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Innovative Finance and Economic Development in Africa; what are the constraints, policy options and opportunities?

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Abstract
Innovative finance performs a vital function in the advancement of socioeconomic activities and this is renowned in development literature. This research investigates the influence innovative finance has on Africa's development with the focal point on potential sources of innovative finance, constraints of innovative finance, potentials for innovative financing and policy options. The Africa economy has been affected negatively due to the 2008 global economic and financial crisis, climate change and the current COVID 19 pandemic as numerous nations in the continent are experiencing reduced export earnings, insufficient growth rates, inadequate investment opportunities, dwindling remittances and decreasing inflow of foreign direct investment. Therefore, there is the need for African economies to source for sufficient internal and external financial resources to increase economic growth as well as realise their development goals, which includes the Millennium Development Goals and the Sustainable Development Goals. Certainly, innovative finance is significant to Africa's investment needs. Based on this, it was proposed that African leaders and governments ought to increase their potential sources of innovative finance, as well as endeavour to tackle the constraints that hinder innovative finance for development of the continent.

Keywords: Innovative Finance, Development, Investment, Africa, Financial Crisis
JEL Classification: F39, O19, O31

1. Introduction

The role finance plays in the growth and development of the African continent cannot be overemphasized. So too are the difficulties African nations encounter in mobilizing domestic and foreign financial resources to rapidly transform their economies, create adequate and sustained levels of economic process , generate additional jobs also as realize their development potentials. Certainly, mobilizing internal and external finance is vital to meet the investment requirements of Africa. For this reason, it is essential that African nations generate adequate financial resources to speed up and sustain economic growth as well as accomplish their developmental goals that have been extensively recognized in numerous spheres

(Mukeredzi, 2015). Nonetheless, over the years, the obtainable conventional finance sources, both local and foreign have shown to be insufficient in fulfilling these financial prerequisites. For instance, it is approximated that the African continent needs in excess US$90 billion yearly to build up and develop its infrastructures as well as amenities, but has only succeeded in raising roughly half of it, and mostly from internal sources (World Bank, n.d.).

Presently, the COVID 19 pandemic has overturned previous improvements, as African economies are experiencing lower export earnings, inadequate growth rates, insufficient investment opportunities, dwindling remittances as well as decreasing inflow of foreign direct investment (United Nations Conference of Trade and Development, 2021). Furthermore, the 2008 global economic and financial crisis as well as climate change before now had and will keep on having stern economic impacts on African nations with wide-ranging effect on their development as well as increasing the level of poverty (Nnadozie 2011). Several studies believe that, African economies might find the cost of climate change expensive, since it might cost them roughly US$ 20-30 billion per annum for over the next 10 to 20 years, which can lead to increased pressure on their development budgets (African Development Bank & African Development Fund, 2011).

Table 1: Tax Revenue for Sub Saharan Africa, Europe and Central Asia

Years	Sub Sahara Africa	Europe and Central Asia
2014	18.92	19.49
2015	18.65	19.26
2016	18.18	19.17
2017	18.94	19.34

Source: World Bank, n.d.

Five years after the adoption of the Addis Ababa Consensus by the Heads of State, Government and High Representatives at the International Conference on Financing for Development and five years after the 2015 MDGs target date, obtainable evidence shows that the majority of African economies cannot achieve their MDGs and SDGs if the present financing trends persists. Since 2015, realizing the goals set by the Addis Ababa Consensus on Development Financing has shown to be a difficult task. From the perspective of raising domestic public resources, tax revenue (% of GDP)s , broadening the tax base, strengthening tax administration, tax evasion, corruption and reducing illicit financial flows by 2030 remains below the Addis Ababa expectations. For instance, tax revenue (% of GDP) for Sub-Saharan African economies is lower than that of Europe and Central Asia (World Bank, n.d.). Also, the CPIA transparency, accountability and corruption in the public sector for Europe and Central Asia are better than what is obtainable in Sub Saharan Africa. This is illustrated in tables 1 and 2.

Despite this perturbing picture, major improvements have been accomplished in debt relief as well as access to global resources, though lot less in domestic public resource mobilization, aid and international trade. Mobilizing domestic public resources ought to be the key to unlock the challenge of development finance African economies encounter. Regrettably, as previously illustrated, the truth is that there exists a momentous venture gap regardless of the laudable endeavours to mobilize investment finance across the African continent. Certainly, improvement of public resource mobilization locally has gotten the interest of African macroeconomic policymakers' way earlier than the Addis Ababa Consensus. The United Nations Economic Commission for Africa's Economic Report on Africa 2019 reveals that a well-organised domestic public resource mobilization can address a considerable part of this financing shortfall, assist to achieve and sustain high growth rates and creates prosperity for all. Additionally, it will give African nations better macroeconomic policy space as well as possession of their development agenda. This state of affairs requires novel and ground-breaking means of mobilizing additional finance that is capable of supplying African economies with resources that will enhance their growth potentials.

