Innovative approaches to financing Agenda 2063 and the Sustainable Development Goals in Africa

United Nations
Economic Commission for Africa

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Abbreviations

AFD	Agence Française de Développement (French Development Agency)
AfDB	African Development Bank
AFF	America Fast Forward
AGI	African Governance Initiative
ATMs	automated teller machines
BBC	British Broadcasting Corporation
BDSSP	Business Development Services Support Project
BoG	Bank of Ghana
BoP	balance of payment
BTL	build transfer lease
CBE	Central Bank of Egypt
CCAF	Cambridge Centre for Alternative Finance
CDG	Caisse de Dépôt et de Gestion (Morocco)
CIP	critical infrastructure programme
DAC	Development Assistance Committee
DFIs	Development Finance Institutions
DZ Bank AG	Deutsche Zentral-Genossenschaftsbank (German Central Cooperative Bank)
EBI	Egyptian Banking Institute
ECA	Economic Commission for Africa
ECLAC	Economic Commission for Latin America and the Caribbean
EEPCO	Ethiopian Electric Power Corporation
EGX	Egyptian Exchange
EIB	European Investment Bank
EIC	Ethiopian Investment Commission
EU ETS	European Union Emissions Trading Scheme
EU	European Union
FDI	foreign direct investment
FinTech	Financial Technology
FSRP	Financial Sector Reform Programme
GBE	government business enterprises
GDP	gross domestic product
GEPF	Government Employees Pension Fund
GEPP	Ghana e-payment portal
Gh¢	Ghana cedi
GhIPSS	Ghana Interbank Payment and Settlement Systems Limited
GHS	Global Harmonized System
GNI	gross national income
GOE	Government of Ethiopia
GoG	Government of Ghana
GSM	Global System for Mobile Communication
GTP	Growth and Transformation Plan
Hi-Tech	high technology

ICT	information and communications technology
IEA	International Energy Agency
IFC	International Finance Corporation,
IFFs	illicit financial flows
ILO	International Labour Organisation
IMF	International Monetary Fund
IP	intellectual property
IT	information technology
KFW	Kreditanstalt für Wiederaufbau (Reconstruction Credit Institute)
KPMG	Klynveld Peat Marwick Goerdeler.
LDC	least developed country
MDGs	Millennium Development Goals
MFIs	monetary financial institutions
MIGA	Multilateral Investment Guarantee Agency
MNCs	multinational corporations
MTN money	MTN mobile money
NDP	national development plan
NEDLAC	National Economic Development and Labour Council
NGO	non-governmental organization
ODA	official development assistance
OECD	Organization for Economic Cooperation and Development
OPIC	Overseas Private Investment Corporation
OSAA	Office of the Special Adviser on Africa
OTC	over-the-counter
PAIDF	Pan-African Infrastructure Development Fund
PPP	public-private partnerships
PPPCU	Public-Private Partnership Central Unit
PWC	PricewaterhouseCoopers
QPIBs	qualified public infrastructure bonds
SARS	South Africa Revenue Services
SDGs	Sustainable Development Goals
SLDBs	Sri Lanka development bonds
SMEs	small and medium-sized enterprises
SSA	sub-Saharan Africa
SWFs	sovereign wealth funds
TiGO Cash	Tigo mobile financial service
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme

Executive summary

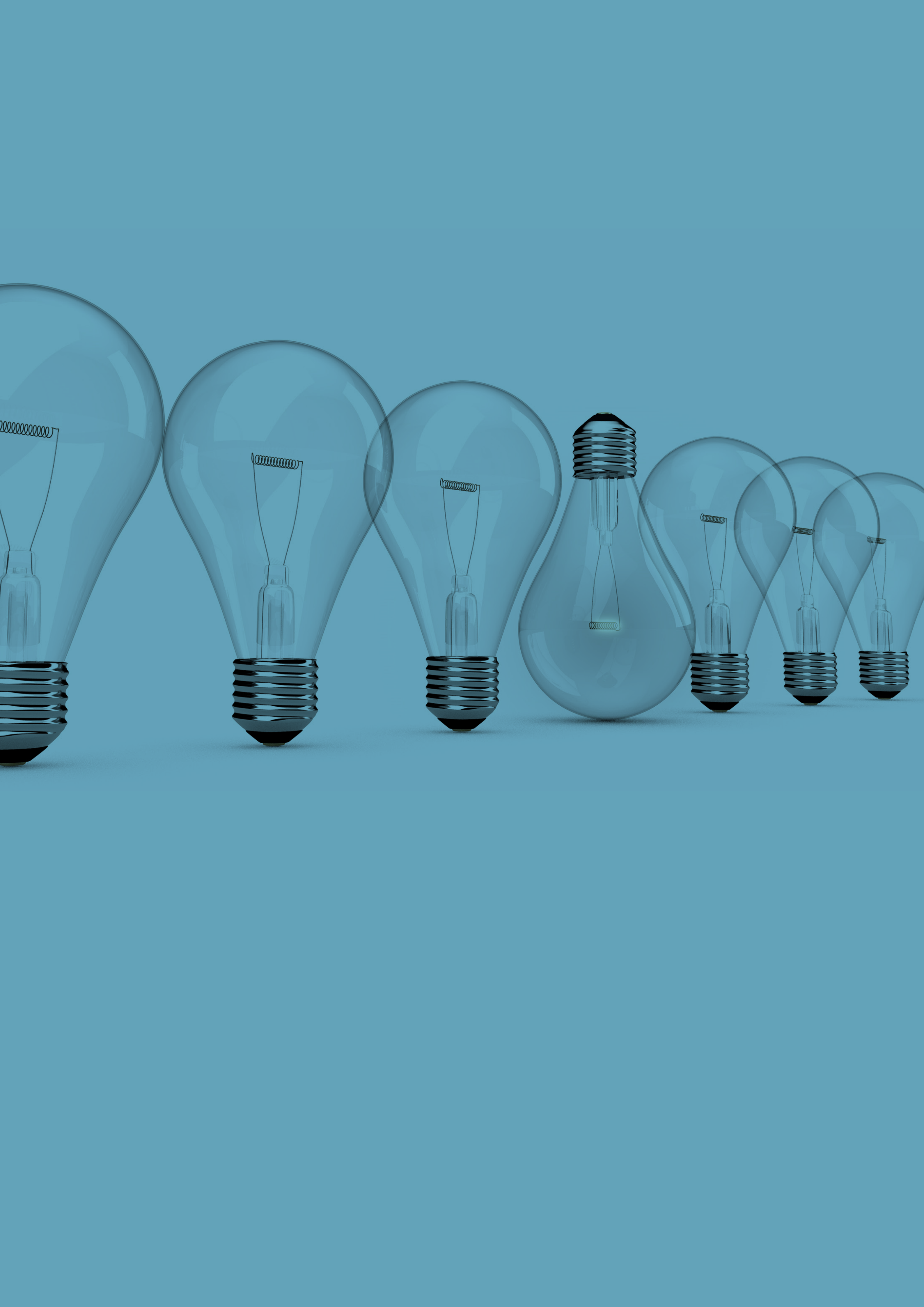
Africa's growth and development are presently anchored on two mutually inclusive programmes namely, the United Nations Sustainable Development Goals (SDGs) and Agenda 2063. The expected result of the implementation of the two agendas is the achievement of inclusive growth based on structural transformation of African economies. In this context finance remains a major constraint to achieving the two agendas and should therefore be addressed throughout their implementation.

Since the Monterrey Consensus in 2002, the international community has recognized the importance of exploring innovative sources of finance beyond the traditional methods. The 2008 Doha Declaration on Financing for Development also called for the scaled up use of innovative financing for development. More recently, the Addis Ababa Action Agenda encouraged the exploration of additional innovative mechanisms based on models combining public and private sources of finance. The cumulative results of these declarations informed the need for this study, the broad objective of which is to investigate innovative mechanisms for financing the SDGs and Agenda 2063.

The study posits that innovative financing has no unique definition, but could be explained as the mobilization of financial resources to meet specific goals. That said, however, some common features of innovative financing are discernible. These are: a new approach to financing development; redesigning old products for new markets; designing entirely new products; pooling funds through a broad range of financial instruments; appearance of a new set of investors; and financing breakthrough. The fundamental issue is that financial intermediation of innovative financing should enhance efficiencies by spreading risks across various parities, enhancing liquidity and pooling resources.

The study identified a number of traditional sources of finance that could be innovatively improved upon for efficient delivery, and new sources of financing that evolved over time as a result of the continuing search for improvement. African countries have different capabilities for mobilizing domestic resources and attracting private and public foreign capital. Five countries were used as case studies to show how they have used emerging innovative sources of finance for the transformation of their economies. Those countries are: Egypt, Ethiopia, Ghana, Morocco and South Africa. The case studies examine innovative ways by which each of the countries has improved upon the traditional sources of financing different programmes, and introduced or adopted new innovative financing strategies. The study also reviewed innovative financing strategies across the globe and identified the low level of innovative financing strategies in Africa. It is on this premise that a number of recommendations are presented to enhance creative thinking on innovative financing strategies on both traditional and new instruments for economic transformation among African policymakers and governments. The recommendations include:

First, meeting the financing needs to achieve the 2030 Agenda for Sustainable Development and the Agenda 2063 will require African countries to take a more strategic and holistic approach to mobilizing and fostering financing from the public and private sectors, which are invested in and aligned with national priorities. Second, financial policies and frameworks in Africa should be harmonized in line with global best practices, in order for the countries to benefit from global initiatives, innovation and inflows. Third, African countries should look to mobilize additional private finance for public projects and also consider using public finance in private investment (for example through national development banks and subsidizing semi-social projects). In this way, they can go beyond the historical blind spots of development finance and mobilize additional finance for key national projects, whether they are in the public or private sectors. Fourth, there is the need to provide regional models or programmes to enhance national efforts aiming at mobilizing domestic resources creatively and attracting foreign investment. Fifth, the adoption of innovative financial strategies should be based on adequate knowledge, expertise and cost effectiveness.



Chapter 1: **Introduction**

1.1 Background

Agenda 2063 of the African Union and the global 2030 Agenda for Sustainable Development offer a unique opportunity for Africa to achieve structural economic transformation and inclusive growth. The 2030 Agenda has refocused global attention on the centrality of sustainability to the development discourse. In this context, African Member States are prioritizing structural transformation in their national and continental development programmes to promote employment through commodity-based industrialization. The future of growth and its impact on poverty eradication in Africa therefore hinge on the pace of structural transformation.

Women and young people have been left behind as a result of the lack of inclusive growth on the continent, as seen in many studies (AfDB, 2015; ECA, 2016). Likewise, growth has not taken place in all sectors of the economy in recent times. Most of the value addition has come from the service sector, with the contribution of the agricultural and manufacturing sectors either remaining the same, or experiencing contractions. Given that not much of the recent growth is attributable to agriculture, the majority of people working in this sector have remained poor (AfDB, 2015). Labour is currently largely shifting towards the services industry, which historically has been less productive than the manufacturing (AfDB and others, 2013). Moreover, the manufacturing sector is largely informal, and less productive than the formal firms required for unconditional convergence. Accordingly, African countries need to assess what type of growth model is both suitable and feasible (Rodrik, 2016).

Implementing the two Agendas, 2030 and 2063, in an integrated and coherent manner, critically depends on prudent management of the available resources at the starting point and innovatively generating more resources as the execution of the programme progresses. Research on the nature and scale of Africa's financing needs consistently demonstrates, however, that the mobilization of sufficient financial resources for achieving the objectives of the two Agendas remains a huge obstacle to the achievement of sustainable, economic transformation in Africa (ECA, 2016a). In fact, the current financing gap in Africa – the difference between what is available and what is needed to finance its development – remains a critical challenge. For example, estimated financing requirements to close the infrastructure gap amount to some $93 billion a year between 2010 and 2020 (IISD, 2015). These financial needs represent about 10 per cent of gross domestic product (GDP) in middle-income African countries and 15 per cent in low-income African countries (ECA, 2016).

On one side, official development assistance (ODA) to Africa has been falling since 2013 and is still well short of what African countries need. The recent available data show that the total ODA received by Africa in 2015 is lower than what the region received in 2011 (OECD, 2016a). Besides, the commitments by donor countries to provide more aid remain unfulfilled. In addition, the 2008 financial and economic crisis led to the drying up of bilateral loans and grants from traditional development partners and forced developing countries, including Africa, to seek alternative sources of financing.

On the other side, most African countries have low per capita income with a high marginal propensity to consume and, hence, low marginal propensity to save. Furthermore, a staggering amount of capital leaves Africa as illicit financial flows and deprives the region of the much needed development finance for the structural transformation of its economies. ECA (2018) reports that the estimates of the trade mispricing component of illicit financial flows from Africa range from at least $73 billion to $87 billion per year. In addition, at least an average of $26.7 billion gross left Africa as illicit financial flows through other channels over the period 2005–2014 (Spanjers and Salomon, 2017). This is why while addressing illicit financial flows, the need for mobilizing additional resources to finance Africa's development agenda has led to a search for innovative sources of development finance.

Since the 2002 Monterrey Consensus, the international community has recognized the importance of exploring innovative sources of finance beyond the traditional modes of finance, provided that those sources do not unduly burden developing countries. The 2008 Doha Declaration on Financing for Development also called for the scaled up use of innovative financing for development. More recently, the Addis Ababa Action Agenda encouraged the exploration of additional innovative mechanisms based on models combining public and private resources, and invited more countries to voluntarily join in implementing innovative mechanisms, instruments and modalities. As highlighted by the General Assembly in its resolution 65/1, innovative sources of finance should be stable, predictable and supplemental to, not a substitute for, traditional sources of financing (UN, 2010). There is therefore an urgent need to strengthen and scale up existing innovative financing mechanisms while exploring new ones.

1.2 Rationale for the report

The main objective of this study is to examine the key challenges that African countries face in innovatively mobilizing domestic and external resources to finance Agenda 2063 and the SDGs. Given the role of finance in attaining the structural transformation agenda premised on African-owned and African-driven developmental initiatives, the central objective of the study is to investigate innovative mechanisms for the financing of Africa's structural transformation. The specific objectives of the study are to explore how existing and new mechanisms for innovative development finance can, first, increase the scale of development financing available and, second, provide stable and predictable financing to enhance sustainable development.

These objectives are in line with the recent ECA work on financing for development, notably, ECA, 2014a; ECA, 2014b; ECA, 2015b; ECA 2015e; ECA, 2017, and the report on the joint African Union Commission and ECA consultation (2015). This report adds new material that was not included in these studies. The material tracks the progress that African countries have made towards implementing the elements of the SDGs relevant to financing for development, by comparing the progress made by different African countries. Furthermore, despite the importance of innovative financing for development, there is no generally agreed definition on innovative development financing. The lack of consensus on the definition has led many studies, including the previous studies by regional and international institutions, to offer a broad interpretation and consider all types of non-conventional forms of finance. This study will review the various definitions adopted by different institutions and regions of the world and intends to come up with a definition that captures what innovative sources of finance means in the African context.

The report reviews a sample of five African countries – namely, Egypt, Ethiopia, Ghana, Morocco and South Africa – engaged in using emerging innovative sources of finance. The selection of these countries is based on the level of income and the degree of industrialization as captured by manufacturing value added per capita, and the subregional coverage of Africa. These countries have a mixed record of development planning, with a concerted effort to develop and implement a strategic national planning framework supported by an industrial policy and other supplementary policies shaping domestic resource mobilization, foreign direct investment, infrastructure financing and other sources of finance, including innovative sources of finance.

1.3 Structure of the report

The report has six chapters. The next chapter – chapter 2 – focuses on tracking the funding to achieve the SDGs and the Agenda 2063 for Africa. Chapter 3 presents a review of the three different innovative financing mechanisms for financing the SDGs and Agenda 2063 – market-based financing, result-based financing and voluntary and compulsory contributions, using examples from developed and developing countries, and also from emerging markets. A critical analysis of innovative sources of financing in the case studies of African countries is undertaken in chapter 4. This analysis highlights the challenges and success stories with regards to infrastructure financing, financial inclusion, pension and insurance funds, bonds targeted to the general public, and other forms of innovative sources of finance. Chapter 5 outlines the implementation of current traditional methods to improve the efficiency, effectiveness and impact of the traditional sources used to finance the SDGs and Agenda 2063. It provides a critical analysis of selected traditional financing methods used in an innovative manner in the case studies of African countries. The focus is on domestic resource mobilization, ODA, multilateral and bilateral organizations, development finance institutions, private sector investments, public-private partnerships, remittances and South-South cooperation. Chapter 6 contains the conclusion and policy recommendations derived from the analysis.

Chapter 2: **Innovative approaches to financing the transformation agenda: the SDGs and Agenda 2063 of the African Union**

2.1 Introduction

This section deals with issues relating to African structural change, the relevance of SDGs and Agenda 2063 in Africa's transformation agenda, the need and mechanisms for innovative financing for both Agendas. It also looks at the financial implications of Africa's transformation agenda, the funding gap and innovative solutions for bridging the financing gap, and provides an overview of all identified sources of financing in the region.

2.2 Achieving the SDGs and Agenda 2063 in Africa through structural transformation

The global 2030 Agenda for Sustainable Development has refocused global attention on the centrality of sustainability to the development discourse. In the meantime, African Member States are prioritizing structural transformation in their national and continental development programmes to promote employment through commodity-based industrialization. The future of growth and its impact on poverty reduction in Africa hinge on what happens to structural transformation. This, however, requires huge investments in both human and physical capital. In addition, the structural transformation process in African countries is optimized when policy interventions adopt an integrated approach to sustainable development that takes into account all of its dimensions (Armah and Baek, 2017).

The recent economic performance of Africa has vastly improved, as its annual growth rate since 2000 has approached 3 per cent in per capita terms (World Bank, 2016). Studies claim that this growth is driven not just by investment, but also by total factor productivity growth seen for the first time since the 1970s (Rodrik, 2016). While there was growth during the 2000s, the economic decline prior to this decade was so profound that many African countries have yet to catch up with their post-independence income levels. In many parts of the region, impressive economic growth has been accompanied by improved poverty reduction and social outcomes. Compared to the rest of the world, however, the continent is the only region where the number of poor people has increased over the past 15 years (African Development Bank, 2015b). In addition, the contribution of growth to reducing inequality remains low. The transformation of growth into poverty reduction is partially impeded by persistent inequality. As a result, the recent economic growth in Africa has not benefited the majority of Africans; particularly the majority of the people working in the agricultural sector have remained poor (African Development Bank, 2015a).

African structural change is therefore unlike the pattern by European and Asian industrializers, since labour is currently largely shifting towards the services industry, which historically has been less productive than that of manufacturing in other countries (African Development Bank and others, 2013). Moreover, the manufacturing sector is dominated by informal businesses, which are less productive than firms in the formal sector, of the sort required for unconditional convergence. African countries thus need to assess the type of growth model that is both suitable and feasible (Rodrik, 2016).

2.3 New financing framework: Addis Ababa Action Agenda

The Addis Ababa Action Agenda of the Third International Conference on Financing for Development highlights the need for integrated national financing frameworks to leverage the full potential of all financial flows – private and public – for sustainable development. The Agenda therefore captures the essence of the challenges to be tackled in the SDGs by turning them into operational commitments. Formulated as a set of specific actions, it signals a clear departure from the business-as-usual approach. Yet the commitments alone will not generate change: they will need to be backed by national capacities, responsibility and ownership to build the necessary institutions and strengthen financial management.

With the inclusion of a significant number of commitments in seven action areas, the Addis Ababa Action Agenda forms a comprehensive and coherent framework for financing sustainable development, which is critical for the realization of the SDGs. The Agenda also presents a policy framework that realigns financial flows with public goals. ODA remains crucial, in particular for countries in most need, but aid alone will not be sufficient. The Agenda addresses all sources of finance: public and private, domestic and international. As in the Monterrey Consensus, it recognizes that finance is not just about financing flows, but also depends on public policies that strengthen the national and international enabling environments. The Agenda reiterates that countries have the primary responsibility for their economic and social development, while committing the international community to create an enabling environment for their development. It also goes beyond its predecessors – the Monterrey Consensus and the Doha Declaration – to take full account of the regulatory and other policy requirements for realizing all three dimensions – economic, social and environmental – of sustainable development in an integrated manner.

Furthermore, the Addis Ababa Action Agenda underlines the importance of mobilizing adequate financial resources, beyond the traditional sources of finance, to achieve the SDGs. It insists that the private sector and foreign investors play a key role in sustaining economic growth and job creation in regions like Africa. The Agenda stresses in particular the importance of adopting innovative approaches to financing for development such as public and private partnerships and the role that blended finance and other risk mitigation mechanisms can play in leveraging resources for infrastructure and private sector financing. It also recognizes how innovative financing mechanisms can address shortcomings in financing for small and medium-sized enterprises in developing countries, both for domestic investment and trade. In fact, it encourages more countries to voluntarily join in implementing innovative mechanisms, instruments and modalities and to explore additional innovative mechanisms based on models combining public and private resources. Raising more domestic resources will strengthen Africa's sovereignty and independence, and reduce its susceptibility to external shocks and, most important, ensure a more reliable flow of funds for the continent's transformation agenda.

Issues relating to domestic resource mobilization and finance for development are central to the overall development process. Recently, they have been raised in connection with the attainment of the SDGs and Agenda 2063. The policy agenda has recently moved in new interesting directions partly because of the relevance, and also the importance, of domestic resource mobilization for accelerating progress in achieving the SDGs, and partly through the emergence of new initiatives.

Development finance is increasingly diverse and complex within the framework of the 2030 Agenda for Sustainable Development and Agenda 2063. Properly tracking all components of different financing arrangements will be important in realizing the ambition and the promise of the SDGs and Agenda 2063 so as to shed light on complex financing packages. Given the complexity of Africa's development path and the scale of its development finance needs, African countries need to leverage all possible sources of finance. This subsection evaluates current efforts that Africa is making towards mobilizing financial resources and whether spending is consistent with internationally agreed SDG-related targets, drawing on different data sets, such as the Global Spending Watch on African countries, the National Statistics Bureau, the SDG Index and Dashboards, AidData, the SDG Centre for Africa, and Total Official Support for Sustainable Development (TOSSD), among others.

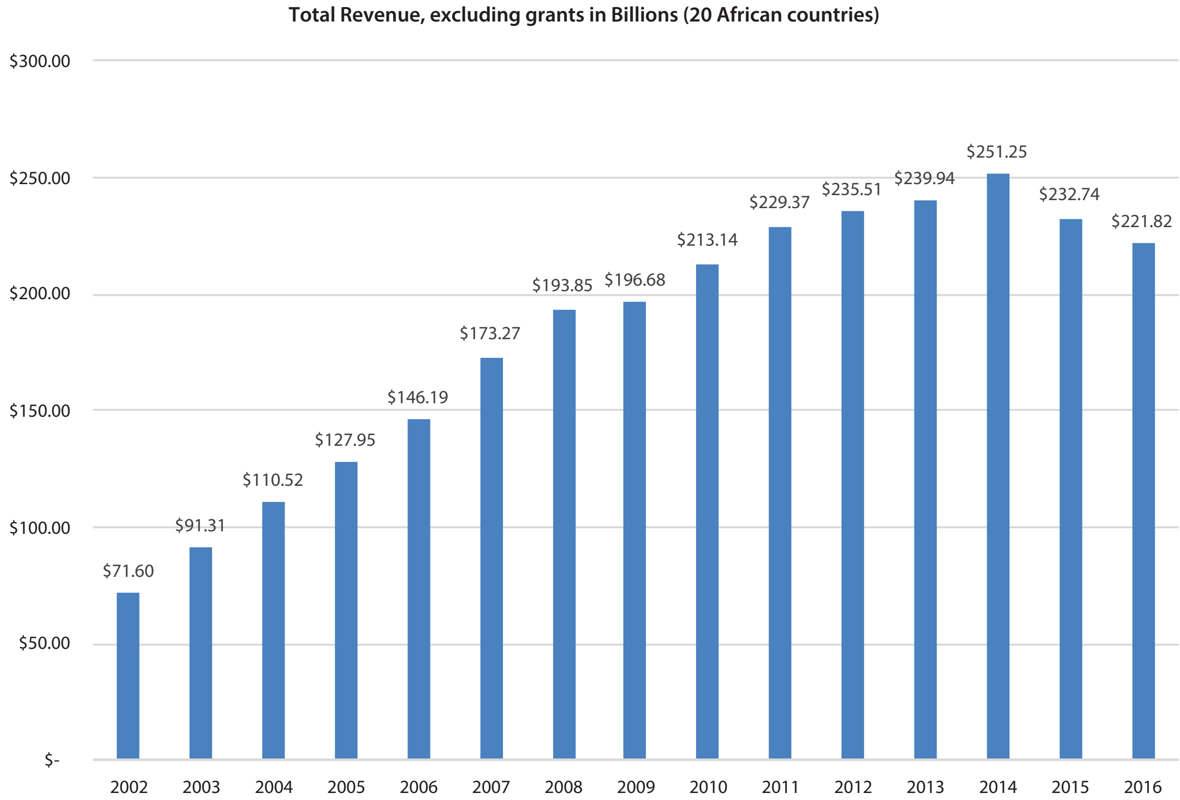
2.4 Public financial resources

The global development finance landscape has evolved, as reflected in the outcome document of the Addis Ababa Action Agenda (UN 2015). There is a shift from a model centred on ODA and the coverage of remaining financing needs through external debt, to a framework with greater emphasis on the mobilization of domestic resources. There is also the need for greater domestic finance in Africa because present domestic investment levels, although rising, are still inadequate to make possible a significant growth in per capita income on a sustained basis (UNCTAD, 2014). Increasing the rate of public investment would lead to even greater relative dependence on external resources, unless domestic financial resources grow at least commensurately. One of the specific objectives for the Istanbul Programme of Action is to achieve sustained, equitable and inclusive economic growth in least developing countries, to at least the level of 7 per cent per annum. This important target for countries such as those in Africa has been reinforced in the 2030 Agenda, as target SDG 8.1.

Increasing domestic public finance is essential so as to enhance the ability of African countries to provide public goods and services, finance infrastructure, increase equity, through social protection and help manage macroeconomic stability, thus creating an enabling environment for structural transformation and accelerated growth, which is necessary to be able to attain the SDGs (ECA, 2016). It can also reduce countries' dependence on aid. Compared to ODA and foreign direct investment (FDI), domestic resources will provide a more sustainable and less volatile base to finance poverty alleviation and better service delivery. This will in turn enhance the tax base and create a virtuous cycle of growth and poverty reduction.

