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African Development Bank
Angle des l'avenue du Ghana et des rues
Pierre de Coubertin et Hédi Noura
BP 323 -1002 TUNIS Belvédère (Tunisia)
Tel: +216 71 333 511
Fax: +216 71 351 933
E-mail: afdb@afdb.org

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AFRICAN DEVELOPMENT BANK GROUP

Africa's Quest for Development: Can Sovereign Wealth Funds help?

Thouraya Triki and Issa Faye ⁽¹⁾

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⁽¹⁾ Thouraya Triki and Issa Faye are, respectively, Principal Research Economist and Division Manager at the Development Research Department of the African Development Bank. The authors are very grateful to Ines Mahjoub and Aymen Dhib for excellent research assistance, Desire Vencatachellum and Hafedh Bouakez for comments provided on an earlier version of the paper and Victoria Barbary from the Monitor group for sharing data.

Abstract

This paper discusses the potential role that SWFs could play in African economies, both as recipient countries and home countries. We use new hand collected data to document the landscape of African SWFs as well as SWFs interventions on the continent. Our analysis shows that African SWFs are small, suffer from poor governance structures and are mainly focusing on stabilizing local economies. This suggests that their potential role as long term

institutional investors to foster economic growth is likely to be limited if current practices are maintained. Conversely, foreign SWFs are increasingly interested in Africa and are poised to play a bigger role in supporting the continent's growth if Africa uses the right strategies to attract their resources. Overall, the paper identifies opportunities that Africa offers for SWFs as well as challenges that need to be addressed in order to enhance SWFs role in supporting Africa's development.

Keywords: Sovereign Wealth Funds (SWF), Africa, institutional investors

JEL Classification: G28, O16, O55

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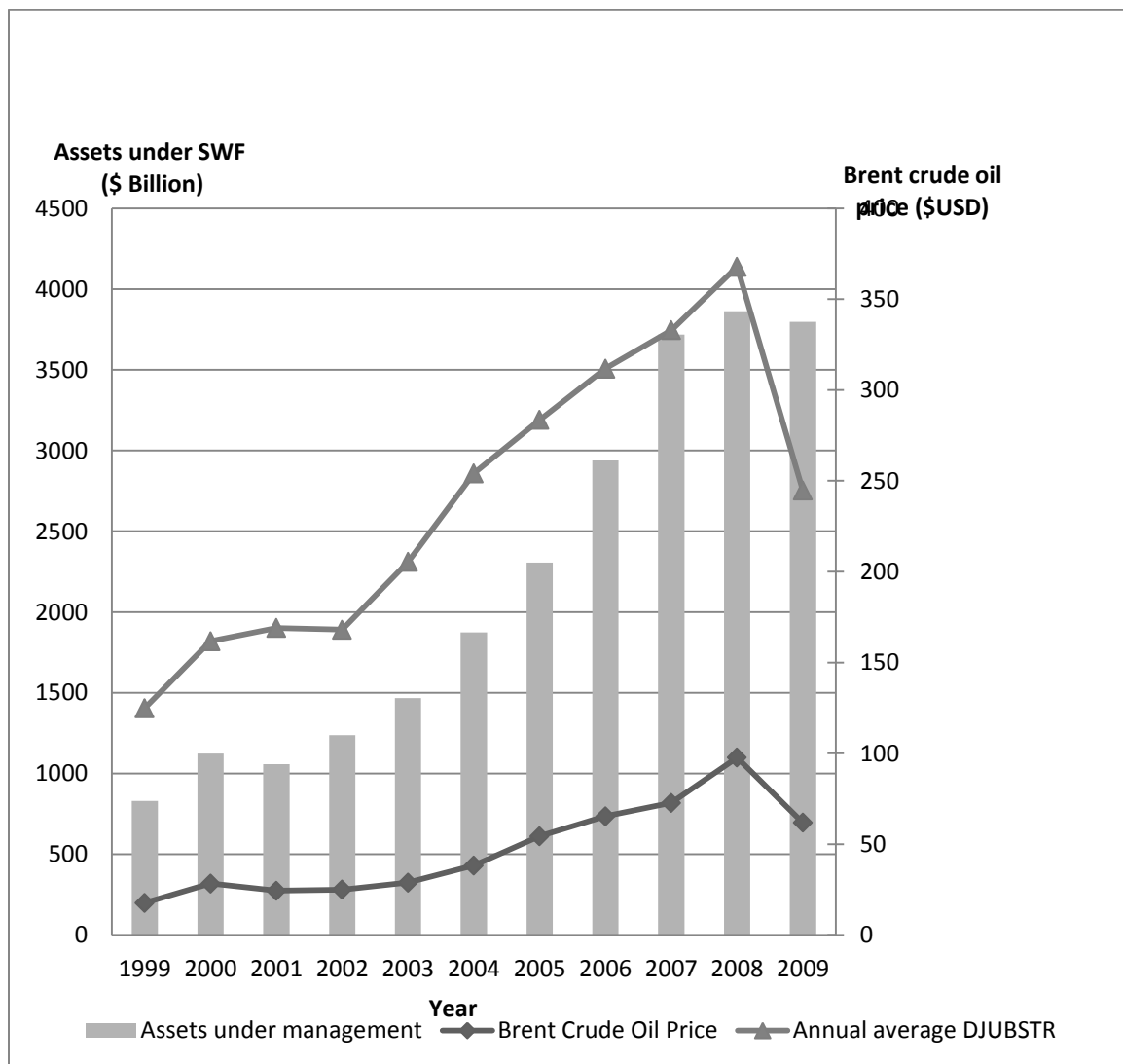
"At a time when people are fearful of Sovereign Wealth funds, I'm saying let's look at this as an opportunity", R. Zoellick, World Bank, 2008

Sovereign Wealth Funds (SWFs) have emerged as potential solutions to actively manage foreign reserves accumulated from commodity sales or strong exports. They correspond to government-owned investment vehicles managed by a state-controlled entity or external managers, on behalf of a nation, to serve primarily medium to long term economic and financial objectives. Their existence could be traced back to the 1950's when Kuwait established in 1953 a SWF to manage its foreign reserves. Impressive growth in the size of SWFs assets and the recent eye-popping cash infusions they made into high profile Western financial institutions like Morgan Stanley, Citigroup, UBS and the Blackstone group, to mitigate the negative effects of the financial crisis, helped spur the phenomenal increase in their popularity. Latest statistics published by Preqin show that SWFs managed USD 4 trillion in assets as of December 2010, 11% more than in 2009, reflecting the start of a global economic recovery.¹ OECD expects assets under SWFs management to reach USD 10 trillion by 2015. Figure 1 depicts the strong positive association between the value of total assets managed by SWFs and commodities prices over the period 1999-2009. Preqin (2010) estimates that exports of hydrocarbon and other commodities provide respectively 60% and 8% of resources managed by SWFs.

Significant revenues from commodities over the last decades had led to the inception of a number of SWFs in Africa, notably in oil exporting countries (e.g., Libya, Nigeria, and Chad). Botswana (Pula Fund) and Ghana (Minerals Development Fund) pioneered the establishment of African SWFs in 1993. According to our research, the continent counts at least 15 SWFs (Appendix A1). With the notable exceptions of the Libyan Investment Authority (LIA) and the Algerian *Fonds de Regularisation des Recettes* (FRR), which rank among the largest 15 SWFs worldwide in terms of size, African funds are dwarfed by their peers from other regions of the world (mainly Asia and the Middle East).

