

**MONITORING PRIVATE CAPITAL FLOWS
TO DEVELOPING COUNTRIES:**

*Capacity-Building
For Codes, Standards And Analysis*

**PROGRAMME DOCUMENT
VERSION FOR INFORMATION**

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1. Background and Rationale

1.1. Compliance with international best practice

In the context of the recent establishment of codes and standards for the international financial architecture, in order to improve the stability of international financial flows, one of the key elements has been the need for countries to monitor the inflows and outflows of private capital.

More specifically, monitoring:

- All flows is essential to IMF General Data Dissemination System (GDDS) and Special Data Dissemination Standard (SDDS) which establish guidelines and benchmarks for coverage, periodicity and timeliness; quality, and integrity of disseminated data; and access by the public. This includes private capital as an integral part of the BOP and wider accounts¹.
- Private sector external debt (PSED) and short-term debt is crucial to BIS-led national and cross-border banking supervision, capital adequacy and bank transparency, and to IMF-World Bank led guidelines for sound debt management;
- Portfolio flows is crucial to IOSCO information-sharing and transparency guidelines;
- FDI fits with the OECD guidelines for multinational enterprises.

Improvements in capital flows data are consistent with international efforts to improve the wider System of National Accounts (SNA) and other macroeconomic data. They complement donors' wider efforts in this area by promoting institutional coordination within countries, and by the fact BOP data itself supports other macroeconomic data (eg, bank flows data can provide a crosscheck against banking supervision data).

1.2. DFI's experience in monitoring private capital²

1.2.1. Country coverage

The need for this project arises from demand expressed by many countries in earlier projects conducted during 1996-2000. These provided 16 countries with information on how to improve their monitoring³, assisted Mozambique, Tanzania, Uganda, Zambia and Zimbabwe to implement pilot surveys of regional and international flows, and then assisted Ghana, Guyana and Tanzania to implement comprehensive censuses.

1.2.2. Donor involvement, and project management

The projects were funded by the Danish Foreign Ministry, the UK Department for International Development (DFID), the Swiss State Secretariat for Economic Cooperation (SECO), and the

¹ Presently 20 countries participate in the GDDS, of which 4 African (Cote d'Ivoire, the Gambia, Mauritius and Uganda), 1 Latin American (Bolivia) and 7 Caribbean (Antigua and Barbuda, Barbados, Dominica, Fiji, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines). Development Finance International and sister organisation Debt Relief International already work with Bolivia, Cote d'Ivoire, Gambia, Mauritius, and Uganda. Other DFI/DRI countries have expressed strong desire to participate if they had the capacity.

² More details of DFI's wider programme are provided in Annex F

³ Botswana, Ghana, Guyana, Kenya, Jamaica, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Trinidad and Tobago, Uganda, Zambia, and Zimbabwe.

Swedish International Development Cooperation Agency (Sida). The specific projects (with DFID's involvement indicated) include:

1. "Private Capital Flows and Macroeconomic Policy in Sub-Saharan Africa" (1996-7);
2. "Monitoring Private Capital Flows in Eastern and Southern Africa" (1997): DFID North and West Africa funded Ghana, and (via LSE Centre for Research into Economics and Finance in Eastern and Southern Africa (CREFSA)) DFID Southern Africa funded Botswana, Lesotho, Malawi, Namibia, and Swaziland;
3. "Intra-Regional Private Capital Flows in Eastern and Southern Africa" (1998): DFID funding arrangements as in 2;
4. "Public-Private Partnership to Monitor Private Capital Flows Country Censuses" (2000-1): DFID North and West Africa in Ghana; DFID Caribbean in Guyana, and DFID East Africa in Tanzania.

External Finance for Africa (EFA, the predecessor of DFI), and the Centre for Research into Economics and Finance in Southern Africa (CREFSA) at the London School of Economics implemented the first three; EFA is implementing the censuses in Ghana and Tanzania, and DRI in Guyana under the HIPC Debt Strategy and Analysis Capacity-Building Programme.

1.2.3. Development of best practice in methodology

DRI has developed best practice methodology in implementing censuses, covering national ownership and coordination, reporting forms, software and regional partnership.

National leadership and coordination

DFI promotes in-country leadership and coordination by assisting the establishment of "National Taskforces" (NTF) of senior and technical government officials from bodies interested in capturing and analysing BOP data, which are responsible for the design and implementation of the census. To improve relations with the private sector, NTFs coordinate with key investor groups by hosting sensitisation events prior to launch of each census, to brief them on its importance, obtain comments on methodology, and address investor concerns. In Tanzania, Ghana and Guyana this leadership and coordination with the private sector has yielded very positive results. In addition, DFI helps countries run feedback events, where data and analysis are disseminated to the private sector, to promote public-private cooperation in policy making.