In terms of volume, public domestic resources are the largest and the most important sources of development finance for Africa (ECA, 2017). This is not surprising, since the public sector continues to play major roles through fiscal spending on infrastructure, social services and even in investments in economic ventures, while private sector businesses only leverage public sector spending and private households are enmeshed in a low level of income, low saving and high marginal propensity

Figure 1
Composition of domestic revenue mobilization in Africa: Total Revenue, excluding grants



Source: WDI (2017) .

to consume. Figure 1 shows the composition of domestic revenue mobilization in Africa, i.e. total revenue. As can be seen from the figure, direct and indirect tax revenues collected by governments form the bulk of the revenues.

2.4.1 Tax and tax revenue

Tax systems, the combination of tax policy and tax administration, are central to successful fiscal policy and the overall management of the public sector. However, many sub-Saharan African countries face difficulty in raising revenue from taxes for public expenditure purposes. Low per capita incomes, an economy based on subsistence agriculture, poorly structured tax systems, weak tax and customs administrations, all contribute to difficulties in raising revenue from taxes. Africa has good potential to raise more domestic resources from efficient tax administration systems, by broadening the tax base rather than increasing taxes and tapping relatively underused sources of taxation, such as property tax, environmental tax and taxes levied from the informal sectors. However, determination of the tax-GDP ratio is a complex process involving many variables but it ultimately reflects a political decision on how much economic activity should be channelled through the public sector.

Tax revenues in African countries are rising as a proportion of national incomes. According to the Revenue Statistics in Africa Report in 2016 (OECD/ATAF/AUC, 2016), Cameroon, Côte d'Ivoire, Mauritius, Morocco, Rwanda, Senegal, South Africa and Tunisia reported tax revenues as a percentage of GDP ranging from 16.1 to 31.3 per cent. Since 2000, all of these countries have experienced increases in their tax-to-GDP ratios. The size of these increases ranged from 0.9 percentage points in Mauritius to 6.7 percentage points in Tunisia. Morocco, Rwanda and South Africa had increases of around 5–6 percentage points. In comparison, the Organization for Economic Cooperation and Development (OECD) average of 34.4 per cent was only 0.2 percentage points higher in 2014 than in 2000. The increases in tax revenues in African countries reflect continuing efforts to mobilize domestic resources, as well as the result of tax reforms and modernization of tax systems and administrations. The biggest driver of tax increases since 2000 in many African countries has been rising taxes on income and profits, and, more specifically, increases in corporate income tax revenue.

There is also a growing reliance in many African countries on substantial increases in indirect value added tax (VAT) revenues. Central to this is the reliance in many African countries on indirect taxes such as VAT and customs duties, which tend to be disproportionally borne by the poor (AUC-ECA, 2015). In this context, tax compliance could be enhanced by providing affordable State pensions and other welfare packages, and improved public service delivery at national, subnational and local levels, because citizens are more likely to pay taxes if they feel that their lives would be improved in return. This will be particularly helpful in inducing the large informal sector, as its employees will see tangible benefits in this new form of citizen-based social contracts.

2.4.2 Illicit financial flows

In 2015, illicit financial flows became part of development orthodoxy in the formulation by the United Nations of the SDGs and at the Financing for Development Conference in Addis Ababa. World leaders still have much to do to curb the opacity in the global financial system that facilitates these outflows. Illicit financial flows reduce domestic resource mobilization efforts and the tax revenue needed to fund poverty-reduction programmes and infrastructure development in developing countries such as those in Africa. They are therefore receiving growing attention as a key development challenge.

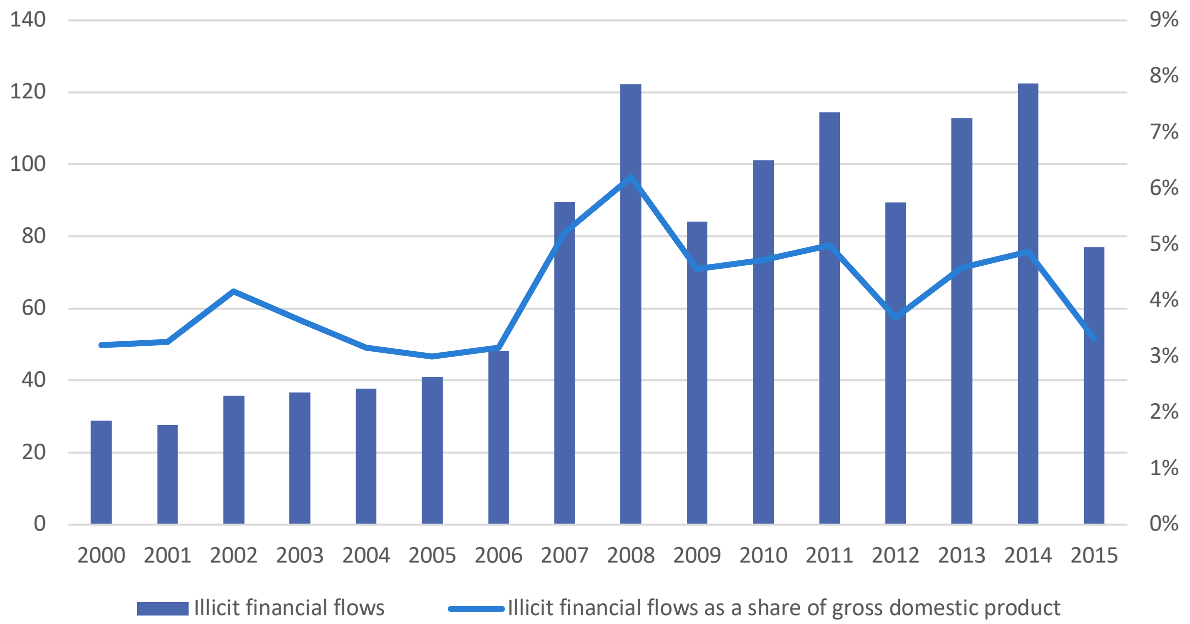
While illicit financial flows occur in many countries around the world, their social and economic impact on Africa is far more severe, given its smaller financial resource base and markets. IFFs adversely affect both public and private domestic expenditure and investment. Together with the global community, Africa must tackle illicit financial flows, which deprive the continent of important resources for development. Figure 2 below (based on a methodology that has been updated since the issuance of the report of the High-Level Panel on Illicit Financial Flows from Africa) shows that, between 2000 and 2015, net illicit financial flows between Africa and the rest of the world averaged \$73 billion annually (at 2016 prices). These losses amount to over 4 per cent of the continent's gross domestic product (GDP) over the period. The losses of public revenue in the extractive sector could be mainly attributed to the inefficient taxation of extractive activities and the inability to fight abuses of transfer pricing by multinational enterprises (ECA, 2017).

Figure 2 shows that the illicit financial outflows had been on the high side since 2007, and peaked in 2008 and 2014. Although the share of the outflow in relation to GDP shows a decline in a number of years, the proportion is quite high and indicates that the countries were losing a lot of productive resources necessary for development. Illicit financial flows must be curtailed if domestic resource mobilization initiatives are to stand any chance of succeeding. National and international

Figure 2

Estimates of illicit financial outflows between Africa and the rest of the world (through trade re-invoicing only), 2000 to 2015 *($ billions at 2016 prices and as a percentage of GDP)*

Source: ECA calculations based on United Nations Department of Economic and Social Affairs/United Nations Statistics Division, 2017; Gaulier and Zignago, 2010; World Bank, 2017, and US Bureau of Labour Statistics, 2017.



policymakers must consider the outsized effect of such flows on development and implement appropriate policies.

2.4.3 Domestic private capital flows

Domestic private capital flows can be examined in the light of the credit markets, savings, capital market activities and outcomes. Each of these is discussed in turn below.

Credit markets in Africa

Credit markets are central in economic development. One of the indications of economic development and prosperity is the development and increasing share and role of the private sector in the national economy or GDP of a country. Referring to data from the World Bank, an economic measure of so-called domestic credit to the private sector (percentage of GDP) indicates that such financial resources as loans and non-equity securities are provided to the private sector by banks and other financial intermediaries, all measured as percentages in relation to GDP. For instance, in South Africa, domestic credit to the private sector has fluctuated substantially in recent years, although it tended to increase through the 1966–2016 period, ending at 66.9 per cent in 2016. Meanwhile, domestic credit to the private sector (percentage of GDP) of Mauritius increased from 47.02 per cent of GDP in 1995 to 100.12 per cent of GDP in 2014, growing at an average annual rate of 4.36 per cent (Knoema, 2017). In the case of Nigeria, the domestic credit growth between 2006 and 2009 was put at between 12 and 36 per cent of GDP and, in real terms (2002 prices), the domestic borrowing by the private sector grew almost fivefold (Griffith-Jones and Karwowski, 2013).

African credit markets are highly segmented because of the number and range of financial institutions. Credit to the private sector is limited by the government's pre-emption of credit for financing its budget deficits and those of its parastatals. However, there are positive developments to address credit market imperfections. Private credit bureaux have been established in some African countries, including Angola, Ghana, Kenya, Madagascar, Mauritius, Mozambique, Nigeria, Uganda, United Republic of Tanzania and Zambia. The bureaux are essential for well-functioning credit markets. They help to reduce asymmetric information, moral hazard, and adverse selection problems between borrowers and lenders, thereby mitigating credit risk, supporting access to credit, and improving credit repayments. Nevertheless, some problems remain. Many African countries are still characterized by weak creditor rights and poor enforcement of loan contracts. In addition, accurate identification and evaluation of collateral for credit tend to be protracted.

Africa has witnessed a resurgence in financial development in the last couple of years. Indicators of financial deepening such as bank deposits as a percentage of GDP and bank loans as a percentage of GDP have shown some improvement (AfDB, 2015a). In recent years, innovations in information and communication technologies (ICTs) have had a growing impact on the delivery of financial services in Africa and also in other developing regions. These new technologies have helped to increase the coverage of the financial sector by reducing the cost of the infrastructure needed to carry out financial transactions. In Kenya, for example, the mobile banking system known as M-Pesa, which started as a way for mobile phone users to transfer unused air minutes to others, quickly turned into a cash payment platform. As a result, more people are saving and borrowing, and the proportion of the population excluded from financial services has fallen below 17 per cent. Kenya is now third in Africa, excluding North Africa, for financial access, behind South Africa and Mauritius. Other East African countries such as Rwanda, Uganda and the United Republic of Tanzania are following the example of Kenya and using financial technology to leapfrog traditional banking systems and provide financial services to all levels of society (IMF, 2016).

Savings

The literature on economics has traditionally attributed an important role to domestic savings in the process of long-run growth and economic development. One channel by which savings are affecting growth is that represented by domestic investment. Studies focusing explicitly on Africa have documented the positive impact of domestic savings on domestic investment. Oyejide (2002) examines trends in aggregate investment in sub-Saharan African countries from the late 1960s to the mid-1990s and finds that they closely match trends in aggregate domestic savings over the period. This empirical evidence suggests that low domestic savings is a cause of concern for investment and growth. Indeed, African countries have traditionally performed poorly on the savings front. While figures vary from country to country, gross domestic savings in the region averaged about 18 per cent of gross domestic product in 2015, compared with 26 per cent in South Asia and nearly 43 per cent in countries of East Asia and the Pacific, according to World Bank estimates.

Domestic savings and credit to the private sector have proved to be the most robust sources of financing for domestic investment and resource mobilization. Private savings in the existing policy environment have remained low and are at present probably no more than some 5–10 per cent of GDP (AfDB, 2015b). Together with external aid, they constitute a total investment of 15–20 per cent of GDP. Although substantially higher than a decade earlier, this is still inadequate, including because of the great need for replacement and modernization. Moreover, it is difficult to analyse the trends in private savings in a comprehensive manner because of severe limitations of available information. There is also a limited array of financial instruments for fund mobilization, due to the large proportion of people in rural and semi-urban locations without banking facilities.

A key condition for the effectiveness of the linkages between domestic savings and domestic investment is the level and efficiency of financial intermediation in the economy. Specifically, financial intermediation plays an important role by shifting the composition of savings towards investment capital (Ndikumana and others, 2015). Similarly, furthering financial sector development to effectively channel savings into investment can increase employment and growth.

Capital markets

Capital markets and financial sector development can be important facilitators of economic growth in Africa as in any other parts of the globe. Capital markets, encompassing markets for stocks, bonds, and other financial instruments, are traditionally thought of as exchanges or other centralized institutions for transactions between willing investors and those companies and borrowers in need of long-term funding. Transparent, deep and accessible capital markets are a vital element of the financial sector. As a means for long-term investments and for diversification of funding sources, capital markets strengthen the overall economy and render it more resilient in the face of any economic shocks.

Stock market capitalization remains low, and with the exception of Nigeria and South Africa, all sub-Saharan stock exchanges are characterized by a relatively low number of listed companies. African bond markets are also in their infant stages of development. The region's debt markets are dominated by government securities mostly of short duration, with activity focused on the domestic primary market and limited activity in the secondary market. Corporate debt markets are largely non-existent in Africa, with the exception of South Africa and, to a limited extent, some North African markets. Domestic institutional investors such as banks, insurance companies, pension funds and local private investors dominate the investor base in African capital markets. Capital market regulations differ widely across the region, as legislation and regulatory structures vary between jurisdictions, reflecting both local market conditions and varied historical backgrounds.

The Addis Ababa Action Agenda highlights the need for developing countries, in particular those in Africa, to develop domestic capital markets, with a focus on long-term bond and insurance markets to meet longer term financing needs (paragraph 44). It also recognizes the importance of borrowing as a tool for developing countries to finance investment which is critical to achieving sustainable development, including the goals, but states that such borrowing must be managed prudently and that many countries remain vulnerable to debt crises.

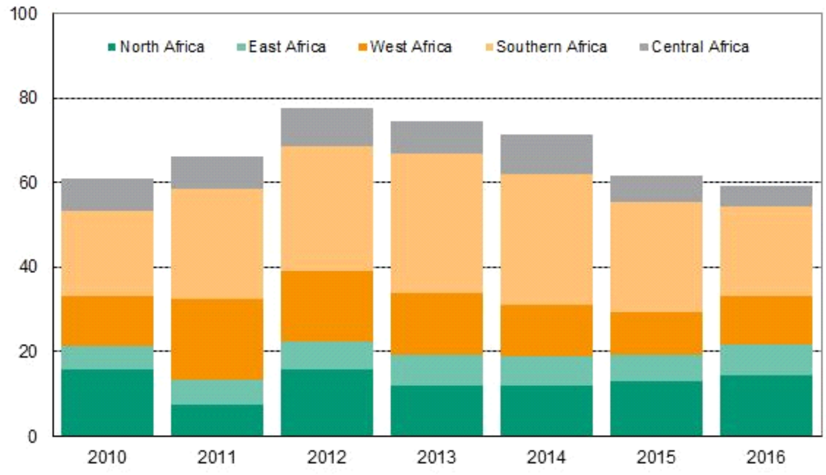
2.4.4 International private financial flows

Agenda 2063, the 2030 Agenda and the Addis Ababa Action Agenda all assign a central role to the private sector in sustainable development strategies and thus render efforts to expand the private sector and enhance its capabilities in Africa more critical now than ever before.

Foreign direct investment

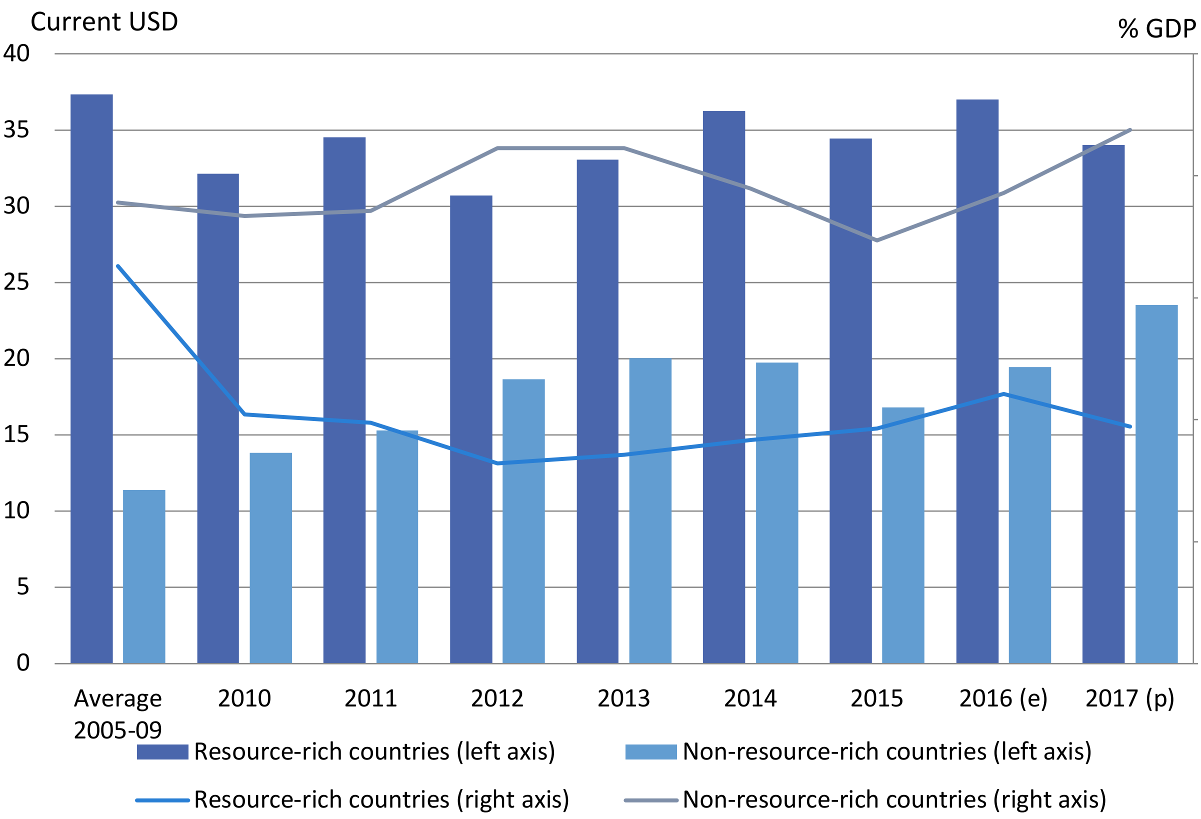
According to the Ernst and Young latest Africa Attractiveness report (2017), heightened geopolitical uncertainty and multispeed growth

Figure 3
African FDI inflows, by subregion, 2010–2016



Source: UNCTAD, WIR (2017).

Figure 4
Foreign direct investment to Africa, 2005–2017



Sources: Adapted from IMF (2016), EY (2017) and UNCTAD (2017).

across Africa present a mixed FDI picture for the continent. The report provides an analysis of FDI investment into Africa over the past ten years. The 2016 data shows Africa attracted 676 FDI projects, a 12.3 per cent decline from the previous year, and FDI job creation numbers declined by 13.1 per cent. For its part, however, capital investment rose by 31.9 per cent. The surge in capital investment was primarily driven by capital intensive projects in these sectors, namely real estate, hospitality, construction, transport and logistics. The continent's share of global FDI capital flows increased to 11.4 per cent from 9.4 per cent in 2015. This made Africa the second fastest-growing FDI destination in terms of capital.

According to the 2017 World Investment Report of the United Nations Conference on Trade and Development (UNCTAD), FDI flows to Africa continued to decline in 2016, falling by 3 per cent to $59 billion. Inflows to the continent remained unevenly distributed, however, with five countries (Angola, Egypt, Ethiopia, Ghana and Nigeria) accounting for 57 per cent of the total. Although foreign investors still favour the key hub economies in Africa, a new set of FDI destinations is emerging, with francophone and East African markets being of particular interest (see figures 3 and 4).

Portfolio flows to Africa

Portfolio flows appear to be a relatively new phenomenon in Africa's capital markets. In the region, because developments in international capital flows have not received much attention, there is very little literature on the subject. Portfolio flows, by their nature, are more temporary and more volatile than foreign direct investment and other investment flows. Opportunities for speculation can attract portfolio flows, which have been associated with asset bubbles, especially in real estate and stock markets, and with financial crises in developing countries. This association is explained partially by the fact that the scale of such inflows has often contrasted with the relatively small size of the recipient domestic markets (ECA, 2017).

Studies suggest that international portfolio flows to African countries are characterized by high volatility and low persistence. The expected portfolio flows show a positive and significant relationship to stock market returns, implying that increase in expected portfolio flows will stimulate market performance as it creates confidence among investors in the regional market. For instance, South Africa and several other emerging markets have received average annual net bond inflows amounting to more than 2 per cent of their respective GDP since 2009 (IMF, 2016).

African countries continue to have limited links to international financial systems, and receive substantially less private capital inflows than other regions (Tyson and others, 2014). Indeed, African countries remain on the periphery of the international financial system. Over the last decade, however, cross-border capital flows have steadily increased.

Research evidence strongly suggests that, despite the role of portfolio flows in lowering the cost of capital and financing growth, promoting local investment and macroeconomic stability is also important in improving the performance of the stock market in the continent (Ifeakachukwu, 2015). Thus, caution must be the watchword because portfolio flows are considered to be "hot money", creating instability through sudden outflow and contagion effects.

Remittances

In Africa, remittances are increasingly becoming important resources for development, even though recorded inflows remain smaller than ODA or FDI. Estimates suggest that remittance flows to sub-Saharan Africa declined by an estimated 6.1 per cent to $33 billion

Table 1
Remittances in various regions

Region	2010	2013	2014	2015	2016e	2017f	2018f
	($ billions)						
Developing countries	340.3	426.4	444.3	439.8	429.3	443.6	459.1
East Asia and Pacific	94.9	114.3	122.7	127.3	125.8	129.0	132.7
Europe and Central Asia	37.8	54.6	51.7	40.3	38.4	41.0	43.6
Latin America and Caribbean	56.5	61.5	64.5	68.3	73.1	75.5	78.2
Middle-East and North Africa	39.0	50.5	54.4	51.1	48.8	51.8	53.5
South Asia	82.0	110.8	115.8	117.6	110.1	112.3	115.3
Sub-Saharan Africa	30.1	34.7	35.3	35.1	33.0	34.1	35.7
World	466.7	574.8	598.3	582.4	575.2	593.8	615.9
Low and middle income countries[a]	334.2	419.0	435.9	432.3	422.5	436.3	451.1
	(Growth rate, per cent)						
Developing countries	11.2	5.2	4.2	-1.0	-2.4	3.3	3.5
East Asia and Pacific	19.5	6.7	7.4	3.8	-1.2	2.5	2.9
Europe and Central Asia	4.8	17.1	-5.3	-22.1	-4.6	6.6	6.4
Latin America and Caribbean	2.6	2.1	4.8	6.0	6.9	3.3	3.6
Middle-East and North Africa	18.2	3.4	7.8	-6.1	-4.4	6.1	3.3
South Asia	9.4	2.6	4.5	1.6	-6.4	2.0	2.7
Sub-Saharan Africa	9.6	1.0	1.7	-0.4	-6.1	3.3	4.9
World	8.3	5.3	4.1	-2.7	-1.2	3.2	3.7

Source: World Bank (2017).

in 2016, owing to slow economic growth in remittance-sending countries; decline in commodity prices, especially oil, which affected remittance-receiving countries; and diversion of remittances to informal channels due to controlled exchange rate regimes in countries such as Nigeria. Indeed, it is estimated that over half of remittance transfers to the continent are unrecorded. The region has the highest remittance costs in the world. Nevertheless, remittances to the region are projected to increase by 3.3 per cent to $34 billion in 2017 (World Bank, 2016).

The UNCTAD Economic Development in Africa Report (2016) suggests that African countries should tap into diaspora savings and make greater use of remittances, which reached $63.4 billion in 2014. Diaspora savings could be attracted through diaspora bonds, foreign-currency-denominated deposits and syndicated loans with remittances as collateral. These mechanisms, however, require the use of formal remittance channels, thus the need for efforts to facilitate and lower the cost of formal remittance channels.

Public international resources

Traditionally, ODA has played a critical role in the provision of financing for development in Africa. However, ODA in Africa has been falling as a share of total external flows (from 39.4 per cent in 2000 to 27.6 per cent in 2013) and traditional donor countries members of the Development Assistance Committee have scaled back such assistance in real terms, in particular in the least developed countries, most of which are in Africa (UNCTAD, 2015).

In 2015, net ODA from member countries of the Development Assistance Committee of OECD totalled $131.6 billion. Taking account of inflation and the rise in the value of the dollar in 2015, this was 6.9 per cent higher in real terms than in 2014, and represented the highest level ever reached. Total ODA from those countries as a share of their gross national income was 0.30 per cent, on par with 2014. Most of the increase derived from higher expenditures for costs associated with refugees. Even if those costs are excluded, however, ODA still rose by 1.7 per cent. Seven countries met the United Nations target for ODA of 0.7 per cent of gross national income in 2015, namely, Denmark, Luxembourg, the Netherlands, Norway, Sweden, the United Arab Emirates and the United Kingdom.

Given the current growth trajectory, Africa has today become increasingly attractive to new key partners in the global economy. The role of emerging economies as trading partners, investors and providers of development cooperation has substantially increased over the past decades. South-South cooperation has taken on a broader approach than cooperation from traditional donors. It usually goes beyond the provision of aid and is framed as part of a larger set of initiatives that can include trade and investment agreements. This has the potential to capitalize on the economic strengths of recipient countries by supporting the reduction of transaction costs (Lin and Wang, 2017).

