

OECD DEVELOPMENT CENTRE

Working Paper No. 303

SOVEREIGN WEALTH FUNDS AS INVESTORS IN AFRICA: OPPORTUNITIES AND BARRIERS

by

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Research area:
African Economic Outlook



September 2011

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ACKNOWLEDGEMENTS

This paper was prepared for the OECD *African Economic Outlook 2011: Emerging Partners*. I am grateful to Rolando Avendano, Andrea Goldstein, Karim Hussein, Christian Lim, Helmut Reisen, Romain Perez and Samuel Munzele Maimbo for helpful comments and suggestions.

PREFACE

Economic linkages between Southern countries are intensifying continuously, as a result of the shifting wealth from OECD to Southern countries since the 1990s. In this general context, Sovereign Wealth Funds from emerging countries are also increasingly interested in the developing world, and are recycling surpluses in emerging countries towards developing countries, and no longer only towards developed countries. This represents a major development opportunity, as these investments have long-term and stable perspectives, the type of funding needed in developing countries.

However, Africa remains underinvested, despite big opportunities. Consequently, policy decisions need better evidence on the possible role that foreign Sovereign Wealth Funds may play in their development. The present paper focuses on Sovereign Wealth Funds' investments in Africa:

- by analysing the great and specific relevance of Sovereign Wealth Funds' investment;
- by describing the rising interest of Sovereign Wealth Funds for developing countries, but at the same time, the specific barriers they face in Africa; and
- by providing policy advice for African governments on how to attract Sovereign Wealth Funds and make a good use of these investments.

The study shows that Sovereign Wealth Funds' investments may be crucial for African countries to meet the Millennium Development Goals in the 2010-20 decade, and that Africa can benefit from the rising interest of Sovereign Wealth Funds in developing countries, beyond natural resources. However, there are specific barriers to Sovereign Wealth Funds' investments in Africa, which need to be addressed.

The present paper served as a background paper for the *African Economic Outlook 2011*, and for the debate on how to promote efficiently African development.

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RÉSUMÉ

Dans ce document, l'auteur étudie les opportunités et barrières pour les investissements des fonds souverains en Afrique. A partir de données historiques sur les transactions des fonds souverains, il montre que leurs investissements peuvent faciliter jusqu'à 50% des investissements en infrastructure nécessaires pour atteindre les objectifs du Millénaire pour le développement pendant la décennie 2010-20, et que les économies africaines peuvent grandement bénéficier de l'intérêt croissant des fonds souverains, au delà des ressources naturelles. Cependant, il y a des barrières spécifiques. Certaines d'entre elles sont structurelles (manque de technologies ; petite taille, faible liquidité et fragmentation des marchés ; mauvaises notations de dettes souveraines ; faible cadre de régulation ; manque de capacité institutionnelle), et requièrent des changements de long terme, tandis que d'autres requièrent des changements de plus court terme (comme la définition d'une stratégie de développement mieux coordonnée et des actions spécifiques envers les fonds souverains). La communauté internationale et des institutions financières peuvent également jouer un rôle de plus en plus actif dans l'attraction de fonds souverains en Afrique.

Classification JEL: F3; F21; O16; O19; O55; Q3.

Mots clés: fonds souverain; investissements transfrontaliers; pays en développement.

ABSTRACT

This paper studies the opportunities and barriers for Sovereign Wealth Funds' (SWFs) investments in Africa. Based on historical databases on SWFs' transactions, it shows that SWFs can facilitate up to 50% of the investment needs in infrastructure in Africa over the next decade to meet the Millennium Development Goals over the 2010-20 decade, and that African economies can benefit highly from the rising investor interest, which stretches increasingly beyond natural resources. However, there are specific barriers to SWF investments. Some of them are structural (lack of technologies; small size, low liquidity and fragmentation of markets; bad sovereign ratings; weak regulatory framework; lack of capacity building), requiring long-term changes, whereas others require shorter term adjustments (more co-ordinated development strategies, more active actions dedicated to SWFs). The international community and major financial institutions may also play an increasingly active role in channelling SWFs into Africa.

JEL Classification: F3; F21; O16; O19; O55; Q3.

Keywords: sovereign wealth fund, cross-border investment, developing countries.

I. INTRODUCTION

Over the last two decades, a number of emerging countries have become major players in regional and global affairs, due to their strong growth and their rising share in the world income. As a result, economic linkages between Southern countries have been intensifying continuously, as shown by the growing flows of trade and investments between emerging and developing countries, and the decreasing weight of the traditional OECD counterparts.

An important investment vehicle for a growing number of emerging countries is their Sovereign Wealth Funds, which are increasingly used when they invest in OECD countries as well as in some emerging and developing regions. Sovereign Wealth Funds (henceforth SWFs) are generally meant to comprise government investment vehicles that hold, manage or administer large pools of public funds, separated from foreign official reserves. In this paper, public pension funds are not included (in particular those from Japan or Norway, which would strengthen the macroeconomic weight of SWFs). As a result, the SWFs considered come almost entirely from emerging countries. SWFs are attracting growing attention, due to the quickly growing scale of their assets linked to global imbalances and/or raw material prices at high levels on a historical scale;¹ but also due to their increasingly active investment policy.²

In Africa, although investments by emerging partners are rapidly growing (African Development Bank and OECD, 2011), this investment potential of SWFs remains largely unexploited. This is a missed opportunity, since SWFs may well be a growing catalyst for development in Southern countries over the 2010-20 decade. This note aims at analysing the key features of SWFs' investments in African economies, and at providing policy advice to African governments on how to better attract these investments.

The structure of the paper is as follows. Section II underlines the high relevance of SWFs' investments for development in Africa. Section III describes the growing interest of SWFs for developing countries, Africa remaining however largely outside this trend. Section IV analyses the specific barriers to SWFs' investments in Africa. Finally, section V presents key policy suggestions for African governments in order to attract SWFs' investments and make optimal use of them, and also discusses the role of Multilateral Development Banks and other financial institutions in channelling SWFs into Africa.