Table 2: CPIA Transparency, Accountability and Corruption in the Public Sector for Sub Saharan Africa, Europe and Central Asia

Years	Sub Sahara Africa	Europe and Central Asia
2014	2.73	2.70
2015	2.71	2.60
2016	2.68	2.60
2017	2.65	2.60
2018	2.71	2.60
2019	2.72	2.60

Source: World Bank, n.d.

Numerous studies on innovative finance have focused on what the concept is all about, why it is needed and its evolution. This study not only discusses all these but in addition, looked at the following issues that relate to innovative financing: the potential sources of innovative finance, constraints of innovative finance, the potentials for innovative financing as well as policy options. This study is significant to various governments in Africa, macroeconomic policy makers, various development institutions, academics and the general public.

2. Literature Review

Conceptualization

Innovative finance for development denotes different things to different people. Presently, innovative finance for development includes a lot of diverse initiatives. The Leading Group on Innovative Financing for Development (2012) sees innovative financing for development as financial solutions to development challenges that are not adequately dealt with by conventional aid flows. According to innovative financing consists of: 1) innovative sources which assist in generating modern budgetary streams for economic improvement that might emanate from different financial segments; 2) innovative machineries that assist in maximizing the effectiveness, effect as well as leverage of obtainable resources. Innovative financing is a used to explain financing methods dealing with development issues that are inadequately tackled by conventional aid flows and which might attempt to leverage extra financing and/or try to offer financing promptly, efficiently and with more dependable and greater influence (Gelil, 2018). According to Sandor (2011), the Organisation for Economic Cooperation and Development (OECD) defines innovative financing for development as instruments for increasing funds or persuading activities in encouraging international development that exceed conventional expenditure methods. Its features include: 1) authorised sector participation 2) cross-border transfer of resources to developing economies; 3) mobilise additional finance; and 4) functional.

The United Nations (2012) opines that innovative financing for development include initiatives with these features: 1) authorised sector involvement; 2) cross-border transfer of resources to developing nations; and 3) innovation, in the sense that mechanisms are utilised in a new context or incorporate innovative characteristics with respect to conventional finance. Nnadozie (2011) asserts that a variety of nonconventional means employed to supplement additional funds for development via innovative projects/schemes such as market-based financial transactions, nonconventional taxes, micro contributions and public-private partnerships (PPP) is termed innovative financing.

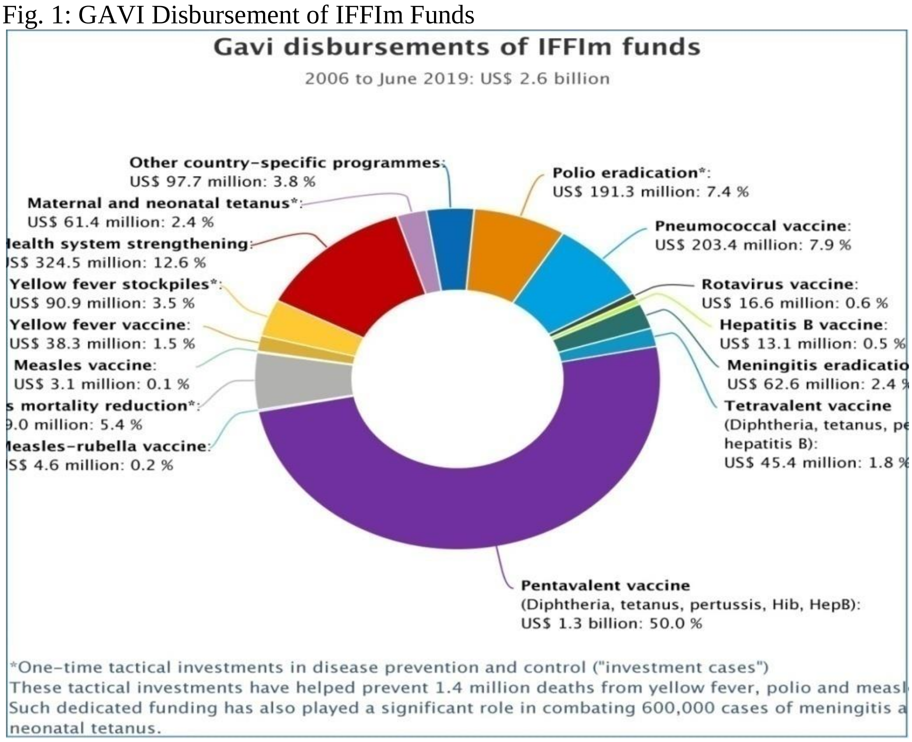
Financing method that assists to: 1) create supplementary development funds as a result of utilising novel sources of funds (e.g. by looking further than budget expenditures) or by attracting new partners (e.g. up-and-coming donors, private sector); 2) improve the effectiveness of financial flows, by lessening costs and/or time of delivery; 3) capable of making financial flows more efficient, through clearly connecting flows of funds to assessable feat on ground. Such financing apparatus can be termed innovative financing for development (World Bank, n.d.). Guarnaschelli et al. (2014) indicated that innovative financing denotes different things to different persons. From their survey, we could see two different aspects of innovative financing. The first aspect concentrates on innovative financing as the capital base which adds to flows that are accessible, specifically that of governments and non government organisations. This thought implies that innovative financing supplies finance that are secure, conventional as well as complementary to Official Development Assistance (ODA) from donor nations. The focal point of the second aspect is on innovative finance as a utilization of capital. This aspect centres on the various methods in which innovative financing enables the efficiency of development initiatives, economical and useful by enhancing liquidity, reallocating risk as well as harmonising the gestation period of investments with project requirements. Their opinion is that innovative financing procedure for development includes both aspects: methods to mobilize resources as well as enhance the efficiency/effectiveness of monetary/financial flows that tackles environmental and socioeconomic challenges globally.