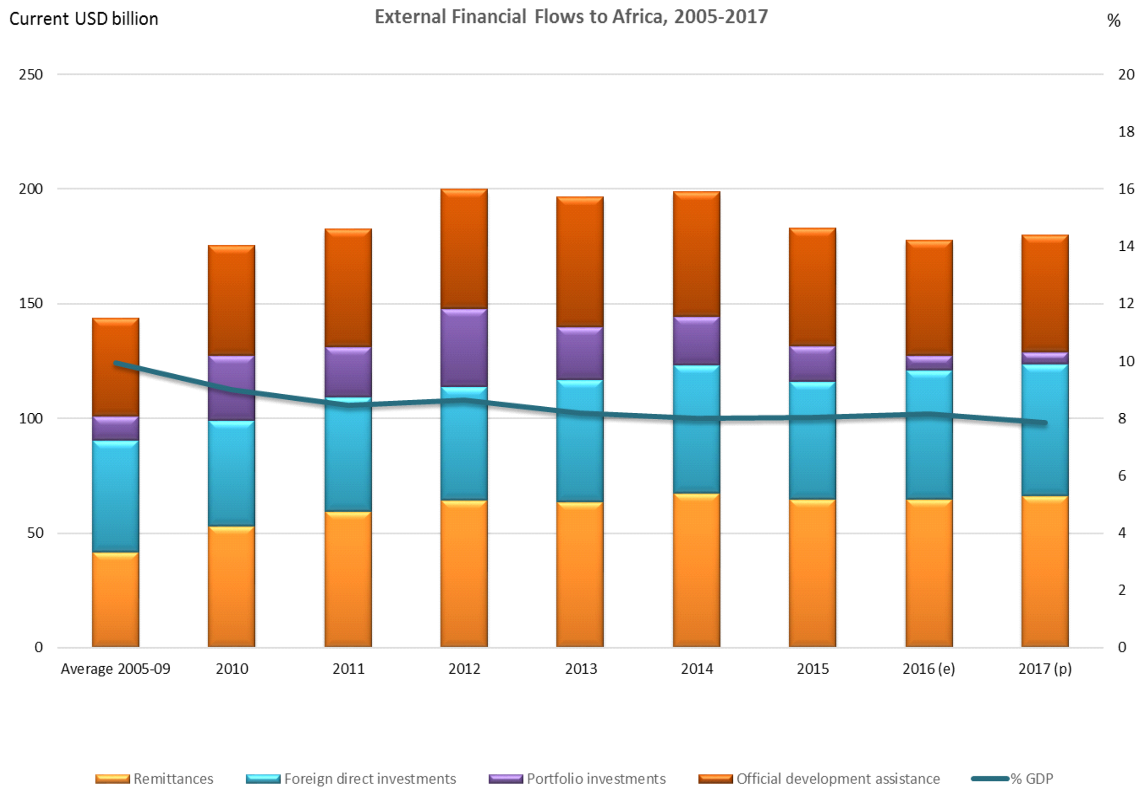
Table 2

Top 10 ODA recipients in Africa *(millions of US dollars, receipts from all donors, net ODA receipts)*

	2012	2013	2014	3-year average	% of all recipients
1. Egypt	1 807	5 508	3 532	3 616	7%
2. Ethiopia	3 221	3 885	3 585	3 564	7%
3. United Republic of Tanzania	2 823	3 431	2 648	2 967	5%
4. Kenya	2 653	3 312	2 665	2 877	5%
5. Democratic Republic of the Congo	2 847	2 583	2 398	2 610	5%
6 Nigeria	1 912	2 515	2 476	2 301	4%
7 Mozambique	2 074	2 315	2 103	2 164	4%
8. Morocco	1 465	2 004	2 247	1 906	4%
9. Uganda	1 642	1 701	1 633	1 658	3%
10. Côte d’Ivoire	2 635	1 272	922	1 610	3%
Other recipients	28 053	28 190	29 983	28 742	53%
Total ODA recipients	51 132	56 715	54 193	54 014	100%

Source: OECD (2016).

Figure 5
External financial flows to Africa



Blended finance

Blended finance, defined as the strategic use of official (public) funds to mobilize private sector investment for emerging and frontier economies, is recognized as an important tool within the development toolbox in the mobilization of new capital sources to achieve the SDGs. Through blended finance, public funds can target a risk that the private sector is unwilling or unable to take. It also can be used to improve the risk-return profile of an investment to a level acceptable for the private sector. What all this does is to attract much-needed private sector investment and know-how for projects. Interest in blended finance has mushroomed over recent years and it now represents one of the most dynamic fields in the financing for development arena. In paragraph 48 of the Addis Ababa Action Agenda, countries are encouraged to explore innovative mechanisms that combine public and private resources. It notes that "both public and private investment have key roles to play in infrastructure financing, including through ... mechanisms such as public-private partnerships [and] blended finance".

2.4.5 Other financing sources for SDGs and Agenda 2063

Trade as a means of implementing the SDGs

The 2030 Agenda for Sustainable Development, and to some extent Agenda 2063, recognize that international trade is an important mechanism through which many of the specific goals and targets that have been agreed upon can be achieved. Making trade an effective means of implementation will, however, require action on a broad front. Most African countries are heavily dependent on trade (exports and imports). Trade is a source of foreign exchange, intermediate inputs and employment, among other benefits. Trade policy provides important instruments like tariffs and export taxes, to raise the revenue that African governments need to finance development. It is also a non-financial means of implementation through its impact on social and environmental development. For instance, trade policy can affect food security and nutrition (FAO, 2016). Besides, it can affect health outcomes by facilitating access to essential medicines (SDG 3).

Trade is more prominent as an instrument for the attainment of the SDGs than was the case with the MDGs. The trade targets that are included in the SDGs and are further elaborated in the Addis Ababa Action Agenda centre on improving market access for developing countries, concluding the negotiations of the Doha Development Agenda under the World Trade Organization (WTO) and duty-free, quota-free market access for the least developed countries. These policy areas have long been on the agenda of international trade negotiations. Cooperation in these areas can contribute to sustainable development, but may not do much to address the main constraints that limit the scope for trade to make a positive difference.

A major factor inhibiting the more effective use of the global trading systems by firms in Africa is high trade costs. Extensive evidence suggests that trade costs are much higher than prevailing tariff rates of protection. Even if account is taken of non-tariff measures, foreign market access barriers in export markets are rarely the binding constraint on trade expansion. Post-1980 experience makes it clear that autonomous reforms drive economic development. However, non-tariff barriers and restrictions to trade do not figure prominently in the SDGs and the 2030 Agenda (Hoekman, 2016).

Public-private partnerships as complementary financing modalities

African markets today do not provide adequate incentives for private businesses to contribute to sustainable development. The key is to combine public financing, regulation, and private market participation with an effective public-private partnership. Public-private partnerships offer great promise for sustainable development, but can be extremely complex to design and can come in a variety of forms (SDSN, 2015).

While public-private partnerships are complex contractual undertakings and bear borrowing risks, they do offer access to specialized skills, technologies, and innovation from the private sector. These factors can lead to greater operational efficiency and thus better quality and competitiveness to public services. To prevent the contingent liability of public-private partnerships turning into a debt burden, African governments must strengthen public-private partnership frameworks and regulations at the national and subregional levels. This requires legal, managerial, and technical capacities to clarify the roles and responsibilities of contracting partners, provide clarity in the event of litigation, plan and monitor implementation effectively, and carry out robust investment appraisals and financial analysis. The public-private partnership modality has the potential to bring long-term quantitative and qualitative value to many African States, but the transaction costs of public-private partnerships and the ability of a country to manage such partnerships must be carefully weighed against the intended benefits.

Climate financing

Africa is the continent most affected by climate change. Two thirds of Africans make their living off the land. Consequently, it is critical that the continent adopts a climate-resilient economic and development policy. SDGs recognize the fundamental interdependence of climate change with concerns for the environment, and for social and economic development. Development finance plays a key role in helping developing countries transition to the low-carbon, climate-resilient and environmentally sustainable pathways needed to achieve the SDGs (OECD, 2015). Integrating financing for climate change and development can maximize results in both areas.

Africa requires massive amounts of climate financing in order to make its economies both low-carbon and climate-resilient. The continent will require an estimated $377 billion in financing for climate mitigation investments and $222 billion for climate-resilience investments in order to reach its nationally determined contributions, while North Africa will require an additional $125 billion for combined mitigation and adaptation financing. Current financing falls far short of this figure, however. In 2014, only $12 billion of climate finance reached Africa, with another $9 billion ranging across the Middle East and North Africa (CPI, 2015).

Climate finance has been a core element of the climate negotiations. In the Paris Agreement on climate change, countries agreed to make finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development. Developing countries will receive financial resources for both mitigation and adaptation actions, while developed countries are expected to continue leading in mobilizing climate finance from a variety of sources, with public funds playing a significant role in reaching the previously agreed $100 billion annual target by 2020 (UNFCCC, 2016). The role of climate finance in supporting climate outcomes needs to be understood within the broader set of goals and compliance mechanisms established at Paris.

2.5 Financing gap

It is important to highlight that determining the financing gap is a speculative endeavour. This, of course, has been acknowledged by many previous studies. The complexity stems from at least two sources. First, the resource requirement to achieve the SDGs will largely depend on many factors that will vary across African countries. It is clear that member States have a varying capability to mobilize domestic resources and attracting private and public foreign capital. Other factors include, among others, the effectiveness of the economic policies, social inclusion and social protection policies, the quality of institutions and the extent to which such policies address issues relating to corruption and prioritize service delivery.

As highlighted in the 2017 report of the Inter-Agency Task Force on Financing for Development, the different goals and targets of the SDGs will present a range of challenges for many African countries depending on their present state of development and other national priorities. So when it comes to implementation, different African countries will need to give different levels of attention, support and effort to the various goals and targets, depending on where they stand in relation to them at present, depending on their differentiated responsibilities and their capabilities and resources. The balance between the social, economic and political effort needed to deliver the different objectives is also likely to differ from one African country to another and between subregions of the continent.

The financing needs related to the implementation of the SDGs and Agenda 2063 are enormous. For instance, quantifying the needed financial resources to implement the SDGs is complex and estimates vary widely, from $2.5 trillion to over $5 trillion per year. Studies estimate that the incremental costs of financing the SDGs in Africa alone amount to more than $600 billion per year (Schmidt-Traub, 2015). This amount equates to almost one third of Africa's aggregate gross national income (GNI). But this may be a conservative figure, as estimates differ depending on the method used. Chinzana and co-authors (2015) estimate the required GDP growth rate to achieve SDG 1 (ending poverty) and the corresponding investment-to-GDP ratio and financing gap-to-GDP ratio, assuming that savings, ODA and FDI all remain at current levels. According to this study, an annual GDP growth rate of 16.6 per cent per year will be required, along with an additional investment of $1.2 trillion per year, to meet SDG 1 only. Another study carried out by the Food and Agriculture Organization of the United Nations (FAO), the International Fund for Agricultural Development and the World Food Programme (WFP) (2015) estimates $148 billion as the required income to end hunger by 2030.

A recent German study (GIZ/BMZ, 2017) estimates that investment needs in the economic and social infrastructure sector alone amount to $135 billion per year in Africa. The same study estimates the financing gap at about $60 billion per year. African countries must mobilize considerably more domestic revenues, but average private sector participation in current infrastructure investment in most African countries is considerably lower than that in developed countries and may not address existing investment needs without significant upscaling (African Union and others, 2015). While infrastructure investment needs are already large, including requirements related to the other SDGs raises this number even higher. Estimates made prior to the United Nations Conference on Sustainable Development, held in Rio de Janeiro, Brazil, in June 2012, determined that Africa would require close to $200 billion per year to implement sustainable development commitments under the social, economic and environmental dimensions (ECA, 2015).

2.6 Conclusion

A bold financing approach for development is required to achieve the SDGs and Agenda 2063. Given an investment gap for Africa to achieve the SDGs which, as indicated above, lies between an incremental outlay of $200 billion and $1.2 trillion per annum, new frameworks for development finance are required for national governments and financial institutions. Implementation of the 2030 Agenda calls for a revitalized global partnership for sustainable development, supported by specific policies and actions as outlined in the outcome document of the third International Conference on Financing for Development (UN, 2015).

The scope of financing needs makes it imperative to seek an innovative method for, and increase in, private and public investments related to the SDGs and Agenda 2063. The need for additional and more predictable development financing has led to a search for alternative innovative sources of finance. Various initiatives to develop and implement innovative development financing mechanisms have emerged across the globe. The Inter-Agency Task Force on Financing for Development has also identified elements to respond to the challenges posed by the current economic and social environment, including increased long-term investments, complemented by measures to directly better the living conditions of the poor and vulnerable, such as social protection floors.

Chapter 3: **Innovative sources for financing SDGs and Agenda 2063**

3.1 Introduction

Following on from the various financing mechanisms for achieving SDGs discussed in the preceding chapter, chapter 3 outlines the conceptual framework of innovative financing approaches, taking account of the major objective of structural transformation based on inclusive growth and sustainable development anchored on reliance on domestic public and private resources. The issue of definitions relating to innovative financing will also be discussed in this chapter. The chapter also covers the avenues or sources of financing using the three different innovative financing mechanisms for Financing SDGs and Agenda 2063, namely: market-based financing; result-based financing; and voluntary and compulsory contributions. To this end, the discussion is structured in accordance with the three different innovative financing mechanisms from developed, emerging markets and developing countries, with a view to seeing the areas both of convergence and divergence in the modes of financing. The chapter concludes by noting that the mainstream literature on innovative financing for development has a number of apparent "blind spots", where useful sources of finance can, in fact, be found.

3.2 Issues of definitions for innovative financing

Since the 2002 Monterrey Consensus, the international community has recognized the importance of exploring innovative sources of finance beyond the traditional modes of finance, provided that those sources do not unduly burden developing countries. The 2008 Doha Declaration on Financing for Development also called for scaling up the use of innovative financing for development. More recently, the Addis Ababa Action Agenda has encouraged the exploration of additional innovative mechanisms based on models combining public and private resources and invited more countries to join voluntarily in implementing innovative mechanisms, instruments and modalities. The Agenda also encourages the replication of existing mechanisms, such as the International Finance Facility for Immunization, to address broader development needs.

Despite the importance accorded in recent literature to innovative financing for development, there is no generally agreed definition of the term. The lack of consensus on the definition has promoted many studies, including those by regional and international institutions, to offer a broad interpretation and consider all types of non-conventional forms of finance as innovative sources of finance. A World Bank report defines innovative financing as the non-traditional applications of solidarity, public-private partnerships, and catalytic mechanisms that support fundraising by tapping new sources and engaging investors beyond the financial dimension of transactions as partners and stakeholders in development, or that deliver financial solutions to development problems on the ground (Girishankar, 2009).

To OECD, innovative financing comprises the "mechanisms of raising funds or stimulating actions in support of international development that go beyond traditional spending approaches by either the official or private sectors, such as: new approaches for pooling private and public revenue streams to scale up or develop activities for the benefit of partner countries; new revenue streams (e.g. a new tax, charge, fee, bond raising, sale proceed or voluntary contribution scheme) earmarked to developmental activities on a multi-year basis; new incentives (financial guarantees, corporate social responsibility or other rewards or recognition) to address market failures or scale up ongoing developmental activities" (Sandor and others, 2009).

In the view of the Leading Group on Innovative Financing for Development "An innovative development financing mechanism is a mechanism for raising funds for development. The mechanisms are complementary to Official Development Assistance. They are also predictable and stable. They are closely linked to the idea of global public goods and aimed at correcting the negative effects of globalization."[1]

Fuchs, Hurley and Minsat (2012) argue that, as the purpose of innovative financing is to "widen fiscal space, domestic public resources can be mobilized by: enhancing tax revenues to increase public savings; raising public sector access to savings from households and firms for investment in public expenditures focused on Millennium Development Goal (MDG) attainment; and increasing the efficiency of public expenditures, notably by lowering the unit cost of providing public services without reducing their quality and quantity". With fiscal space being widened, innovative finance will catapult economic growth, compliment the conventional revenue, fix the loopholes in official donations and align the income and expenditure with the MDGs (Reghbenda, 2002).

Based on the foregoing exploration of innovative financing or sources of finance, innovative financing may be considered to have the following attributes:

- It represents a new approach to financing development
- It redesigns old products for new markets
- It designs entirely new products
- It represents development funding contributions from stakeholders that may be driven by either the public or private sectors
- It comprises funds pooled through a broad range of financial instruments
- It brings to the fore a new set of investors and a breakthrough in financing modalities.

3.3 Innovative financing mechanisms

Innovative finance covers a broad spectrum of initiatives that address specific market failures and institutional barriers that hinder development. Innovative financing instruments often reallocate risks from investors to institutions better positioned to bear the risk and, in the process, enable participation from mainstream investors (Ketkar and Ratha, 2009a). A report by Dalberg Global Development Advisors (2014) posits that innovative financing emanates from either voluntary or compulsory contributions to funding through the design of an entirely new product, the introduction of an old product in a new market or the involvement of new investors.

The mechanisms for innovative financing have been grouped into three categories and these are: first, market-based financing; second, result-based financing; and, third, financing

1 http://www.leadinggroup.org/article1175.html.

through voluntary and compulsory contributions (Basu, 2010).

For the various mechanisms of innovative finance to be sufficiently effective, Fuchs, Hurley and Minsal (2012) call on stakeholders to avoid increasing the complexity of fundraising and delivery mechanisms through the multiplication of small-scale and competing initiatives, which crowd one another out and lack strategic visibility. At the same time, principles of sustainability, transparency and local ownership would favour developing regions devising and implementing their own innovative financing.

Arising from the definition and explanations of the concept of innovative financing discussed above, this section explores avenues or sources of financing using the three different innovative mechanisms for financing the SDGs and Agenda 2063, namely: market-based financing; result-based financing; and voluntary and compulsory contribution (Basu, 2010). To this end, the discussion is structured in line with the three different innovative financing mechanisms from developed, emerging markets and developing countries, with a view to seeing the areas of both convergence and divergence in the modes of financing. Suffice it to state that, over time, the different economies have borrowed ideas from one another, such that many of the types of innovative financing cut across economies.

3.3.1 Market-based financing

According to Basu (2010) the innovative market-based financial instruments tend to leverage remittances and the wealth of the diaspora and consequently improve access to capital markets for developing countries. On the other hand, however, Dalberg Global Development Advisors (2014) reasserts the significance of the mechanisms that target below-market returns, which "remain an important component of the landscape (53 per cent of the total in 2012), with increased focus on opportunities that target both social and financial returns". This can be viewed from the investor's standpoint, where emphasis is placed on investments which offer risk-adjusted market returns. "This includes low-risk investments, such as green bonds that are backed by development bank balance sheets, and riskier propositions, such as microfinance funds and impact investment funds".

There has been an increased focus on opportunities that target both social and financial returns (sustainability themed investments), on low-risk investments such as green bonds that are backed by development bank balance sheets, and on riskier propositions such as microfinance funds and impact investment funds, which are increasingly contributing to market-based innovative financing (Dalberg Global Development Advisors, 2014). Innovative market-based financial instruments tend to also leverage remittances and the wealth of the diaspora (Basu, 2010) and consequently improve access to capital markets for developing countries. Some of the advantages of these market-based financial instruments include their ability to improve sovereign credit ratings; the securitization of future remittance flows; and the use of diaspora bonds to tap into the wealth and savings of migrants.

Private capital in the form of equity, bonds, debt, non-concessional loans, risk mitigation instruments (including guarantees), private voluntary contributions and worker remittances has become a growing source of funding and accounts for the bulk of financial flows. In 2014, the emerging market economies received $60 billion in remittances and $93 billion in portfolio investment flows (ECLAC, 2015 and 2016). The international bond market, in particular, has become a major source of financing for private and public sectors in areas including natural resources, infrastructure and the financial sector. This shift is mainly due to quantitative easing in the United States of America, which has encouraged bond investors to seek higher returns in emerging markets across the board, including Latin America and the Caribbean, where the $20 billion bond issuance in the region in 2009 stabilized at around $80 billion in 2014–2015 (ECLAC, 2016).

Sustainability-themed investments

In recent years there has been a growth in private equity and venture capital firms that raise funds in developed countries and deploy those funds in emerging markets for sustainabilitythemed investments or projects that focus not only on generating financial returns but also on having a positive impact on environmental and social standards. Impact investments, a term created in 2007, is estimated at $60 billion in 2015, with predictions ranging from $400 billion to $1 trillion worldwide by 2020 (JP Morgan and others, 2010). It is estimated that 22 per cent of the global-impact enterprises are in Africa, demonstrating the significant share of opportunities for impact investing that lie in the continent (Bertha Centre, 2016).

Impact investing in Africa is rendered all the more imperative by the decline in ODA funding to meet basic needs. Furthermore, Africa needs to harness private investment sources which can be used to solve some of the continent's social and economic problems through private sector initiatives (UNDP, 2015). Impact investment tends to move into areas such as renewable energy, rural development and health where, in many developing nations, conventional investors are not available (Wilson, 2016). Meanwhile, in Europe, the market capitalization of sustainabilitythemed investments grew from €7 billion in 2005 to €48 billion in 2011, €8.75 billion of which was impact investment contributed by institutional and individual investors (Jahn and others, 2014).

China and India are the largest recipients of the Climate Investment Funds to date (UN, 2012). In 2014, the provision of innovative funding through green credit lines and green climate funds was discussed at the Lima Climate Change Conference. The development banks are encouraged to provide green credit lines that encourage long-term investment in low-carbon projects. For example, the Peru Development Bank provided funding for COFIGAS – a natural gas project in Lima that converts vehicles from petrol to the use of lower-emission natural gas. The project funding has been extended to both the private and public sectors with the aim of converting 50,000 vehicles, but it surpassed the target by successfully converting 190,000 vehicles within the initial five-year period (Masullo and others, 2014).

Green bonds represent another example of such sustainable themed investments. The green bond market is an innovative private sector financing method that contributes to sustainable development and biodiversity as it targets global value chains to reduce direct pressures on biodiversity (Fétiveau and others, 2014). The funds raised through green bonds are used exclusively to finance or re-finance what are termed "green" projects, assets or business activities such as energy efficiency and renewable energy infrastructure.

The market for green bonds has grown rapidly because they can be evaluated using standard risk models, provide a risk-adjusted return that meets investor expectations, and offer investors the opportunity to be associated with a positive environmental outcome (Dalberg Global Development Advisors, 2014). Institutions with excellent credit ratings and strong balance sheets have issued green bonds.[2] It was reported that the green bond market has multiplied more than fivefold in size from 2013 to 2016, when it reached $81 billion in new issuances. The market grew by 92 per cent from 2015 to 2016 and is projected to reach between $120 billion (HSBC) and $200 billion (Moody's) in 2017 (ALCB Fund, 2017).

It has been suggested that the green bond concept does not need to be limited to environmental projects. It can be used when there is a need for investment in global priorities that surpasses the current resources of the public sector; and the investments will generate adequate cash flows through either profits or accrued savings to repay the principal and interest on the bonds (Dalberg Global Development Advisors, 2014). For instance, the International Finance Facility for Immunization has used a similar mechanism to mobilize resources and streamline the deployment of funds for vaccines. As with sovereign bonds, the Facility allows governments to make a legally binding commitment to repay bonds sold to institutional and individual investors. To date, the Facility has raised $4.5 billion at costs similar to those of the World Bank, proving that this structure can efficiently raise capital (Dalberg Global Development Advisors, 2014).

One of the world's major emissions trading systems for carbon dioxide is the European Union Emissions Trading Scheme. It is a pillar of the European Union climate policy launched in 2005 to fight global warming. As of 2014, the Trading Scheme covered approximately 13,500 stationary installations in the electric utility and major industrial sectors and all domestic airline emissions in 31 countries (Ellerman and others, 2016). The Trading Scheme has, however, encountered some implementation challenges, such as lack of data and benchmarking (Ellerman and Buchner, 2007). It is also argued that Trading Scheme renewable energy targets do not make economic sense as they represent an expensive option for the reduction of carbon dioxide emissions, therefore a multidisciplinary economic analysis of the climate and energy policy mix is required to reduce trade-offs (del Río, 2017).

Securities and derivatives

Securities and derivatives are highly significant mechanisms in innovative financing. A 2014 report by Global Development Incubator stated that 80 per cent of innovative financing mobilized between 2000 and 2013 came from securities and derivatives. The largest components of securities and derivatives are guarantees ($36 billion, or 39 per cent of the total). This reflects the importance of the Multilateral Investment Guarantee Agency (MIGA), which, as the largest single mechanism in this domain, mobilized $24 billion between 2000 and 2013 (26 per cent of the total) (Dalberg Global Development Advisors, 2014).

Many emerging economies have used backup by MIGA in the form of guarantees to

2 As of December 2017, the following institutions are issuer members of the Green Bond Principles: African Development Bank, Agence Française de Développement, Agence France Trésor (on behalf of France), Agricultural Bank of China Limited, Bank of China Limited, Berlin Hyp AG, BNG Bank, Caisse des Dépôts et Consignations, Caja Rural de Navarra, Sociedad Cooperativa de Crédito, Commonwealth of Massachusetts, Council of Europe Development Bank (CEB), Deutsche Hypothekenbank AG, Deutsche Kreditbank AG, Development Bank of Japan Inc., District of Columbia Water and Sewer Authority ("DC WATER"), EDF SA, Enel SpA, ENGIE (ex GDF Suez), European Bank of Reconstruction and Development (EBRD), European Investment Bank (EIB), FMO (Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V), Hannon Armstrong Sustainable Infrastructure (HASI), ING Bank N.V, Instituto de Crédito Oficial (ICO), International Finance Corporation (IFC), Kommunalbanken AS (KBN), KommuneKredit Kommuninvest I Sverige AB Massachusetts Bay Transportation Authority, Municipality Finance Plc, Nordic Investment Bank (NIB), NRW. BANK, NWB Bank (Nederlandse Waterschapsbank N.V.), Overseas Private Investment Corporation, Province of Ontario, Région Ile-de-France, Renovate America, Inc., SNCF Réseau, Toronto-Dominion Bank, Unibail-Rodamco, Unilever, World Bank, YES BANK Ltd (ICMA, 2017).

commercial banks which provide funding for infrastructure development in bridging funding gaps in the area of infrastructure. For example, this type of innovative finance has been successfully tested in Brazil to fund the São Paulo State Transport Project. The estimated cost of the project was $729 million, with a funding gap of $300 million. In addition to the credit already provided by the World Bank, MIGA issued guarantees to Banco Santander of Spain, which provided funding to close the $300 million gap (World Bank, 2014).

MIGA, however, is not innovative as such, nor is the idea of political risk insurance. Since its inception in 1988, MIGA has issued more than $45 billion worth of guarantees, in support of over 800 projects in 110 of its member countries. The Agency has also supported multiple programmes at regional and global levels in member countries (MIGA, 2017). MIGA has large exposure in Latin America since its mission is to promote investment in emerging markets, and it creates value by lowering the cost of borrowing compared to commercial offerings or by creating new instruments, such as long-tenor loans. Changes in policy, combined with new market opportunities, mean that it has increasingly been used by African countries in recent years. As reported on the MIGA website, only 36 projects from Africa (excluding North Africa) were backed by MIGA between 1990 and 2000, but from the millennium to date that number has increased more than fivefold, to 205 projects.

Securitization has been used to finance credit-enhanced bonds issued to finance social and economic infrastructure projects such as waste management, hospitals and schools, and to support utilities delivering water, electricity, and gas services. The unitization and securitization of revenue streams from mature infrastructure assets offer financing options for government agencies and private investors. The investment characteristics of mature infrastructure assets include limited competition, regulated tariffs, stable and frequently indexed revenue streams, low variable costs, high leverage for enhanced return to equity, and low demand elasticity. In mixed asset portfolios, infrastructure assets are an option for portfolio diversification (Della Croce and Gatti, 2014).

A recent example is Africa's first securitization for an off-grid solar deal made in January 2016 in Kenya. The Netherlands investment firm Oikocredit and United Kingdom-based solar energy provider, BBOXX, have formed a partnership to fund the distribution and financing of the off-grid solar market in rural areas in Kenya. The off-grid solar sector has encountered difficulties in attracting sufficient investments to finance what is perceived as a risky business model, involving relatively new technology, doing business in developing countries and clients with little or no credit history. This securitization has enabled the supply of approximately 1,200 new solar home systems to households with limited or no access to grid electricity, benefitting an estimated 7,000 people.