-
1. Their size worldwide has increased dramatically over the past 15 years. In 1990, SWFs probably held around USD 500 billion (IMF, 2007); in 2010, the total was an estimated USD 4 trillion and could reach USD 7 trillion by 2019 (post-crisis projections based on past foreign exchange reserves growth, Kern, 2009).
 2. On average, SWF asset allocation is split between fixed income securities (35-40%), public equity (50-55%) and 8-10% in alternative investments such as hedge funds or private equity (Fernandez and Eschweiler, 2008). There was also a strong focus on the rise in SWFs' investments in major quoted Western companies which followed the financial crisis in 2008.

II. WHY SWFS ARE A GOOD INVESTOR FOR AFRICA

Africa needs accelerated investments to achieve the United Nations' Millennium Development Goals (MDGs) and to reduce its development gap over the medium term. For instance, it has been estimated that, to close the gap between its infrastructure and the rest of the world's by 2020, the African continent would require an annual investment of USD 93 billion over the 2010-20 decade (Foster and Briceño-Garmendia, 2009³), only USD 40 billion of which is currently being met with internal and external sources of funding (African Development Bank, 2009). Further massive funding would also be needed for technological upgrading, private sector development, and efficient public services.

II.1 Africa still needs external funding for its development

Even if domestic resource mobilisation is improving (African Development Bank and OECD, 2010), African countries' capacity to fill the investment gap is still limited and, over the medium term, most African countries will continue to rely on external resources of funding:

- Regarding public domestic resource mobilisation, the average African tax revenue as a share of GDP has been increasing since the early 1990s, mostly (on average) because of taxes on the extraction of natural resources. There are large differences in tax collection performance across countries but, on average, African countries generally raise tax revenues similar to those of countries at similar stages of development on other continents. Furthermore, Africa is facing structural challenges with respect to mobilising additional public resources, which require long-term improvements (African Development Bank and OECD, 2010).
- Regarding private domestic resource mobilisation, the investment climate has improved, with better macroeconomic fundamentals in the 2000s than in the past (IMF, 2010b). However, private domestic savings remain largely below current investment needs, making Africa dependent on external resources.⁴ Few African countries show regular current account surpluses, and investments need to accelerate significantly to allow an effective development catching-up.

As a result, external sources of funding will be increasingly needed. This will concern in particular foreign investments, since other flows, such as Official Development Assistance (ODA) or remittances from OECD countries, are far from sufficient to meet investment needs, and are uncertain, given the economic slowdown and budget constraints in most OECD countries.

3. The report shows that poor infrastructure cuts national economic growth by two percentage points every year and reduces productivity by as much as 40%

4. For instance, according to World Bank (2010), by 2008, FDI represented already more than 15% of total investment in sub-Saharan countries, which is high among developing countries.

II.2. SWFs are a good kind of investor in the context of development in Africa

a. The amount may be significant and may leverage other funding

By assuming that SWFs invest even only 1% of their assets in Africa (as World Bank's President targets; Zoellick, 2010), this may facilitate joint investments by enterprises and SWFs up to about USD 420 billion over the 2010-20 decade,⁵ which would broadly correspond to the missing half of required investments in infrastructure to meet the MDGs. This may also attract other private-sector investors to enter new market once the benefits are clearer and the political context is proven safer through these state-sponsored investments. Furthermore, if developed economies raise barriers to state-backed investors,⁶ developing markets might seem even more attractive.

b. Africa needs long term and stable funding, that SWFs can bring

SWFs' investments can serve long-term development goals, by bringing the long-term and stable funding that is generally lacking to African economies. In particular, their long-term liability is not entirely similar to private investors, and SWFs are not subject to the discipline of the market. They can thus invest in illiquid and long-maturity assets that other institutional investors, such as private sectors funds, cannot. Furthermore, as SWFs are not debt leveraged, there is little risk that they have to call capital at short notice. This implies that there will be fewer constraints regarding withdrawals on investments than for other investors, and that they may contribute, not only to increase the size of investment flows to developing countries, but also to reduce the volatility of these flows, which is harmful for development (Lensink and Morrissey, 2006). This has been even more accurate for Africa since the 2008 financial turmoil, as, FDI in Africa declined by 19% in 2009, with many countries facing the risks of severe downturn when investments are suddenly withdrawn (UNCTAD, 2010a).

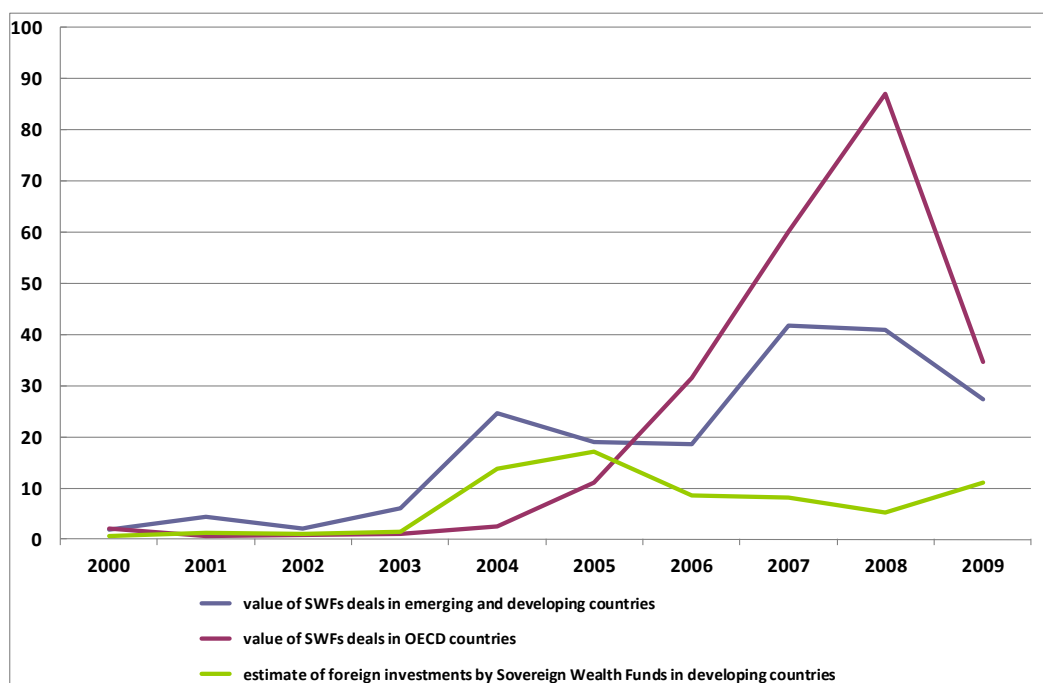
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5. Based on Kern's (2010) projections, one assumes that SWFs' assets will reach USD 7 trillion in 2019, so that 1% asset invested would account for USD 70 billion over the decade. Regarding the leverage effect, one takes into account investments by enterprises directly facilitated in joint projects with the SWFs. For instance, Chinese SWF is mentioned to have facilitated joint investments with Chinese enterprises in Africa to the value of about five times the value invested by the SWFs. The USD 70 billion investments by SWFs may hence directly facilitate other USD 350 billion investments.
 6. This was the case, for instance, with Unocal and the state-owned China National Offshore Oil Corporation in 2005 or with US ports and DP World, a state-owned company in Dubai, in 2006. Conversely, during the financial turmoil, SWFs' injections of capital into several large OECD financial institutions have been broadly welcomed.