¹ By the end of 2009, SWFs were reported to manage 1.72% of World financial assets, twice the value of assets managed by hedge funds.

Fig. 1: Evolution of SWFs Assets as compared to Oil and commodity Prices



Source: Authors' calculation using Monitor Group SWF 2009 annual report, International Financial Statistics published by the IMF and Dow Jones Official Website. The line with triangles describes return on the Dow Jones-UBS Commodity Index (DJUBSTR).

SWFs are often created either to stabilize government fiscal and/or foreign exchange revenues and macroeconomic aggregates by smoothing out fluctuations in export prices and demand, or to save for future generations a fraction of the revenues accruing from the sale of non-renewable natural resources. There is considerable controversy about the relative merits of SWFs and their value added. Proponents of SWFs argue that these funds can help foster economic growth and prosperity for current and future generations by showcasing successful experiences such as Norway. They also point out that these vehicles can help stabilize the global financial system by providing cross-border liquidity in times of financial turmoil. Opponents, on the other hand, are expressing serious

concerns that SWFs would endow governments with too much power, which could move the global economy away from liberalism and impede market forces and competition. A second reservation concerns the possibility that SWFs may threaten national security in recipient countries if investments are made for strategic or political rather than economic purposes. Such a scenario would trigger a protectionist backlash that could have disastrous effects on the world economy.

Where does Africa stand in this debate? To what extent, if at all, SWFs can benefit African economies? Can the controversy discussed above be resolved in the case of Africa? Unfortunately, the literature does not provide clear answers to these questions, as research about SWFs potential support to Africa's development is rather scant. This largely reflects the strong opacity surrounding SWFs existence, holdings, and institutional arrangements.

The objective of this paper is to improve understanding of SWFs activities in Africa and to discuss the potential role that SWFs could play in African economies, both as recipient countries and home countries. The remainder of the paper is structured as follow. Section 1 draws a detailed portrait of African SWFs, providing what we believe is the first comprehensive list of those funds, putting them in perspective, and describing their characteristics and activities. Section 2 describes the interventions of foreign SWFs in Africa while section 3 discusses the potential benefits of SWFs for African states given the socio-economic context of those economies. Section 4 discusses issues that may arise from SWFs operations in Africa. Section 5 concludes by providing some recommendations.

The paper makes several contributions to the debate on the role that institutional investors are poised to play in global capital markets. First, it analyzes how African economies can benefit from SWFs and use them as a channel to tap into international financial markets. Second, the paper documents the size of assets managed by SWFs and describes how and to what extent they can contribute into broadening and deepening African financial systems. This includes discussions on their capacity to mobilize sizeable amount of long-term financing and to diversify African financial systems out of the banking sector, through investments in a various set of non-bank financial assets (equity, fixed income securities, real estate, etc.) and institutions (insurance, leasing companies and private equity funds). Last but not least, the paper examines the very important role that SWFs could play to stabilize the global financial system, through large injections of funds into the global economy. This is documented with reference to investments made by the Libyan Investment Authority (LIA) in some European (e.g. Italy, United Kingdom, Netherland-Belgium and Spain) financial institutions to prevent some of the deleterious effects of the recent global financial crisis.

1. What do African SWFs look like?

According to our research, Africa counts 15 SWFs (Appendix A1). Among the five (5) largest African SWFs, four (4) are sourced from oil and gas revenues, the last being sourced from diamonds, minerals and other natural resources. These funds were established on a voluntary basis, with the notable exception of Chad's Future generation fund which resulted from the World Bank requirement to establish a petroleum revenue management law in Chad as a condition to disburse a loan aimed at funding the Duba oil fields and the Chad-Cameroon pipeline. Strong opacity surrounding their existence, holdings and institutional arrangements makes tracking of African SWFs a challenging task. A plausible explanation for this limited attention is the relatively small size of African SWFs compared to their counterparts from other regions of the world as well as their passive management strategies.

African SWFs motives

It comes out fairly clearly from Appendix A1 that African SWFs are predominantly driven by stabilization motives and to a lesser extent by the need to generate higher returns on domestic resources in order to accumulate wealth for future generations. For most African countries, stabilization needs are twofold. On the short term, African countries need to smooth their expenditures in a context of volatile commodity prices to avoid challenges in macroeconomic planning resulting from revenue instability (Asfaha, 2007). On the long term, African countries need to protect themselves against decline in revenues resulting from depletion of non-renewable resources. Moreover, non-renewable commodities are often the single most important source of foreign currency revenues in these countries which makes them haunted by the *paradox of plenty* or the so called *resource curse*. Auty (1993) first introduced this term to describe the potential devastating effects that natural resources could have on economic growth in developing countries, therefore transforming natural resources from a desirable asset to a curse. The resource curse thesis is based on observations that countries richly endowed with natural resources tend to have lower rates of economic growth and development than countries with fewer natural resources. The resource curse can originate from different sources, including government mismanagement of revenues arising from these resources, weak governance or the *Dutch Disease*.²

As shown in Appendix A1, African SWFs are commodity-based and derive their funding from commodity sales. This makes them useful to absorb large foreign exchanges surpluses and avoid inflationary pressures as well as the need for sterilization interventions which can be costly for African countries with prevailing high interest rates. In theory, foreign reserves accumulation through SWFs represents also a “self insurance”

²The term *Dutch Disease* was first used by the Economist during the late 70's to describe a contraction of the manufacturing sector in the Netherlands resulting from a surge in revenues from natural gas discoveries. It describes a severe decline and loss of competitiveness of the non-commodity sectors (mainly manufacturing) resulting from an appreciation of the real exchange rate as revenues from the natural resource sector enter the economy.

against capital flight that should favor autonomy in macroeconomic policy (Griffith-Jones and Ocampo, 2010).

Available information suggests that African SWFs have been subject to regular capital withdrawals to balance governments' budgets and repay external debt. For instance, the balance of Nigeria Excess Crude Account (ECA) decreased from USD 20 billion in 2008 to less than USD 3 billion in 2010 while Sudan almost wiped out its Oil Revenue Stabilization Fund (ORSF) (Medani, 2010). Similarly, Algeria has been using its *Fonds de Regularisation des Recettes* (FRR) to repay public debt and fund fiscal deficits while Mauritania withdrew USD 45 million from its *Fonds National des Revenus des Hydrocarbures* leaving a balance of USD 34.25 million as of march 2009.³

Such statistics suggest that African governments kept spending while also accumulating resources in their stabilization funds, which may have potentially resulted in zero net savings. This raises concerns about intergenerational equity and long term fiscal and macroeconomic sustainability, especially in a context of external negative shocks. With few notable exceptions, most African countries have no limitations on the amount that could be used to close budget deficits from commodity-based revenues. Such features have been identified by Asafah (2007) as common design problems in SWFs. Yet, one might argue that reducing external debt decreases the financial burden on future generations which is only true if the reduction in debt is permanent and leads to improved economic growth. In the African context, this still needs to be proved.

African SWFs size

The regional distribution of SWFs (Fig. 2) displays a predominance of the Middle East (43%) followed by Asia (36%), and Europe (18%).⁴ Africa-based SWFs have a market share that presumably does not exceed 2%. As of December 2009, African SWFs had USD 114.27 billion in assets under management, much less than their peers from the Middle East, which held assets amounting to USD 1.41trillion. Interestingly, African SWFs have experienced a surge from 2008 to 2009 despite decreasing oil prices. Potential explanations for this growth include an increase in the volume of commodity exports, a raise in the share of foreign reserves received by SWFs, or the establishment of new SWFs on the continent.