Census forms

DFI and CREFSA have developed specific census forms to capture Foreign Direct Investment (FDI), portfolio, and flows through banks and foreign exchange bureaux, as well as a census of investor perceptions which promotes compliance with the data census, and captures data for investment promotion and facilitation. Methodology is based on best international and regional practice. BOP-related forms draw on a vast pool of expertise, from specialists in international institutions (BIS, IMF, OECD, UNCTAD, World Bank); and a wide range of international central banks, investment promotion agencies and stock exchanges (Australia, Belgium, Botswana, Canada, Chile, Guyana, Indonesia, Malaysia, Mauritius, Namibia, Philippines, Poland, South Africa, Uganda, UK and Zimbabwe).

The investor perception forms draw on DFI's own experience of interviewing investors in the UK, Africa and the Caribbean; and on best practice in such surveys by investment promotion agencies, private sector associations and accountancy and consultancy firms.

The forms have been refined through extensive in-country application. Rather than being a blueprint, they are tailored to country circumstances and analytical priorities, and stressing simplicity (fewer forms and less frequent periodicity than some IMF recommendations) but meeting GDDS standards. As a result, countries (public and private sector) own the methodology, with DFI providing quality control based on international best practice.

Software design

DFI has created tailor-made software for data collection and analysis. For the larger surveys, we have commissioned Bank of Tanzania to design data entry and analysis software in Access. It is flexible enough to be modified for use in other countries (eg, it is presently being adapted for Ghana). For smaller census populations, DFI has created software in Excel to capture investor perception data. This is presently being used in Guyana. As Excel input and output is compatible with Access, countries can switch records between systems as necessary.

Reliance on developing country expertise

During these projects, DFI has identified experts from developing countries which are more advanced in various aspects of monitoring, such as Namibia, Tanzania and Zimbabwe. DFI has trained them as trainers, and they are presently helping to build capacity in other countries, and sharing their own experiences to enhance regional cooperation.

1.3. Analytical findings from past DFI work

During past projects, many developing countries found they were experiencing flows (especially of FDI, through bureaux and short-term bank loans) much higher than previously believed, with higher ratios compared to GDP or GFCF than prominent recipients of flows in Asia or Latin America. Flows had also been extremely volatile, creating severe crises.

Flows therefore had major effects on their economies, notably:

- Excessive *exchange rate volatility and appreciation/depreciation*, with knock-on effects on export competitiveness or inflation (given limited potential for intervention in forex markets);
- Highly *volatile imports*, leading in some cases to a growing trade deficit;
- *Boom and bust economic cycles* compounded by simultaneous terms of trade or climatic shocks, and failure of countercyclical official flows to respond in time;
- *Reserves volatility* causing problems in meeting monetary targets;
- Significant *positive effects on investment* (which probably has less to do with causality than with other factors influencing foreign private flows and domestic savings and investment);
- Relatively *strong impacts on growth*, notably through FDI, private transfers being transformed into FDI, and short-term pre-export financing;
- Persistently *high real interest rates, with greater volatility*, due in part to foreign purchases of treasury bills, causing major problems for government financing and private investment;

- Dramatic *volatility of monetary aggregates* through changes in net foreign assets, and switches between domestic and foreign borrowing, elements of which (foreign currency accounts and commercial bank reserves) are largely outside the control of monetary policy.
- *Banking crises* due to overexposure of banks to foreign currency borrowing on behalf of clients, or to interest rate volatility.

1.4. Country demand

Given the volatility of flows and their effects on their economies, many countries have identified improving their monitoring of private capital as a top priority, and have asked DFI for assistance. Gambia, Jamaica, Malawi, Uganda and Zambia have all expressed particularly urgent need. HIPCs participating in the Debt Relief International (DRI) HIPC Debt Strategy and Analysis Capacity-Building Programme⁴ from the Franc Zone (BCEAO and BEAC), Latin America (Honduras and Nicaragua) and Caribbean have identified failure to monitor private capital as a key weakness in their analysis of future debt and economic sustainability. HIPCs reinforced their demand for capacity building in this area at HIPC Ministerial Meetings in Geneva and Prague (June and November 2000), because HIPC documents project large increases in FDI inflows.

2. Objectives and Outputs

2.1. Monitoring

The primary objective will be to respond to the requests of those countries identified above for assistance to strengthen and build capacity in national institutions to monitor private capital and investor perceptions, due to their own wish to improve transparency and quality of economic statistics, and to comply with international codes and standards.