III. SWFS' INVESTMENTS IN DEVELOPING COUNTRIES AND IN AFRICA

III.1. SWFs' growing interest in developing countries

To date, their reported investments have been mostly in OECD countries and domestically. However, SWFs are progressively increasing their investments in developing countries (despite a temporary decline in overseas investments by some SWFs, which followed the financial turmoil). This rising interest for developing countries is part of a shift in capital flows towards Southern countries and can be seen as a part of a redistribution of global capital away from developed countries towards countries that have not traditionally received significant investments, and may have different purposes, such as securing access to strategic resources and new markets, or seeking higher yields and diversification in developing countries.

Figure 1. Sovereign Wealth Funds' direct investments by location between 2000 and 2009 (USD billion)



Notes: publicly available data for SWF equity and real estate deals, joint ventures and capital injections. Data include some state pension's funds, in particular from Norway, Australia, Ireland and New Zealand.

Source: Monitor-FEEM SWF Transaction Database, own calculations.

The relative weight of developing markets in SWFs assets may be furthermore significantly underappreciated, since a growing share of SWFs' investments in OECD countries is also indirectly linked to operations in developing economies. For instance, half the value of SWFs' investments in North America during the first half of 2010 involved asset management companies and investment funds, many of which in turn are investing in developing and emerging markets – or in natural resources companies whose business is centred in developing countries, though they are either based in OECD countries or quoted in OECD stock markets (Barbary *et al.*, 2010).

However, African economies, in particular sub-Saharan African ones, remain largely outside this trend, apart from some exceptions. Developing and emerging economies which attract the most SWFs cross-border investments are based in Southeast Asia (Malaysia, Thailand, Indonesia, China and Chinese Taipei) and MENA (Oman) and to a smaller and irregular extent since 2008, in Latin America and Central Asia. South Africa and Tunisia are the only African countries which have attracted major SWFs inflows in the recent years.

Table 1. Selection of the largest publicly reported cross-border M&A deals outside OECD countries by SWFs between 1995 and 2009

Year	Value in USD million	Host economy	Industry of the acquired company	SWF's home economy
2009	2 433	China	Banks	Singapore
2005	2 359	Chinese Taipei	Industrial chemicals	United Arab Emirates
2006	2 313	Tunisia	Telephone communications	United Arab Emirates
2006	1 880	Thailand	Telecoms and medias	Singapore
2007	621	Oman	Banks	United Arab Emirates
2006	400	Chinese Taipei	Banks	Singapore
2007	391	Singapore	Shipbuilding and repair	United Arab Emirates
2005	337	Indonesia	Banks	Malaysia
2006	280	Malta	Telephone communications	United Arab Emirates
2006	276	Malaysia	Banks	United Arab Emirates
1998	266	Thailand	Banks	Singapore

Sources: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics) and Monitor-FEEM SWF Transaction Database.

This may be surprising, since African countries seem to have big potential. For instance, according to UNCTAD (2008), income on FDI in Africa yielded the highest rate of return among developing host regions in 2006 and 2007, after several years of rapid growth. More recently, the IMF (2010a) estimates that real GDP growth in Africa will reach 5.5% in 2011, which are better forecasts than for other developing regions,⁷ and significantly more than for OECD countries.

7. For instance in Latin America (4.1%), or in developing Asia (between 4.5% and 5.0%, excluding in particular China, India and Indonesia).

III.2. SWFs in Africa

SWFs' investments in Africa come mainly from the Gulf (Istithmar World – subsidiary of Dubai World, Mubaldala – subsidiary of the Abu Dhabi Investment Authority and the Qatar Investment Authority), from North Africa itself (Libya), and from Asian funds (China-Africa Development Fund). This may be due to **proximity**. Indeed, when SWFs invest in foreign developing economies, they privilege close countries, where they may hold advantages of information, networks and historical knowledge, and where investments may have direct positive externalities on the domestic economy. Likewise, Asian funds have invested heavily in their emerging Asian neighbouring economies. A similar pattern occurs for Arab funds in the Middle East.

While a growing number of SWF investments occur in Africa, the total value of these investments remains comparatively small. An incomplete collection of reported investments in sub-Saharan Africa by Gulf SWFs suggests investments of at least USD 1.6 billion by Istithmar World and Mubadala in 2009 (Ziamba, 2008b). According to available data, investment remains in any case lower than USD 3 billion in 2009.⁸ These investments are part of a global picture and may undercount the total sovereign investments in Africa. State-Owned Enterprises (SOEs), in particular from China and other emerging partners,⁹ are also interested in Africa. Several countries, including China and the Gulf States, sponsoring SWFs investing in Africa are also increasing development assistance or loans.

