

# Decentralised finance may be the panacea for filling Africa's investment gap

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African countries continue to face substantial financing gaps as they take on projects of all sizes in pursuit of development. To tackle the slowdown in foreign direct investment since the onset of the pandemic, some African countries are actively courting their diaspora and looking for pockets of cash-rich businesses around the continent.



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Each country is on its own development trajectory. However, continental and regional initiatives, such as the African Continental Free Trade Area (AfCFTA), are being harnessed as broad-based wealth-creation vehicles. The AfCFTA, which took effect on 1 January 2021, aims to create an integrated continental market by reducing trade barriers among its 54 signatory countries. The trading pact is still under implementation due to the substantial undertaking involved in integrating a massive economically fragmented continent. The AfCFTA Investment Protocol, one of the many legal instruments that make up the agreement, is still under negotiation.

Even at this stage, the benefits of the agreement are undeniable as institutional capabilities designed to alleviate hurdles to economic development are being deployed at record pace. It will take some time to work through all of the practical and regulatory issues that arise in cross-border trade and investments. Fortunately, the challenges of implementation have not dampened the appetite of Africa-based businesses to expand into other African markets. This trend can be seen in recent large investments going into refineries and pipelines, manufacturing facilities, logistics, telecommunications and technology. Partial backing for such projects has come from the global financial and investor community.

Africa's technology industry has been a lubricant in institutional building in all corners of the continent. Africa's top 10 economies, making up a combined GDP of over \$2-trillion, are already embracing blockchain technology to build capabilities in agriculture, logistics, procurement, education, banking and other sectors. Decentralised finance (DeFi),

which is in its infancy, presents immense opportunities for the African Union to further its vision for development through the creation of one integrated, digitalised capital market. A DeFi solution could accelerate the continent's economic integration by facilitating a seamless flow of capital.

## Progress

This is not to say that there has not been any effort in this regard. A project to link all Africa-based capital markets has been in progress for some time. This is a good first step. However, traditional capital market systems, which are still based largely in the physical world, are increasingly becoming less competitive when compared to blockchain-enabled financial platforms that connect sellers and buyers directly and execute many functions via smart contracts. Recent successful high-profile bond offerings on such platforms have demonstrated the scalability of the technology and, even in highly regulated markets like the US, investors locked into illiquid investments are already benefitting from blockchain-enabled exchanges that facilitate trading of securities among parties that are subject to lower registration and disclosure requirements under securities laws.

As the technology takes hold, it seems logical that the world will be migrating to more agile capital markets platforms that are accessible anytime, anywhere. While a country-by-country adoption makes sense at this stage, selective uses in trading blocs should not be overlooked, as such technologies can deliver on the policy objectives of development agreements like the AfCFTA.

DeFi has raised novel regulatory and tax issues, especially in the developed world where long-standing rules and agencies that regulate securities and financial products based on clear categorisations of assets, activities and participants have struggled to adjust to new digital asset classes and ecosystems. These challenges are especially acute in cross-border activities and, thus far, laws that have extraterritorial reach and international collaborations among enforcement agencies have been used to fill the gap in this borderless environment. As DeFi uses continue to expand, we should expect to see a range of domestic and multilateral regulatory developments in consumer protection, tax compliance, prevention of illicit finance and data privacy, among others.

## Benefits

Africa's journey in the capital markets space could be different. Although the majority of African countries have stock exchanges, most have limited listings. Accessibility has long been cited as one of the major hurdles to participation. Despite the regulatory challenges, DeFi presents immense benefits by streamlining the listing and other processes, broadening the investor base, and providing bespoke solutions to administrators. To that end, serious consideration should be given to including in the AfCFTA Investment Protocol ground rules for trading in securities issued by governments and businesses in member states. Such provisions could be instrumental in providing harmonised rules for mobilising capital needed for large projects within the continental investor community and their global alliances, and could pave the way for member states to open up their markets to the region via cost-effective alternative platforms. Consistent with the over-arching theme of the AfCFTA agreement, the primary regulators and enforcement agencies in this space should be those belonging to the member states themselves.

While the borderless nature of DeFi raises the stakes for policymakers, the technology itself provides solutions to many of the underlying concerns. Negotiations concerning outstanding AfCFTA protocols should take into account the potential of this industry to transform the continent. For those companies in the DeFi industry looking for opportunities to deploy their technology and know-how beyond cryptocurrencies, Africa holds tremendous potential. In the fourth industrial revolution, Africa could be the frontrunner in creating a virtual universe.

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