

Intra-regional Private Capital Flows in Eastern and Southern Africa:

*Findings from Mozambique, South Africa, Tanzania,
Uganda, Zambia and Zimbabwe*

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Introduction

The monitoring and analysis of private capital flows in Africa has received increasing attention in recent years. In part, this is a response to the erosion of previous monitoring systems following the partial liberalisation of capital controls. More significantly, it reflects a recognition of the growing importance of timely and accurate data on the balance of payments to feed into a wide range of policy-making processes. Private capital flows to Africa have increased substantially since the 1990s, with inevitable consequences for macroeconomic policy (see, for example, Bhinda *et al.*, 1999). Moreover, with the liberalisation of economies, opportunities for intra-regional investment flows have expanded - the promotion of cross-border investment within the region is seen as an important component of integration initiatives such as the SADC Free Trade Area, COMESA and the Cross-Border Initiative. Indeed, evidence from existing data on investment approvals from investment promotion agencies around the region suggest that regional investment may be a significant source of capital for many countries in Eastern and Southern Africa.

It is clear, however, that trade and exchange control liberalisation alone will not be sufficient to encourage greater levels of cross-border flows of capital in Africa. A broad range of policies at the macro and microeconomic level are required to create an environment that is conducive for private investment. Understanding and responding to the factors influencing investment decisions will therefore be crucial if integration initiatives are to succeed in encouraging greater levels of cross-border investment. For this reason, regular analysis of investor opinions on factors that encourage investment and factors that act as barriers can be an important input into the policy process.

But to fully understand the determinants of foreign investment - and other forms of financial flows - it is also necessary to have in place adequate systems for collecting, compiling and disseminating statistics on capital movements. Understanding the scale and nature of existing capital flows is the first step in developing a policy framework aimed at encouraging investment and for managing the impact of flows on the domestic economy.

This paper presents the findings of a joint research and capacity-building project on intra-regional private capital flows in Eastern and Southern Africa. The project was coordinated by Development Finance International and the LSE Centre for Research into Economics and Finance in Southern Africa and brought together teams of officials from central banks, investment promotion agencies, stock exchanges, and company registrars in Mozambique, South Africa, Tanzania, Uganda, Zambia and Zimbabwe. The aims were to contribute to a greater understanding of the scale and determinants of intra-regional capital flows and to further develop balance of payments monitoring capacity in the region. The project generated new data sets on the composition of regional capital flows and on the factors influencing investment decisions. These data were analysed by the country teams and research and methodological findings were disseminated through six country studies. This paper summarises the findings of the country studies and draws together recommendations - both methodological and institutional - for further improvements in the monitoring of private capital flows in Eastern and Southern Africa. Both CREFSA and DFI are participating in follow-on projects which build on the conclusions and recommendations of this project. These are described in the final section of this paper.

Methodology

The main analytical tool for this study was a pilot survey of companies with foreign assets and liabilities¹. Supplementary surveys of banks, foreign exchange bureaux and institutional investors were also introduced where relevant to collect additional new data on flows through these financial institutions. At first, these surveys focused on a sample of regional companies, with a view to extending the pilot to a full survey of companies engaged in capital/financial account transactions in the future. During the course of the project, some country teams extended their samples to non-regional investors. These surveys were developed to capture company-level data on the scale and composition of intra-regional investment. Raw data from the company surveys were entered into an analytical spreadsheet designed to produce aggregate statistics on direct investment, both stocks and estimated flows, by partner country, and by type of flow - i.e., new equity, reinvested earnings, and long-term and short-term inter-company loans. The definitions used in each of the surveys followed, where possible, the recommendations of the IMF's Balance of Payments Manual, fifth edition (BPM5).

To gain a greater understanding of the factors driving regional investment decisions, an investor perceptions survey was carried out in each of the countries, targeting the same sample of regional (and some international) investors. These surveys were aimed at senior managers in the host economy, with the exception of South Africa where the survey was aimed at parent companies undertaking regional investment. Respondents were asked to rank the impact of a range of factors on their investment decisions. The survey questionnaire included sections on macroeconomic conditions, infrastructure and services, governance, financial indicators, labour market characteristics and other political and economic factors. Results from the survey were compiled and analysed using a spreadsheet template.

The samples of companies surveyed were developed using a range of information sources: records of investment approvals from investment promotion agencies, stock exchange records, exchange control applications, business directories, newspaper reports and individual contacts. Where possible, samples were constructed to be representative of the population both in terms of firm size, sector and source of investment, although variable response rates created difficulties in maintaining a representative sample (see below).