Sovereign wealth funds

A sovereign wealth fund serves as a long-term approach to achieving a country's long-term strategies and financial goals through the acquisition of international equities, commodities and private fixed income securities. These facilities are essentially funded through three major sources: first, revenue from the export of natural resources; second, transfer of assets from foreign exchange reserves; and, third, disbursement of sovereign debts on the international market. African sovereign wealth funds can enhance productivity and spur intra-African investment by allocating part of their assets to growing sectors in Africa. In addition, African countries can use their own assets to invest in domestic companies to boost growth and to create jobs. In

2009, Africa had 14 sovereign wealth funds totalling $114 billion, representing 3 per cent of global sovereign wealth funds. Africa's contribution could increase in future with the establishment of new funds and the expansion of existing ones. The largest funds are the Libyan Investment Authority and the Algeria Revenue Regulation Fund, with $65 billion and $56.7 billion in total assets, respectively (ECA, 2016).

Spurred by the region's rapid economic development, sovereign wealth funds in Asia have increased in both size and number over the past decade. Given their size and close links to governments, sovereign wealth fund investments often attract media attention and are scrutinized for political motives as well (Borst, 2015). Like other regions, several Asian economies have created such funds to hold and invest part of their large holdings of international reserve currencies. In addition to investment purposes, sovereign wealth funds also vary significantly in the area of source of funding. Sovereign wealth funds are commonly financed from such sources as balance of payment surpluses; funds accumulated by central banks during foreign currency operations; proceeds from the privatization of State-owned enterprises; fiscal surpluses; and receipts from commodity exports. Asian sovereign wealth funds differ in that they are primarily funded from government revenues, foreign exchange reserves, or the contributions of retirees. As a region, Asia accounts for nearly 40 per cent of the more than $7 trillion in total sovereign wealth fund assets and a disproportionate number of the largest funds. From this, pension reserve funds account for a large share of Asian sovereign wealth fund assets.

Development bank finance

Co-financing with development banks is another approach to mobilizing funds and spreading risk. In this approach, investors can gain a greater level of comfort via a lead development bank's connection with governments, its financial strength, its willingness to remain through difficult economic conditions, and its financial imprimatur, all of which help attract other financiers. For instance, Eleme Petrochemicals of Nigeria became a world-class chemical manufacturer – from a poorly performing industrial giant – when IFC provided advice, financing and deal structuring to allow privatization of the State-owned firm.

Both national and regional development banks are playing an increasingly important role in development finance in Latin America and the Caribbean. There are over 100 development finance institutions in the region. According to the Economic Commission for Latin America and the Caribbean (2015), net lending by development banks in Latin America and the Caribbean region increased, on average, by 15 per cent annually during the period 2000–2009. National development banks currently hold an average share of 30 per cent of total assets, and 24 per cent of total deposits. Development banks in the region have also been recognized for their role in financing social and economic projects (ibid.). Subregional development banks have also significantly increased their lending volume to Latin America and the Caribbean since 2000. In 2011, subregional banks, including the Central American Bank for Economic Integration and the Development Bank of Latin America and the Caribbean, lent almost $12 billion in the region. On the other hand, the Inter-American Development Bank lent around $11 billion to the region while the World Bank lent around $10 billion in 2011. Latin America has also used a regional investment bank, the Latin American Investment Facility, to directly support development of production in the region.

Diaspora bonds

A diaspora bond is a debt instrument issued by a country or, potentially, a sub-sovereign entity or a private corporation to raise financing from its diaspora (Ketkar and Ratha, 2009b). Since 1991, India has been at the forefront in raising hard currency financing from its diaspora. The Government of India has raised about $12 billion to date, often during liquidity crises, by tapping into the wealth of its diaspora communities to support balance of payments needs and finance infrastructure. The Government of Sri Lanka has also sold Sri Lanka Development Bonds (SLDBs) since 2001 to several investor categories including non-resident Sri Lankans raising a total of $580 million to date. The downside risk with the diaspora bond is that debt service payments by the issuer are in local rather than hard currency. However, since diaspora investors often have liabilities in their country of origin, they are likely to view the risk of receiving payments in local currency with much less trepidation than would non-diaspora investors.

Although migrant workers from developing countries have been sending remittances to support family and friends in their country of origin, there are considerable opportunities to unlock additional value from these flows. For instance, the use of diaspora bonds that specifically target a country's emigrant population is a time-tested but underused means to raise money to finance development. Several African countries have introduced diaspora bonds, in order to help bridge financing gaps (for example Egypt, Ethiopia, Nigeria among others), as these bonds are useful for tapping into the wealth of the diasporas for financing projects on infrastructure, housing, health and education (Basu, 2010). For African countries, the World Bank has estimated that these instruments could raise as much as $5 billion to $10 billion annually, but so far their potential has been almost completely untapped (Bensoussan and others, 2013).

Pension funds

As a debt security, infrastructure investments are well matched to pension funds' long-dated liability curve and yield preferences. Pension fund investment in infrastructure takes several forms: direct and indirect equity investment, debt, and specialist infrastructure funds. Infrastructure debt offers above average risk adjusted returns and portfolio diversification attributed to low-return correlations with equities, direct and indirect real estate, bonds, and leading economic indicators (Duygun, Qian and Tam, 2017). According to Global Pension Assets study (Watson, 2014), around 64 per cent of funds are in countries in Asia and the Pacific region, namely: Japan (13 per cent), Republic of Korea (3 per cent), China (1 per cent), Malaysia (1 per cent), and Singapore (1 per cent).

African pension funds offer enormous potential as a continental source for investment capital. Africa's nascent pension fund industry is growing rapidly in size and ambition, a product of the region's robust economic growth and reforms in a number of countries. Africa has experienced tremendous growth in pension assets over the last five years with 90 per cent of the assets concentrated in Botswana, Namibia, Nigeria and South Africa. In these countries, a number of large funds also tend to dominate. In 2014, pension fund assets in Africa were estimated at $334 billion, with growth variations across subregions and countries. This high growth trend is expected to continue as Africa moves towards increased coverage, and more inclusive and comprehensive systems.

Public-private partnerships

Public-private partnerships are a tested strategy for mobilizing resources, especially for large infrastructure projects and other projects involving public services like health, education, among others. There are variants of public-private partnerships but the common ones are: Build and Transfer (BT); Build, Operate and Transfer (BOT); Build, Operate, Lease and Transfer (BOLT); Build, Own, Operate and

Transfer (BOOT); Build, Own and Operate (BOO); Buy, Build and Operate (BBO); Build, Lease and Transfer (BLT); Build, Transfer and Operate (BTO); Design and Build (DB); Design, Build and Operate (DBO); Operate and Maintain (OM) and Alliance (see details in Central Bank of Nigeria, 2014). This array of public-private partnerships allows for the choice of the appropriate model for different projects which requires some level of expertise.

Almost all countries within the group of emerging economies have had some experiences with public-private partnerships, from Latin American countries to Asia and even Africa. In 1990, only $10 billion was invested in public-private partnerships in Latin America and the Caribbean. This investment increased to $90 billion in 2012 but declined to $70 billion in 2013. The distribution by sector of investments in public-private partnerships between 1990 and 2013 in Latin America and the Caribbean was as follows: $282 billion in energy (accounting for 33 per cent of investments by value); $352 billion in telecommunications (accounting for 42 per cent); $176 billion in transport (21 per cent) and $35 billion in water and drainage (4 per cent) (ECLAC, 2016).

Public-private partnerships can be a significant source of finance. Furthermore, a few countries in Latin America and the Caribbean also begun to use public-private partnerships to meet some social infrastructure needs, such as investments in physical infrastructure or the operation of prison and health services. In Chile, Peru and Mexico, public-private partnerships have now been tried out in the healthcare sector while Colombia and Honduras have announced plans to tender out projects for public-private partnerships in the sector over the coming years. In addition, in the most traditional sectors such as energy, public-private partnerships have begun to play a role in new areas like investment in clean technologies that reduce carbon emissions (ECLAC, 2016). In China, the public-private partnership has been in use since the late 1980s and has been enjoying government support ever since. In 2014 the Government gave it a boost by establishing a public-private partnership centre and approved 1043 public-private partnership projects for execution across the country worth 1.97 trillion yuan (Deloitte, 2017).

The Indian Government has also embraced the public-private partnership, which has been used as a source of funding projects such as road network, seaports, airports, railway construction, power generation and urban utilities (Mondaq, 2016). There have been noticeable problems in the execution of these projects which have resulted in the government reassessing the ***modus operandi*** of the public-private partnership.

Power generation, which is lacking across the developing countries, requires large-scale funding, the appropriate regulatory framework, sector planning and a high quality offtake to provide the comfort level that private investors require to participate in the energy sector. From the 1990s, most of the developing nations made efforts to develop infrastructure through public-private partnerships, although the level of success differs from country to country, thus providing good experience for legal and policy formulation in the respective countries (OECD, 2005). The determination of a destination investment in developing nations is selective, since this is based on the market size (where consumer demand is high), coupled with macroeconomic stability (Jomo and others, 2016). Most developing countries have made efforts to use public-private partnerships to fund infrastructure through public-private partnerships although the level of success differs in each country (OECD, 2005). In order to attract investment through public-private partnerships, market size and macroeconomic stability are key factors (Jomo and others, 2016).

However, public and private sources are not necessarily substitutable; each has its own incentive structures, goals and mandates. This is reflected in the breakdown of public and private finance across sectors. Public investment typically accounts for more than half of all infrastructure investments globally. In developing economies, three quarters of infrastructure is financed by the public sector (government, official development assistance and development banks), while in developed countries, this pattern is reversed, with about two thirds of investments coming from the private sector.

Hence, while most countries use their central banks, private banks, or multilateral development banks like the World Bank to finance their infrastructure projects, the majority of states and cities across the United States go directly to citizens for their borrowing. In 2015, nearly 75 per cent of the $3.6 trillion of outstanding debt issued by cities and states usually through a municipal bond fund was owned directly or indirectly by American households (Brookings, 2015). Over the years, a variety of subsidy and incentive programmes have been implemented to help complete state and local government projects with low and flexible borrowing costs. In January 2017, the United States Government introduced a new and innovative bond through Build America Investment Initiative: the qualified public infrastructure bonds (QPIBs) and two different versions of America Fast Forward (AFF) bonds. QPIBs are designed to let the private sector take a more active role in designing, building, financing, operating, and maintaining public infrastructure assets while the AFF bonds are aimed at attracting new types of investors into the infrastructure market, particularly public pension funds, corporate pensions, sovereign wealth funds and insurance companies. The 2016 report by the United States Treasury Department shows that the country has benefited greatly from the projects under public-private partnership (see AECOM, 2016, p. 14). Nevertheless, ineffective project management in the public sector, constraints on public finance could lead to a failure inefficient investment and consequently to the privatization of some state assets, which could be a controversial situation.

Given the variants of public-private partnerships, with a wide array of options, the size and nature of the project can be used to determine the choice of public-private partnership. The benefits include provision of financial expertise, faster implementation of projects, risk and cost sharing, greater certainty in construction and operational cost estimation, among others. Furthermore, Jamali (2004) notes that the public-private partnership has become an innovative policy tool for remedying the lack of dynamism in traditional public service delivery. The challenges of public-private partnerships include decisions on public or private provision of services, enhancing the enabling institutional environment, building capacity at all levels of government, making public-private partnership work, and encouraging responsible business conduct.

Indeed, these challenges can be so severe that they lead some Governments to question whether public-private partnerships are an appropriate strategy at all. The Governments of Sweden and the United Kingdom of Great Britain and Northern Ireland have both considered public-private partnerships to be problematic, with the former even taking the decision to ban the practice. These countries have recommended an approach of using traditional government contracts rather than pursuing public-private partnerships (Alemayehu, 2017). King and Crewe (2015) underline the problems faced by the United Kingdom of Great Britain and Northern Ireland in ensuring that private contractors in public-private partnerships deliver good value for money on such contracts, which often relate to poor management of the process by the state.

Blended finance

Under the blended finance approach, concessional funds are mixed with those of commercial development institutions and private investors in a risk-sharing arrangement, such that a competitive risk-return package is offered to the private investors, which is made possible because the concessional investors are willing to accept a less-than-competitive package. Blended finance investment solutions often capitalize on partnerships among diverse actors, including international organizations, development cooperation agencies and private enterprises (Bertha Centre, 2016).

The Addis Ababa Action Agenda notes that "both public and private investment have key roles to play in infrastructure financing, including through ... mechanisms such as public-private partnerships [and] blended finance". Blended finance is an approach that can be used to enable the private sector to invest in areas where it would not otherwise be possible. In blended finance, concessional funds are mixed with those of commercial development institutions and private investors in a risk-sharing arrangement, with aligned incentives to make sure official assistance can be leveraged as much as possible with private capital. In effect, blended finance investment solutions capitalize on partnerships among diverse actors, including international organizations, development cooperation agencies and private enterprise (Bertha Centre, 2016).

Indeed, multilateral and bilateral development finance institutions can help set up joint investment platforms that enable institutional investors to pool resources. Mechanisms such as public-private partnerships, equity investments, guarantees and insurance have become increasingly looked to as ways of using official resources to leverage private investment through risk-sharing between the public and private sectors. However, this would need to be done with care, since there is the risk that short-term capital attracted to an infrastructure asset class would lead to increased volatility and risk creating bubbles during boom periods, which could then increase the probability of defaults in times of global risk aversion when the bubbles burst (UN, 2017). Blended finance is already being used in emerging and developing countries.

Organizations including the Multilateral Investment Guarantee Agency, the Overseas Private Investment Corporation of the United States of America, the International Finance Corporation, the World Bank, and the African Development Bank also provide financing for energy infrastructure projects. Since development finance institutions have a long track record in funding projects that both encourage sustainable development and allow for economic returns on investment, they are persuasive and compelling partners for traditional financiers. This is another factor that can help to attract private finance for projects that would not otherwise receive it (in addition to the increase rate of return for private investors that can be made possible by blending it with concessional finance).

Nevertheless, blended finance and public-private partnerships are fairly controversial in debates on implementation of the SDGs, with views ranging from the essential need for public-private partnerships in meeting large financing needs, to concerns that public-private partnerships will be used to privatize public services, subsidize the profits of the private sector, and keep investment and contingent liabilities "off balance sheet". Nonetheless, such mechanisms have become increasingly looked to as a method of using official resources to leverage private financing.

The use of such instruments in official development assistance is still quite limited, but it has increased steadily over the last few years. According to a survey by OECD, $27 billion was mobilized from the private sector in 2015 by official development finance interventions, and new platforms have been established to further expand blended finance.

In addition, aside from the difficulty of attracting concessional finance for national priority projects, it can also be difficult for developing countries to attract private finance for such projects, even when blending finance is used to make the projects more attractive for private investors. This is because, even when blended with concessional finance, it can be difficult to provide an attractive package for private investors. Moreover, as private sector involvement in public investments increases the need to generate financial returns for private partners, there is also a broader risk of developing countries focusing their financing efforts on projects with lower-risk profiles and less development impact. For example, existing surveys on private sector instruments in developing countries show that their use is concentrated in middle-income countries. The allocation of scarce public resources to support specific private investments must be carefully considered, and should follow the recipient countries' expressed priorities. This perspective is reflected in the Addis Ababa Action Agenda, which develops a deeper understanding of appropriate conditions for blended finance, how it should be used and structured, and how associated risks can be evaluated and managed (UN, 2017).

Financial inclusion

Inclusive finance is crucial to sustain economic and social development. In the emerging and developing economies, efforts to develop financial services for small and medium-sized enterprises have been growing and have evolved considerably in the past few decades. In response to a growing understanding of the financial needs of such enterprises, there has been a shift toward commercializing these efforts through formal financial services. While there are many ways in which Asian banks become engaged in small business lending, previous empirical works have classified the strategies that banks normally use to enter the **microfinance market** into two main categories: direct and indirect. The direct approach is when banks set up internal units within the banks to serve small and medium-sized enterprises or establish separate companies to deal with this market. The indirect approach is when commercial banks enter into a small and medium-sized enterprise segment by working with existing monetary financial institutions (Isern and Porteous, 2005).

Microfinance is no longer limited to just providing loans. In fact, the microfinance sector has traversed a long journey from microsavings to microcredit and then to microenterprises and now entered the field of microinsurance, microremittance and micropension. Cross-Asian country case studies have demonstrated that banks, monetary financial institutions, clients and social processes such as women's empowerment, can all benefit from microfinance (Khawari, 2004). In Africa microfinance is the leading model, accounting for 42 per cent of the total market volume (CCAF and Energy-4Impact, 2017).

In Brazil, there are municipalities that do not have bank agencies and as a result have no access to bank credit. **Credit unions** in Brazil have come to fill this gap. They function differently from the country's banks, in that they "assume the risk of their applications for the community, promoting local development through the formation of savings and microcredit initiatives aimed at local business". Rodrigues and de Oliveira Gonçalves (2016) measured the impact of credit unions on the income of municipalities using a difference-in-difference method. Their results "showed an average impact of R$ 1,825 in GDP per capita for a sample of 3,580 Brazilian municipalities, with a 5 per cent significance level" (ibid.). The advantages of membership of the Union are that members enjoy free of charge services and interest on loans advanced to members are relatively below the average market rates thereby allowing members of the Union to enjoy credit facilities at a higher return on capital compared to loans obtained from other financial institutions (de Carvalho and others, 2015).

Internet based financing, or online finance, has been the norm since the late 1990s and the sector has become increasingly competitive and innovative ever since then. In line with global technology advancement, a variety of online savings, investments and trading platforms have been introduced with packages that are increasingly more secure, efficient and low cost to customers. For example, **crowd-funding** was initially created in the 1990s to support music and art projects. However, crowd-funding has now morphed into an alternative financing method for small businesses particularly for those with innovative models, scientific researches and technologies. Between 2012 and 2014, equity-based crowd-funding and reward-based crowd-funding recorded €120.33 million and €82.56 million respectively in Europe alone (excluding the United Kingdom) (Wardrop and others, 2015) and has expanded to a global market worth over $16 billion (Polzin, Toxopeus and Stam, 2017).

Financial innovation efforts by development banks in Latin America have given access to financial services to previously excluded firms and individuals. ECLAC (2016) highlights a number of them including the following two cases. In 2009, Mexico created an international factoring guarantee to "provide support for the Mexican automotive industry by allowing exporters to obtain liquidity against their accounts receivable". In Brazil, payroll loans, in which instalments are deducted directly from the worker's wages and repaid to the bank, were introduced in 2003. The concept has also been adopted by the private sector and the pensions industry in light of its positive results (ibid.).

A total of $83.2 million in online alternative finance funds was raised across Africa in 2015. In 2015, over 75 per cent of the total online alternative finance raised from Africa and the Middle East region was funding for start-ups and small and medium-sized enterprises, with $62.2 million raised across the continent. However, 90 per cent of online alternative finance originated from platforms headquartered outside the region. **Donation-based crowd-funding** also features strongly in Africa, accounting for 17 per cent of market share, while reward-based crowd-funding accounts for 10 per cent. Relatively low levels of peer-to-peer consumer and business lending activities exist in Africa. Specifically, Peer-to-Peer Business Lending accounted for only 17 per cent of total market volume in Africa. Kenya and South Africa are the market leaders in Africa with $16.7m and $15m raised respectively from online channels in 2015 (CCAF and Energy4Impact, 2017). The key challenge to the alternative finance sector in Africa is its exposure to a variety of risks, including the absence of an appropriate regulatory framework and fraud (CCAF and Energy4Impact, 2017).

Like online funding and investments, **digital money** has been a growing phenomenon worldwide. Its properties are similar to physical currencies, but it enables instant transactions and borderless transfer of ownership. However, cryptocurrencies use a more sophisticated system to secure the transactions and to control the creation of additional units of the currency. These currencies use decentralized modes of exchange and are used primarily outside existing banking and government institutions. Although they are in the early stages of development, these alternative currencies have the unique potential to challenge existing systems of currency and payments. For instance, **bitcoin –** a cryptocurrency introduced in 2009 – is the most widely used and accepted digital currency. Its market capitalization was reported at $30 billion in May 2017 and the number of daily trades in bitcoin, has grown extensively from around 40,000 in 2013 to more than 330,000 in 2017 (BBC, 2017a). The cryptocurrency has grabbed more headlines this year after its value soared. A year ago 1 bitcoin was reported to be worth £580 on CoinDesk, a cryptocurrency news site, but today it is worth £12,400 (BBC, 2017b).

Nevertheless, digital currencies are a very volatile commodity in terms of pricing. The Financial Conduct Authority reported to the British Broadcasting Corporation (BBC) that neither central banks nor the government stood behind the "currency" and therefore it was not a secure investment. Buying bitcoin, he said, was similar to gambling – and had the same level of risk (BBC, 2017b).

3.3.2 Results-based financing

Results-based financing and results-based aid approaches refer to incentive-based payments to optimize the performance of investments or projects and generally the financier only disburses the funds when the agreed results have been achieved. The Swedish International Development Cooperation Agency (SIDA) (2015) outlines the difference between the two approaches, by observing that the former refers to agreements with service providers where a proportion of funds is linked to the completion of pre-specified outputs or other performance measures and are often implemented through market actors, for example private sector or non-State actors as contractual partners. The latter are however often implemented through government or State counterparts as agreement partners; unlike traditional approaches where aid is given in advance in order to finance input for activities that are expected to produce results, funds are linked to outcomes. In many cases output measures are used as a proxy indicator and the instrument leaves more space for the recipient or implementer to choose the actions to achieve the selected results (SIDA, 2017).

The results-based aid approach has the potential to address some of the shortcomings of existing traditional, input based aid, and also of programme based aid where the concern for inefficiencies, corruption and misuse of funds has sometimes led to using suboptimal and more expensive implementing channels. In addition, its focused approach based on mutual objectives and verified results could perhaps address some of the risks and shortcomings associated with traditional aid.

Furthermore, many of the common characteristics of results-based financing are compatible with the aid effectiveness agenda. Instead of setting conditions or targets to be met, results-based financing can thus be used to create incentives for improved performance and reward incremental small steps towards a final common objective. Results-based financing could serve as an opportunity to further enhance the principles of aid effectiveness such as ownership, transparency and accountability and results. From the implementer's perspective, the results-based financing opportunities allows private companies and non-governmental organizations to compete to provide social goods. Some of the prominent examples of results-based financing and aid are: Debt2Health – Global Fund Debt Conversion; the Global Alliance for Vaccines and Immunization (GAVI); and Tertiary Education Trust Fund (TETFund).

The impact of aid will depend on its alignment with the development plans in developing countries. In addition, international donors should follow an innovative approach of meeting their commitments to allocate 0.7 per cent of their gross national income as official development assistance. They should also "establish specific targets and indicators for the alignment of official development assistance with the host country priorities, and in its particular structural transformation priorities, along with a mechanism to monitor aid effectiveness... Establish a transparent system of measuring and accounting for official development assistance that prioritizes country-programmable aid and supports the efforts of countries to mobilize domestic resources... Make a commitment to and set targets for mechanisms to monitor the impact of public funds channelled through private sector actors [and] make a commitment to and set targets for assistance to African countries to enhance their aid absorptive capacities" (AU and ECA, 2015).

However, results-based financing should not be seen as a silver bullet, but as a potentially useful addition to the range of measures that developing country governments and their development partners might deploy to promote energy sector development. Commonly cited limitations of RBF include the need for agents to secure pre-financing, higher data collection and auditing costs, and the challenge of accurately setting the incentive to avoid rent-seeking whilst achieving the desired results.

3.4 Voluntary and compulsory contributions

Voluntary and compulsory contributions are another form of innovative financing mechanisms. The largest mechanism within this category is the voluntary carbon market in which companies purchase carbon credits to offset emissions (Dalberg Global Development Advisors, 2014). Other voluntary mechanisms, such as efforts to tie a percentage of companies' profits to global challenges, have limited scale and are difficult to replicate. For example, since 2001, Product (Red) has contributed $215 million to the Global Fund, an amount which represents less than 1 per cent of total contributions to the Fund. Within the category of compulsory contributions, the largest single example is the "solidarity levy on airline tickets," which is a small tax. Also in this category is the financial transactions tax that has been identified as a means for filling the current funding gaps.

3.5 Looking beyond the mainstream approach to innovative financing

As can be seen from the analysis above, most of what were considered as innovative sources of development finance initiatives and launched over the last decade have focused on market-based initiatives, which overemphasize the role of new modalities of private sector financing. We offer here an alternative approach that goes beyond the mainstream approaches identified above. In order to better understand innovative sources of finance, and how African countries can innovatively mobilize finance for development, it may be useful to understand what common elements can be identified among innovative sources of finance for development, beyond the simple fact that they are new and previously untested.

In order to do this, we need to understand the conceptual framework behind the traditional approaches to financing for development and see what is left out, to identify blind spots in traditional approaches to development finance that may prove to be useful sources of development finance. Looking at historical approaches (and the common elements of innovative financing sources recently being adopted), it appears that traditional methods of development finance were based on a theoretical framework in which the government would fund public projects, and the private sector would fund investments in the private sector, and there would be little or no cross investments (except when the private sector bought Government bonds). This could be called the "separation of the public and private in development finance".

There were two justifications given for this: first, that the private sector would not be interested in investing in public projects (owing to the "public goods theory", in which for some goods or services the marginal cost of provision is less than the average cost and therefore would not be efficiently provided by the private sector, or the idea that public projects involved redistribution of wealth which would generate no revenues for the private sector); and, second, that the government should not be involved in making investment decisions in other sectors, as it would be less efficient than the private sector (not benefiting from market discipline to keep its investments in line) and giving officials discretion in allocating public investments to other sectors risked corruption. As such, it was preferable to leave investments in other sectors of the economy to private investors.

In line with this view, on the public sector side, governments would be exclusively responsible for investments in infrastructure, public science and research efforts, and public services, and would fund this spending through receivables in the government budget (for example, revenues from publicly owned assets, aid, taxation or government borrowing). The private sector would be involved in these projects only as a contractor in public procurement, or as a buyer of government bonds. Even though in practice governments might also invest in other sectors (for example state-owned enterprises), economists and theorists considered this to be a less than ideal situation, an undesirable legacy generated by the existence of State-owned enterprises or other reasons. The sources of development finance identified in the Monterrey Consensus appear to reflect this view.

