization*, *Emory Law Journal* 53(923), 2004.

⁹³ For such a view, see Ray Bush, *Scrambling to the Bottom? Mining, Resources & Underdevelopment*, *Review of African Political Economy* 35(117), 2008.

⁹⁴ See Adam Levitin, Andrey Pavlov, and Susan Wachter, *Securitization: Cause or Remedy of the Financial Crisis?* *Georgetown University Law Center Business, Economics and Regulatory Policy Working Paper Series Research Paper No. 1462895*. See also John B. Taylor, *The Financial Crisis and the Policy Responses: An Empirical Analysis of What Went Wrong*, *NBER Working Paper 14631*. See also Elena Loutskina, *The Role of Securitization in Bank Liquidity and Funding Management*, *Journal of Financial Economics* 100(3), 2011.



Numerous previous studies point to areas for profitable and productive investment in IGAD member states. Figure 36 shows these sectors. Ethiopia's PASDEP for example, highlights major areas of desired industrial development.⁹⁵ However, none of the plans makes allowance for an opportunistic organisation to develop new large-scale profitable projects which respond to market incentives rather than administrative/planning incentives.⁹⁶ Ethiopia and other IGAD members do helpfully provide online lists of projects they would like funded. In Ethiopia's case, these projects revolve around 15 sub-sectors. Yet, not unique to Ethiopia, many of these projects either lack business sense or a persuasive investment rationale.⁹⁷ As shown by the concreteness scores of both the development plan for various sectors and the offers for investment proposals available online, a large, experienced organisation will need to help develop these incipient ideas into profitable projects. **A development bank needs to make these kinds of lists, only with companies for large-scale investment projects and joint-ventures.**

⁹⁵ See Ministry of Finance and Economic Development, *Ethiopia: Building on Progress - A Plan for Accelerated and Sustained Development to End Poverty (PASDEP) 2005/06-2009/10, Volume I: Main Text*, 2006, available [online](#).

⁹⁶ To take the Ethiopian case, we could use existing input-output matrix data to figure out how resources will likely "tilt" as the economy grows and as finance constraints are lifted (using past econometric relationships and similar countries' "development path"). However, such an exercise would likely fail to detect new tastes and technologies emerging as well as prejudice any future development toward erroneously investing in such sectors. We thus note the areas of possible growth, without giving specific sector recommendations. For the data, see Ethiopian Development Research Institute, *Ethiopia: Input Output Table and Social Accounting Matrix*, 2009, available [online](#).

⁹⁷ For example – and this problem infects investment promotion agencies world-wide – a fish-farming project provides estimated rates of return and extent of market demand (already far better than what most marketing materials provide!). Yet, investors have no sense of the people running the proposed company, their integrity and the way they plan to work in a challenging business environment. See 16. Fish Farming, available [online](#).

Figure 36: A Review of the Places Others Think Money Should Go in the IGAD Region

Country	Sectors/sub-industries	C-score
Ethiopia	Telecoms and power (requires deregulation), construction and floriculture (already growing apace), large players in agriculture, energy (electricity generation). ⁹⁸	4
	Animal, Crop production, agro-processing, chemicals and pharmaceuticals, Leather and Leather Products, Metal and Metal Products, Non-metallic Products, Paper and Paper Products, Textile and Garment, Wood Products, Construction, Education, Health, Hotel & Tourism, Mineral Water	7
Djibouti	None found	N/A
Sudan	Livestock, Tourism, Fishing, Salt, Banking, Insurance, Infrastructure, Telecommunications, Renewable Energy and Housing. ⁹⁹	3
	“foreign trade”, agricultural commodities, of manufacturing industry, metals exploration. ¹⁰⁰	
South Sudan	Agriculture (11), Livestock, Industry and Mining (11), Energy, Infrastructure (14). ¹⁰¹	1
	Oil sector. ¹⁰²	1
	Mining, quarrying, energy and electricity, petroleum and gas industries, Forestry products, Transport, telecommunications, print and electronic media, and information communication technology (ICT), etc. Basically every sector one can imagine. ¹⁰³	1
Eritrea	N/A	
	Ad hoc lists of projects ¹⁰⁴	1

⁹⁸ See IMF, Advisory Note on the Growth and Transformation Plan (2010–2015), *Report No. 63592-ET*, 2011, available [online](#).

⁹⁹ Investment opportunities, available [online](#).

¹⁰⁰ The latest plan we could find (which ended in 2011) consists of mission statements and SWOT analyses of the most general kind. See Sudanese National Council for Strategic Planning, *The Five-Year Plan (2007-2011)*, available [online](#).

¹⁰¹ The projects listed represent a wish-list rather than assessments of potential profitability, market demand, etc. The numbers next to each category show the number of “investments” on offer. See [Sudan Invest](#) and the [Sudanese Embassy](#) for source material. and

¹⁰² The South Sudan Development Plan (SSDP) – which was recently extended until 2016 – refers only to oil as a sector which is “led by the private sector.” See South Sudanese Ministry of Finance and Economic Planning, *South Sudan Development Plan (SSDP)*, 2010, available [online](#).

¹⁰³ All the investment opportunities we could find (on South Sudanese embassy websites and so forth) only provide lists of general, abstract sectors. No specific projects mentioned. See South Sudan opf Chamber of commerce, industry and agriculture (SSCCIA), *Investing in South Sudan*, 2015, available [online](#).

¹⁰⁴ The Common Market for Eastern and Southern Africa ([COMESA](#)) provides one such list whereas the [Eritrean Embassy](#) provides another.

Figure 36 (continued)

Somaliland*	Agriculture, livestock, fisheries, industry, commerce, tourism, mining. (Somaliland). We could not find a plan for Somalia, but the one we found for Somaliland compared favourably with others in the IGAD region.	6
	General presentation of sectors where investment might be helpful and general investment fora matching needs to money. ¹⁰⁵	2
Kenya	The Strategic Plan seems to provide only information on government staffing and public sector issues.	1
	Transport and Infrastructure (16), Energy (10), projects of regional development authorities (3), tourism (1), energy (1), agriculture (1), integrated projects (2). ¹⁰⁶ Investments are tied to a national strategy (<u>Vision 2030</u>) and are supported by broader macro-analysis.	4
Uganda	Agriculture, forestry, tourism, mining, oil/gas, manufacturing, information technologies. ¹⁰⁷	5
	The <u>Uganda Investment Authority</u> seems to give broad sector overviews, rather than describe specific opportunities. The <u>Uganda National Chamber of Commerce and Industry</u> provide 8 opportunities in a range of sectors.	3

The figure shows in **black letters** the industries targeted by a national development plan. The **green letters** show the sectors in which an investment promotion agency or similar body tries to interest investors through the offer of specific project proposals. C-scores refer the concreteness of the development plan or investment proposal (such as giving specific information rather than abstract generalities). A C-score of 1 represents a completely abstract plan/proposal and 10 represents best-in-class.

* We report on Somaliland rather than Somalia as Somaliland has far more information available. At the time of this writing, Somalia had only launched its work on a national plan.¹⁰⁸

The market for mergers and acquisitions (M&A) in the region also tells us something interesting about the potential role of a development bank in the IGAD region. Figure 37 shows the sectors involved in cross-border and domestic M&A deals in the IGAD member states.¹⁰⁹ As shown, the value of transactions in the wholesale and retail sector eclipsed other sectors in the cross-border M&A trade. Clearly, foreign companies could offer skills, know-how, supply chains and other synergies in this sector. In contrast, most domestic M&A activity involved banking – a sector often involved in M&A for “predatory” reasons (reducing competition, seizing economies of scale, regulatory reasons and so forth). The M&A market in the IGAD came to around \$3 billion in transaction sizes since 2006 – suggesting that even a development bank focusing mainly on “cleaning up” IGAD members’ sectors would have sufficient market size.¹¹⁰

¹⁰⁵ The attractively laid-out [Somaliland Investment Portal](#) provides general “recommendations for investors” for a range of sectors. We could not determine who owns and runs the website. The [Somali Investment Forum](#) looks like one of the many events designed to bring investors and projects together. Yet, we could not find any institutionalized website or listing attempting to “clear” the market for investable projects in Somalia.

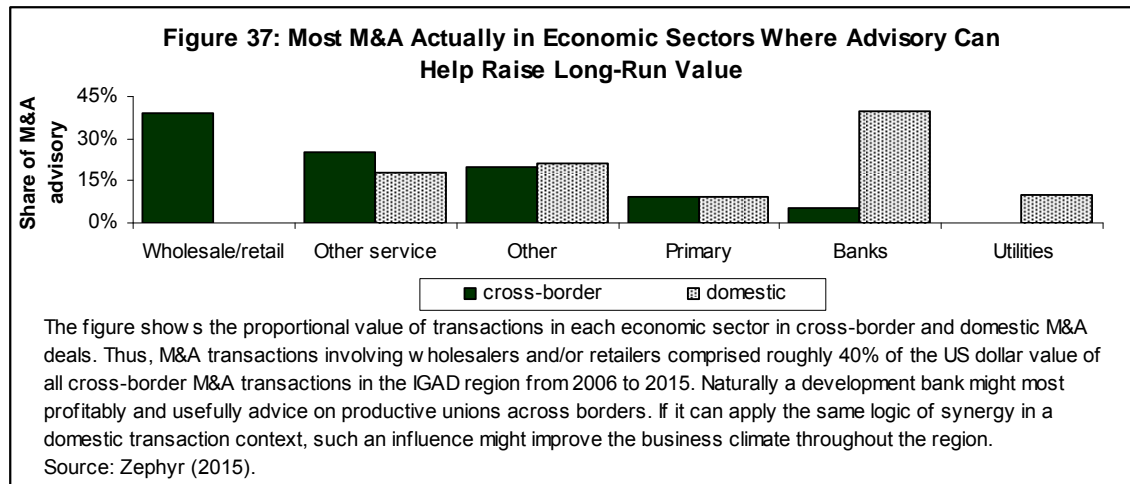
¹⁰⁶ The professional looking site of KenInvest shows [current projects](#) on offer.

¹⁰⁷ The Ugandan National Planning Authority has just completed its second strategic plan (for 2015 to 2020). The sectors identified in that plan remain much the same as the sectors identified in the first strategic plan (for 2010 to 2014). See Ugandan National Planning Authority, *Second National Development Plan 2015/16 – 2019/20 (NDPII)*, 2015, available [online](#).

¹⁰⁸ See Somali Ministry of Planning and International Cooperation, Federal Government of Somalia launches National Development Plan, 2015, available [online](#).

¹⁰⁹ For an overview of M&A markets in East Africa more generally, see KPMG, *DealSpace: East Africa*, 2015, available [online](#).

¹¹⁰ Most analysts of M&A transactions argue that such M&A activity seeks to consolidate a sector or introduce innovations which improve the functioning of a particular sector. A development bank only engaged in M&A

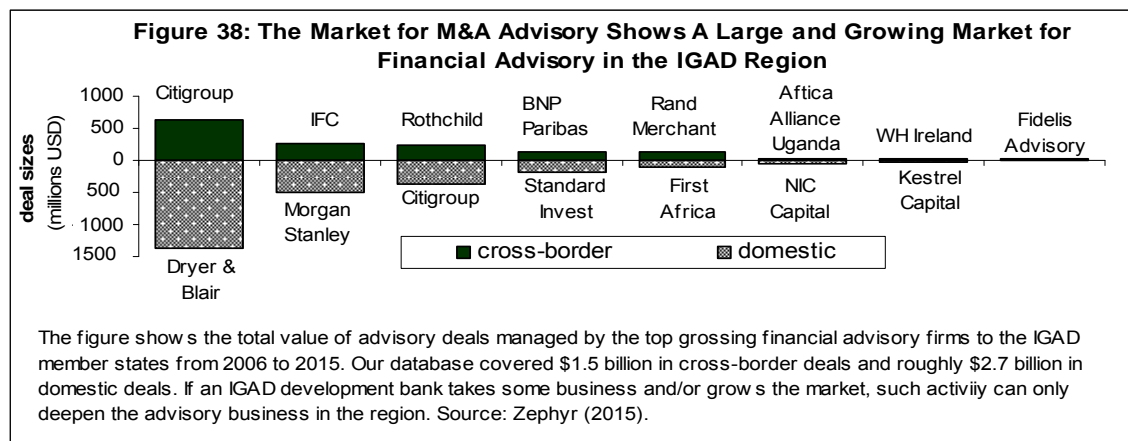


Even a cursory look at the market for M&A financial advisory services illustrates the need for a domestic “native” advisor. Figure 38 shows the largest total mandate sizes managed by various cross-border and domestic M&A financial advisors to IGAD-based target companies. Africa Alliance Uganda looks like one of the only advisors from the IGAD region itself – showing that companies need to look outside the region for financial advice.¹¹¹ The IFC (a part of a multilateral development bank) has served as the second most important financial advisor (as judged by the size of the transactions it advises on). The IFC’s historical role shows that a multilateral bank can add value in the IGAD’s business environment. **The still limited role the IFC (as well as other advisors) play in the region clearly shows the need for another private sector-focused multilateral development organisation.**¹¹²

activity as a way to encourage rationalization (such as merging small and inefficient producers, encouraging cross-border unions within the IGAD, etc.) would have sufficient justification to exist. When considering the role such a bank would play in expanding markets through investment, the justification for such a bank becomes only stronger. The figure we cite comes from the Zephyr database.

¹¹¹ We do not show the data here, but they also needed to go to the US or Europe for legal advice. Freshfields Bruckhaus advised on \$365 million in cross-border transactions. Anjarwalla & Khanna advised on roughly three-quarters of that transaction size since 2006 at \$273 million. A development bank which could offer in-house legal advisory as well would only help grow markets for legal services (and legal experts) within the region.

¹¹² Abdi and Aragie show that existing development banks do not provide the needed expertise and liquidity to provide the kind of resources that Citigroup or the International Finance Corporation (IFC) of the World Bank provide to the IGAD region. See Ali Abdi and Emerta Aragie, Financial Sector Development in the IGAD Region, *The Horn Economic and Social Policy Institute Policy paper 12/2*, 2012, available [online](#).

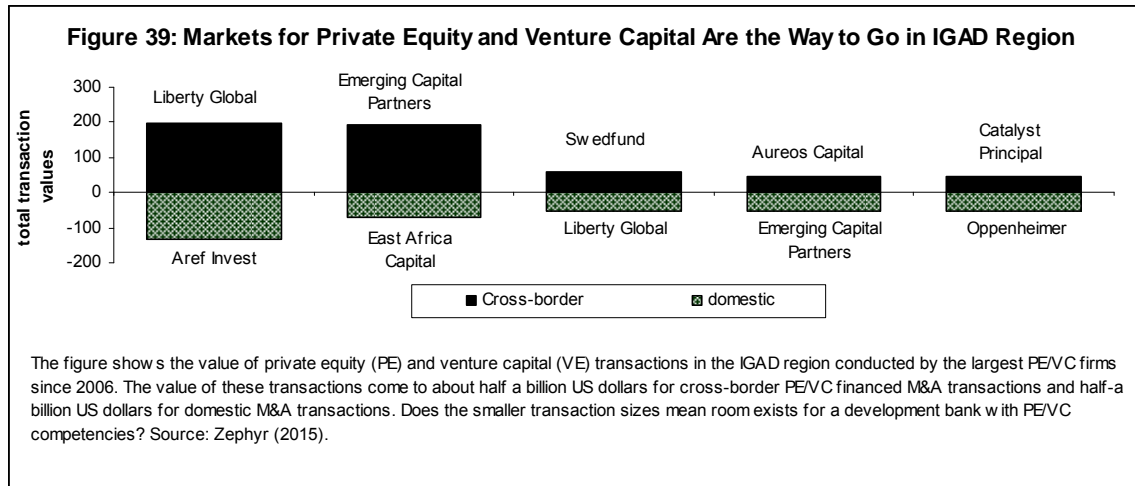


The market for private equity (PE) and venture capital (VC) in the IGAD regions shows even more clearly the need for a multi-lateral development bank which does not focus on old-school lending.¹¹³ Figure 39 shows aggregate amounts invested by the largest PE/VC investors in the IGAD region. First, some of the largest PE/VC investors provide the bulk of such financing. Second, such funding tends to focus on specific countries; and such lending usually comes from outside the region rather than from the IGAD region itself.¹¹⁴ Third, PE/VC finance remains very limited – suggesting that a more risk-loving institution could usefully provide finance in a context where few institutional investors would tread.¹¹⁵

¹¹³ Throughout this working paper, we contrast “old school” risk-averse lending-focused development banking - as conducted by the IBRD (World Bank) and African Development Bank with the more equity-focused, risk neutral approach adopted by the European Investment Bank, EBRD and even firms like East Capital.

¹¹⁴ For another data source looking at PE/VC investment in the region, see Africa Private Equity and Venture Capital Association, *Spotlight on East Africa Private Equity*, 2015, available [online](#). See also E&Y, *Private Equity Roundup: Africa*, 2014, available [online](#).

¹¹⁵ As we argue in the next section, such an “institution” might provide a marketplace where investors may purchase specific securities online. As such, the usual mindset of institutional investors as a “body corporate” need not apply in the internet age. For an application of this logic in the Hong Kong context (with a discussion of the UK and US), see Bryane Michael, Simon Zhao and Dariusz Wojcik, *What Role Can an International Financial Centre's Law Play in the Development of a Sunrise Industry? The Case of Hong Kong and Solar Powered Investments*, *HKU Law Faculty Working Papers*, 2014, available [online](#).



What do we know about the promising sectors for investment by an IGAD development bank? First, we know that **staple industries like retail, wholesale, agriculture and other “primary” sectors will require roughly \$20 billion in investment** in the medium-term in order that all IGAD members will reach the level of Kenya.¹¹⁶ As roughly 10% of the IGAD’s 188 million population enter the “shopping class” (with urban jobs, incomes and mobility needed for the production and consumption of mass consumer goods), the market for consumer goods should generate roughly \$25 billion in revenue per year – a market segment which will develop eventually in all the IGAD member states.¹¹⁷ A development bank could co-invest with regional retailers, provide partners for foreign chains as well as provide finance the development of local retailers and their distribution channels.¹¹⁸ Second, the **process of urbanization will require another \$45 billion in investment** in the medium-term to fund companies which provide automobiles (and associated kit), infrastructure, as well as home and office builders.¹¹⁹ Third, each country will develop competencies in areas

¹¹⁶ This means that these sectors account for roughly half of the \$40 billion in estimated required investment for the IGAD region in general. Such a back-of-the-envelope figure comes from simple linear extrapolation of the value of capital formation in the retail-wholesale sector in the IGAD member states and the level of Kenya’s retail/wholesale sector (in US dollar terms). Countries like Somalia and Eritrea would require significant investment currently prevented by excessive regulation, political risk, high transport and other costs. A development bank, by taking and spreading these risks to investors actively seeking these risks, would be able to provide large scale investments in this sector where private sector investment would fail. For a discussion, see Dave Weatherspoon and Thomas Reardon, *The Rise of Supermarkets in Africa: Implications for Agrifood Systems and the Rural Poor*, *Development Policy Review* 21, 2003.

¹¹⁷ Such a calculation uses historical Gini coefficients (or estimates of these coefficients) to figure out what the “marginal middle class” -- or the addition to household income of a proportion of the population that might be dubbed ‘middle class’ for a change in gross capital formation – might spend. Such spending comes to an average of around \$400 US dollars per year. We do not provide detailed data as we do not want to give the illusion of precision in predicting fundamentally unknowable data in region experiencing on-going political upheaval. For more on this problem, see Lorenzo E. Bernal-Verdugo, Davide Furceri, Dominique Guillaume, *The Dynamic Effect of Social and Political Instability on Output: The Role of Reforms*, *IMF Working Paper* 13/91, 2013, available [online](#).

¹¹⁸ For a discussion of retail development in the region generally, see ATKearney, *The 2014 African Retail Development Index, Seizing Africa’s Retail Opportunities*, 2015, available [online](#).

¹¹⁹ These estimates come from investment data for available urban agglomerations and the data on urbanisation in the IGAD member states for the next 5-10 years. The costs of residential and commercial construction,

we can not yet predict. We hint at the likely evolution of some of these competitive sectors – based on existing “revealed comparative advantage” in the next section.¹²⁰ Yet, at the risk of over-simplification, the likely specialisation in the IGAD will occur as follows. **Kenya and Uganda** will continue to expand their diversified economies, while deepening their mining and manufacturing sectors.¹²¹ **Djibouti**’s shipping and construction sectors would see the fastest growth – particularly financed by Middle East money – if the business environment were better.¹²² **Eritrea** to some degree splits the advantages of Djibouti and Ethiopia, offering the same markets for construction – as well as agriculture.¹²³ The **Sudan’s and South Sudan’s** focus will likely centre on basic market development (the retail and infrastructure we described previously) as well as the transport sector and the linkages forming concomitant with resource extraction.¹²⁴ **Ethiopia** looks poised to develop the broader diversification of Uganda and Kenya, though with a broader focus on agriculture.¹²⁵ **Not any multilateral financial institution can provide money for the development of the**

infrastructure development and similar costs are well-established in most East African markets. These estimates simply follows the procedure used in Michael (2014) by multiplying artificially constructed “average cost per person” real estate costs, infrastructure costs, costs of increased access to automobiles other costs on a “per new urban dweller” basis. For an overview of this urbanization, see Tabukeli Musigi Ruhiiga, Growth of Urban Agglomeration Nodes in Eastern Africa, *Journal of Human Ecology* 41(3): 237-246, 2013. See also Bryane Michael, The Upcoming Four Trillion-Dollar Infrastructure Gold Rush, *Institute for Emerging Market Studies Brief* 14(2), 2014, available [online](#).

¹²⁰ Revealed Comparative Advantage refers to the likely comparative advantage a country possesses in a particular type of tradable good based on large market shares and/or rapid growth in trade in that sector. For more on the way these comparative advantages will evolve in the IGAD context, see William Easterly and Ariell Reshef, African Export Successes: Surprises, Stylized Facts, and Explanations, *NBER Working Paper* 13365, 2010.

¹²¹ The available data suggests Uganda and Kenya would have far more developed economies with more available finance for its manufacturing, upstream and downstream industries. See Pietro Calice, Victor Chando and Sofiane Sekioua, Bank Financing to Small and Medium Enterprises in East Africa: Findings of a Survey in Kenya, Tanzania, Uganda and Zambia, *Africa Development Bank Group Working Paper* 146, 2012, available [online](#).

¹²² For a background of the Middle East’s role in funding this area already, see Ethan Chorin, Articulating a “Dubai Model” of Development: The Case of Djibouti, *Dubai School of Government Working Paper*, 2010, available [online](#). For the geopolitics of heavy industrial investment in Djibouti, see David Styan, Djibouti: Changing Influence in the Horn's Strategic Hub, *The Royal Institute of International Affairs*, 2013, available [online](#).

¹²³ Analysing each IGAD member by its political borders obviously poses more problems than it solves. The Nile Region serves as a unifying area of analysis, regardless of state borders. See Simon Thuo and Phil Riddell, Political Economy Versus Comparative Advantage in the Nile Basin: Short-Term Advantages or Long Term Gain? In Victor Roy Squires, Hugh Martin Milner, Katherine Anne Daniell, *River Basin Management in the Twenty-First Century: Understanding People and Place*, 2014.

¹²⁴ Nour provides a reasonably good (if now outdated) overview of the structure of the Sudanese economy and the likely growth prospects around oil. Yongo-Bure provides a even more dated, but equally comprehensive, view, specifically of South Sudan. See Samia Nour, Assessment of the Impact of Oil: Opportunities and Challenges for Economic Development in Sudan, *African Review of Economics and Finance* 2(2), 2011. See also Benaiah Yongo-Bure, *Economic Development of Southern Sudan*, 2006.

¹²⁵ Many analysts see such growth as the scaling-up of the previously inefficient economic structure – rather than a process of transformation to an industrial or post-industrial economy. For more, see Paul Dorosh, Emily Schmidt and Admasu Shiferaw, Economic Growth without Structural Transformation: The Case of Ethiopia, *Journal of African Development* 14(2), 2012, available [online](#).

basic economic sectors shared by all countries as well the specialised sectors each IGAD member country will develop as it enters into global production and trade chains.¹²⁶

Looking at international trade

What does the IGAD's pattern of international trade tell us about the way various economic sectors will likely evolve as access to finance and institutions improves?¹²⁷ Figures 40 and 41 show salient aspects of international trade within and outside of the IGAD region. Figure 40 shows the irrationality of trade relationships – particularly pertaining to petrol. Several IGAD members import petrol, despite oil-exporters sending oil abroad. Figure 41 shows the major exports of IGAD member states – and their major trading partners. Two points emerge from the data. First, several countries – contrary to both the theory and practice of international trade – export similar products. Ethiopia and the Sudan export gold as their major commodity export. Djibouti and Somalia export animals as their chief export. Lack of specialisation clearly signals lack of the free-trade which makes such specialisation possible. Second, most IGAD traders prefer to trade with the Middle East and Asian economies rather than their own neighbours in the IGAD region. Only Kenya and Uganda have their greatest proportion of trade going to another IGAD member (Uganda and Sudan respectively).¹²⁸

Figure 40: Room Exists in the IGAD for Regional Rationalization of International Trade



The figure shows the "circuit" of trade for petrol in the IGAD region and major bilateral trade relationships in the IGAD region. Kenya and Uganda have historical links to the Indian economy and with each other. Ethiopia ends up sending commodities to poorer neighbours. Instead of each country trading with India and China, why not set up a large buyer and then distribute goods across the IGAD region for cheaper?
Source: UN data (2015).