Surveys were implemented towards the end of 1998 through the first half of 1999. Survey forms were sent to firms by fax, post and, where possible, by hand and were followed-up with phone calls and personal visits. Face-to-face interviews to conduct the surveys played a key role in generating a reasonable response rate. For instance, personal contact allowed queries and concerns relating to the sensitivity of information to be more easily resolved. Furthermore, interviews gave teams the opportunity to explore in more detail the motivation of investors, providing valuable additional information for the analysis of investor perceptions. Interviews were carried out with directors and finance officers - targeting sufficiently senior managers was key to obtaining an informed view, particularly in the case of the investor perceptions survey.

Each team undertook an analysis of data from the various surveys and produced a country report based on findings from the data and on the methodology used. The teams presented these reports at a workshop, sharing their experiences with officials from eight other African countries. Following discussions on the conclusions and recommendations of the project, each of the country teams attending the workshop developed an action plan for further improvements in capital flows data and

analysis.

Country teams

Across the six countries, a range of institutions conducted the surveys, with the aim of promoting institutional cooperation.

In Mozambique, the Centro de Promoção de Investimentos (the Investment Promotion Centre) carried out the investor perceptions survey, while officials from the Banco de Moçambique implemented the assets and liabilities survey.

The South African study was undertaken by the SADC Finance and Investment Sector Coordinating Unit (FISCU), based in the South African Department of Finance. Monitoring systems in South Africa are well-developed and surveys of foreign transactions have been conducted by the South African Reserve Bank since 1956. Using data provided by the Reserve Bank, this study analysed the extent of South African investment in Eastern and Southern Africa. A new investor perceptions survey was used in order to understand better how South African investors view the region.

In Tanzania, the project was undertaken by officials from the Bank of Tanzania and the Tanzania Investment Centre. A combined survey of foreign assets and liabilities and of investor perceptions was implemented, together with a supplementary survey of banking institutions. The sample of companies was derived from the approval records of the investment centre.

The Uganda team was drawn from the Bank of Uganda and the Uganda Investment Authority. The assets and liabilities survey was combined with the investor perceptions survey and was targeted at a sample drawn from the records of the investment authority on foreign investments that were either operational or being implemented. Supplementary surveys of banks and foreign exchange bureaux were also carried out.

In Zambia, the combined assets and liabilities and investor perceptions survey was carried out by the Zambia Investment Centre and the Bank of Zambia, with the sample largely drawn from approvals records. Additional surveys were carried out of the banks and bureaux in this sample. The Bank of Zambia and the Lusaka Stock Exchange implemented a survey of fund managers and institutional investors.

In Zimbabwe, officials from the Reserve Bank carried out the assets and liabilities survey based on a sample of companies provided by the Zimbabwe Investment Centre and on information from the Zimbabwe Stock Exchange and other sources, including the Export Processing Zone. Supplementary surveys of banking institutions and foreign exchange bureaux were also undertaken. A private-sector consultant helped implement the investor perceptions survey, with support from a local business association.

Research findings²

Findings from the survey of foreign assets and liabilities

The scale of regional investment

Most studies found that regional investment is small, but rapidly growing. Recent growth in intra-regional investment is partly due to the expansion of South African industry into the region but there is also evidence of significant outward investment from Zimbabwe, Mauritius and, in Eastern Africa, Kenya.

Unsurprisingly, South Africa, the largest regional economy, was identified as an important regional investment partner in all of the studies. This is particularly the case for Zimbabwe and Mozambique, where South Africa was found to be by far the most important source of regional investment. The case studies of Tanzania and Uganda also highlighted the growing importance and influence of South African companies. It is worth noting, however, that the smaller regional economies also have significant foreign assets in South Africa - these financial flows appear to be driven by trade and financial integration (see below). Table 1 presents data on South Africa's assets and liabilities *vis-a-vis* Eastern and Southern Africa. While the stocks of regional assets and liabilities are a small fraction of the total for South Africa, they represent significant amounts for the smaller economies.

Table 1: South African foreign assets and liabilities (in millions of US dollars, at end-1997)

	Direct and non-direct investment assets ¹			Direct and non-direct investment liabilities		
	<i>Direct</i>	<i>Non-direct</i>	<i>Total</i>	<i>Direct</i>	<i>Non-direct</i>	<i>Total</i>
Eastern and Southern Africa	670	569	1,239	120	1,368	1,488
Other Africa	642	40	682	69	205	271
Rest of World	26,182	17,741	43,963	18,180	42,970	61,150

Source: Mowatt and Zulu (1999) using data from the South African Reserve Bank, converted into US dollars

Note: 1. See the discussion of the coverage of data on South African investment in the region in the methodological section of this paper.

