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The New Reforms of the US' Overseas Private Investment Corporation (OPIC): Impacts on the Development Finance Landscape and Opportunities for Africa

On October 2018, US policymakers passed into law "The Better Utilization of Investments Leading to Development (BUILD) Act of 2018". One of the key provisions of the BUILD Act is the establishment of a new government agency dubbed the United States International Development Finance Corporation (USDFC). This new development finance institution subsumes the Overseas Private Investment Corporation (OPIC) and incorporates some facilities from the US Agency for International Development (USAID), namely the Development Credit Authority (DCA), the Office of the Private Capital and Microenterprise (OPCM), and enterprise funds.

The reform of the US' OPIC reflects the increasing recognition of the catalytic role played by DFIs in a competitive world where the rise of emerging developing market economies is changing the dynamics of commercial diplomacy. It recognizes the increasing role of DFIs in the process of growth and economic development in underserved areas where access to finance is a major constraint to infrastructure development and growth. At the same time, the reform is a recognition of growth opportunities offered by the African continent and the set of institutional constraints which have prevented US corporations and businesses from effectively competing in a rapidly changing global economic environment where financial innovation has become a key driver of success. The key constraints include excessive dependency on debt investments and US-dollar-based lending.

The new BUILD Act of 2018 is underpinned by three core principles: i) additionality to ensure that new interventions do not crowd out private capital; ii) catalytic in nature to leverage the equities of the private sector and partnering with like-minded institutions; and iii) alignment with US policy strategic objectives. However, the reforms envisaged to enhance the effectiveness and development impact of the newly established USDFC, also takes into account the scale of the financing gap and scope of development financing needs as well as emerging innovative steps for risk mitigation in a high-risk high-return environment. It is responding to the changing nature of demand for financing in developing and emerging market economies by expanding its current capabilities and interventions in a number of key areas, including:

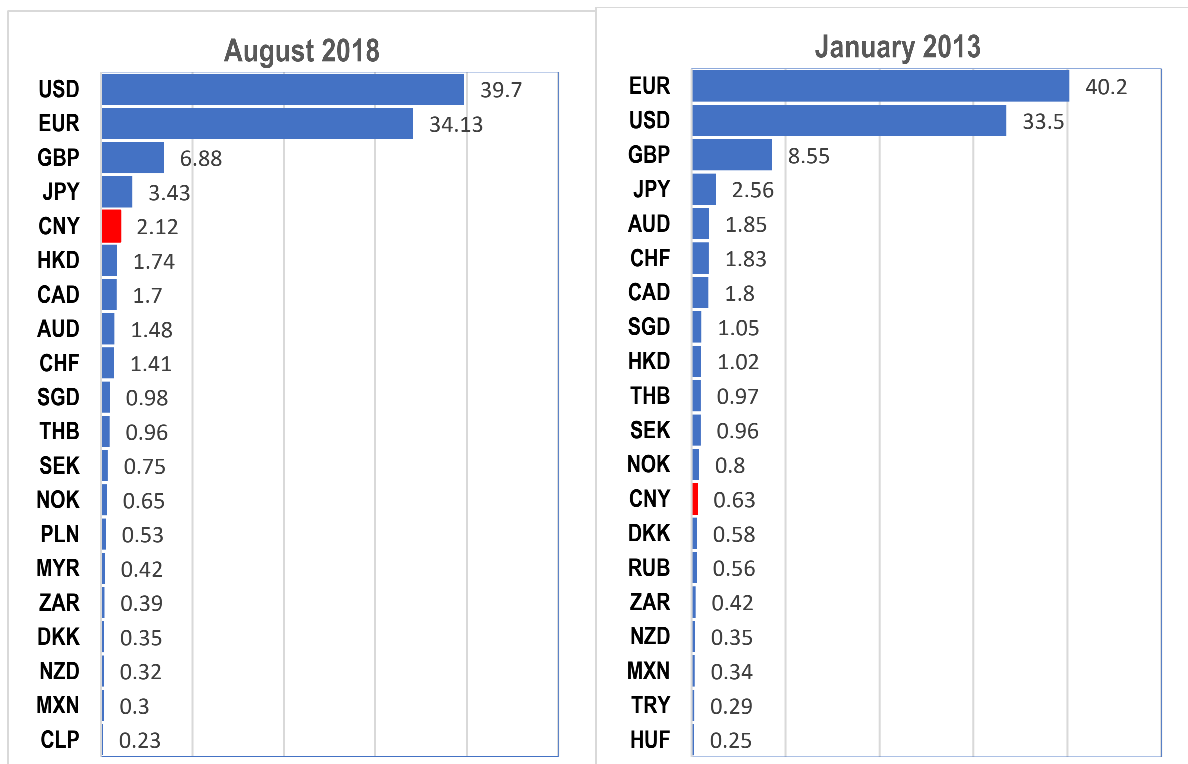
i. raising the contingent liability cap from the current level of US$29 billion (OPIC lending cap) to US$60 billion over the next five years;
ii. reducing excessive dependency on debt by permitting minority equity investments of up to 30% of total equity in any given projects;
iii. providing technical assistance and grants for advisory services, project studies and projects promotion–a clear recognition of constraints associated with the limited number of bankable projects which led the African Export-Import Bank to launch its project preparation facility early this year; and
iv. allowing products to be denominated and repayable in a foreign currency, not just US dollars, a move fully in line with the rise of local currency loans which provide lower cost capital and are more in tune with local economic conditions in Africa.