¹²⁶ Such a teleological view of economic development in the region assumes that each country would follow a natural progression, with access to adequate finance and institutions. The profession does not unanimously share this view. For one view of the IGAD as a region where progressive and under-developed sector co-exist, see Quy-Toan Do and Andrei Levchenko, Comparative Advantage, Demand for External Finance, and Financial Development, *World Bank Policy Research Working Paper No. 3889*, 2006, available [online](#).

¹²⁷ Throughout this working paper, we refer to "access to finance and institutions", as the design of the development bank aims at importing money as well as laws from outside the IGAD region. As we argue, if commerce and investment is conducted according to IGAD members' present institutional arrangements, a viable development will not likely emerge.

¹²⁸ South Sudan, by economic necessity, trades with neighbouring countries. Such trade has not yet caused the gelling of a large-scale, competitive export sector outside of the petrol sector. See Duncan Kayiira, Isaac Sekitoleko, and Kenyi Spencer, *A Study on Competitiveness and Cross Border Trade With Neighbouring Countries*, *African Development Bank monograph*, 2013, available [online](#).

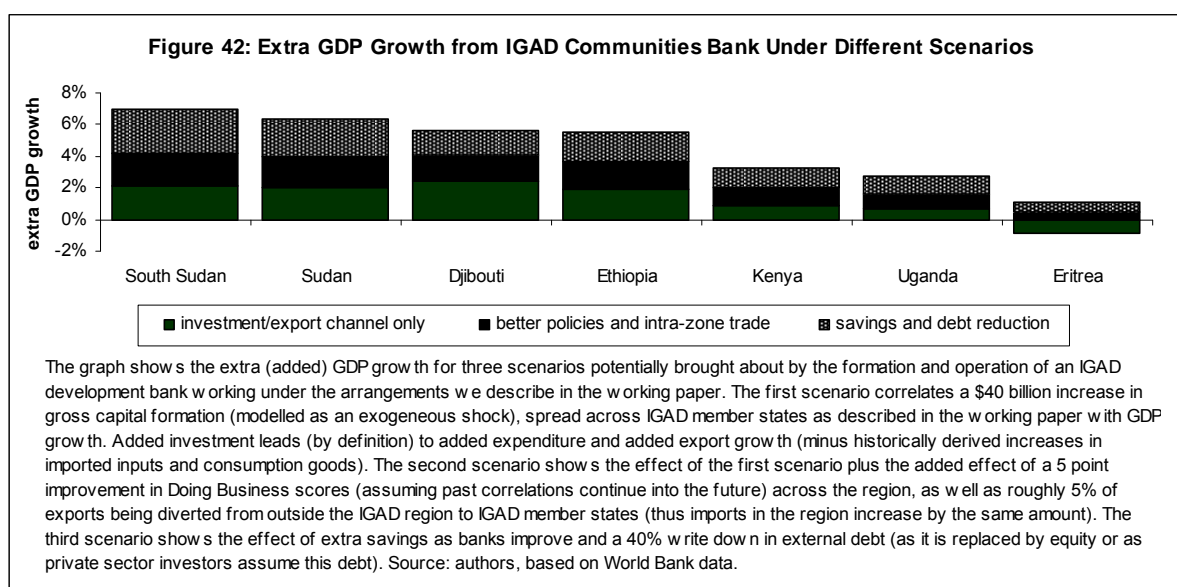
Figure 41: The Comparative (Dis)Advantages of the IGAD Members

Djibouti	Exports (\$37m)	Imports (\$2.8b)
	Animals (32%), Coffee (13%), Bovine (10%), Dried Legumes (5%)	Palm Oil (10%), Wheat (6%), Fertilizers (8%),
	<u>Partners</u> Egypt (32%), India (9%), Oman (8%), Italy (5%).	China (32%), India (14%), Indonesia (10%), Ethiopia (4%).
Eritrea	Exports (\$400m)	Imports (\$365m)
	Gold (90%), Silver (5%), Iron ore (5%)	Raw sugar (12%), Rubber Tires (6%),
	<u>Partners</u> Canada (94%), India (2%)	China (15%), Italy (15%), Egypt (14%), Germany (9%), India (8%).
Ethiopia	Exports (\$3b)	Imports (\$12b)
	Coffee (28%), Oily seeds (15%), vegetables (8%), cut flowers (7%).	Petrol (19%), Delivery trucks (4%), Fertilizers (3%).
	<u>Partners</u> China (11%), Germany (9%), Somalia (9%), Switzerland (7%).	China (21%), Saudi Arabia (14%), India (8%). Kuwait (6%).
Sudan	Exports (\$4.8b)	Imports (\$9.3b)
	Gold (45%), Petrol (37%), Oily Seeds (4%)	Wheat (6%), Raw Sugar (5%), Refined Petrol (5%)
	<u>Partners</u> UAE (35%), China (28%), Japan (8%)	China (21%), India (8%), Egypt (6%)
S. Sudan	Exports (\$580m)	Imports (\$114m)
	Crude Petrol (99%)	Raw sugar (9%), Large construction vehicles (6%), cars (5%)
	<u>Partners</u> China (77%), Japan (22%)	China (30%), Pakistan (23%), Uganda (15%), USA (14%), Japan (10%).
Somalia	Exports (\$170m)	Imports (\$1b)
	Bovine (40%), Sheep/goats (37%), Other oily seeds (5%)	other vegetables (18%), raw sugar (18%), rice (5%).
	<u>Partners</u> Oman (51%), Yemen (28%), India (5%)	Ethiopia (25%), India (19%), Oman (17%), China (10%), Pakistan (6%)
Kenya	Exports (\$4.5b)	Imports (\$14b)
	Tea (21%), Cut flowers (13%), Coffee (6%)	Refined petrol (19%), packed medications (3%)
	<u>Partners</u> Uganda (12%), Tanzania (12%), Netherlands (10%), UK (10%), US (8%)	India (27%), China (20%), S. Africa (5%).
	Exports (\$2.7b)	Imports (\$5.7b)

Uganda	Coffee (17%), Broadcasting equip. (5%), Refined petrol (5%).	Refined petrol (21%), packaged medicines (4%).
	Partners	
	Sudan (15%), Rwanda (9%), Demo. Rep. Congo (9%), Kenya (8%)	India (20%), China (12%), Kenya (10%), UAE (7%), S. Africa (5%).

Economic impact of a development bank

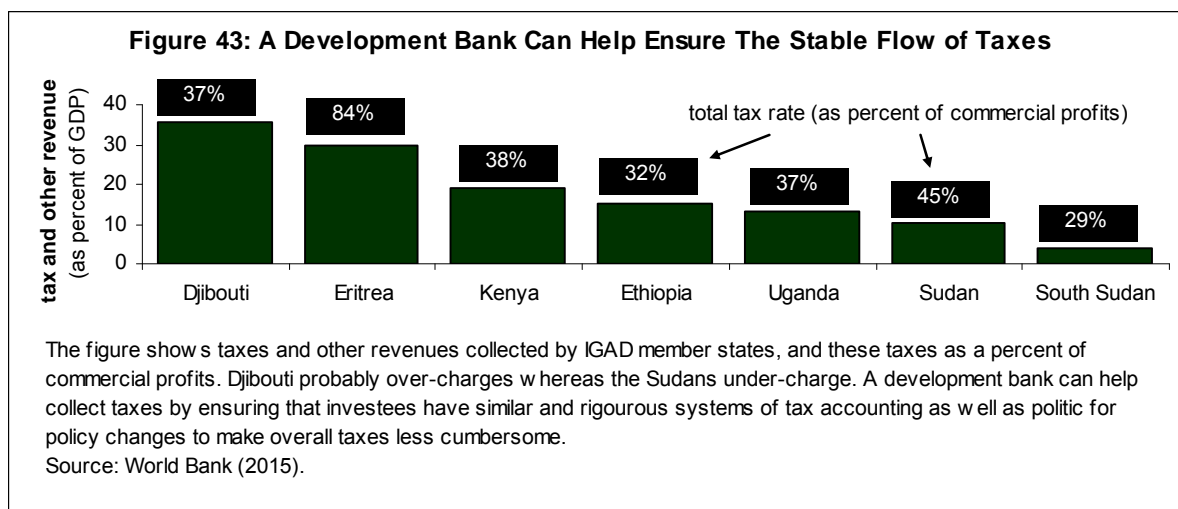
What impact would a development bank's investment in the IGAD region have on GDP growth and future tax revenues? Figure 42 shows the likely effect on GDP growth of an IGAD development bank under three different assumptions about its likely impact. The first scenario shows the effect only of a "shock" of \$40 billion in added investment from such a bank – distributed mostly in the fast growing countries we previous described. Djibouti benefits the most (when only looking at investment and export growth). Such rapid growth probably reflects its importance in regional trade. Interestingly, Eritrea actually shrinks slightly – probably due to the lack of absorption capacity and temporary structural adjustments in the Eritrean economy coming about from such investment. Investments in Uganda's and Kenya's highly diversified economies cause relatively little impact, while Djibouti and the Sudans benefit as transport hubs and due to a low-base effect.



These effects become more pronounced when we look at the effect of better policies and deeper, more sustainable financial markets. The Sudans benefit the most, as their policies most limit their growth. Djibouti and Eritrea also benefit, due to increased intra-IGAD trade. Again, the cumulative effects of the investment plus better policies have less of an effect on Uganda and Kenya – already relative leaders in the region. Under the third scenario, we look at the effect of increased savings (as a percent of GDP), increased bank deposits and a 40% write down in external debt (a debt which presently constrains these governments' ability to offer investments domestically and internationally). **A development bank focused on**

investment, improving the investment climate and helping to deepen financial markets generates almost \$80 billion in additional GDP growth for the whole region.¹²⁹

What about the tax benefits? Figure 43 shows the amount of taxes IGAD member states collect. In countries like Eritrea, the tax burden falls most heavily on companies – with companies reporting that they pay 84% of their profit in taxes. Due to the difficult political environment, South Sudan collects the least. Given that the Sudans, Uganda and Ethiopia collect the least amount in taxes, an IGAD development bank which encourages investee companies to pay taxes will help raise government revenues. Assuming that only companies financed by the development bank pay taxes (namely no tax multiplier effects due to large-scale black markets in these countries), **we can expect roughly an extra \$20 billion in extra taxes paid per year in the IGAD region.**¹³⁰ Such an increase would more than double existing taxes on products.¹³¹



An IGAD development bank can promote tax paying behaviour in three ways. First, the Bank can audit investees (and even possibly suppliers) to ensure they have functioning tax accounting and reporting systems. The right to conduct such inspections can be written into investment contracts (as allowed by law).¹³² Second, the Bank can help educate

¹²⁹ Thus, in our most optimistic scenario – and if investors’ returns match GDP growth rates – investors would realize an 100% growth of their initial \$40 billion investment in the short-to-medium term. As we describe elsewhere in this paper though, as GDP levels per capita catch up with the upper-middle income economies, investors can expect several multiples of their initial investment in returns.

¹³⁰ We describe elsewhere in the paper the effect on existing businesses and on new business formation. We take each countries official tax rate and multiply it by the expected bump in profits of these businesses. As we show in an appendix, we can find this profit rate by using the growth rate of GDP, reported profits in various sectors (as reported in enterprise surveys), and some assumptions on the way costs correspond to revenues for the sectors we look at. We use the official, rather than actual, tax rate – as we assume the financial systems required by the development bank for investees would result in investees paying taxes honestly.

¹³¹ The patchy World Bank data on “taxes on products” shows – after extrapolating the likely taxes paid by Djibouti and Uganda – that these taxes came to around \$10 billion (excluding Somalia and South Sudan).

¹³² An increasing number of contracts in the developed and developing world include anti-bribery and social corporate responsibility related contractual provisions. For the justification of such provisions, see Reuven Avi-Yonah, Taxation, Corporate Social Responsibility and the Business Enterprise, *Comparative Research in Law*

policymakers – using its profits – in areas like public financial management, treasury management, tax collection methods, criminal audit, and other areas which reduce the strain on the IGAD’s public finances.¹³³ Third, Bank officials can organise events and lobby public officials in IGAD member countries to rationalise their tax policies, provide specific wording for amendments to existing law, publish studies and popular media arguments for more business-friendly regulation (tax regulation, licensing and other policies related to access to public services) – without violating citizens’ rights or amenities.¹³⁴ **Such a bank would provide finance for win-win projects which generate profits as well as increased tax revenue in a way which possibly expands the bank’s assets.**¹³⁵

The Location, Structure and Governance of the IGAD Communities Bank

What is the Bank’s Mandate?

The failure of previous development banks requires that the IGAD development bank’s mandate differ significantly from previous models. A strictly developmental mission, as previously described, opens the door to potentially destructive politically motivated projects in a highly politicised region. As such, the bank’s mandate should achieve three objectives. First, the mandate should be vague enough to allow the bank to pursue all kinds of activities – whether strictly profit-focused or focused on creating the public goods needed to raise the profitability of all companies in the region.¹³⁶ Second, the Bank should crowd-in other investments – particularly by investors outside the IGAD region -- by investing larger amounts and syndicating deals. Such investment would thus solve investment co-ordination failures where political, economic and other risks keep money away. Third, by trading money for influence, the Bank can encourage member governments to adopt pro-community policies.

& *Political Economy Research Paper 19/2009*, 2009, available [online](#). For a discussion of these contractual provisions, see Andreas Ruhmkorf, *Corporate Social Responsibility, Private Law and Global Supply Chains*, 2015.

¹³³ EU-style Twinning provides a natural model, where Bank staff can sit in IGAD ministries of finance (or other relevant spending department) to work on specific assignments – like reducing expenditure by \$20 million while keeping the same level of amenity. In theory, if such a service becomes successful enough, the Bank can spin-out the advisory service as a private company. Again, China leads by example. See Paul Guest and Dylan Sutherland, *The Impact of Business Group Affiliation on Performance: Evidence from China's ‘National Champions’*, *Cambridge Journal of Economics* 34(4), 2010.

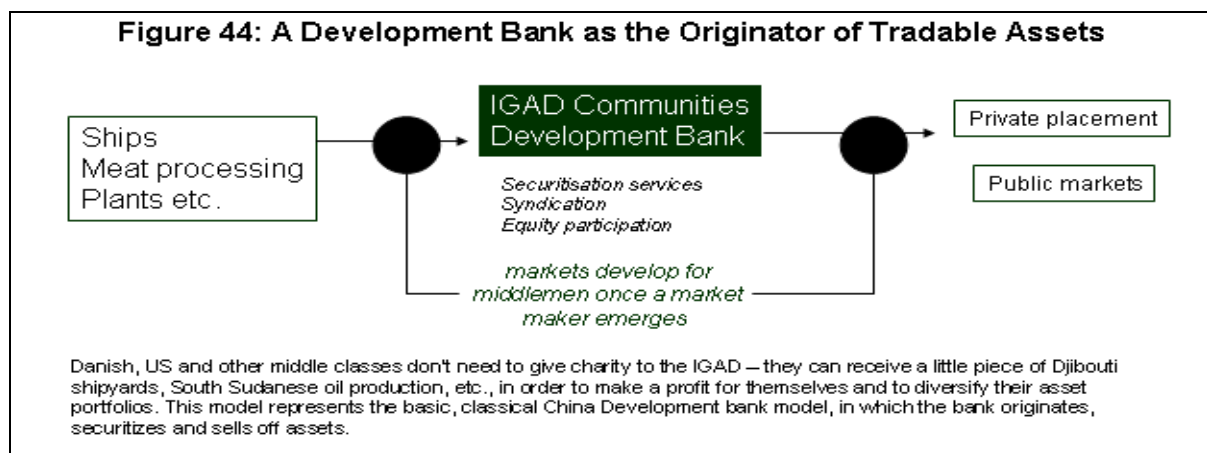
¹³⁴ An international development bank with an express mandate to interfere in the domestic politics of its member states (albeit within the narrow sphere of investment and business policy) simply makes explicit existing practices by the World Bank, EBRD, Africa Development Bank and others which attempt to push their view of policy on member countries. See John Marangos, *What Happened to the Washington Consensus? The Evolution of International Development Policy*, *The Journal of Socio-Economics* 38(1), 2009.

¹³⁵ The Bank would necessarily follow national law and policy. The Bank is absolutely not designed to favor investors or investments at the expense of citizens or consumer rights groups. Indeed, another strike against traditional development banking comes from its poor record in helping to protect citizens in borrowing countries. For a description, see Sanae Fujita, *The World Bank, Asian Development Bank and Human Rights*, 2013.

¹³⁶ We showed in the previous section that no correlation exists between a development bank’s focus, its impact and/or profitability. For a discussion of how companies use “social” investments to internalize positive externalities, see Patricia Crifo and Vanina Forget, *The Economics of Corporate Social Responsibility: A Survey*, *Cahier de Recherche-21*, 2012.

The Bank’s mandate should be to “capture the long-term monetary value of externalities in the IGAD region.”¹³⁷

The operations of the China Development Bank – or the more profit-focused corporate social responsibility programmes run by large companies world-wide – provide a new and useful model for a 21st century development bank. Figure 44 shows the way an IGAD development bank should function. The observant reader will note the parallels between this figure and the figure used to describe the China Development Bank earlier in this working paper. The bank would hold and sell shares to third-parties like a conventional universal bank/broker-dealer.¹³⁸ Such a structure will allow for the pooling and transfer abroad of risks traditionally shouldered by IGAD governments and citizens themselves.¹³⁹ **By creating a subsidised version of bulge bracket banks like JP Morgan or Deutsche Bank, the IGAD can tap the same kinds of expertise and capabilities, without the high cost.**¹⁴⁰



Despite such a broad mandate, several restrictions should be in place to ensure the Bank’s long-term viability. First, and in line with the general mandate described above, the Bank

¹³⁷ Such a mandate corresponds with the broad need for government lending. Such an objective naturally prevents potentially useful investment which the bank can not eventually internalize. Yet, numerous other development banks and government agencies can serve this purpose. For a discussion on the mandates behind government lending, see Veljko Fotak, *Why Do Governments Lend? Evidence from the Corporate Loan Market*, 2014, available [online](#).

¹³⁸ See Alan Morrison, Universal Banks, In Allen Berger, Philip Molyneux, John Wilson, *Oxford Handbook of Banking*, 2015.

¹³⁹ Some scholars like Geyfman and Yeager would disagree, noting that conglomerate/universal banks do not always provide a useful mechanism for aggregating and ultimately reducing risks. Demirguc-Kunt and Huizing might highlight the risk of increased fragility involved in designing such a banking structure which holds commercial and investment risks. See Victoria Geyfman and Timothy Yeager, On the Riskiness of Universal Banking: Evidence from Banks in the Investment Banking Business Pre- and Post-GLBA, *Journal of Money, Credit and Banking* 41(8)2009. See also Asli Demirguc-Kunt and Harry Huizing, Bank Activity and Funding Strategies: The Impact on Risk and Returns, *Journal of Financial Economics* 98(3), 2010.

¹⁴⁰ Despite their supposed private sector roots, most bulge bracket banks have their antecedents in government support. See Onnig Dombalagian, Requiem for the Bulge Bracket?: Revisiting Investment Bank Regulation, *Indiana Law Journal* 85(3), 2010, available [online](#).

should invest in assets in the IGAD region or affecting any part of the IGAD region.¹⁴¹ Thus, investment in a US high-tech venture where IGAD member country citizens can acquire know-how when they return to the region would qualify for IGAD development bank investment. Second, all investments would go through normal bankruptcy and resolution just like any private sector financial institution.¹⁴² The bank itself would have certain immunities and privileges, though the bank could face dissolution if managed poorly.¹⁴³ Third, the bank could not represent the only investor in any IGAD state-owned enterprises (though they can engage in joint investments). Such a restriction ensures IGAD member governments do not use the Bank to fund inefficient state owned enterprises and use the bank to bridge public deficit gaps. Fourth, the bank would have very strict requirements to publish deliberations, accounts and other information which allows investors to take informed decisions. In exchange for exemptions from certain types of banking and securities regulation, the bank would offer wide disclosures to allow investors to accurately assess risks.¹⁴⁴

Such a mandate relies on regulators in the IGAD and in the OECD member countries providing special privileges to such a bank. First, regulators in the OECD (particularly the US and UK) may need to provide access for the bank's relatively risky securities to their securities markets. Regulators have talked about removing safe harbour, private placement and other kinds of provisions on the offer of securities in key financial markets which the Development Bank can currently use to bypass much of the onerous securities regulations in place in these economies.¹⁴⁵ Some provisions like the US JOBS Act allow for the limited offer of certain kinds of securities -- even online.¹⁴⁶

Second, the IGAD and multinational development institutions (like the World Bank and IMF) would need to agree to give the bank powers to negotiate for the substitution of debt for equity or other assets relatively shortly after the Bank starts functioning. Such replacement will quickly create a market for the Bank's securities, encourage the Bank to originate such securities, and help inspire market confidence in these assets. Multilateral lenders would need

¹⁴¹ Such a geographical focus is not foreign to development banks and financial institutions, as most of them deal with very specific issues and/or geographies. We do not address the issue of geographical concentration in this paper. If the development bank consistently only invests in one area – such as assets only in Nairobi – the Bank's Board of Directors should deal with this issue as a political/operational issue.

¹⁴² Such a focus would encourage investors to correctly price risk, after accounting for risk taking, transfer or attenuation by the Development Bank. For a discussion of how the failure to write off loans has severely compromised the mission of the African Development Bank, see US General Accounting Office, *Multilateral Development Banks: Financial Condition of the African Development Bank*, 1995, available [online](#).

¹⁴³ Lack of precedent exists for the winding-up international organisations of any kind, as these organisations tend to exist beyond their useful lives. While the bank itself can not be dissolved if any investment goes bad, the investment vehicle used can be dissolved, wound-up, and sued in court just like any company.

¹⁴⁴ The issue of whether disclosure or regulation serves as the best method of disciplining markets remains on open question. See Augustin Landier and David Thesmar, *Regulating Systemic Risk through Transparency: Tradeoffs in Making Data Public*, *NBER Working Paper 17664*, 2011, available [online](#).

¹⁴⁵ See Stijn Claessens and Laura Kodres, *The Regulatory Responses to the Global Financial Crisis: Some Uncomfortable Questions*, *IMF Working Paper 14/46*, 2014, available [online](#).

¹⁴⁶ Michael and colleagues describe the legal changes needed to adopt a more flexible approach to offering securities in innovative companies online and to the general public. See Bryane Michael, Simon Zhao, and Dariusz Wojcik, *What Role Can an International Financial Centre's Law Play in the Development of a Sunrise Industry? The Case of Hong Kong and Solar Powered Investments*, *University of Hong Kong Faculty of Law Research Paper No. 2014/034*, available [online](#).

to develop policies for buying risky assets, procedures for appointing staff to deal with oversight and possible resolution/liquidation of unprofitable assets. **As such, an IGAD could help foster adaptive change in the Bretton Woods institutions themselves.**

Bank's fit in current institutions

The IGAD represents a proto-trade and political union, which provides the initial framework for the development of a multilateral bank. The IGAD also clearly represents the basis for the creation of supra-national law and organisations in the region. The IGAD has served as the forum for concluding the Protocol on the Establishment of a Conflict Early Warning and Response Mechanism for IGAD Member States, the IGAD Convention on Mutual Legal Assistance in Criminal Matters and the IGAD Extradition Convention.¹⁴⁷ Specific organisations like the IGAD Climate Prediction and Application Centre and the IGAD Centre for Pastoral Areas and Livestock Development specifically arise from the competencies vested by the IGAD member states in the IGAD itself.¹⁴⁸ Thus, the IGAD Agreement provides sufficient foundations (with some minor amendments) for a development bank.

