



Empowered Lives.
Resilient Nations.

SUMMARY OF COMMISSIONED STUDIES

Prospects of Non-Traditional Sources of Development Finance in Ethiopia

1- Introduction

Ethiopia has experienced strong economic growth in the last few years. To a large extent, public investment has been the key engine of this recent performance.

In particular, large public expenditure programmes for infrastructure and social services have been undertaken with the objective of accelerating growth and progress towards the achievement of the Millennium Development Goals (MDGs). Ethiopia's fiscal budget allocation is currently one of the most pro-capital and pro-poor in Africa.

Nonetheless, these scaling up efforts have been partly constrained by the lack of financial resources and the recent global economic crisis. The latter has required a fiscal adjustment (on the expenditure side), which only recently started to ease. The former is compounded by the difficulty in mobilising domestic resources and the current uncertainty about global foreign aid inflows. Moreover, Ethiopia is currently unable to access international capital markets or attract significant foreign investments. Considering the magnitude of the MDG financing needs, the government requires further sources of finance in order to keep up this positive momentum and continue pursuing its ambitious public investment programmes.

UNDP Ethiopia Country Office commissioned a study that explored prospects of non-traditional sources of development finance for Ethiopia. The study identified five non-traditional sources of finance namely: issuing Diaspora bonds, South-South cooperation, Public-private partnerships (PPP), tourism and carbon trading.

The study estimates that \$500 million can be raised annually from these sources, which is equivalent to 1.7 percent of GDP, 8.7 percent of current government budget or some 20 percent of the \$2.4 billion resource gap that is equivalent to \$121 per capita expenditure to meet the country's MDGs goals. The study further suggests that: first, attracting financing should be stable and sustainable, second, Ethiopia should see the various sources of finance as mutually reinforcing and third, a good deal of the non traditional sources should be channelled towards socially responsible and green growth projects. The synergies between the different sources of financing could be an integral part of the county's development strategy focusing on inclusive growth and meeting the MDGs.

The Government has began to apply some of the recommendations of this report, for instance, its recent high level delegation's visit to North America and Europe to present the national Growth and Transformation Plan (GTP) and the Diaspora Bond initiative to the Diaspora in these regions. The Government is also strengthening its partnership with China, India, Brazil and others in addressing poverty and stimulating growth through investments and technology transfers.

2- Objectives

Development finance plays a critical role in accelerating growth, poverty reduction and promoting economic transformation. UNDP Ethiopia believes that there is a need to support the government efforts in robustly exploring potentials of non-traditional sources of finance in Ethiopia. In collaboration with the Ministry of Finance and Economic Development (MoFED), the Country Office commissioned a study to identify potential non-traditional sources of development finance to a consulting firm - Centre for Development Policy and Research at SOAS. Accordingly, CDPR undertook the study and submitted its final report in February 2011. The main objectives of this study were identifying non-traditional sources of development finance and provide an assessment of their prospective potentials.

3- Methodology

A shortlist of potential non-traditional sources of development finance was prepared and discussed with MOFED, UNDP and other partners. The selected sources were Diaspora Bonds, South-South cooperation, and public-private partnerships. In addition, some preliminary work had already been undertaken on carbon trade and tourism which are added to this study report. .

In order to evaluate each non-traditional sources, a formal assessment framework was developed. The criteria employed bears in mind Ethiopia's socio-economic and political context, and includes the following dimensions:

- **Feasibility** - This includes the financial, human and technical capacity needed to implement the specific financing mechanism. Moreover, it also bears in mind the timeframe required to effectively mobilise resources.
- **Resources** - This evaluates the capacity to generate substantial resources, therefore creating significant fiscal space.
- **Sustainability** - It is important that the new sources of finance are sustainable and predictable, in order to support long-term fiscal planning.

4- Key Findings

The study provided an assessment of the prospects of a selected group of sources: issuing Diaspora bonds, South-South cooperation, public-private partnerships, tourism and carbon finance. For each of the selected sources, the report provides a brief explanation of the financial instrument, a review of relevant experiences, and a tentative assessment of their potential to generate resources.

