

Chapter 6

Diaspora Bonds in the MENA Region: A Financial Insight

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Abstract

A diaspora bond is a type of financial vehicle issued by a country to tap into the financial resources of its citizens living abroad, known as a diaspora. Patriotism is the principal motivation for the diaspora bond issue. These bonds are intended to encourage members of the diaspora to invest in their countries' development projects, infrastructure, or other economic initiatives. This helps the country raise capital and develop while fostering a connection between the diaspora and their country of origin. Today, it is possible for immigrants to remain connected with their native countries and give back to their motherland. The emigration of skilled people is a loss for a country, but, on the other hand, skilled migration is an opportunity to receive remittances, trade, investment projects and new knowledge for a country. Some countries in the MENA region are pursuing government policies to develop links with their overseas citizens and encourage them to return or to use their knowledge and financial support for the development of their country.

Keywords: Diaspora, migration, connection, development

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A budget deficit is a basic challenge that many developing countries face. Developing countries are not successful

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in collecting sufficient tax revenue due to weak economic policies, capital deficit, tax avoidance and many other economic reasons. In this situation, governments of developing countries utilise foreign borrowing as the main vehicle for financing their budget deficit. Developing countries do not have easy access to international debt markets, whereas developed countries have access to foreign financial assistance that grants loans from multi- or bilateral donors or foreign governments. This assistance includes strict conditions that governments of developing countries cannot meet.

However, in times of economic and financial crises, and also in the long run, it is not judicious for developing countries to completely depend on external financing. The difficulties with borrowing from international capital markets and the unfavorable effects of remittances have therefore motivated governments to develop an alternative external borrowing instrument called the diaspora bond.

Diaspora bonds are debt securities issued by governments or government agencies and are explicitly target to their diaspora. Diasporas are given the option to invest part of their wealth in their homeland in the form of diaspora bonds. As the issuing country may not be able or willing to pay interest appropriate to its credit rating and market perception, it relies on some kind of patriotic discount offered by the buying diasporas. The idea is that by offering diaspora bonds instead of asking for donations, the countries can leverage the diaspora's charitable intention.

The Middle East and North Africa is a geographic region whose countries are often collectively referred to by the acronym MENA. The region shares a number of cultural, economic and environmental similarities across its component countries. Diaspora members, in particular the professional and skilled individuals, are an important human capital asset for their home countries and the MENA region as a whole. The MENA diaspora can be an important catalyst and partner for governments and development institutions to foster regional integration and regional co-operation in MENA region.

According to official United Nations data, approximately 20 million MENA citizens live abroad, representing 5 percent population of the region. A new sociopolitical situation is now emerging in many MENA Countries, with some countries transitioning from dictatorship to democracies, and space opening up for more involvement and investment by the diaspora.

In recent times of crisis in the debt markets, many countries have faced difficulties in obtaining private financing using traditional financial instruments. Official aid or government financing alone will not be adequate to bridge near or long-term financing deficiencies. Ultimately, it will be necessary to adopt innovative financing approaches to fulfill targets from previously untapped investors. Diaspora bonds are one such mechanism that can enable developing countries to borrow from their diaspora communities. MENA diaspora bonds are a very significant example in this context.

MENA countries are still developing and require substantial funds to accelerate growth. The diaspora, through diaspora bonds, can lend a helping hand and play their role in economic development of this region. The logic of a diaspora bond is simple. Usually, they are tied to a specific purpose and targeted exclusively at nationals of a country residing abroad. The main reason is that home bias would encourage citizens to view these bonds as a special opportunity to contribute their funds to the development of their home countries. A recent example is the Greek debt crisis which compelled the Greek authorities to issue diaspora bonds, relying on the fact that the ideal group of external creditors would be Greeks living abroad. That being said, patriotism is not the sole motivation. Diaspora bonds can be very attractive for those seeking high return investments. Rather than deposit money with relatives at home who sometimes make rather liberal use of them, these bonds serve as an opportunity for local investment. Meanwhile, the diaspora is usually protected from the harsh economic environment at home.