The IGAD Communities Development Bank should be set up as a sister organisation to the IGAD Secretariat. Figure 45 – and Appendix III -- describe exactly how an IGAD Communities Bank should be constituted under existing legal arrangements. The IGAD would be sister organisation of the IGAD – and accountable to the IGAD. However, the Bank would have official independence from the IGAD. Such an arrangement would encourage greater reporting by the Bank as well as to the IGAD Secretariat.¹⁴⁹ Independence would insulate the Bank from the IGAD's politics (and politicians).¹⁵⁰ **Such a quasi-formal relationship between the two organisations would also encourage the use of the IGAD development bank to use some of its profits to fund further IGAD operations.**¹⁵¹

¹⁴⁷ See IGAD, Legal Documents, available [online](#).

¹⁴⁸ See IGAD, Specialised Institutes, available [online](#).

¹⁴⁹ The IGAD publishes only one Annual Report on their website (from 2009). Presumably, the lack of other reports stems from lack of funding (of the \$6 million dollars in funding reported, the IGAD Member States themselves only put in \$2 million).

¹⁵⁰ Given the political issues tackled by the IGAD, many of persons the IGAD website reports on are ambassadors and other diplomats. Investors are famous for becoming very nervous when politicians and diplomats start inferring in investment decisions. The tie to the IGAD can help resolve political problems which may stunt profitability, without importing the politics that would stunt such profitability in the first place.

¹⁵¹ The availability of these funds will depend on IGAD member states' investments in the investment vehicles offered and any share capital in the development bank itself. The IGAD member states and/or Secretariat would have no more rights over residual cash flows (profits) than any other investor – after accounting for their fixed 15% share of all profits.

Figure 45: The Legal Basis For a Development Bank in the IGAD Agreement and Next Steps

The IGAD – at its heart – is a talk-shop of presidents, ministers of foreign affairs and ambassadors of the IGAD member countries (arts. 9-11). The IGAD has a Secretariat – but does not comprise a regional authority as we commonly think of it. Nothing in the organisation’s aims and objectives (article 7) or areas of cooperation (article 13A) refers to anything close to regional cooperation of this kind. The organisation currently focuses mainly on agriculture. Yet, a regional development bank certainly fits into goals 7(a), 7(b) and 7(c) --- talking about macroeconomic harmonization, the creation of a common market, and a common investment market respectively. Provision 7(c) probably provides the best basis for a regional development bank. Yet, as we argue in Appendix III, Member States should amend the IGAD Agreement to specifically acknowledge the Bank, set up the authority for a non-political Executive Director (or President), and describe the relations between the Secretariat and its independent sister institution.

No necessary conflict needs exist between an IGAD Communities Development Bank and other institutions – due to its novel design and focus. The East African Development Bank, for example, serves two IGAD members (Kenya and Uganda). And similar to our proposal, that bank allows private sector banks to participate as shareholders.¹⁵² As previously mentioned, the Africa Development Bank and the World Bank’s International Finance Corporation (IFC) have increasingly worked with private sector organisations.¹⁵³ Yet, they do not have the mandate to raise money from outside investors, or use such investment to import knowledge and expertise.¹⁵⁴ **Thus, the IGAD’s function to provide a bridge with outside capital markets represents a more classical and effective form of banking than traditional development banking.**

Moreover, no one IGAD member alone has the political system needed to ensure the viability of such a development bank. Figure 46 shows the structural political situation in each IGAD member state. As shown, one single party (with a key politician at its head) rules many of the IGAD states.¹⁵⁵ The strong possibility for arbitrary and capricious state interference thus exists.¹⁵⁶ As the EU experience shows, a supra-national organisation encourages collective

¹⁵² The East Africa Development Bank claims that SBIC – Africa Holdings, the Commercial Bank of Africa, Nordea Bank Sweden, Standard Chartered, and Barclays Bank represent “Class B” shareholders.

¹⁵³ The AfDB’s website boasts finance of roughly US\$2.25 billion in 48 new projects in 2014. See AfDB, Selected Projects, available [online](#).

¹⁵⁴ Article 2(1) of the [Agreement Establishing the African Development Bank](#) (ADB) defines the Bank’s functions as engaging in investment, not intermediating capital.

¹⁵⁵ We do not want to criticise or cast aspersions on these leaders. We only wish to provide a realistic assessment needed to take investment decisions. In that light, we refer readers wanting to know more about national politics in the region to Chege, Political Parties in East Africa: Diversity in Political Party Systems, *IDEA manuscript*, 2007.

¹⁵⁶ We do not claim here that these governments engage in such behaviour – only that institutional incentives and structure allow for the exercise of such power. Indeed, many analysts note the lack of grassroots support for these political parties and senior government officials as a stumbling block in policy implementation. See Pa Kasaija, Regional Integration: A Political Federation of the East African Countries? *African Journal of International Affairs* 7(1-2), 2004.

beneficial rules, by balancing the interests of several states.¹⁵⁷ In that way, no one charismatic leader or national party can usurp the supra-national organisation for its own nationalistic ends.¹⁵⁸ Any structure which encourages cooperation between IGAD countries can thus only inculcate the experience of give-and-take democracy across the region. Building cooperation in the region based on economic interests will provide a far stronger foundation for future union than simply political statements and diplomatic meetings.¹⁵⁹ **Yet, while the IGAD Communities Development Bank may lobby for pro-business policies, the Bank shall not interfere in the domestic politics of any IGAD Member.**¹⁶⁰

Figure 46: The Bank Must Balance the IGAD's Mostly "Strong Man" States

IGAD Member	Description
Djibouti	One party dominant state with the People's Rally for Progress currently in power.
Eritrea	There are no legal Eritrean political parties, as Eritrea is ruled by a single political movement, the People's Front for Democracy and Justice.
Ethiopia	In theory, a multiparty parliament reigns. In practice, the Ethiopian People's Revolutionary Democratic Front and its allies won all 547 seats and the media reports the oppression of minority parties.
Sudan	Many think that the National Islamic Front (NIF) created the National Congress as its legal front. President al-Bashir continues to hold power over parliament and the executive.
South Sudan	Fledgling democracy.
Somalia	Fledgling democracy.
Kenya	Kenya's period of single party, strong man politics ended around 1990. Kenya is now a vibrant multi-party democracy (albeit with significant problems of corruption).
Uganda	The country has been making the transition from an "authoritarian" democracy (according to several democracy indices) to a hybrid, more open and free democracy. The media reports cases of the president's intimidation of rivals (including the arrest of a leading opposition candidate).

Sources: Various political reports. See authors for details.

¹⁵⁷ As even the experience of the European Central Bank (or the European Investment Bank for that matter) shows, even technocratic organisations are susceptible to political influences. Even if classical politicians don't influence policy, vested interests do. See Ivan Lesay, *Discoursing Development: The Case of the European Investment Bank*, *Nova Economics* 23(2), 2013. See also Eric Monnet, Stefano Pagliari and Shahin Vallee, *Europe between Financial Repression and Regulatory Capture*, 2014, available [online](#).

¹⁵⁸ Scholars have pointed to such interests as hindering regional integration in the past. Even as early as 1978, Mugomba described how national politics led to the failure of the pre-IGAD cooperation. As such, an organisation focused on economic interests, rather than political views, seems to provide far more stable foundation for regional cooperation. See Agrippah Mugomba, *Regional Organisations and African Underdevelopment: the Collapse of the East African Community*, *The Journal of Modern African Studies* 16(2), 1978.

¹⁵⁹ For a more detailed analysis, focusing on Kenya as one of the powerhouses of the region, see Leonard Wanyama, *The Economic Diplomacy of Kenya's Regional Interests*, *South African Institute of International Affairs (SAIIA) Occasional Papers* 137, 2013, available [online](#).

¹⁶⁰ Of course, the Bank's charter would forbid the payment to lobbyists of any kind in third-party countries (like the US or EU). For a description of the way national governments in the IGAD region pay lobbyists in Washington, see Aaron Kessler and Wanjohi Kabukuru, *Shadow Diplomacy: African Nations Bypass Embassies, Tap Lobbyists*, *100 Reporters Online*, 2013, available [online](#).

What back-up plan exists in case the IGAD is unwilling or unable to provide the platform to set up such a development bank? How can IGAD Member States proceed without the help of the IGAD Secretariat and other IGAD organs? Three other scenarios may arise. First, the presidents (the sources of the authority for the IGAD) may meet to establish the development bank outside the IGAD Secretariat. Indeed, as we describe in Appendix III, the IGAD has no authority – and IGAD Member States sign Protocols and other treaties on a multi-lateral basis.¹⁶¹ The development bank would thus emerge from yet another regional agreement.¹⁶² Second, a sub-group of member states may establish the development bank by themselves. In theory, nothing prevents the attachment of the development bank to the IGAD Secretariat – with some countries abstaining from participation in the bank.¹⁶³ The Bank would then invest in IGAD members who are not a party to such an agreement on terms it negotiates with them. Yet, incentives for these states to provide favourable policies for the Bank would be significantly dulled.¹⁶⁴ Third, a single country could spearhead the effort – and the Bank together with the host government could subsequently engage in bilateral or multilateral diplomacy in order to access other IGAD markets (much as China did with the Asian Infrastructure Investment Bank). Again, such a structure would very strongly dull incentives for mutual cooperation and profit-sharing – while providing disproportionate gains to the host country.¹⁶⁵

Where should the Bank locate?

London represents the best location for the Bank. As we described previously, business conditions are too bad in any particular IGAD member state to host the kind of bank needed to tackle the investment challenges faced by IGAD countries.¹⁶⁶ The IGAD bank needs to tap global capital markets, so should locate in one of its most successful financial centres.¹⁶⁷ A location in London would give the Bank access to British law and to English courts (which have far more experience settling international finance-related cases than any court in the

¹⁶¹ Protocols represent the main way that IGAD countries use the IGAD as a reason for signing agreements with each other. Yet, legal authority derives from the heads of the state, and not from any derived powers vested in the IGAD itself.

¹⁶² For a detailed description of such agreement-making, see Ulf Terlinden, IGAD – Paper Tiger facing Gigantic Tasks, 2004, *Report on International Development Cooperation*, available [online](#).

¹⁶³ For an example of the legal document that member states consider signing to join such a bank, see Australian Senate Economics Legislation Committee, *Inquiry into the Asian Infrastructure Investment Bank Bill 2015 [Provisions]*, 2015, available [online](#).

¹⁶⁴ Only the profit motive would incentivise governments to suspend their self-serving tight restrictions on business, trade and investment. For a description of the long-standing antipathy toward foreign investment in the region, see Todd Moss and Vijaya Ramachandran, Foreign Investment and Economic Development: Evidence from Private Firms in East Africa, *Centre for Global Development Brief December*, 2005, available [online](#).

¹⁶⁵ For a discussion of these issues in the formation of the Asian Infrastructure Investment Bank, see Eiichi Sekine, Aims and Prospects of the Asian Infrastructure Investment Bank Proposed by China, *Nomura Journal of Capital Markets* 6(4), 2015, available [online](#).

¹⁶⁶ As a reminder, we presented data on corruption and rule of law levels, as well as data on contract enforcement, minority investor protections, the quality of statistical information and other areas of law needed for the functioning of a successful development bank.

¹⁶⁷ Most surveys place London in the top 3 international financial centres. See Z/Yen, *The Competitive Position of London as a Global Financial Centre*, 2005, available [online](#).

IGAD region).¹⁶⁸ Figure 47 other pros (and cons) for locating in London. Many regional and international organisations locate in areas outside of their member countries. OPEC represents one of the most well-known (located in Vienna).¹⁶⁹ The EBRD works on Eastern Europe – yet is located in London. If a bank focused on Central and Eastern Europe can settle in London, why can't one focused on the IGAD?

Figure 47: Pros and Cons of Locating in London

Pros	
Access to global capital markets	Free-ride off of local universities and think-tanks to raise the IGAD's global visibility
Insulation from domestic/regional political pressures	Proximity to major donors (to look for synergies between aid and development finance)
Access and use of best banking and investment law	Avoid debate about which IGAD member to locate the bank in
Can see how European Communities and their institutions have worked	Incentive to build infrastructure like airports and roads (to reach London)
Access to cheap capital and labour	Credibility with investors – both foreign and domestic
Provides incentives to “bring the Bank home”	Protection from corruption under UK's bribery laws
Cons	
Potential lack of feeling of ownership	Extra cost of moving the Bank later
Increases operating expenses	Potential active attempts to undermine the Bank's authority at home in the IGAD
Potentially lack of touch with projects	Creates feuds over the distribution of benefits

Locating the bank outside the IGAD may provide motivation for policy changes needed to bring the Bank to one of the IGAD Member States in the future. As previously mentioned, the Bank should have an explicit mandate to provide research and encourage policymakers in the IGAD region to adopt measures to adopt statutes and regulations which “encourage Doing Business.”¹⁷⁰ If the business environment improves to the point where a successful IGAD development bank can function in the region, the IGAD's Board of Directors will have no further reason to keep the bank in London. As such, the Bank should have the explicit goal of moving to the IGAD region once “business conditions allowed for the successful operation of the Bank and business environment more generally.”¹⁷¹ The goal of moving the Bank serves as a performance-based goal which would bring employment, capital and prestige to the IGAD region – as a way to encourage policymakers to do the right thing.

¹⁶⁸ We make a distinction between the legal traditions of the UK and the actual application and enforcement of laws in England. Wales and Scotland has quasi-independence to manage their judiciaries. London is located in England, so English law would apply in cases where a Kingdom wide act was not in force.

¹⁶⁹ The African Development Bank and Islamic Development Bank are located in the regions they serve. Yet they do not have the same stature as even the EBRD or the bulge bracket banks which locate there.

¹⁷⁰ We chose the phrase “Doing Business” explicitly in reference to the World Bank's regular surveys on business environments world-wide. Such a phrase would likely enter any organic documents creating the Bank – as a measure already exists to assess the Bank's performance in this area.

¹⁷¹ Again, this is likely wording in the founding documentation.

The success of the Bank in part hinges on diplomatic immunity for staff and for its investments within the IGAD and in the host state.¹⁷² Diplomatic immunity for a development bank does not represent a departure from standard practice – as the UK has already allowed for the immunity of the EBRD.¹⁷³ The IGAD Agreement already allows for immunities of IGAD personnel working in headquarters and in any IGAD member state.¹⁷⁴ International contracts already primarily use English law. Thus, the application, use and enforcement of certain provisions in English investment law in the conduct of Bank business does not represent something completely foreign.¹⁷⁵ **Without protections and immunities of IGAD bank investments and property from the national laws of IGAD member states, any development bank project will likely fail.**

What happens if London refuses to extend privileges to yet another multilateral development institution? The IGAD can approach other financial centres as it looks for the best package of amenities on offer (land, diplomatic privileges, etc.). Figure 48 shows some possible financial centres the IGAD can approach. Fierce competition between financial centres encourages demand for a multilateral bank which can bring in \$40 billion in assets under management and generate hundreds of white-collar jobs.¹⁷⁶ The IGAD would need to develop a consensus among other nations for the establishment and operation of such a multilateral bank. Given the debt burden and on-going humanitarian crises in the region – in part caused by the lack of functioning market economies – countries besides the host country could well recognise and work with an IGAD development bank.¹⁷⁷ The raft of new development banks created under Chinese initiative shows that an IGAD development bank could ride the wave of recent popularity for this organisational form.¹⁷⁸

¹⁷² Naturally, property does not receive “diplomatic immunity” (and we use this phrase to make the idea as vivid as possible). Investments and property would receive exemptions from certain types of regulations – which we describe later in this paper.

¹⁷³ The EBRD’s founding documentation and the Act granting privileges to that bank serve as potentially useful models. See EBRD, *Basic documents of the European Bank for Reconstruction and Development*, 1991, available [online](#). See also UK Parliament, *The European Bank for Reconstruction and Development (Immunities and Privileges) Order 1991, Act 757 of 1991*, available [online](#).

¹⁷⁴ Article 5 provides for such immunities and privileges in the host country (Djibouti). Article 6 provides for such immunities in the other IGAD Member States.

¹⁷⁵ Indeed (and to raise a political sensitive issue), many IGAD member states -- like the Sudans, Kenya, Uganda, and parts of Somalia -- already have a background in English law from colonial times.

¹⁷⁶ For a recent recap of this competition, see Andrew Rose and Mark Spiegel, *Offshore Financial Centres: Parasites or Symbionts?*, *The Economic Journal* 117(523), 2007. One of these financial centres may want to create a niche in IGAD finance. For a discussion of the creation of a recently popular niche area of global finance (Islamic finance), see David Bassens, Ben Derudder and Frank Witlox, *Searching for the Mecca of Finance: Islamic Financial Services and the World City Network*, *Area* 42(1), 2010.

¹⁷⁷ Some international organisations receiving popular support from many nations include those regulating finance internationally. For the law of these organisations and their place in the international jurisprudence, see David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*,

Texas International Law Journal 33(281), 1998.

¹⁷⁸ For a description and analysis, see Helmut Reisen, *Alternative Multilateral Development Banks and Global Financial Governance*, *International Organisations Research Journal* 10(2), 2015, available [online](#). See also Rajiv Biswas, *Reshaping the Financial Architecture for Development Finance: The New Development Banks*, *LSE Global South Unit Working Paper 2/2015*, 2015, available [online](#).

Figure 48: Competition Among International Financial Centres Means Someone Will Probably Want an IGAD Development Bank

Rank	Centre	Country	Rank	Centre	Country
1	London	UK	19	Luxemburg	Luxemburg
2	New York	USA	11	Doha	Qatar
3	Hong Kong	China	44	Casablanca	Morocco
4	Singapore	Singapore	47	Istanbul	Turkey
5	Tokyo	Japan	50	Bahrain	Bahrain
6	Seoul	S. Korea	53	Jersey	UK
7	Zurich	Switzerland	54	Guernsey	UK
14	Frankfurt	Germany	56	Gibraltar	UK
16	Dubai	UAE	58	Isle of Man	UK

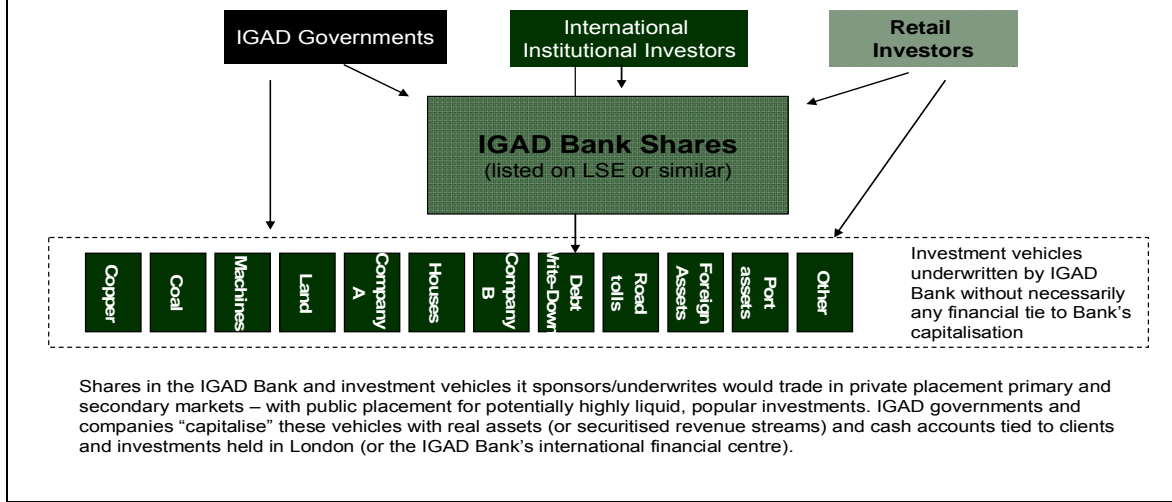
The figure shows the Z/Yen rankings of international financial centres. We have selected only some examples, leaving out cities unlikely to host an IGAD Bank (like Toronto or Osaka) or cities in the same country as a higher ranked financial centre.

What investment products and services will the Bank offer?

The Bank's products will look far more like a conventional bank than the classical development bank. Figure 49 shows the types of investments that its major shareholders (principally the IGAD governments and international institutional investors) will hold. These investors may hold shares in the Bank itself (and receive votes and potentially Board positions which we describe later in this working paper). Much of the Bank's work would consist of underwriting (creating) investment vehicles – providing both domestic citizens/residents and foreign investors access to assets located in the IGAD region. Another part of that work consists of making markets and providing a platform for the trade of securities with underlying assets in the IGAD countries.¹⁷⁹ Such market making represents a standard business practice already underway in Africa – as private funds like East Capital provide many of these services. **Yet, by providing an online trading platform (with appropriate disclaimers and attention to regulatory requirements in the jurisdictions where these securities are sold), the Bank can offer something too risky for normal banks and fund houses to offer.**

¹⁷⁹ Such market making falls into the Bank's broad mandate to "capture the financial value of externalities" as creating more liquid markets for the securities it creates and sells can only enhance the Bank's long-term profitability, reduce liquidity risk, and so forth.

Figure 49: Financial Products Offered By the IGAD Communities Development Bank



Real estate represents one obvious hard asset which IGAD governments can offer in order to capitalise their accounts at the Bank.¹⁸⁰ Several African capitals report booming property prices – suggesting that the offer of residential and/or commercial real estate can serve one hard asset tradable by the development bank.¹⁸¹ **Even conservative valuations of real estate at around \$150 per meter and average sizes of 50 meters gives an estimated market size of residential and commercial real estate valued at around \$218 billion.**¹⁸² Clearly, if IGAD member states could offer (and the development bank could clear) this amount of property, such funds would provide more than adequate value and collateral to raise cash for other investment (like infrastructure, education and so forth).¹⁸³ The agglomeration of rental

¹⁸⁰ IGAD governments or businesses would list securities giving ownership or cash flow rights over properties which they own. Once these assets are prices and sold, funds can be deposited in their account at the Bank for the purchase of assets, collection of dividends (payments) or even cash remitted back to the treasury. Indeed, such trading may provide stronger incentives to create and keep an accurate land registry.

¹⁸¹ For a recent description in the Sudan, see May Ali, Khartoum's Real Estate Prices Are Becoming Unaffordable, *Al-Araby*, 2015, available [online](#). For Somalia, see Kevin Mwanza, Could Somalia Be The Best Real Estate Investment In The World? *AFK Insider*, 2015, available [online](#).

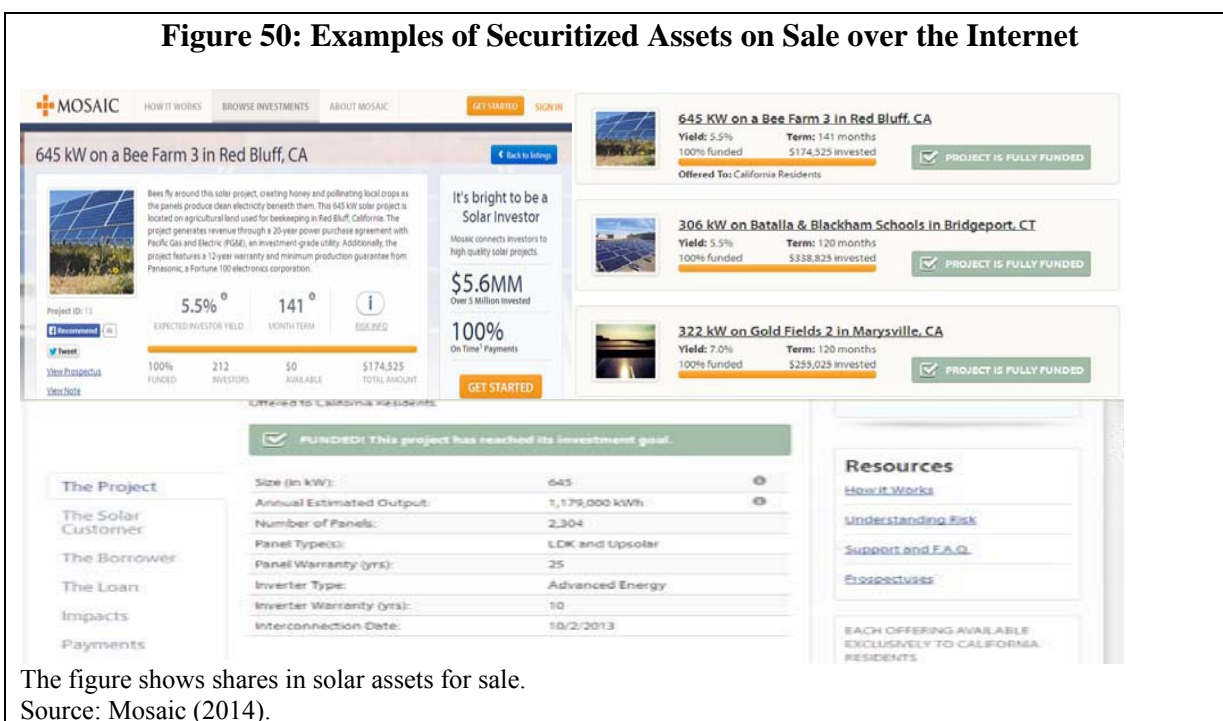
¹⁸² We arrive at this figure by finding the total population of the largest cities in the IGAD region (about 90 million), multiplied by the estimated residential population needed for this population (around 20 million properties) and commercial real estate (of roughly 9 million properties). We multiply these two numbers by the average price per square meter and the average number of square meters per property to arrive at the estimate presented. We found these numbers by looking at real estate offer websites and news articles for all the IGAD countries, and using the numbers we found as the basis for the regional averages we provide. We do not attempt to disaggregate by country – so that we do not stray too far from the main point of this working paper (to describe a development bank and not provide very detailed estimates of the markets it works in).

