Policy Brief: Whither Sovereign Wealth Funds in Africa?

By Raymond Gilpin
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African countries have developed a range of financial arrangements that aim to improve the utilization and governance of export earnings since the 1960s. These investment vehicles, generally referred to as Sovereign Wealth Funds (SWFs), are growing across the continent, particularly in resource-rich countries. The Sovereign Wealth Fund Institute defines a SWF as "a state-owned investment fund or entity that is commonly established from balance of payments surpluses, official foreign currency operations, the proceeds of privatization, government transfer payments, fiscal surpluses and/or receipts resulting from exports."[1] This paper provides a summary critique of SWF challenges and prospects in Africa.

The Rise of SWFs in Africa

Country	Fund name	Assets (in USD)	Year est.	Notes
Algeria	Fund for the Regulation of Receipts	$77.5 billion	2000	Funded by oil & gas profits.
Angola	Fundo Soberano de Angola	$5 billion	2012	Funded by oil profits. 7.5% of fund to social projects.
Botswana	Pula Fund	$6.9 billion	1994	Funded by diamond profits.
Ghana	Petroleum Holding Fund	$.072 billion	2012	Funded by oil profits. Comprising a heritage and stabilization fund.
Libya	Libya Investment Authority	$66 billion	2006	Funded by oil & gas profits.
Mauritania	Fonds National des Revenus des Hydrocarbures	$.3 billion	2006	Funded by oil & gas profits.
Nigeria	Nigeria Sovereign Investment Authority	$1.5 billion	2011	Funded by oil profits. Comprising stabilization, future generations, and infrastructure funds.
Rwanda	Crystal Ventures	$.5 billion	2009	Funded by mineral and agricultural profits.

A selection of African sovereign wealth funds. Data from 2014.[2]

Historically, the first wave of stabilization funds emerged in the newly independent African countries in the 1960s. State-owned commodity marketing boards created ill-fated stabilization funds to smooth volatility in export earnings. Since the mid- to late-1990s there has been a gradual resurgence of efforts to manage windfall gains effectively. The main motivating factors for SWFs are: (a) a government's desire/strategic plan to improve resource management; (b) recommendations by international financial institutions, like the World Bank and International Monetary Fund; and (c) demands for transparency by civil society. Table 1 (above) shows a selection of current SWFs in Africa. A number of other African

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countries are either considering SWFs or are at the very early stages of implementation. It is, however, important to note that Africa's SWFs are still fledgling and represent a tiny fraction of the trillion dollar global industry and a fraction of the GDP of their host countries.

Four broad categories of SWFs are identifiable in Africa: (a) next generation funds; (b) stabilization funds; (c) welfare distribution and equity funds; and (d) investment funds. It is important to note that some SWFs may demonstrate aspects of more than one category. While this provides for more flexibility and presents the possibility of broader welfare gains, it also poses a challenge for management and accountability.

Governance and Management of SWFs in Africa

Countries that were either pushed to establish SWFs by international financial institutions or decided to go this route for political reasons in response to civil society advocacy are more likely to mismanage, misuse, and abuse SWFs. Governance and management challenges include:

- **Competence and independence of SWF boards:** In a number of cases the boards are appointed by the government, usually as political favors. Unsurprisingly, the competence and efficacy of these boards are questionable and oversight is lax.
- **Use of SWFs as currency reserve instruments:** Africa's SWFs get raided when governments are in a financial bind and seek to support monetary policy goals (e.g. defending the currency). This results in a precipitous dwindling of SWF assets.
- **Accountability to parliament:** This is not always clear, given their amorphous position as parastatal entities. The political heft of the boards usually provide tacit immunity from oversight.
- **Public legitimacy:** SWFs often lack public legitimacy. There is inadequate civic education and insufficient ownership by civil society and the population as a whole.

