The Role of Sovereign Wealth Funds (SWF) in Africa

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Introduction

US Bank "JP Morgan" pointed out in analyzing the category of sovereign funds that Africa is witnessing the opening of more and more national sovereign funds due to the accumulation of the proceeds of raw materials and exchange reserves. During the past two years, 15 national sovereign funds have been established in African countries including Tanzania, Zimbabwe, Mozambique, Uganda, and Sierra Leone. This is in addition to the first African countries that have established this type of funds, namely Botswana in 1994, Gabon in 1998, and Algeria In 2000, followed by Libya and Mauritania in 2006, Nigeria and Ghana in 2011, and Angola in 2012. It's worth mentioning that a revenue regulation fund, also officially known as Fond de Regulation des Recettes (FRR) or The Fund for the Regulations of Receipts, was set in Algeria in 2002 to partially cover the fiscal deficit as well as foreign debts, and to lessen a potential foreign impact on the fiscal policy.

Algeria's Revenue Regulation Fund (FRR) is among the world's fifteen largest sovereign wealth funds, the Las Vegas-based Sovereign Wealth Funds Institute (SWF) has reported. Of the 67 sovereign wealth funds identified by the institute in the world, the FRR of Algeria is ranked 14th with an equivalent amount of $ 77.2 billion, the source said in its updated June 2013 data. In Africa, Algeria tops the rankings, followed by Libya (17th place in the world) with a ruler 65 billion fund, Botswana (38th worldwide) with $ 7 billion, Angola (45th place) with $ 5 billion, and Nigeria (50th) with one (1) billion, while funds sovereignty of other African countries each have a value of less than one (1) billion.

Sovereign Wealth Funds Definition:

A sovereign wealth fund (SWF) is a state-owned investment fund or entity that is set for completely economic purposes. Such Funds keep the assets or exploit or manage them to achieve financial objectives through some investment strategies including foreign assets investment. Also, these funds are commonly established from balance of payments surpluses, official foreign

currency operations, the proceeds of privatizations, fiscal surpluses and/ or receipts resulting from resource exports.

SWFs funded by the proceeds of raw materials, which represent 2/3 of the assets of these funds, especially petroleum and gas, are considered as the main source of assets for the largest funds in the world .In this respect a question is raised concerning the ability to obtain such money in the future within a petrol price drop due to the current world finance crisis in addition to other crises and the falling prices of natural resources

Another Definition: A sovereign wealth fund (SWF) is a state-owned investment fund investing in various financial assets such as lands, stocks, bonds, real estate, precious metals, and/or other investment entities. In other words SWFs are simply the state savings that are invested by various entities for the purposes of investment return.

SWFs are, also, known as State-owned investment organizations investing in long term investments outside the country of origin. These funds, particularly GCC sovereign wealth funds, play a prominent role on the global economic arena, and also raise several problems.

So sovereign funds are, originally, state-affiliated funds used to obtain more proceeds than those obtained by treasury bonds.

The Evolution of Sovereign Funds Phenomenon:

The emergence of Sovereign Funds on the global financial arena isn't a new phenomenon; however it witnessed a rapid growth by the Late Twentieth Century and the Early Third Millennium. The emergence of these funds dates back to the fifties of the Twentieth Century when the State of Kuwait established Kuwait Investment Authority (KIA) in 1953. This was followed by the appearance of other several funds in Singapore and the United Arab Emirates (EAU) until they reached 53 funds in 2008.

And then the number of sovereign funds rose worldwide with increasing assets and investments in the wake of the world economic development since the mid-nineties of the last century, which witnessed the establishment of the WTO and the multilateral agreements aiming to liberalize foreign trade and the movements of foreign capital.

Therefore, most of sovereign funds all over the world emerged in the past few years since in 1969,{there were only three funds and in 1999 the number raised to 21 funds until it reached 53 funds nowadays.

The Number and Size of Sovereign Wealth Fund (SWFs): The number and size of SWFs have increased dramatically according to the fol-

lowing:

- High oil prices, starting from the nineties of the twentieth century at an unprecedented pace.
- Slow global growth and its implications on the current account of the United States of America and its major Asian trading partners, especially after the 1997 financial crisis in East Asia.
- Increase in the allocated reserves and the transfer of balance surpluses to such funds.
- Appearance of new Sovereign Funds in Taiwan, Brazil, China, Japan ...etc.
- Governments make reserve cushions based on exchange rate policies and achieve trade surpluses in order to provide «self-insurance» against crises and disasters that may face capital markets.

SWFs Investments in Africa:

Most of the SWFs investments were in OECD countries. However, such funds investments showed a noticeable increase in developing and emerging countries despite the financial crisis. This represents a part of the transfer process of capital flows towards the countries of the South, which is regarded as a part of the redistribution of the long -term global capital from developed countries towards countries that do not receive significant investments for different purposes such as secure access to strategic resources and new markets and/or seeking to invest in various fields.