¹⁸³ Real estate – and indeed other types – of securitisation represent such a new market and legal innovation for Africa that only South Africa has attempted to grow local securitisation markets. For an overview of Africa's progress, see Noel Edison, *Securitisation in Emerging Markets*, In Rick Watson, Jeremy Carter, *Asset Securitisation and Synthetic Structures: Innovations in the European Credit Markets*, 2006.

income, regular mortgage payments or other use payments from across the IGAD could well provide a steady return for investors.¹⁸⁴

Direct asset securitisations represent perhaps the other key resource for the fledgling development bank. We have previously estimated that such securitisations could raise the \$40 billion required to fund sufficient growth in the IGAD region. Figure 50 shows a picture of a screen an investor might see as s/he buys “pieces” of IGAD-located assets. As shown, they can see pictures, prospectuses, talk to other investors on a chat board, and see regulatory and third-party investment advisors’ opinions. Several OECD member countries have already started relaxing rules to allow the offer of securities in such online market places/brokerages.¹⁸⁵ **A large institution capable of raising large amounts of institutional investor funds, negotiating with regulators as an equal, and with the authority to operate in the IGAD could leapfrog standard securities trading and create next generation securities markets in the IGAD region.**¹⁸⁶

Figure 50: Examples of Securitized Assets on Sale over the Internet



The figure shows shares in solar assets for sale.
Source: Mosaic (2014).

¹⁸⁴ Investors may bid lower than the value of these assets because they fear expropriation or the nationalisation of their private property. Over time, this risk haircut will diminish as IGAD members create a credible record of protecting property rights.

¹⁸⁵ Such securities offers usually go under the guise of crowdfunding. South Africa dominates such funding on the African continent. For a legal discussion in the US context, see Edan Burkett, A Crowdfunding Exemption - Online Investment Crowdfunding and U.S. Securities Regulation, *Tennessee Journal of Business Law* 13(63), 2012.

¹⁸⁶ A parallel exists with mobile banking and other innovations created in the IGAD region. Many recognise the Kenyan regulator as one of the most innovative – a spirit which a regional development bank can help spread to the entire region. See John Gachiri, CMA Ranked Top Regulator in Africa For Its Innovations, *Business Daily*, 2015, available [online](#).

Natural resources provide another potential revenue source. Many of these resources – as we have already shown, have already been traded to Chinese and other companies (in the form of implicit or explicit guarantees in exchange for investment). The techniques of securitizing resources -- from oil and minerals deep in the earth to timber not even grown yet -- remain relatively uncontroversial.¹⁸⁷ **Even back-of-the-envelope estimates of the value of IGAD member states' natural resources available for collateralisation comes to around \$20 billion.**¹⁸⁸

Company shares represent one of the most important assets the bank can create and trade. Scholars and investors have long known about the impediments to buying and trading equities in the IGAD region.¹⁸⁹ A single clearinghouse for share origination and trade would eliminate the need for the development of local stock exchanges, securities regulators, and even create much of its own demand (as the bank can trade for its own account).¹⁹⁰ **The IGAD would have a combined market capitalisation of roughly \$5 billion if we only used global patterns in market capitalisation-to-GDP as a guide.**¹⁹¹

Bank shares represent a way of turning loans into equities as well as deepening capital available for lending. Many banks lack capital – thus ration capital at high interest rates.¹⁹² By buying bank shares and reoffering them to international investors, an IGAD development bank could increase the capitalisation of IGAD region banks by over \$100 million. Such deepening could also encourage the transfer of remittances – already roughly valued at \$12 billion – as senders and receivers see local banks as credible places to store wealth.¹⁹³ The secondary impacts of such a scheme likely include higher export earnings and more government spending on infrastructure and other public goods and services.¹⁹⁴ **Selling IGAD bank shares could allow for a 60% increase in bank capitalization – translating into roughly \$2 billion in extra lending (if demand exists for such lending).**

¹⁸⁷ Even in the 1990s, scholars and resource professionals understood that securitising future cash flows from resources still in the ground could provide the collateral needed to bring (buy) the assets into existence needed to exploit those resources. See Charles Harrell, James Rice and Robert Shearer, Securitization of Oil, Gas, and Other Natural Resource Assets: Emerging Financing Techniques, *The Business Lawyer* 52(3), 1997.

¹⁸⁸ To arrive at this estimate, we have multiplied the value of each country's major commodity exports by their world price and multiplied by 10 (roughly the discount factor taking into account the time value of money). We do not even adjust for the increased extractive productivity added investment would bring.

¹⁸⁹ See Jacob Gakeri, Enhancing Securities Markets In Sub-Saharan Africa: An Overview of the Legal And Institutional Arrangements in Kenya, *International Journal of Humanities and Social Science* 1(9), 2011.

¹⁹⁰ Several attempts to bring securities regulation to the region have been tried. The East African Member States Securities Regulatory Authorities (covering only Uganda and Kenya from the IGAD region) rules and regulations represent one such attempt.

¹⁹¹ As implied in the text, we regressed market capitalisation on GDP for a number of developing economies and used that relationship to find estimated capitalisations for the IGAD members. See Appendix II for more on this data.

¹⁹² See Valentina Flamini, Liliana Schumacher, and Calvin McDonald, The Determinants of Commercial Bank Profitability in Sub-Saharan Africa, *IMF Working Paper* 09/15, 2009, available [online](#). For a broader overview of the challenges, see Patrick Honohan, and Thorsten Beck, *Making Finance Work for Africa*, World Bank 2007, available [online](#).

¹⁹³ See Hussein Abdi Halane, The Importance of Remittances in the IGAD Region, *IGAD Presentation*, 2015, available [online](#).

¹⁹⁴ See Thomas Gries, Manfred Kraft, Daniel Meierrieks, Linkages Between Financial Deepening, Trade Openness, and Economic Development: Causality Evidence from Sub-Saharan Africa, *World Development* 37(12), 2009.

Debt write-downs provide another resource (freeing up other resources for productive use). **A total write down coming to only 5% of the IGAD's combined GDP would free up roughly \$11 billion.**¹⁹⁵ Existing donors would have four strong reasons to use the development bank to finally settle the debt overhang question. First, donors have already embraced performance-based aid – with cash given for the achievement of concrete objectives in recipients' health, education and other sectors.¹⁹⁶ Write-downs work better than new cash grants – as they resolve a serious source of investor uncertainty.¹⁹⁷ Second, such swaps would increase the likelihood of repayment of the remaining debt. Debt overhang harms financial systems and increases the odds of inflationary monetary finance.¹⁹⁸ Third, these swaps would likely crowd-in other productive investment – as the Bretton Woods institutions lend in order to maximise profits on their equity holdings and as they sell to investors able to bring skills and complementary lines of business to IGAD companies.¹⁹⁹ Fourth, even exchanging debt for cash positions at the development bank would encourage these previous donors to have a vested interest in the success of an IGAD development bank.²⁰⁰

Provisional estimates place the value of created and traded securities “around” the proposed IGAD Communities Development Bank at roughly 120% of current GDP.²⁰¹ Even if the development bank managed to market only 0.001% of this value, its benefit to the region would still well exceed any possible costs in its development, creation and ongoing operation.

¹⁹⁵ Economists have already reached consensus a long time ago on the problems and prospects of debt-swaps in resolving high sovereign indebtedness. See Michael Bowe and James Dean, Has the Market Solved the Sovereign Debt Crisis, *Princeton Studies in International Finance* 83, 1997, available [online](#).

¹⁹⁶ Such performance-based aid entails giving cash once governments have achieved specific targets (like Millennium Development Goals). For progress on, and performance of, these systems, see Benn Eifert and Alan Gelb, Improving the Dynamics of Aid: Towards More Predictable Budget Support, *World Bank Policy Research Working Paper* 3732, 2005, available [online](#). For a deeper background, see Danny Cassimon and Jos Vaessen, Theory, Practice and Potential of Debt for Development Swaps in the Asian and Pacific region, *Economic Systems* 31(1), 2007.

¹⁹⁷ For evidence, see Leonce Ndikumana, James Boyce, Public Debts and Private Assets: Explaining Capital Flight from Sub-Saharan African Countries, *World Development* 31(1), 2003.

¹⁹⁸ For recent evidence, see Carmen Reinhart and Belen Sbrancia, The Liquidation of Government Debt, *NBER Working Paper No. 16893*, 2011, available [online](#).

¹⁹⁹ Lending tied to equity participation is a well-known phenomenon in economics. See Emilio Barucci and Fabrizio Mattesini, Bank Shareholding and Lending: Complementarity or Substitution? Some Evidence from a Panel of Large Italian Firms, *CEIS Working Paper No. 118*, 2008. As for the trade in IGAD-related shares, even a theory as simple as the Coase Theorem suggests that a shipping company (for example) would want any shipping asset shares the World Bank holds, in order to build scale, add geographic diversity and build complementary business lines. For proof from China, see Gary Jefferson and Thomas Rawski, China's Emerging Market for Property Rights: Theoretical and Empirical Perspectives, *Economics of Transition* 10(3), 2002.

²⁰⁰ The World Bank has traditionally shown more engagement in sectors attracting large-scale investment. See Vivien Foster, William Butterfield, Chuan Chen, and Nataliya Pushak, Building Bridges: China's Growing Role as Infrastructure Financier for Sub-Saharan Africa, *World Bank Trends and Policy Options* 5, 2009, available [online](#).

²⁰¹ This number looks high because securitisation values depend on the lifetime expected value of these assets (broadly a “stock” or wealth concept) rather than yearly income (a “flow” concept) epitomized by GDP.

Composition of shareholders and the Board

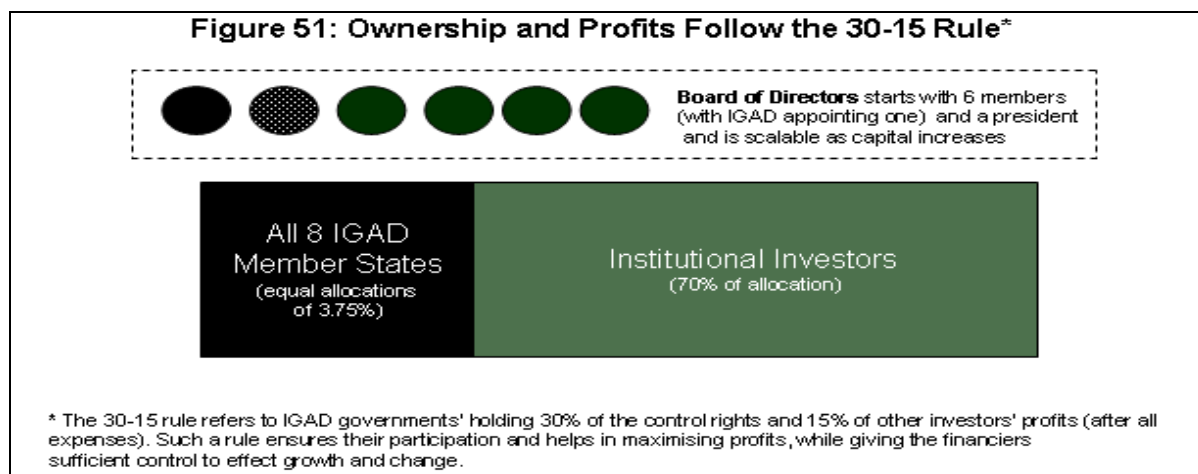
What should be the initial distribution of shares in the Bank itself? Figure 51 shows the initial share allocation among investors. Five factors determine such a distribution. First, giving too many or too few shares to IGAD governments will result in disinterest. In many cases of start-ups, economists have calculated the optimal state participation (of course depending on the situation) at roughly 30%.²⁰² Second, the *raison d'être* of the Bank consists in bringing foreign capital and expertise to the IGAD region. If foreigners provide most of the finance, and given the private sector's focus on profit rather than politics, shouldn't they control their own money?²⁰³ Third, such a proportion of foreign ownership sends a clear message to markets that the owners will control their own investments. Africa's history of expropriation and lack of rule law clearly requires that IGAD Member States can commit to keep foreigners' investments secure – even if their own historical track records are beyond reproach. Vesting majority control rights with foreigners helps them feel that security.²⁰⁴ Fourth, IGAD member states are still free to own any proportion of shares in investment vehicle companies created by the Bank. So, if the Bank packages rights over land in Nairobi, IGAD Member States are free to provide 100% of all the capital for that particular vehicle. Thus, such an arrangement does not deprive IGAD governments from profitable investment opportunities. Fifth, such a design minimises the role of politics in a highly politicised part of the world. Each member states has less than 4% of the total value of the Bank's shares at inception. Such a small proportion discourages fights within or between countries for more ownership, while providing sufficient ownership to incentivize these countries to support the Bank.²⁰⁵

²⁰² The IGAD represents the ultimate “start-up” with 8 countries either creating enterprises or restructuring existing ones. For one discussion, see Clifford Holderness, A Survey of Blockholders and Corporate Control, *Economic Policy Review* 9(1), 2003.

²⁰³ Even if IGAD Member States had reasons to fear foreign investors in the past, evidence for a round of enterprise surveys show how productivity, employment, and firm sizes grow with foreign investment. See Todd Moss, Vijaya Ramachandran, and Manju Shah, Is Africa's Scepticism of Foreign Capital Justified? Evidence from East African Firm Survey Data, *Center for Global Development Working Paper No. 41*, 2004, available [online](#).

²⁰⁴ Many countries in the region have adopted anti-expropriation legislation. Yet, providing another level of security can only further allay any investor fears. Conversely, such ownership – and rules in investors' home countries – can also help insure that IGAD members treat local investors well. See Liz Wily, ‘The Law is to Blame’: The Vulnerable Status of Common Property Rights in Sub-Saharan Africa, *Development and Change* 42(3), 2011.

²⁰⁵ Economists have wrestled with the optimal degree of state ownership and control in developing economies. China's experience has changed many people's opinions about state control. Too much and too little state control can hinder the effectiveness of organisations operating in the absence of markets. See Ian Bremmer, State Capitalism Comes of Age: The End of the Free Market?, *Foreign Affairs* May/June, 2009, available [online](#).



The president (or executive director) of the Bank also sits on the Board of Directors.²⁰⁶ She or he will serve as a mediator between the IGAD's interests and investors' interests. Such a one-and-a-half members of the Board provides far more representation than these countries would obtain in any other multilateral financial institution.²⁰⁷ Elevating the President as a Board member will help guarantee that the President serves the interests of the Bank, rather than the IGAD governments.²⁰⁸ The strong focus on investors and private sector representatives on the Board, rather than politicians or individuals representing national interests, also reduces focus on social issues which many see as a distraction to multilateral banks' mission.²⁰⁹ **Putting the Bank's funders, rather than IGAD politicians on the Board will thus provide the best incentives for raising the amount of money needed to finance development in the IGAD region.**²¹⁰

Why don't IGAD governments have more control rights? After all, most development banks consist only of member governments. First, as we showed previously, the classical development bank model does not work. Even in that environment, where countries control the bank, national interests become distorted – limiting the ability of member states to set

²⁰⁶ We use these terms interchangeably as the decision about the leader's official title represents a political/operational decision.

²⁰⁷ One-and-a-half because the president does not hold (much) equity, except perhaps in incentive-based compensation. Many authors who review the performance of multilateral development banks cite excessive voting power by governments (particularly upper-income governments) as a key reason for ineffective lending. See Enrique Carrasco, Wesley Carrington and Hee-Jin Lee, *Governance And Accountability: The Regional Development Banks*, *Boston University International Law Journal* 27(1), 2009, available [online](#).

²⁰⁸ Many analysts cited politicisation of the African Development Bank as a core reason for its relative poor performance over the years. Creating a power base in the Bank separate from the Executive Directors and Governors represents a key challenge which private sector banks have already solved through presidential appointments as Chairman of the Board. See Taïeb Hafsi and Jean-Yves Le Louarn, *The African Development Bank (A): Hope For African Development*, available [online](#).

²⁰⁹ By the 2000s, projects had so many social objectives to fulfil, that many commentators argued that they could no longer focus chiefly on poverty reduction and development. See Susan Park, Jonathan Strand, *Global Economic Governance and the Development Practices of the Multilateral Development Banks*, 2015.

²¹⁰ Indeed, the need for a non-politicised Board which is shielded from the bureaucratic politics of home governments and the Bank itself has become almost accepted wisdom. See Dennis de Tray and Todd Moss, *Fixing International Financial Institutions: How Africa can lead the way*, *Centre for Global Development Notes*, 2006, available [online](#).

policies.²¹¹ Second, in a highly politicised region, we want a structure which encourages consensus, rather than politicking between IGAD member states. Because IGAD Members States only get one vote – they must form some kind of consensus (by common agreement or by logrolling) when voting.²¹² Third, IGAD governments remain sovereign and omnipotent within their own national boundaries. Thus, member states have far more control than their votes on the Board suggests. Fourth, as we show in a later section of this paper, such a proportion provides sufficient resources for buying the participation of existing elites who benefit from the status quo.²¹³ Fifth, as the Bank succeeds in its mandate, the Bank will look more like any universal/investment bank. Once the Bank becomes indistinguishable from the Credit Suisses or Barclays of the world, IGAD members can sell their stakes (thus completely privatizing it) or buy up others' stakes.²¹⁴

In exchange for their participation and help in making the Bank successful, IGAD members get performance bonuses of 15% of other investors' after-expenses profits – allocated equally to all IGAD members on an equal basis. Such performance bonuses ensure three things. First, foreign investors choose very profitable investments, those that still work after deducting the roughly 40% reduction in overall profits.²¹⁵ Second, all IGAD members have a financial interest in the profitability of projects – most of which will probably be concentrated in the Sudan, Uganda, Kenya (and to a lesser extent Ethiopia). Such equal payments provide incentives for other members to use diplomatic pressure to foment a more investor-business friendly environment.²¹⁶

The initial allocation and pricing of shares will be conducted by an international investment firm. The firm will conduct the road show, prepare a prospectus, solicit expressions of interest, take initial orders and manage the final auction. The investment firm (or other consultants) will also work with the IGAD Member States to identify the assets made available, as their payment for their initial share allocation. **If the new bank has even half the success the Asian Infrastructure Investment Bank (AIIB) had, the underwriters can expect subscriptions equally \$50 billion.**

²¹¹ For data, see Daniel Nielson and Michael Tierney, Principals and Interests: Common Agency and Multilateral Development Bank Lending, *Princeton Working Papers*, 2008, available [online](#).

²¹² For a discussion on the way a multilateral bank can help forge a broader policy consensus between members, see Andrew Cooper and Asif Farooq, Testing the Club Dynamics of the BRICS: The New Development Bank from Conception to Establishment, *International Organisations Research Journal* 10(2), 2015, available [online](#).

²¹³ We show, given the Gini coefficients and income distribution of the top 10% of the population that they should earn at least the same amount of money as before the Bank starts operations in order to politically allow the Bank to operate.

²¹⁴ For a discussion about the ways that states “incubate” internationally competitive companies, see Terence Gomez, François Bafail, Kee-Cheok Cheong, *Government-Linked Companies and Sustainable, Equitable Development*, 2015.

²¹⁵ A 15% payment to 70% of the shareholders comes to around 10% of total profits. Thus IGAD member states would receive their 30% plus this extra 10%. In theory, such a payment might ultimately be defined legally as a tax – and thus eligible for deductibility in some countries.

²¹⁶ Kenya would agree to share profits with Somalia when investments are exclusively in Kenya (for example) because of the large budgetary costs of stabilizing the region. Such sharing could even qualify as a “conflict early warning” mechanism – as these payments serve as prophylactics against future instability. See Herbert Wulf and Tobias Debiel, Conflict Early Warning and Response Mechanisms: Tools for Enhancing the Effectiveness of Regional Organisations? A comparative study of the AU, ECOWAS, IGAD, ASEAN/ARF and PIF. *Crisis States Research Centre working papers series* 2(49), 2009, available online.

How Should the Bank Be Capitalised, Funded, and Structured?

Who is likely to fund the IGAD Communities Development Bank? As previously noted, investment in the Bank's equity will differ from investment in the investment vehicles tied to particular projects, assets or groupings of assets. The Bank will securitize assets from the region, written them into investment vehicles (like off-the-shelf corporations) and sell shares in these corporations. The Bank will hold shares for its own account, and/or sell them to other investors. **We do not envision bond issuances in this already over-indebted region.**

Classes of investors

Sovereign Wealth Funds. Sovereign wealth funds already hold over \$6 trillion (yes, trillion as in 1,000 billion) in assets – many placed with other governments.²¹⁷ Some analysts think far more sovereign funds slosh around global financial markets. For example, a Spanish academic recently noted that if these funds allocate even 10% of their resources in emerging markets (in order to achieve the diversification that comes with an efficient portfolio), such diversification would generate \$1.4 trillion in emerging market funding.²¹⁸ Even 1% of that money – or \$14 billion – would go a very long way toward achieving the IGAD's funding gap of roughly \$40 billion.²¹⁹ Available evidence supports our strategy to keep politically-influenced investors off the IGAD Bank's Board – as they reduce performance.²²⁰ Yet, political motivations of these sovereign wealth funds' investors to help the IGAD with investment rather than aid may generate some demand among sovereign wealth funds for IGAD originated securities.²²¹ Large trading partners like China have natural affinities with this type of investment – as demonstrated by the likes of the China-Africa Development Fund.²²² **An IGAD development bank would represent a point of common attraction and one-stop shop for these wealth funds as well as help generate the projects which these funds would finance.**

²¹⁷ Prequin, *2015 Prequin Sovereign Wealth Fund Review*, 2015.

²¹⁸ Javier Santiso, *Sovereign Development Funds: Key Financial Actors in the Shifting Wealth of Nations*, *OECD Emerging Markets Network Working Paper*, 2008, available [online](#).

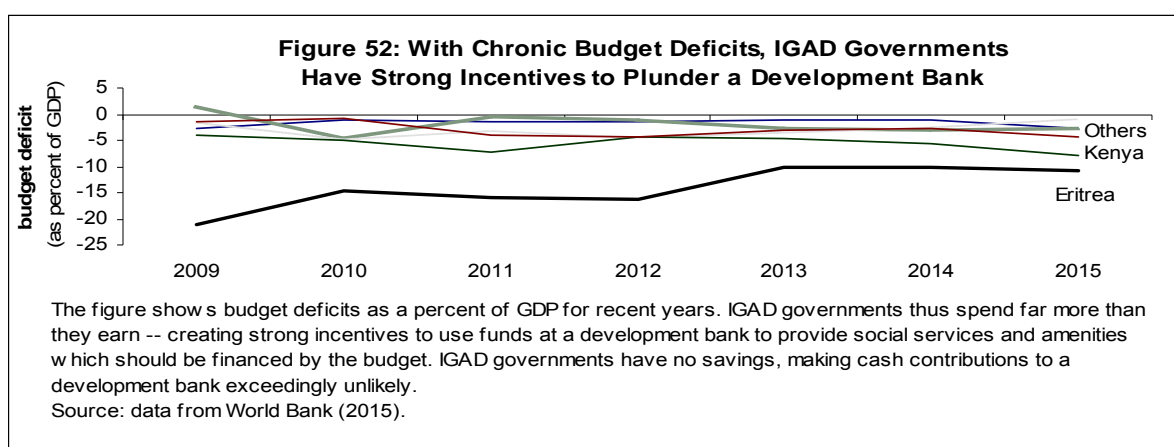
²¹⁹ The OECD has also noted the potential for these funds to finance African development. Turkish notes that absorption capacity prevents more sovereign wealth investment. A large, successful private sector oriented development bank like the one we propose would solve most of the problem he outlines. See Edouard Turkish, *Sovereign Wealth Funds as Investors in Africa: Opportunities and Barriers*, *OECD Development Centre Working Paper 303*, available [online](#). See also Thouraya Triki and Issa Faye, *Africa's Quest for Development: Can Sovereign Wealth Funds help?*, *Africa Development Bank Working Paper 141*, 2011, available [online](#).

²²⁰ For evidence, see Bernardo Bortolotti, Veljko Fotak, William Megginson, and William Miracky, *Sovereign Wealth Fund investment Patterns and Performance*, *Eni Enrico Mattei Foundation Working Paper*, 2009, available [online](#).