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For the country issuing these bonds, one appeal is the patriotic discount. Diasporas are often more than willing to purchase their home government's debt, making debt raising cheaper. It also offers a more stable source of foreign exchange in African countries, as diaspora funds are consistent across business cycles, unlike Foreign Direct Investment (FDI) or portfolio flows. Nigeria appears to be the latest African country to propose a diaspora bond sale. The Ministry of Finance recently suggested that a \$300 million diaspora bond offering will follow the freshly completed, and heavily oversubscribed, \$1 billion Euro bond sale. However, when the Ethiopian Electric Power Corporation issued a diaspora bond, the outcome was disappointing. This is because identifying and marketing viable projects is necessary in a country with such a large infrastructure gap. The most successful diaspora bond that can be found in Africa is Israel's. Israel's case is remarkable. They have been selling development-linked diaspora bonds since 1951 and in doing so, have established a strong economic and social connection between the nation and its diaspora. For diaspora bonds to work, the economics must be the main factor. But, as shown by Israel, the relationship between a country and its citizens must also be close.

North African countries must come to understand the peculiar demographics of their diaspora and their attitude towards home countries. Some will find a large class of citizens in political or economic exile who are unwilling to engage with the government. Others will find a sizeable base of second-generation diaspora members keen to partake in the economy of their home nation in whichever way possible. Highly skilled migrants in wealthier host countries are likely to be the principal purchasers of diaspora bonds. For diaspora investors to purchase hard currency bonds issued by their countries of origin, there has to be a minimum level of governance. Absence of governance, as reflected in civil disputes, is clearly a negative factor for diaspora bonds. Sometimes, a lack of governance would not disqualify most countries in the East, and many Eastern European countries, like Cuba, Haiti, and several Southern African countries which have large diasporas

abroad, but low levels of governance. Israeli and Indian experience also shows that countries will have to register their diaspora bonds with the US Securities and Exchange Commission (SEC) if they want to tap into the US retail market.

The MENA region independently and collectively lacks finance for development. The truth is that it is unlikely that Western powers would finance Africa's development in the same way that the United States financed Western European's post Second World War reconstruction through the Marshall Plan, or the US's post Second World War financing of East Asia's reconstruction as part of its strategic objective to secure these countries against communist influence. The collective savings of African citizens in countries on the continent are wholly inadequate to finance development. Africa exhibits the world's lowest rate of personal savings. Internationally, diaspora bonds tend to be long-dated securities which a country redeems on maturity. Such bonds are a source of foreign finance which are long-term and relatively stable in nature. The income from such bonds has considerable potential to finance development.

The Case of Israeli Bonds

Israel has been at the forefront of exemplifying the ways in which diaspora bonds can be used as a successful instrument in the development of finances. At their inception in 1951, diaspora bonds were issued and administered by the Development Corporation for Israel (DCI) as the authority established by the Israeli government. Although the bond was targeted at the Israeli diaspora, it was not limited as the DCI was registered with the US SEC. The bonds could be exchanged as listed securities and were subject to the US federal laws and regulations that govern the financial markets. The availability of Israel's diaspora bonds was consistent, while providing different investment avenues depending on market requirements as dictated at the time.

DCI bonds worth more than \$32 billion have been raised for development in Israel, particularly for infrastructure

development in the transport, energy, water and telecommunication sectors. The bonds issued by the DCI were fixed, along with floating rate bonds and notes, with maturity periods ranging from 1 to 20 years, with bullet repayment options. These bonds presented a large patriotic discount, and other financial incentives included Israel making its interest rate slightly higher than US treasury bills.

To make the bonds more accessible, the DCI established retail agencies in the US (considering that 6 million of the 7.5 million Jews representing the Jewish diaspora live there) and in other countries. The Israeli government extended the range of the bond by granting any member of the Jewish diaspora the right to Israeli citizenship, provided that the members demonstrated commitment to defending and rescuing Jewish people residing in oppressive countries. The Jewish diaspora has a distinctive connection to Israel in that there is an irrevocable sense of shared being and belonging in Israel's economics and politics, stemming primarily from a shared religious belief that reinforces patriotism.