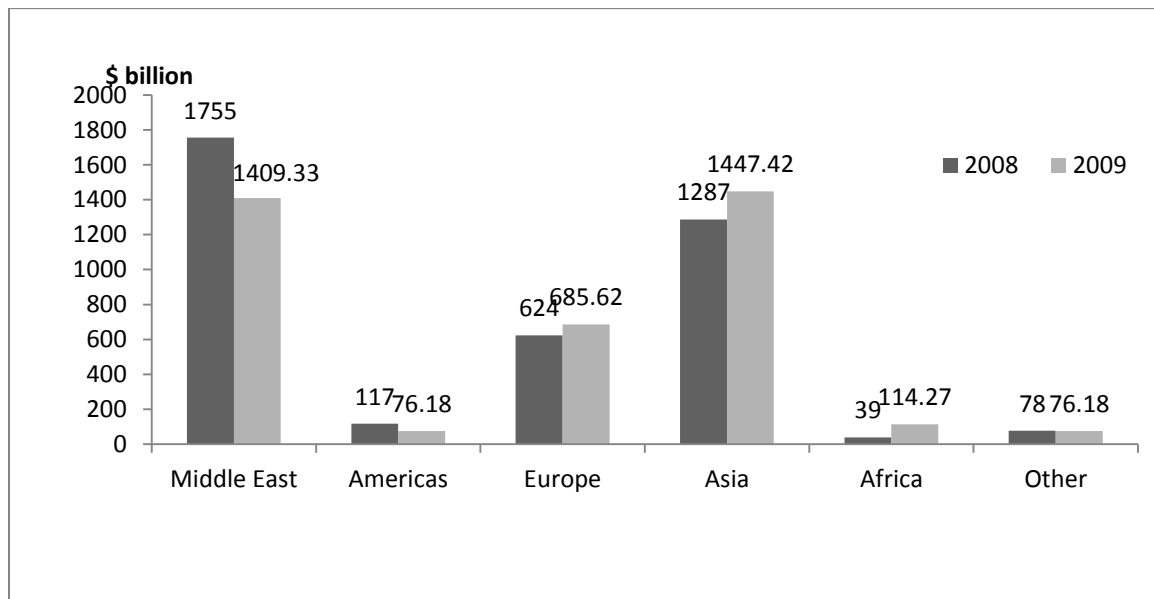
While statistics describing total assets under SWFs management are publicly available, very little information exists on their individual characteristics. According to our estimates, Africa counts 15 SWFs (Appendix A1), the Libyan Investment Authority (LIA) being the largest with assets amounting to USD 70 billion. Additional SWFs will

³ <http://www.fr.for-mauritania.org/1373-0-Exclusif-For-Mauritania-publie-des-documents-confidentiels-sur-le-pillage-du-Fond-National-des-Revenus-des-Hydrocarbures-par-la-Junte.html>

⁴ According to the Sovereign Wealth Institute, there are currently 53 SWFs operating worldwide. In terms of market share, China, United Arab Emirates and Norway come out as the major centers, accounting for 24%, 18% and 12% of the global market, respectively (IFSL, 2010). The three largest SWFs in terms of asset size are commodity-based and are the following in importance order: The Abu Dhabi Investment Authority from the UAE, the Government Pension Fund from Norway, and the SAMA Foreign Holdings from Saudi Arabia.

presumably be launched in African countries including Zimbabwe and Mauritius.⁵ Similarly, several countries which have already stabilization funds are now considering the establishment of SWFs with savings and development mandates. For instance, Nigeria, which established in 2004 the ECA to insulate the Nigerian economy from boom and bust cycles in commodity prices, is expected to launch soon the Nigeria Posterity Fund to stabilize macroeconomic fundamentals, accumulate savings for future generations and develop critical infrastructure. Thus, the growing number of African funds is likely to increase the share of African SWFs in global SWF assets.

Fig.2: SWFs’ Assets under management by region



Source: International Financial Services London Research (2009), SWF Institute Website, Authors calculations

African SWFs governance structures

So far, public disclosure about assets, strategies, rationales, and structure of African SWFs remains extremely heterogeneous and scarce. This makes governance a main issue to be addressed for African SWFs. Governance encompasses institutional arrangements to report on investments composition and performance, and accountability and transparency measures to ensure prudent management of sovereign resources and independent decision making. Table 1 documents the low level of transparency of SWFs as measured by the Linaburg-Maduell Transparency Index.⁶ Moreover, as can be seen from Table 1, out of the 15 African SWFs we were able to identify, only 3 (from Libya,

⁵ <http://oxfordswfproject.com/2010/11/19/field-work-in-mauritius-please/> and <http://oxfordswfproject.com/?s=zimbabwe>

⁶ Refer to Appendix A2 for details about the Index calculation.

Botswana and Equatorial Guinea) have signed the Santiago Principles.⁷ Nevertheless, African signatory countries barely disclose information about their SWFs activities or structure. The transparency of each fund is usually related to the openness of the country's political system. Thus, setting up corruption-free SWFs in several African countries, known to have opaque political regimes, is very challenging.

Governance problems in African SWFs may arise from lack of institutional arrangements. For example, Nigerian finance minister recently announced that the ECA is not backed by a law and that *“the process of accessing the ECA is not as transparent and clear to the Nigerian people, therefore there is a general perception that there is some level of mismanagement”*.⁸ Governance issues may also arise from poor enforceability of existing institutional arrangements. For instance, Chad amended in 2005 its national revenue management law in order to increase the share of oil revenues that goes into the budget revenue from 15 to 30%. Later it included defense in the discretionary expenses and canceled the fund for future generation (Asfaha, 2007). This type of behavior casts doubt about the quality of governance in African SWFs.

Table1: Transparency status of African SWFs (2010)

SWF name	Country	Santiago Principles Signatory	L-M Transparency Index
Fonds de Régulation des Recettes	Algeria	No	1
Reserve Fund for Oil	Angola	No	NA
Pula Fund	Botswana	Yes	3
Fund for Future Generations	Chad	No	NA
Fonds de Stabilisation des Recettes Budgétaires	Congo	No	NA
Fund for Future Generations	Equatorial Guinea	Yes	NA
Fonds de Stabilisation des Recettes Budgétaires	Equatorial Guinea	No	NA
Fund for Future Generations	Gabon	No	NA
Minerals Development Fund	Ghana	No	NA
Libyan Investment Authority	Libya	Yes	2
Fonds National des Revenus des Hydrocarbures	Mauritania	No	1
Minerals Development Fund	Namibia	No	NA
Excess Crude Account	Nigeria	No	1
National Oil Account	São Tomé and Príncipe	No	NA
Oil Revenue Stabilization Fund	Sudan	No	NA

Source: Authors' calculation using data from the Monitor Group, SWF Institute. Unfortunately, the value of this index is not available for African SWFs that were not previously identified in the literature. African SWFs investments