²²¹ We have previously documented several cases where multilateral finance institutions like the European Investment Bank had invested in projects in the IGAD region. Yet, econometric evidence suggests that IGAD governments will need to engage in intense marketing and sales effort to convince these funds to invest on humanitarian grounds. See Rolando Avendano and Javier Santiso, *Are Sovereign Wealth Funds' Investments Politically Biased? A Comparison with Mutual Funds*, 2009, available [online](#).

²²² An IGAD development bank would provide liquidity for the China-Africa Development Fund (and others') investments -- encouraging more investment. See Qiao-Wen Zhang, *China Africa Development Fund: Beyond a Foreign Policy Instrument*, *Centre for Chinese Studies Commentary*, 2015, available [online](#).

IGAD Governments Themselves. IGAD governments themselves seem highly unlikely to capitalise any development bank. Figure 52 illustrates the chronic budget deficits IGAD governments have run in recent years. IGAD governments spend more than they earn – making any contributions to a development bank unlikely. Worst yet, any well-capitalised bank would represent a large temptation for IGAD governments with significant political power to use development bank finance as a surrogate for their own social spending.²²³ Yet, the region’s prospects may be brighter than they seem. The prospect of large profits from such a bank could provide sufficiently strong incentives for governments to spend more responsibly.²²⁴ The development bank’s investment in vibrant banks across the IGAD region could finally give savers a place to save – and therefore raise national savings (much of which might find its way into IGAD bank originated investments).²²⁵ **Eventually, a successful IGAD Development Bank would also serve as a de facto sovereign wealth fund for IGAD members holding accounts with the Bank.**



Foreign Governments. Many multilateral development banks involve the participation of OECD member states like the US. Many governments view the multilaterals as an extension of their foreign policy.²²⁶ As early as 1990, Mingst’s in-depth study of the African Development Bank illustrated the damning influence of politics between Member States in the Africa Development Bank.²²⁷ Several years later, English and Mule are hardly more

²²³ Development practitioners have long known about this substitutability problem. Empirical data shows governments would replace tax-financed spending by foreign financed spending if they could. See Marwa Farag, A.Nandakumar, Stanley Wallack, Gary Gaumer and Dominic Hodgkin, Does Funding From Donors Displace Government Spending For Health In Developing Countries?, *Health Affairs* 28(4), 2009.

²²⁴ Foreign investors, seeing such budget deficits, would likely stay away from IGAD development bank investments. Thus, to attract and inspire confidence in these investors, governments might run budget surplus on the assumption that these surpluses would draw foreign investments into their countries.

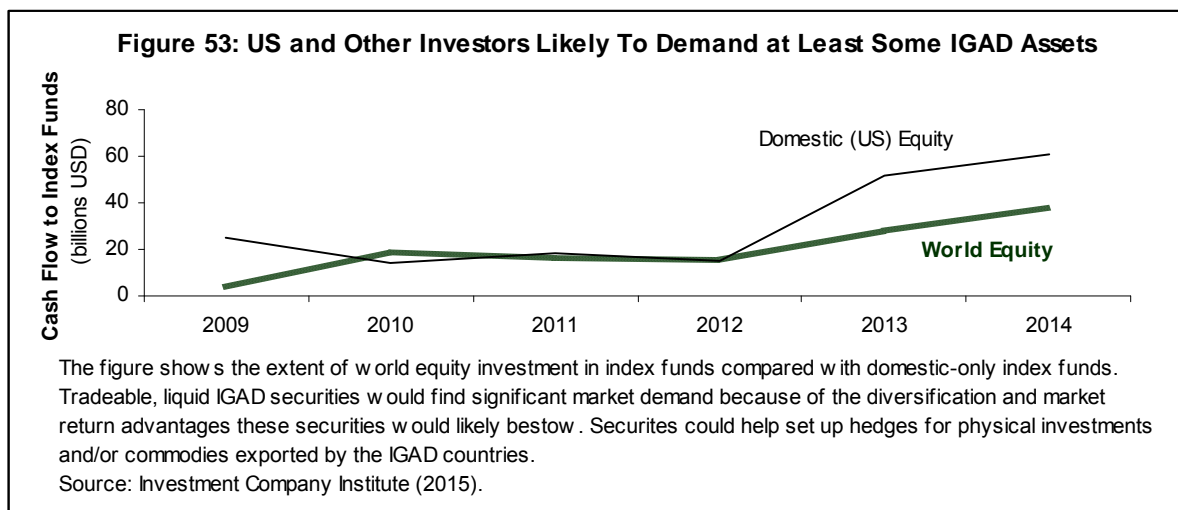
²²⁵ See Jacques Morisset, Foreign Direct Investment in Africa: Policies Also Matter, *World Bank Policy Research Working Paper* 2481, 2000.

²²⁶ For a US perspective, see Rebecca Nelson and Martin Weiss, Multilateral Development Banks: How the United States Makes and Implements Policy, *Congressional Research Service Report* 7-5700, 2014, available [online](#). Yet, the evidence is mixed, with some authors finding little statistical correlation in the data. See also Jonathan Strand and Tina Zappile, Always Vote for Principle, Though You May Vote Alone: American Political Support for Multilateral Development Loans, 2004-2011, *7th Annual Conference on the Political Economy of International Organizations (PEIO)*, 2014, available [online](#).

²²⁷ See Karen Mingst, *Politics and the African Development Bank*, 1990.

charitable toward the African Development Bank.²²⁸ Three scenarios may call for foreign government participation in an IGAD development bank. First, if market demand for shares is weak, foreign governments may purchase the shares to help support their price until the Bank's investments start to show a profit. Hopefully, the/se government(s) would encourage large companies from its jurisdiction to work with the Bank – adding value to the Bank's investments.²²⁹ Second, governments could acquire shares as the result of the debt-to-equity swap we discussed in a previous section. Hopefully, governments would subsequently divest these shares to recoup at least part of the par value of the debt. Third, government entities could control private sector companies engaged in portfolio or direct finance of Bank originated securities. Governments from the UAE to China run large-scale conglomerate financial industrial firms.²³⁰ Except for China, the overall position of these governments in the Bank's shareholder list will probably be minor. **Government investment in the IGAD development bank is not preferred – as these governments have other fora for offering finance to IGAD governments (like the African Development Bank and World Bank).**

Institutional investors and mutual funds. Institutional shareholders should hold most of the 70% of the shares not already allocated to IGAD governments. We already presented several institutions investing in Africa. However, the establishment of a credible private-sector driven IGAD development bank could encourage the creation of funds targeting the region. Figure 53 shows the extent of US index fund investment in foreign (non-US) equities. As shown, in some years (like 2010), demand for foreign securities exceeds US securities. IGAD-related securities can provide diversification and returns unavailable elsewhere.



²²⁸ These authors try to gloss over the issues by presenting organisational and other “facts” related to the Bank’s structure and operation. Nevertheless, the structural problems they present should seem apparent – especially now with the benefit of hindsight. See Philip English and Harris Mule, *The Multilateral Development Banks: The African Development Bank*, 1996.

²²⁹ As our China example previously showed, government has a role to play in providing funding and guarantees. For a broader view, see OPM, *Financing Requirements of Private Enterprises in Developing Countries*, 2002, available [online](#).

²³⁰ For the way that one country – Canada – dealt with investment by state-owned Chinese enterprises, see Gail Henderson, *The Regulation of Foreign Direct Investment by State-owned Enterprises in Canada*, *Asian Institute for International Financial Law Working Paper 14*, 2014, available [online](#).

These securities will likely find three outlets. First, international funds may put some selected shares into their funds. Obvious examples include funds like the iShares MSCI Frontier 100 ETF (FM), the EGSshares Beyond BRICs (BBRC), the Global X Next Emerging & Frontier ETF (EMFM) and the Guggenheim Frontier Markets ETF (FRN). Second, entire funds can emerge – marketed by the IGAD development bank as a wholesaler or retail provider to fund managers.²³¹ Third, demand in the IGAD itself should grow as incomes grow. Many studies document a “home bias” in equity investing. The IGAD will not yet show such a bias – lacking both corporations offering shares and a stock market to buy and sell these shares on. As we previously mentioned, these shares might help provide savings opportunities to IGAD households – in turn generating more finance from household savings.²³² **The offer of IGAD originated securities will reshape portfolios world-wide, and especially affect savings rates in the IGAD countries.**

Joint venture partners. Developing deep, liquid markets for IGAD-origin securities could help provide foreign direct investors and operators of joint ventures with markets needed for eventual partial or total exit. Firms like Bechtel (or even publicly listed firms like Fluor) can sell shares in their joint venture – reducing their risk. The offer of these securities can also eventually facilitate IGAD firms’ expansion outside their home countries. We have already shown trends in such securitisation in a previous section – noting that demand for the securitisation of joint venture investment vehicles could total around \$60 billion.

Retail investors. Retail investors, while probably contributing a minor share of capital to the Bank, represent one of its most important stakeholders. Many upper-income jurisdictions are in the process of setting up institutional arrangements to allow their citizens access to securities markets like a possible future IGAD market.²³³ Figure 54 shows demand for securities (stocks) in a number of OECD countries.²³⁴ The figure shows the diversity of potential demand for IGAD securities from a variety of likely sources. Retail investors may not comprise the key group (by assets) -- but they do influence society and culture. Widely dispersed understanding and ownership of IGAD securities would encourage trade, communications and other ties between the IGAD and the rest of the world.²³⁵ As such, **the IGAD development bank would represent a vector of beneficial globalization for the region.**

²³¹ We document how Chicago fund houses saw opportunities to market shares of Chinese solar panel companies – creating a deep and vibrant Chicago-based market for these securities. See Bryane Michael, Simon Zhao and Dariusz Wojcik, What Role Can an International Financial Centre's Law Play in the Development of a Sunrise Industry? The Case of Hong Kong and Solar Powered Investments, *University of Hong Kong Faculty of Law Research Paper No. 2014/034*, 2014, available [online](#).

²³² Traded equities could ignite the development of **pension markets** – which would (even before considering household purchases of securities for savings accounts) substantially increase savings rates. See Gregorio Impavido and Alberto Musalem, Contactual Savings, Stock and Asset Markets, *World Bank Policy Research Working Paper 2490*, available [online](#).

²³³ For an example from the US, see Ethiopis Tafara and Robert Peterson, A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework, *Harvard International Law Journal* 48(31), 2007.

²³⁴ Kristian Rydqvist, Joshua Spizman, Ilya Strebulaev, The Evolution of Aggregate Stock Ownership, *Centre for Financial Studies Working Paper No. 2011/18*, 2011, available [online](#).

²³⁵ For evidence, see Richard Harris and Cher Li, Review of the Literature: The Role of International Trade and Investment in Business Growth and Development, *UK Department of Trade and Industry Ref. UKTILITREV 05/01*, 2005, available [online](#).

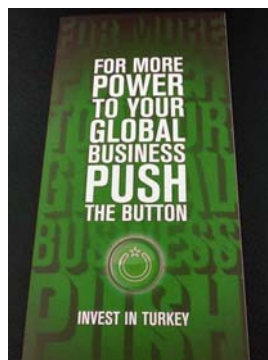
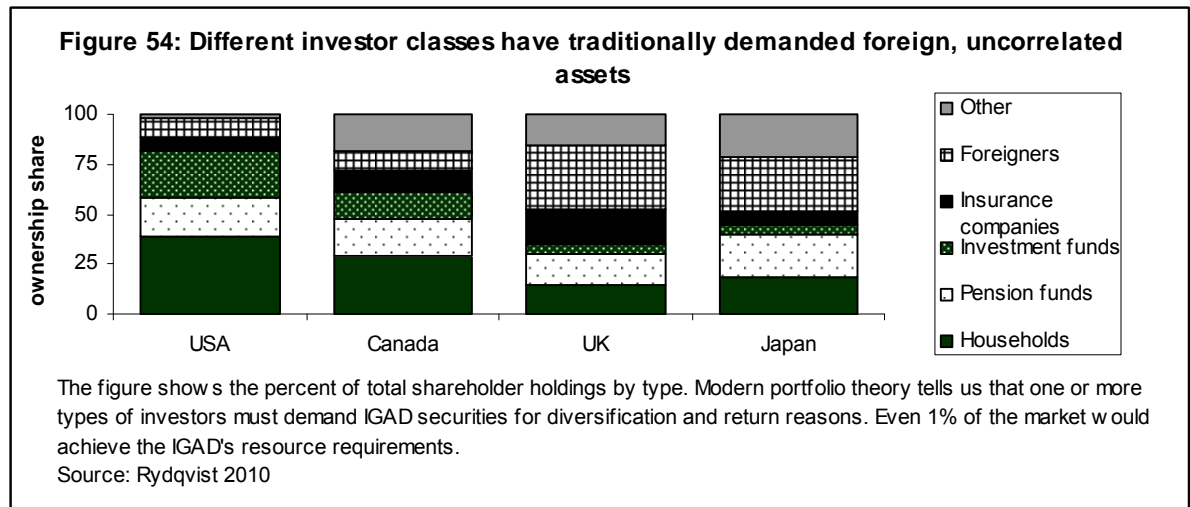


Figure 55: Case Study – Invest in Turkey

Perhaps nothing has been more successful than Turkey's PR campaign to promote foreign investment. Ads in magazines, on buses and in airplane seat pockets painted a modern, vibrant view of Turkey for millions of ordinary people. As attitudes shifted from *Midnight Express* to *The Secret of My Success*, fund managers and others took notice. Turkey now exports foreign investment – and its PR materials also serve to make foreigners keen to work with Turks. An IGAD bank can help reverse decades of news images of the region as a source of famine and war.

Revenue sources

An IGAD development bank would have the same sources of revenue as any commercial/investment bank. These include profits from making markets in IGAD securities and brokering, providing information, trading on its own account, management fees and from the offer of professional services. Estimated earnings within a few years from inception should come to around \$60 million in the best case – and zero in the worst case.²³⁶

Market maker and broker. The IGAD development bank will make markets in IGAD originated securities. The Bank will originate many of these securities and offer these securities online to wholesalers, institutions and retail investors (as allowed under the relevant law). As shown in Figure 56, the IGAD bank would likely achieve its most profitable economies of scope and scale offering around 5,000 issues and with trading of around 8 million transactions.²³⁷ Too many transactions and securities require very costly review. Insufficient volume limits network effects.²³⁸

²³⁶ IGAD countries do not go further into debt, as the bankruptcy of the development bank would destroy incentives to protect investors' property rights in the immediate term. We assume the governments would then recover legal title to assets located within their borders by all methods fair and foul.

²³⁷ We consulted a variety of sources when trying to figure out how much money the Bank would make for making markets. See Charles Jones, A Century of Stock Market Liquidity and Trading Costs, *Columbia Business School Working Paper*, 2002, available [online](#). See also Alexander Butler, Gustavo Grullon and James

Figure 56: Estimated Operating Earnings from Work as Market Maker and Broker

Volume --> Number of Issues	2 million transactions	8 million transactions	16 million transactions
500	\$20 million	\$34 million	\$38 million
1000	\$24 million	\$29 million	\$33 million
5000	\$26 million	\$37 million	\$24 million

The figure shows the estimated operating earnings (revenue minus operating expenses)

Information provider. The Bank may charge for providing services which inform investors about different types of securities.²³⁹ Such information may take the form of online stock price quotes, trade information, and expert analysis. The Bank may also offer multimedia services like investor presentations/conferences and annual meetings. Over time (if the US serves as an example), these services will become free as competition enters the market. **Yet, until that time, the Bank would probably raise about \$1.5 million offering these services.**²⁴⁰ A large foreign presence in this market helps improve the market's performance.²⁴¹

Capital appreciation and dividends. The Bank will earn most of its profits from holding long positions in IGAD securities. The IGAD may realize gains by eventually selling on the secondary market (to IGAD-based institutions and households for example) or from repurchases by IGAD governments. Of course, we do not expect that all the Bank's positions should be profitable. But how many of its projects can fail before the Bank starts to lose money? Figures 57 show the relationship between the percent of the IGAD bank's portfolio which fails and the required return on the rest of the portfolio.²⁴² To take an obvious example, if half the Bank's assets fail, then the remaining assets values need to double in value in order for the Bank not to lose money. **Thus, the amount of profit will depend on the amount of money investors want to risk on highly speculative (from their point of view) investments.**

Weston, Stock Market Liquidity and the Cost of Issuing Equity, *Journal of Financial and Quantitative Analysis* 40(2), 2005.

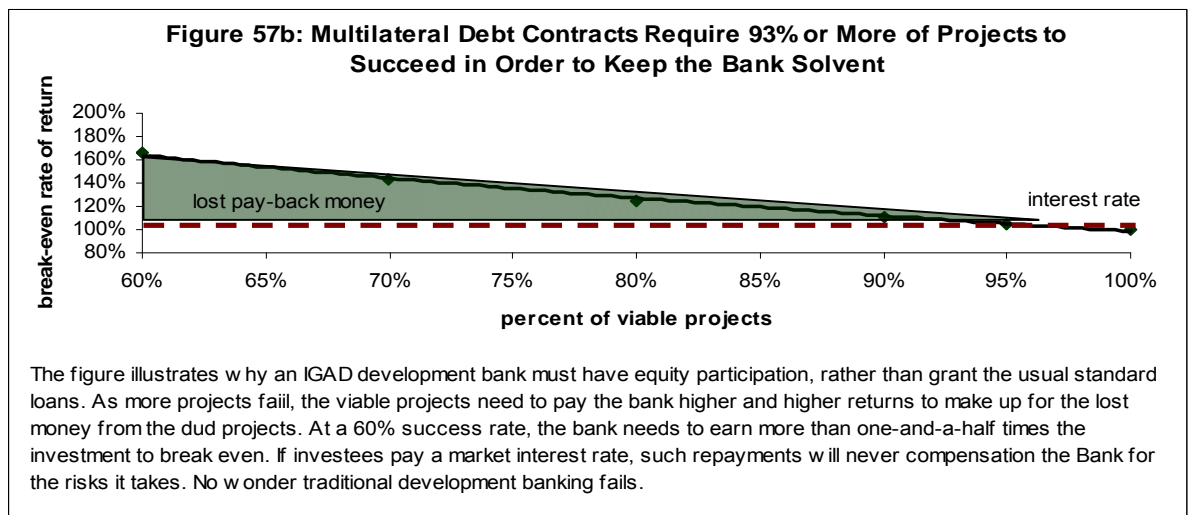
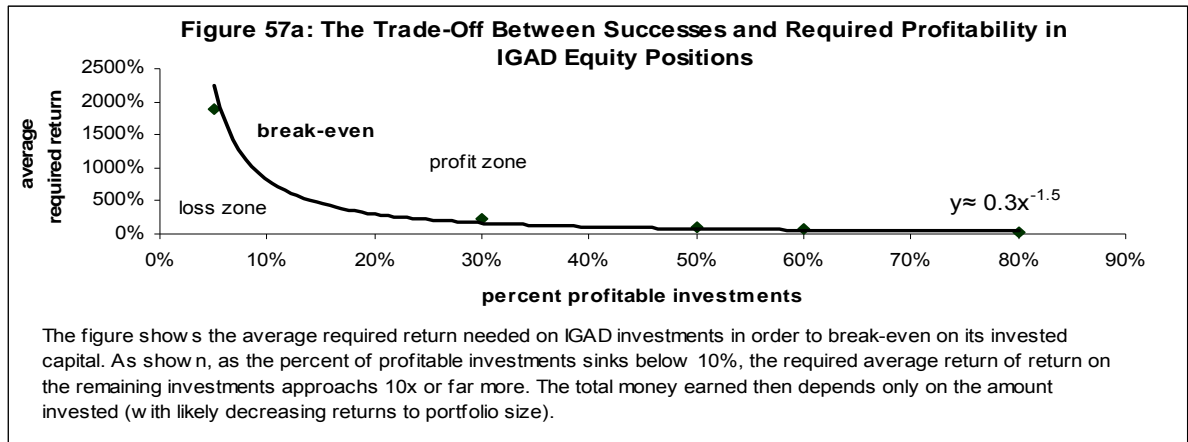
²³⁸ For an analysis of such, post-origination costs see Carole Comerton-Forde, Terrence Hendershott, Charles Jones, And Pamela Moulton, Time Variation in Liquidity: The Role of Market-Maker Inventories and Revenues *Journal of Finance* 65(1), 2010. See also Katrina Ellis, Roni Michaely and Maureen O'Hara, When the Underwriter Is the Market Maker: An Examination of Trading in the IPO Aftermarket, *The Journal of Finance* 55(3), 2000.

²³⁹ Other jurisdictions also have market makers as information providers. See Pietro Perotti and Barbara Rindi, Market Makers as Information Providers: The Natural Experiment of STAR, *Journal of Empirical Finance* 17(5), 2010.

²⁴⁰ This figure comes from roughly 5,000 institutional users and advertising paying for retail users of online material.

²⁴¹ For empirical evidence, see Wen He, Donghui Li, Jianfeng Shen, and Bohui Zhang, Large Foreign Ownership and Stock Price Informativeness Around the World, *Journal of International Money and Finance* 36, 2013.

²⁴² As the Bank's initial work will resemble venture capital far more than investment banking in its early years, we assume that assets will yield binary results (either they pay off big time or not at all). Such an assumption seems very fitting in a region where some money will likely be stolen, financial information falsified, etc.



As if to belabour the point, Figure 57b shows why the development bank must not engage in lending of any kind. The figure shows the required rate of return needed on viable projects as the proportion of its non-performing loans increases. If a development bank charges 8% interest (still a relatively high amount in the current interest rate environment), the bank can have no more than about 10% of its portfolio projects failing. If more projects fail, the bank starts losing money. If the IGAD development bank starts a company tomorrow, it can expect roughly an eight fold return (if its price growth reflects average GDP growth up to the time IGAD members become upper-middle income countries in the next century).²⁴³ **Access to multi-bagger investments (investments which earn several hundreds times the initial sum invested) provides the only means for an IGAD development bank to succeed.**

Assuming the bank earns a 5% return annually on \$40 billion in deployed capital (after netting out losses), the bank can expect to earn \$2 billion in capital gains and dividends. Such

²⁴³ To see where the eight times figure comes from, imagine the bank investing \$100 in shares in a new company. Imagine further than the company represents the economy in microcosm. The \$100 doubles eight times – yielding \$25,600. If the company represents the GDP per capita of the IGAD member state, then such a figure would place the country in upper-middle income status.

an amount clearly eclipses all other income sources – represents the Bank’s most important source of income.

Management fees. The Bank may need/want to assign professional managers to look after some of its investments and/or assets. Having the Bank charge for professional management services increases the profit motive of these managers – thereby helping to ensure the employment of these managers.²⁴⁴ Placing 50 such managers and taking their first month salary (as is the standard practice among executive recruitment firms) provides roughly a meagre \$350,000.²⁴⁵ Clearly, the main benefit will result from these managers’ effect on the Bank’s share values.

Professional services and foreign exchange. The Bank would likely need to provide professional services which may not exist in IGAD member states. Professional law services, arbitration, accounting, engineering, IT and other services which the Bank may develop in-house should charge for their services. If these services grow significantly, the Bank can spin them out – adding to employment and revenue in the IGAD economies themselves. Again, given limited market sizes, the Bank’s trading profits would eclipse any expected contribution from professional services profit-centres.

A Marketing Structure for the Bank

Like any capitalist institution, the IGAD Communities Development Bank human resources policy should concentrate mostly on marketing staff. Such marketing staff would find and develop projects in the IGAD member states, as well as arrange and structure financing in collaboration with headquarters staff. In theory, there is no upper bound on the number of marketing staff the Bank would employ – as any staff whose expected revenues exceeds his/her salary should find a job.²⁴⁶ Figure 58 shows the likely changes in employment – if other banks’ experience serves as a guide for the IGAD.²⁴⁷ If headquarters staff represents mostly or entirely international staff (hired from the international pool of bankers and professional services specialists), local marketing staffs would provide the local knowledge.