To facilitate capacity building and ensure structures are in place for ultimate transfer to the country itself, DFI would work with national governments to establish a “National Taskforce” comprising all relevant government bodies as a first step. This will confirm or strengthen existing legal provisions for data collection, agree broad methodological issues, institutional arrangements and resource allocation for the surveys and censuses (see next section).

2.2. Analysis

In addition, this programme will produce major benefits by providing essential material for national, regional and international analysis, allowing refinements to policy responses and investment promotion, which will in turn increase and stabilise flows and contribute to sustainable economic growth and poverty reduction. While the Programme does not include a research component, the censuses provide rich material for both BOP and policy analysis. It is expected that the results will substantially enrich analysis by the countries themselves, as well as by regional organisations. This is vital for all developing countries given their growing openness to international capital (and for HIPCs in the period leading up to and following relief under the HIPC Initiative). Knowledge by governments of the scale, composition

⁴ Funded by the Governments of Austria, Denmark, Sweden, Switzerland and the UK.

and origin of private capital and PSED, the nature and sectoral diversity, and hence policy implication and response is essential to promoting their stability, and hence the stability of the macroeconomy.

3. Methodology

3.1. Prioritising country need

Table 1 ranks countries that have so far expressed need for, and requested technical assistance from DFI. This takes account of how strongly need is demonstrated, and how soon countries will be in a position to participate in censuses.

Table 1: Country Requests to DFI for Technical Assistance, as of November 2000

<i>1. Countries presently implementing censuses with DFI/DRI (3)</i>	Ghana, Guyana, Tanzania
<i>2. Present proposal to DFID (12-15 month project): DFI/DRI countries demanding immediate training and censuses (5)</i>	Gambia, Jamaica, Malawi, Uganda, Zambia
<i>3. Anticipated wider proposal to DFID and other donors (3-year follow-on project): the countries above, plus 18</i>	<ul style="list-style-type: none"> a. <i>Anglophone Africa:</i> Ethiopia, Kenya, Rwanda, Zimbabwe b. <i>Francophone Africa (BCEAO and BEAC):</i> Cameroon, CAR, Chad, Rep of Congo, Equatorial Guinea, Gabon, Guinea, Mauritania c. <i>Luso & Hispanophone Africa:</i> Angola, Guinea Bissau, Mozambique, Sao Tome d. <i>Caribbean:</i> Trinidad and Tobago e. <i>Latin America:</i> Bolivia, Honduras, Nicaragua

The aim is therefore to prove the value of the project over the next 12-15 months, working on country-specific censuses with four of the priority countries in Table 1 (to add to the three where DFI is already working intensively), and holding an international workshop for 15 countries from the wider group and experts from 5 more advanced countries, to refine methodology and share analytical lessons. The Work Programme for the next 12-15 months is attached as Annex A.

Depending on progress made, the project would then be expanded into a 3-year programme to include other developing countries requesting capacity-building in this area, based on strong demand and demonstrated need from the country. During this period, training and methodology would be decentralised to regional partner institutions currently working with DRI (BEAC, CEMLA, MEFMI and WAIFEM), to transfer capacity and responsibility where possible. This proposal therefore describes a multi-country programme for building developing country capacity to monitor private capital flows.

3.2. Implementation of Census

3.2.1. Flexibility to Suit Country Need

The programme will use methods successfully deployed elsewhere, but tailored to country need. The 1-year cycle for a typical census will comprise:

1) Country Request to DFI for Assistance

The first step is for senior policymakers to formally reconfirm demand.

2) DFI Mission to Establish NTF and Run National Workshop

DFI visits the country to finalise census methodology, and help build a National Taskforce (NTF) to manage the project.⁵ NTF organises a 1-week workshop to sensitise investors on the need for data, obtain their input on methodology, and train NTF officials in implementation.⁶

3) Census Preparation and Launch

In final preparation, NTF revises census forms and tests them on a sample of investors, finalises investor register and instruction manual for field staff. DFI quality controls methodology and NTF launches the census with a national publicity campaign and distribution of census forms.

4) Census Execution

NTF staff follow up proactively by “educating” investors in completing the form, collecting and checking data, and interviewing respondents. DFI conducts a 3-week mission to assess and assist progress, with refresher training where needed.

5) Data Entry and Checking

Using Bank of Tanzania and DRI software adapted to local methodology, NTF staff enter and check data, sending to DFI for spot-checking and approval prior to analysis.

6) Analysis and Report Writing

NTF, in consultation with DFI, writes an analytical report for public and private sector and donors. This identifies priority issues for follow-up and research.

