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Africa's Sovereign Wealth Funds are a Source of Development Finance

Introduction

Austerity measures resulting from constrained fiscal space to respond and recover from COVID-19 are forcing policy makers to think innovatively about all available options to finance development. In August 2020, Namibia, for the first time in three decades of its independent history, applied for an International Monetary Fund (IMF) emergency loan to battle the COVID-19 pandemic. Earlier in June, the Government released a statement to announce the decision by Cabinet to set-up a sovereign wealth fund (SWF), assigning the Ministry of Finance the task to research and find an appropriate model and plan to set up the SWF. If implemented, Namibia will be joining a select group of African countries that are already using this mechanism to fund development projects, and to catalyse additional and non-traditional finance.

SWFs are special purpose investment funds owned by state governments, which can be shielded from liabilities and can expand investment horizons due to their lack of dependence on short-term liquidity. They comprise the gamut of domestic sources of public finance, in addition to tax revenues, non-tax revenues, public domestic borrowing, and public-private partnerships.

SWFs emerged in Kuwait with the objective of investing surplus revenues from oil in order to decrease the country's dependence on the fossil fuel. SWFs can be traced to 1953, and many were founded during the 1970s or early 2000s, when commodity prices were high. They were established to serve as a source of stability for government and export revenues that are related to the volatile nature of oil and commodity prices, and to accumulate reserves in excess for intervention purposes as well as balance of payment.

There are various types of SWFs that countries have set up depending on their goals. The Santiago Principles classifies them as: a) stabilisation funds, b) saving funds, c) reserve funds, d) development funds and e) pension reserve funds without explicit pension liabilities. There is also variation in the scope of assets and the specific policy objectives of the SWFs largely determine their financial management, including investment and risk management decisions. These funds are often set up with capital from fiscal surpluses, balance of payments surpluses, foreign currency operations, or commodity exports, and they often invest in foreign financial assets for macroeconomic purposes. African SWFs often cover stabilisation, intergenerational savings, and economic development purposes, thereby functioning under an "umbrella model" that covers multiple goals.

1. Stabilisation funds are set up to insulate the budget and economy from commodity price volatility and external shocks. Their investment horizons and liquidity objectives resemble central banks' reserve managers, in view of their role in countercyclical fiscal policies to smooth boom/bust cycles;
2. Saving funds are set up to share wealth across generations by transforming non-renewable assets into diversified financial assets. Their investment mandates typically reflect a higher tolerance for volatility and a focus on long-term returns;
3. Development funds are set up to allocate resources to priority socioeconomic projects, usually infrastructure;
4. Pension reserve funds are set up to meet identified outflows in the future with respect to pension-related contingent-type liabilities on the government's balance sheet. They usually hold high shares in equities; and

5. Reserve investment corporations are set up to reduce the negative carry costs of holding reserves or to earn higher return on ample reserves, while the assets in the funds are still counted as reserves. They often maintain high allocations in equities and alternative investments.

Estimates of total global assets vary greatly, given there is no consensus on the definition of SWFs. However, the 2018 Preqin Sovereign Wealth Fund Review estimated that SWFs held roughly US $7.5 trillion in assets in March 2018, representing a growth rate of 13% since 2017 and more than double the asset base of 2008. This makes SWFs the fourth largest institutional investor group with about 2.4% of total global financial assets.

Thus, SWFs have attracted attention for their growth as an investor class and for the striking speed of this growth. Yet, African SWFs represent an estimated 0.24%, or US $16.4 billion, of the world total, according to the Sovereign Wealth Funds Institute. The publicly disclosed capitalisation of SWFs in sub-Saharan African countries is the lowest in the world. However, it is likely that the amount is much higher than what is being disclosed publicly. Although small in proportion to the global total, the value of sub-Saharan African SWFs is not insignificant compared to the continent's financing needs. The potential of SWFs as financiers of the Sustainable Development Goals (SDGs), as well as their special characteristics as state-administered funds has to be evaluated.