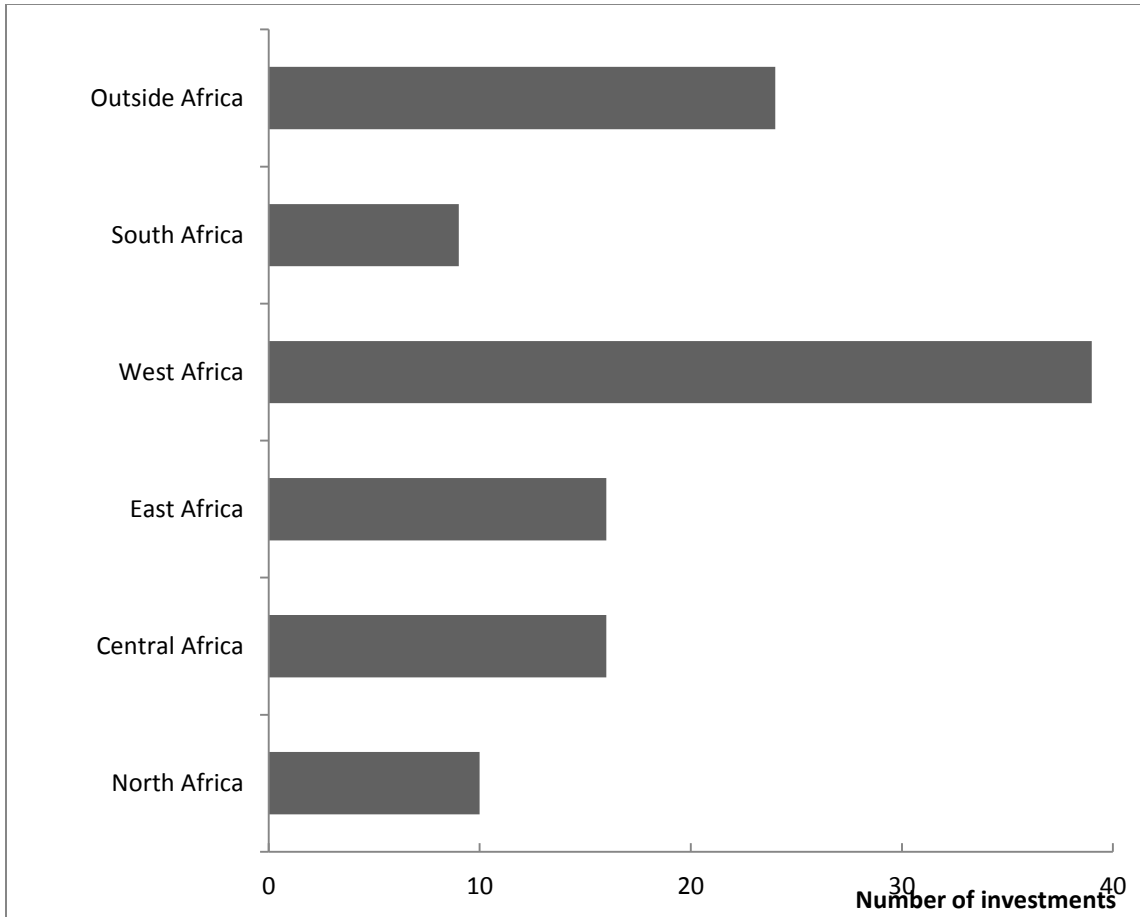
⁷ The Santiago principles were launched in October 2008 by the International Working Group of Sovereign Wealth Funds (IWG) in a joint effort with the IMF to foster trust, openness, transparency and probity in the management of SWFs. They are expected to preserve domestic SWFs and support further investments by these vehicles by addressing the fears of recipient countries.

⁸ <http://oxfordswfproject.com/page/2/>

Unfortunately, it is very difficult to find accurate information about how and where African SWFs invest their resources. Available data suggest that African SWFs have been adopting prudent investment strategies with an emphasis on liquidity, reflecting mainly their stabilization mandates. For example, a recent IMF report shows that Nigeria's ECA is mainly invested in short-term, liquid government securities and money market instruments while research published by JPMorgan (2008) shows that the Pula fund has invested 59% of its assets in bonds and 13% in cash and restricts its investments to rated assets. African SWFs are also actively investing outside Africa. Asfaha (2007) reports that Chad invests its proceeds from natural resources sales abroad while Sao Tome and Principe oil revenue management law prohibits investments in companies controlled by locals (Albin et al. 2004). Similarly, Belaicha et al. (2009) estimate that half of Algeria foreign currency reserves have been invested in US sovereign bonds and deposits and tier-one banks. Hence, African SWFs are mainly seeking "safe investments" in stable economies leaving limited resources for their local economies, and even less for their neighboring countries.

The Libyan Investment Authority (LIA) remains the only African SWF that has a relatively active and aggressive investment strategy. LIA was created in December 2006 by a decree of the *Comité Populaire Général*, with the purpose of consolidating existing investment vehicles, namely the Libyan Arab Foreign Investment Company, the Libyan African Investment Portfolio (LAP), the Long-Term Investment Portfolio and the Oil Investment Company, which have become subsidiaries. Appendix A3 provides a description of LIA's main subsidiaries. Most of LIA's investments in Africa are undertaken by the Libyan African Investment Portfolio. Its subsidiary, the Libyan African Investment Company (LAICO) has presence in 30 African countries. We were able to track 114 investments made by LIA over the last 3 decades, out of which 24 are located outside Africa. While this sample describes only part of LIA's activities, it still provides insightful information about the region and sector distribution of its investments. Figure 3 shows that West Africa is the main target of LIA investments, followed by East and Central Africa while North Africa and Southern Africa rank at the bottom. However, the value clustering shows a different picture with North Africa capturing USD 9 billion, the highest share of investments. This probably reflects the stable and business friendly environment offered by North African countries compared to Sub-Saharan Africa. The sector distribution of LIA investments in Africa shows a large number of small scale deals in the real estate, hotels and restaurants, and agriculture sectors as well as a small number of large deals in Infrastructure and oil and gas sectors. LIA deals outside Africa targeted mainly companies from Italy and the United Kingdom. Oil and gas and manufacturing captured the largest number of these investments while the financial sector benefited from the highest share of deal values.

Fig.3: Regional distribution of selected LIA investments



Source: Authors' calculation

African SWFs reputation

Cash infusions made by Africa-based SWFs have not always been greeted with alloyed gratitude. A 2010 survey conducted by Hill & Knowlton and Penn Schoen Berland on national officials' attitudes towards SWFs shows that African SWFs in Libya, Algeria and Nigeria were ranked less favorably than their Middle Eastern peers (Fig. 4). According to this survey, even African host countries like Egypt share this view.