On the private sector side, firms would be exclusively responsible for investment in all other sectors of the economy, and would fund this themselves, through capital markets or from financial sector firms. The government's only involvement would be to enforce financial regulations and property rights. Nonetheless, developments in innovative sources of finance and experience with active industrial policy have shown that this view was too categorical in its separation of the public from the private. First, public-private partnerships and social impact bonds show that private investors can indeed be involved in financing public projects. Second, the history of industrial policy shows that the government can be usefully involved in financing industrial development (ECA, 2017). Furthermore, the role of government in mobilizing finance can go beyond regulating and enforcing intellectual property rights, to include efforts to facilitate the flow of finance between different private sector actors, or remittances from outside the country.

As such, this report argues that, in order to mobilize additional finance for development, African countries should look to mobilize additional private finance for public projects and also consider using public finance in private investment (for example through national development banks, subsidizing semi-social projects). In this way, they can go beyond the historical blind spots of development finance and mobilize additional finance for key national projects, whether they are in the public or private sectors. They can also benefit from this wider range of financing methods for different projects to select the method that is most appropriate.

At the same time, as this report shows, there are challenges to bridging the gap between the public and private sectors in development finance, notably when it comes to getting the private sector to finance public projects. This is because the long-term duration of many public investment projects, as well as limited revenues that can be used to compensate the private sector for its investment, can make it challenging to offer attractive terms to private investors investing in public projects.

3.6 Conclusion

In this section we looked at the avenues or sources of financing using the three different innovative financing mechanisms for financing SDGs and Agenda 2063, namely, first, market-based financing; second, result-based financing; and, third, voluntary and compulsory contributions. As outlined above, throughout the different regions, the innovative financing market is still very conservative. Market-based financing, particularly bonds and guarantees dominate the market by shifting the risk from private to public investors. The more innovative mechanisms that do exist often only involve a small set of actors or target specific issues. Furthermore, innovative financing opportunities are often missed because few players have the context and credibility to differentiate between public finance institutions, private players, and local governments.

In order to increase innovative financing, various incentives must be offered by the various actors in the sector such as enhancing profit margins by blending capital from socially motivated investors with more profit-oriented organizations, enhancing credit by shifting project risk to organizations with more creditworthy balance sheets, and creating marketing opportunities by being associated with socially responsible investments.

Thus, in order to mobilize additional finance for development, countries can mobilize additional private finance for public projects and also consider using public finance in private investment (for example, through national development banks, subsidizing semi-social projects). By so doing, they can go beyond the historical blind spots of development finance and mobilize additional finance for key national projects, whether they are in the public or private sectors. They can also benefit from this wider range of financing methods for different projects to select the method that is most appropriate. Nevertheless, there are challenges to bridging the gap between the public and private sectors in development finance, notably when it comes to getting the private sector to finance public projects. The next section will explore the ways that various countries have tried to do this, where they have succeeded and where they have failed, and the lessons learned.

Chapter 4: **Innovative sources of financing: case studies of five African countries**

4.1 Introduction

This chapter reviews different types of innovative sources of finance in Africa based on five sample countries, namely: Egypt, Ethiopia, Ghana, Morocco and South Africa. It analyses the fund structure and the extent to which the sample countries have used innovative sources of financing for development projects in their respective countries.

Mobilization of sufficient financial resources for the structural transformation of African economies has become a challenge in a very dynamic global environment. Previous research has underlined that, for Africa, domestic resource mobilization is critical to meet the continent's financing needs, including the Sustainable Development Goals (as outlined in chapter 2). In view of this, since the 2002 Monterrey Consensus, the International Community has recognized the importance of exploring innovative sources of finance beyond the traditional modes of finance, provided that those sources do not unduly burden developing countries. The 2008 Doha Declaration on financing for development also called for scaling up the use of innovative financing for development. More recently, the Addis Ababa Action Agenda encourages exploring additional innovative mechanisms based on models combining public and private resources and invites more countries to voluntarily join in implementing innovative mechanisms, instruments and modalities.

The 2008 financial and economic crisis also reinforced the resolve of developing countries to seek alternative sources of financing for social and developmental infrastructure due mainly to the drying up of bilateral loans and grants from traditional development partners. As a result, the development finance landscape has also been changing, with an expanding number of development finance options available beyond the traditional sources of development finance. That is why innovative sources of development finance are becoming more and more important in financing development projects in Africa.

4.2 Sample selection and typology of countries

This study presents the evidence on key innovative sources of finance in Africa based on the five sample countries mentioned above. The selection of these countries is based on the level of income and the degree of industrialization as captured by manufacturing value added per capita (ECA, 2017), and subregional coverage of Africa. In developing countries, the degree of industrialization captured by manufacturing is strongly and positively correlated with the level of per capita income, and this relationship is found to be curvilinear rather than linear, with low levels of per capita GDP associated with low shares of manufacturing, intermediate levels with high shares and high income economies with lower shares. Compared to agriculture, the manufacturing sector is assumed to offer special opportunities for capital accumulation as productive investment opportunities in manufacturing encourage high savings rates.

The selected sample countries provide clear evidence of the positive correlation between the level of income and the manufacturing value added per capita. South Africa is an upper middle income country with high manufacturing value added per capita. Ghana is a lower middle income country with low manufacturing value added per capita while Ethiopia is a low-income country with the lowest manufacturing value added per capita. Both Egypt and Morocco are lower middle income countries with high manufacturing value added per capita. The sample selection also covers four subregions of Africa: Eastern Africa (Ethiopia), North Africa (Egypt and Morocco), Southern Africa (South Africa) and West Africa (Ghana). The countries selected as case studies are therefore representative of Africa as a whole, and hence, their experiences are expected to provide lessons applicable to other African countries. On one hand, South Africa, Egypt and Morocco are diversified economies whereas Ghana is a country in transition, and Ethiopia is at the pre-transition stage. The five countries that are at various stages of industrialization and diversification also provide the opportunity to examine their strategies, particularly for mobilizing innovative sources of development finance.

What drives many African countries, like any developing region, to look for alternative sources of development financing besides enhancing traditional sources of development finance is their transformation vision as reflected in their national development plans. Development plans focus on industrial policies that aim to leverage domestic capabilities, technological advancement and natural resource management in the context of a highly complex globalized market context, in order to fashion a pathway appropriate for their economy, usually by establishing strong linkages to the wider economy and supporting access to regional or global value chains. Such ambitions have been reflected in the African Union first ten-year implementation plan for Agenda 2063, the recently adopted regional development framework for inclusive growth and sustainable development (ECA, 2017).

The sample countries considered in this study have a mixed record of development planning, with a concerted effort to develop and implement a strategic national planning framework supported by an industrial policy and other supplementary policies shaping domestic resource mobilization, foreign direct investment, infrastructure financing and other sources of finance, including innovative sources of finance. Financing for development remains central to the implementation of the national development plans in the five countries.

The Ethiopia Growth and Transformation Plan 2010-2015 is a medium-term development framework that carries on from the plan for accelerated and sustained development to end poverty 2005-2010. The current strategy of Ethiopia is based on State-led development that would sustain the rapid and broad-based growth path achieved from 2005 to 2010 based on sustaining faster, equitable economic growth, agricultural and industrial development supported by enhanced infrastructure services. The current growth and transformation plan of Ethiopia, which is in its second phase, focuses on two complementary areas of agricultural and rural development, and industrialization. The focus of the first phase of the growth and transformation plan (2010/11–2014/15) was on infrastructure and capacity development while phase two (2015–2020) was expected to focus far more on the mechanisms adopted to increase manufacturing and agricultural exports.

Since the early 2000s, the Moroccan Government has played a more active role in the transformation of the economy by intervening to develop promising sectors based on a close relationship between the government and the private sector. In 2005, the

Government of Morocco adopted the emergency plan, as above followed by the national pact for industrial emergence (2009–2015), which had three main objectives: recovery of the industrial sectors in which Morocco has clear competitive advantages; strengthening the competitiveness of small and medium-sized enterprises, improving the business climate and developing industrial parks; and establishing an institutional approach to ensure the implementation of effective and efficient programmes. In 2014, the pact was replaced by the industrial acceleration plan 2014–2020, the main focus of which was to renovate the domestic industrial base, attract more foreign direct investment and improve the competitiveness of Morocco in international markets.

The vision 2020 plan of Ghana aims at making Ghana a middle-income country. The first medium-term development plan (1997–2000) focused on the following priority areas: human development; economic growth; rural development; urban development; infrastructure development; and an enabling environment. The vision 2020 plan was followed by the Ghana Poverty Reduction Strategy (GPRS I, 2003–2005) and the Growth and Poverty Reduction Strategy (GPRS II, 2006–2009). The Ghana Shared Growth and Development Agenda (GSGDA) II, 2014–2017, is the fifth in the series of medium-term national development policy frameworks with the main focus on leveraging the country's natural resource endowments, the potential of agriculture and relatively large human resource base to accelerate socioeconomic transformation through value addition and industrial production. To achieve the medium-term national development objectives under the second shared growth and development agenda II, the Government of Ghana found it imperative that the fiscal space necessary be created for increased investment in key priority sectors for the accelerated transformation of the economy.

After three years of economic slowdown (2011–2013), the new Government of Egypt adopted an ambitious plan in 2014 to boost GDP growth to 6 per cent by the fiscal year 2018/19, to restore macroeconomic stability, to reduce unemployment and address poverty. The plan involves launching extraordinary infrastructural projects, reforming the framework that organizes investment activities in Egypt and tackling the country's long-lasting fiscal imbalances. The plan of Egypt for achieving the SDGs known as Egypt vision 2030 or Sustainable Development Strategy (SDS), which is aligned with the global goals, was launched in March 2015, six months prior to the release of the SDGs at the United Nations, and it has undergone a number of modifications and expansions since then. Egypt Vision 2030 or the Sustainable Development Strategy serves as an umbrella for all development strategies in Egypt, and is strongly guided by the universal SDGs. While the country's Sustainable Development Strategy does share many common objectives with the universal SDGs, certain aspects of it do not fully capture some of the SDG priority areas. The Sustainable Development Strategy incorporates economic, social, and environmental dimensions in addition to knowledge and innovations.

In 2013, the Government of South Africa adopted its National Development Plan, which is a development vision to put the economy on a new growth strategy. The National Development Plan of South Africa aims to eliminate poverty and reduce inequality by 2030. Although the achievement of the objectives of the National Development Plan requires progress on a broad front, its three priorities are: raising the level of employment through faster economic growth by improving the quality of education; skills development and innovation; and building the capability of the state to play a developmental, transformative role. The National Development Plan outlines sector specific goals and a vision for South

Africa to be achieved by the year 2030. The country's Medium Term Strategic Framework (MTSF) for 2014 –2019 is the first framework drawn up following the adoption of the National Development Plan in September 2012. It sets out actions to implement the Plan over the first five years of the plan, and provides a framework for the other plans of national, provincial and local government.

In the context of the five national development plans identified above, the following sections in the chapter outline efforts by the five countries to pursue innovative sources of finance for structural transformation and inclusive growth.

4.3 Infrastructure financing

As traditional sources of financing development are inadequate to close the financing gap, the governments of the five African countries have been increasingly looking for innovative mechanisms to address the growing infrastructure deficits and to identify the challenges and strategic issues of innovative financing of infrastructure projects.

The establishment of the Fund further provides the nation with the opportunity to systematically tackle the complex demands of infrastructure financing and investment. It will partner with the private sector to finance critical infrastructure projects. Both domestic and international public sources will continue to play a vital role in financing the majority of infrastructure investments. However, these sources are woefully insufficient to finance the level of investment required to close the infrastructure gap. Therefore, the role of private investment and Public-Private Partnerships is seen as indispensable to address this financing gap and improve the quality of infrastructure services. In effect, the Board of Directors of the Ghana Infrastructure Investment Fund issued the Investment Policy Statement of the Fund in April 2017 (GoG, 2017b), and the Fund approved a $30 million corporate loan to Ghana Airports Company Limited (the first of its kind in Ghana) in June 2017 to finance capital investment programmes in the country's transport sector (GoG 2017a).

In **South Africa**, infrastructure spending as a percentage of GDP was targeted to grow from 21 per cent in 2015 to 30 per cent by 2030. Central to the efforts by the Government of South Africa to close the gap has been the use of public-private partnerships, which goes back to 1998. Since then, 31 public-private partnership projects have been completed (GoSA 2017). The projects include hospitals, transport and roads, tourism and head office accommodation, which were financed through a combination of equity, debt and government capital contributions.

The public-private partnership projects in South Africa only account for a mere 1.7

Box 1
Ghana infrastructure investment fund

To sustain rapid urbanization and industrial growth in Ghana, as well as achieve the post 2015 development agenda and Sustainable Development Goals (SDGs), infrastructure remains a key development priority. In view of this, the Ghana government established the Ghana Infrastructure Investment Fund in 2014 to mobilize, manage, coordinate and provide financial resources for investment in commercial infrastructure projects. The establishment of GIIF is an innovative approach in catalysing other sources of finance by leveraging its capital with private sector capital for financing infrastructure projects in target sectors such as energy, agriculture, transportation, water and industry (GoG, 2017b).

Box 2
Ghana mortgage finance

In respect of mortgage financing for owner occupier, Ghana Home Loans (GHL), the foremost mortgage financing company in Ghana since 2006, has advanced in obtaining the pre-requirements from the Bank of Ghana (BOG) to pave way for commencement of operations as a commercial bank in the country. After meeting the requirements for the provisional banking license, the company is expected to begin operations as a bank in 2017. In 2017, the Securities and Exchange Commission (SEC) also gave the approval for the Ghana Home Loans to raise a Domestic Medium-Term Note Programme in a bid to increase the cash flow of the mortgage company which was to allow the company access 380 million cedis from the domestic market. As of 2012, the Ghana Home Loans had provided financing to over 1,500 households totalling 90 million dollars for the acquisition, construction and improvement of homes across Ghana.

per cent (R16.5 billion) of the R947.2 billion planned for public-sector medium-term infrastructure spending. Furthermore, in 2010, the Independent Power Producers Procurement Programme (IPPPP) was established as an urgent intervention to enhance the power generation capacity of South Africa. The primary mandate of the IPPPP office is to secure electricity from renewable and non-renewable energy sources from the private sector. In addition, IPPPP has been designed to go beyond the procurement of energy to also contribute to broader national developmental objectives such as job creation, social empowerment and broadening of economic ownership.

The critical infrastructure programme (CIP) of the South African Government was implemented in 2015, to stimulate investment growth in line with the national industrial policy framework (NIPF) and Industrial Policy Action Plan (IPAP). The critical infrastructure programme is a cost-sharing grant for projects designed to improve critical infrastructure by leverage investment through lowering the cost of doing business. The programme covers 10-30 per cent of the development cost of the infrastructure project at a maximum of 30 million rand. In addition, the critical infrastructure programme also requires projects to be at least a level four Broad-Based Black Economic Empowerment (B-BBEE) contributor in terms of the Codes of Good Practice for B-BBEE (GoSA, 2015).

In **Ethiopia**, infrastructure financing has been traditionally shared between aid, foreign loans and public investment. The country has a good record in implementing successful infrastructure projects. The success of

Box 3
South Africa energy bond

Project Bonds are also considered to be a viable alternative means of financing infrastructure projects. They allow access to international non-bank money and could potentially fill some of the gaps left by international banks scaling down their involvement in the project finance arena. Project bonds are typically debentures and are issued with a long maturity period, usually longer than 10 years. This is in contrast to the tenure of five to seven years for the more traditional means of financing projects such as corporate bonds and bank loans. Projects bonds would therefore generally appeal to long-term investments, notably pension funds and insurance firms. In 2013, South Africa saw its first listing of investment-grade rated infrastructure project bond, issued by CPV Power Plant No.1 Bond SPV (RF) Limited, a Soitec Solar GmbH affiliate. The proceeds were used to finance the construction of a 44 MWp Concentrated Photo Voltaic Plant. The plant will be the largest CPV plant in the world (Deloitte, 2016).

Box 4

Ethiopia Grand Renaissance Dam

Ethiopia Hydropower Plant

The Grand Renaissance Dam, due for completion in 2017, is expected to generate 6,000 megawatts of electricity. This $5 billion project is mainly funded by Ethiopia, with 80 per cent of the financing coming from taxes and the remaining 20 per cent from bond issues, and is expected to earn Ethiopia in excess of $1 billion a year and establish the country as a principal exporter of hydroelectric power (ECA, 2016). Free from the usual requirements and restrictions of traditional western financers, the dam has allowed Ethiopia to involve local contractors such as METEC in the execution of major project components, thereby building local capacity and fostering key knowledge transfer. Ethiopia is also looking beyond its hydropower potential in its pursuit of clean energy. Another mega-project is the new 750km railway line connecting Ethiopia and Djibouti. This $4 billion project, labelled a game-changer by the state-owned Ethiopian Railways Corporation, connects the Djiboutian ports of Doraleh and Tadjourah with the Ethiopian highlands. The recent completion of the Addis Ababa Light Rail, which cost $475 million with the Exim Bank of China granting 85 per cent of it in loans, has eased the traffic congestion in Addis Ababa, transporting over a million people a day. The external financing models of many of the country's infrastructure projects illustrate the country's preference for loan financing from Asia (particularly China) when available, with the trend likely to continue following the recent announcement by China of its plan to loan a staggering $1 trillion under its One-Belt–Road programme for infrastructure projects in developing countries over the next decade (ibid.).

the state-owned and managed Ethiopian Airlines, a leading regional carrier, a number of hydroelectric dams, and water and sanitation infrastructure expansion projects are among the achievements of the last two decades. Furthermore, a number of mega projects are emerging under the umbrella of the Growth and Transformation Plan.

The Ethiopian infrastructure financing landscape is changing with an unprecedented shift towards private sector participation. In 2013, the Government and Corbetti Geothermal Plc signed a power purchase agreement to build and operate up to 1,000 MW of geothermal power in two 500 MW phases by 2018. The ambitions of Ethiopia, however, go beyond this, with plans to sell power to neighbouring markets and further afield, with Yemen and Turkey in its sights. Another example is the Koshe Waste-to-Energy plant development agreement signed with Cambridge Industries Limited, a United Kingdom-based firm. Under the terms of this agreement, the Ethiopian Electric Power Corporation will finance the entire $120 million cost of the facility with a capacity to generate 50MW power, while Cambridge Industries will supply the technology and management of what is to be the first waste-to-energy facility in sub-Saharan Africa (ibid.).

Public-private partnerships are also emerging in a number of areas such as irrigation, housing, agro-processing, exhibition centre management, prepaid metering, unified billing, dry waste management and recycling. The estimated resource generation of such partnerships in infrastructure development is $270 million per year, although implementation remains a challenge. There are increasing calls for the establishment of a specific public-private partnership facility to enhance capacity, act as the key point of contact to facilitate the coordination of such projects and develop appropriate legislation and regulatory frameworks (ibid.).

In **Egypt**, a mortgage finance subsidy and guarantee fund was also established in 2003 for the purpose of providing affordable housing to low-income families, whose total monthly income did not exceed LE 17500. The fund is assigned to finance residential units at a maximum level of finance of LE 95,000 per unit (EFSA, 2017). In 2006, the Egyptian Mortgage Refinance Company (EMRC) was established with a capital of 212 million Egyptian pounds, with the objective of providing long-term finance to the mortgage finance companies and the banks operating mortgage services. Finance is collateralized by the real estate portfolios of companies and banks and is granted according to specific rules and controls. In this respect, EMRC resolved to issue bonds duly collateralized by real estate loan portfolios, which help enhance the bond market and provide long-term finance resources (EFSA, 2017a).

Nevertheless, despite the legal framework in place for housing finance, a number of shortcomings remain and initiatives to finance low-income housing projects are inadequate as they only finance individuals and not real estate companies (Sharif Sami head of ESFA, quoted in Daily News Egypt, 2017). Therefore, the Central Bank of Egypt has now allowed Mortgage Finance Companies to work side by side with Banks instead of working under their umbrella, which allows the companies to play a more effective role in the initiative and take part in boosting the sector in the next few years (EMRC, 2017). Recently, Egypt is seeing signs of a recovery, and with that confidence in the market, housing has risen to the top of the policy agenda in the country. Mortgage finance granted by the companies was 722 million Egyptian pounds compared to 364 million pounds during the same period in 2016, representing an increase of 98 per cent. The total amount of mortgage granted by the companies until the end of April 2017 was estimated at 3.5 billion pounds representing an increase of 25 per cent. The Egyptian Mortgage Refinance Company (EMRC) held operations amounted to 55 million pounds (EFSA, 2017b). The growth in the mortgage market is influenced by the rise in population, particularly in Cairo, which is set to see a growth in its population by half a million this year, more than any other city in the world.

Morocco is expected to benefit from the Africa50 Fund, which provides finance for development projects across Africa. Even infrastructure projects outside Morocco focused on transport or communications should help to boost the country's trade with the rest of the continent, by making it easier for Moroccan firms to access and penetrate further into other African markets (Economic Commission for Africa, African Union Commission and African Development Bank, 2017). The Fund is exempt from paying corporate tax in Morocco. Its operations are located in Casa Finance City, allowing it to seek financial services from the firms surrounding it. Casa Finance City itself has tax exemption for 5 years, followed by a period of reduced tax rates (Ministère

Box 5

Morocco infrastructure finance on transport and energy

Impact Finance for Transport and Energy Infrastructure in Morocco

The European Investment Bank (EIB) provided an impact financing of 420 Euros to boost energy and transport infrastructure through Autoroutes du Maroc, the project promoter for Morocco in December 2012. The amount is split into 240 Euros and 180 Euros for transport and energy infrastructure respectively. The road facility will be used to construct a new 142 km road between El Jadida and Safi. The facility would reduce time spent on the journey by half as well as safe trips for travellers. The energy financing portion provides the third face of erection and upgrade of 1300km of overhead power lines as well as the installation of 6400 MVA (megavolt ampere) of transformation capacity and 150 substations bays. The infrastructures are expected to enhance growth and create employment in Morocco. (European Investment Bank 2012).

de l'Economie et des finances, interview, 17 May 2017). The Fund had a capital subscription of $830 million by August 2016, with a target capital of $3 billion and was expected to attract investments of ten times its capital (Africa50 Fund, 2017b; African Development Bank Group, 2015).

4.4 Financial inclusion

There have been a number of attempts in the five countries to identify new methods of providing financial services at low and affordable cost from financial institutions. These methods have a multitude of dimensions, reflecting the variety of possible financial services, from payments and savings accounts to credit, insurance, pensions, and securities markets. The key issue in financial inclusion is the degree to which the lack of inclusion derives from a lack of demand for financial services or from barriers that impede individuals and firms from accessing the services while innovative financial inclusion is based on new modes of financing the poor by minimizing exclusion.

In **Ghana**, an innovative financial inclusion through mobile banking and payments has accelerated the shift in the payment system.

Since the launch of mobile money in the early 2000s, mobile payments have been gaining strength both in terms of value and volume of payments due largely to significant efforts on the part of the banks and telecommunication companies to target the country's unbanked society. With four mobile money operators in Ghana, the country had an estimated 13.1 million mobile money subscribers at the end of 2015, of which only 4.9 million were active. Given the country's total population estimated at 27 million, this suggests that mobile money has achieved around 20 per cent penetration in Ghana (ibid.). Wider adoption of mobile payment systems in Ghana has been limited by a number of factors including: lack of awareness about interoperability; mobile network problems; high barriers to customer entry; and concerns regarding security. Currently, the top uses for mobile money in Ghana are airtime purchases and sending and receiving money, indicating significant room for more sophisticated payment uses.

Improvements in the national economic infrastructure such as the availability of GSM technology, increased internet penetration and the rising deployment of ATMs over the past decade has influenced the payment landscape in Ghana positively. To enhance the broader use of electronic payments in Ghana, the Bank of Ghana (BoG) established the Ghana Interbank Payment and Settlement Systems Limited (GhIPSS) to own and operate e-payments schemes and infrastructure within the country. However, Ghana remains a largely cash and cheque society despite efforts by the BoG at strengthening the infrastructure baseline.

In 2004, **South Africa** introduced the Financial Sector Charter that has been instrumental in increasing the focus on financial inclusion and the engagement with lower-income households. As a result, overall financial inclusion was increased from 55 per cent in 2005 to 85 per cent in 2016. This means that most adults in South Africa now have some form of financial product from a regulated financial institution (National Treasury Republic of South Africa, 2017d). However, this improvement has not adequately translated into a better quality of life for low-income households, nor into viable economic prospects for many small firms.

A local non-governmental organization known as SaveAct was established in 2008 to improve the high level of inequality in South Africa by providing financial services that could lead to sustainable livelihoods for the poor. Between 2008 and 2016, SaveAct operated in five provinces and had 50 000 members.

Approximately R213 million was shared out to savings group members and the return on savings was 33 per cent (SaveAct, 2016). Although, this programme covers a very small portion of the rural population it is a scheme that is important for rural development and financial inclusion.

Technology advancements in South Africa have increasingly led to diverse opportunities in the financial services sector and in revolutionizing the sector. Therefore, given the size of such an untapped market, Financial Technology (Fintech) companies offer investors potentially high returns, and equally important, these new forms of financial services provide financial inclusiveness to low-income consumers and the unbanked or underbanked populations. Furthermore, the Fintech sector has a high potential for job creation, particularly for the entrepreneurial youth population. The Standard Bank of South Africa Limited, one of the largest financial services groups in the country, launched its inclusive banking strategy in 2007. A report by B4D Pathfinder stated that approximately 900,000 low-cost accounts were opened by 2012 and most of these customers had never used banking services before.

Last but not least, to mitigate constraints to ownership transformation, the Financial Sector Charter proposed R100 billion in funding, based on commitments by members, to support black business growth through skills development, employment equity, socioeconomic development, preferential procurement, enterprise development, especially small and medium-sized enterprises, promoting the entry of black entrepreneurs into the mainstream of economic activity, and the advancement of co-operatives. This would entail a combination of equity equivalents (estimated at R25 billion) and empowerment financing (estimated at R75 billion). Each year, the National Treasury intends to publish an ownership monitor of listed companies to assess progress against ownership targets. According to the National Treasury the financial sector is performing better in relation to black economic empowerment (BEE) procurement, but stronger efforts are required to promote smaller black businesses (GoSA, 2017b).

Regarding the development of financial services, **Ethiopia** is lagging behind many African countries mainly due to distance, cost and documentation requirements. The poor, youth, rural residents and women appear to face greater constraints for access to financial services. The share of adults with mobile money accounts is only 0.03 per cent, even though the mobile or internet access at home was 57 per cent showing that there is a promising potential for mobile based financial inclusion. Only 22.4 per cent of adults save formally at financial institutions while 47.3 per cent of adults have access to borrowing. With regard to access of firms to financial services, 92 per cent of them have saving or current accounts at financial institutions and 40 per cent of firms lack access to credit which is their main barrier. The firms with outstanding loans or lines of credit were 29.6 per cent in 2015/16, indicating that 70.4 per cent of firms in Ethiopia tend to have no lines of credit so it is very hard to access finance for starting a business, particularly for small firms (Baza and Rao, 2017).