Islamic Bonds

A number of Middle Eastern Countries have recently issued Islamic bonds for people of the Islamic faith, rather than for a country-specific diaspora. Such bonds are typically structured as asset-backed securities, with medium term maturity. Investors share the proceeds. Islamic law, Sharia law, prohibits receiving or paying of interest. The Islamic bond market is comprised of corporate, Sukuk, sovereign and quasi-sovereign markets. Markets for Islamic bonds were severely affected by the global financial crisis of 2007 to 2009. These bonds have, however, rebounded and have recently been thriving again. The Indonesian government, for example, has issued \$13 billion in Islamic bonds over the past years. The government issued its first Sukuk (Islamic bond) in 2008 to help reduce its budget deficit. Almost 80% of Indonesia's population is Muslim. In April 2012, Saudi Arabia overtook the UAE to become the largest Sukuk issuer in the Gulf region, raising \$6.4

billion in the first quarter of 2012. Overall, Malaysia accounts for 71 per cent of total bonds issued and was among the top six Sukuk issuers, with \$31 billion. Malaysia was followed by Saudi Arabia (\$6.4 billion, 15 percent of the total) and Indonesia (\$3.4 billion). Sukuk bonds issued in the first quarter of 2012 reached a record \$43 billion worldwide.

Other Examples of the MENA Diaspora Providing Finance

Other instances of MENA diaspora bonds channeling funds into a home country exist, primarily through remittances. In 1991, Lebanon initiated a treasury account aimed at reducing Lebanese debt. Through this account and treasury bonds that were made available, the Lebanese diaspora contributed about \$35 million to assist their home economy. Lebanon has an estimated 4–15 million diaspora members worldwide, and it also receives high levels of remittances. Of overall household income, remittances represent 22 percent and savings accounts contribute 8.8 percent. The Lebanese diaspora has enabled the acquisition of homeland bonds. After the 1991 issue of bonds, however, additional funds could have been raised but subsequent government regimes prolonged and retained the diaspora bonds.

The World Bank has come up with a novel plan to help rebuild “Arab Spring” economies—people power. In a move to raise funds to reconstruct nations hit by unrest, the bank is recommending that bonds be issued and financed by nationals of those countries who work abroad. “So-called diaspora bonds could help to generate more than US\$ 1 billion in each African Nation, including those affected by unrest”, said Dilip Ratha, a World Bank economist. “The diaspora can be a friend in foul weather. If things are not going well in your country and foreign investors aren’t there, the diaspora will still be there,” said Mr. Ratha, the manager of the migration and remittance development prospect group at the World Bank.

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Libya is the only country to have suffered major damage to its infrastructure through armed conflict. But other countries' abilities to fund civil projects have been hobbled by dwindling public funds and high financing costs. The World Bank believes diaspora bonds could help to meet some of the funding needs in the years ahead.

Egyptians working abroad send home about \$7.7 billion every year, more than the country receives in receipts from the Suez Canal. The amount of money sent home by Moroccans is about \$6.7 billion, which exceeds the value of receipts from Morocco's tourism industry. The World Bank estimates that foreign workers hold similar amounts in bank accounts in the countries in which they work. Much of the cash is in deposits, offering a yield of only about 1%, according to Mr. Ratha. Apart from raising cash for infrastructure projects and boosting the finances of migrants, diaspora bonds would serve other purposes. After popular revolutions in 2011 toppled the rulers of Egypt, Tunisia and Libya, many nationals were keen to help in rebuilding their countries' battered economies. Selling bonds linked to a specific infrastructure project such as a school or hospital would tap into the desire of many people to make an emotional investment in the future of their countries, according to Ratha.