In aggregating the estimates for each potential source of development finance, the study found that from the selected sources Ethiopia may be able to raise about US\$ 500 million per annum.

Diaspora bonds

The study found that Ethiopia has a very large and vibrant Diaspora around the world. Despite initial limited success with issuing the Diaspora bonds in the recent past, this experience shows that it is a highly feasible source of development finance for the country.

The country has a positive attitude towards its Diaspora, and has in place an institutional framework to take maximum benefits from it.

More specific reasons in support of Diaspora bonds include:

- **Firstly**, these bonds constitute an additional way to tap into the resources the Diaspora holds abroad, so that they can complement the resources that a country attracts in the form of remittances, FDI and so forth;
- **Secondly**, the bonds can tap a portion of the Diaspora resources fairly quickly and with a discount; and
- **Thirdly**, they could be seen as a first step of a learning curve that may lead a country with initially no experience with international capital markets to successfully attract stable long-term capital for development and poverty reduction.

In terms of capacity to generate significant resources, Ethiopia's Diaspora is large in number and in many cases considerably affluent too. The study estimated Ethiopia can generate on average US\$ 175 million annually.

The study's main recommendation in relation to Diaspora bonds is that it should be seen as the first step of a long-term strategy, which could have as a follow-up the issuing of different types of bonds, but still targeting specific constituencies. For example, a second type of issuance could be Islamic bonds, which would tap into the wealth of the Muslim community from all over the world.

Next, Ethiopia could aim to target the Socially Responsible Investing (SRI) community, by offering low-carbon bonds. These are bonds to finance environmentally friendly development projects or projects that have the potential to generate resources from carbon trading. The SRI community could be targeted again by offering development bonds, which would be used to finance development with high capacity to generate jobs and reduce poverty.

The government can establish this system with fairly low cost by instituting a book-entry system, putting up the secondary market and maintaining its credibility.

South-South cooperation

The study assessed South-South cooperation, which has been revitalised globally in recent years.

Much of the recent initiatives in this area have involved large developing countries with China, India, Korea, Brazil, Turkey and Saudi Arabia among the driving forces in the re-emergence of South-South cooperation, through bilateral, trilateral and interregional initiatives, with financial assistance as one of their key components.

The main advantage of attracting financial assistance from this group of countries is that it does not usually come with policy conditionality, which allows southern countries to exercise greater sovereignty in shaping their own development strategies.

Moreover, the focus of this financial assistance has been on infrastructure projects and productive activities, from which traditional donors have increasingly become disengaged.

To the extent that Ethiopia is already successfully tapping into resources from non-traditional donors, this potential source is feasible. Going forward, the challenge is how to diversify the use of such resources to productive activities that maximise the benefits to Ethiopia and that can leverage additional resources for development finance.

The study estimates that by strengthening its South-south cooperation, Ethiopia can raise on average US\$ 265 million a year under the South-South cooperation framework.

The study recommended that it is important for the Ethiopian authorities to better understand the decision-making process behind the provision of funding by the non-traditional donors, so that they can approach the right people and resources and therefore maximise its chances to increase additional resources successfully.

Public-Private Partnerships (PPPs)

The study made the point that PPPs usually refers to a collaborative arrangement between a government authority or public corporation and a private entity regarding the provision of public infrastructure or services. It is important to distinguish PPPs from other forms of private involvement in the provision of public goods. While traditional public procurement involves a single transaction whereby the government purchases

goods or services through a tender process, PPPs are a longer-term form of private engagement. Bearing in mind Ethiopia's current stage of development, the study focuses on infrastructure development as the main area for engagement in PPPs. The estimate on resource generation from such engagement is US\$ 270 million per year, the highest among the various sources of finance discussed in this study. The cost of achieving this would be implementing the existing policy space and government be engaged in the private public partnership dialogue in a pragmatic manner.