Other identified great obstacles to access and usage of financial services in Ethiopia by individuals include physical factors (access to bank branches and ATMs), bureaucratic factors (difficulty to access credits and saving products by the poor due to market failures as well as regulations and the structure of financial institutions), and financial factors (minimum cost of opening a savings account and fixed transaction costs).

As of December 2015, the number of ATMs used for withdrawal of cash was only 709 and 1,635 POS terminals, and only 1.56

Box 6

South Africa – Broad-based black economic empowerment (B-BBEE)

South Africa – Broad-based black economic empowerment (B-BBEE)

In 2003, the Government of South Africa introduced an economic empowerment policy known as Black Economic Empowerment (BEE), which was changed to Broad-Based Black Economic Empowerment (B-BBEE) to include more population groups. According to the Economic Development Department of South Africa, the B-BBEE empowerment policies aim to ensure that the economy is structured and transformed to enable the meaningful participation of the majority of its citizens and to further create capacity within the broader economic landscape at all levels. This will be through skills development, employment equity, socioeconomic development, preferential procurement, enterprise development, especially small and medium-sized enterprises, promotion of the entry of black entrepreneurs into the mainstream of economic activity, and the advancement of cooperatives (GoSA, 2016a).

Nevertheless, despite the affirmative action intended to reduce inequality, the policies have brought about some controversies. In June 2017, in line with B-BBEE, the mining charter pushed up the black ownership target from 26 per cent to 30 per cent. Some have welcomed the policy as an effort to redress economic imbalances caused by the apartheid system while others regard the target as too ambitious for black representation at board and management levels of mining companies as there may be a limited pool of people in the industry to meet the target (Bloomberg, 2017). Consequently, following the new mining charter target, it was reported that the rand weakened the most in more than two months and local mining stocks slumped. There are fears that this will be negative for growth and investment in the industry and lead to outflows, both in a portfolio sense and in terms of foreign direct investment (Bloomberg, 2017).

Critics of the B-BBEE argue that a policy of qualification equality should be used instead, to allow businesses to focus on employing the person with the highest qualifications, the most experience and the best recommendations. To help disadvantaged individuals to achieve these qualifications and experience the government should place more emphasis on secondary and tertiary education, as well as subsidizing companies wishing to employ entry level applicants, or fund tertiary education for students from previously disadvantaged communities (Bloomberg, 2017).

Source: Department of Trade and Industry South Africa (2013).

per cent of Ethiopians had ATM cards, with an ATMs per capita of 1.28. The number of merchants and debit cards were 1,214 and 860,463 respectively. The number of prepaid cards and bank agents (correspondent banking) were 520 and 631 respectively. In 2016, the number of mobile money transactions per 100,000 adults was only 0.24 per cent, with 24,752 transactions for transfer/payment made via mobile (ibid.).

In order to bridge the gap between the banking sector in **Egypt** and small and medium-sized business owners, in 1991, the Central Bank of Egypt (CBE) established the Egyptian Banking Institute (EBI) as its official training arm in developing the technical and managerial skills of financial sector professionals. The institute has provided training in various areas with its edge in banking training complemented by managerial, leadership, IT training, and two specialized training units for small and medium-sized enterprises and corporate governance.

The small and medium-sized enterprises unit was established in 2009 in collaboration with the Business Development Services Support Project (BDSSP) to enhance and boost the small and medium-sized enterprises financing environment through training and technical assistance, as well as various supportive knowledge management solution activities. The small and medium-sized enterprise unit's ultimate goal is to bridge the gap between the banking sector of Egypt and small and medium-sized business owners. It provides various international and local training programmes, research and technical assistance services to enhance the capacity of banks at all levels, as well as raising the awareness of small and medium-sized enterprises towards banking requirements and good governance (Egyptian Banking Institute, 2017).

Sixty per cent of the Egyptian population are below the age of 30 (Global Banking and Finance Review, 2017), many of whom face problems in finding employment. Banking density in 2017 is 1 branch for 23,600 persons which is low compared to the rest of the world. However, there was a dramatic increase during the five-year period from 2005 to 2009, from 3.8 branches per 100,000 to 4.6 branches per 100,000, an increase of 21 per cent. The changes occurred parallel to the Financial Sector Reform Programme (FSRP) implemented between 2004 and 2009, which aimed to address the identified weaknesses in the banking sector, the insurance sector, the capital market, and the mortgage industry, including developmental issues in the sectors. In addition, the rate of ATMs per 100,000 adults increased from 2.3 to 13.8 between 2004 and 2015.

Compared to other African countries, **Morocco** has also been successful in achieving a relatively high level of financial inclusion. Morocco also made substantial efforts to extend credit to new borrowers through microcredit. The Government also ensured that microfinance providers were closely monitored. International donors also supported the development of the microfinance industry in Morocco, beginning with bilateral donors and continuing with development finance institutions. Moroccan commercial banks are strong backers of the sector (Reille, 2009).

As a result of the above efforts in Morocco, the loan portfolios of microfinance institutions grew by a factor of 11 from 2003 to 2007 and the institutions were reaching four times as many clients. The growth was driven by a number of leading microcredit institutions which performed very well in terms of "scale, depth of outreach, asset quality and profitability", winning several international prizes for this work (ibid.).

However, this growth proved unsustainable due to competition among the country's various microfinance institutions for market share, which led them to pursue growth even without the relevant systems in place. Multiple lending to the same clients also posed problems, with an estimated 40 per cent of clients holding more than one loan in 2008. As a result, the sector faced challenges from 2007, notably loan delinquency. In addition, microfinance loans appeared to be concentrated in the country's large cities (ibid.). Non-performing loans "started to rise significantly from one of the lowest levels in the world, 0.42 per cent in 2003 to 1.9 per cent in 2007" (MIX and MFI audited reports, cited from Reille, 2009). In 2008, non-performing loans rose sharply and reached 10 per cent by June 2009 (Reille, 2009).

The sector however responded well and quickly. The government organized the acquisition of one troubled microfinance lender by another which was backed by a sound state bank, within a very short time "to restore confidence and avoid contagion effects". By 2013, 5 per cent of Moroccans were using microfinance products (World Bank Group, Bank Al-Maghrib and Schweizerische Eidgenossenschaft, 2014). In terms of opportunities and challenges, the sector could move into providing pensions and money transfer services (World Bank, 2015; Ismaili Idrissi, 2015). This would require Bank Al-Maghrib to develop micro-pension products (World Bank, 2014).

In general, the relatively small number of jobs generated through FDI has also limited the transfer of skills and know-how. This highlights the need to strengthen the development of homegrown skills. The Addis Ababa

Action Agenda therefore suggests that more countries should adopt national financial inclusion strategies (NFIS). Policies to strengthen financial inclusion and nourish entrepreneurship could help develop domestic small and medium-sized enterprises. To date, there are at least 58 developing countries with NFIS. There is evidence that countries that adopt NFIS reduce exclusion twice as fast as those that do not (UN, 2017). Nevertheless, the Inter-Agency Task Force report suggests that one of the biggest challenges policymakers and stakeholders face in raising resources for sustainable development is how to address excessive short-term oriented decision-making and develop financial markets that are inclusive, long-term oriented, and support sustainable development. This raises critical questions on the appropriate size of financial intermediation as financial markets develop the appropriate set of policies to promote inclusiveness (UN, 2017).

4.5 Pension and insurance funds

The Addis Ababa Action Agenda echoed the Monterrey Consensus and the Doha Declaration on Financing for Development in that more focus should be placed on domestic resource mobilization to support infrastructure projects. In addition to enhanced tax collection efforts and broadening tax bases, pension funds could be used for investment in infrastructure. Domestic insurance markets could also be developed to mobilize resources to meet the longer-term financing needs of the region. However, these schemes are currently underutilized on the African continent. Pension and insurance funds could take on a greater role in transforming the continent's infrastructure landscape if African countries had the right governance, regulation, and instruments to assess and manage the risks associated with long-term investment in infrastructure.

Africa's domestic institutional investors dominate the investor base in African capital markets. Pension fund administrators and insurance companies in Africa are looking to channel increasing amounts of long-term savings into the African capital markets. African pension funds alone offer enormous potential as a continental source of investment capital. Pension funds in ten African countries already have $379 billion in assets under management. These domestic resources can fuel investment in local businesses, infrastructure projects and services desperately needed for the continent's continued transformation and growth (ECA, 2017). This subsection briefly presents pension and insurance funds as a source of financing development in selected sample African countries.

In **Ghana**, pension fund investments increased between 2014 and 2015. Preliminary data for 2015 show that aggregated pension fund investments in Ghana amounted to about $1.2 billion, an increase of 72.5 per cent of pension fund investments compared to the level in 2014. These investments still represented 3.3 per cent of the country's GDP, as the funded pension system is not mature yet. The number of members grew in Ghana, leading to a higher amount of contributions to pension plans and therefore more investments (OECD, 2016).

Ghana has one of the fastest growing insurance industries in the world. Expansion in the middle-class population, strong regulation, rising public awareness of the benefits of insurance, and acceptance of mobile insurance products supported the overall growth in the insurance industry. The broader African middle-class population is eager to protect its valuables and make future provisions for that purpose. Plentiful resources, a youthful population and the need for investments in infrastructure, energy, health, education and other basic facilities drive the demand for insurance protection and reinsurance cessions. Rapid growth in population in recent times shows the potential of the youth to grow and contribute enormously in national development.

The Government Employees Pension Fund (GEPF) of **South Africa** is the largest fund in Africa. GEPF of South Africa invests in infrastructure assets and is the largest investor in the Pan-African Infrastructure Development Fund (PAIDF), which invests directly and indirectly in infrastructure, including transportation, telecommunications, energy, water, and sanitation. As a share of GDP, pension funds in South Africa accounted for 87.1 per cent in 2013. In the same year, the South African GEPF invested 1.2 per cent of total assets in infrastructure including the road network and the power sector (Sy, 2017).

Pension funds in South Africa are also allowed to invest up to 15 per cent of their assets in hedge funds and private equity funds, whether local or foreign, and socially responsible investments are encouraged. South Africa has the largest variety of instruments available to institutional investors, and pension funds have invested in infrastructure using project finance loans for toll roads, municipal bonds, and jointly owned infrastructure funds. Although South Africa has a well-developed occupational pension system, it has limited coverage and a large number of untapped funds. In Ghana, however, pension funds have favoured instruments such as government bonds earmarked for infrastructure financing and regional funds such as the Social Security and National Insurance Trust.

The institutional and contractual savings sector in **Ethiopia** provides a promising opportunity to finance long-term development projects. A minimum level of savings for retirement is compulsory but much remains to be done to ensure the compulsory pension system includes the private sector and those in the informal labour market. The International Monetary Fund (2013) estimates that there are about 85,500 permanent workers in the large and medium-scale manufacturing industries in Ethiopia, 55,000 in small-scale manufacturing industries, and 1,231,000 owners of cottage or handicraft manufacturing industries. Only some 500,000 workers (including civil servants) have pension or provident fund coverage, suggesting a huge potential for expanding coverage. In this regard, the establishment in July 2011 of the Private Organizations Employee Social Security Agency is a step in the right direction. In the first year of operation, the Agency collected more than Br 800 million, further illustrating the industry's huge potential to grow and generate savings.

Despite the narrow customer base in Ethiopia, the insurance sector has made impressive strides over the last five years with a total capital of Br 1.5 billion (about $82.4 million) in 2013. Fifteen private insurance companies accounted for 74.7 per cent of total capital, while one public insurance company alone accounted for 25.3 per cent. The main obstacle to mobilizing capital through pension or provident funds and insurance companies is low coverage (ECA, 2017).

In **Morocco**, the Caisse de Dépôt et de Gestion (CDG) is an important source of finance for development in the country (Ministry of Economy and Finance, interview, 17 May 2017). Today, the CDG Group has become a key actor in the pensions management sector, a major player in the consolidation of the financial and banking sectors as well as a leading operator in territorial and sustainable development of the country. The main mission at the core of the CDG Group is efficient long-term savings mobilization through, among others, pension funds and ensuring that these mobilized funds are efficiently allocated to development projects profitable for the country's economic development. Provident and pension funds are one of the four core lines of business activity of the CDG Group.

Morocco requires employers to contribute 26 per cent of the employee's gross salary for pensions and healthcare, while employees must contribute 9 per cent of their pre-tax salary (Deloitte, 2015). According to a Financial Capability Survey carried out in 2013, 41 per cent of Moroccan adults use a formal financial product or service, including "deposit and current accounts, credit from banks, payment services such as internet banking and Western Union, microfinance institutions and credit cards, insurance products, and investment and pension products" (cited from World Bank Group and others, 2014). However, private pension products are used by fewer than 3 per cent of the population. Among adults without a formal financial account, 37 per cent said that this was because they did not have funds to deposit in it, while 27 per cent reported that they had no need of an account, and 24 per cent said that it was too expensive (ibid.).

Compared to other countries in Western Asia and North Africa, the share of pension assets of Morocco as a share of its gross domestic product is lower than the regional average, at a little over 10 per cent of gross domestic product (Robalino, 2005).

For most African countries, building an institutional investor base will require upgrading expertise and skills, as well as reforms in licensing, portfolio requirements and changes to security laws. Such countries should therefore learn from the experiences of developed countries, and lessons learned from among themselves, with the aim of building institutional investor bases and capital markets that are long-term and that "promote incentives along the investment chain that are aligned with long-term performance and sustainability indicators, and that reduce excess volatility," as called for in the Addis Ababa Action Agenda (Inter-Agency Task Force on Financing for Development, 2017).

4.6 General public targeted bonds

4.6.1 Diaspora bonds

Diaspora bonds can be an attractive vehicle for countries to secure a stable and cheap source of external finance. Since patriotism is the principal motivation for purchasing diaspora bonds, they are likely to be in demand in both good and bad times. The development of the diaspora bond market also improves a country's sovereign credit rating as home investors have superior access to information about domestic firms or economic conditions.

In addition to patriotism, several other factors may also help explain diaspora interest in bonds issued by their country of origin including risk management opportunities provided by diaspora bonds. Although the issuing country may be unable to make debt service payments in hard currency, its ability to pay interest and principal in local currency is perceived to be much stronger. Other factors include the satisfaction that diaspora investors gain from contributing to the economic development of their home country. Diaspora bonds also allow investors the opportunity to diversify their assets away from their adopted country. Finally, diaspora investors may also believe that they have some influence on policies at home, especially on bond repayments.

Some African countries have been exploring the option of issuing diaspora bonds to bridge financing gaps. The African experience with diaspora bonds suggests that they tend to do better where a receiving country has a sizeable first generation in the middle to high-income group in the diaspora. African countries with a large proportion of their population abroad are therefore well placed to benefit from a strong diaspora bond policy, though some African countries might not be able to attract investors because of a perception of political risk. They may also struggle to harness the potential of diaspora bonds because of technical or bureaucratic requirements for selling them abroad (UNCTAD, 2016).

Ghana is one of the largest recipients of remittances in Africa, but the country has not yet tapped exclusively into the financial resources of its citizens in the diaspora through diaspora bonds. In 2007, the Government of Ghana issued a $50 million Golden Jubilee savings bond targeted at both Ghanaians at home and abroad. The funds raised through the sale of the bonds targeted investment in infrastructure projects in Ghana, and the country is currently structuring diaspora bond programmes that target expatriates. In other words, the Government of Ghana is currently considering the option of issuing diaspora bonds to raise funds from Ghanaians living abroad. According to the Ghana Ministry of Finance, the initial assessment in 2017 on the potential of financial resources mobilization through diaspora bonds points out that the country can access the fund at a good rate, looking at the rising enthusiasm among Ghanaians to invest back home following the sound economic policies embarked upon by the current government. In other words, due to the current conducive economic policy environment, Ghanaians living abroad are willing to invest back home.

In 2008, **Ethiopia** issued its first diaspora bond, the Millennium Corporate bond, which was intended to finance a hydroelectric project of the Ethiopian Electric Power Corporation, but failed to meet its funding target. The issuance did not meet the expectations due mainly to: risk perceptions on the payment ability and its future earnings from the operations of the hydroelectric power; lack of trust in the government as a guarantor; and political risks. In 2011, Ethiopia launched its second diaspora bond, the Renaissance Dam bond, the proceeds of which were used to fund the construction of the Grand Renaissance Dam which was estimated to cost $4.8 billion. This dam will be the largest hydroelectric power plant in Africa when completed (5,250 megawatts). However, information on how much has been mobilized for the project through the diaspora bond is not known. About 80 per cent of the funding was sourced from local taxes and the remaining 20 per cent from treasury bonds. Ethiopians abroad and at home contributed to the project's first $350 million and government workers donated amounts equivalent to a month's salary.

To attract money from abroad, **Egypt** introduced new dollar- and euro-denominated certificates of deposit for Egyptian expatriates (Reuters, 2016). State banks also introduced a currency hedging option to attract foreign investors to Egyptian treasuries. Overall, the BoP of Egypt registered a surplus of $7 billion in the first half of the current fiscal year (2016/17), a significant leap from the $3.7 billion recorded deficit in the previous year, attributing the improvement to the November pound flotation decision. Egyptians working abroad have also contributed to the 64 billion Egyptian pound (almost $9 billion) subscriptions collected through: funds in existing bank accounts in Egypt, particularly, in foreign currency; or sending remittances to allow the family to buy investment certificates.

Some African countries are also exploring the option of issuing diaspora bonds to bridge financing gaps. World Bank preliminary estimates suggest that Africa, excluding North African countries, can potentially mobilize $5-10 billion per year by issuing diaspora bonds. African countries that can potentially consider diaspora bonds are: Ghana, Kenya, Morocco, Nigeria, Senegal, South Africa, Uganda, Zambia, and Zimbabwe. From the five sample countries that are considered for this study, four (Ethiopia, Ghana, Morocco, and South Africa) are exploring the option of mobilizing external financial resources for development projects through diaspora bonds.

Box 7

Suez Canal: Symbol of Egyptian national pride

The Suez Canal Zone was created in 2002 and then amended in 2015, it cost $8 billion to construct and 80 per cent of the funding was through issuing State bonds to the Egyptian public (Business Insider, 2015). It provides 100 per cent exemption from duties and sales taxes on all imports. The aim of the project is to increase the role of the Suez Canal region in international trading, develop three new canal cities and improve five existing ports. It will, therefore, not only help first-time investors but also support companies to expand and grow more, and thereby create thousands of jobs. The new canal cities will have industrial zones, fish farms, and completing the technology valley will increase capacity and transfer the new canal cities into an important trading centre globally (SCZone, 2017). In 2014, the Suez Canal was earning Egypt about USD 5 billion a year and the new canal is set to boost annual revenues to $13.5 billion by 2023 (Reuters, 2014).

4.6.2 State bonds

Egypt also issued State Bonds to develop the extension of the Suez Canal. In Egypt, historically, the Suez Canal has been a symbol of Egyptian national pride since its return in 1956 from the British and placed it under Egyptian state ownership. However, Egypt issued a presidential decree on the investment certificates for the New Suez Canal project in 2014. The plan appeared to be an expensive project at a time when Egyptians were experiencing rising poverty and economic and political instability, but a significant number of citizens invested in the $8.4 billion project with the will to restore the greatness of the country. The fiscal year 2014/2015 witnessed the selling of Suez Canal investment certificates (from 4 to 15 September 2014) and the sale proceeds of the Suez Canal certificates reached LE 64.2 billion. This indicates that national pride coupled with a sound return on an investment deal is considered a great tool for domestic resource mobilization.

4.7 Eurobond markets

Eurobonds have become an important source of development finance for Africa, particularly since 2006. Seychelles was the first African country excluding North African countries, after South Africa, to make its foray into the international financial markets with the issue of its $200 million Eurobond in 2006. Since then, several other African countries (Angola, Cameroon, Côte d'Ivoire, Ethiopia, Gabon, Ghana, Kenya, Namibia, Nigeria, Rwanda, Senegal, and Zambia) have issued Eurobonds, with values generally ranging from $500 million to $1 billion. The total value of yearly issues of Eurobonds by African governments rose from just about $200 million in 2006 to about $6.3 billion in 2014 and 2015, with the total cumulative value of all Eurobond issues over the same period standing at $20.8 billion.

Following the 2008 economic and financial crisis, a few African countries obtained funds from international capital markets, or sovereign bonds, which were cheaper sources of alternative financing. There are currently 15 countries in Africa excluding North Africa which have issued Eurobonds, with a total market capitalization of $30 billion. Eurobond issuance by African sovereigns was recorded at $9.726 billion by four countries (Egypt, Ghana, Mozambique and South Africa) in 2016 compared to $6.750 billion issued by eight countries (Angola, Cameroon, Côte d'Ivoire, Egypt, Gabon, Ghana, Namibia, and Zambia) in 2015. Most African countries tap into the Eurobond markets as a result of its unregulated nature which requires a comprehensive set of well-coordinated measures to avoid what happened recently in Mozambique. In January 2017, Mozambique became the first African country (excluding North Africa) to default on its recently issued Eurobonds when it was unable to service the coupon payment on a bond guaranteed by the Government (Vanek, 2017).

Ghana accessed the international capital market in 2007 by issuing a Eurobond of $750 million for the development of infrastructure. Following the first issuance, Ghana also raised $1 billion on the international capital markets in August 2013. The Eurobonds were oversubscribed (ten-year maturity at an annual rate of approximately 9 per cent). The proceeds of the 2013 Eurobond in Ghana were used for infrastructural development, counterpart funding and refinancing of maturing short-term domestic debt (Quartey, 2013). Recently, Ghana issued the fifth Eurobond in 2016, amounting to $750 million at a 9.25 per cent yield. The bond was oversubscribed, with orders exceeding $4 billion compared to a target issuance size of $750 million, clearly indicating the high appetite for the country's credit. The Ghana Eurobond market offers an alternative source of finance for the country as it is not subject to the conditions usually attached to bilateral and multilateral loans. However, despite the advantages, such as funding infrastructure, benchmarking and restructuring debt, the country's sovereign bonds add up to its external debt as a result of which Ghana continues to face the high risk of external debt distress (IMF, 2017).

In April 2016, **South Africa** issued a $1.25 billion 10-year Eurobond at an interest rate of 4.875 per cent. The proceeds of the bond will partially finance the government's foreign currency commitments of $6.4 billion over the medium-term. In September of the same year South Africa placed two more bonds worth $3 billion maturing in 2028 (12 years) and 2046 (30 years) via an innovative one-day new issue and tender switch transaction. The 12-year bond was priced at a coupon rate of 4.3 per cent while the 30-year bond was priced at a coupon rate of 5 per cent. All transactions were more than twice oversubscribed (GoSA, 2016b).

To finance its infrastructure development programmes, **Ethiopia** entered into international capital markets in December 2014 for the first time ever and issued Eurobonds worth $1 billion at 6.75 per cent, with a maturity of ten years (Jalata, 2014). Ethiopia offered for sale only $1 billion worth of Eurobond, the demand by investors reached two billion dollars. The bond was oversubscribed by 260 per cent, driven by the remarkably fast growing Ethiopian economy; stability of the government; a vast potential market and manpower for companies and investors as a result of the large population size. These factors make Ethiopia an attractive destination to Western investors.

Following the liberalization of the Egyptian Pound in November 2016, the Ministry of Finance of **Egypt** issued bonds worth a total of $4 billion. The bonds were issued in three tranches, with different maturities and yields: 6.13 per cent for five-year notes; 7.5 per cent for ten-year notes; and 8.5 per cent for long-term, 30-year, securities. The 30-year tranche is an unusual prospect for an African sovereign and is an indication of the growing ability of Egypt to raise foreign debt on a long-term basis. There has been increased foreign investor appetite for Egyptian Government Treasury bills, following the flotation of the pound, which resulted in the depreciation of the local currency, and the rise in yields on domestic securities. Accordingly, on 24 May 2017, more bonds worth $3 billion were issued through a "tap" mechanism with improved terms, reflecting positive market sentiment about the medium to long-term economic prospects of Egypt. Investors are also highly encouraged by the positive review of the IMF $12 billion loan for Egypt to finance its reform programme.

Morocco has been accessing international capital markets since it issued its maiden

Eurobond in 2007, in a bid to curb its reliance on local borrowing. In late 2012, the country also raised $1.5 billion in a heavily oversubscribed dual-tranche offering. In 2014, Morocco sold a €1 billion ($1.4 billion) Eurobond with a 10-year maturity and a yield of 3.7 per cent, following dollar debt issues in many years.

The heavy over-subscriptions of Eurobond in all five sample African countries clearly indicate the existence of high demand for credit in these countries. However, the downside risks associated with Eurobond sales on the international market is the associated external debt problems. The cost of finance or the capacity to raise the resources for repayment of the debt from commodity export revenue for the Eurobonds is also another key risk factor.

4.8 Green bonds

Another relatively new type of bond in the international debt market is the Green bond. It was introduced in 2007 through some international financial institutions like the World Bank and the European Investment bank. A few years after the introduction, some corporate organizations started to issue it and this enhanced its growth (Katsomitros, 2017). The Green bond is a means of raising funds which are specifically used for financing "Green Projects" like renewable energy (wind or solar energy) transportation through non-fossil fuel and renewable water management to support climate and/or environmental projects. The Green bond has grown in market size from $4 billion in 2010 to about $37 billion in 2014 (World Bank, 2015). The market improved further in 2015 with a fresh issue of about $40 billion (OECD, 2015).

Some multilateral banks have issued Green bonds to finance related climate issues. For example, the African Development Bank issued one in 2013 for $500 million to finance the problem of climate change in Africa. The European Investment Bank (EIB) issued 600 Euro worth of Green Bonds in 2007 to finance renewable energy while the International Finance Corporation (IFC) also issued a three-year Green Bond for $1 billion in 2013 aside from the one launched by the World Bank for $440 million in 2008 (World Bank, 2015).

South Africa appears to be the first in Africa to issue R5 billion Green bonds to fund infrastructure for sustainable energy. In the same market, the Johannesburg municipality was the first municipality in the country to borrow R1.46 billion from the Johannesburg Stock Exchange to set up a biogas plant and solar energy as a means of electricity supply. In 2017, the Cape Town municipality raised R 1 billion for a sustainable water project (GCX, 2017).

In **Morocco**, Masen, an agency for sustainable development issued the first Green bonds for 106 million euros in 2016 to finance electricity through renewable sources like solar energy. This was the first in Morocco (Masen, 2016). In the same country, the IFC and Proparco, a subsidiary of Agence Française de Devéloppement, desire to invest the first Green bond for a 10-year period. The value of the Green bond is for 100 million and 35 million euros respectively, to be issued by Banque Centrale Populaire for environmental projects. The Green Bonds floated by Masen was completed by private placement authorized by the country's capital market authority to four local investors backed by government guarantee.