In addition, diaspora bonds could help with the development of capital markets and provide a long-term source of financing to governments. The World Bank is keen to offer technical expertise on the pricing and structure of diaspora bonds as well as acting as a broker between the governments issuing the bonds and their nationals working abroad. Selling bonds linked to projects ring-fenced from political uncertainty would encourage investment in so-called "Arab Spring" economics in times of instability, according to Mr. Ratha. Diaspora bonds have helped countries as diverse as India and Israel to raise money. The World Bank has also advised the governments of Kenya and the Philippines on issuing diaspora bonds.

Drawbacks of Diaspora Bonds

Diasporas from the MENA region can be critical to foster regional integration, entrepreneurship and economic growth, and can help countries in the region become major players in the global economy, says the new World Bank Group. “There are more than 20 million people from the Middle East and North Africa living abroad, but we fail to think of them beyond remittances”, said Hafez Ghanem, World Bank Vice President for the Middle East and North Africa. “This diaspora is a potential goldmine of knowledge, skills and business networks which, given the right circumstances, could be tapped to address some of the region’s current challenges, such as lacklustre investment and high youth unemployment.” Using data gathered from an online survey and interviews of about 1000 MENA diaspora members worldwide, there was an almost unanimous consensus amongst the participants that if their respective governments treated them as partners rather than a source of remittance, their engagement with their home country would significantly increase. Diasporas remain more willing than foreign investors to invest in their home country during turbulent times, as they have more awareness of the business environment and local practice. “Through these surveys, we understand better that if capitalised upon effectively, the MENA diaspora can be an indispensable vehicle to enhance trade, boost countries’ competitiveness and foster knowledge transfer”, said Anabel Gonzalez, senior director of the World Bank Group’s Trade and Competitiveness Global Practice.

Potential Challenges of an African Diaspora

Unlike Israel and India, Africa does not have a shared identity. The measure of shared identity among African is arguably an affinity in being mutually victim to slavery, colonialism and apartheid. Africans are arguably united in their wanting to overcome the continued residue of underdevelopment left by the triple oppression of African people. Poor governance,

a lack of democracy and appalling cases of mismanagement by African governments render investors cautious when purchasing diaspora bonds. Globally, investors are skeptical of Africa's long-term stability and future security.

How Bonds Aimed at the Diaspora Raise Funds for Africa

If structured the right way and linked to clear goals, diaspora bonds have huge potential to raise much-needed development finances. As many African countries attempt to raise development finance, diaspora bonds, which resemble other kinds of bonds but are targeted at citizens abroad, are highly appealing. The African diaspora is massive and has significant accumulated wealth. Moreover, diaspora investors are typically motivated by more than simply maximising returns. They often also want to help improve the socio-economic conditions in their home countries, making them willing to accept below-market returns, a phenomenon known as the "patriotic discount".

It is for some of these reasons that the likes of India and Israel have used diaspora bonds to raise money in the past, as well as in the present. However, their use in Africa, including in fragile and conflict affected states, is more recent and less certain. The experience of Ethiopia is a case in point. Ethiopia's first diaspora bond was issued in 2008, but sales fell well short of expectations. A second release in 2011 also appears to be struggling, raising only a small portion of the investment required to fund the Grand Renaissance Dam project.

Reasons for Success of Diaspora Bonds

A wide variety of factors determine the success of a diaspora bond, but a report by Oxford Economic Forecasting points out that these features fall largely into two categories. The first is the offering's structure. Diaspora bonds need to be structured in a way that makes them appealing and accessible

to a wide range of diaspora members. For example, a range of investment options, particularly in ensuring low minimum purchase requirements, can help attract individual, small-scale investors. Meanwhile, ensuring bond denomination in stable and convertible currencies such as Euros, British pounds or US dollars can overcome investors' concerns over currency stability. While time-consuming and expensive, proper registration of the bonds in investors' countries of residence can also be critical to ensure investor's confidence and avoid regular penalties.