SWFs in Africa

SWFs are a noteworthy source of investment capital and African SWFs are largely funded from surpluses derived from commodity exports, such as mineral or energy exports. The African SWFs Index notes that there are currently twelve SWFs in the African continent with combined assets of US $89 billion. Due to the SWFs definition discrepancy, reports utilising a more expansive definition place the number at sixteen to twenty African SWFs with assets totalling over US $159 billion. In 2015, the largest investment of SWFs in Africa was done in Algeria and Libya, amounting to US $55 billion of assets under management in each country. Botswana and Angola hold the second largest funds, each managing around US $5 billion as of 2015. The remaining African SWFs each managed under US $2 billion in assets at that time. By comparison, in 2015, Norway's Government Pension Fund Global (GPFG) managed over US $817.9 billion, China Investment Corporation (CIC) managed US $650 billion, and Singapore's Temasek Holdings managed US $160.7 billion. To put that into perspective, all three of these SWFs ranked within the top 10 or top 13% of SWFs by size of total assets under management, and Norway's GPFG and Singapore's Temasek are two of the most well-known and reputable SWFs.

About half of all African SWFs were created within the past decade, and at least seven other countries on the continent have announced their intentions to create SWFs. An estimated eighteen African countries are said to be home to SWFs. Most sub-Saharan African SWFs are stabilisation funds (see Table 1). The Bank of Botswana notes that the Pula Fund is a long-term investment vehicle with the essential characteristics of a SWF. Having been created in 1994, the Pula Fund is an evolving best practice and it is important to understand government intentions to

develop it further. Ghana's SWF, which held about US $540 million in 2014, is divided into three sub-funds: the Ghana Stabilisation Fund, the Ghana Heritage Fund, and the Infrastructure Investment Fund. The Minerals Development Fund of Namibia (Namibia MDF) is also mentioned as a SWF by the Sovereign Wealth Fund Institute.

Table 1: Sovereign wealth funds in Africa

Country	Capitalisation (US $ billion)	Type	Hard Commodity
Algeria	7.24	Future Generations	Oil/Minerals
Angola	5.00	Development	Oil
Botswana	6.90	Future Generations	Minerals
Chad	0.03	Future Generations	Oil
DR Congo	1.39	Stabilisation	Oil/ Minerals
Equatorial Guinea	0.07	Stabilisation	Oil/ Minerals
Gabon	0.40	Future Generations	Oil
Ghana	0.49	Future Generations	Oil
Libya	60.0	Development	Oil
Mauritania	0.30	Stabilisation	Minerals
Mauritius	0.50	Development	
Namibia	N/A	Development	Minerals
Nigeria	1.40	Stabilisation	Oil
Rwanda	0.21	Development	Minerals
Sao Tome and Principe	0.01	Stabilisation	
Senegal	1.00	Development	
Sudan	0.15	Stabilisation	Oil
Uganda	0.08	Development	

Source: Author, adapted from United Nation Economic Commission for Africa (UNECA). 2017. "Fiscal Policy for Financing Sustainable Development in Africa"; United Nations Conference on Trade and Development (UNCTAD) 2012, "Commodities and Development Report"; UNECA. "Innovative Finance for Private Sector Development in Africa", forthcoming.

To ensure the growth of their portfolio value, these SWFs invest around the world in profitable investment projects. Unfortunately, Africa attracts a relatively marginal share of the investments of these funds. Asia, North America and Europe are the main regions that attract the most investments made by SWFs. In addition, over the 2000-2013 period, the SWFs that invested the most in sub-Saharan Africa were from Asian countries, mainly China. Investments by Asian SWFs accounted for 49% of all SWFs

investments in sub-Saharan Africa as compared to 38% by African SWFs. At present, the bulk of SWFs investments in sub-Saharan Africa are in the real estate and hotel sectors. More investments by SWFs can be made within Africa.

African SWFs shoulder much of the financial burden in implementing the SDGs, through the allocation of substantial funds to infrastructure development in underserved communities. Furthermore, African SWFs are the necessary local counterpart to foreign co-investments, as they attract foreign capital for developing domestic infrastructure. In addition, African SWFs are setting an excellent example for SWF best practices in green investing and decision-making, with Morocco's Green Growth Infrastructure Facility (GGIF), and Senegal's Fonds Souverain d'Investissements Strategiques (FONSIS), emerging as leaders. Lastly, African SWFs in Angola and Nigeria are pioneering frameworks for financing social impact projects.