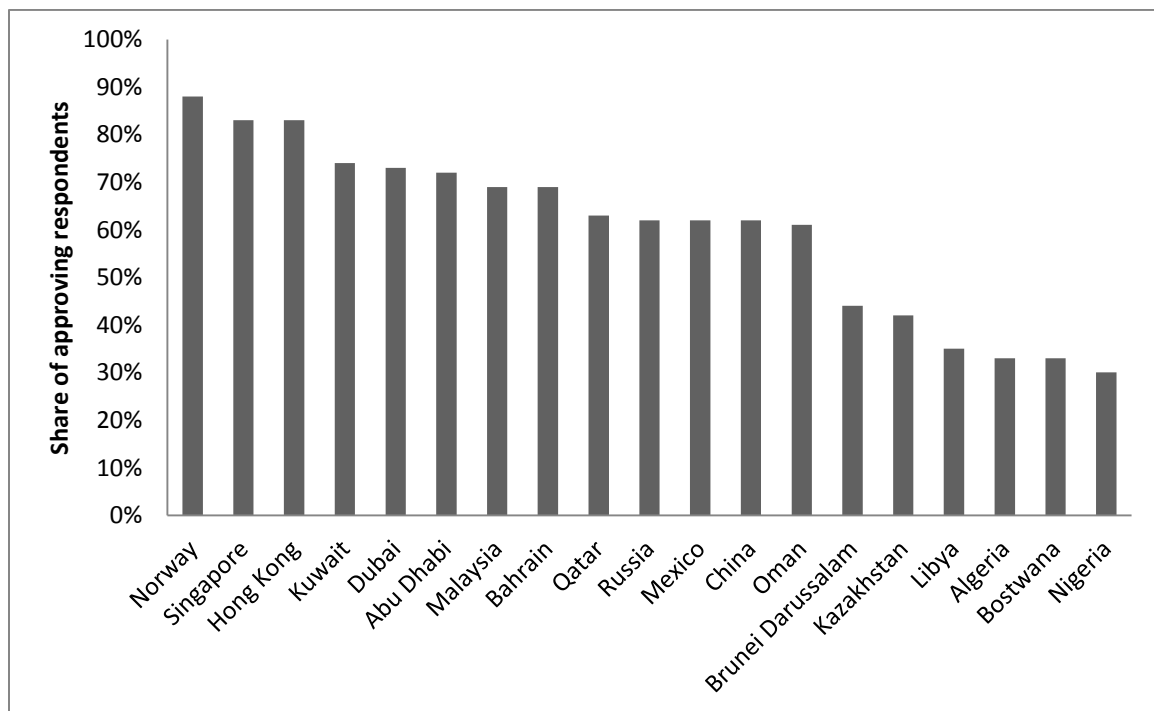
Given that some of these funds do not invest abroad, the negative perception likely reflects the negative image of African countries rather than wrong doing by these funds . This is corroborated by the results of the above mentioned survey which shows that home country reputation is a major determinant of the image, transparency and governance structure of a SWF. It should also be noted that most of the non-African SWFs that received better ranking do not necessarily disclose more information about their asset allocation or returns than African funds.

Prominent concerns that were expressed by recipient countries include fear from the increased role of the states in financial and economic systems, and the possibility that

some African SWFs' may pursue “non commercial” objectives. Such concerns led the Pentagon to cancel in 1986 a USD 7.9 million contract between the US marine and Fiat because of the LIA shareholding in the company.⁹ Africa remains also portrayed by the mass media as a charity case suffering from political violence, corruption and famine. This cast doubts about the capacity of African SWFs to have value added as investors and the potential negative effects that their presence could have on the transparency and governance structure of beneficiary investees.

This negative perception most likely translates into additional barriers to African SWFs activities. Recent turmoil in Libya and allegations about control of LIA resources by political elite are likely to further cast doubts about the legitimacy of African SWFs and showcase the importance of strong governance structures. Nonetheless, the negative perception does not mean that Africa's SWFs money is not welcome in other regions of the world. Headlines from the business press have reported investments by LIA in some European (e.g. Italy and Spain) financial institutions to prevent some of the deleterious effects of the crisis despite allegations about LIA weak governance. In July, 2008, LIA bought a share in the Dutch-Belgian bank of [Fortis](#), which needed additional funds to maintain solvability. More recently, the LIA drew public attention when it backed a new London hedge fund (FM Capital Partners) with hundreds of millions of dollars.

Fig.4: Extent of SWFs investment approval by home country



Source: Sovereign brands survey 2010. The figure summarizes responses to the question: to what extent do you approve or disapprove of SWFs from the following countries investing in your country? (Strongly/somewhat disapprove).

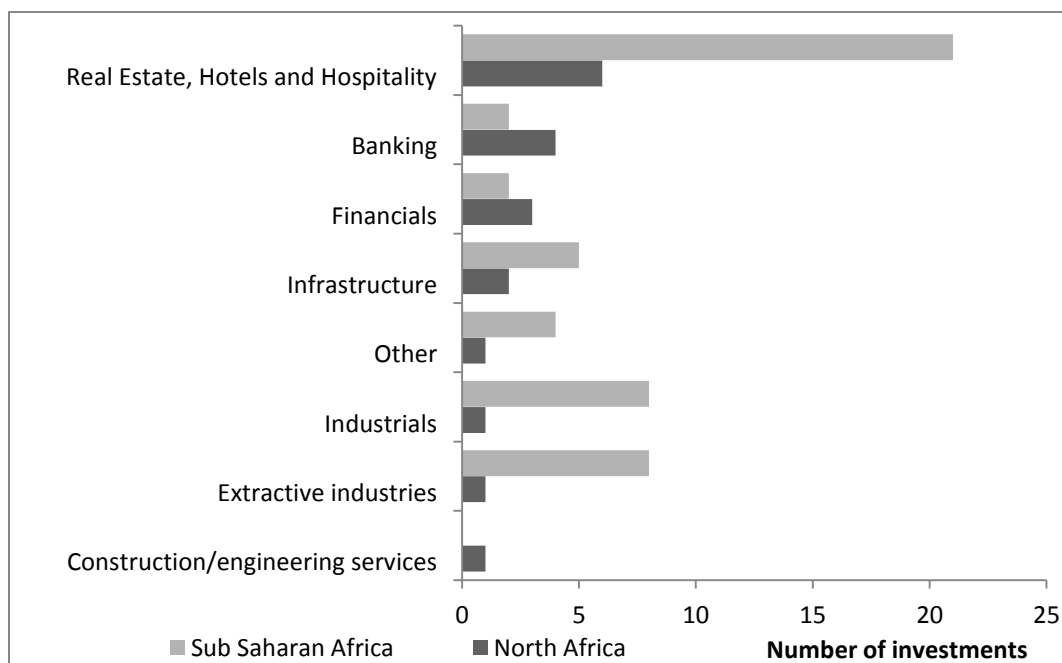
⁹ <http://www.time.com/time/magazine/article/0,9171,961510,00.html>

2. What are foreign SWFs doing in Africa?

African countries made headlines in the business press as targets for investments by SWFs. Some governments are even creating development funds (China –Africa development Funds) or Investment companies (Dubai World Africa) entirely dedicated to Africa. These vehicles are designed to take advantage of the substantial and diverse opportunities the continent is offering given its 900 million young population, its emerging economies and growing middle-income class. The continent natural resources remain also untapped, offering a wealth of opportunities for commodity investors. In a 2008 speech, the World Bank president, Robert Zoellick, called on SWFs from the Middle East and Asia to Invest 1 percent of their assets in Africa. This could potentially channel up to USD 29.7 billion in foreign investment for Africa, almost one third of Africa’s needs for infrastructure funding.

Nevertheless, Africa’s share in foreign SWFs investments remains negligible. According to recent research published by IFLS (IFLS, 2010), Africa attracted less than 5% of SWFs resources. For example, as of December 2009, out of 8,300 companies in which the Norway SWF held equity investments, only 144 (corresponding to 1.74%) were Africans. These companies are concentrated in 3 countries, namely South Africa (104 companies), Egypt (32 companies) and Morocco (8 companies). Tracking investments made by foreign SWFs in Africa is challenging given the limited public disclosure. We were able to track a sample of 69 direct investments undertaken by foreign SWFs, including 17 investments made by the China-Africa Investment Fund. This sample is by no means exhaustive. Nonetheless, it provides useful information and stylized facts on the sector and regional allocation of foreign SWFs’ investments.

Fig.5: Sector and regional distribution of selected foreign SWFs direct investments in Africa



Source: Authors' calculation

Figure 5 shows that real estate and hospitality sectors attracted the largest number of deals on the continent while North Africa attracted a smaller number of deals than sub-Saharan Africa. Interestingly, while North Africa attracted deals in the banking and financial sector, foreign SWFs invested in the industrial sector and extractive industries in sub-Saharan Africa. Conversely, the value clustering shows that North Africa received a larger share of foreign SWFs resources, mainly to fund large real estate and infrastructure projects.