The reforms consolidating US development finance institutions and raising the cap of contingent liabilities is a positive development in the development finance landscape. In addition to fostering a more competitive global development financing environment, it is likely to raise the level of development financing towards Africa—a region confronting both huge trade and infrastructure financing gaps. Over the last decades Africa has received an increasingly large amount of financing from OPIC, accounting for more than 27 percent of OPIC's total portfolio in 2017, up from just about 7 percent in 2008. That share is likely to grow even more in the coming years given the current regional distribution and prior commitment by OPIC to increase investment in infrastructure and development of regional value chains across Africa.

Internationalisation of the Yuan and Implications for China-Africa Trade

There has been an increase in the use of the Chinese yuan (CNY) as a settlement currency globally. According to the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the CNY now accounts for around 2 percent of domestic and international payments. In November 2014, the CNY overtook the Canadian and Australian dollar to become the fifth most-used currency in global payments and settlement systems. However, the use of the CNY in international payments remains incommensurate with China's position as the world's second-largest economy and the world's largest trading nation, though the CNY's global ranking has improved significantly over the last five years when it was outside the top ten international payments currencies (see chart below).

CNY's share as a domestic and international payments currency (%)



**Messages exchanged on SWIFT based on value*
Source: SWIFT

According to the People's Bank of China (PBoC) the CNY may supplant the Japanese yen and the British pound sterling within five years and join the US dollar and the euro as the three most used currencies in international financial transactions. The move towards the internationalisation of the CNY received a boost after its inclusion into the IMF's Special Drawing Rights (SDR) basket in 2015 with a weight of 10.92 percent—alongside the US dollar (41.73 percent), the euro (30.93 percent), the Japanese yen (8.33 percent), and the British pound (8.09 percent). It may be further enhanced by the recent launch of the first crude oil futures contract priced in CNY.

Already, the increasingly important role played by China as the leading trading nation in the world and its position as Africa's top trading partner has made CNY availability for importers a competitive advantage, offering a path to mitigate exchange risk and further expand trade. It is in this regard that a growing number of global central banks are entering into currency swap arrangements with the PBoC. According to most recent estimates over 30 countries, including three African countries, have signed such arrangements with China since 2008, while Zimbabwe has adopted the CNY as an official currency. Following a three-year US$30 billion arrangement with South Africa in 2015, and a three-year US$2.62 billion arrangement with Egypt in 2016, Nigeria and China signed a three-year US$2.4 billion (CNY15 billion /NGN720 billion) arrangement in June 2018. According to the Central Bank of Nigeria (CBN), the swap arrangement will provide CNY and naira liquidity to Nigerian and Chinese businesses respectively, which would improve the speed, convenience and volume of transactions between the two countries.

Pursuant to the swap arrangement, the CBN executed its first ever auction of the CNY in the domestic market through a combination of spot and short tenored forwards and alongside its usual sale of US dollars. This, and subsequent fortnightly CNY sales, which have averaged around CNY60 million (US$8.5 million) per auction, have been dedicated to the payment of yuan denominated letters of credit for raw materials, machinery and agricultural goods. The successful roll-out of these auctions is an important development in Africa's trade finance landscape especially as few central banks outside Asia actively sell the yaun to local importers.

Trade between Nigeria and China totaled US$10.41 billion in 2017, with China being the largest single origin for Nigerian imports. Although the value of the CNY/NGN swap accounts for around one-third of the value of Nigeria's imports from China, the CNY holdings are diversifying Nigeria's reserves and should reduce the cost of trade with China. The PBoC recognises that one way to further enhance the globalisation of the CNY will be by maintaining ongoing financial reforms and further integrating the Chinese economy with the rest of the world.

2018 Beijing Summit of the Forum on China-Africa Cooperation (FOCAC)

The 3rd Forum On China-Africa Cooperation (FOCAC) was held on 3-4 September 2018 in Beijing with the vast majority of African leaders attending. Established 18 years ago as a Ministerial Conference, FOCAC has become a significant marker of South-South cooperation and anchor of cooperation between China and Africa. The 2018 Forum was organised at a time of rising trade tensions between China and the US, and deepening and expanding South-South trade emerging as an alternative path to mitigate volatililty and sustain the growth of international trade.

The adoption of the Beijing Declaration, themed “China and Africa: Toward an Even Stronger Community with a Shared Future through Win-Win Cooperation” and a FOCAC Beijing Action Plan (2019-2021) were among the major outcomes of the Forum. Under that new blueprint China pledged US$60 billion to African development (see table below). The support provided during the period will prioritise cooperation initiatives in eight key areas, including: industrial promotion, infrastructure connectivity, trade facilitation, green development, capacity building, health, people-to-people exchanges, and peace and security.