SWFs and Financing Development

Long-term investors such as SWFs can make an important contribution to growth in various ways, most importantly by financing long-term projects, such as infrastructure, clean technology, real estate and agriculture. African SWFs directly participate in domestic public finance through infrastructure development, climate conscious financing, and socially responsible investing.

The greatest impact SWFs can have for the SDGs is through long-term investments in the alternative private market asset classes such as infrastructure, real estate, agriculture, timber, venture capital and private equity. For example, it is estimated that if global SWFs allocated about 1.3% of total global assets to Africa, it would close the continent's infrastructure financing gap, thus demonstrating their financial capacity for addressing the issue. Additionally, Angola's SWF, the Fundo Soberano de Angola (FSDEA), dedicated about US $1.1 billion to infrastructure development between 2012 and 2016, which included projects in the energy, transport, and industrial sectors. Furthermore, about 50% of Angola's SWF is dedicated to emerging markets and priority investment sectors in the continent. The Nigeria Infrastructure Fund (NIF) and the Ghana Infrastructure Investment Fund (GIIF), also focus on developing strategic infrastructure within their respective countries.

African SWFs support local infrastructure development in ways that align with the SDGs. They include elimination of poverty (Goal 1), good health (Goal 3), quality education (Goal 4), clean water and sanitation (Goal 6), affordable and clean energy (Goal 7), stronger innovation and infrastructure (Goal 9), and sustainable cities (Goal 11). SWFs can also indirectly finance infrastructure by acquiring infrastructure bonds, underwriting loans, and investing in infrastructure debt funds. By providing extra liquidity to local debt and equity markets and stabilising the domestic financial system, SWFs can reduce risks and ensure that infrastructure projects receive continuous financing even in the event of an economic crisis. During the global recession of 2008 for example, Kuwait's SWF intervened to stabilise the country's economy by investing US $4 billion into the stock market to support local firms. Norway's GPFG is a leader in the integration of the SDGs as a guiding framework for investment decisions.

The intrinsically long-term and large-scale nature of SWFs makes them an attractive match for the financing of sustainable development. Because of their unique set up, SWFs tend to have longer-term or well-defined liabilities, which enable them to invest in more illiquid assets. Furthermore, certain SWFs, such as sovereign development funds, have a specific mandate to invest in sectors that support the social and economic development of local economies. While there may be instruments and opportunities to support the SDGs across the asset-class spectrum, the greatest impact in the sustainable development sectors will come from investments made in the private market space (i.e., areas such as infrastructure, real estate, agriculture, timber, venture capital and private equity). Furthermore, investments made in these sectors have proven to not only provide wider economic and social benefits, in line with many of the goals of the 2030 Agenda for Sustainable Development, but these investments also provide attractive risk-adjusted commercial returns to investors.

Governments have a significant role to play in matching sovereign capital to the SDGs through sectoral targeting as certain sectors, such as infrastructure and housing, require governments to procure assets in a way that allows investments to be made by investors.

Botswana's Pula Fund

Botswana's Pula Fund is one of the institutions that is a best practice in the country's management of its natural resources' revenues. The Bank of Botswana maintains a long-term SWF, known as the Pula Fund, in addition to a regular foreign reserve account providing basic import cover. The Pula Fund, with an estimated value of some US $6.1 billion, was established under the Bank of Botswana Act and forms part of the country's foreign exchange reserves, which are primarily funded by diamond revenues. The Pula Fund is wholly invested in foreign currency-denominated assets and is managed by the Bank of Botswana Board with input from recognised international financial management and investment firms. All realised market and currency gains, or losses are reported in the Bank of Botswana's income statement.

Operation of the Pula Fund is related to government fiscal rules as stipulated in Section 5 of the National Development Plan II. Deposits to the Fund are dependent on the quality of budgeting and spending decisions: if spending is controlled, then there is a surplus in the national budget, which is deposited to the Pula Fund, during deficits, there are no deposits to the Fund. The Pula Fund is overseen by Parliament, and information on the value of the Fund is made public including through the weekly Government Gazette. Government can draw down from the liquidity component of the Fund during special crises, e.g. the 2015 economic crisis, during which an Economic Stimulus Package (ESP) was issued.