- **China is increasingly investing in Africa through the CADFund, jointly with SOEs**

Introduced in 2007, the China-Africa Development Fund (CADFund) is a financing mechanism, essentially an equity fund, investing in Chinese enterprises with operations in Africa. The target group of the fund consists of Chinese enterprises (state-owned or private) whose trade and economic activities relate to Africa and firms/projects in Africa invested by Chinese enterprises, in particular in the agriculture, energy, manufacturing, and urban infrastructure and extractive industry sectors. According to the CADFund, by the end of 2008, it had invested nearly USD 400 million in over 20 projects, which in turn had facilitated investment by Chinese enterprises to the value of about USD 2 billion in Africa.¹⁰ This also increasingly concerns SOEs' investments. Globally, around 30% of projects tendered by the World Bank and the African Development Bank has been completed by Chinese contractors (Frontier Advisory, 2008), an important share of Chinese projects being now supported by the CADFund.

- **Arab funds seem to privilege 'alone' acquisitions in local projects**

The Libyan Foreign Investment Company invested in infrastructure projects. Somalia and Sudan, for instance, have benefited from direct investments to support their projects. Similarly, the Libyan Investment Authority also invested directly in a range of infrastructure projects in the

8. Compilation of data and information from Roubini Global Economics, Monitor-FEEM and UNCTAD.

9. As well as re-emerging partners, like Russia.

10. CAD Fund's information.

whole Africa (OECD, 2008), and sought to acquire shares in subscribed North African Initial Public Offerings, without participation of other Libyan SOEs. The same pattern occurs in the investments done by Istithmar World and Mubaldala. The instability in some North African states receiving SWFs' investments (*e.g.* Egypt, Tunisia), as well as in Arab States with SWFs (*e.g.* Libya and the freeze of Libyan assets abroad) may however imply a slowdown of these flows in the short term.

Geographical and sector diversification

In value terms, investments remain concentrated in North Africa (Tunisia, Algeria and Egypt) and South Africa. However, there is a progressive geographical diversification, in particular towards sub-Saharan countries. Istithmar World is reported to invest in Rwanda, Mozambique, Comoros, Senegal or Zimbabwe. Mubadala invested in Nigeria and Guinea. As mentioned, the Libyan Investment Authority invested in many local projects across the whole of Africa.¹¹

There is also a sector diversification, which concerns interestingly not only North and South Africa. Indeed, until recently, SWFs' investments in Africa were focused on traditional natural resources (*e.g.* hydrocarbon and minerals) and/or infrastructures linked with the extraction of them (ports, also roads), in order to secure energy supplies:

- Firstly, there is a recent trend in land purchases, which concerns mostly sub-Saharan countries. Important investors in these deals have been governments and government-backed institutions. For instance, Libya's SWFs invested in Liberia (2007) and Mali (2008).¹² The Abu Dhabi Investment Authority (ADIA) was also interested in launching an agricultural fund in Africa.¹³ The stated objective of these projects is to help to meet local food needs, but the issue on food security for home countries is also raised, despite the growing concerns it implies in African countries, especially since the food price crisis of 2007-08.
- Secondly, other sectors were progressively targeted, such as infrastructure in a broader sense (for instance, Telecom in Cote d'Ivoire, Niger, Nigeria, Rwanda, Tunisia, Uganda, medias in Gabon, airlines, tourism), the banking sector (for instance, Egyptian bank EFG Hermes, Tunisian Banque de Tunisie et des Emirats, or Standard bank in South

11. As of 2008, in Egypt, Democratic Republic of Congo, Gambia, Mali, Niger, Chad, Burkina Faso, Guinea, Togo, Liberia, Ghana, Central African Republic, Ethiopia, Uganda, Zambia, Madagascar, Congo, Gabon and South Africa.

12. Libya invested USD 30 million in a rice project in Liberia. Libya also signed a deal with Mali, including agriculture (rice, tomato) and other linked infrastructure (canal, road), the construction of which has been contracted to Chinese company. The Libya Africa Investment Portfolio is responsible for managing both projects, in partnership with local foundations.

13. Cotula *et al.* (2009) showed however that the private sector may be playing a larger role, and that domestic land purchases may also be significant.

Africa¹⁴), and other regional operators which can access several countries' markets (Sovereign Wealth Fund Institute website, 2010). Indeed, Africa is showing apparent signs of opportunity, with own internal growth drivers creating a dynamic that goes beyond natural resources.

14. The Industrial and Commercial Bank of China's (ICBC) purchased a 20% stake in Standard bank, South Africa's biggest bank. However, as the ICBC is also a commercial bank, this investment is not always counted in statistics regarding SWFs, and hence does not appear in Table 1.

IV. THE AFRICAN CONTEXT: THE BARRIERS TO SWFS' INVESTMENTS IN AFRICA

For the past two decades, there has been increased competition to attract foreign direct investments, in particular as barriers to international investment have progressively fallen (OECD, 2000; UNCTAD, 2010b). Focusing on SWFs, countries have allowed incentives and tax exemptions to attract their investments (for instance the US; from another perspective, Singapore has also decided on tax incentives and exemptions for foreign SWFs that establish a presence in Singapore). For African economies, whose scarce financial resources often push them into a heavy reliance on incentives and other discretionary policies to attract foreign direct investments, this competition may be costly, especially if pre-requirements are not met, given the greater importance investors attach to the “fundamentals” in investment decisions. Furthermore, tools to attract investments from SWFs can differ from those aiming to attract other kind of foreign direct investments.¹⁵ It is then important to consider the specific barriers to investments that SWFs may face in Africa.