China’s Commitments 2019-2021	US$ billions
Grants, Interest Free Loans and Concessional Financing	15
Credit Lines	20
Special Fund for Financing Chinese Imports from Africa	5
Investment from Private Companies	10
Special Fund for Development Financing	10

While the quantum of China’s commitment has remained unchanged from the US$60 billion pledged at the 2015 Forum—the first time since 2006 that China’s commitments have not grown—the composition of this package has changed considerably. For instance the weight of ‘aid’ rather than financing at commercial terms will grow, with 25 percent or US$15 billion provided in the form of grants, interest-free loans and concessional loans. At US$5 billion per year, this would place China as the third largest official donor to Africa, after the United States and the European Union. China is also committed to set up a US$10 billion special fund for development financing, perhaps reflecting a changing model of financial engagement in Africa away from the resources for infrastructure model. China is increasingly keen on utilizing financing provided by Chinese development finance institutions, such as China Development Bank and China-Africa Development Fund, to support Chinese companies’ equity investment in Africa and has pledged to encourage Chinese companies to make at least US$10 billion investment in Africa over the next three years.

Africa’s industrialisation and infrastructure also featured prominently on the FOCAC agenda. China is Africa’s single largest trading partner, and imported around US$70 billion worth of goods in 2017. However, more than 95 percent of this were minerals, fuels and other commodities. The Forum recognised that African countries need to diversify their export structure to become more resilient and saw China commit a US$5 billion special fund for financing Chinese imports from Africa, especially of non-mineral products with a focus on value added agricultural produce and industrial products. Establishing mechanisms for monitoring progress towards the diversification of Africa’s sources of growth and trade during the implementation of FOCAC over the next three years will be critical for the realisation of aspirations expressed in the Bejing Declaration which calls for a win-win cooperation between Africa and China.

China’s Role in Africa: An Insider View

Over the past two decades, China has emerged as a major economic player in Africa. Trade between Africa and China grew from US$9.6 billion in 2000 to US$154.4 billion in 2017, making China Africa’s single largest trading partner. With the stock of Chinese investment growing from around US$70 million in 2000 to US$40 billion in 2017 China has become the fourth largest investor in Africa. Over this period, China has extended around U$100 billion in commercial loans to African governments and state-owned entities. Through the China-Africa Development Fund and Export-Import Bank, China has supported the development of over three thousand infrastructure projects across Africa, emerging as the region’s largest creditor—accounting for over 14 percent of the region’s stock of external debt. At the most recent Forum on China-Africa Cooperation (FOCAC) held in September 2018, China announced an additional commitment of US$60 billion over three years to African countries.

The rise of China as a major player in Africa’s economic development has raised some concerns. On the one hand are those who welcome the growing partnership as a way for the region to reduce its heavy dependence on traditional development partners and enhance its own development agenda and integration into the global economy. On the other hand, critics argue that China’s policy towards Africa which primarily aims at exploiting natural resources is undermining the process of industrialization, displacing Africa’s traditional partners while countering efforts to improve governance in Africa. Still, others warn that the heavy volume of loans provided by China to African governments could set countries on another path of debt overhang. In response to these growing concerns, Chinese officials have consistently argued that the main objective of China’s Africa policy is to create a “new type of strategic partnership” that is based on mutual trust, economic cooperation, and cultural exchanges.

A 2011 European Parliament Report examining export finance activities undertaken by the Chinese government and corporations provides a candid assessment of the deepening relationship between China and Africa. The review suggests that China’s engagement in Africa has been informed by its own development experience which was largely financed with natural-resource backed loans from Japan. Japan provided low-interest loans to finance the export of industrial technology and materials to China in exchange for Chinese natural resources. The financing was used to support China’s infrastructure development and contract Japanese firms to build China’s main transport corridors, coal mines and power grids. However, the experience of Japan and China’s relationship during the meteoric rise of China also suggests that the collaboration and partnership emphasised the transfer of technology and active support for industrialisation and expansion of infrastructure for value addition. Low-interest loans provided by Japan to finance industrial technology and manufacturing infrastructure positioned China as the next factory of the world, with multinational companies taking advantage of low factor costs to relocate to China.

While the financing of physical infrastructure in Africa by China—primarily executed by Chinese contractors and backed by priority access to natural resources—is an important first step to close the region’s infrastructure gap, more will need to be done to dispel concerns raised by the international community and foster the win-win partnership sought by both African and Chinese authorities. This could involve supporting value addition along commodities and natural resources to enhance Africa’s

integration into global value chains. It could also involve supporting the growth of light manufacturing industries taking advantage of the still low labour costs in Africa, and prioritising Africa in the ongoing outsourcing of low-skill and labour-intensive light manufacturing jobs associated with the process of rebalancing and technological transition in China.

More than 85 million jobs are expected to leave China in the coming decades for new destinations offering higher returns on investment. Opportunities for economies of scale offered by the African Continental Free Trade Area (AfCFTA) could act as a catalyst for Foreign Direct Investment and multinational companies looking to relocate to Africa. However, African countries should also undertake other critical reforms and investments, including to raise technical skills, improve the business environment and reduce factor costs with a view to becoming globally competitive and further the win-win partnership with its single largest trading partner.

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