With the exception of South Africa, most of the country studies focused on direct investment in their analysis of regional liabilities. It is worth bearing in mind that the South Africa study of regional assets and liabilities was based on existing and comprehensive survey data, while other country studies used pilot surveys attempting to capture the most important cross-border capital flows into the domestic economy. With the possible exception of Zimbabwe, these economies generally have underdeveloped financial systems and, as such, direct investment is likely to be the most important form of inward private capital flow.

There appears to be no single sectoral pattern for regional direct investment. For example, the Zimbabwe team found that the retail sector was dominant, followed by agro-industry; Tanzania highlighted the financial sector, industrial holdings, and food and beverages; and both Tanzania and

Uganda emphasised the growing importance of the telecommunications sector. However, issues identified below in the methodological section suggest that the sectoral distributions identified in the sample survey should be treated with some caution.

As can be seen in Table 2, regional direct investment was found to be predominately financed through equity (new equity and retained earnings) as opposed to liabilities in the form of shareholder and inter-company loans and supplier credits from related companies. Similarly, the study of Zambia found equity finance to be the more significant component of the total stock of foreign direct investment. In contrast, the studies in Tanzania and Uganda both found that firms with non-regional foreign investment were more reliant on non-equity liabilities for financing investment. The distinction between these types of direct investment should not be overemphasised, however, as the practical distinctions in the risk exposure faced by the parent company are not always evident. Other reasons may explain company choices with regard to debt versus equity financing, such as tax and exchange control treatment.

Table 2: Stock of foreign liabilities captured by the pilot company surveys of direct investment enterprises (at end 1997, in millions of US dollars)

	Mozambique	Tanzania		Uganda		Zambia	Zimbabwe
	<i>Regional</i>	<i>Regional</i>	<i>Total</i>	<i>Regional</i>	<i>Total</i>	<i>Total</i>	<i>Regional</i>
Direct investment	61.1	90.9	262.8	14.0	34.7	186.5	6.8
Equity	45.5	77.9	153.7	12.3	23.7	172.5	4.1
Non-equity	15.6	13.0	109.1	1.7	11.0	14.0	2.7
Portfolio investment	0.3	6.2	13.0	0.0	0.0	0.0	4.9
Other investment	73.1	10.6	151.0	9.1	32.9	...	5.8
Long-term	71.4	7.7	144.4	8.9	29.7	...	0.1
Short-term	1.7	3.2	6.7	0.1	3.3	...	5.7

Source: Fernandes *et al* (1999); Kalyalya *et al* (1999); Kasekende *et al* (1999); Mashiringwani *et al* (1999); and Noni *et al* (1999)

Note: The pilot surveys used in each of these countries varied both in the approach to sampling and in the response rates achieved. For this reason, the numbers presented in this table should not be interpreted as a cross-country comparison of stocks of foreign investment.

Trade and regional capital flows

A common theme in these studies is that regional capital flows appear to be, in part, driven by trade. For instance, in Uganda it was found that most regional direct investments are from East Africa (both Kenya and Tanzania), reflecting the history of economic cooperation. In the South Africa case study, a sharp distinction was drawn between the sizeable capital flows to and from South Africa's Customs Union partners and the much smaller flows to the rest of SADC. The case of SACU (where intra-regional trade between the smaller members and South Africa is significant) suggests that

growing trade integration in Southern Africa could lead to increased regional investment in the long term. Nevertheless, in spite of South Africa's perceived importance as a source of direct investment in the region, one of the conclusions to emerge from the South African study is that trade and financial integration appears to be more important in driving non-direct investment flows. One reason for this is the significance of trade-related finance in these flows as well as the ability of capital to move more freely between financially integrated economies.

Moreover, the South Africa case study shows that the relatively sophisticated financial system of South Africa attracts capital from its neighbours in the Customs Union due, at least in part, to trade and financial integration. Indeed, according to the South African investment position data, South Africa appears to have net liabilities to its SACU partners. However, the complex nature of investment transactions means that data on South African direct investment assets in the region is likely to understate the true extent of South African-controlled companies (see below for an explanation).

This finding suggests that, as regionalism gathers pace in Eastern and Southern Africa, outward flows to the more advanced financial centres could also increase. This underscores the importance of monitoring outward, as well as inward, capital flows.