Potential Benefits of SWFs in Africa

African countries with a clearly defined strategy to use proceeds from natural resources for national development will have more success with SWFs. Potential benefits include:

- **Ensuring effective short-term earnings:** SWFs can provide short-term relief for temporary market volatility. Most SWFs are relatively small in size (a fraction of annual productivity) and would be depleted if they are used to address structural or long-term crises.
- **Closing the investment gap:** Africa's SWFs can address some of the social and infrastructural investment needs on the continent. Strategically, it might be prudent for SWFs to focus on domestic investments during their early years before turning to investments in global markets.
- **Leveraging investment inflows:** Well-managed SWFs boost investor confidence and attract foreign direct investment. They also contribute to more positive country credit ratings, which in turn reduces the cost of borrowing and leverages capital inflows.[3]
- **Enhancing transparency and accountability:** Professionally-managed, independent SWFs bode well for transparent policies and accountable officials. The likelihood of corrupt practices is also curtailed significantly.
- **Rebuilding the social contract:** When citizens understand the objectives of SWFs, and derive benefits from the investments, they are more likely to have more confidence in the system. The government, for its part, will focus on sustainable, longer-term solutions rather than politically expedient quick fixes.

Lessons from Selected African SWFs

- **Management:** Botswana's Pula Fund was established in 1994 to manage profits from the country's lucrative diamond trade. An independent, professional management team contributed to the steady growth of the fund, consistent with the country's long-term investment goals. The Pula Fund had won international acclaim for its adherence to the Santiago Principles.[4]

- **Mandate:** Nigeria's Sovereign Investment Authority was preceded by another SWF, the Excess Crude Account (ECA). Established in 2004, this stabilization fund grew from $5 billion in 2005 to $20 billion in 2008. The mandate of the ECA was unclear. While many thought of it as a future generation fund, parliamentarians failed to distinguish between the fund and the country's petroleum allocation arrangements, and the government treated it as a foreign currency reserve asset. Consequently, between discretional payments to the politically connected and massive withdrawals during foreign currency crises, ECA assets dwindled to $400 million in 2010.

- **Mechanisms:** The Chadian government established the Oil Revenue Management Plan in 2003 to help manage oil revenues, at the insistence of the World Bank. However, the mechanisms for use and withdrawal were not as robust as they could be. The government used the SWF as an alternate treasury account and the funds were eventually depleted, leading to its collapse in 2008.

Summary and Policy Recommendations

1. **SWFs should be part of the broader national development dialogue.** This promotes ownership, transparency, and predictability.

2. **SWFs must be distinguished from currency stabilization funds.** Governments using SWFs for currency stabilization reasons must pay a market-determined premium (as a deterrent).

3. **SWFs must be depoliticized.** Roles and responsibilities of accountable boards should be clearly laid out and publicized.

4. **Rules governing the domestic/external investments SWFs could explore should be clarified.**

5. **Capacity should be built within SWFs, oversight institutions (parliament, auditors general), the media, and civil society.**

6. **External actors could support Africa's SWF's through strategic management and investment partnerships.**

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1 See the Sovereign Wealth Fund Institute's website: www.swfinstitute.org/sovereign-wealth-fund/

2 Sovereign Wealth Funds: A race to unlock Africa's hidden potential? http://www.polity.org.za/article/sovereign-wealth-funds-a-race-worth-joining-to-unlock-africas-hidden-potential-2014-06-11 and List of African Sovereign Wealth Funds 2013: http://www.investmentfrontier.com/2013/12/20/list-african-sovereign-wealth-fund-2013/

3 *The Rise of the African Sovereign Wealth Fund* http://www.thisisafricaonline.com/Policy/Rise-of-the-African-sovereign-wealth-fund

4 *Case Study: Botswana's management of the Pula Fund Observance of the Santiago Principles*. http://www.bankofbotswana.bw/assets/uploaded/BOTSWANA%20PULA%20FUND%20-%20SANTIAGO%20PRINCIPLES%20(2).pdf

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