7) Dissemination and Next Steps

NTF disseminates findings to private sector and donors at a closing workshop, and agrees steps for sustainable structures and financing for regular monitoring. In line with GDDS guidelines, DFI recommends countries capture FDI annually through sample surveys, and censuses every 3-5 years. As bank, bureau and portfolio investor populations are small, DFI recommends annual censuses. For PSED, it is recommended that this be done quarterly.

3.3. International Workshop

DFI will organise an international workshop for NTF heads, regional organisations, countries applying to the programme, and international experts. It will benefit from input by countries with completed censuses by that time (Ghana, Guyana, Tanzania). By sharing methodological, data, analytical and policy findings from national censuses, it will set the agenda for analysis, which will in turn feed into revised methodology. It will be highly practically focussed, and held in a project country chosen according to logistical costs and ease of access (Annex B).

⁵ As in DFI projects in Ghana, Guyana and Tanzania, the NTF will include as relevant, the central bank, statistics bureau, investment promotion agency, stock exchange, finance ministry, company registrar, and sector-specific ministries, with a wider consultative group including private sector bodies.

⁶ See Annex C for a sample Training Manual contents page.

3.4. Reporting

With DFI assistance, each NTF will compile the following reports to DFID:

1. Report on initial workshop/mission and sensitisation/training;
2. Interim report immediately following launch to describe progress, together with copies of all methodology (forms, staff instruction manual, software);
3. Report on second mission and finalisation of census implementation/data collection;
4. Report on third mission/closing workshop, Analytical Report of Project Findings and proposals for future sustainability.

Materials relating to training, project background and results would be made available in several languages on the DRI/DFI website in electronic format.

3.5. Institutional structure

3.5.1. Technical Office

The structure of the programme will be highly cost effective, drawing on existing staff within DFI/DRI for some financial management and administrative support. In addition to the DRI/DFI Director and the DFI Programme Manager, the TO will require only a Programme Coordinator (leaving the Director free for higher-level issues covering both programmes), and a DFI administrator with responsibility for organising workshops, manuals and information-sharing.

3.5.2. Resource people

As described above, the project will make intensive use of consultancy from known regional and international experts, based on our existing network. As more countries join the project and capacity is built, this pool will expand, such that after 3 years, regional experts will execute the programme in cooperation with regional partner organisations (see Annex D).

4. Risks, Contingencies and Sustainability

4.1. Medium-term sustainability

It would be unrealistic to expect that by end 2001 every country which requests assistance from the programme will have developed a fully sustainable capacity to monitor private capital. Firstly, over the medium term, civil strife, other national priorities and staff turnover might either delay implementation, or might wipe out large parts of the capacity built by the programme. Secondly, while it will focus on locating monitoring of private capital within the context of support to improve wider national statistics, it will not conduct training in the whole range of economic statistics. As a result, some countries, especially those with low capacity, are likely to require continuing support beyond 2001. However, it is expected that the majority of countries will have developed structures and internal financing sources which allow them to continue sample surveys and small-scale censuses without drawing substantially on donor resources.

4.2. Transfer of functions to regional partners

In order to transfer functions to the countries as soon as possible, the proposed project will continue to draw on regional expertise. It is expected that with wider exposure to different countries, the pool of available experts will expand. As part of the exit strategy, DFI will endeavour to work closely with

regional partners, such as those working with DRI on the HIPC-CBP, with the aim (as part of the wider project) of handing capacity to them. These include:

- Banque Centrale des Etats de l’Afrique de l’Ouest (BCEAO);
- Banque des Etats de l’Afrique Centrale (BEAC);
- Communauté Economique et Monétaire de l’Afrique Centrale (CEMAC);
- Macroeconomic and Financial Management Institute of East and Southern Africa (MEFMI);
- West African Institute for Financial and Economic Management (WAIFEM);
- Union Economique et Monétaire Ouest Africaine (UEMOA);
- Centro de Estudios Monetarios Latinamericanos (CEMLA);
- Eastern Caribbean Central Bank (ECCB).

ANNEX F

About Development Finance International

The External Finance for Africa Group was established in 1993 by Matthew Martin, as a non-profit economic policy advisory, research, training and capacity-building consultancy group. We have worked with more than 40 developing country governments in Africa and Latin America to improve their capacity to design, analyse and implement key strategies on debt, on the external and domestic financing of development, on core macroeconomic policies and on poverty reduction. In view of our recent expansion beyond Africa, we have changed the group’s name to Development Finance International (DFI).