Perceptions of the climate for investment in Eastern and Southern Africa

Broadly speaking, regional investors appear to have a positive picture of the investment climate in Eastern and Southern Africa. This was reflected by respondents in the host countries and, in the case of South African investors, in the parent country too. The survey of investor perceptions in South Africa indicates that there is "cautious optimism" about economic policy frameworks in many regional countries and also that investors generally believe that the conditions for investment are improving. Nevertheless, some investors reported a "wait and see" approach to regional investment - this view was expressed particularly by investors in Zimbabwe and Uganda.

The informed view of regional investors

The survey results indicate that investor perceptions vary from country to country suggesting that regional investors have a relatively informed view of differences in economic and political conditions across the region. This is most evident in the study of South African investment in Southern Africa, where sharp differences emerge in firms' views of conditions in countries where they invest. This is in contrast to the generally singular and anecdotal view of many foreign investors regarding conditions in Africa. This simplistic view of Africa has often been given weight by the international media in its coverage of African issues. Earlier studies have suggested that regional investors were far more positive about investing in Africa than their international counterparts. While part of the explanation almost certainly lies in the benefits of familiarity for investors, it would also appear that there is, more generally, a significant difference between the quality of information available to investors on the ground within the region compared to investors based overseas. This is borne out by the findings of this study.

Constraints to investment

The survey highlighted several factors that act as a constraint to regional investment. Exchange rate instability, inflation and high interest rates were reported as constraining factors for several regional

economies. For example, investors highlighted these factors in Tanzania, Zambia and Zimbabwe, and, for exchange rate instability, in Uganda. Many investors cited aspects of infrastructure such as roads, water and power supplies as having a negative impact on investment for some countries. In some cases, investors have made alternative arrangements, increasing the cost of investment. For example, in Mozambique and Uganda, the provision of power generators and water supply have added to investment costs. In addition, some features of governance were found to cause concern, particularly the extent of corruption and the length of time required for official processes, although the survey of South African investors indicates a notable improvement in perceptions for some countries in the region.

Factors encouraging investment

Nevertheless, there are also many factors which are encouraging intra-regional investment, although these tended to vary from country to country. Despite concerns about exchange rate and price instability, macroeconomic policy and the commitment to liberalisation were regarded as a positive factor in Tanzania and Zambia. This commitment was also noted by investors in Mozambique, where significant progress has been made over a relatively short period of time. In Uganda the macroeconomic framework and labour-related factors were seen as positive. In Zimbabwe, in contrast to many other countries, infrastructure and the quality of labour were viewed positively. Improvements in telecommunications, through email and the internet, were also cited by investors in Tanzania and Uganda.

In line with the findings from the quantitative surveys, investors were found to believe that regional integration is important for encouraging cross-border investment - although both positive and negative concerns were expressed about the pace of integration at the time of the survey. Some investors expressed fears regarding the impact of competition from regional firms in domestic markets, while others complained of an apparent lack of commitment on the part of regional governments to agree and implement regional trade and investment integration initiatives.

Bank lending and deposits

The quantitative data generated by the survey of banks in Tanzania, Uganda, Zambia and Zimbabwe were disappointing. For those that did submit data on loans, only one bank in Uganda (since closed) was found to have exposure to non-resident companies - mostly in the form of import finance and bridging finance.

Where data were reported, non-resident deposits in Tanzania, Uganda and Zambia were found to be small but rising. In Tanzania, these deposits originated mainly from parent companies and were held in foreign currencies. The motivation for holding these deposits was mostly for carrying out local business transactions. The reporting banks in these countries also generally reported a declining involvement in Treasury Bill transactions on behalf of foreign clients. This was attributed to a fall in demand in response to declining interest rates.

Banks were also asked to provide their views on the likely expansion of their activities into the region and factors that would encourage regional lending. The data generated here were more satisfactory. Banks in Uganda were generally positive about the possibilities for undertaking a range of activities in the region. In contrast, banks in Zimbabwe reported no plans for regional expansion. Banks expressed the view that guarantee mechanisms would have a positive influence on regional lending. Indeed, in

Zambia, high risk was noted as the main factor deterring regional lending. The banks were generally positive about prospects for regional integration. In Uganda, Zambia and Zimbabwe, banks argued that lending would be encouraged by closer regional integration but that tax incentives and greater transparency would also be important factors.

Banks also expressed generally a willingness to supply more information on financial flows. However, respondents argued that the survey methodology should be simplified through shortening forms, removing duplication in the reporting requirements of official institutions, providing training for bank staff in completing the required information, and providing greater assurances of confidentiality. Feedback of survey results would also help to encourage reporting.