Assessments of the main specific barriers for SWFs in Africa

African economies present specific weaknesses which may deter SWFs from investing, in particular related to the macroeconomic risk and volatility, the large mismatch between the funding structure of many African economies and the long-term perspectives of SWFs, as well as to the size and liquidity of African markets. The low level of technological knowledge is also a structural barrier, compared to developed countries but also compared to other developing countries.

a. The macroeconomic risk and high volatility of returns

The relatively bad rating of many African sovereign debts may be a significant barrier (see Table A2 in Appendix). In November 2010, the Russian SWF decided to avoid Spanish or Irish bonds, due to the worsening of their rating. Indeed, not all SWFs invest in risky assets, and evidence suggests that when they start investing in a country, they start with conservative assets such as sovereign debt, local currency and foreign debt (see for instance Xiang *et al.*, 2009; Sovereign Wealth Fund Institute website).

More generally, there is also a high returns' volatility in African economies, whereas the predictability of returns can be an important factor for SWFs' investments when entering into a

15. Tax exemptions granted to SWFs are not likely to be what is motivating their decision to invest. Many recent deals use derivatives in such a way that they avoid paying tax on interest.

new market. According to UNCTAD (2010a), although remaining at high levels, returns on FDI in Africa show globally very high volatility, compared with returns in other world regions. Few projects in Africa are implicitly linked to inflation, show stable cash flows or have a low elasticity of demand. The instable internal demand and lack of diversification explain why export-led industries and energy are searched. At the same time, exchange rate instabilities make another barrier to investments in sectors that earn revenues in local currency.¹⁶

b. Lack of long-term loans in African economies: mismatches with the perspective of SWFs

SWFs prefer to invest in long-term projects, as well as in projects with track-record (Sovereign Wealth Fund Institute website). The structure of the credit in most African economies shows a low proportion of long-term loans, in particular for sub-Saharan countries (World Bank, 2007). This is another barrier to SWFs' investments, as there is a mismatch between the economic structure and the horizon of the SWFs. On the other hand, this underlines the possible interest in attracting SWFs.

c. Size and liquidity of African markets

The size and liquidity of African financial markets may be another limiting factor. Many SWFs invest only in bond issues that are above a threshold size,¹⁷ possibly because of transaction costs and scarcity of internal capacity to manage a range of small investments (IMF, 2009b).

The small size of most of Africa's stock markets makes big investments difficult. For instance, excluding the stock markets of South Africa and Egypt, the average capitalisation ratio (market capitalisation relative to GDP) in African stock markets is about 27% of GDP, much lower than in other emerging markets (see Table A1 in Appendix). Malaysia, for example, had a capitalisation ratio of about 180% in 2008. However, based on available data for 16 SWFs, Barbary *et al.* (2010) note that SWFs made recently more but smaller individual investments, which is a positive trend for Africa.

Investment opportunities may also be dominated in a small number of flagship companies. Indicators of stock market development show that they have few listed companies. Market liquidity is also low, with turnover ratio going from less than 1% in Swaziland to 60% in South Africa, compared with 85% on average in stock markets of developing countries having received significant SWFs' investments. This means lower business volume and implies greater difficulty in building a local market with its own market analysis (IMF, 2009c).

d. Lack of technological knowledge

Obviously, the low level of specific technologies in African countries may be a structural limiting factor to investment. Indeed, SWFs may be interested not only by financial returns, but

16. On the regulatory side, the opacity of corporate governance may also accentuate the lack of predictability, and hence the aversion of SWFs.

17. According to publicly reported transactions between 1995 and mid-2009, 68% of SWFs' deals valued at USD 1 billion or higher.

also by possible technological transfers (Summers, 2007; Klodt, 2008). This barrier won't be removed in Africa in the medium term.

But furthermore, and strikingly, the technological level in African countries is not only lower than in developed countries, but also significantly lower than in those other emerging and developing countries having received significant SWFs' investments between 1991 and 2008.

To show this, one considers the Global Competitiveness Indexes constructed by the World Economic Forum (2010), which rank 139 countries regarding different aspects of their competitiveness. One focuses here on technological readiness and innovation. Table 2 shows that, worldwide, 80% of emerging or developing countries having received significant cross-border SWFs' investments (according to available data from UNCTAD) have a better ranking in technological readiness and innovation than 75% of all African countries. The differences are larger when considering all receiving countries (i.e. including developed countries). Exceptions on the African continent are Tunisia and South Africa, which are precisely the African countries having received significant SWFs' investments during the recent years.

Table 2. Indicators on technological readiness and innovation, in countries having received significant SWFs' investments between 1991 and 2008 and in African countries

	Rank in technological readiness	Rank in innovation
All countries having received significant SWFs' investments		
median ranking	29	29
80% of countries are better ranked than	76	66
Developing countries having received significant SWFs' investments		
median ranking	71	47
80% of countries are better ranked than	87	78
African countries		
median ranking	116	93
75% of countries are worse ranked than	100	80
Tunisia	55	31
South Africa	76	44

Source: Global Competitiveness report 2010, UNCTAD World Investment Report 2008.

Notes: The ranking is out of 139 countries. Indicators are sub-items of the Global Competitiveness Index constructed by the World Economic Forum (2010).

This underlines another possible barrier to investment linked with the lack of technological level in Africa: apart from natural resources, the expected profitability (and hence investment opportunities) is higher in sectors with high technologies. This may be the result of the current state of development and of technological readiness in Africa, rather than a cause by itself.

V. POLICY SUGGESTIONS

In the meantime, despite these barriers, some tools aimed at attracting more actively SWFs in Africa were recently put in place, or can be mentioned given successful experiences in Africa or in other developing countries. They concern specific tools that African countries could use as well as mechanisms aimed at channelling SWFs into Africa.

V.1. Own barrier removal: the role of African countries

African countries can use tools which may have been successful in attracting SWFs' investments. In particular, they can develop their own financial capital markets, improve regional co-operation and integration, and progressively benefit from recently launched African SWFs. They can also be more active in attracting specifically SWFs and progressively improve the frameworks for SWFs' investments. All in all, African governments need to define a more co-ordinated development strategy when attracting SWFs and at the same time, when receiving their investments, to avoid pitfalls linked to the relatively large size of SWFs' investments compared to the size of their economy.