3. What are the benefits of SWFs for African economies?

The landscape of African SWFs drawn earlier suggests that African SWFs are relatively small compared to their peers from other regions like the Middle East or Asia. They also suffer from governance and reputation problems that limit their ability to invest outside their home countries and to achieve good financial performance. Given their cyclical role, most African SWFs (which have a stabilization purpose) have also limited capacity to invest in long term illiquid assets. Thus, one might argue that African SWFs have very limited value added for African economies that is linked to short term stabilization.

However, home grown SWFs can be beneficial for African nations if they are used and structured properly in order to take advantage of their full potential. This implies that African SWFs, at least most of them, would have to go beyond their stabilization and macroeconomic stability motives to position themselves as instruments geared towards achieving economic growth, intergenerational resource transfers, infrastructure financing, financial sector stabilization, deepening and broadening, and regional integration. Similarly, we also believe that foreign SWFs can provide a sizeable source of FDIs to African countries which should lead to human and physical capital formation and ultimately growth (Rios-Morales and Brennan, 2009). The benefits of creating or attracting SWFs in Africa can be appreciated from many different perspectives as discussed below.

SWFs as instruments to maximize investments' risk-adjusted returns and accumulate resources for future generations. Unlike reserves management by central banks which is usually limited to investments in US and European sovereign fixed income securities, SWFs' holdings are more diversified and could be structured to maximize risk-adjusted returns that are not necessarily pegged to the dollar value. A *business week* article published in 2008, indicated that the Abu Dhabi Investment Authority has returned about 10% a year since its inception,¹⁰ while the 2009 annual report for the Norway Government pension fund reported an impressive 25.6 percent in return during 2009. These rates exceed by far any return that African central banks could potentially earn from fixed income securities. Given Africa's demographics and important financing gaps observed in almost all sectors, accumulating resources is very important to meet the increasing needs that may arise from existing and future generations.

¹⁰ <http://black-capital.com/news/2010/04/inside-the-abu-dhabi-investment-authority-adia-june-2008/?lang=en>

SWFs as channels for economic diversification and development. SWFs could be useful in supporting economic diversification given that they often invest in a wide range of asset classes. They also have long term investment horizons and exhibit higher risk tolerance than central banks in managing foreign currency reserves. Thus, Africa-based SWFs can play an important role in supporting their local economies by directly providing capital, or by encouraging their international investees to invest in African companies. Countries like China and Saudi Arabia have been successful in supporting their economies by using their SWFs. According to Monitor (2008), 26% of SWFs reported investments were made in home countries. The share of SWFs resources dedicated to local investments should result from a tradeoff between the local economic needs and the amount of foreign assets required to ensure macroeconomic stability and revenue diversification.

African SWFs' investments can also be made strategically to secure inputs needed in local economies. For example, in 2007, the Abu Dhabi Mubadala took an 8.3% stake in Guinea Alumina Corporation, a USD 3 billion joint venture aimed at transforming the bauxite of Guinea into alumina. This venture will provide the alumina plant that the government of Abu Dhabi is planning to set up with, a life-long access to cost-effective alumina. African SWFs can facilitate technology transfer to African industries through their investments in multinationals as well, and by encouraging these companies to set up Research and Development (R&D) facilities in Africa. Balin (2008) argues that SWFs can play an active role in shaping up patent laws for technologies created from these R&D facilities to favor dissemination to domestic firms.

Similarly, foreign SWFs resources could be channeled to Africa to develop new sectors or supporting existing ones. This could have striking effects on the amount of direct investment received by African recipient economies. Africa's performance during the last decade shows that the continent has favorable investment prospects which fit well with the long-term, high-return perspective of SWFs. Since, foreign SWFs are looking for good investment opportunities in new emerging markets, this can turn out to be good news for Africa.

SWFs as channels to bridge the infrastructure financing gap. According to estimates from Infrastructure Consortium for Africa, a little under USD 93 billion of annual investments are required to address Africa's infrastructure needs, about one third of which is to upkeep existing networks. Infrastructure encompasses energy plants, roads, ports, water and sanitation facilities but also information and telecommunication networks. As Africa grows at 5% per year, one can expect additional demand for more reliable and efficient infrastructure to emerge. So far, Africa's infrastructure has been mainly funded by local governments with donors' support and to a limited extent by private investors.

According to Preqin (2011) the proportion of SWFs investing in infrastructure has increased from 47% in 2010 to 61% at the beginning of this year. This suggests that SWFs could play a bigger role to bolster infrastructure investments in Africa. Such long term high-yielding investments meet the time and risk profile of SWFs needs (OECD,

2008). First, given the monopolistic structure of many infrastructure projects in Africa, the demand for the asset tends to be inelastic and price adjustments for inflation are unlikely to be affected (JPMorgan, 2007). Hence, infrastructure investments could provide a hedge against inflation. Second, infrastructure projects offer long term cash flow streams which aligns appropriately with the investment time horizon of SWFs. As a matter of fact, revenues from infrastructure projects are mainly generated through income rather than investment appreciation, which should provide more predictable, and reliable long-term cash flow streams and returns (JPMorgan, 2007). Besides, infrastructure projects historically delivered high returns (see Table 2) with low correlations with traditional asset classes thus serving as a risk reduction tool. Third, the scarcity of long term finance on the continent and the low liquidity of African financial markets offer SWFs a good opportunity to negotiate attractive terms on their long term funding in Africa.

Table 2: Risk and return performance of infrastructure projects in %

	1 Year Return	1 Year Std Dev	2 Year Return	2 Year Std Dev	3 Year Return	3 Year Std Dev
Macquarie Global Infrastructure	32.28	10.23	30.80	8.78	28.50	9.23
Macquarie USA Infrastructure	21.05	11.05	19.68	9.75	21.48	9.98
Russell 3000	14.53	8.12	15.45	7.41	13.81	8.02
MSCI World ex US	26.33	7.95	26.90	8.75	24.02	9.67
Lehman Aggregate	5.38	2.62	5.29	2.48	3.88	2.78

Source: JPMorgan (2007)

SWFs as channels for regional integration. African SWFs could place some of their resources in banks throughout the continent to shore up their long term deposits. Given the long time investment horizon of SWFs, this should help address the scarcity of long term resources at the continent level. The LIA has been actively investing in hotels in Africa through LAICO (Libyan African Investment Company). Most of these acquisitions correspond to 3 to 5 star hotels and are managed by international operators. In 2008, LAICO established a joint venture, called LAICO Hotels Management Company, with Tunisia Travel Service (TTS), a Tunisian company involved in the hospitality sector through hotels management, airlines and ground transportation. This illustrates how an African SWF could develop business within Africa while leveraging on another African country expertise. Given the relatively small size of most African SWFs, the latter could pool part of their resources to create regional development banks or a fund of funds that will significantly scale up their individual financing capacities. This would foster regional financial cooperation (Griffith and Ocampo, 2010).

SWFs as stabilizing instruments for financial systems. Given their long term investment horizon and low leverage, SWFs can have a stabilizing effect on African financial market volatility, especially during periods of financial turmoil. As indicated by Monitor (2009) SWFs have been instrumental in stabilizing the global financial system during the recent financial crisis while providing a total of USD 128 billion into the global economy to the substantial benefit of European and American financial institutions (USD 57.9 billion).