In Africa, funding environmental projects and climate related issues through the issuance of Green bonds is considerably low. The barriers to finance through Green bonds in the international market are due to many factors such as: absence of long-term gestation projects with low risk of technology; low level of capital market development; weak market for government bonds; poor macroeconomic framework; and deficient regulatory and legal frameworks (GIZ, 2017). All these factors account for the reasons why many countries including those used in the samples have not accessed Green bonds in Africa.

4.9 Conclusion

A review of the innovative financing techniques shows that a menu of such methods cuts across developed, emerging and developing economies while some of these methods such as public-private partnership, financial inclusion and pension funds have a cross-cutting edge across the three classifications. The need for Africa to embrace innovative financing methods is not in doubt, but transparent modalities for raising the funds and channelling the same into investments to achieve the SDGs and Agenda 2063 remains a challenge for the region. In the developed nations the use of many forms of innovative financing techniques have been tested and perfected for the development of infrastructure and commercial projects. Exposure, however, of developing economies to the use of some of these innovative financing techniques such as Green bonds are yet to be fully standardized for sustainable use.

In the emerging economies, innovative financing methods that have been used for financing new infrastructure include: Multilateral Investment Guarantee Agency Facility, climate finance and pension funds while diaspora bonds have been used to support BoP deficit, excess funds from BoP have also been invested in Sovereign Wealth Bonds. In the developing economies some of the innovative financing methods used in this region include: impact financing, diaspora bonds, pension funds and infrastructure bonds. Africa has also had the experience of using innovative finance for development projects. The paper explains some of the innovative financing methods that are being used in Africa – impact finance, diaspora bonds, online alternative finance as well as the microfinance approach. Furthermore, co-financing with development banks, blended finance, which are meant to share lending risks among credit participants are also widely used. Although the capital market serves as a veritable source of funding for business enterprises in the continent, Africa needs to do more in the area of policy and regulation as well as improved efficiency in the operational conduct of the market.

Lessons learned from the countries considered for the case studies show that Eurobonds, financial inclusion and infrastructure financing have been widely used, in varying degrees, by all of them for financing development. In countries with a relatively high external debt, issuance of sovereign bonds should be carefully planned and prepared to avoid external debt unsustainability. Innovative financing through diaspora bonds has not enjoyed popular usage except in Ethiopia which is in the forefront of the use of this method, while Egypt is still in the preliminary stage of employing the diaspora funding approach. With regard to the pension fund scheme as a means of funding long-term projects, South Africa is in the lead while Morocco and Ghana follow, but Ethiopia needs to do much more in raising long-term funds through the pension scheme. The next chapter examines how innovatively to mobilize traditional sources of development finance.

Chapter 5: **Innovative approaches to mobilizing traditional sources for financing Sustainable Development Goals and Agenda 2063**

5.1 Introduction

This chapter presents innovative approaches to mobilizing traditional sources of finance to meet the achievement of the objectives of global 2030Agenda /SDGs and the Agenda 2063. It draws on the evidence from various innovative approaches to mobilizing traditional sources of finance that have been implemented in the case study countries namely: Egypt, Ethiopia, Ghana, Morocco and South Africa.

The traditional sources considered in this chapter are tax revenue, illicit financial flows, equity markets, export earnings, official development assistance, multilateral and plurilateral organizations and development finance institutions, private investment, public-private partnerships, remittances and South-South cooperation.

5.2 Innovative approaches to mobilizing traditional sources

As noted in the previous chapter, mobilizing additional resources will be essential for African countries in order to achieve the SDGs and Agenda 2063. As such, African countries may wish to consider using innovative approaches to mobilizing traditional domestic sources of finance. The present chapter reviews the experiences of the case studies (and some other African countries) in doing this.

5.2.1 Tax revenue

As highlighted in Chapter 2, tax revenue is an important source of revenue for African countries. One of the useful ways in which Africa can mobilize additional funds through taxation is the elimination of non-strategic tax incentives (ECDPM, 2014; ECA, 2017). These incentives are often granted without being subjected to cost-benefit analysis and are not necessary to attract investment anyway (High-level Panel on Illicit Financial Flows out of Africa, 2015; ECA, 2017b; United Nations, 2017).

Beyond tax avoidance and tax evasion by multinational corporations, African countries can improve tax compliance among ordinary citizens. In particular, the African Union and ECA (2015) note that: “Tax compliance could be enhanced by providing affordable State pensions and other welfare packages, and improved public service delivery at national, subnational and local levels, because citizens are more likely to pay taxes if they feel that their lives would be improved in return. This will be particularly helpful in inducing the large informal sector, as its employees will see tangible benefits in this new form of citizen-based social contracts.” To this end, the tax directorate within the Morocco Ministry of Economy and

Finance also makes efforts to mobilize additional resources from the Moroccan diaspora through taxpayer education (Marocains du Monde, cited from Ismaili Idrissi, 2015).

In addition, improvements in the efficiency of tax administration can bring in additional tax receipts, as has been the case in South Africa. The South Africa Revenue Service Modernization Programme was introduced in 2011 and it enabled the Service to process taxpayer information faster. As a result, tax registration by individuals increased by 74.79 per cent, from 5.9 million **registrations** in 2011 to 10.3 million in 2012. The South Africa Revenue Service has also increased registrations compliance through other methods including tax education, outreach and enforcement initiatives, introducing bulk registration at places of employment and providing an online facility for registering as submitting monthly pay-as-you-earn returns.

Ethiopia could also benefit from improvements in tax administration, since the country's low tax compliance rate is primarily a result of these weaknesses. One of the reasons for this is the poor salaries of tax officials and the link to corruption in tax administration (ECA, 2016a, pp.38-9). Yet the Government of Ethiopia (2015) reports progress in identifying instances of corruption and bringing them to trial. The government has also expressed its commitment to strengthening domestic tax revenue mobilization through various interventions as indicated in GTP-II. The establishment of a tax directorate with the Ministry of Finance and Economic Cooperation indicates the government's commitment to enhance the tax revenue capacity.

Other countries in Africa, such as Ghana, which has historically had relatively inefficient tax administration (Addo, 2016), could benefit from similar measures. The Government of Ghana has taken a number of measures to improve on its tax administration, but it is currently too early to see the results. The engagement of tax consultants/experts by the public sector to collect taxes on their behalf is a creative way and has worked satisfactorily in some countries such as Nigeria.

One of the measures that can be used to formalize businesses in the informal sector is to reduce the red tape for firms, and make it easier (and less time-consuming) for them to comply with the regulations in the formal sector. This approach has been successful in Africa, notably in Burkina Faso, Mali and Rwanda (ECA, 2015). Morocco has been following a similar approach, and has successfully reduced the size of the country's informal sector by reducing the tax burden, and encouraging more firms to enter the formal sector (Bank Al-Maghrib, interview, 19 May 2017). The opportunity or challenge in this regard is that the informal sector in Morocco remains large and there is some way to go to bring the vast majority of economic activity from the informal into the formal sector (U.S. Department of State, 2017).

In addition to these taxes, the African Union and ECA (2015) note that African countries can consider raising additional taxes from royalties, income tax, land tax and leases. Morocco has recognized the regressive nature of indirect taxes and has introduced special tax brackets for basic commodities to protect those on low incomes from paying high rates of tax (ECA, 2016a). Ethiopia has pursued a number of tax reforms in recent years (see table below), but these do not appear to have increased tax revenues (Daba, 2014).

In addition to increasing revenue through taxes, it is also important for African countries to increase the efficiency of public spending. To begin with, in many African countries, public financial management processes, budgeting and development planning are not done jointly; this makes it difficult to allocate public financial resources to priorities in national

Box 8
Tax reforms in Ethiopia

- Rate schedules rationalized and a significant reduction in rate classifications.
- Value added tax introduced to replace conventional sales tax in 2003.
- Maximum foreign trade tariffs reduced from 230 per cent to 35 per cent.
- In 2001, the Ministry of Revenues replaced the Revenues Board to lead the tax system reform.
- A tax reform taskforce was established to deepen tax policy and administrative reforms.
- Interministerial steering committee established to lead the national reform programme to refine and support the tax system reform programme.
- In 2009, the Ethiopian Revenues and Customs Authority was established as a centralized tax unit through the merger of the Federal Inland Tax Authority, the Ethiopian Customs Authority and the Ministry of Revenues, which dealt with regulatory affairs.

Source: Daba, 2014.

development plans. Using official development assistance to support public services worsens the culture of poor public financial management (ECA, 2016a, p.8). In this regard, Ethiopia has had great success that has been recognized internationally as a best practice in public financial management. The country's approach included devolution, accountability and separation of politics from administration, but with some innovative approaches that helped it to be successful in the Ethiopian context. As a start, the government took the view that reform would only be successful if it was led by officials that understood the reforms. As such, financial institutions led the public financial reforms, and there was an effort to make sure that senior government officials understood the reforms (Kararach, Kedir, Ajambo and Suominen, 2017).

The Government of Ethiopia then took the view that in order to be effective there must be capacity at local level and accountability of local authorities. As a result, the government devolved financial management to the district level, while at the same time ensuring that district authorities had the capacity to deliver frontline public services, training relevant staff in budget and accounts and putting in place performance agreements linked to the transfer of funds. In keeping with this idea that when changing the responsibilities of public officials, it must be ensured that they have the capacity to deliver, Ethiopia also introduced IT reforms in public financial management, adapted to local circumstances. New financial information systems were established but operating online at low bandwidth in line with the state of the country's internet infrastructure at that time; and also, the systems operated in five local languages. At the same time, the country brought the financial management system up to date, requiring current reporting, and advance submission of budgets to parliament for review one month in advance (ibid.).

Morocco has also pursued fiscal decentralization (Vaillancourt, cited from Bird and Vaillancourt, 1998; Ebel, Fox and Melhem, Vaillancourt, both cited from Ebel and Yilmaz, not dated; the World Bank, cited from Ebel and Yilmaz, not dated). This has meant that the country has abandoned the previous practice of giving grants to local governments to balance the local government budgets, to grants to local governments that do not take account of borrowing (Vaillancourt, cited from Bird and Vaillancourt, 1998). In addition, "lenders were explicitly told not to count on financial bail-outs". In Morocco, local government grants have also been used to shape local investments in roads, water, sewerage and electricity (Bird and Vaillancourt, 1998).

Beyond reforms such as those pursued by the Governments of Ethiopia and Morocco in improving the efficiency of public spending, African Governments can improve public expenditure management through "[Better selection, design, and management of public investment projects…[and] Reforming regressive and harmful subsidy and procurement regimes" (AU and ECA, 2015). African countries also need to strengthen their anti-corruption measures (ECA, 2018). This includes creating anti-corruption agencies with sufficient political backing, funding and capacity to tackle corruption (High-level Panel on Illicit Financial Flows from Africa, 2015). One criticism of this approach is that officials of these agencies can themselves be corrupted, which, so the criticism goes, may render the anti-corruption efforts pointless. Empirical research, however, shows that even in contexts where anti-corruption efforts themselves risk becoming corrupt, these efforts still reduce the incidence of corruption (Banerjee and Duflo, 2011).

5.2.2 Illicit financial flows

In addition to tackling the loss of tax revenues (both to tax evasion or avoidance and to poor management of public spending), African countries also need to tackle other aspects of illicit financial flows. As highlighted in Chapter 2 of the present report, according to ECA latest estimates, Africa is losing $73 billion net through illicit financial flows through trade re-invoicing alone.[3] In addition, as noted in ECA (2018), the latest estimates of Global Financial Integrity imply that Africa is losing at least $27 billion annually through other channels, which means that the total amount is estimated at around $100 billion annually, or around 4 per cent of the continent's gross domestic product. Notwithstanding, the losses due to tax evasion and avoidance and corruption may represent less than half of this total, and it is therefore important to tackle losses through other sources of illicit financial flows, such as organized crime and money-laundering.

In order to tackle this problem, ECA (2018) makes a number of policy recommendations. The first is for African countries to ensure that relevant agencies are established and have the training, finances and staff needed to address the problem. The second is to ensure that African countries implement relevant international standards on preventing money-laundering and financing terrorism, particularly the financial action task force recommendations. Furthermore, African countries should ensure that trade mis-invoicing is considered illegal and that they have the capacity to check invoices for evidence as to whether they have been falsified. African countries should also ensure coordination and information sharing between relevant law enforcement agencies.

At the global level, the report also recommends a comprehensive international agreement on tackling illicit financial flows as well as a global mechanism to coordinate efforts against such flows. In addition, it recommends greater action to pressure financial secrecy jurisdictions to cease offering financial secrecy, further action to promote the return of stolen assets and funds to their countries of origin and for development partners to support development of African countries' capacities to tackle illicit financial flows.

3 Trade re-invoicing refers to the illicit practice of changing the value stated on an invoice for an international shipment so that the difference between the value stated at export and the value stated at import differs from the cost of insurance and freight. Another way to describe it is trade mis-invoicing (falsifying values or quantities stated in invoices presented to customs at import or export) where the perpetrators do not take the pains to ensure that the invoices at import and export match (that is, differ only by the cost of insurance and freight).

In terms of individual country experiences in this area, Ethiopia is estimated to lose on average $2.5 billion per year through illicit financial outflows, of which an average of $2 billion per year is through trade mis-invoicing. In particular, import trade mis-invoicing has remained the main driver of illicit financial outflows, while export under-invoicing is less of a concern.

Morocco has taken a number of steps to tackle illicit financial flows from the country. These include exemplary efforts to tackle trafficking in cannabis, passing a new law outlawing human trafficking in 2016, implementing the recommendations of the Financial Action Task Force on tackling money-laundering and financing terrorism, and implementing most of the provisions in the United Nations Convention Against Corruption (International Narcotics Control Board, 2013; United Nations Office on Drugs and Crime, 2012, 2016 and interview, 17 May 2017; Middle East and North Africa Financial Action Task Force, 2014). The country also follows a risk-based approach to auditing businesses for violation of tax laws and foreign exchange regulations. All international transactions involving the exchange of currency must have real firms on both sides of the transaction (Ministère de l'Economie et des Finances, interview,17 May 2017, Office des Changes, interview, 19 May 2017). Despite this, the country is estimated to still experience high levels of illicit financial flows.

5.2.3 Equity markets

As noted above and in chapter 2 of this report, capital markets are an important means to mobilize additional finance for development in Africa. Equity markets in particular have great potential to mobilize additional funds for development. In particular, foreign investment in equities could seemingly provide much of Africa's financing needs. According to the latest available data for each country, worldwide international holdings of equities total $54 trillion, which is over 20 times greater than Africa's current gross domestic product (authors' calculations based on International Monetary Fund, 2017; Economic Commission for Africa, African Development Bank Group and African Union Commission, 2017). Some African countries have taken steps to seize this opportunity to mobilize additional domestic finance for the private sector, which is also key for economic transformation (see for example, Rousseau and Wachtel, 1998, Rousseau, 1998, and World Bank, cited from Demetriades and Luintel, 1997). Yet in many African countries, capital market development remains limited, and is frustrated by the lack of capacity, poor regulations, lack of technological infrastructure and legal frameworks that provide insufficient protection to investors (ECA, 2016a, pp. 8-9).

African countries may be able to learn important lessons on developing capital markets for economic transformation from the Egyptian Exchange, which has had great successes in mobilizing capital for Egyptian firms. The Egyptian Exchange is one of the leading stock exchanges in Africa and was awarded for being the Most Innovative African Stock Exchange in 2014. In particular, the introduction of block trading and cancellation of precautionary measures adopted after the 2011 Revolution helped to boost confidence in the Egyptian investment market, helping the stock market to grow by 108 per cent between June 2013 and June 2014. It also increased liquidity levels, which provided funding of more than 10 billion Egyptian Pounds ($1.4 billion) for Egyptian companies enabling them to grow, expand and provide job opportunities (The Cairo Post, 2014). Block trading was implemented to protect the market and its participants from the influence of the change in prices as a result of the huge trading at different prices in the market.

Listing on the Egyptian Exchange provides the shareholders of the listed companies with certain tax exemptions relating to the distribution of dividends and capital gain taxes. The exemptions were recently subject to limitations, including imposing taxes on capital gain taxes achieved by trading in securities (a 10 per cent capital gain tax applicable to mergers and acquisitions was imposed in 2013), and on dividend distributions (charged at 10 per cent, although this can be reduced to 5 per cent).

In 2015, the Egyptian Exchange began trading in the nation's first exchange-traded fund, creating a deeper market and offering new investment options. The exchange-traded fund is an open-ended fund that issues certificates in exchange for investing its money in a portfolio that tracks one of the exchange indices, and therefore follows the EGX 30 index and at the same time its certificates are allowed to be traded as any other securities through brokerage firms. The Egyptian Exchange also announced the launch of the second phase of the OTC (over-the- counter) market in 2015. OTC helps investors in non-listed companies to trade their shares within a simple automated mechanism without the problem of finding another party to perform the transaction (Egyptian Exchange, 2015). Between 2015 and 2016, over $600 million worth of foreign investment in equities and investment fund shares flowed into Egypt (compared to a flow of only $13 million the previous year), which could suggest that the reforms, which took place in 2015, helped to significantly boost investment.

However, the equity market in Africa remains thin as only four stock exchanges have active trading. These are in South Africa, Egypt, Nigeria and Morocco. There is the need for countries to learn from each other and to harmonize the trading processes and procedures as this may help those with less-developed exchanges to emulate the more successful capital markets on the continent. That being said, African countries should be careful to ensure that the relevant institutions are in place for the success of such exchanges, including consumer protection measures, financial stability measures and adequately staffed financial regulatory and supervisory authorities. Otherwise, they face a number of risks:

- If there is inadequate financial regulation and/or supervision, there is the risk of financial fraud leading to the misallocation of resources into non-viable businesses that attract investment by misstating their results or running Ponzi schemes. There will also be the risk of financial losses due to businesses pursuing excessively risky strategies; the 2008 financial crisis underlined this risk. There is also the risk of insider trading (ECA, 2016a, p.27);
- If there is inadequate contract enforcement, there is the risk that investors will be defrauded by firms. This is currently the case in a number of African countries (ECA, 2016a, pp.8-9). In addition, if there are insufficient consumer protection regulations, small investors may be exploited by unscrupulous firms or financial advisors, for example, those who use their advice to manipulate investors into buying a stock that they hold simply so that they may profit from the increase in price.

5.2.4 Export earnings

As outlined in chapter 2, export earnings from international trade remain an essential source of foreign exchange for African countries. Analysis of the balance of payments identity tells us that this remains critical for Africa to finance its investment needs. Other methods that could be pursued include measures to connect previously isolated communities to the global trading system. Morocco has had one such experience, albeit on a small scale. In particular, a non-profit organization in Morocco has allowed relatively isolated rural producers to export their wares by providing pro-bono online marketing services for producers who would otherwise not have access to the Internet. The organization takes pictures of the relevant products and posts them online, receiving payments on their behalf, thus reducing the cost and time to make the payments, and subsequently remitting them.

In addition, five per cent of the asking price for the products is donated to the village association to finance village improvements (Davis, 2008). The success of this kind of intervention shows that interventions from the government or a third party to connect isolated producers to markets can help them to export, which will, as a consequence, mobilize additional foreign exchange.

Most African countries produce few agricultural products whose prices fluctuate internationally and there is the need to study this pricing method with a view to adapting it into the present circumstance. Marketing strategies will also need to be improved upon, compared to those used in this case. That being said, according to Acemoglu and Robinson (2012), marketing boards have also been used to extract rents from producers in Africa, with proceeds accruing to officials rather than going into financing for development. As a result, before implementing such an approach, African countries should ensure that adequate governance arrangements are in place to prevent marketing boards from simply extracting rents from producers and diverting the funds into the pockets of officials.

Beyond this, where Free Trade Zones exist in Africa as a means of mobilizing additional export earnings, they are not always being used to their full potential. In Nigeria, for example, consistent, practical and integrated government policies are needed to improve their efficiency, particularly regarding fiscal policy. This could include strengthening ex-ante analysis of free trade zone fiscal policies. In addition, laws and procedures could be simplified (ECA, 2016a).

5.2.5 Official development assistance (ODA)

Information analysed from OECD (2017) sources indicates that official development assistance disbursed to Africa totalled $51 billion in 2015. While much less important than tax revenues (see chapter 2 of the present report), this source of finance is nevertheless significant for Africa. The experience of African countries in this regard highlights the challenges that need to be addressed to make the most of official development assistance. In Ethiopia, net official development assistance to the country totalled $3.2 billion in 2015 (OECD, 2017); but 33 per cent of committed official development assistance was not disbursed in 2015/16, due mainly to bottlenecks in the implementation of large infrastructure projects. Consultations with stakeholders indicate that there is the need to ensure effective utilization of external resources and improve project planning and management capacity to execute projects on time and with the required quality (Government of Ethiopia and UNDP, 2017).

The experience of Morocco highlights the fact that African countries can attract greater funds through pursuing policies favoured by donor countries, though in many cases, the cost of such an approach may be considered too great. Morocco, which has historically pursued policies that are favoured by key donor countries, though there is no suggestion that this was the reason for these policies, continues to attract high levels of official development assistance. Moreover, Harrigan, Wang and El Said (2006) find that this effect holds for countries across Western Asia and North Africa. South Africa has made use of a different innovative technique to mobilize official development assistance: that of General Budget Support Funding. This type of official development assistance involves a transfer of funds to the partner country for allocation within the country, using the country's allocation processes, with the aim of supporting a national development policy and strategy of the partner country. It ensures that the assistance provided is aligned to the country's development priorities (as outlined in chapter 3 of the present report) and improves public financial management at the same time, compared to aid provided outside the country's public spending systems. In South Africa, general budget support funds allocation for the 2018/19 medium-term budget is R600 million (approximately $44 million). South African government systems are used for allocation, planning, implementation, procurement, accounting, reporting, monitoring and evaluation.

5.2.6 Multilateral and plurilateral organizations and development finance institutions

Similar to the points made regarding Morocco in the section in the present chapter on official development assistance, pursuing particular policies appears to have helped certain countries to receive more favourable terms in loans from international financial institutions and development finance institutions. As noted earlier, these institutions can play important roles in providing development finance. In particular, Harrigan, Wang and El-Said (2006) reviewed a number of studies that find that countries that move their international political stance closer to that of key donor countries are more likely to receive loans from the International Monetary Fund (Barro and Lee; Bird and Rowlands; Rowlands, all cited from Harrigan, Wang and El-Said, 2006). They also found that Morocco has benefitted from this in terms of loans received from both the World Bank and the International Monetary Fund. Pfeifer (1999) also finds that political motives explain why some countries received more favourable terms for structural adjustment programmes than others. Pursuing good relations with donor countries may therefore continue to help African countries to receive favourable treatment from multilateral and plurilateral organizations in terms of concessional lending and official development assistance.

As noted in the section on official development assistance in the present chapter, multilateral and plurilateral organizations are also important partners for blended finance projects.

Beyond the use of finance from multilateral and plurilateral organizations, the establishment of development banks (whether regional or national) has been used by developing countries desirous of promoting sectorial development in their economies. They are specialized banks publicly established to cater or provide long-term funds for specific sectors of the economy like agriculture, and industry (small, medium and large-scale industries). The establishment is premised on the Gap Thesis, Exigency Thesis and Catalyst Thesis. The involvement of the development bank specifically targets the issue of the growth in long-term liquidity in the economy since the government provides the funds for the operations of the banks. Commercial and merchant banks hardly provide funds in the long term, so the development banks fill this gap (Gap Thesis).

The success of the state-owned Development Bank of Ethiopia in increasing liquidity in the Ethiopian financial system mirrors the success of development banks elsewhere in Africa. In South Africa, in June 2017, Standard Chartered Bank signed a $200 million loan to the Development Bank of South Africa for its infrastructure development projects in Africa (Development Bank of Southern Africa, 2017). Despite the success of the use of the development bank to finance sectorial development, the funding is often tied to the health of each economy. When the economy is booming, the government's ability to fund the banks is enhanced, while a downturn in the economy equally affects funding negatively.

The major challenge facing development banks is that these institutions are often run inefficiently. There is therefore the need for innovative ways of operating the development banks in Africa to achieve the global objectives for which they are established. In this context, the banks should be run like private outfits established not only to bridge the gap in loan availability (Gap Thesis) but also to serve as guarantors for private concerns seeking funding from international capital markets and institutions within the context of the catalyst and exigency theses. In this context, they prepare feasibility reports for small and medium-sized enterprises and use these to seek for long-term credits from international financial institutions like the International Finance Corporation and the Africa Finance Corporation. This will improve their financial base and increase patronage by small and medium-sized enterprises.

5.2.7 Public-private partnerships

In order to attract finance through public-private partnerships, African countries would do well to look at the Ethiopian reforms (tax reliefs, guaranteed loans, training support and facilitation of access to markets) which should encourage public-private partnership funds on a sustainable basis in the country (ECA, 2016a). Ethiopia has been successful in raising finance through a number of public-private partnerships. For instance, about $4 billion capital was raised in three public-private partnership arrangements alone, namely, Lehulu, Addis Ababa Exhibition Centre, and geothermal energy projects. Yet, the use of public-private partnerships is limited in the country, despite the existence of some good practices in this regard. This may be due to the fact that the country has not had a specific policy and legal framework governing public-private partnerships (though a draft of such a framework has been prepared). In addition, the country has weak technical and managerial capacities for negotiating and carrying out public-private partnership contracts, lacks a standard operating procedure and has financial constraints.

In response to these challenges, the Ministry of Finance and Economic Cooperation is attempting to make reforms to support greater use of public-private partnerships in the country (including the draft legal framework). The draft legal framework includes the establishment of a dedicated institution to support public-private partnerships and to mobilize resources from the private sector. However, this needs to be followed by capacity-building programmes for public and private sectors to successfully implement the public-private partnership framework (Government of Ethiopia and UNDP 2017; UNDP Ethiopia, cited from ECA, 2016a). In addition, the country needs to build relevant domestic expertise and establish a point of contact to facilitate the coordination of public-private partnership projects, as well as mechanisms to address obstacles and constraints to public-private partnership opportunities (UNDP Ethiopia, cited from ECA, 2016a).

As noted in chapter 2, public-private partnerships have been successful across Africa for funding strategic projects. In South Africa, public-private partnerships have raised significant amounts of finance. Table 3 below outlines the value of public-private partnership projects in infrastructure that is forecast over the next few years.