More deepening and integration of financial markets is needed

Local capital markets are developing in Africa. Countries are seeking better sovereign ratings, and bond and equity offerings are progressively increasing. The number of stock markets in sub-Saharan African countries has risen from five in 1989 to sixteen in 2010. There are about twenty stock exchanges operating in the whole African continent. Regional initiatives have also been launched, like the Bourse Régionale de Valeurs Immobilières (BVRM) and the Southern African Development Community (SADC) stock exchange, or, for instance, in the framework of the East African Community. At present, consultations are underway to deepen equity market liquidity in Africa, but this is a slow process. For instance, discussions over creating a central African stock market have stalled since 1998.

The diversification of risks through regional co-operation

Significant SWFs' investments in Africa involved *de facto* several recipient economies at the same time, in particular concerning infrastructure projects (including Telecom), regional operators, and banks. Whereas African markets are small considered individually, increased regional co-ordination among receiving countries could help limit the risks of individual projects and increase the size of possible investments, and in principle afford greater economies of scales. This may therefore attract SWFs' investment, and also have the side benefit of increasing exchanges and avoiding bidding wars linked with incentives to attract foreign investments.

Active government actions to attract SWFs

Many OECD and emerging countries are increasingly active in attracting SWFs, and a range of deals have been first discussed or channelled through the political level (Sovereign Wealth Fund Institute website). In recent years, there have been increased numbers of deals between SWFs and foreign emerging or developing countries' governments, aiming at creating common vehicles to facilitate investments in the latter. These concerned for instance Argentina, Indonesia, Oman, South Korea, Philippines and Viet Nam (see Table A3 in Appendix). Information is not always publicly available regarding these mechanisms, but far fewer co-ordination mechanisms and government involvement are reported in African countries. African governments' initiatives appear rare and, most of the time, consist of initiatives by the SWFs from the Gulf or Asia. More active actions targeting SWFs may then be useful. To this end, improved co-ordination across ministries, as well as between government and civil society, could help to attract SWFs more efficiently. This is however a long-term process which requires capacity building.

Improving the frameworks for SWFs' participation, e.g. in government projects

Participation of SWFs can be encouraged in sectors which involve monopolistic or quasi-monopolistic activities, as shown with the growing involvement of SWFs in infrastructure projects (OECD, 2008). In some participation frameworks, the possibility of transferring the risk to the host state or to the clients, as well as the nature of SWFs as strategic partners for the host state, may create further guarantees for SWFs' investments.

Beyond the different frameworks, the need for a co-ordinated development strategy and the specific challenges for Africa

All in all, even when attracting SWFs' investments, African countries need to take a close look to maximise the benefits from them. This requires **defining a coherent and co-ordinated development perspective** when attracting them, which is lacking in Africa. For instance, in successful emerging countries (such as China or Singapore), the state has defined national development strategies when attracting foreign investments. These strategies were aimed at fostering the development of domestic capacities by improving productivity, technology and competitiveness. In this area, experiences could be drawn from other emerging countries. For instance, African governments must be more concerned with technology transfers when engaging with emerging SWFs, just as China was itself when engaging with OECD countries. Some corporations from emerging countries and SWFs indeed have expertise and may transfer it to developing countries, to make higher returns. However, the African context differs just as policies and growth models differed a lot in each of the successful emerging countries, so that it is difficult to build a simple global lesson for African countries when attracting investments (African Development Bank and OECD, 2011).

There is also a need to avoid the pitfalls linked to the expected large size of SWFs' investments compared to African markets. While SWFs' assets are relatively small in comparison

to global market capitalisation and total financial assets,¹⁸ their investments are significant in comparison to the size of African markets, which raises a number of challenges:

- Firstly, the starting SWFs' **investments diversification in non traditional sectors should be promoted** (*e.g.* Telecoms and banks) by African countries. Indeed, large investments directed to some sectors only may also create a risk of over-specialisation, and cancel the effects of some costly policies aimed at diversifying the economy. Furthermore, in some African countries running regular current account surpluses, the possible significance of SWFs' inflows may also put an upward pressure on African exchange rates and prices¹⁹, which may lead to a loss of competitiveness for (other) manufacturing sectors, as a wide literature on Dutch disease suggests in the case of countries endowed with natural resources.
- Secondly, **the regulatory framework has to be strengthened**. In part due to the small capitalisation in African economies, SWFs may want to take majority stakes and a management role in key sectors, alone or in partnerships with foreign SOEs (*e.g.* the joint involvement of the CADFund in Africa with Chinese SOEs; see Miracki *et al.*, 2008 for a broader study on developing countries). As within OECD countries, this raises concerns, especially where strategic sectors or countries with weak regulatory frameworks for the protection of competitive environment are involved. On the other hand, the increasing involvement by SWFs in management roles may also be positive as they may improve corporate governance. Furthermore, many SWFs have investment behaviour similar to that of many private investors (Avendano and Santiso, 2009), which can in part reassure the markets.

V.2. African home-grown SWFs can also help

African governments have also launched their own SWFs (Libya, Algeria, Botswana, Cap Verde and recently Nigeria). Ghana also plans to create a sovereign fund to manage its crude oil earnings. To date, Angola, Gabon, Equatorial Guinea and Chad have not built up significant long-term savings from their oil exports, but they may consider this in the future. This will raise interest in Africa, firstly as SWFs increasingly invest in close economies and secondly as more SWFs from abroad could be attracted.

18. As of mid-2009, SWFs assets make up less than 10% of global stock market capitalisation and only 3% of bank assets worldwide.

19. Although many African countries show current account deficits, some countries show regular surpluses. For instance, over the 2000 decade, Algeria, Angola, Botswana, Gabon, Libya, Namibia and Nigeria showed annual current account surplus of more than 2% of their GDP on average (IMF, own calculations).