Financial flows through foreign exchange bureaux

Surveys of financial flows taking place through licensed foreign exchange bureaux were undertaken in Uganda, Zambia and Zimbabwe, although there was a wide variation in reporting in these countries. The main uses of foreign exchange provided through the bureaux are for current account transactions, while the sources of foreign exchange are largely from direct investment and NGO activities in the case of Uganda, and export receipts in the case of Zambia. Cash is the main instrument used by the bureaux, although letters of credit, telegraphic transfer and bank drafts are also in use. In Zambia, transactions associated with regional transfers accounted for around 23 percent of total purchases of currency.

In terms of the factors that would encourage an expansion of their activities, most bureaux argued for greater liberalisation, an increased supply of foreign exchange, and greater competition with banks. As with banks, the foreign exchange bureaux appeared willing to supply more information on flows but pre-requisites are improved relations with government, simpler survey methodologies, assurances of confidentiality, training, and feedback.

Institutional investment and other portfolio investment in the region

The case study of South African investment in the region provides some interesting regional conclusions regarding outward portfolio investment from the largest regional economy. This study finds that portfolio investment by South African residents is particularly low compared to other forms of flows to the region and is virtually non-existent compared to assets held in the rest of the world. As exchange controls on South African residents have been gradually liberalised, greater allowances have been introduced for investment (both direct investment and portfolio investment) in SADC economies. This more rapid liberalisation with the region is intended to encourage investment in South Africa's regional partners. One explanation for the clear lack of investment response to date, however, lies in the restrictions placed by South Africa's financial regulator on South African institutional investors. Up until recently, institutional investors were not allowed to invest in stock exchanges that were not members of the International Federation of Stock Exchanges. At present, the Johannesburg Stock Exchange is the only member from Africa - as such, South African institutional investors have been effectively barred from investing in regional stock exchanges.

Partly in recognition of the apparent contradiction between regulatory requirements and government policy of encouraging investment in the region, these regulations were reviewed during 1999 with the aim of putting a more flexible policy in place, while still safeguarding managed funds from excessive risks. The new framework now offers the possibility of greater South African investment in those

regional stock exchanges that can meet certain criteria for investor protection.

A survey of fund managers and institutional investors was carried out for the project in Zambia. Investors not subject to restrictions on outward investment reported regional investments (in particular in bonds and Treasury bills) in South Africa and Zimbabwe. Decisions on investing in particular countries appear to be influenced by similar factors to those driving direct investment (see above). Sectoral choices were in turn dictated by the investment policy of the fund, barriers to entry, taxation and tariffs, sectoral stability and growth prospects. Companies were selected for investment according to a range of financial and institutional factors, cyclical trends and growth prospects; issues of environmental impact were also highlighted as important by some funds.

Methodological and institutional issues

As discussed above, new data on intra-regional investment were collected through a pilot company survey of foreign assets and liabilities, supplemented with additional surveys of financial institutions and a survey of investor perceptions. The implementation of surveys raised issues around the sample of companies, the quality of responses, and on the resource cost implications for central banks.

Samples

In most cases, the sample of companies was, in part, drawn from records on investment approvals. In many cases, these records were found to be inaccurate: investments had been approved but never taken place or companies had moved address or closed down. A related problem was that some firms were owned by resident foreign nationals - such investment is not classed as "foreign" in balance of payments statistical terms (see text box below).

For future surveys, a register of companies with foreign assets and liabilities will need to be maintained. This points to the need for greater follow-up of approved foreign investments and classification of resident or non-resident status. In addition, broader sources of information should be used - examples range from exchange control records (while these are still in use) to trade publications and newspapers. Institutional cooperation between central banks, investment authorities and, where relevant, stock exchanges will be particularly important in maintaining accurate records on investment for sampling purposes.

In order to draw firm conclusions from the data generated by the sample survey, the sample must be representative of the population of investments, in terms of the sector of investment, firm size, and the source country of investment. Here there are clearly trade-offs between the size of the sample and cost. Sampling also requires a benchmark on which to base sample selection. This could be based on periodic censuses of foreign transactions, as in South Africa, although this is a resource-intensive process.

A further finding, which had serious implications for the interpretation of data, was that the classification of investment as regional or non-regional was complicated by the role of third country subsidiaries in undertaking investment. This particularly affects South African investment in the region and is a common problem encountered in balance of payments monitoring. For a variety of reasons, large South African companies have often chosen to use their international subsidiaries when undertaking investment in the region. In balance of payments terms, this may appear as new investment from the third country, rather than from South Africa. From South Africa's perspective, to

the extent that such investments enhance the market value of the third-country subsidiary, these investments will appear in the international investment position as an increase in the value of assets in the third country, and not in the investment position *vis-a-vis* the region. While for balance of payments statistics, this approach is appropriate, it does limit the usefulness of data. From a policy perspective, it is probably more important to understand where the actual investment decision is made rather than the strict definition of source country. This issue is also highlighted in the text box below.