African SWFs have contributed to stabilizing the global financial system as well. This can be seen through the interventions of the LIA to help dampen the deleterious effects of the crisis faced by some European (e.g. Italy and Spain) financial institutions. It has been reported that in July, 2008, the LIA rescued Dutch-Belgian bank of Fortis, while acquiring some shares, to ensure its solvability.

Similarly, a large number of African financial institutions-especially non banks- are not adequately capitalized. Foreign and African SWFs can strengthen the capital base of these financial institutions which should ensure the continuation and expansion of their activities. As institutional investors, SWFs can also provide comfort to other investors and help improve governance and business structures of Africa's financial institutions. Ultimately, this should lead to a more resilient financial system. In the wake of the financial crisis, China and Algeria resorted to their SWFs' assets to recapitalize their domestic banks, which is a clear example of SWFs as means to stabilize the financial system.

SWFs as channels for enhancing financial systems' depth and breadth. In the wake of the financial turmoil, SWFs are worried that dollar-denominated assets are no longer reliable stores of value. This leaves African financial markets with a window of opportunity to attract these investors especially that African markets have been performing quite well. On average, SWFs allocate 35 to 49% of their resources to fixed income securities, 50 to 55% to listed corporations and the remaining to alternative investments (real estate, private equity, etc.) (OECD, 2008). Using this asset allocation and a 5% share for Africa in SWFs portfolio, SWFs could invest up to USD 125 billion in African listed stocks, almost two third of the combined 2009 market capitalization of the Lusaka, Nairobi, Botswana, Nigeria and Egypt stock exchanges¹¹.

SWFs can also enhance financial systems breadth by supporting non-bank financial institutions such as insurance and leasing companies and private equity funds. This will diversify financial systems in most African countries which are currently mainly bank-concentrated. For instance, the Norway government pension fund relies on 9 external fund management companies in South Africa.

4. What are the challenges facing SWFs operations in Africa?

SWFs offer several benefits that were discussed earlier. Yet, their establishment and management in the African context could entail the following issues.

Lack of coordination with fiscal and monetary policies. In theory, SWFs are no different from any other fiscal resources at the disposal of a given government, and as such their establishment and management need to be carefully coordinated with monetary policy in the originating countries. In several African countries where inflation is an issue, a sudden increase in liquidity resulting from repatriation of returns on foreign assets can lead to unwanted inflationary pressure, which would force the monetary authority to raise interest rates above desired levels, thus slowing the economy and reducing growth. In

¹¹ Based on information available on the website of the African Stock Exchanges Association

countries with a fixed exchange rate regime, such an inflow of liquidity would lead to an undesired change in the stock of foreign reserves in order to sustain the peg.

SWFs home countries also face the fundamental and longstanding issue of how to allocate their resources between SWFs and public spending on education, health and infrastructure. In African countries, where a non-negligible fraction of the population is plagued by poverty, hunger and health problems, such a tradeoff is even more complex to resolve. Finally, in countries where SWFs are funded via taxation of non-renewable resources, the government ought to maintain the tax rates at levels that do not hamper economic activity. Furthermore, while SWFs could be used as a tool to support sound fiscal policies, they should not be viewed as a replacement solution to fiscal reforms (Le Borgne and Medas, 2007).

Potential disruptive effects on markets. Potential destabilizing effects of foreign SWFs investments on recipient African countries can happen through three (3) channels. First, large investments in recipient assets might trigger speculation bubbles leading to higher market volatility in host countries. In fact, these flows are likely to affect the capital and financial account, and relative prices, and thus may affect external stability. Strong opacity characterizing most SWFs prevents proper market expectation which is likely to amplify market volatility. Small African economies and those with nascent markets are more vulnerable. Moreover, African stock markets are often poorly regulated when it comes to insider trading and other market manipulation, and are therefore more prone to high volatility. Second, destabilization can result from SWFs involvement in the banking sector with SWFs distorting credit allocation process to favor their home country businesses (Heyward, 2008). Third, large reverse in SWFs flows resulting from profit repatriation or asset reallocations involve also currency transactions that might affect African currencies.

Protectionist behavior against FDI. One corollary to the fact that SWFs are often seen as hostile vehicles is that recipient countries may implement protectionist regulation that adversely affects FDI flows. This is the case when SWFs are perceived as a threat to national security in the recipient country. For instance, the Foreign Investment and National Security Act enacted in the US in 2007 imposed more scrutiny on foreign investment made by sovereign entities. Several developed countries have also special agencies that oversee and regulate foreign investments including those done by SWFs (Committee on Foreign Investment in the US-CFIUS). African recipient countries may follow this tendency which could have negative consequences on their FDI inflows. For instance, African countries that have been implementing privatization strategies may enact such regulation to reduce foreign states intervention and encourage private sector investments. To the best of our knowledge no African country implemented regulation that specifically limits foreign sovereign investments. Yet, this may come in the near future as these SWFs (especially China) become more active on the continent.

5. Concluding remarks

This paper discusses the potential role that SWFs could play in African economies, both as recipient countries and home countries. We first draw a landscape of African SWFs putting them in perspective, and describing their characteristics and investment activities in Africa. We also provide some insightful patterns about foreign SWFs activities on the continent.

Our analysis suggests that African SWFs are small and mainly focusing on achieving stabilization objectives. They are also characterized by poor governance structures. Thus, their role as long term institutional investors in Africa is likely to be negligible if current practices are maintained. To fully benefit from their SWFs, there is a need for African economies to:

- Clarify SWFs' roles, objectives and responsibilities as suggested by the fiscal transparency and reserve management guidelines established by the IMF. SWFs should have clear objectives. Lack of clarity about the expected outcomes from SWFs can lead to their failure. Home countries should also ensure that investment strategies are consistent with underlying objectives.
- Carefully synchronize deposits and draw downs from commodity-based SWFs with the country's income accruing from the sale of nonrenewable natural resources in order to ensure that revenues are set aside to stabilize the country's fundamentals, should resources be exhausted. For instance, countries need to establish limits on the contribution of commodity revenues to fiscal deficits and create "permanent endowment" that will serve long term savings objectives only. This endowment could be used to invest in relatively illiquid assets over a longer time horizon and enhance African SWFs participation in African financial systems.
- Implement strong corporate governance structures to make sure that resources are well managed and that SWFs' investment strategies are supporting the country's macroeconomic policies and development plans. Obviously, there is no "one-governance-structure-fits-all" solution given the plurality of legal forms adopted by African SWFs. Adequate risk management systems and human resources need also to be put in place to ensure accountability and transparency. Several African SWFs are managed by local central banks. Countries should either develop internally required capacity to implement optimal investment strategies or use external managers

Conversely, Foreign SWFs are expected to play a greater role in Africa. However, in order to better attract and benefit from foreign SWFs, African economies should:

- Avoid overregulation of investable sectors/companies. African countries need to find a balance between protecting themselves and offering a regulatory framework conducive to SWFs involvement in their economies. This does not

mean that they should enact relaxed regulation that hinders their long term growth simply because they desperately need FDI. Relaxed FDI regulation could give foreign SWFs a high bargaining power to make acquisitions in strategic sectors and in some extent, to exert some pressure geared towards pushing the economic, financial and regulatory reforms agenda forward in the host African countries. A potential solution to limit SWFs influence on African economies would be to prohibit majority stakes for SWFs holdings or cancel their voting rights, should their stake exceed a threshold that needs to be determined. Another option would consist in requiring SWFs to publish a voting list on a regular basis.