The Fund is audited through the Bank of Botswana accounts, whose financial reports on all revenues and expenditures (Annual Books of Accounts), including on the Fund are submitted to Ministry of Finance (Accountant General), which has oversight over the Fund through a constitutional mandate. The Auditor General which plays an oversight role, then audits the Reports and submits findings to the Parliament's Public Accounts Committee, which sanctions all expenditures. All procurement is guided by the Public Procurement and Asset Disposal Act.

Botswana is among the founding members of the International Forum of Sovereign Wealth Fund and was one of the architects of the Santiago Principles in 2008 and the Pula Fund also undergoes international assessment of SWF transparency published by the Sovereign Wealth Fund Institute, through the Linaburg-Maduell Transparency Index, which is based on ten principles relating to SWF transparency to the public.

SWFs require clear rules on governance, management to ensure they meet their stated objectives as the perception of Africa as a risky investment environment requires SWFs to heavily signal improvements in transparency and governance standards to attract co-investors. According to the Sovereign Wealth Fund Institute, African SWFs have relatively low ratings on the Linaburg-Maduell Transparency Index, the global index for rating SWF transparency. However, transparency has been improving, and several African SWFs are increasing their adherence to the Santiago Principles, which are twenty-four generally accepted guidelines that promote good governance, accountability, and transparent investment practices.

Good governance is a most crucial aspect to the development of robust investment strategies for SWFs and a critical determining factor for funds to invest over the long-term. A SWF works well if it is insulated from especially political pressures. This can be achieved by investing in financial assets, whereby the investment and asset allocation is a technical, objective process through clearly established independence. This is particularly relevant for development funds or strategic investment funds where domestic investments may destabilise macroeconomic management and undermine the quality of public investments and the wealth objectives of the funds. A clear separation needs to be made (generally for all SWFs) between the government as a promoter of investments and as owner of the SWF. It is thus necessary to build capacity for an SWF to operate as an expert, professional investor that can independently appraise prospective investment opportunities. Issues related to how the funds are set up and the processes involved in making investments need to be addressed, in order to enable the flow of capital into sustainable development sectors, and long-term projects that need investment.

A role for the Development Bank of Namibia (DBN)

SWFs may be a valuable source of funding for investment or capitalising national development banks. Extraordinary revenues obtained from discovery and exploitation of natural resources, accumulated for example in SWFs, can be partly channeled to increase capital of national development banks, which can then use the increased lending headroom generated for increasing loans to infrastructure and other key sectors. This could help transform the natural resource curse "into a "resource blessing".

Development banks such as Namibia's DBN can provide funds both to the private sector through loans or equity. With a diversified portfolio integrating riskier and less risky projects, they can fund their operations through their revenues as well as through funds levied on the market. Development banks may coexist at international, regional and national levels. At international and regional levels, they may largely focus on regional integration and trade while at the national level, they will focus more on nationally

oriented infrastructure. National development banks (NDBs) are particularly flexible, as they may have more leeway to fund themselves via local sources.

African SWFs consistently participate as the local counterpart to foreign co-investments, thereby attracting foreign participation and financing for infrastructure growth, while also setting aside funds for investment in domestic infrastructure. Co-investments are a growing trend in infrastructure financing, and African SWFs play a crucial role as the domestic counterpart to foreign co-investment. African SWFs have the expertise and risk-sharing ability to co-invest or coordinate investments with foreign stockholders.

Well-managed African SWFs can signal credibility and attract foreign investors. Establishing SWFs can signal sophistication, as seen from the increases in Angola's and Nigeria's respective credit ratings after establishing SWFs. In addition, SWFs can increase their governments' ability to meet investment obligations and thereby increase the confidence of foreign investors, attracting the private sector to infrastructure projects. SWFs can also provide liquidity to ensure that projects continue in the face of unforeseen circumstances or financial crises, as seen in the Gulf Cooperation Council (GCC) countries during the global recession of 2008, where the GCC governments used SWFs to sustain their development projects.

SWFs will continue to be an influential and important source of financing for the SDGs. Many of their activities directly map onto the seventeen core targets of the SDGs, and there remains great potential for African SWFs to lead the way in facilitating long-term, inclusive, and sustainable development. As large domestic institutional investors, the work of African SWFs, including stabilising investments and attracting foreign capital, fulfills the SDGs by strengthening international partnerships for implementation of the goals (specifically goal 17 and targets 17.3, 17.16, and 17.17) of the 2030 Agenda.

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