CATEGORISING FOREIGN DIRECT INVESTMENT

In implementing the pilot surveys, issues surrounding the definition of foreign direct investment were an important area for discussion. Distinctions arose between the strict definition of direct investment, as set out in the IMF's BPM5 guidelines, and the data that one would ideally like to use in analysing the importance of regional investors, or other categories of investors. Below we highlight two interesting examples.

Returning Asians

One important group of investors in Uganda is referred to as "Returning Asians". These investors are typically Asian families who fled Uganda in the 1970s but are now investing in the country partly as a result of policies introduced in the 1990s to return seized property. Their motivation is to re-acquire assets in the country and to build on their broader regional knowledge. Such investments have been recorded as private transfers in the balance of payments but contain a large component of foreign direct investment. (Kasekende *et al*, 1999) Furthermore, the treatment of resident versus non-resident in the strict balance of payments sense complicates the interpretation of these capital flows.

Investments by returning Asians take the form of a family member returning to Uganda to acquire previously-seized property. They invest both their capital *and* the capital of other family members, who remain resident elsewhere and thus represent foreign investors in Uganda. The distinction between resident and non-resident investors becomes important in the balance of payments treatment of such capital flows: in such cases, the family member that becomes a resident in Uganda is not strictly speaking a foreign investor. However, in policy terms, this distinction is less important than the evidence that capital is returning to finance productive investment.

Investment through third countries

The presence of exchange controls in South Africa has meant that, until recently, regional expansion by large conglomerates has often been implemented through international subsidiaries. This raises tricky problems for analysing South Africa's international investment position (IIP) by country or region. For instance, while some large companies are active regional investors, these investments have frequently been implemented through subsidiaries in Europe. In such cases, the value of regional investment is not always reflected in the IIP *vis-a-vis* the regional country; instead it can be reflected in the market value of the European subsidiary and thus in the IIP *vis-a-vis* the European country. While this treatment is correct from the perspective of the IIP, for policy purposes it is more relevant to know where investment decisions are made - in this case, not necessarily in Europe but in South Africa.

A related problem to emerge in recent years is the transfer of ownership of several large South African conglomerates to London through listings on the London Stock Exchange. These companies are no longer South African entities for IIP purposes. The resulting shift in the pattern of ownership of foreign assets and liabilities as reflected in South Africa's IIP has been dramatic. There will also be notable implications for the pattern of ownership of foreign assets and liabilities for several regional countries.

The quality of responses

All country teams involved in the project encountered problems in getting companies to respond to the survey. This was to be expected as the pilot surveys were a first attempt at introducing new reporting requirements. In most cases, achieving an adequate response rate for any sort of meaningful data analysis required extensive follow-up by phone, fax, and, most importantly, through personal visits to companies. This was costly and resource-intensive.

In the longer-term, the successful implementation of the company survey will require developing a culture of reporting in the private sector and there are useful lessons to be learnt from the regional experiences of South Africa and Namibia³. Central banks should consult with the private sector on the development of the survey - both to understand private sector concerns about the sensitivity of the information requested and to ensure that the survey is understood by reporting companies. Central banks should look for ways to emphasise the importance of responding to the survey, for example, through newspaper articles or central bank seminars. They should also share the findings - dissemination of the results to participating companies is a potential way of demonstrating the importance of the survey. Issues of credibility of the data-collecting agency are crucial in building a reporting culture. Surveys should be backed by legislation that not only requires companies to report information, but also sets out credible mechanisms to ensure the confidentiality of company responses. As a last resort, the use of penalties on companies who do not respond should also be considered, although every effort should first be made to encourage voluntary compliance.

The quality of data collected was also affected by the limited ability of many companies to measure the current value of foreign equity investment. In measuring stocks of foreign assets and liabilities, best practice suggests that the current *market value* of assets and liabilities should be reported in addition to the *nominal value* (or book value) of investment. Nominal value (based on historical cost) is unlikely to provide an analytically useful measure of equity assets and liabilities as it fails to capture the impact of profitability and inflation over time. It does not reflect the value of resources held by investors - this is important if we consider the implication of the sale of an asset and the subsequent capital outflow. Market value, on the other hand, in principle captures the commercial value of an asset or liability at a particular reference date. In general, a range of methods is available for estimating market value including, for example, net asset values, directors' valuations or recent transaction prices. Nevertheless, the use of market value is problematic for many countries and reliance on book values is common (IMF, 1993 and 1996).