Table 3. Sub-Saharan (possible) African SWFs: the cases of Botswana, Nigeria and Angola

State of play, as of mid-2011	
Botswana	<p>The Pula Fund was established in 1994 with the aim of preserving part of the income from diamond exports for future generations. The fund Foreign exchange reserves that are in excess of what is expected to be needed in the medium term are transferred to the Pula Fund and invested according to investment guidelines, with a long term perspective.</p> <p>The Pula Fund has increased substantially in value in real terms since it was established in 1994. This reflects both a sustained period of substantial balance of payments surpluses as well as returns on investment.</p> <p>However, there have been substantial outflows, following the establishment of the Public Officers Pension Fund, which resulted in a substantial transfer of assets from Government; and following the financial turmoil of 2008, due to adverse market conditions and to outflows in order to maintain a sufficient level of foreign reserves in the Central Bank.²⁰</p>
Nigeria	<p>Currently, the surpluses linked with oil revenues are held in the Excess Crude Account (ECA) to help stabilise the budget. The rationale behind the ECA is to act as a stabilisation fund, closing budget deficits that are a product of oil price volatility, and to potentially fund domestic infrastructure investments.</p> <p>In mid-2010, it was decided that the Excess Crude Account (ECA) would be replaced by a SWF with a long-term perspective. The Nigerian Sovereign Investment Authority (NSIA), designed as a statutory corporation, will be saddled with the triple objectives of bridging the national infrastructure gap, building a savings base for the benefit of future generations of Nigerians, and providing stabilisation support in times of financial stress.</p> <p>Discussions and negotiations among various stakeholders have been going on since 2010. There is a lingering disagreement between the states and the Federal Government over the funding of the SWF. The Federal Government does not want it to be funded exclusively from excess crude revenues, and would like a situation where the states make monthly contributions from other sources. On their part, governors do not want any other source of funding that might either make their states receive less or contribute more.</p>
Angola	<p>Angola is in the process of launching a SWF to invest abroad. The fund will be called Fundo Soberano Angolano (FSA). Plans to create the fund were announced in November 2008, but the project has since been delayed several times due in particular to the global economic downturn. There is currently no set date for the completion of the creation of the SWF and, as of April 2011, the fund was still waiting to be approved by the cabinet.</p> <p>The FSA will be funded by oil revenues from Angola's oil sector. All revenues over USD 58 a barrel of oil will be placed in the fund. It is expected that the fund will replicate the investment strategy of the Government Pension Fund of Norway (which has advised the fund on the best way to manage oil revenues) by purchasing small stakes of common stock in international companies.²¹</p>

Source: Sovereign Wealth Fund Institute Website; national sources.

20. The Bank of Botswana Act requires the Bank to maintain a Primary International Reserve, which is commonly referred to as the Liquidity Portfolio. Section 35 of the Act further provides for the creation of an additional fund, the Pula Fund, which is the excess or residual from the Liquidity Portfolio. The benchmark level for the Liquidity Portfolio is reviewed from time to time: it is currently set at six months of import cover.
21. Angola also has a state-owned oil firm Sonangol, which it has used to buy stakes in companies. However, the primary goal of Sonangol is to develop Angola's oil sector, and it is not clear if Sonangol will transfer its stakes to FSA.

V.3. Multilateral Development Banks and other financial entities as channels

When investing in Africa, SWFs have recently engaged in increased co-operation with the World Bank and other private financial entities. These co-operation frameworks appear promising and may play a growing role in the future.²²

a. Co-operation between SWFs through the World Bank

In 2008, the World Bank's President Zoellick suggested that SWFs should invest 1% of their assets in equity in Africa, through its vehicle for private-sector investment, the International Finance Corporation (IFC). This would bring in the World Bank's expertise in evaluating projects in Africa, and limit the fear of political interference. A programme was announced in April 2010, according to which the Korea Investment Corporation (KIC), the State Oil Fund of the Republic of Azerbaijan (SOFAZ), the Dutch pension fund manager PGGM, and an unnamed SWF in Saudi Arabia agreed to invest USD 600 million in a World Bank-sponsored equity fund for less-developed countries, the African, Latin American and Caribbean Fund (ALAC) whose mandate is to find commercially viable opportunities to finance growth and jobs in the developing world, by buying stakes in (normally mid-cap) companies in Africa. The first investments by ALAC fund appeared to be conservative, by focusing on multinational companies in sectors with expected safe returns, but may progressively target other sectors and smaller enterprises.²³

Similarly, through support to the banking sector, the IFC Asset Management Company (AMC) created in 2010 a "fund of funds", the African Capitalization Fund, a private equity fund to help channel sovereign wealth into African businesses such as agricultural processing and manufacturing.²⁴ The fund's mandate is to strengthen the banking sector by increasing capacity for lending by private sector commercial banking institutions, and to contribute to increased efficiency and access to finance. The fund would seek a minimum of 5% ownership through equity or equity-related investments (jointly with IFC or other funds managed by AMC).

b. Partnership with private financial institutions

SWFs have also decided to form joint ventures with private financial institutions to develop projects in Africa. This could bring in the expertise of these private institutions. For instance, ADIA and the Swiss bank UBS started a joint venture for entering into infrastructure

22. However, common channels involving many counterparts are not always sought after by SWFs. For instance, regarding investments in agriculture projects in Africa, the Abu Dhabi Fund for Development (ADFD) was interested in creating a joint venture with the *Agence Française de Développement*. When an "African Agriculture Fund" was proposed (which included many other counterparts) the ADFD withdrew from the project, probably because such large channel would have diluted its interest and would have given no guarantee regarding direct access to the agricultural resource or to French networks in Africa.

23. It went into HeidelbergCement, the world's fourth largest cement maker, which has expansion plans in West and Central Africa, and Ecobank Transnational, a pan-African bank group seeking to boost lending.