The study recommends that a Public-Private Partnership (PPP) Unit needs to be created within MoFED in order to provide a key point of contact and facilitate the coordination of PPP projects; develop appropriate legislation and regulatory frameworks, so that the public interest can be safeguarded; build relevant expertise and skills to ensure that performance monitoring and regulatory functions can be fulfilled by the public entity; and define clear investment needs (e.g. in infrastructure) and evaluate any obstacles and constraints to PPP opportunities.

Tourism

In Ethiopia, tourism has been effectively recognised as an important sector for poverty reduction. The government's strategic intent is to make Ethiopia one of the top ten destinations in Africa by 2020, while attracting low-impact high-value tourists.

However, this major thrust would require substantial financial resources for investment in infrastructure, capacity building, product development, and marketing.

The study also identified a number of issues and constraints facing the sector in Ethiopia. These included the fact that:

- The sector is still fragmented, with each region approaching tourism from its own perspective;
- There is an overemphasis on the physical attributes compared to the soft aspects such as the customer service levels, staff capacity and so on;
- There is a need for incentives to encourage investment in the sector; and
- The tourism Master Plan needs to be revitalised, so that tourism zones can be created and the attractions within them protected. The overall diagnosis of the sector in Ethiopia is that it is still considerably underdeveloped and its potential not yet realised – especially in terms of creating wealth and reducing poverty.

The study also identified a number of potential new sources of development finance within the tourism sector. Some of these were: a tourism development levy, on-line booking commissions, voluntary contributions, mobile phone tourism support, 'stay Ethiopia', Eco-Tourism certification, and environmental impact levy.

The study estimates that the tourism sector would be able to raise on a yearly basis an average of US\$83 million, once the several instruments for generating additional resources are taken into account. This however requires significant investment in

improving the infrastructure and changing Ethiopia's image.

In order to encourage value-based tourism and ensure that the poor are major beneficiaries of tourism development, the study recommendations included such actions as pursuing a common marketing approach, investing in capacity building and training, and adopting a pro-poor strategy and a responsible tourism approach,

Carbon Trading

The study examines the prospects of carbon trading as a non-traditional source of finance. A wholly market-based instrument for carbon finance is the Clean Development Mechanism (CDM), which permits project-based carbon trading between developed and developing countries. Examples of carbon projects include the use of renewable energy, the use of biomass residues, the implementation of energy efficiency measures, and so on. However, Ethiopia is yet to benefit in a meaningful way from any scheme under the CDM.

The study finds that Ethiopia can increase its fiscal space by about US\$ 140 million annually if it can reduce its deforestation by 50 percent. This represents about 0.4 percent of GDP in 2009 or 3.4 percent of revenue and grants in the same year. These revenues can be generated under the Reduced Emissions from Deforestation in Developing Countries (REDD) mechanism, which is based on grants and concessional finance as seed money to leverage the private sector.

The study puts forward the view that it is of crucial importance that carbon trading is seen as an integral part of clean and inclusive growth.

In this regard, the study underscored the need for government's medium term plan, the Growth and Transformation Plan (GTP), to articulate carbon sequestration as both a clean growth strategy as well as a source of financing.

5- Conclusion

Ethiopia would be able to maximise the benefits of raising additional financial resources through buttressing the green dimension of its current development strategy and ensuring access to resources that are stable and sustainable over time.

The implication is that policy makers need to consider these non-traditional financing sources, which if tapped would augment the traditional financial resources of the country and thereby provide additional fiscal space for the government to finance its development programs including the GTP.

This coupled with enhanced domestic savings mobilization and improved tax revenue collection would adequately expand the fiscal space on a sustainable basis. ■

Rights and Permissions:

This paper summarizes a study commissioned by UNDP Ethiopia. Text and data from this paper may be reproduced provided the source is clearly cited. Reproduction of this document for commercial purposes is strictly forbidden.

For more information contact:

communication.et@undp.org
ks.et@undp.org
www.et.undp.org
www.facebook.com/undpethiopia
<https://undp.unteamworks.org>