3. Potential Sources of Innovative Finance

Thus far, innovative finance for development initiative funds mobilised sums up an average of US$2 billion annually. This is a small percentage (approximately 14.29%) of the sum allocated as ODA in 2012 (United Nations, 2012). Also, the United Nations' ball park figure entails that more than US$600 billion could be mobilised annually, that is five times as much as ODA in 2012 (United Nations, 2012).

A development cooperation report on mobilizing resources for sustainable development by OECD in 2014 showed that the International Finance Facility Immunisation funds (IFFIm) has offered huge amount of cash for immunisation programmes by putting up for sale vaccine bonds in capital markets sponsored by long-term pledges from suppliers of development co-operation. As a result of the World Bank managerial assistance, bonds offered in the international capital markets by the IFFIm are to be paid back from ODA allocations. According to Nnadozie (2011), the IFFIm has raised in excess of US$3 billion for immunization programmes. The advantages of IFFIm are demonstrated by the use of US$ 535 million in proceeds from IFFIm bonds to finance strategic purchases in special disease areas, identified as investment cases. This assisted in preventing 1.4 million deaths from yellow fever, polio and measles. Also, such dedicated funding played an important role in fighting 600,000 cases of meningitis and maternal and neonatal tetanus (International Finance Facility Immunisation Funds, n.d.).The Global Alliance for Vaccines and Immunizations (GAVI) has led the effort to vaccinate in excess of 760 million children from 2000–2019, saving over 13 million lives in the long run. With no funds from the IFFIm. All in all, US$2.6 billion has been disbursed to assist in purchasing as well as delivering vaccines to 71 developing economies (International Finance Facility Immunisation Funds, n.d.). Fig 1 below shows GAVI disbursements of IFFIm funds.

Fig. 1: GAVI Disbursement of IFFIm Funds



Source: *International Finance Facility Immunisation Funds, n.d.*

The International Drug Purchasing Facility (UNITAID), is an international health initiative set up by the governments of United Kingdom, France, Brazil, Chile, Norway in 2006 to provide sustainable financial support for diagnostics, medicines and prevention for tuberculosis, malaria and HIV/AIDS. The main source of UNITAID's income is the international solidarity tax on airline tickets. According to UNITAID's 2018 – 2019 annual report, it has committed US$1.3 billion to make tuberculosis, malaria and HIV/AIDS treatments more affordable; it has increased its grants to recipient countries from 28 in 2014 to 48 in 2018; it has carried out in excess of 60% investment with focal point on antimicrobial resistance. UNITAID and partners have brought unused, reasonable HIV medications to Africans in just three years, three times quicker than the past eras of antiretroviral. Additional decrease in prices will assist the global health response save US$300 million annually. In July 2018, UNITAID invested US$26 million in two projects led by the MTV Staying Alive Foundation and Solthis to increase Africa's HIV self-test and jointly collaborated with a distinct group of to launch the MenStar Coalition, an endeavour to increase the diagnosis and treatment of HIV in men, especially in Sub-Saharan Africa. Furthermore, in February 2019, UNITAID invested US$59 million in two innovative projects to corner malaria-carrying mosquitoes (The International Drug Purchasing Facility, n.d.).

