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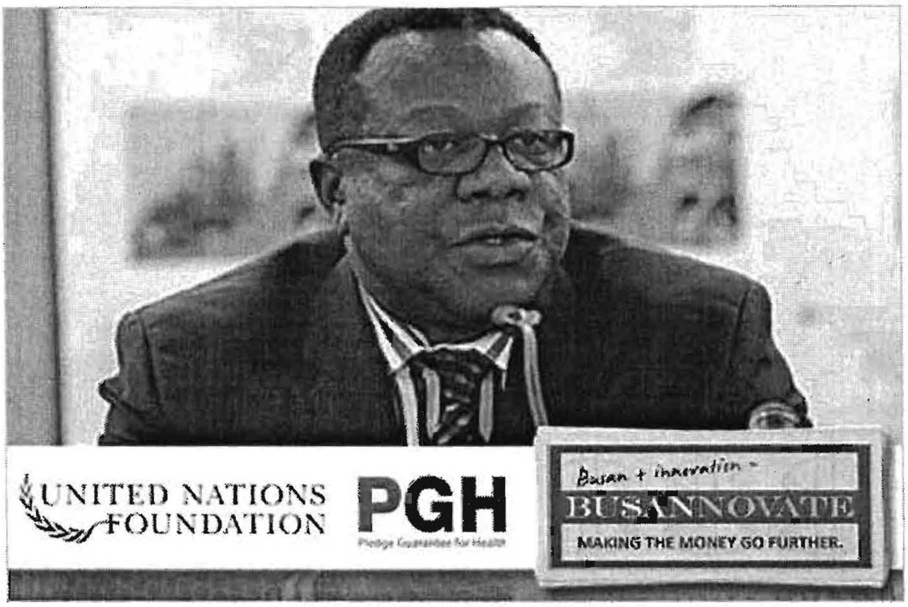
Innovative Financing for Development: Opportunities and Policy Options for Africa

By Emmanuel Nnadozie on 28 November 2011



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The central role finance plays in development is well-known in the development literature. So too are the challenges African countries face in mobilizing internal and external financial resources to transform the structure of their economies, unleash high and sustained levels of economic growth, create jobs and achieve their development potential. Indeed, mobilizing domestic and external finance is critical to Africa's investment needs. Hence, the need for African countries to raise sufficient financial resources to accelerate and sustain growth and achieve their development goals, including the Millennium Development Goals (MDGs), has been widely acknowledged in various circles. However, over the years, the existing traditional sources of finance — both domestic and external — have proved inadequate in satisfying these financial requirements. For example, the 2010 World Bank Africa Infrastructure Country Diagnostics Report estimates Africa needs more than $90 billion annually to develop its infrastructure, but has managed to raise only about half of that — mostly from domestic sources.

The global crisis threatened to reverse earlier advances, as African countries experienced weaker export revenues, lower investment and growth rates, and shrinking remittances and FDI flows. Further, climate change is already having and will continue to have severe economic consequences for Africa with far-reaching impact on growth and poverty reduction. Adapting to the impact of climate change will be costly to African countries and is projected to cost them anywhere between $25 billion and $50 billion dollars a year, increasing pressure on development budgets.

Nearly 10 years after the adoption of the Monterrey Consensus by the Heads of State and Government at the International Conference on Financing for Development and four years before the 2015 MDGs target date, available evidence indicates the majority of African countries will not meet the goals if current financing trends continue. Since 2002, achieving the targets set under the Monterrey Consensus on Development Financing has proved to be a challenge. Within the context of domestic resource mobilization, the performance of both tax revenue and savings remains below the Monterrey expectations. Tax revenue remains less than 15 percent of GDP for a quarter of sub-Saharan African economies. Similarly, gross savings for Africa (excluding

North Africa) declined from a decade-high of 24.2 percent of GDP in 2006 to 19.8 percent in 2010, which is comparatively much lower than other developing regions such as Developing Asia (44.9 percent), and Middle East and North Africa (34.8 percent) in 2010. Further, although external private capital inflows to Africa have increased over the past decade, they have fallen short of the required targets.

Notwithstanding this worrisome picture, significant progress has been made in debt relief and access to international resources, although much less in domestic resource mobilization, foreign aid and international trade. Mobilizing domestic resources should be the answer to the challenge of development finance in Africa. Unfortunately, as shown earlier, the reality is there is a significant investment gap despite commendable efforts to mobilize investment finance across the continent. Indeed, the issue of enhancing domestic resource mobilization attracted the attention of African policymakers long before the Monterrey Consensus. As the Economic Commission for Africa's "Economic Report on Africa 2011" points out, this is mainly because eventual dependence on domestic financial resources will help to achieve and sustain high growth rates, in addition to giving African countries greater policy space and ownership of their development agenda.

The situation calls for new and innovative ways to mobilize additional financing that can provide African countries with increased resources for development. Innovative financing refers to a range of nontraditional mechanisms to raise additional funds for development through innovative projects such as microcontributions, nontraditional taxes, public-private partnerships and market-based financial transactions. The following issues relating to innovative financing are examined further: the potential for innovative financing, the potential sources of innovative finance and policy options.

The potential for innovative financing

The recent global financial crisis underlined the fact that African countries face significant exposure to the current sources of external finance and the need to find other more sustainable, predictable and complementary sources. Given the heavy reliance on overseas development assistance by a number of African countries, the crisis exposed the risks associated with its volume and volatility. Consequent to the global crisis, foreign direct investment declined from a peak of $73 billion in 2008 to about $53 billion in 2010. This is a wake-up call for Africa to look to new and more resilient sources of external finance.