One example of such a public-private partnership project in South Africa was the Independent Power Producers Procurement Programme. Established in 2010, the programme was designed to enhance the power

Table 3

South African public-private partnerships: forecast value over next five years

	2016/17	2017/18	2018/19	2019/20
Sector	**Millions of rand**			
Transport	1,903	2,001	2,120	2,129
Health	992	1,003	1,016	1,016
Correctional services facilities	1,008	1,015	1,028	1,100
Accommodation	938	1,115	1,308	1,624
Total	4,840	5,134	5,471	5,869

Source: National Treasury Republic of South Africa, 2017c).

generation capacity of South Africa. The programme is a collaboration between the Department of Energy, National Treasury and the Development Bank of Southern Africa. In addition, the South Africa Critical Infrastructure Programme provides a cost-sharing grant to projects designed to improve critical infrastructure by leveraging investment by lowering the cost of doing business. The programme covers 10–30 per cent of the development cost of the Infrastructure project at a maximum of 30 million rand. The Critical Infrastructure Programme also requires projects to be at least a level four broad-based black economic empowerment contributor in terms of the Codes of Good Practice for broad-based black economic empowerment (Trade and Industry Department, 2015). As such, South Africa has managed to innovatively refocus public-private partnerships for greater social impact.

Yet due to challenges in public financial management, African countries may face different challenges (loss of funds due to embezzlement and difficulty in attracting investors) if they attempt to forego public-private partnerships and fund public projects through traditional government contracting. The solution therefore may be to attempt to learn from

Box 9

Public-private partnerships in Morocco

Morocco uses public-private partnerships to finance infrastructure projects. Since the current King of Morocco ascended to the throne in 1999, the country has signed 16 projects with private participation in infrastructure, with a total value of around $27 billion (expressed at 2015 prices). These have included a number of different models for the involvement of the private sector contributor, such as "build, own, operate", "build, operate and transfer", "merchant" and "rehabilitate, operate and transfer". They have covered sectors including electricity distribution, electricity generation plus water utilities and sewage, information and communications technology and a port. Financing has involved the use of multiple banks (Maroc.ma, 2017; World Bank, 2017b; authors' analysis of World Bank, 2017b; Arab Maghreb Union, interview, 19 May 2017).

In addition, there are several other projects that are financed through a mix of public-private partnerships and international financing (Ministère de l'Economie et des Finances, interview, 17 May 2017). Bilateral development banks and aid agencies have also been involved in some cases (such as the Agence Française de Développement, Japan Bank for International Cooperation, KfW of Germany) (World Bank, 2017b; authors' analysis of World Bank, 2017b; Arab Maghreb Union, interview, 19 May 2017).

the mistakes of the past and do public-private partnerships better, instead of abandoning this funding source. In this regard, a recent report by the World Bank Group and Global Infrastructure Facility (2017) makes recommendations on how best to structure contracts for public-private partnerships, while OECD (2007) provides twenty-four principles intended to help governments attract private sector participation in infrastructural development. African countries can take good note of these recommendations, but should ensure that they have the appropriate institutions, policies and laws in place to enforce the contractual provisions, rather than simply relying on the guidance provided. In this regard, public-private partnerships present a potential additional source of funding for public projects, but also carry significant risks. It will be important for African countries to ensure that they get the details right for their approaches to public-private partnerships.

Indeed, for successful use of public-private partnerships, countries need the institutional capacity to create, manage and evaluate them, which includes project selection, transparent fiscal accounting and reporting, and legal and regulatory frameworks. Blended finance and public-private partnerships are fairly controversial in debates on implementation of the SDGs, with views ranging from the essential need for public-private partnerships in meeting large financing needs, to concerns that public-private partnerships will be used to privatize public services, subsidize the profits of the private sector, and keep investment and contingent liabilities "off balance sheet". Nonetheless, such mechanisms have become increasingly looked to as a method of using official resources to leverage private financing. The Addis Ababa Action Agenda calls for sharing risk and returns fairly, to avoid undue subsidies to the private sector and undue risk for the public sector. Valuing risks and rewards in complex projects is notably difficult, even for governments with strong capacities, and climate risk makes this task more difficult (United Nations, 2017).

Therefore, more in-depth analysis and guidance is required on the conditions under which public-private partnerships can best bring benefits, avoid adverse societal and environmental impacts and advance sustainable development. The Addis Ababa Action Agenda on Financing for Development recognizes both the potential and the challenges associated with public-private partnerships. It notes that "careful consideration should be given to the appropriate structure and use of … blended finance, including public-private partnerships, [and that projects] should share risks and reward fairly, and include clear accountability mechanisms (United Nations, 2017). ECA (2016b) provides advice for African countries on how to make a success of public-private partnerships in renewable energy, building on several case studies from the continent.

5.2.8 Remittances

Remittances are an important source of development finance. Indeed, the amount of remittances in 2015 into developing economies was about three times that of the official aid flows (World Bank, 2016). In Egypt, liberalization of the local currency in 2016 helped increase inflows from Egyptians working abroad. Approximately $4.6 billion was sent from expatriate workers in the fourth quarter of 2016, up 12 per cent from a year earlier (Bloomberg, 2017). According to the Migration and Remittances Factbook 2016 by the World Bank, Egypt became the top remittance receiver in the North Africa and Western Asia regions and among the top ten countries in the world with $20.4 billion each year (World Bank, 2016). Morocco has had similar successes in mobilizing additional remittances through liberalizing exchange controls for members of the Moroccan diaspora. This is reflected in the fact that deposits held in Morocco by Moroccans resident abroad roughly doubled during the period 2002 to 2013. The accounts come with payment or credit cards that can be used for payments in Morocco or abroad. However, the country still struggles to encourage the diaspora to invest the funds remitted (Abdourahman, O. I. interview, 19 May 2017; Ismaili Idrissi, 2015).[4]

Box 10

Mobilizing additional remittances in Morocco

In addition to liberalizing access to foreign exchange for members of the diaspora (as mentioned earlier in the present chapter), Morocco has undertaken a number of initiatives that have increased, or would be expected to increase, the level of funds being remitted to the country. The first of these is the measures taken to improve the business environment, as shown earlier in the present case study. Many studies have demonstrated the importance of the business environment for attracting remittances (cited from Ismaili Idrissi, 2015).

Second, the costs of cash-to-cash remittances have fallen in Morocco and the share by value of remittances being transferred via this method has increased. The third has been to convert the Barid Al-Maghrib into a postal bank, now known as Al Barid Bank, which is likely to have made it more attractive to send remittances via bank transfer. Fourth, Morocco has improved the regulatory environment governing remittances, making it easier for Moroccans living abroad to remit through formal channels (Ismaili Idrissi, 2015).

In addition to the above efforts to make it easier to remit funds, Morocco has also made efforts to encourage diaspora Moroccans to actually invest in the country (funds remitted to Morocco are usually not invested). As regards access to foreign exchange, diaspora Moroccans can freely convert foreign exchange as needed for the conduct of their investments, repatriation of profits or the proceeds of liquidating an investment. They are allowed to borrow dirhams for the purpose of acquiring or constructing buildings in Morocco. They are also allowed to import or export foreign exchange unrestricted, without any limits on the amount being transferred (though cash amounts of 100,000 dirhams or more need to be declared to customs). Diaspora Moroccans may also buy back and export up to 50 per cent of the foreign exchange that they brought into the country and exchanged for dirhams in the previous twelve months, up to a maximum of 100,000 dirhams; amounts kept in convertible dirhams in their bank accounts are excluded from this amount of 100,000 dirhams (ibid.).

The "regional investment centres" described in the earlier section on private sector investment also offer special services for diaspora Moroccans. In addition to the services that are available to all Moroccans, be they from the diaspora or not (as detailed above), the regional investment centres offer particular services to encourage diaspora Moroccans to invest in the country. These include prioritizing responses to requests for information by diaspora Moroccans and efforts to actively inform diaspora Moroccans about investment opportunities, including sending business delegations to their host countries, and producing reports on investment opportunities, alongside other measures. Certain "regional investment centres" have been particularly successful in this regard. The Conseil déontologique des valeurs mobilières (see above) also treats diaspora Moroccans as other Moroccans and gives the same access to information and financial products as is given to other Moroccans. In addition, L'office des changes (the Exchange office) extends to Moroccans in the diaspora the same rights accorded to other Moroccan citizens, including access to credit in dirhams from institutions based in Morocco, as well as the freedom to invest and acquire any kind of equity in Morocco, access to foreign currency for either tourism, religious trips abroad, educational expenses or medical treatment. L'office des changes also provides remittance services (ibid.).

4 In total, Moroccans in the diaspora invested 500 million dirhams in Morocco during the period 2005 to 2011. According to the latest available data on investments by Moroccans in the diaspora (for 2005), 38 per cent of Moroccans in the diaspora invest in their host country (when they could, presumably, be investing the same funds in Morocco) (Fondation Hassan II pour les MRE, cited from Ismaili Idrissi, 2015; Ismaili Idrissi, 2015). What investment there is has been concentrated in the real estate sector, and in smaller projects (only 14 per cent of invested funds are in projects of 5 million dirhams or more) (Ismaili Idrissi, 2015).

Box 10

Mobilizing additional remittances in Morocco, cont.

In addition, the Ministère Chargé de la Communauté Marocaine Résidant à l'Etranger et des Affaires de la Migration (Ministry Responsible for the Moroccan Diaspora Community and Migration) has a section dedicated to assisting investors from the Moroccan diaspora. This section also provides information on the Moroccan economy to potential investors from the Moroccan diaspora, and supports investors from conception to realization of their investment projects and to identify and help to establish partnerships between actors based in Morocco and the diaspora (ibid.). In 2007, Morocco created Le Conseil de la communauté marocaine à l'**étranger** (the Council of the Moroccan community abroad) which is responsible for monitoring and evaluating Moroccan public policy regarding the Moroccan diaspora.

In 2009, the Government of Morocco and the Caisse Centrale de Garantie (Central Guarantee Fund) created "MDM invest", a fund designed to co-finance (and therefore incentivize) investments by Moroccans in the diaspora. The fund was reserved for projects promoted solely by Moroccan investors. Through the fund, for investments of at least 1 million dirhams where the Moroccan diaspora investor would invest at least 25 per cent (in foreign exchange) of the value of the project, the government would provide a 10 per cent subsidy (capped at 5 million dirhams maximum), with the financing of the remaining balance flexible. However, by 2015 the fund had not achieved the expected level of interest from Moroccans in the diaspora, financing only 21 projects with a total contribution from the fund of 140 million dirhams plus an additional 14 million dirhams in subsidies (ibid.; Ministère Chargé de la Communauté Marocaine Résidant à l'Etranger et des Affaires de la Migration, 2017).

The reasons for the lack of success of this fund include the obligation for investors to use their own funds and the general challenges of investing in Morocco, including bureaucracy. In response, the fund was closed at the end of 2011, but re-launched in April 2013 with new rules. In particular, the rule that investment projects would be eligible only if promoted solely by diaspora Moroccans, was relaxed, and in its current form the fund allows investments by diaspora Moroccans even if they are joint projects with non-Moroccan investors (though there must be at least one diaspora Moroccan promoting the project). The financing proportions allotted to the diaspora Moroccan investor and the fund itself (as detailed above) remain the same as in the fund's first iteration (ibid.; Ministère Chargé de la Communauté Marocaine Résidant à l'Etranger et des Affaires de la Migration, 2017).

La fondation Hassan II pour les MRE (Hassan II Foundation for the Moroccan diaspora) also aims to maintain links between Morocco and its diaspora. Since 2002, the foundation has been planning to sign an agreement with the International Organization for Migration to develop an observatory of the Moroccan diaspora community. The observatory provides information and analysis that support better decision-making with regard to the Moroccan diaspora (and could potentially help Morocco to mobilize additional funds from members of the diaspora) (Ismaili Idrissi, 2015; Groupe Banque Populaire, cited from Ismaili Idrissi, 2015).

Aside from investment per se, Morocco has also been successful in facilitating philanthropy on the part of Moroccans in the diaspora. For example, in the health sector, government guidelines for medical equipment and nursing staff shaped the design and construction of a medical centre funded by Moroccan diaspora philanthropy. The government also "collaborated with migrants and their communities of origin to design better and cheaper systems to deliver basic infrastructure, such as roads and electricity, to rural areas; once supplied with services that linked them to the rest of Morocco, formerly isolated villages were brought into the national economy" (Iskander, 2010).

International remittances form the major share of development financing in Ethiopia, surpassing merchandise exports in recent years. In 2015, with $0.6 billion inflows, Ethiopia was among the top ten largest recipients of remittances in Africa (World Bank, 2017). The actual remittance inflows to Ethiopia could be higher than that reported by the National Bank of Ethiopia since informal remittances are known to be used (Government of Ethiopia and UNDP, 2017). The country has been able to significantly boost incoming remittances by allowing the diaspora to open foreign currency accounts that they can use as collateral for loans in domestic currency (ECA, 2016a, p.51).

In Ghana, remittances have become a significant and important source of external finance. In 2015, with $2.0 billion inflows, Ghana was the second largest recipient of remittances in Africa. Remittances, together with gold, cocoa and the tourism, are the country's top forex earners.

In South Africa, the domestic remittances market has over 24 million people who send and/or receive money locally, which translates to two-thirds of the adult population. Mainly driven by the high number of domestic migrants within the country, the total volume is estimated to be between $11 billion and $13 billion, equivalent to 4 per cent of GDP and six times as large as the flows of international remittances out of South Africa (TechnoServe, 2016). Since 2006, there has been an explosion of diverse products by retailers, banks and mobile operators targeted at remittance users which the recipient can retrieve from an ATM with an access code and PIN or partner retail outlets. In contrast to international remittances, regulatory issues have not emerged as a major barrier to the introduction of low cost offerings for domestic remittances.

In addition, the authorities of the member States of the Southern African Development Community recently made regulatory changes that have allowed new remittance providers to enter the market, with promising results. In particular, at the level of the Southern African Development Community, in the 2013-14 regulatory change cycle, financial regulatory authorities created a new licensing category for money transfer operators. This enabled facilitation of cross-border transactions independent of a bank. This change has enabled non-bank formal providers to enter the market with an explicit focus on providing cross-border remittance services to serve Southern African Development Community member countries. According to Eighty20 (2016), four institutions had been registered under this new regulatory category at the time of writing, facilitated by the growing consumer adoption of mobile platforms that are leveraged to provide efficient money transfer services (Eighty20, 2016).

The cost of money transfer is a major constraint to remittances and tends to entice the use of informal channels. An international agreement to reduce remittance transfer cost to 3 – 5 per cent by 2030 is expected to promote faster and safer transfer of remittances. It will also enhance accuracy of statistics on remittances. The inflow of remittances could be enhanced through, among others, allowing additional operators to play a larger role in money transfers (for example, microfinance institutions) and opening bank branches or setting up money transfer agents in areas where there is a large diaspora concentration. Promoting offshore banking for local banks will ease money transfer, even at a reduced cost.

In addition, the countries reviewed in these case studies have had difficulties in encouraging individuals to invest remittances, despite explicit efforts to do so (this is evident for Morocco, see Ismaili Idrissi, 2015). In the African context, this may be because of the continent's low income level. In general, countries with low incomes have low saving rates (which is true in Africa), presumably because earnings need to be used for consumption, which may also be frustrating efforts to encourage saving remittances. Nonetheless, African countries may be able to mobilize more remittances for investment, by using the banking sector. If African countries can encourage remittances to be sent through formal channels (as Egypt and Morocco have successfully done) and stored in bank accounts while they are gradually used up by the recipients of the remittances, the banking system should in principle be able to channel a portion of these funds into investments. However, doing so will require African countries to address the continued challenge of excess liquidity in their banking sectors. Another approach to better mobilize remittances is to launch innovative financial products such as diaspora bonds, as detailed in the previous chapter (and as noted in AU and ECA, 2015). There is also the approach of Ethiopia of allowing remittances to be used as collateral for loans in domestic currency.

5.2.9 South-South cooperation

South-South cooperation can be an important source of development finance for African countries. Indeed, the role of emerging economies as trading partners, investors and providers of development cooperation has substantially increased over the past decades. South-South cooperation follows a broader approach than cooperation from traditional donors. It usually goes beyond the provision of aid and is framed as part of a larger set of initiatives that can include trade and investment agreements. This has the potential to capitalize on economic strengths of recipient countries by supporting the reduction of transaction costs (Lin and Wang, 2017). Other developing regions, including Latin America, already benefit from South-South cooperation. Indeed, recent evidence shows that all Latin American countries benefit from funds or other assistance through South-South cooperation. This has included both bilateral South-South cooperation and triangular South-South cooperation (ECLAC, 2015).

A number of African countries like Ethiopia, Ghana and Nigeria have some project relationships with China. Indeed, Ethiopia maintains strong development cooperation with many non-traditional donors such as Brazil, China, India, Kuwait, Saudi Arabia, Turkey and the United Arab Emirates. It has also developed strong relations from traditional donors, namely Japan and the Republic of Korea. Since 2011/12, Ethiopia has mobilized $1.75 billion through official assistance from China, India, Kuwait and Saudi Arabia. The financial assistance from these countries is mainly in the form of loans ($1.74 billion) with a small grant element ($8.2 million). China is the main source of financial assistance to Ethiopia (with $1.3 billion in loans and $8.2 million in grants between 2011/12 and 2016/17). Ethiopia also receives concessional loans and grants from Southern multilateral institutions, mainly from the African Development Bank (AfDB), the Arab Bank for Economic Development in Africa and others. The African Development Bank has remained the main source of financial support, both in the form of grants and loans (Government of Ethiopia and UNDP, 2017).

Official development flows from donors that are not members of the OECD Development Assistance Committee to Ghana have generally been on the rise, although they remain small compared to traditional official development assistance flows. The most important non-traditional donors to Ghana are Brazil, China and India. The presence of China in Ghana has been growing over time, with a diversified set of instruments including interest free loans, resource-backed loans, export buyer's credit, grants, debt relief, and cultural and education exchanges, and they have recently been shifting from interest-free to concessional and non-concessional loans. Ghana has also had major access to Chinese credit lines for some time, but take-up has been slow. On the other hand, the presence of Brazil in Ghana is modest, with agriculture as the main area of collaboration (both financial and technical assistance) between the two countries. Although official development assistance flows from other non-traditional development partners have been increasing, the volume remains low (ibid.). As South–South cooperation is an increasingly important source of advanced technology and skills, it can contribute towards building a strong local manufacturing sector for Ghana or in areas that will contribute to reducing unacceptable high import bills (Addo, 2016).

However, in order for such cooperation to be mutually beneficial, African countries must rely on their experts to provide the appropriate framework for the relationships. It is necessary to set goals and strategies for the cooperation but many African countries lack the required expertise. In this case, African regional or continental institutions like the African Union, ECA and the African Development Bank can combine efforts to produce a blue print for such economic cooperation.

5.3 Conclusion

This chapter has underscored examples from the case study countries (and elsewhere) as to how traditional sources of finance can be innovatively developed and applied. The major ingredient to achieve this was from the preceding chapters that contain existing literature and the experiences of the case study countries. Thus, the content of this chapter underlines a range of strategies that could enable African countries to innovatively mobilize additional finance for development from traditional sources and emerging innovative sources within and outside Africa.

In terms of mobilizing additional private finance, we can note the importance of several strategies: the use of state-owned development banks to provide additional liquidity; improving mechanisms for channelling liquidity from savers to borrowers; connecting isolated producers to international markets; and improving the ease of doing business to attract foreign investors, whether through better logistics services, reforming regulations or providing assistance to foreign investors through information centres to support their investment.

In addition, there are a number of techniques that this section has shown can be used to mobilize additional public finances. These include steps to improve tax administration; steps to eliminate non-strategic tax incentives, and to monitor, evaluate and remove those that have already been granted; steps to coordinate blended financing packages among multiple lenders; steps to encourage additional official development finance and loans from development finance institutions by strategically positioning the country as one to which donors will wish to send funds. Yet most of these approaches also come with challenges. In order to make the most of them, African countries will have to make sure that the appropriate institutions (with appropriate capacities), laws and policies are in place. Furthermore, for public-private partnerships and blended finance, for example, countries must not only try to mobilize additional finance for development projects, but ensure that the terms of this financing are favourable and that the project is really in the interest of the public.

It is clear that a number of the innovative financing models have neither been adopted nor adapted by many African countries. This is not unexpected in view of factors such as the level of development of the financial system, level of sophistication of the economy, availability of required expertise, database and requirement, general information about the existence of some of these innovative financing models and the modus operandi, among other factors. On this note, the conclusion and policy recommendations presented in the next chapter will address some of these issues.

Chapter 6: **Conclusion and policy recommendations**

6.1 Summary and conclusion

In line with the positions held consistently by ECA, the present report makes a strong case that the mobilization of domestic resources efficiently, effectively and innovatively should be of paramount importance to African countries, in order to meet the transformation objectives of Agenda 2063 and the goals of the 2030 Agenda.

In fact, the financing needs relating to the implementation of the SDGs and Agenda 2063 are enormous. For instance, new frameworks for development finance are required as a result of Africa's investment gap to achieve the SDGs which is between an incremental outlay of $200 billion and $1.2 trillion per annum. Thus, innovative financing is presented as a new or alternative way of raising funds to fulfil the objectives of the two Agendas. Innovative financing encapsulates new approaches which consist in the redesigning of old mechanisms or the designing of entirely new mechanisms, with the appearance and contribution of a new set of stakeholders, such as the private sector.

Since then, the global development finance landscape has evolved with a shift from a model centered on official development assistance, foreign direct investment and external debt, among others, to a framework with greater emphasis on the mobilization of domestic resources. Nevertheless, the mechanisms for innovative financing are meant to compliment these traditional international flows in order to annex additional resources for development and address specific market failures and institutional barriers.

These mechanisms englobe the innovative market-based financial instruments that tend to leverage on remittances and the wealth of the diaspora; the results-based financing opportunities that allow private companies and non-governmental organisations to provide social goods; and the voluntary and compulsory contributions mechanism of financing with the voluntary carbon market as the largest mechanism within this category.

The report shows how a combination of initiatives and innovative financing are now being employed to leverage and supplement existing sources of development financing. More specifically, with the private sector and public financing and investments moving beyond their traditional sectors, and leading to private sector development financing, donor funding, a mix of public and private financing, and debt and equity instruments.

The report reviews new innovative approaches to funding, as well as innovative approaches to mobilizing traditional sources of finance adopted in the developed economies, the leading emerging economies and the developing economies, and assesses their relevancy in the African context. The case studies address the innovative funding mechanisms in five African countries, namely, Egypt, Ethiopia, Ghana, Morocco and South Africa.

Some of the innovative financing methods used in the developing economies include: impact financing, diaspora bonds, pension funds and infrastructure bonds. In addition, Africa has also been experiencing the use of online alternative finance, microfinance, as well as co-financing with development banks and blended finance, which are meant to share lending risks among credit participants. Lessons learned from the case study countries show that public-private partnership, issue of Eurobonds, financial inclusion and infrastructure financing have been widely used for financing long-term projects. While some African countries are exploring the option of innovatively tapping into the wealth and savings of the diasporas to bridge financing gaps, Ethiopia launched its second attempt to use this method in 2011, and Egypt is in the preliminary stage of employing the diaspora funding approach. Regarding the pension fund scheme as a means of funding long-term projects, South Africa is in the lead, while Morocco and Ghana follow but Ethiopia needs to do much more to raise long-term funds through the pension scheme.

The report also underlines a range of mechanisms that could enable African countries to innovatively mobilize additional finance for development from traditional and emerging innovative sources. A number of the innovative financing models have neither been adopted nor adapted by many African countries. This is not unexpected in view of the different levels of development of the money and capital markets, the cultural differences, the limited array of financial instruments available to African countries, the availability of required expertise, among other aspects. Furthermore, the use of some of the innovative financing mechanisms adopted by the developed and emerging economies are yet to be fully standardized for sustainable use in the developing economies.

The following recommendations are presented to generate creative thinking among African policymakers, governments, donors and supporters that will enrich existing knowledge of innovative financing sources.

6.2 Recommendations

Meeting the financing needs to achieve the 2030 Agenda for Sustainable Development and the Agenda 2063 will require African countries to take a more strategic and holistic approach to mobilizing and fostering financing. Public and private investment would be sufficient – but only if financial resources are invested in and aligned with national priorities. This requires a comprehensive approach, which mobilizes public finance, sets appropriate public policies and regulatory frameworks, unlocks the transformative potential of citizens and the private sector, and incentivizes changes in consumption, production and investment patterns in support of sustainable development.

This report supports the call for comprehensive tax reforms that promote investment and diversify the economy in order to achieve economic transformation and inclusive growth (ECA, 2017). African countries should widen their tax income through effectiveness in tax collection and efficiency in widening the scope of tax generation. Financial transaction tax on domestic financial transactions should be put in place to represent an additional source of raising finance for sustainable development in Africa. More tax revenue would not only help the governments of African countries function and pay for goods and services, but would also open the way for other market and state reforms that would promote economic, social and environmental development. Accordingly, the issues of accountability and transparency in the use of taxes collected are important for voluntary tax payment by citizens.

African countries should look to mobilize additional private finance for public projects and also consider using public finance in private investment (for example through national development banks, subsidizing semi-social projects). In this way, they can go beyond the historical blind spots of development finance and mobilize additional finance for key national projects, whether they are in the public or private sectors. They can also benefit from this wider range of financing methods for different projects to select the method that is most appropriate.

Yet at the same time, as this report shows, there are challenges to bridging the gap between the public and private sectors in development finance, notably when it comes to getting the private sector to finance public projects. This is because the long-term duration of many public investment projects, as well as limited revenues that can be used to compensate the private sector for its investment, can make it challenging to offer attractive terms to private investors investing in public projects.

Since remittances have become a major segment of financial flows and second to major raw material exports as sources of foreign exchange for many of the African countries, there must be major policies in place towards proper channelling and coordinating of their flows and uses. Towards this, efforts should be made to encourage the direct investment of the remittances in the real sectors to jump-start massive economic growth in Africa. Also, issues of diaspora bonds should be encouraged as a means of innovative finance in Africa because this avenue has not been widely employed being a veritable means of funding public and private investment and business concerns.

Despite the potentials to raise a large amount of funds, the report reveals that many African countries have not benefitted from diaspora bonds for example. African countries need robust analytics on their diaspora members, credit enhancements to entice overseas nationals to invest and trustworthy government institutions which protect the interest of the bondholders. There is a particular need for relevant instruments to help African countries to improve the financial literacy and regulatory environment through technical assistance, reform programmes and institutional support. The main Pan-African institutions could help by providing the expertise to: provide reliable demographic data; customize regulatory framework by lowering the cost of compliance across multiple jurisdictions and speed up the regulatory approval process as suggested by many studies.

There is the need to provide regional models or programmes to support national efforts aiming at mobilizing domestic resources creatively and attracting foreign investment. These efforts should be well coordinated and supported by effective institutional frameworks.

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