Among the major projects we have implemented are:

1. **External and Domestic Debt and Financing Policy, Strategy, Analysis and Negotiation**

Single-country advisory and capacity-building missions, resident advisors and single or multi-country training/capacity-building workshops in 34 African and Latin American countries funded by the governments of Austria, Denmark, the European Union, the Netherlands, Sweden, Switzerland, UK, US, and UNDP, UNCTAD and the World Bank

The missions and advisors have assisted countries to analyse their needs in reinforcing their institutional capacity to design external and domestic debt and financing strategies, and to design, refine and implement such strategies. Among the highlights of this work have been the invention of the first coordinated mechanisms for relief on multilateral debt (Multilateral Debt Funds); assisting 5 of the first 6 countries eligible for the HIPC Initiative to gain their maximum entitlement to relief under the Initiative; the invention of “live” training on debt sustainability and strategy analysis using a country’s own data; integrated capacity-building on external and domestic debt strategy; and the invention of “live” training on debt renegotiation, using a country’s own data and documents to simulate relief negotiations with its major creditors.

The training events have focussed on Debt Strategy and Negotiation including:

- ***debt strategy training*** using live country data and documents to conduct portfolio reviews, design external and domestic debt relief and new financing strategies, macroeconomic forecasts and poverty reduction programmes, and to recommend optimal debt strategies for economic sustainability and poverty reduction.
- ***debt renegotiation workshops*** using actual country data and documents, and simulating renegotiations of debts to all different types of creditors (Paris Club, other governments, multilateral organisations, commercial, debt conversions) and of various types of commercial and concessional new financing

In recognition of our successes in this field, five European governments have committed US\$14 million over 1997-2001 to a Debt Strategy and Analysis Capacity-Building Programme for Heavily Indebted Poor Countries, for which we have created a subsidiary company, *Debt Relief International (DRI)*, as a non-profit implementing agency.

2. **International Debt Policy Studies**

DFI (formerly EFA) is one of the best known independent advisory groups on international debt policy, including advisory studies for the Swedish and UK Governments, Group of 24, Commonwealth Secretariat, UNCTAD and UNDP on the *HIPC Initiative, Domestic Debt Reduction, the Fiscal Burden of Debt, Linking Debt Relief and Poverty Reduction, Multilateral Debt Reduction, Debt Conversion and Bilateral Debt Reduction*.

3. **Private Capital Flows Analysis and Monitoring**

Since 1996 DFI has been building a programme to reinforce the capacity of developing country governments to analyse and monitor private capital flows (FDI, portfolio flows, bank flows, bureaux and private transfers), through

- multi-country survey projects and training and information exchange workshops on monitoring techniques, and
- cross-country research projects on “Capital Flows and Economic Policy in Africa” and “Private Capital Flows with Eastern and Southern Africa”
We are now working with 16 countries, funded by Denmark, Sweden, Switzerland, UK and the European Union

4. **Aid Management and Evaluation**

Since 1993 DFI has analysed the impact of aid on development, including:

- building capacity in African governments to analyse programme aid and its macroeconomic impact through projects funded by the British, Danish and Swedish governments involving 9 African countries.
- evaluating donor programme support to Mozambique and Guinea-Bissau.
This work has been funded by the British, Danish and Swedish governments and the EU.

5. **Macroeconomic Policy/Forecasting and Poverty Reduction**

(funded by governments of Austria, Denmark, Sweden, Switzerland and UK, European Union and African Economic Research Consortium) including

- training, information-exchange and capacity-building workshops for networks of African policymakers from 26 African countries on Macroeconomic Forecasting, Exchange Rate Policy, Monetary Policy and Financial Sector Reform, Fiscal Policy, and Budget Revenue Mobilisation
- evaluating monetary and financial sector policy in Mozambique and Uganda
- research and training projects involving 16 countries examining and enhancing their capacity for macroeconomic forecasting/modelling;
- tailored training in constructing poverty reduction in developing countries.

The DFI group turnover has risen sharply, reaching US\$4.1 million in 1999/2000 and a projected US\$4.7 million in 2000/2001. We have 41 projects currently under implementation. Our staff complement has risen to 10, including Matthew Martin, (Director DRI/DFI); Juan-Carlos Aguilar, former Secretary of State for Finance in Bolivia (Programme Coordinator, DRI); Alison Johnson, former Senior Economist at the Commonwealth Secretariat (Programme Manager, Debt/Aid, DFI); and Nils Bhinda (Programme Manager, Capital Flows, DFI). However, most of our work is conducted by more than 80 consultants, most of them from developing countries, who are currently working in 4 languages across 34 countries. For more information on Development Finance International, please contact Matthew Martin, Alison Johnson or Nils Bhinda at Development Finance International, 4th Floor Lector House, 151-153 Farringdon Road, London EC1R 3AF, United Kingdom.

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