However, African economies; especially desert countries in Africa, remain away from this trend despite the presence of some investments. This is because the developing and emerging economies which do attract investment funds exist in South Asia such as Malaysia, Thailand, Indonesia, China, the Middle East, Latin America and Central Asia. Whereas, South Africa and Tunisia are the most African countries that attract most of the funds flows.

Nevertheless, according to the UNCTAD Organization in 2008, African countries are eligible to receive a large proportion of the SWFs money because African countries hit the highest investment rates in 2006 and 2007.This is in addition to the rapid growth of most of the continent countries, since the International Monetary Fund estimated the a better growth rate than other developing areas.

In this respect, Africa needs quick investments to achieve the Millennium Development Goals and to reduce the development gap, at least on the medium term for the following reasons:

1. Africa still needs external funding for its development, because, the capacity of African countries to fill the development gap is still limited despite the mobilization of

domestic resources. And on the medium term, African countries still rely on external sources of funding.

2. The private sector savings are still less than the required investment needs in Africa, making Africa in need of more external resources.
3. Africa needs a long-term and stable funding to attract more private investments.
4. These funds differ in their work from the traditional private investments, since they are not subject to the market system and do not focus on the high rates of short term profits since they, unlike private sector investments, invest in illiquid long-term assets.
5. These fund investments are not debt investments and thus, unlike private sector investments, there is a little risk to claim capital on the short term, and few restrictions are imposed.
6. SWFs not only contribute to the size of investment inflows to the developing countries, but also reduce the outflow of these investments which may harm the development process. This was clearly embodied in Africa in 2008 due to the financial crisis, where direct foreign investments fell by 19% in 2009 and many African countries faced the dangers of depression by withdrawing these investments.
7. SWFs can play the role of the local economy savior in case any major crisis outbreak, as the state can, by such funds, pump large investments to develop the infrastructure, provide jobs for the citizens, and construct factories as well as roads in order to ensure the rotation of the wheel of economy.

8- SWFs can increase the confidence of foreign investors in the local government's ability to meet its obligations and repay its debt. And also governments can benefit from such sovereign funds by obtaining low-interest loans as long as they have the ability to repay and have enough money to ensure a continuous flow of investments.

- The main funds investments in Africa come from the Gulf countries, namely Abu Dhabi investment fund, Dubai and Qatar, in addition to Libya in North Africa, and China-Africa Development Fund in Asia.

For example, Gulf funds invested in sub-Saharan African countries about 1.6 billion through Abu Dhabi Fund and Dubai in 2009.

- Investments are concentrated in both North Africa (Tunisia, Algeria, and Egypt) and South Africa. In addition, such fund showed interest in geographic diversity by investing in sub-Saharan African countries. For

example the world investment fund invested in Rwanda, Mozambique, Cameroon, Senegal, Zimbabwe, Nigeria, and Guinea. While Libya is investing through its fund in infrastructure projects and in local projects all over Africa.

The Most Prominent Sovereign Wealth Funds (SWFs) Investments:

The China-Africa Development Fund (CADFUND) forms part of the Chinese government's practical implementation, for some of its plans and objectives, for the African continent. CADFUND was established as part of the eight measures announced by the Chinese President Hu Jintao, at the 2006 Forum on China-Africa Cooperation (FOCAC). While operating according to market principles, the Fund is an economic and diplomatic tool of the Chinese government to encourage Chinese enterprises' investments in African countries and to provide advisory services for investment projects in Africa.

The Fund has been operating since 2007 and is a subsidiary of China Development Bank (CDB). CADFUND, however, is also a policy tool and reports annually to a Supervisory Board which consists of members from various Chinese Departments - for example, the Department of Foreign Affairs and the Department of Commerce, in addition to members from the CDB and CADFUND. CADFUND is, also, one area to which the Chinese government is allocating its currency reserves which in turn promotes investment ties with Africa.

The Fund was allocated an overall US$ 5 billion. It is expected to reach its full US$ 5 billion capitalization in 2014. Up until 2012 CADFUND has (co-)financed and supported 60 projects across 30 African countries. Another 100 projects are reportedly in the pipeline.

The Fund currently has representative offices in four African countries: South Africa, Ethiopia, Zambia and Ghana. These offices are meant as providers of advisory services for Chinese businesses wishing to operate in African countries. Each office is in-charge of supplying funding and consultation services to specific African countries in their region.

The Fund's activities are not concentrated on particular areas, but extended to cover most of the continent countries. Similarly, the investments did not focus on specific sectors but included infrastructure, mineral resources, agriculture and manufacturing. Furthermore, the Fund has invested in a cotton cultivation project in Malawi, Mozambique, and Zambia and in a power plant in Ghana. Investments have also been undertaken in Ethiopia's

manufacturing sector, for example in leather processing, cement production and in glass production. Shares are owned by CADFUND in two Special Economic Zones, Lekki/ Nigeria and Suez/Egypt.

However, one of the disadvantages of the fund is that it focuses on financing big Chinese enterprises rather than small businesses and/or focuses on particular countries rather than other others.