24. In June 2010, the African Development Bank, the European Investment Bank and the OPEC Fund for International Development, announced support of USD 200 million. The Abu Dhabi Fund for Development also announced that a commitment to the fund is under consideration.

projects. The purpose of the fund is to focus on utility, transport, social and energy-related projects in the Middle East and North Africa (OECD, 2008). Similarly, Dubai International Capital LLC (a subsidiary of the Investment Corporation of Dubai) has settled an agreement with HSBC Holdings PLC and Oasis International Leasing Co to invest in Middle East and North African projects for USD 300 million. In the same line, although this does not come through a SWF *per se*, the Nigerian government has invested USD 462 million into the African Finance Corporation, a private equity fund focused on Africa.

CONCLUSION

Despite low current volumes, SWFs' investments in Africa are growing and may significantly accelerate over the next few years. This can represent a major opportunity: by their possible size, their long-term perspective and their capacity to leverage other investments, SWFs may be a particularly useful tool to meet the MDGs.

However, different barriers have to be tackled by African countries and the international community. Some of these barriers are structural and will take a long time to overcome, such as the lack of technological knowledge or the size and liquidity of African markets. Nevertheless, on the one hand, the globally improving macroeconomic fundamentals in many African countries (compared, for instance, to the 1990s), the progressive development of non-traditional sectors and of local markets, as well as the will of the international community to launch common vehicles to channel better investments to Africa, may provide good incentives for SWFs to invest more actively in Africa. On the other hand, African countries can design more active and co-ordinated strategies to benefit the most from these growing sources of funding and to orient them efficiently towards development.

APPENDIX

Table A1. Description of Stock Exchanges Markets in Africa and in (other) developing countries having received cross-border SWFs' investments

African countries			
Country	Stock market capitalisation / GDP	Stock market total value traded / GDP	Stock market turnover ratio
Botswana	61%	1%	2%
Côte d'Ivoire	56%	1%	1%
Egypt	102%	39%	29%
Ghana	18%	1%	2%
Kenya	46%	3%	8%
Malawi	7%	0%	2%
Morocco	86%	36%	35%
Namibia	12%	0%	3%
Nigeria	18%	2%	19%
South Africa	308%	197%	60%
Swaziland	7%	0%	0%
Tanzania	4%	0%	2%
Tunisia	17%	2%	13%
Uganda	1%	0%	5%
Zambia	23%	1%	5%
Average*	27%	4%	7%
Emerging and developing countries having received significant cross-border SWFs' investments			
Country	Stock market capitalisation / GDP	Stock market total value traded / GDP	Stock market turnover ratio
China	32%	26%	67%
Hong Kong, China	603%	213%	79%
Indonesia	55%	13%	82%
Malaysia	180%	43%	78%
Oman	44%	9%	27%
Chinese Taipei	203%	461%	222%
Thailand	73%	40%	42%
Average	170%	115%	85%

Notes: last year available. * Excluding South Africa and Egypt.

Sources: World Bank database on Financial Development and Structure, World Bank's Financial Sector Development Indicators database, 2010; own calculations.

Table A2. Sovereign debt ratings (long term) of selected African countries as of year 2009 or 2010 and of (other) developing countries having received significant SWFs' inflows

African countries			
Country	Standard & Poor's	Fitch	Moody's
Benin	B	B	B
Burkina Faso	B	-	-
Cameroon	B	B	-
Egypt	BBB-	BB+	Ba1
Ghana	B+	B+	-
Kenya	B	B+	-
Morocco	BB+	BBB-	Ba1
Nigeria	B+	BB-	-
Senegal	B+	-	-
South Africa	BBB+	BBB+	A3
Tunisia	BBB	BBB	Baa2
Uganda	B+	B	-
Emerging and developing countries having received significant cross-border SWFs' investments			
Country	Standard & Poor's	Fitch	Moody's
China	A+	A+	A1
Hong Kong, China	AA+	AA	Aa2
Indonesia	BB+	BB+	Ba2
Malaysia	A+	A-	A3
Oman	A	-	A1
Chinese Taipei	AA-	A+	Aa3
Thailand	A-	BBB	Baa1

Sources: Standard & Poor's, Fitch, Moody's.

Table A3. Some recent government involvements in setting joint investment vehicles with SWFs

	Description of the deal or the memorandum of understanding
Asia	QIA had been in talks for more than two years with the Indonesian government to set up a joint investment vehicle. QIA established (finally a wholly-owned venture) PT Qatar Holding Indonesia, a USD 1 billion fund to invest in infrastructure and mineral resources in Indonesia.
	A memorandum of understanding (MOU) was signed in 2009 on co-operation between KIA and the State Capital Investment Corporation (SCIC) of Viet Nam .
	Under the MOU, the SCIC and KIA enter into a partnership to further promote joint investments in such areas as infrastructure projects, property development, privatisation of SOEs in Viet Nam and others.
	In 2009, South Korea's Korea Investment Corporation signed a co-operation agreement with Gulf States' SWFs. The aim is to attract investment in a range projects, including infrastructure.
	The Philippines authorities (Department of Trade and Industry) are seeking, from 2011, SWFs from Qatar and Abu Dhabi for USD 2 billion of equity investments in public-private partnership projects and a wide range of sectors.
Middle East	Qatar and Oman set up a new joint investment company (the Qatar Oman Investment Company) with around USD 80 million in order to invest in both countries, in particular in the domains of real estate, infrastructure and the financial sector.
Latin America	Argentina is increasingly active in talks with Kuwait's SWF (KIA) for investments in infrastructure. A MOU was signed with KIA, which enabled businessmen to present KIA with projects worth USD 3.3 billion.
Europe	Qatar and UK governments jointly established the "Clean-Technology Investment Fund" to invest in low-carbon-emitting energy's technologies. QIA pledged GBP 150 million (pounds sterling), while the U.K.'s Carbon Trust, a government body, pledged GBP 10 million and a commitment to attract investment from private companies worth an additional GBP 90 million.

Source: Sovereign Wealth Fund Institute, national sources.

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