The 2015 United Nations Economic Commission for Africa and the Organisation for Economic Co-operation and Development (UNECA & OECD) Mutual Review of Development Effectiveness in Africa: Promise and Performance Report showed that the present levels of climate finance to Africa excluding North Africa are mainly inadequate to meet the regions adaptation requirements approximated to be US$ 7 – 15 billion yearly by 2020. Based on Climate Fund Update, the 20 bilateral and multilateral climate funds effective in Africa excluding North Africa have a cumulative total of US$ 2.3 billion from 2003 – 2014. Bilateral climate related-development finance commitment to Africa average US$ 5.6 billion annually from 2010 – 2013 (United Nations Economic Commission for Africa & the Organisation for Economic Co-operation and Development, 2015)

In order to facilitate additional external private capital, numerous means have either been proposed or put into practice. For instance, African nations can utilise new financial sources from the population of their citizens residing overseas by issuing modified financial instruments and/or making available a structure that encourages remittances. According to Shimeles (2010), Africa approximately received US$37 billion net remittance inflows in 2010 and considering its effect on the economy, remittances make up in excess of 5% of GDP in no less than 12 African nations in 2009.It is approximated that Sub-Saharan African economies are likely to raise a minimum of US$23 billion by cutting the cost of international migrant remittances, issuing diaspora bonds, and securitizing future remittances as well as other future receivables (Nnadozie, 2011).

4. Constraints of Innovative Finance

There are some constraints that hinder innovative finance and addressing them could bring a substantial increase from the currently projected US$24 billion annual growth trajectory. They include:

Demand Constraints- Inadequate investment in financing designs restrict innovation and raises the costs connected with bringing in new instruments. Generating new innovative financing mechanisms particularly mechanisms with no track records can be extremely expensive. The GAVI Alliance, for instance, gave over US$30 million to the Pneumococcasl Vaccines Accelerated Development and Introduction Plan (PneumoADIP) to develop the business case for the Pneumococcal AMC. It took decades of grants and concessional finance before microfinance became a market able feasible investment. Designing new mechanisms also requires a considerable amount of time. For example, it took more than two years for the World Bank, the UK Government, Goldman Sachs, as well as lawyers for GAVI to collaborate in designing the IFFIm. Similarly, in spite of having assurances from the Norwegian government and Gates Foundation, the Global Health Investment Fund, initiated an impact investing fund that assists research and development for new vaccines. They used more than two years in raising capital. Innovative financing mechanisms frequently fail to function efficiently and achieve their potential in the absence of major upfront assistance.

Supply Constraints– Not many organisations have the capability, authorisation or experience with innovative financing mediums required to make new products or to assess the risks of the ones that exists. Large organisational investors have a duty to accomplish risk-adjusted returns that align with the expectations of investors. While a lot of large investors accept as true that responsible investing can generate financial returns and cut reputational risk, they are not eager to give up financial return in place of social benefits. This unwillingness limits the provision of capital to opportunities where financial and social returns are connected. From a public sector viewpoint, a lot of big donor organisations do not possess the legal right and institutional incentives to engage in innovative financing programmes. Numerous donors make investment decisions on the basis of yearly appropriations, which restrict their capability to make long-term obligations. In addition, they frequently do not have the right to create investments with contingent liabilities. Whereas multilateral financial institutions (e.g. the World Bank) and bilateral institutions with a private sector authorisation (e.g. the CDC group in the UK) have better flexibility, innovative financing remains a comparatively small part of government assistance.

The sponsor of innovative financing products failure to connect with a large part of the financial sector also hinders capital and expertise. Specific suppliers of financial services, such as private banking and private equity, have presented microfinance investments as well as impact investing. On the other hand, other types of financial institutions, for instance, pension fund managers as well as insurance companies have simply looked at innovative financing in a limited capacity. Also, within financial institutions, there has been not much meeting with the risk assessment and credit departments to be taught how to assess new innovative financing mechanisms. This inadequate participation hinders the supply of capital and does not utilise the departments’ expertise, which is essential to create and develop new products.