Performance-based compensation for marketing staff would come from the Bank’s own

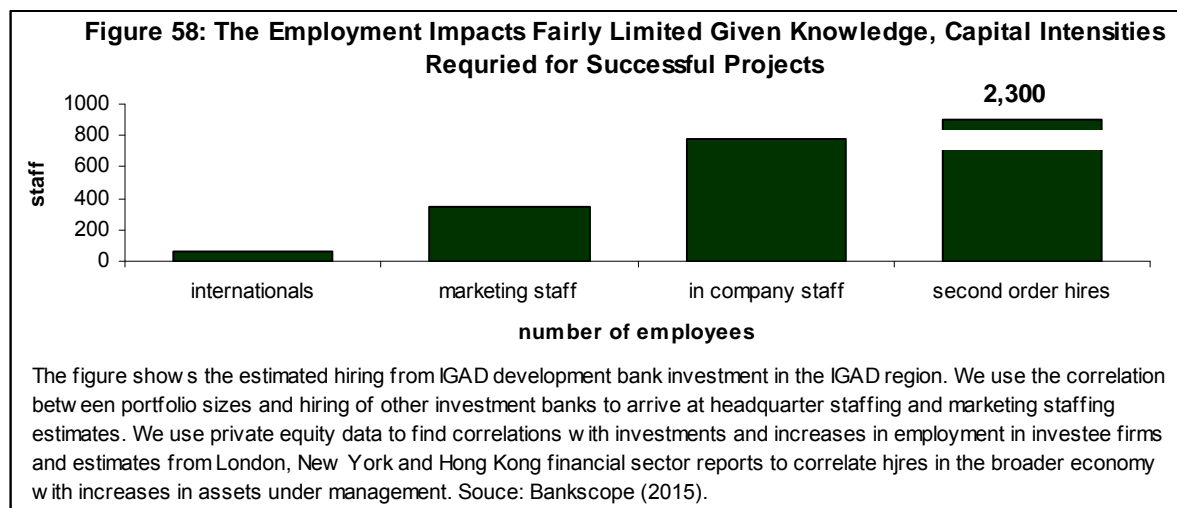
²⁴⁴ Simply hiring professional managers, letting them keep all their compensation-based emoluments, and having them increase the value of the Bank’s shares provides some profit-based incentive to the Bank. However, if the Bank spends real resources on finding and possibly grooming these managers, the Bank should expect to earn a market-set return (just like any other company).

²⁴⁵ Such a calculation assumes a perfectly competitive market for talent. The Bank can expect to earn internally from finding and placing managers as a professional search firm would earn. We provide this slightly unrealistic assumption to show the (small) magnitude of these returns.

²⁴⁶ Expected revenue and costs include factors like the person’s reputation risk (the addition to overall potential risk of screw-ups from hiring too many staff). The Bank should clearly exercise discretion and good judgment when hiring. However, we refer to this revenue rule to dramatically illustrate the nature of the hiring decision.

²⁴⁷ Such employment changes come from loosening financing constraints of the Bank, even if the Bank does not directly provide the finance. For example, in Kenya, studies find that firms lending to other firms provides a key source of finance, especially for SMEs. To the extent the Bank supports profitable companies, generalized financing constraints should ease. See Rosemary Atieno, Linkages, access to finance and the performance of small-scale enterprises in Kenya, United Nations University *WIDER Working Paper 2009.06*, 2009, available [online](#).

profits, leading to a slight dulling of hiring incentives – but increasing consumption in the IGAD economies more generally.²⁴⁸



The bank’s organisational structure and operations would roughly follow the template set up by the international bulge bracket banks. Figure 59 provides a summary of the major provisions related to the IGAD Communities Development Bank. The Bank’s management will eventually decide on its organisational form in the IGAD countries themselves. Namely, whether the Bank sets up a regional branch office, representation offices in each IGAD member or leave marketers to fend for themselves will depend on the profitability of such a decision. **Marketing staff would not have the privileges and immunities of “core” bank staff.** As such, their salaries would be taxable, they would contribute to their pensions and so forth. Their effort will be eased by marketing conducted by/from their investee firms.

²⁴⁸ Marketing staff traditionally earn about 1% of the assets they pull in under management. A marketer earning \$100,000 per year would thus source \$10 million in deals – a small sum to be sure. These salaries should encourage others to train up, raising education levels for job aspirants.

Figure 59: The IGAD Communities Development Bank at a Glance

Name:	IGAD Communities Development Bank
Mandate:	Profit from potential externalities in IGAD markets
Target capitalisation:	\$40 billion
Shareholding:	70% private and 30% IGAD governments
Profit sharing:	IGAD governments receive 15% on all profits (in addition to their 30% of profits from their share of the Bank's initial capital). All IGAD governments share the 15% on an equal basis ("collective incentives").
Location:	London (or other major international financial centre). Marketing offices where demand.
Regulator:	Self-regulating, with regulation in foreign markets provided by foreign governments.
Staff:	Around 60 at height in headquarters and around 350 working in marketing in field
Hiring:	Only private sector employees hired on merits. No national quotas.
Pay:	Like investment banks (mostly bonuses).

Regulatory framework

Given the lack of regulatory infrastructure across the IGAD, the IGAD development bank would follow a mixed disclosure-based regulatory model – with regulation and oversight coming from three sources. First, and most importantly, the Bank would have an independent oversight and compliance department responsible for setting the relatively relaxed rules the Bank would follow (at least in the IGAD region itself). The department has an interest in the Bank's on-going profitability – and thus would not allow risky activity which would imperil such profitability in the future.²⁴⁹ Second, OECD member states – which oversee regulations in the countries where most of the Bank's capital will be raised – provide their own rules which the Bank must follow in their jurisdictions. Hopefully, they would allow for some

²⁴⁹ Much evidence shows that financial elites mould financial regulation favourable to them. The independent regulatory unit of the Bank would hopefully comprise career regulators from other jurisdictions (rather than the very rich). For a discussion of the way regulation reflects the interests of the financial elite (at least in the US), see Efraim Benmelech and Tobias Moskowitz, The Political Economy of Financial Regulation: Evidence from U.S. State Usury Laws in the 19th Century, *The Journal of Finance* 65(3), 2010.

flexibility, particularly in the solicitation to retail investors online.²⁵⁰ Because the Bank provides its non-confidential information online (and any confidential information in aggregates), the regulators in these countries would hopefully signal problems before they cause harm.²⁵¹ Third, the IGAD national regulators themselves may impose requirements that the Bank can not avoid. However, the Bank's economy might should hopefully provide bargaining power to encourage right-regulating given these countries' current economic situation.²⁵²

In theory, prudential regulation and market conduct oversight centralized in the Bank itself addresses potential problems at the source, and provides resources for effective oversight.²⁵³ Figure 60 shows the need for such a regulatory approach.²⁵⁴ Four of the eight IGAD countries did not have any information at all online about their financial regulations. Kenya and Uganda have the most rules online – though they still lack many of the “core” rules that most OECD regulators have adopted. A bank earning several billion a year in revenues would have enough resources to pay for regulatory oversight and the drafting of key regulations that make its markets as stable and profitable as possible.²⁵⁵ Self regulation has another political benefit. Working with such a regulator will require levels of cooperation between regulators in the IGAD countries themselves – fostering cooperation sought by the IGAD Agreement itself. Yet, the IGAD development bank has an advantage of providing access to developed markets and the financial wherewithal to modernize IGAD region financial services.²⁵⁶

²⁵⁰ Work has only begun on the international mutual recognition of financial regulations. Australia and New Zealand as well as Hong Kong and Mainland China have such agreements in place. Reports about US agreements with the EU and Australia have abounded for some time. See Frederick Tung, Passports, Private Choice, and Private Interests: Regulatory Competition and Cooperation in Corporate, Securities, and Bankruptcy Law, *Chicago Journal of International Law* 3, 2002.

²⁵¹ Such a structure differs from the China Development Bank, which provides its data only to the government. Hopefully such transparency will increase investor confidence in the Bank.

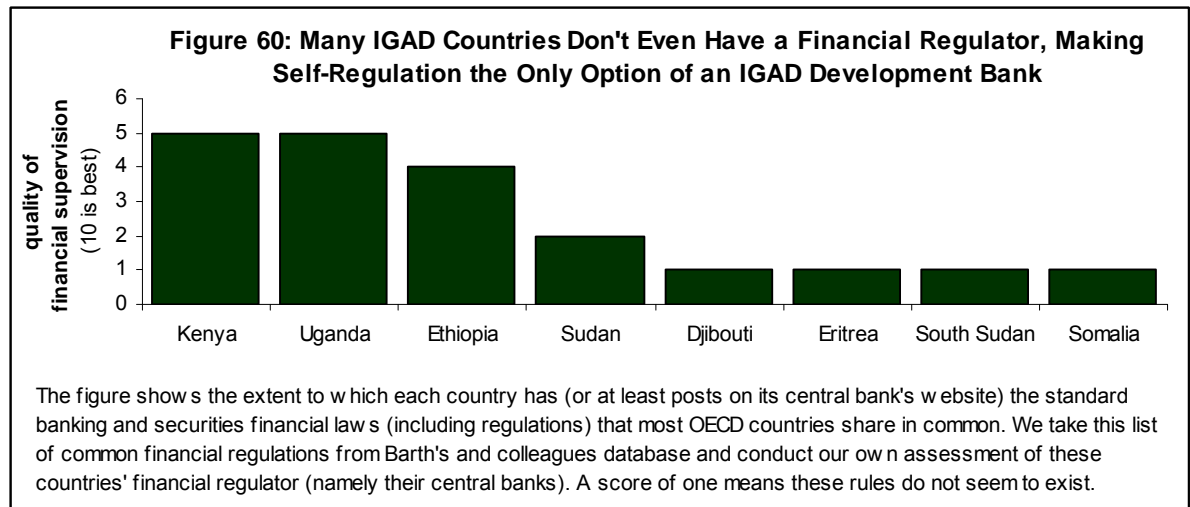
²⁵² Numerous academics and practitioners have argued for relaxed rules in under-developed areas as they catch-up with more developed countries. Yet, this is very much an open question. See Marco Rossi, Financial Fragility and Economic Performance in Developing Economies: Do Capital Controls, Prudential Regulation and Supervision Matter? *IMF Working Paper No. 99/66*, 1999, available [online](#).

²⁵³ Much evidence supports the need to centralise such supervision. See Donato Masciandaro, Divide et Impera: Financial Supervision Unification and Central Bank Fragmentation Effect, *European Journal of Political Economy* 23(2), 2007.

²⁵⁴ See James Barth, Gerard Caprio, and Ross Levine. Bank regulation and supervision in 180 countries from 1999 to 2011, *Journal of Financial Economic Policy* 5(2), 2013.

²⁵⁵ Self-regulation in financial markets has a long and venerable (if recently maligned) history. For such private sector finance of public financial regulation, see Biagio Bossone and Larry Promisel, The Role of Financial Self-Regulation in Developing Economies, *World Bank Finance Sector*, 2000, available [online](#).

²⁵⁶ For a primer on the future of financial services in the IGAD (as well as for the rest of us), see World Economic Forum, *The Future of Financial Services*, 2015, available [online](#).



Risks and resolution

The structure we propose offers superlative risks as well as possible returns. The proposed level of capitalization would represent roughly 40% of the region's GDP. In contrast, the Marshall plan gave roughly \$130 billion dollars – or 5% of US GDP.²⁵⁷ The US spent the modern-day equivalent of \$47 billion. As noted, this figure only represents part of the total aid given to the region in the past. The increased direct investment conducted by the IGAD Communities Development Bank will result in increased volatility of its securities.²⁵⁸ Our proposal would import capital markets volatility to a region without effectively and widely functioning capital markets.²⁵⁹ The region's bouncy GDP growth figures would translate as well into an equities rollercoaster ride.²⁶⁰ **The Bank's net benefit will depend on whether the benefits from expanding real output exceeds the output losses from volatility and inevitable crises.**

The effect on current account balances best illustrates the nature of such risks. As shown in Figure 61, most IGAD member states have run serious current account deficits.²⁶¹ The sudden inflow of foreign capital would represent an inflow into the each country's capital account. As investment funds export-oriented projects, earnings would further right current accounts. We do not show the inevitable current account deficits that would emerge years or

²⁵⁷ Just as we propose for the IGAD development bank, scholars argue that the Marshall Plan's biggest impact consisted not in investment, but policy advice and conditions which transformed the recipient countries into more market-driven economies. See J. Bradford De Long, Barry Eichengreen, *The Marshall Plan: History's Most Successful Structural Adjustment Program*, *NBER Working Paper No. 3899*, 1991, available [online](#).

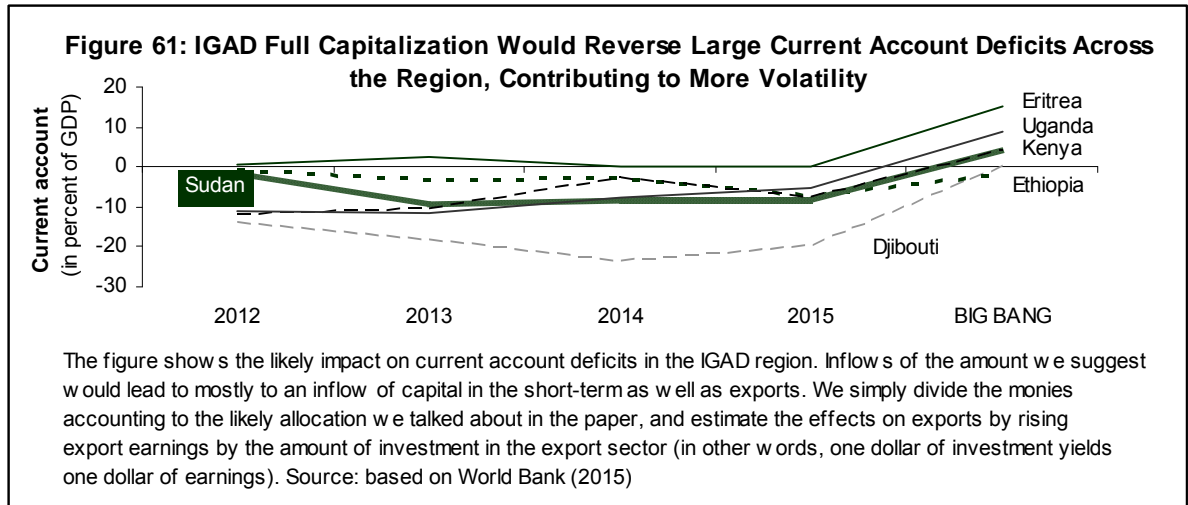
²⁵⁸ For exact numbers in a developing country context, see Hiray Gozgor and Yaman Erzurumlu, *Causality Relations Between Foreign Direct Investment and Portfolio Investment Volatility*, 2010, available [online](#).

²⁵⁹ For quantification of the likely spill-overs, see George Milunovich and Susan Thorp, *Valuing Volatility Spillovers*, *Global Finance Journal* 17(1), 2006.

²⁶⁰ In most IGAD countries, GDP growth rates have fluctuated by up to 10% of GDP or more (from rapid growth to sudden contraction). Such volatility would translate into stock price volatility. See Francis Diebold, Kamil Yilmaz, *Macroeconomic Volatility and Stock Market Volatility, Worldwide*, *NBER Working Paper No. 14269*, 2010, available [online](#).

²⁶¹ Such deficits themselves fragilize financial sectors. See Sebastian Edwards, *Does the Current Account Matter?*, In Sebastian Edwards and Jeffrey Frankel, *Preventing Currency Crises in Emerging Markets*, 2001.

decades after – as import demand grows and monies return to investors. Yet, even taking into account the inflows, we see significant macroeconomy volatility. Yet, to coin a phrase, from the IGAD region's perspective – it is better to have invested and lost, than not to have invested at all.²⁶²



The Bank is exposed to higher reputational risks than an average Bank – requiring large amounts of internal oversight. Evidence from developed economies shows that large banks run significant reputational risks which can cost investors dearly in case of fraud, loss or other operational problems.²⁶³ Guaranteeing adequate risk management procedures does not necessarily equate to an increase in costs (and thus a reduction in profits).²⁶⁴ Policies which penalise managers from excessive risk taking – and large amounts of disclosure-based oversight – can help ensure the Bank does not increase the financial fragility of IGAD member states.²⁶⁵ Indeed, most IGAD economies with functioning banking systems already exhibit oligopolistic banking concentrations.²⁶⁶ Numerous countries show that powerful development financial institutions can operate for decades without any crisis or stress.²⁶⁷

²⁶² Even if foreign investors lose all their money, welfare would still increase in the IGAD countries (assuming the money isn't stolen and transferred abroad). Entrepreneurs would salvage much of the investment – using it for other ventures. As equity holders simply write-off losses (unlike typical multilateral debt holders), political and social risks are also much lower than sovereign multilateral lending finance.

²⁶³ For a quantification, see Franco Fiordelisi, Maria-Gaia Soana, and Paola Schwizer, The Determinants of Reputational Risk in the Banking Sector, *Journal of Banking & Finance* 37(5), 2013.

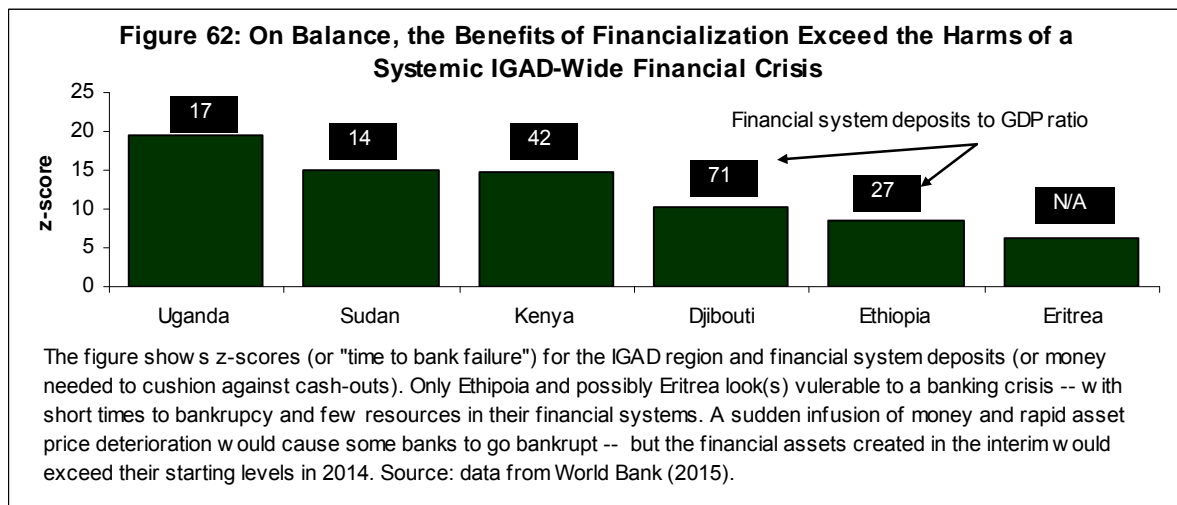
²⁶⁴ Several studies note that high reputation investment banks can pass on the costs of protecting their reputation from excessive risk-taking and control over risks. See Lily-Hua Fang, Investment Bank Reputation and the Price and Quality of Underwriting Services, *Journal of Finance* 60(6), 2005.

²⁶⁵ For a discussion of the measures which the Bank can take to reduce systemic risk as the financialisation of the IGAD economies increases as a result of the Bank's work, see Raghuram Rajan, Has Financial Development Made the World Riskier?, *NBER Working Paper No. 11728*, 2005, available [online](#).

²⁶⁶ World Bank data provide measures of banking sector concentration for only three of the eight economies. The five largest banks in these economies have market shares well in excess of 70%. Thus, any development bank promoting a bigger, cross-border banking system would likely reduce concentration.

²⁶⁷ From post-war Japan to modern-day China, development institutions charged by the government to allocate capital have remained stable. See Kuniko Fujita, Neo-industrial Tokyo: Urban Development and Globalisation in Japan's State-centred Developmental Capitalism, *Urban Studies* 40(2), 2003.

What would happen if equity prices rapidly decrease? The asset values propping up IGAD bank balances and real estate prices would decrease. Figure 62 intimates what would happen during a financial crisis in the region. As resources pour into the IGAD, banks' balance sheets would improve and ownership of financial assets would increase. Uganda, the Sudan and Kenya would benefit from more resources (in that country order). Bank lending would increase and securities would be used to secure loans in shadow banking markets.²⁶⁸ A sudden shock would consequently reduce collateral values and bank solvency. Eritrea's banks – while closest to default – earn almost three-quarters of their revenue from services (not lending). On the other hand, Eritrean banks lend almost half the value of GDP to the government and its state-owned enterprises. At the other end of the spectrum, foreign assets already make up roughly 44% of Kenya's banking system. Thus, they have access to far more resources than the other IGAD countries already. **Yet, because of the development bank's equity rather than debt holdings, a financial crisis would have far less effects on the real economy than a typical banking/financial crisis.**²⁶⁹



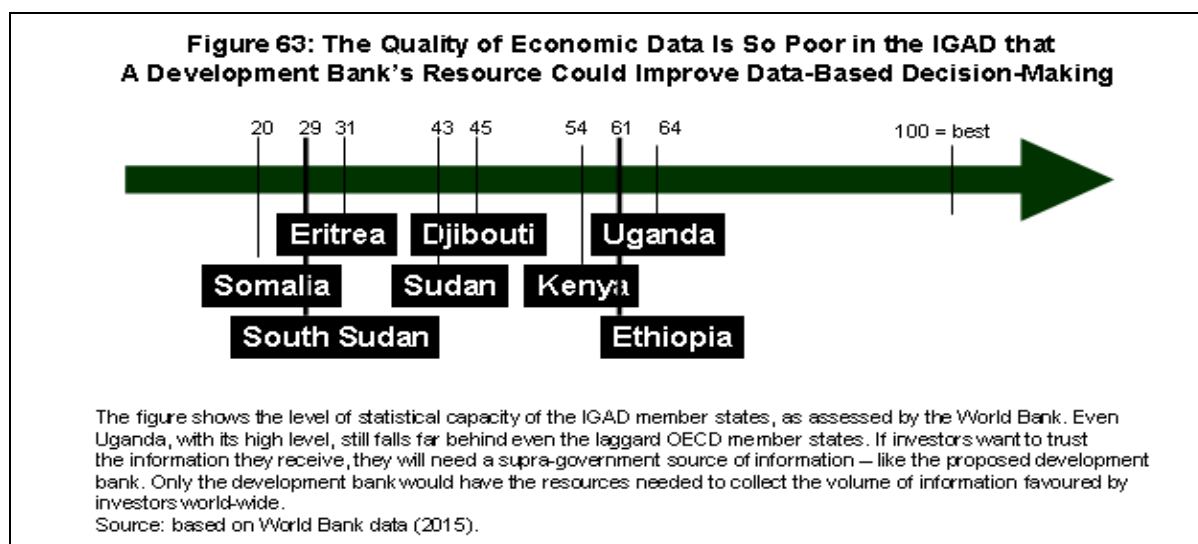
What about insolvency and resolution?²⁷⁰ In this case, the bank may be dissolved and monies returned to the national treasuries of the IGAD member states (and other investors) – and assets repatriated. UK reorganisation/bankruptcy law would apply (or the law of the jurisdiction the Bank finally locates in). In theory, the UK (or other relevant authority)

²⁶⁸ While trade finance, insurance and pension monies remain negligible across the region, the extremely wealthy (as we describe later) hold a relatively large share of GDP. Private banking – as asset backed lending to high net worth individuals -- thus could pose significant risks as asset prices fall.

²⁶⁹ While econometric studies show that bank-led financial crises significantly slow GDP growth, the evidence is far more mixed about the effect of rapid equity price drops. For buy-and-hold investors like the development bank, the effects would likely be minimal. In any case, such a crisis would bring "short term pain and long term gain." See also Graciela Kaminsky and Sergio Schmukler, Short-Run Pain, Long-Run Gain: Financial Liberalization and Stock Market Cycles, *Review of Finance* 12 (2), 2008.

²⁷⁰ Resolution in this context refers to the ability to resolve a liquidity crisis and/or wind-up in an orderly way. For a more technical discussion, see Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, 2011, available [online](#).

regulator would take charge for the resolution.²⁷¹ As the Bank would be “systemic important” for the IGAD economies themselves (and possibly even for investor economies if they purchase sufficient amounts of IGAD securities), special rules would apply to the development bank.²⁷² Both UK and US regulators have encouraged the adoption of legislation defining resolution rules for globally systemically important financial institutions.²⁷³ On the one hand, the Bank can free-ride off of their experience – as the Bank would certainly need to comply with at least part of their resolution regimes. **On the other hand, IGAD member countries’ central banks may wish to consider adopting prudential regulation and monitoring to ensure minimal impact on IGAD countries’ real economies of any resolution of the IGAD development bank.**²⁷⁴ Indeed, as shown by Figure 63, because statistical quality is so poor in the IGAD region, the Bank’s data can serve as a useful repository for policymakers in the IGAD. The World Bank and other international financial institutions probably wouldn’t provide enough assistance in case of a serious crisis.²⁷⁵



²⁷¹ This assumes the agreement of the UK (or relevant host jurisdiction) government. Naturally, any authority in charge of resolution would set conditions – such as a “living will” (resolution plan) or other remedies.

²⁷² For an update on progress in defining a resolution regime for systemically important institutions, see Financial Stability Board, *Resolution of Systemically Important Financial Institutions: Progress Report*, 2012, available [online](#).

²⁷³ Federal Deposit Insurance Corporation and the Bank of England, *Resolving Globally Active, Systemically Important, Financial Institutions*, 2012, available [online](#).