Some of the country teams found that it was impossible to collect market value data: no stock market evaluation was available and respondents were unwilling or unable to use other proxies of market value. Nominal value was then used as a second-best option. For these countries, further consideration needs to be given to methods for approximating market value and to convincing companies that this is a more useful measure.

Resource cost implications

All teams involved in the project found that the implementation of the survey was time-consuming, largely because of the intensive follow-up that was required to achieve a reasonable response rate. Surveys are inevitably resource-intensive processes and there are trade-offs to be faced between cost and accuracy and timeliness. Moreover, a well-trained and sufficient staff, with access to sufficient

financial resources, is a critical component of the survey process. These resource implications have an important role in defining capacity building needs and in budgetary planning and are a key area where donor support could be sought in the future.

Conclusions, recommendations and next steps⁴

The new data generated by this project suggest that regional investment is playing an increasingly important role in Eastern and Southern Africa. This is in the context of a general increase in private capital flows to the region from the rest of the world. While the pilot surveys introduced in this project yielded valuable new information on the scale and determinants of cross-border flows within the region, low response rates and methodological difficulties highlighted the need for further improvements in statistical systems for monitoring and analysing capital flows.

Regional cooperation

Regional cooperation in balance of payments statistics presents a promising means of sharing expertise and building institutional capacity. A regular regional forum of balance of payments compilers could provide an ongoing opportunity to share and discuss best practice in data collection, compilation and dissemination. Issues for discussion at this forum might include the estimation of the market value of equity assets and liabilities; mechanisms for encouraging compliance, including the design of legislation and the use of incentives and penalties; and the distinctions between ownership and control of investments (i.e., where third-country subsidiaries are involved in investment transactions). Such a forum could also institute further research projects to examine specific aspects of capital flows in the region. Initial steps towards creating such a forum are currently being taken in a new project that will bring together representatives from 20 developing countries on an annual basis to discuss issues in the monitoring of private capital flows.

A further means of promoting regional cooperation in balance of payments statistics is to undertake exercises in bilateral reconciliation of investment positions and flows data. A pilot exercise in bilateral reconciliation is currently being undertaken by members of the Southern African Customs Union, where most of the statistical systems are sufficiently advanced to allow for a meaningful comparison of data. Examples of bilateral reconciliation around the world are relatively rare and it is hoped that this pilot exercise will contribute to establishing an international benchmark for reconciliation methodology.

Further research on capital flows

Further research is needed on the role of trade and financial integration in promoting cross-border capital flows in Eastern and Southern Africa. Indeed, a new research project examining investment within the economically integrated members of the Southern African Customs Union has already been launched. Further research could also investigate the impact of flows on economic growth and development. Issues for analysis here include the extent to which direct investment promotes job creation, whether skills and technology transfers accompany direct investment, and the implications for poverty reduction. Efforts are underway to establish new research projects to examine these issues and the linkage between capital flows and financial sector liberalisation in low-income Africa. The findings of this research will inform a wide range of economic policies, for example on investment promotion, financial liberalisation, and regional integration.

Institutional issues

Perhaps the most pressing challenge facing countries wishing to establish a survey-based monitoring system is to encourage a culture of reporting on the part of firms. An important first step could be for the statistical agency to engage in dialogue with the private sector. Workshops and media coverage can help to explain the role of the survey and, more generally, the importance of accurate BOP statistics for policy-making purposes. Such workshops may also play a role in convincing respondents of the commitment to confidentiality. While adequate legislation guaranteeing confidentiality is crucial in this respect, it should be recognised that building trust is likely to be a long-term goal. Incentives for reporting are another means of encouraging respondents. This might be in the form of, for example, the sharing of the findings with respondents, which may provide useful information for companies in developing their long-term investment strategies.

The statistical agency must be backed by legislation that provides a clear legal mandate to collect company-level data. Such legislation should provide for penalties for non-compliance although, in the interests of relationship building, these should be used only when other means of encouraging firms to respond have been exhausted. However, legislation alone will not be sufficient - as discussed below, there is no substitute for persistent follow-up to ensure reasonable response rates to surveys.