Intermediation Constraints– Inadequate liquidity, performance, data as well as standards metrics makes it hard for investors to evaluate the opportunities of innovative financing. Apparent, inclusive, and credible performance information will permit profitable investors to partake in the market. For instance, in the case of microfinance and green bonds, the accessibility of consistent information concerning the mechanisms' financial performance has allowed investors to take part in these markets. Though, it is not easy to collect this information for a lot of other types of innovative financing mechanisms. Furthermore, while institutions such as the Global Impact Investing Network (GIIN) have made substantial attempts to provide the benchmark metrics for evaluating the development effect of these investments, nevertheless there is no means to evaluate the environmental, social, and economic outcomes of diverse investments.

With the remarkable exception of microfinance and green bonds, instruments of innovative financing do not possess the essential market infrastructure to produce liquidity. The diverse as well as modified nature of numerous innovative financing mechanisms prevents investors from dealing on products to generate liquidity in the market. An everyday infrastructure, for instance, credit rating organisations and exchanges, can assist in making the trading of products easy to enhance liquidity

5. Potentials for Innovative Finance

The present COVID 19 pandemic as well as the global financial crisis in 2008 emphasized the reality that African economies face major exposure to the current sources of external finance and the necessity to discover other more conventional, predictable, sustainable and balancing sources. Given the extreme dependence on overseas development aid by numerous African nations, these crises exposed the risks connected with its volume and volatility. The declining trend of Africa's foreign direct investment (FDI) inflow is set to worsen considerably in 2020 amid the shock of the COVID 19 pandemic. According to the United Nations Conference on Trade and Development's (UNCTAD's) *World Investment Report 2020*, FDI flows to Africa are estimated to contract between 25% and 40% base on gross domestic product (GDP) growth projections and a variety of certain investment factors (UNCTAD, 2020).Also, as a result of the 2008 global crisis, FDI plummeted from a peak of USD$73 billion in 2008 to roughlyUSD$53 billion in 2010 (Nnadozie, 2011). This is an awakening for the African continent to discover new and more resilient external finance sources.

More than a few innovative mechanisms are being talked about at numerous meetings, which draw on both the official as well as private finance sources. These include taxes on universal activities that are either taxed a little or not taxed at all, for instance, air ticket solidarity charges or international financial transactions levies, pre-financing mechanisms based on financial markets with public warranty (IFFIm) or depending on market mechanisms (carbon emission auctions), states (advanced market commitments), and voluntary donations by the private sector channeled as well as made easy by the public authorities (diaspora bonds, migrants' remittances, voluntary solidarity donations).

6. Policy Options for Innovative Finance

African leaders and governments have a vital role to play in making sure that the enormous potential market for new development finance sources are brought into fruition. A good number of the proposed innovative mechanisms depend on building the trust of the private sector to partake in this market. Thus, African governments have to be in the forefront in: i) expanding and promoting the market for these instruments where there is obvious market failure (for instance, through provision of partial warranty or securitization of prospective public financial flows), ii) providing a suitable officially permit policy environment that will support market growth, development and deepening, and iii) making sure the new mechanisms intensify macroeconomic as well as debt sustainability risks.

In addition, other proposed means can only be put into practice via partnership, collaboration as well as harmonisation amongst African governments. Finally, international development institutions can leverage their numerous strengths to assist in developing the capabilities of market players (including governments) and make technical assistance and pertinent information available that can assist in advertising several markets and instruments for innovative finance. In this regard, the Economic Commission for Africa will carry on to strengthen its endeavours through awareness, policy assistance, knowledge, experience sharing and technical assistance to African economies in mobilizing resources for development.

Realistically, innovative financing ought not to be perceived as a universal remedy, nevertheless, to a certain extent as a significant accompaniment for closing down Africa's investment gap. An important lesson from COVID 19 pandemic and 2008 global financial crisis for Africa is the necessity to pay extra attention to internal public resource mobilization via accountability, good governance, tax reforms, balancing different types of taxes and efficient management of natural resource incomes. African nations teaming up with their associates have to manage illegitimate capital flows out of the continent, which are more and more depleting the continent's financial resources required for development.

7. Conclusion and Recommendation

The paper examined the impact of innovative finance on economic development in Africa focusing on the potential sources of innovative finance, constraints of innovative finance, potentials for innovative financing and policy options. The 2008 global economic and financial crisis, climate change and the current COVID 19 pandemic has negatively affect Africa as various countries in the continent are experiencing lower export earnings, inadequate growth rates, insufficient investment opportunities, dwindling remittances as well as decreasing inflow of foreign direct investment. Thus, it is essential for nations in the continent to put up adequate innovative financial resources to improve the growth and development of their various economies. Base on this, it is recommended that African leaders and governments should increase the potential sources of innovative finance such as IFFIm and UNITAID as well as endeavour to deal with the constraints that restrict innovative finance for development of the African continent.

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