The value of all GCC Sovereign Wealth Funds hit USD 1.775 trillion at the beginning of 2013, however Gulf Sovereign Funds investments are still very weak compared to the size of the investment opportunities available in these regions. This is because most of the investments of such funds focus on local projects in the Gulf region or are headed west towards Europe and North America. It's worth mentioning that infrastructure and agriculture sectors are of the most important sectors that can attract Arab investments to Africa.

While China and India are competing to pump more investments in Africa, the African continent has not received the same willingness to invest whether from Arab capital or Arab governments. For example, the trade size between African countries and China, mount up to $ 200 billion per year, but it did not exceed $ 21 billion between Arab and African countries.

<u>Challenges facing SWFs investments in the continent:</u>

1. African economies are weak and may hinder the funds from investment as a result of macroeconomic risks and smuggling money.
2. The extremely variable revenues and incomes of African economies: Estimating investment revenues is an important factor for investment funds when entering new markets. And according to UNCTAD 2010 report, global foreign investment revenues are much more variable in Africa than in any other part of the world which means that investing in the continent countries is very risky.
3. The instability of domestic demand showing less flexibility along with the lack of diversity in the productive sectors lead to the concentration of investment funds on energy and extractive industries, in addition to the instability of the exchange rate which hinders sectors that earn revenues in local currency.
4. The lack of long-term loans in African economies contradicting the point of view of sovereign funds which prefer to invest in long-term projects.
5. The size and liquidity of African financial markets limit the funds

investments because of transaction costs and the inability to manage a group of large investments.

6. Small-cap stocks hinder large investments where the ratio of cap market value to GDP in African stock markets is about 27%. This is far less than the ratio in other emerging markets such as Malaysia, which has a cap rate of about 80 % in 2008. Accordingly, it is mainly depended on small individual investments with positive trend concerning Africa.
7. The small number of companies listed in the stock market in addition to their low liquidity.
8. Lack of knowledge technology: The low technology level in Africa limits investment because sovereign funds are not only interested in financial revenues, but also in the transfer of and the availability of technology in the recipient country, since the expected profit is higher in high-tech sectors. However, the level of technology in Africa is not only lower than that in the developed countries but even lower than that in emerging markets which received large investments from 1991 up till 2008.
9. The events that took place in Libya as a result of the Arab Spring revolutions led to the freezing of Libyan sovereign wealth funds which in return had a strong impact on Africa. Libyan Arab African Investment Trade Company (LAAICO) invested in nearly 25 countries in Africa, of which 22 countries are located in sub-Saharan Africa. It was planned to increase investments in the next five years, especially in the fields of mining, industry, tourism and telecommunications. But Libyan investments faced obstacles in allowing RASCOM Company to implement Libyan African Satellite (the first private satellite company in African) that shall be responsible for controlling the RASCOM-QAF1 (the first satellite entirely dedicated to the African continent) which was launched into orbit in 2010 allowing African countries to be independent of the US and European satellite networks, and definitely save hundreds of millions of dollars a year.

Proposals to develop sovereign funds in Africa

1- Lift barriers: African countries can develop their financial markets by improving regional cooperation and integration. In addition to benefiting from Sovereign Wealth Funds, recently launched in the continent, and setting a specific and clear legal framework for such funds investments.

2- African countries need to identify

a co-coordinating development strategy when attracting funds in order to use them better in the development of the economy. Unfortunately, this is considered as a point of weakness in Africa, unlike Singapore and China, which have a development strategy that maximizes the benefits of the funds investments in their countries, in addition to estimating the risks and pitfalls related to the large size of the funds investments compared to the size of its economy.

3. Increase the number of stock markets which rose in sub-Saharan countries from 5 markets in 1989 to 16 markets in 2010; in addition to 20 stock exchange markets operating all over Africa, besides the launching of regional initiatives such as the SADC stock exchanges.
4- Risk diversification through regional cooperation to the small African markets.
5. Increase regional coordination between the recipient countries. This will help in reducing the risk of individual projects, in increasing the size of large investments and exchanges, in avoiding wars related to the attraction of investment, and in bearing large-scale economies.
6- Improve coordination between government ministries and civil society, which effectively help in attracting funds. However, this is a long term process that needs to build capacity.
7. Set a strategy to promote and develop local capacity and improve productivity as well as competitiveness by drawing experiences from emerging countries or through the transfer of technology when dealing with sovereign funds just as China did when dealing with the OECD countries.
8. African countries should encourage fund investments away from traditional sectors (natural resources) because these fund investments can impact the African exchange rate of the as well as the prices of goods and services causing the loss of competitiveness and thus threatening the economic diversity.
9. Set a clear legislative framework because sovereign funds investments could get the majority share in the sectors in which they invest or could play a role in the management of important and strategic sectors. Actually, this would raise the concerns of states against funds investment since there could be a kind of political interference from States holders of sovereign funds in the national security of African countries.