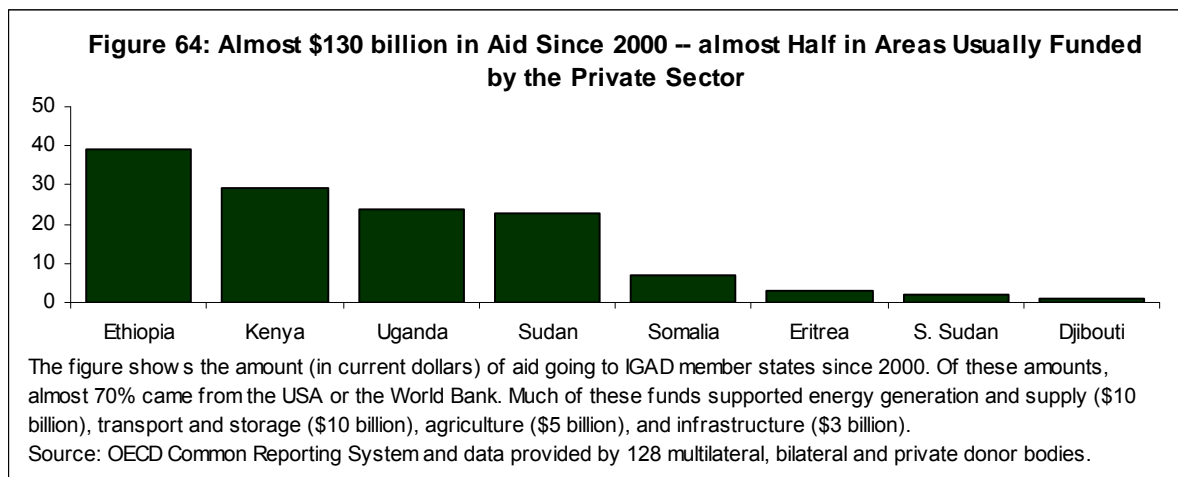
²⁷⁴ As previously mentioned, central banks represent the bank regulator in all IGAD economies. For a discussion of the issues of prudential monitoring conducted by central banks, see European Central Bank, *The Role of Central Banks in Prudential Supervision*, 2010, available [online](#). Indeed, central banks may wish to print money as the economy becomes able to absorb increasing balances. For yet another reason why IGAD central banks should not supervise the IGAD development bank, see Thierry Tresselt and Thierry Verdier, *Optimal Prudential Regulation of Banks and the Political Economy of Supervision*, available [online](#).

²⁷⁵ For analysis, see Evaluating the Reaction of Development Banks to the Financial Crisis, 2011, *Conference Paper*, available [online](#). See also Independent Evaluation Group of the World Bank, *World Bank Group Response to the Global Economic Crisis*, 2011, available [online](#).

The Politics and Logistics of the Development Bank Project

Politics of aid and preferential treatment

The establishment of an IGAD Communities Development Bank has the potential to change the relationship between creditors and debtor countries. Figure 64 shows the amounts of money going in aid to IGAD Member States since the beginning of 2000. Much of such aid consisted of emergency response (\$25 billion). Yet, almost half went toward activities usually funded by the private sector – showing how aid has crowded-out private investment in the IGAD region. Previous debt puts the IGAD in a catch-22 situation. As private money enters the IGAD, donors will want funds to go to repay past debt. Investors – seeing the dissipation of their money into unproductive past loans – will refuse to invest in the IGAD. Worse still, the IGAD can not rely on aid to complement private investment (such as public spending on anti-poverty and other programmes). **Diplomatic resources must be spent to ensure that the two key aid/lenders -- the US government and the World Bank -- support the existence and operation of the development bank.**²⁷⁶



Once the IGAD development bank starts operations, it should prepare a workable plan for converting debt-to-equity and possibly renewing requests for debt forgiveness.²⁷⁷ Because the Bank has increased access to US and EU citizens (through its campaign of awareness raising and informing them of IGAD securities), political support should mount among the donors' electorates. Further support from the electorate will follow if the Bank can show how reasonable write-offs correspond with self-sufficiency.²⁷⁸ **The IGAD Assembly of Heads of**

²⁷⁶ According to AidData, World Bank aid surpassed US government aid to the region for the first time (totalling \$4 billion to the US government's \$3 billion). The other major donors put less than \$1 billion each. The recent US resistance to the Chinese-led Asia Infrastructure Investment Bank shows the need for such consultation. See Jane Perlez, U.S. Opposing China's Answer to World Bank, *New York Times*, 2014, available [online](#).

²⁷⁷ Starting this process close to the start of operations reduces the number of potential investors in the IGAD banks shares who face unpredictable dilution of their shares as former donor government take shares.

²⁷⁸ For the motivations of these electorates, including those looking to see some form of return on loans to the IGAD, see Carol Lancaster, *Foreign Aid: Diplomacy, Development, Domestic Politics*, 2006.

State would take final decisions on debt resolution completely independently from the development bank – as an iron wall must be maintained between politicians and the development bank.

What are the likely results of political action aimed at supporting debt-for-equity swaps? Figure 65 shows the winners and losers in the donor economies. HIPC and other debt relief initiatives have already created a precedent for some debt relief.²⁷⁹ In theory, more voters in OECD lending economies benefit from debt relief in the IGAD than are harmed. An equity-for-debt swap would clearly reduce needed aid and lending to the IGAD region, and even burnish the reputation of traditional lenders like the World Bank -- whose previous loans look unlikely to ever be repaid.²⁸⁰ Past swaps – such as debt-for-environment swaps – have shown the success of this model.²⁸¹ **Credible securitisation of assets in the IGAD region and a debt-for-shares swap would resolve existing debt overhang and satisfy even the most strident opponents of debt relief in the lending community.**

Figure 65: Winners and Losers for a Restructuring of IGAD Debt

Winners	Losers
Future investors	Past investors looking to recoup losses
Past investors looking to get out in a hurry	Aid agencies shown past lending ill-advised
NGO sector militating for such relief ²⁸²	Companies competing in labour-intensive low value added industries.
Companies selling goods and services in the IGAD region	

The other issue deals with the anticompetitive effect of an IGAD Communities Development Bank within IGAD countries themselves. Preferential access to deals and special terms negotiated with Governments (the Bank's bargaining power vis-a-vis governments) will put locals and others at a potential disadvantage. We think the benefits exceed any anti-competitive harms for three reasons. First, until recently, most of the IGAD region has not shown much interest in competition law.²⁸³ Thus from a legal point of view, the Bank has little worry about in the short to medium term. Other countries like Turkey, South Korea, even Hong Kong show that anticompetitive state-sponsored oligopolies can promote

²⁷⁹ Yet, for the IGAD region, the HIPC and other recent debt relief programmes represent no more than an encouraging precedent. Much debt forgiveness has passed over the IGAD region. For a description of the past failures to resolve debt in this and other regions, see Serkan Arslanalp, Peter Blair Henry, Debt Relief, *NBER Working Paper No. 12187*, 2006, available [online](#).

²⁸⁰ For analysis of the substitution effects of debt relief, and the political effects of such relief, see Bernhard Gunter, Jesmin Rahman, Quentin Wodon Robbing Peter to Pay Paul? Understanding Who Pays for Debt Relief, *World Development* 36(1), 2008.

²⁸¹ An OECD report on these programmes concludes that “experience shows that a debt-for-environment swap is a relevant mechanism for low-income countries facing difficulties with servicing their external debt. [These programmes] can help simultaneously reduce fiscal stress, stimulate economic growth and increase domestic resources available for environmental protection” (page 57). See OECD, *Lessons Learnt from Experience with Debt-for-Environment Swaps in Economies in Transition*, 2007, available [online](#).

²⁸² Oxfam, ONE and other international NGOs have engaged in debt relief advocacy for more than a decade.

²⁸³ Uganda's Competition Act only came into force last year and the Common Market for Eastern and Southern Africa (COMESA) has taken the lead on much work toward a regional competition law framework. Sudan passed a version of this law in 2009, while Ethiopia's competition law only came out this year.

development faster than a very free market economy.²⁸⁴ Second, while well connected businessmen and politicians will have preferential access and opportunities to cooperate with the Bank, such preferences do not differ from those in other countries. Local elites have similarly benefitted in the OECD when their governments directed resources.²⁸⁵ Third, as markets come into existence, the Bank's *carte blanche* would be phased out over time.²⁸⁶ Indeed, eventually the Bank could be required to assess the potential anticompetitive effects of its finance decisions, much like the World Bank requires social, environment, gender and other analyses on all its project initiation forms. **Yet, without positive PR and probably some corporate social responsibility spending, some might resent the power and privileges accorded to the Bank.**

Increasing income disparities and buying off local elites

Our proposed development finance institution will absolutely contribute to income inequality and exacerbate some types of poverty in the IGAD countries. Figure 66 shows the proportion of national income earned by the top 10% in various countries. The poorest countries ironically probably have the highest concentration of income (such as it is).²⁸⁷ Providing elites in these countries with access to significant resources will increase their power and influence in their countries and across the IGAD in the short-term. In the longer term, the creation of other millionaires will provide new oligarchs with the resources to run opposition political campaigns.²⁸⁸ Yet, such prospects are so remote and the advantages to existing elites so large that future prospects of losing power should not dissuade local elites from supporting the operation of such a bank today. **Yet, the Bank will exacerbate existing social divides without close attention paid to minority complaints and possible corporate social responsibility programmes aimed at supporting them.**²⁸⁹

²⁸⁴ Academics and policymakers have accepted that state direction of resources and lack of harmful, wasteful competition more efficiently promotes development. Only recently have the international organisations led an offensive against cartelization of the economies they persuaded to cartelize in the first place. For a summary of the new thinking on competition and growth, see Hassan Qaqaya and George Lipimile, *The Effects of Anti-Competitive Business Practices on Developing Countries and Their Development*, 2008, available [online](#).

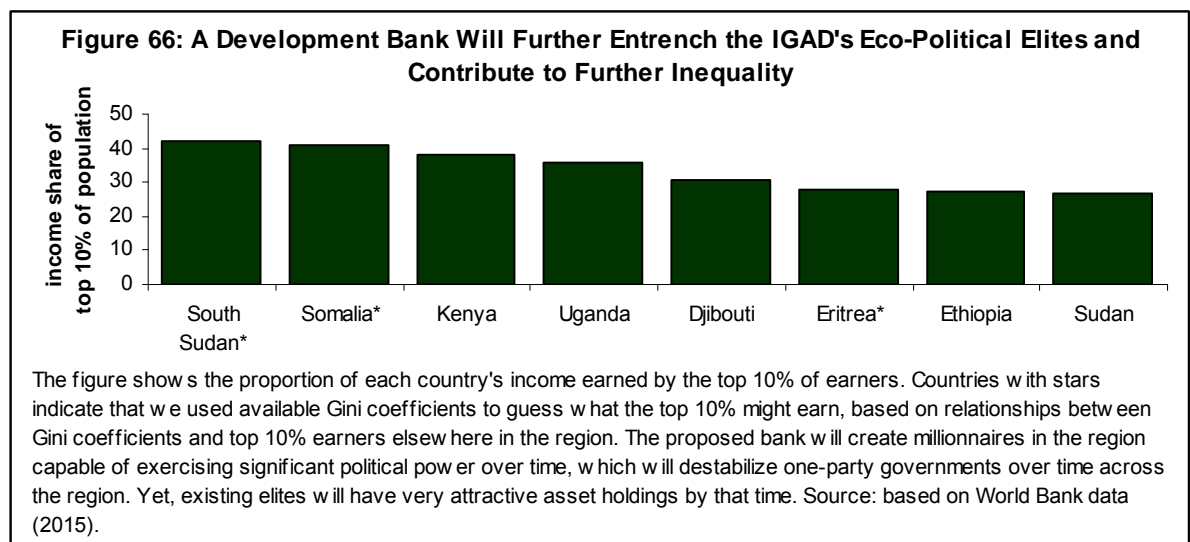
²⁸⁵ See Hubert Schmitz, Anuradha Joshi, Adrian Gurza Lavalle, Ali Cheema and Andres Mejia Acosta, *An Upside Down View of Governance*, *Institute of Development Studies*, 2010, available [online](#).

²⁸⁶ Few have studied the way that capital directed by a large, systemically important financial institution can reduce competition outside the banking sector itself. For one such study, see Daniel Sokol, *Limiting Anti-Competitive Government Interventions That Benefit Special Interests*, *Global Competition Law Centre Working Paper 02/09*, 2009, available [online](#).

²⁸⁷ Indeed, African data fail to show any correlation between financial development and income inequality. Yet, the concentrated politically-connected nature of the proposed method of financial development differs significantly from the diffuse financialisation experienced by African countries in the past. See Michael Enowbi Batuo, Francesco Guidi and Kupukile Mlambo, *Financial Development and Income Inequality: Evidence from African Countries*, *African Development Bank Brief 2(1)*, 2010, available [online](#).

²⁸⁸ Such a pattern is well known. See Axel Hadenius and Jan Teorell, *Authoritarian Regimes: Stability, Change, And Pathways To Democracy, 1972–2003*, *Kellogg Institute Working Paper 331*, 2006, available [online](#). Yet, not everyone would agree that a big bank would contribute to income inequality. For contrary evidence, see also Thorsten Beck, Ross Levine, Alexey Levkov, *Big Bad Banks? The Impact of U.S. Branch Deregulation on Income Distribution*, *NBER Working Paper No. 13299*, 2007, available [online](#).

²⁸⁹ We do not discuss the nature of such corporate responsibility spending. Some groups have already starting criticising the IGAD for its political positions. See Gai James Kai, *The Inter-Governmental Authority for Development's double standard against SPLM-in Opposition*, *South Sudan News Agency*, 2014, available [online](#).



Local elites have three reasons to support Bank promulgated policy recommendations and investments in their countries.²⁹⁰ First, these elites represent the only persons able to buy significant numbers of shares in the Bank in the near-term. Thus, they benefit as the Bank earns profits – a perfectly incentive compatible situation. Second, as gatekeepers of local assets to be securitised and local knowledge, these elites indirectly decide where the Bank allocates its resources. As the Bank looks for attractive deals, many of these elites will originate deals and prepare large projects for funding. Third, the access such a Bank provides to rich countries and resources means that elites can buy flats in London, shop in Vienna and do all the things the global elite loves to do.²⁹¹

Changing the IGAD's Look and Feel

The establishment of a development bank would transform the IGAD into a serious regional economic and political actor. At present, most analysis of the IGAD focuses on its role in conflict prevention and resolution in the Sudan. Figure 67 shows the recent articles about the IGAD. Many academics have noted the IGAD's severe lack of capacity and its inability to act as a separate actor.²⁹² Making a development bank a formal part of the IGAD would

²⁹⁰ The exacerbation of income inequality is by no means a certainty. Authors like Bjornskov find that foreign resource flows into states with authoritarian regimes (like many in the IGAD) do not experience a significant worsening of income inequality. Yet, authors like Findley et al. find that the accountabilities associated with foreign resource flows make elite capture of resources harder. The debate continues. See Christian Bjornskov, Do elites benefit from democracy and foreign aid in developing countries? *Journal of Development Economics* 92(2), 2010. See also Michael Findley, Adam Harris, Helen Milner, and Daniel Nielson, Elite and Mass Support for Foreign Aid versus Government Programs: Experimental Evidence from Uganda, 2015, available [online](#).

²⁹¹ For a discussion of the way rapid growth and privileged access to resources would create a class of the super-wealthy, see Chrystia Freeland, *Plutocrats: The Rise of the New Global Super-Rich and the Fall of Everyone Else*, 2012.

²⁹² For one example, see Isaac Weldesellassie, IGAD as an International Organization, Its Institutional Development and Shortcomings, *Journal of African Law* 55(1), 2011. For another example, see Sally Healy,

expose the bank to same institutional problems plaguing the IGAD. In recent years, the IGAD has appeared to serve as a forum for issuing various kinds of calls and requests – such as requests for World Bank aid, for the harmonization of the regulation of medicines, humanitarian assistance, plans to develop tourism and other issues. Yet, as the region’s most important proto-union, the institutional and political capital built up by the IGAD provides a way of negotiating for the rights of the Bank in the IGAD member states.

Figure 67: Major Issues Associated with the IGAD to Date

Issue	Description	Links
Conflict resolution	The IGAD encourages member countries to attempt to solve conflicts in the region. Other recent includes work on anti-terrorism.	*
Intra-regional trade	The IGAD’s work has only just started in this area—and no formal agreements or procedures appear to have emerged as the result of the IGAD’s work.	*
Infrastructure	Again, the IGAD serves as a forum for calling for resources to develop infrastructure in the region.	*
Climate change	Several studies have looked at the role of climate change, including desertification of the area and drought (the issue that originally brought the Authority into existence).	*
Livestock	From a development (welfare) perspective, work has continued on pastoral livelihoods. Along more economic lines, studies have looked at increasing the competitiveness of meat production, processing and export.	*

An operating development bank, formed along the lines we recommend, would likely significantly alter the focus and issues addressed by the IGAD. IGAD supervision of the Bank – and Bank profits used to fund regional initiatives – would likely focus on developing capital markets, trade, and industrial policies (such as government support for particular industries). Governments will need to devote major time and resources to liberalization and creating a regulatory environment where the Bank can operate.²⁹³ Many senior officials will probably have personal and family connections closely tied to the success of the Bank.²⁹⁴ For better or worse, failure to adopt these policies may represent a big enough political failure to motivate reform of the already criticised IGAD. In other words, failing to adopt pro-market policies could cost existing governments a fair amount of embarrassment and political capital. **As the IGAD’s most internationally visible and profitable project, the IGAD would likely shift focus from humanitarian issues to trade and financial issues.**

Seeking peace and security in the Horn of Africa: the contribution of the Inter-Governmental Authority on Development, *International Affairs* 87(1), 2011.

²⁹³ Pre-accession countries in the EU provide some lessons about the consuming need to engage in regulatory harmonization to join a common trade area open to cross-border investment. See Heather Grabbe, How does Europeanization affect CEE governance? Conditionality, diffusion and diversity, *Journal of European Public Policy* 8(6), 2001.

²⁹⁴ Cronyism has been well documented in the region. For a technocratic look at some of these linkages, see David Booth, Brian Cooksey, Frederick Golooba-Mutebi and Karuti Kanyinga, East African prospects: An update on the political economy of Kenya, Rwanda, Tanzania and Uganda, *ODI Report*, 2014, available [online](#).

Is this unrealistic for a conflict-ridden area focused on agriculture, oil, and livestock?

The IGAD region suffers from serious security, humanitarian and development challenges. We purposely avoid including these issues in this paper for three reasons. First, as we documented earlier, so many other institutions and experts have developed elaborate plans targeting these issues. We do not wish to divert readers' attention or undermine these analyses with other proposals. Second, the Bank would obviously focus attention on areas as dictated by long-term market incentives. Bank activity would obviously not focus on problematic areas where IGAD citizens most need resources. Thus, we don't expect much investment will occur in places like Somalia or South Sudan in the short-term. However, China's experience shows that incomes increase for many. Third, any plan for a development bank must consider the future rather than the present. By 2020 or 2030, many IGAD countries will enter middle income status. The development bank should deal with those economies, rather than grow obsolete if it assumes it will operate in a low-income environment for the foreseeable future.

Different growth rates and institutions will create fundamental tensions in the IGAD. Uganda and Kenya represent diversified economies and have little in common with the other IGAD members. As their income increases, and as much of the Bank's profits will probably come from assets securitized in these economies, they could see the IGAD as a liability rather than an asset. Countries like Somalia and Eritrea could find themselves excluded from much investment, leading these countries to reject further participation in the Bank project as their neighbours become richer. If arrangements to share profits equally among IGAD member states create solidarity and cohesiveness among members today, the richer members may consider such sharing rules as inequitable. **Political frictions would likely cause the Bank to lose its legitimacy if all members do not contribute to free trade of goods, people and money in the region.**

Timetable for activities

The IGAD Communities Development Bank would likely develop through three major phases. Figure 68 shows these phases. In phase 1, the IGAD would set up the institutional foundations for the Bank. These activities include creating the legal instruments setting up the bank (such as an Articles of Association or IGAD Protocol), arranging diplomatic status with the host country, and contacting a promoter to engage in underwriting the Bank. Phase 2 tests the securitisation concept and observes the offer of the first batch of privately placed securities. IGAD members would pass local legislation liberalizing their business environments (and thus allowing the Bank to function). The Bank would negotiate with foreign financial regulators for access to their markets, obtaining the most lenient conditions possible for investor solicitation. IGAD member states would transfer assets into the Bank's custody. The promoter would raise funds for future investments and start setting up investment vehicles for the offer of particularly large, discrete assets. The initial funds would pay for the first managers (president, vice presidents, compliance, risk management, marketing, and IT). In the third phase of operations, the Bank would scale up its investment offering. Funds already raised would also pay for the preparation of the first batch of publicly offered investments – including the writing of prospectuses, preparing listing materials,

marketing materials and so forth. By this time, first results should come in – and initial profits distributed to investors (like IGAD member states). In case demand for IGAD securities does not exist, the Bank would be wound up – nothing ventured, nothing gained.

Figure 68: Schedule for Activities Leading to the Creation of an IGAD development bank

Activity	2016		2017		2018	
	first half	second half	first half	second half	first half	second half
Phase I: Institutional Foundations						
Creation of legal instruments setting up the bank						
Arranging diplomatic status with the host country						
Contacting promoters to underwrite the Bank						
IGAD members pass Bank friendly regulation						
Negotiations with foreign financial regulations for market access						
Phase II: Proof of concept and first steps						
IGAD members transfer assets into Bank's custody						
Promoter sells initial shares, raising money						
Money used to hire staff, premises, and equipment						
Phase III: Scaling up or dissolution						
Offering documents prepared for other investments						
Marketing associates finds assets for securitisation						
Risk management begins in earnest						
First profits transferred back to IGAD						
Initial Board constituted (based on investment)						
First financial results published and discussed						
(In case of lack of demand, winding up)						

Conclusion

Should the IGAD region have its own development bank? The IGAD members already have national development banks and access to several regional development banks. The region needs access to more than just loans – as such finance has historically led to massive debts which cripple most IGAD economies. The IGAD should set up a financial institution (which we call a bank, even though it operates more like an investment company). An IGAD Communities Development Bank would originate (securitize) assets in the IGAD region, and offer these securities – and attendant cash flows from them – to mostly international investors. The massive amounts of money the Bank could raise should motivate local officials to change extremely dysfunctional business and financial regulations. Profits from the Bank could provide much needed cash to the IGAD Secretariat and the IGAD's member governments.

Such a structure has three other objectives. First, the Bank would serve as a vector of globalisation for the region. Investors and ordinary people in OECD economies would learn about the IGAD countries, and hopefully replace images of war-torn cities and starvation bloated bodies with images of new modern investments (much like the China Development Bank has done for China). Second, the Bank would allow IGAD countries to benefit from the investment opportunities which Chinese and US/UK investment banks already profit from. Chinese investors have placed billions of dollars in the region. Securitising these and other investments would allow for the spreading of risks and participation in the IGAD economies. Third, the Bank would provide a useful counterweight to governments, encouraging them to act in their common interest and negotiating market access for friend and foe alike.

The Bank would raise a modest \$40 billion dollars – from a potential market for investments of at least several times that magnitude. Profits of around \$500 million to \$2 billion per year would fund the work of IGAD governments and the IGAD Secretariat itself – even though the Bank remains completely and totally independent from the IGAD. Operating on a disclosure-based regulatory system, the Bank would provide copious amounts of information to investors, the IGAD authorities (the presidents, ministers of finance and ambassadors which take decisions for the IGAD) and other institutions. Such information economizes on resources – as the Bank would rely in part on regulators of the upper-income countries which invest in its securities, to ensure its prudential regulation and proper market conduct.

The Bank's innovative design achieves other key goals. First, securitisation represents the only way such an institution can raise enough money to dent IGAD Member States' GDP growth rates. Fully capitalised, the Bank should contribute several points of GDP growth across the IGAD. Second, securitisation would allow for the first functioning markets able to swap multilateral and other debt for equities. Such swaps would resolve the debt overhang which prevents much useful investment and social expenditure. Third, profit sharing arrangements and independence from politicians helps promote political cohesion across the IGAD. As policies catch up with IGAD investments, the Bank provides significant resources for financial regulation and oversight, the development of vibrant and deconcentrated banking systems, and the rectification of public and current account deficits.

Bulge bracket banks existing for about 100 years attest to the success of this business model. Countries like Japan, China, Singapore and others have adopted some form of the securitisation model to drive their own development. Yet, as a method of development finance – such a model has never been tried at this scale. In case investors fear a relapse of violence or extreme corruption, lack of demand could make the Bank ineffective. By locating in London (or other financial centre), the Bank would import the use of effective contract, investment and even criminal (anti-bribery) law. The Bank's highly risky securities may fail to find favour with foreign regulators and investors in case returns do not adequately compensate for investment risks. Yet, such an ambitious model provides the only historically proven route to achieve the IGAD's goals of development and regional integration. Only time will tell if the Bank's securities find buyers.