- Ensure a foreign-investor friendly business environment and strong protection of investors' rights.
- Make sure that the risk of SWFs controlling banks' capital can be mitigated through the implementation of safeguards to ensure that SWFs-controlled banks are compliant with local regulation and market practices.

A1: Description of African SWFs

SWF name	Country	Date of establishment	Funding Source	Fund Type ^a	Most recent estimate of Assets under management (US\$bn)	Data Source	Year
Fonds de Régulation des Recettes	Algeria	2000 ^a	Oil	Stabilization Fund	59.34	b	2009
Fonds de Stabilisation des Recettes Budgétaires	Chad	2006 ^c	Oil	Stabilization Fund	0.003	d	2010
Reserve Fund for Oil	Angola	2004 ^e	Oil	Stabilization Fund	0.2	f	2008
Pula Fund	Botswana	1994 ^g	Diamonds	Development fund	6.9	h	2010
Fonds de Stabilisation des Recettes Budgétaires	Congo	Unknown	Oil	Stabilization Fund	1.64	d	2010
Fonds de Stabilisation des Recettes Budgétaires	Equatorial Guinea	Unknown	Oil	Stabilization Fund	1.39	d	2010
Fonds de Réserves pour Générations Futures	Equatorial Guinea	Unknown	Oil	Development fund	0.080	d	2010
Fonds Souverain de la République Gabonaise	Gabon	1998 ⁱ	Oil	Development fund	0.380	d	2010
Minerals Development Fund	Ghana	1994	Gold and other minerals	Development fund			

Libyan Investment Authority	Libya	2006 ^a	Oil	Development fund	70	h	2010
Fonds National des Revenus des Hydrocarbures	Mauritania	2006 ^a	Oil	Stabilization Fund	0.03425	j	2009
Minerals Development Fund	Namibia	1995 k	Minerals	Development Fund	NA		
Excess Crude Fund (Account)	Nigeria	2004 ^a	Oil and gas	Stabilization Fund	3	l	2010
National Oil Account	São Tomé and Príncipe	2004 ^a	Oil	Development Fund	0.010	m	2009
Oil Revenue Stabilization Fund	Sudan	2002 n	Oil	Stabilization Fund	0.15	o	2009

(a) Monitor group

(b) Direction Générale de la prévision et des politiques, Ministry of Finance, Algeria

(c) Asfaha (2007)

(d) Banque des États de l'Afrique Centrale (2010)

(e) Sogge (2009)

(f) Norton Rose (2008)

(g) Bank of Botswana, <http://www.bankofbotswana.bw/index.php/content/2009103013033-pula-fund>

(h) Mercer (2010)

(i) Gabon holds since 1998 a reserve account at the level of the BEAC (Banque des Etats de l'Afrique Centrale) under the name of the Fund for Future generations. In 2010, this fund was renamed the Fonds Souverain de la Republique Gabonaise. According to BEAC report as of January 2010, the fund for future generation balance amounted to USD 0.380 billion

(j) Ministère des finances, direction générale du trésor et de la comptabilité publique, available at <http://www.fr.for-mauritania.org/1373-0-Exclusif-For-Mauritania-publie-des-documents-confidentiels-sur-le-pillage-du-Fond-National-des-Revenus-des-Hydrocarbures-par-la-Junte.html>

(k) MDF website available at <http://www.mme.gov.na/MDF/index.htm>

(l) International Monetary Fund, July 2010, Nigeria: establishing a sovereign wealth fund.

(m) Final report on assessment of public finance management in Sao Tome and Principe 2009, EC Multiple Framework Contract Beneficiaries, March 2010 available at http://ec.europa.eu/europeaid/what/economic-support/public-finance/documents/sao_tome_e_principe_pefa_report_2010_en.pdf

(n) Truman (2008)

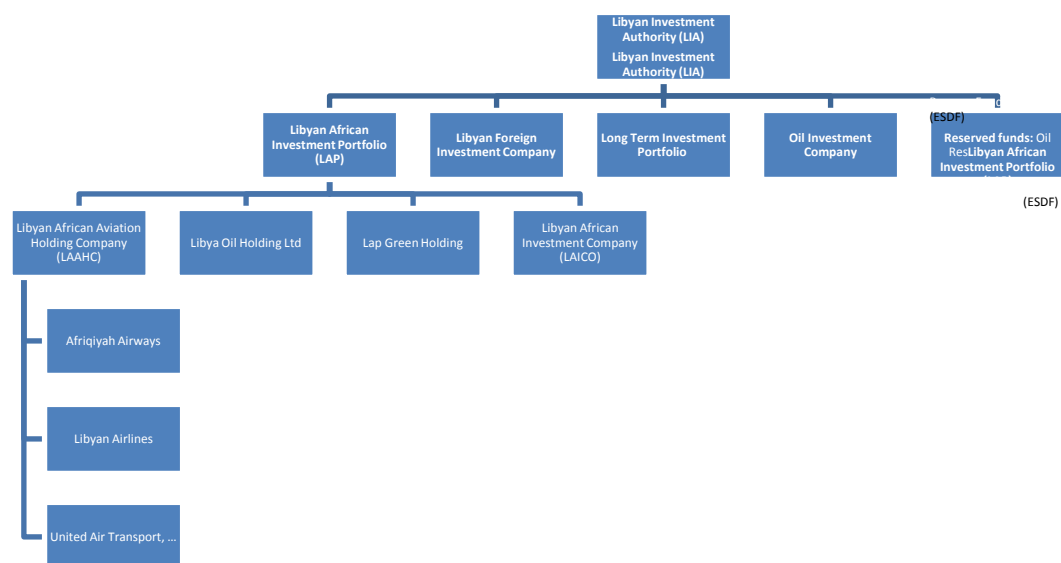
(o) Medani (2010)

A2: Linaburg-Maduell Transparency Index

The Linaburg-Madue;; Transparency Index is based on ten essential principles that depict sovereign wealth fund transparency to the public. The following principles each add one point of transparency to the index rating. The index is an ongoing project of the Sovereign Wealth Fund Institute. The minimum rating a fund can receive is 1; however, the Sovereign Wealth Fund Institute recommends a minimum rating of 8 in order to claim adequate transparency. Transparency ratings may change as funds release additional information. There are different levels of depth in regards to each principle; judgment of these principles is left to the discretion of the Sovereign Wealth Fund Institute.

Point	Principles of the Linaburg-Maduell Transparency Index
+1	Fund provides history including reason for creation, origins of wealth, and government ownership structure
+1	Fund provides up-to-date independently audited annual reports
+1	Fund provides ownership percentage of company holdings, and geographic locations of holdings
+1	Fund provides total portfolio market value, returns, and management compensation
+1	Fund provides guidelines in reference to ethical standards, investment policies, and enforcer of guidelines
+1	Fund provides clear strategies and objectives
+1	If applicable, the fund clearly identifies subsidiaries and contact information
+1	If applicable, the fund identifies external managers
+1	Fund manages its own web site
+1	Fund provides main office location address and contact information such as telephone and fax

A3: Subsidiaries of the Libyan Investment Authority



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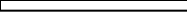
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African Development Bank

Angle de l'avenue du Ghana et des rues Pierre
de Coubertin et Hédi Noura
BP 323 -1002 Tunis Belvédère (Tunisia)
Tel.: +216 71 333 511 – Fax: +216 71 351 933
E-mail: afdb@afdb.org – Internet: www.afdb.org