While statistical agencies require a clear and sole legal mandate for collecting data for the compilation of the balance of payments, surveys aimed at identifying investor perceptions are more open to coordination with other institutions. Coordinating such surveys with investment promotion agencies and other public and private sector agencies can be a useful way of overcoming survey fatigue and thus encouraging the private sector to respond.

A final issue to consider is the institutional structure for implementing surveys. The experience of this project emphasises the need for adequate resources for undertaking either annual or quarterly surveys and for analysing and disseminating the results. Recruitment and training of staff should be considered at an early stage of developing statistical systems. Moreover, experts in statistical agencies should be encouraged to write up methodologies in the interests of maintaining institutional memory in the event of staff promotion or turnover. Tools for data entry and analysis also need to be put in place. These initial start-up costs are a potential area for donor support. But it is also vital that senior officials in central banks and other statistical agencies recognise the importance of monitoring and analysing capital flows in allocating scarce staff and financial resources.

These institutional recommendations are currently being implemented as part of the introduction of private sector censuses in eight developing countries. The approach being taken includes dialogue with the private sector, institutional coordination through national task forces, the development of advanced training manuals and analytical tools, and enumeration manuals aimed at building and maintaining institutional capacity.

Methodological issues

One of the main lessons to emerge from the pilot surveys was that accurate records of firms engaged in foreign transactions need to be maintained in order to draw up a representative sample for the

survey. This might involve following-up approved investments to create a register of implemented investments. Furthermore, a range of sources should be used to maintain this register, as discussed above, and this will require cooperation between the statistical agency and other information-gathering bodies, for instance investment promotion agencies and stock exchanges. Such a register should include information on sector, estimated firm size, investment partners, and contact details. The size of the sample should also be considered - here, there are trade-offs to be made between a large sample that provides wider coverage of firms active in the economy and a smaller sample that allows for more personal and productive follow-up. Resource constraints are likely to be a defining feature of this choice.

Survey design should be considered carefully. There is clearly a trade-off between minimising the length and complexity of the survey form and eliciting the maximum level of detail for analytical purposes. Survey forms should be tested with a small group of companies. This will enable compilers to identify at an early stage the likely problems in interpretation of various questions and where additional explanatory notes are required.

Training respondents in completing the survey forms may also be useful. For instance, this may be one way of explaining methods of estimating market values of assets and liabilities, one of the major problems to emerge in the pilot surveys of this project. Staff should be available to answer queries about aspects of the form and should be prepared to visit firms where necessary. Persistent follow-up, including personal contact with respondents, will inevitably be necessary to build a reasonable response to the survey, especially in the early years. It should be recognised that this will significantly increase the resources required to collect data, particularly in terms of staff time.

Mechanisms should also be in place to check the accuracy of reported data. This can be achieved at the firm level by analysing balance sheet data where this is requested as part of surveys, by building consistency checks into survey forms and by checking previous survey responses. Spot-checking data entry by junior staff is also useful for helping accuracy. At the aggregate level, there is scope for comparing stock and flow data for broad consistency; for comparing certain types of financial flows with monetary statistics; and for comparing national data and international sources with a different reporting base, such as the international banking statistics produced by the Bank for International Settlements.

These methodological issues and others are currently being examined in eight developing countries as part of the introduction of private sector censuses, as discussed above.

Conclusion

In conclusion, this study has contributed new findings on the nature of investment flows within Eastern and Southern Africa. It has also highlighted a range of methodological and institutional issues to be addressed by statistical agencies in the region in terms of further developing their capacity for monitoring and analysing private capital flows. As these economies become more open to foreign investment and as investors search out new opportunities for profitable investment across borders, understanding the composition and determinants of capital flows is likely to play an increasingly important role in policy formulation at both a national and regional level.

Drawing on the findings and recommendations from this project, CREFSA and DFI continue to work with official institutions in developing countries to enhance their capacity to monitor and analyse

private capital flows.

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Notes

1. For those countries implementing the pilot company survey, data on foreign direct investment was previously based on a mix of proxies, including an estimated proportion of investment approvals reported by investment promotion agencies.
2. References for the various country case studies on which this analysis is based can be found in the reference list at the end of this paper. The team members and their institutions are listed in an appendix to this paper.
3. For a discussion of the experience of encouraging reporting in Namibia and of establishing BOP survey systems in general, see Scheun (1998 and 1999).
4. This section draws in part on the discussion from the two workshops that accompanied this project: *Monitoring Private Capital Flows in Eastern and Southern Africa*, Pretoria, 27-29 July 1998; and *Intra-regional Private Capital Flows in Eastern and Southern Africa*, Harare, 21-23 June 1999

Appendix: Country Teams

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