Appendix I: Questions and Answers at a Glance

What is the two sentence summary?

The IGAD Communities Development Bank represents a public-private cooperation, inspired by organisations like TEMASEK, the China Development Bank, which will provide finance for roughly \$60 billion in investment opportunities in the IGAD region.

Why does the Bank look so different than the AfDB and the national development banks?

Traditional development finance doesn't work. And the parts that do won't provide anywhere near enough money to pull these poorest of the poor countries out of poverty in our lifetime. Our securitisation model represents the only mechanism for achieving the IGAD's goals.

How much money will you raise?

\$40 billion to start. Demand for IGAD Bank securities will determine future investment.

Who will own the Bank?

The investors will own the Bank. The IGAD Member States will contribute assets in-kind – representing roughly 30% of the Bank's initial capitalisation. Institutions outside the IGAD will invest the rest. Over time, citizens of IGAD member states could purchase securities in primary or secondary markets.

Who sits on the Board?

The IGAD would get one member of the six member Board (two if you count the President of the Bank as part of the IGAD). The other four Board members would come from the institutions investing in the Bank's securities (as decided in shareholder meetings). The Board could expand as needed.

Why "Communities" in the Bank's title?

When the EU got its start, it was known as the European Communities (plural). The name draws on obvious parallel to this successful trade Union, signals the aspirations of the region to do the same, and highlights the lack of supranational authority.

Why is the Bank proposed for London?

London offers the best international financial law and contacts. The hope is to bring the Bank to the IGAD region someday – encouraging national officials to adopt policies needed for the Bank to function well. The Bank will bring something more important than money – trade and financial connections with the developed world.

Isn't this very fancy for a region concerned about agriculture and cattle ranching?

We aren't concerned with these vital parts of the economy (directly). Enough development organisations deal with these issues. We want to focus on the niches where history shows development bank-led growth occurs.

Aren't you delivering the IGAD region into the hands of the evil capitalists?

Yes. But overtime, hopefully IGAD citizens will represent the majority of those “evil” capitalists.

What if this goes horribly wrong?

As a private company with public participation, unhappy Governments can simple sell their shares. Even if no one is interested in the Bank's securities, having a skeleton crew offering the possibility of investing in the IGAD is no bad thing. Of course, the Bank can be wound-up and liquidated as usual.

Appendix II: Mathematics and Models Used in the Working Paper

In this appendix, we review the data we used and the basic model we used when thinking about the development finance problems facing the IGAD. With this basic model, we can explain the methodologies used in several of the figures more fully.

The basic growth engine model assumes that capital helps create an industrial sector, which subsequently exports services in order to grow. We start by thinking of output as a group of j aspects or valuable parts of asset i . The usual factor exhaustion theorem applies, such that the value added to any piece of output eventually is reflected in its market price. We assume that these asset “margins” yield a true value which investors may not know (or they might). Thus, we see a wedge between the price of an asset and its real value (as contribution to GDP). We further assume that some institutional factor (which we label R as a short-hand regulation) have the effect of geometrically reducing the way that capital (K) contributes to the production of output (Y). In this world, β measures the distortion that these institutional factors cause to international investors, while r represents the distortion to local investors. We assume that a proportion γ comes from domestic sources while $1-\gamma$ comes from foreign investors. The graphic shows the intrinsic non-linearity of the equation.

$$Y = \sum_{j=1}^m \sum_{i=1}^n y_{ij} \quad \text{and} \quad p'Y = \sum_{j=1}^m \sum_{i=1}^n v'_{ij} y_{ij} \quad \text{and}$$

$$\text{that in } pY = \sum_{j=1}^m \sum_{i=1}^n v'_{ij} y_{ij}^{\beta R}$$

$$I = \gamma K_i^{\rho R} + (1 - \gamma) K_i^{\beta R}$$

$$S = \theta K^\psi I^{\delta K}$$

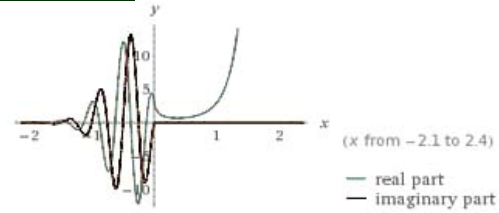
$$S = \theta K^\psi \gamma K_i^{\rho R} + (1 - \gamma) K_i^{\beta R \delta K}$$

$$Y = vS = v\theta K^\psi \gamma K_i^{\rho R} + v(1 - \gamma) K_i^{\beta \delta K}$$

$$\frac{dY}{dK} = v\gamma\psi\theta R \theta K^{\psi\rho R-1} + v(1 - \gamma)\beta\delta K^{\beta\delta K} (\ln K + 1)$$

$$\frac{dY}{dK} = K^{\beta\delta K} \left(\frac{v\gamma\psi\theta R \theta}{K} + v(1 - \gamma)\beta\delta (\ln K + 1) \right)$$

ρ	Way local capital affects industrialisation
β	effect of foreign capital on industrialisation
γ	division of capital
ψ	direct effect of capital on output
θ	“scaling” effect of industrialisation on service exports
δ	geometric effect of industrialisation on exports
v	way service exports translate into output



To test these effects, we look at the extent of GDP growth, capital formation, extent of industrialisation and trade in services. Figure IIa shows the basic descriptive statistics for these variables. We excluded Somalia and South Sudan (for lack of data). Figure IIb shows the (very loose) correlations between these three variables. Figure IIc shows the basic regression results looking at the way capital, industrialisation and exports in services contributes to GDP growth. Changes in the capital stock clearly (and statistically significantly) affect GDP growth rates across the IGAD.

Figure IIa: Descriptive Statistics of Basic Growth Engine Model

	Valid N	Mean	Minimum	Maximum	Std.Dev.
GDP Growth	54	5.58	-9.78	12.55	4.15
Gross Capital Formation	44	24.06	9.26	40.27	7.44
Change in Capital	38	0.80	-27.13	26.82	9.38
Industry	37	20.21	10.18	33.41	6.15
Change in Industry	31	0.082	-27.21	33.72	13.13
Trade in Services	41	17.69	4.22	44.31	11.37
Change in Services	36	-0.36	-23.67	36.63	13.29

Table IIb: Correlations Between Rates of Change in Basic Model

	Means	Std. Dev.	GDP Growth	Change in Capital	Change in Industry	Change in Services
GDP Growth	6.22	3.97		0.21	0.27	0.098
Change in Capital	1.55	9.24	0.21		-0.17	-0.015
Change in Industry	-2.48	9.93	0.27	-0.17		0.005
Change in Services	-1.89	12.6	0.10	-0.01	0.005	

Figure IIc: Regression Results for Basic Growth Engine Model

	Changes Model	Levels Model	Full Model
Intercept	9.19	-8.16	-8.79
	3.16	6.70	8.76
Change in Capital	0.08		-0.08
	0.09		0.12
Change in Industry	0.12		0.17*
	0.08		0.08
Change in Services	0.03		0.00
	0.06		0.05
Capital		0.43*	0.44*
		0.14	0.18
Industry		-0.18	-0.37*
		0.13	0.17
Services		0.06	0.15
		0.10	0.191788
Country proxy	No	No	Yes
Variance explained	3%	24%	34%

The table shows b-values for explanatory factors governing the way IGAD member states grow GDP. The growth rate of GDP serves as the dependent variable in this panel.

We also see from Figure IId that trade has a larger impact on industrialisation than capital. In the main part of the report, we urged that any development bank serve as a vector for globalisation. These results show the importance of foreign for the region. Yet, we can not know the way any of these variables affect output – as all these variables affect each other. Figure IIe shows the equations of motion (as derived from regression analysis) for each of our three variables. We only show the transition dynamics (not the steady-state). As shown, the capital to GDP ratio – using these historical data – comes to 16%. Under the previous systems of investment, such a low figure is realistic. **IGAD member states have not historically been able to absorb capital/finance.**

Figure IId: Trade Affects Industrialisation in the IGAD Region Far More than Growth

	Change Model	Levels Model	Full Model
Intercept	8.36	-41.89*	-44.30*
	8.48	13.41	13.66
GDP Growth	0.45		
	0.49		
Change in Industry	-0.24		-0.13
	0.19		0.16
Change in Services	-0.02		-0.06
	0.14		0.10
Capital		0.60	0.69
		0.31	0.36
Industry		-0.25	-0.22
		0.25	0.377
Services		1.07*	1.14*
		0.24	0.25
Country proxy	No	Yes*	No
Variance Explained	4%	55%	56%

Figure IIe: The Simultaneous Determination of Capital Stock, Industrialisation and Service Exports in the IGAD Region

$\dot{K} = -60 + 1.38K + 0.26I + 2S$ $\dot{I} = -63 + 0.61K + 1.52I + 0.88S$ $\dot{S} = -50 - 1.3K - 0.75I + 0.35S$	$K = 0.7e^{1.1+1.6i} + 0.7e^{1.05-1.6i} - 0.5e^{1.1}$ $I = (0.3 + 0.25i)e^{1.1+1.6i} + (0.25 + 0.25i)e^{1.05-1.6i} + 0.9e^{1.1}$ $S = (-0.15 + 0.6i)e^{1.1+1.6i} - (0.15 + 0.6)e^{1.05-1.6i} - 0.05e^{1.1}$ K=-16+i
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The figure shows the equations of motion for the three variables analysed in our simple model. We solve for levels of each variable (when simultaneous determined in a system). The left-hand side of the figure shows the equations of motion – while the right-hand side shows the solutions. To illustrate these solutions better, we simplified the steady-state level of fixed capital. The solution has an imaginary number – meaning that some variable (we don't know what) must be added to provide a solution. This mystery variable could be human capital or one of a hundred other factors discussed in the literature.

Figure IIf illustrates the problem more clearly. We show the simple relationship between Ethiopia's GDP growth rates and growth in fixed capital stocks (as a percent of GDP). We see that adding capital to the Ethiopian economy hurts growth – holding all other factors as constant. Yet, following other countries, we clearly see that some optimal capital stock exists – a capital stock which maximises GDP growth rates. K^* represents such a capital stock and \dot{K}^* represents the growth rate of that stock – in effect an optimal rate of investment.

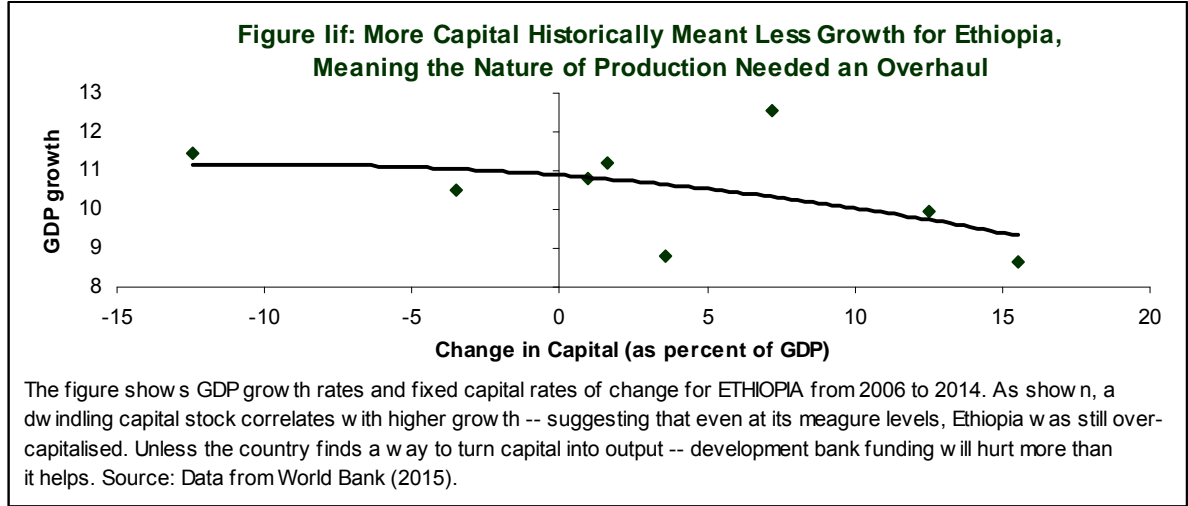


Figure 19 illustrates the optimal investment for the IGAD economies. If α represents the way that the optimal amount of capital translates into growth, and μ represents the current way (and we saw previous how $\alpha > \mu$) and if l represents a discount factor representing the compounding of such growth over 5 years, then the equation below describes that calculation.

$$\lambda \dot{y}^* = \alpha \frac{K^*}{Y} - \mu \frac{K}{Y}$$

As for **Figure 29** the amount of securitisation for the IGAD depend on the amount of foreign direct investment. Recalling from above that capital can be supplied by foreigners or locals. Using the hypothetical figures provided in the figure, we derive an estimate of the extent of institutional failure (as R). Yet, as shown in the next line, we multiply capital provided by the relevant opportunity cost of capital and by the relevant risk premium.

$$210 = v\theta 100^\psi \gamma 100^{\rho R} + v(1-\gamma)100^{100\beta\delta} \quad \text{or} \quad 210 = v\theta \gamma 100^{\rho R\psi} + v(1-\gamma)100^{100\beta\delta}$$

$$\ln \left[\frac{210 - v(1-\gamma)100^{100\beta\delta}}{v\theta \gamma} \right] = \rho R \psi \ln 100 \quad \text{and} \quad R = \frac{5}{23\rho \psi} \ln \left[\frac{210 - v(1-\gamma)100^{100\beta\delta}}{v\theta \gamma} \right] \text{ so,}$$

$$FDI = \frac{(1+r)^n \sigma (1-\gamma) K_i^{\beta\delta K}}{Y}.$$

Figure 31 shows the likely value of assets securitised by “long tail” firms – or smaller firms that do not comprise the countries’ large industrial groupings. If B represents the number of new businesses, and the wavy line above it means we either use the actual data when available or estimated data from regression if we do not have it, and \bar{K} represents average capital employed by these new businesses, then K in this case represents the value of securitisations for smaller businesses. In this case, χ represents the way that IGAD small business start-ups differ in capital from those in countries with better institutions. The term π represents a discount rate over the 5 years in the past we found the “imputed” number of new business starts.

$$\tilde{B} = \alpha + \beta C + \beta Y + \beta K + \varepsilon \quad \text{and so} \quad K = \sum_{t=1}^5 \frac{\chi}{\pi_t^n} \tilde{B} \bar{K}$$

Figure 35 estimates the value of additional GDP if more funding went to fast growing areas of the economy. If y_i represents i sectors – then $\max(y_i)$ represents those sectors. Thus the estimate represents nothing more than $\max(y_i) \cdot Y$ for the two fastest growing sectors i , where Δ represents the difference in GDP. The total added value over n countries equals

$$\Delta Y = \sum_{i=1}^2 \sum_{n=1}^8 y_{in}$$

Figure 42 shows extra growth for the \$40 billion in investment going to the region (by country). If E stands for exports, X for imports, and ζ_1 represents the way that capital passes into exports and ζ_2 represents the way that they pass into imports, then ΔY represents that change in output (and we suppress the sigma and subscript i which represents country). Fortunately, we have both in theory and in practice, estimates for differences in institutions and the marginal effects of intra-IGAD trade. These parameters come from R (as we described above). Savings and debt reduction simply add to the capital used domestically – the $(1-\gamma)$ amount of capital. If q represents the way extra growth translates into extra savings (or debt reduction as both activities simply increase the amount of domestic capital available for investment), then

$$\Delta Y = \alpha + \beta Y + \beta X - \beta X \quad \text{and} \quad \Delta Y = (v\theta\Delta K^\psi \gamma \Delta K_i^{\rho R} + v(1-\gamma)\Delta K_i^{\beta \delta K})(\zeta_1 E - \zeta_2 X)$$

and so adding the extra term gives $\Delta Y = (v\theta\Delta K^\psi \gamma \Delta K_i^{\rho R} + v(1-\gamma)q\Delta K_i^{\beta \delta K})(\gamma_1 E - \gamma_2 X)$.

Appendix III: Legal Issues and Proposed Amendments to the IGAD Agreement to Encourage the Operation of an IGAD Communities Development Bank

The IGAD represents a proto-union – a diplomatic discussion group helping to coordinate the actions of member states on issues such as conflict preventing and climate change. The member states have many times urged closer cooperation and a stronger IGAD Secretariat.²⁹⁵ As we argue in the main body of this working paper, a development bank would significantly strengthen the IGAD union. What changes do member states need to make to the IGAD Agreement to support the successful function of such a bank?

The IGAD Agreement provides the basis for the operation of the IGAD Communities Development Bank. Article 7 provides the major aims of the IGAD – including the harmonisation of policies (articles 7a to 7c), developing programmes and actual outcomes like creating an enabling environment, assisting in regional security, and promoting peace among others (articles 7c, 7d and 7g respectively). Nothing in the article (or agreement in general) forbids the development and operation of such a bank – and IGAD representatives have expressly urged the development of such a bank.²⁹⁶

Four aims in particular provide the basis for the creation of a development institution – as we have defined it in this working paper. Article 7c requires the IGAD to “Create an enabling environment for foreign, cross-border and domestic trade and investment.” As we have conceived the bank, it would militate for such change in the IGAD governments. The bank’s successful operation would lead to businesses which engage in such cross-border investment and trade. Article 7h encourages the “[mobilization of] resources for the implementation of...medium-term and long-term programmes within the framework of sub-regional cooperation.” Such a bank clearly constitutes a long-term programme promoting sub-regional cooperation. Article 7k encourages the “[development of] such other activities as the Member States may decide in furtherance of the objectives of this Agreement.” Article 13A(t) allows the IGAD to “work out programmes and projects that could help establish a relief, rehabilitation and development continuum” (emphasis ours). Thus, the intent of the Agreement clearly allows for the creation of such a financial institution.

In theory, the legal instrument creating the bank could comprise a “protocol” to the Agreement. Article 17a allows for the conclusion of agreements in furtherance of the IGAD’s objectives. Article 17b requires the IGAD Assembly (the heads of states) to unanimously agree to such a protocol.²⁹⁷ Any decisions, protocols or other pronouncements made under the framework of the Agreement, however, do not have direct or indirect legal effect of any

²⁹⁵ Besides the usual speeches and communiques, the IGAD has used donor resources to conduct training and other activities aimed at strengthening their union. See RCMRD Project, RCMRD Attends Launch of the Project Strengthening the Capacity of IGAD in Building Disaster Resilience in the Horn of Africa, 2015, available [online](#).

²⁹⁶ Public sources report IGAD representatives stating such an aim. See Embassy of Ethiopia in Kenya, Seminar on the need to establish a Regional Development Bank for IGAD, 2015, available [online](#).

²⁹⁷ Article 9 provides the definition of the IGAD Assembly. We interpret the requirement to take decisions “by consensus” (article 9.4) as a requirement for unanimous consent.

kind on member states.²⁹⁸ **Thus, any protocol establishing the rights and obligations of any IGAD member states vis-a-vis the proposed development bank would require ascent by the relevant executive or parliamentary decision (as required under the domestic law of each member).**²⁹⁹ Once in existence, the IGAD would (as stipulated in article 18) form relations with this organisation.³⁰⁰

The IGAD has three possible strategies for establishing the legal basis for the proposed development bank. First, the member states could negotiate a Protocol, defining their rights and obligations vis-a-vis such a bank. The protocol would allow for IGAD representatives, shareholdings, and the immunities/privileges afforded to investments and bank staff. The bank has none of the immunities/privileges accorded to the IGAD Secretariat (articles 5 and 6). As such, yet another structure would be created by protocol with very similar competencies to the IGAD.

Second, the bank could form part of the IGAD Secretariat itself. Article 3 allows the IGAD to acquire property and form contracts. Articles 5 and 6 would apply, granting the bank staff with the immunities need for its mandates to succeed. Yet, the functions of the Secretariat (as defined in article 12) seem ill-suited to such a bank. The intent of the Secretariat clearly lies in providing discussion materials for the Assembly (articles 12b through 12f). A glimmer for any bank mandate comes from article 12(a) “to implement the decisions of the Assembly and the Council” (underlining ours) and article 12(d) “to initiate, identify and coordinate development programmes and projects” (underlining ours). Yet, such a solution would still require the cumbersome ascent of a protocol. Worse yet, the bank would become highly politicised and under the control of persons not specialised in banking and finance.

The third option – which we recommend – consists of making the bank an independent sister organisation of the IGAD (much like the World Bank is a “sister” of the United Nations). Such a solution would require several minor amendments to the IGAD Agreement. Under the definitions, the “IGAD Communities Development Bank would consist of a specialised and independent organ of the IGAD Secretariat.” The definitions would also need to define a “Non-Member state as a country not a member of the Authority.” Article 2A would need to authorise the IGAD to locate “any institution of the Authority in any Member State *or Non-Member State*” (italics ours).³⁰¹ Article 4 would be amended to read “The Authority shall negotiate a Headquarters' agreement with the Host State *and other specialised institutions with Non-Member States as required*” (italics ours). A new provision (article 12h) would

²⁹⁸ Namely, no provision in the Agreement provides a procedure for incorporation into domestic law or stipulates any legal effect of any kind.

²⁹⁹ The CEWARN Protocol clearly demonstrates the lack of the IGAD Agreement’s legal effect on member states. Article 3 provides “The Legal Foundation of CEWARN.” That article makes no mention of the IGAD Agreement, referring only to the Protocol itself and national law. Thus, any Protocol establishing such a development bank would require renewed negotiation at the IGAD itself and subsequent negotiation in member states...a likely lengthy procedure to be sure.

³⁰⁰ For an example of such lawmaking, see Australia’s law relating to its membership in the Asian Infrastructure Investment Bank at The Parliament of the Commonwealth of Australia, Asian Infrastructure Investment Bank Bill 2015, *Act 134*, 2015, available [online](#).

³⁰¹ In our working paper, we argue vociferously that the bank must locate outside the IGAD in order to succeed. If the bank locates in the IGAD, the bank would have little purpose in existing.

read “to assist the IGAD Communities Development Bank as required.” An article 13B – as shown in Figure IIIa -- would outline the authority and operation of the bank. Another article 13C would “extend immunities and privileges defined in article 3, to the extent reasonably practicable, to properties invested by or through the Bank.”

Figure IIIa: Article 13B: The IGAD Communities Development Bank

The IGAD Communities Development Bank (herein after Bank) shall serve as an independent part of the Authority located in a Non-Member State. The Bank shall:

- a) have a President which reports annually to the Assembly and Council and Committee,**
- b) report to, and work with, the Executive Secretary as needed,**
- c) present to the Authority and follow as law a Protocol (hereinafter the Bank Protocol) for its operation,**
- d) remit to the Authority and Member States profits as defined in the Bank Protocol,**
- e) with the consent of the Executive Secretary, form relations with other international, multilateral, or national organisations,**
- f) appoint its own staff, govern its own operations and in other ways act independently (but in the interests of) the IGAD and its Member States.**

Such a tactic has the advantage of cementing in the development bank project, while delaying the costly negotiation which will bog down the final adoption of bank-related law. The Bank Protocol would likely be circulated in the Member States, and represent an area of vigorous debate by the Assembly, Council and Committee. To ensure the Bank’s accountability, article 13D could require that “the Assembly may dissolve the Bank by consensus, with resolution and liquidation following the procedures set out in the Bank Protocol.” To cement the Bank into the IGAD, we might also suggest an explicit reference to the Bank as a point 13A(u) “to provide for the functioning of a development bank serving the interests of Member States.” The double reference to the “the interests of the Member States” (in Article 13A(u) and 13B) ensures the Bank does not act too independently. Of course, the Bank’s leadership would decide, within the confines of the Bank Protocol, what constitutes “the interests of the Member States.”

Amendment of the IGAD Agreement need not be unanimous. Article 19 requires ascent by at least two-third of the Assembly if no consensus can be reached. One of the Member States would need to submit an “official written request...to the Chairman of the Council of Ministers.”

The Assembly needs to worry about three other pieces of law. First, and most obviously, the Bank Protocol. Second, represents the treaty with the country hosting the Bank. We provide a template for this agreement in the main body of this working paper (based on the UK's act establishing the conditions for the European Bank for Reconstruction and Development). Third relates the regulatory instruments negotiated with the upper-income jurisdictions providing the investment. As a reminder, we propose special agreements to allow for the solicitation of retail interest in some Bank securities.³⁰²

³⁰² Under various countries "safe harbour" provisions, the Bank could market to institutions and the very wealthy on a private basis without regulatory consent. However, a key mandate of the Bank consists in raising the positive image of the region by offering investments (and showing the way business really takes place) there.