The second set of factors that determine the success of diaspora bonds is the offering's link to development. Investors expect their investments to have a positive impact in the issuing country, and bonds marked for specific projects such as infrastructure, education or healthcare, can be particularly appealing to the diaspora market. Commutating the progress of the development connected to the bond can help attract investors for subsequent offerings. In some instances, bonds focused on sub-national projects may be especially effective in this regard. Many members of the diaspora would have left their countries of origin due to conflict or repression, and may distrust the national government.

Conclusion

This paper discusses the rationale and potential for issuing diaspora bonds as instruments for raising external development finance, mostly drawing on the experiences of Israel and India. The analysis presented indicates the need for MENA citizens living abroad to foster trade, investments, and technology transfer in the MENA region, though it is not necessary for the diaspora to come back home.

Findings

1. The MENA diaspora is mainly motivated and committed to support the economic development of their motherland. Diaspora members are more connected to their nations

- of origin, where families and friends reside, than to their countries of residence.
2. The MENA governments generally do not formally recognise the contribution of their citizens living abroad, except for remittances. Nevertheless, the diaspora can attract foreign investment, promote trade, and facilitate technology and knowledge transfer.
 3. The preferred forms of intervention of the MENA diaspora are knowledge transfer, mentoring and capacity building. A number of diaspora members have invested at home, or have tried to, and believe that their priority should be to help young professionals become more organised, to improve their products and services, and to help them access markets.

Recommendations

To date, however, the actual issuance of diaspora bonds remains weak. A number of factors contribute to this outcome. First, there is limited awareness about this financing vehicle. Governments and other entities are often discouraged by the complexities of this bond instrument. Lacking capacity to undertake bond issuance, they take the easy way out of depending upon national banks to receive local and foreign currency deposits (LCDs and FCDs) from diaspora investors. While FCDs attract foreign currency inflows, these can be withdrawn at any time. This is for any demand and saving deposits. However, even term deposits can be withdrawn at any time by forgoing a portion of accrued interest. Therefore, FCDs are likely to be much more volatile, requiring banks to hold much larger reserves against their FCD liabilities, thereby reducing their ability to fund investments. In contrast, all bonds, including those targeted at the diaspora, are long-term in nature. Hence, the proceeds from such bonds can be used to finance investments with greater predictability. In view of this, many developing country policymakers would certainly benefit from technical assistance aimed at improving their understanding of structuring bond offerings, registering

them with regulatory agencies, such as the US SEC, and assessing whether or not such instruments need to be rated by rating agencies.

Second, many countries still have little concrete appreciation of the capabilities and resources of their respective diasporas. A recent World Bank survey by Plaza (2009) pointed out that very few governments have a complete mapping of their diaspora. Data on diasporas are mainly based on those who register with embassies. Furthermore, there is little coordination at the embassy level when dealing with diasporas. As a result, many governments do not know where their diasporas are located. They also have little knowledge of how much their diasporas earn, save and invest. However, this is now beginning to change. With remittances becoming an increasingly important source of development for finance, countries are now becoming more and more interested in tracking their diasporas for their own interest. Countries are also moving towards granting their diasporas dual citizenship.

A third constraint on diaspora bond issuance comes from the failure of many potential issuers to plan ahead. Indeed, many potential issuers resort to whatever instruments are at hand at the last minute. Furthermore, many also abandon their plans for using new financing mechanisms as soon as the financing gap goes away. This seems to have happened in the Philippines and Sri Lanka, for example.

Diaspora investors must have confidence in the government of their home country if they are to purchase bonds issued by their countries of origin. Countries with a hostile diaspora are unlikely to succeed in raising financing through diaspora bonds. Countries with political insecurity and weak institutional capacity would find it hard to market diaspora bonds unless credit enhancements are provided by more creditworthy institutions. Although patriotism motivates diaspora members to provide funding at discounted rates, they must have confidence that the funds will be used productively. Such confidence can be generated by creating

appropriate structures for the productive use of the income from diaspora bonds.

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