Bankers Association of Zimbabwe

The Role of Public Financial Instruments in Promoting Innovation and Entrepreneurship

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1. Introduction

The new economic blueprint, ZimAsset requires close to US$ 27 billion for the accomplishment of all identified projects so that the country can go back onto a sustainable development path.In is also now an accepted fact that the public budget alone will not be able to provide the necessary financing.
There is therefore a necessity to mobilize resources outside the domain of treasury for investments both from domestic sources and from across the global financial markets.

The success of ZimAsset hinges on successful innovation and entrepreneurial development underpinned by a good national resource mix. Theability of the country to achieve such a feat depends on how the country will leverage itselfto explore new sources of financing, innovative private-to-private sector solutions, and public-private partnerships to mobilize additional financing. There is need to look at both internally available resources and external financing solutions.

2. Role of Public Financial Instruments

For purposes of this discussion, PFIs are any means that Government uses to raise financing for investment projects outside the fiscal envelop or budgetary process. Such Public Financial instruments can represent a resource-efficient way of mobilizing resources in pursuit of the Government strategies of promoting innovation and entrepreneurship. Targeting projects with potential economic viability, financial instruments provide support for investments by way of loans, guarantees, full or partial equity and other risk-sharing mechanisms, possibly combined with technical support and partnerships, non budget funded subsidies or guarantees, fees, subsidiesetc. within the same operation. It is important that resources mobilized should be used for productive purposes and **not be used for consumption** purposes.

Public financial instruments if well-tailored to the specific needs of the country and their target recipients, access to finance can be significantly improved for the benefit of a wide range of Government initiatives or the private sector. Financial Instruments can, for example, serve enterprises investing in innovation (e.g. Africa Enterprise Challenge Fund), SME development (e.g. SME bonds issued by NMB), as well as public infrastructure (e.g. Infrastructure bonds is by IDBZ) or productive investment projects that meet the strategic objectives of the country's economic policy and deliver the expected outputs of its programmes.

The financing mechanisms can be categorized broadly as below.

- First, instruments that provide financing directly to projects. These include Equity, grants, loans and credit lines
- Second, instruments that do not directly transfer money, but transfer knowledge or mitigate risk. These include guarantees and technical assistance
- Third, instruments that are used to raise additional private funds that, then, can be transferred to various projects via one of the above mentioned instruments.

Public Financial instruments should be designed on the basis of an assessment that identifies optimal investment situations, respective investment needs and possible private sector participation. These public financial instruments should have attributes which makes them;

- Better positioned for recycling funds over the long term.
- Help to mobilize additional public or private co-investments in order to address policy priorities.
- Possess additional expertise and know-how which helps to increase the efficiency and effectiveness of public resource allocation.
- Provide a variety of incentives to better performance, including greater financial discipline at the level of supported projects.
- Leverage private sector capital invested alongside Government resources.
- Contribute to developing a new culture amongst investing actors in the project area away from grant dependency.
- Pool expertise and know-how between financial institutions, intermediaries and final beneficiaries of projects.
- Build institutional capacity through partnerships between public and private sectors (PPPs).
- Create broader partnerships through involvement of financial institutions in the implementation of the investmentprogrammes.
- Strengthen the spirit of entrepreneurship through closer cooperation with private sector and financial institutions.

Diaspora Bonds as a Financial Innovation

One example of creative methods could be the issuance of "diaspora bonds" to finance specific investment projects.

A diaspora bond is a debt instrument issued by a country or, potentially, by a private corporation in a home countryto raise financing from its overseas diasporans or international investors.

Diaspora Bonds can be made sufficiently attractive through credit enhancements and tax and other incentives so that they can find appeal even to non-diasporans and other international institutional investors.

Challenges and Constraints in using PFIs

Some of the constraints that the country may face with public finance instruments include;

- Risk perceptions on the payment ability of the Government from its future earnings.
- Lack of trust in the Government as a guarantor.
- Perceived political risks.
- Weak and non-transparent legal systems for contract enforcement;
- Lack of national banks and other institutions in destination countries, which can facilitate the marketing of these instruments;
- A lack of clarity on regulations in the host countries that allow or constrain investors from investing in the various instruments.

3. Conclusion

Public Financial Instruments are basically financial engineering tools that have been used by countries for decades. These instruments can contribute to developing a new culture that steers programmes away from grant dependency. Apart from attracting capital for investment PFIs can enrich entrepreneurs and projects with knowledge and expertise, capacity development and other incentives for an overall business oriented attitude to public sector projects. This leads to a more efficient use of funds, the pooling of expertise and know how between public authorities,investing financial institutions and final beneficiaries of projects and facilitates internationalization of activities with great market potential (for example regional toll link roads such as the proposed Beitbridge –Chirundu Highway).