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DIASPORA'S INVESTMENT IN FRAGILE AND CONFLICT IMPACTED ECONOMIES

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POLICY IMPLICATIONS:

Blended Social and Profit Outcomes: The large majority of diaspora investors are driven by a combination of profit motives and a desire to positively impact socioeconomic development. Investment opportunities targeted to the diaspora should therefore focus on those opportunities which satisfy both motivations.

Local Focus: Many diaspora communities feel a sense of connection to a hometown or region while relationships with national governments in their country of origin can be fraught or confrontational. Crafting investment opportunities which focus on local impacts rather than national level scope will be more appealing to these investors.

Diversity of Terms: Diaspora investors are quite diverse in their levels of risk aversion or acceptance, access to quality investment information, preferred investment amounts, and preferred investment terms. Developing investment mechanisms which are diverse and flexible in investment term, amount, liquidity, and holding will be critical to capturing the entire spectrum of potential diaspora investment.

Diaspora Relations: Diaspora investment cannot be taken as automatic. Failure to target diaspora investors and effectively understand their preferences hampers their ability and desire to invest in countries of origin. Basic research on these preferences and even modest official efforts to engage with diaspora communities can have an outsized impact on diaspora investment inflows that can be leveraged for development.

RESEARCH SUMMARY

The Puzzle

Small and medium enterprises (SMEs) in fragile and conflict-impacted economies have very limited access to capital and rely nearly exclusively on internally generated capital for growth. This lack of access places an artificial ceiling on private-sector development and economic growth. Overcoming this challenge will be a prerequisite for such states to reach their economic potential. Diaspora investors are uniquely suited to help fill this credit gap in the economies of fragile and conflict-affected states (FCS). They have the capacity, unique motivations, and skillsets to invest in these complex environments and do so successfully. This not to say that diaspora investors placing capital in FCS countries of origin will not face significant challenges, but they are a uniquely motivated population capable of providing crucial access to capital to SMEs that have few alternatives. This brief and the accompanying report explore both diaspora-targeted investment mechanisms and public policies which can help facilitate diaspora investment, providing much-needed capital to FCS economies.

Investment Mechanisms

There is a diverse array of potential investment mechanisms that might appeal to members of the diaspora community who are looking to invest in their country of origin. Targeting these various mechanisms to the diaspora has been attempted to varying degrees in the past with different levels of success. Some of the critical investment mechanisms that need to be further explored and refined to facilitate diaspora investment include the following.

- *Diaspora Bonds:* These can take the form of traditional sovereign debt bonds or be tied to a specific development project. They have a history of mixed effectiveness in their implementation in FCS economies, but they are potentially particularly useful for infrastructure development. Infrastructure investment is characterized by the prohibitively large scale, long time horizons for return, a lack of flexibility, and often only modest returns, which can deter individual diaspora investors. Pooled risk, fixed terms, and stable returns mean bonds may help mitigate some of these concerns and, in combination with non-financial motivations, help mobilize diaspora capital for large-scale development efforts.

- *Mutual Funds:* Mutual funds may appeal particularly to non-expert diaspora investors for several reasons. First, they provide more flexibility than substantial direct-equity purchases or fixed-term products. This is important to diaspora members who are concerned about potential volatility in the political and security situation. In addition, mutual funds are likely to appeal to investors who lack sufficient information to properly vet investments. The pooled nature of investment means mutual funds may also appeal to more risk-averse diaspora investors.

- *Social Enterprise Models:* Social enterprise investment models may be particularly appealing to diaspora investors because the dual financial and social objectives of these firms match the dual motivations of the typical diaspora investor. Previous initiatives have sold investment notes to a diaspora community, the proceeds of which were pooled and funneled through domestic financial institutions to social enterprises in the country of origin. Alternatively, individual or small groups of diaspora members may choose to make direct investments in existing social enterprises or establish their own.

- *Savings Accounts in Country of Origin:* This is obviously an indirect means of encouraging diaspora contributions to SME growth, but is also relatively low-hanging fruit for both diaspora members and FCS financial institutions and could have significant impacts. Having deposit accounts in their country of origin may serve as a low-risk entry point for the diaspora's financial engagement in that country. However, in order to attract diaspora investors and ensure development impact, financial institutions in the country of origin will likely need to offer flexible terms and make clear commitments to use a specific proportion of deposits for domestic SME financing.

A picture taken on December 10, 2018 shows silhouettes of migrants, part of an art installation, at the grounds of the International conference on Global Compact for Migration in the Moroccan city of Marrakech. FADEL SENNA/AFP/Getty Images

Public Policy

In addition to further development of the diaspora-targeted investment mechanisms described above, there are several public policy considerations that could further facilitate diaspora investment into FCS economies.

The first is FCS states making official efforts to map and actively engage with their diaspora. Relatively modest efforts in this area have the potential to have an outsized impact on diaspora investment. Research has shown that on average, a 10 percent increase in spending on the promotion of investment leads to a 2.5 percent increase in foreign direct investment. Donor states and international institutions can help increase the capacity of such government bodies through training and budgetary support, while NGOs and academic institutions could play a very valuable role by conducting research on the location, number, and investment preferences of a given diaspora.

Another potential tool for facilitating the diaspora's investment in FCS economies is the use of political risk insurance (PRI). Though diaspora investors may have unique characteristics which help mitigate some of the risk of investing in FCS economies, investment risk in these contexts is still significant and constitutes a major barrier to increased investment. Development of PRI services which target the diasporas of FCS economies may help overcome this barrier. International financial institutions, nonprofit organizations, or public–private partnerships may be well placed to develop PRI programs for the specific purpose of facilitating diaspora investment to improve SME access to capital in FCS economies.

Finally, it is important to note that none of the investment mechanisms or policy initiatives discussed above will have effects on SME access to capital in these economies as fundamental as improvements in the areas of corruption, good governance, and rule of law would. Governance of this kind is all strongly negatively correlated with inbound foreign direct investment. Lack of contract enforcement and corruption have been shown to be significant barriers to the diaspora community's willingness to invest in their countries of origin. Sustainable improvements in governance capacity, rule of law, and the overarching business environment will likely do more to increase the inflow of all forms of capital available to SMEs, including diaspora investment, than the more specific investment mechanisms and policy options detailed above.

ENDNOTES

1 "The Role of the Diaspora in Nation Building," African Development Bank, p. 23.

2 Liesl Riddle, Jennifer M. Brinkerhoff, and Tjai M. Nielsen, "Partnering to Beckon Them Home: Public-Sector Innovation for Diaspora Foreign Investment Promotion," Public Administration and Development 28, no. 1 (February 2008): p. 56, https://doi.org/10.1002/pad.469.

3 Azmat Gani, "Governance and Foreign Direct Investment Links: Evidence from Panel Data Estimations," Applied Economics Letters 14, no. 10 (2007): p. 753–756, https://www.tandfonline.com/doi/abs/10.1080/13504850600592598.

4 Jay Benson, Lindsay Heger, Lee Sorensen, and Alexandria Wise, "Somali Diaspora Investment Survey Report: Typologies, Drivers, and Recommendations," Shuraako Research Report, June 16, 2016, p. 36, http://shuraako.org/sites/default/files/SDIS-Survey-Report.pdf.

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