

FOREIGN PRIVATE CAPITAL CAPACITY BUILDING PROGRAMME (FPC CBP)

# PRIVATE CAPITAL FLOWS TO LOW INCOME COUNTRIES: DEALING WITH BOOM AND BUST

FPC CBP Series No 2

Nils Bhinda  
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**DFID** Department for  
International  
Development

Statisssekretariat für Wirtschaft  
Secretariat of State for the Economy  
Segretariato di Stato dell'economia  
State Secretariat for Economic Affairs

SWITZERLAND **seco**



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November 2009

Nils Bhinda  
Matthew Martin

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ISBN 1-903971-48-2

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Published by

**Debt Relief International Ltd**

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# FOREWORD AND ACKNOWLEDGEMENTS

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This publication is part of a series written in response to the increasing number of requests Development Finance International (DFI) has received for information on the activities of the *Foreign Private Capital Monitoring and Analysis Capacity Building Programme* (FPC CBP) and on the technical aspects of monitoring, analysing and designing policies to manage foreign private capital.

The aim of the FPC CBP (which has been funded since 1998 by Switzerland, Denmark, the EU, Sweden, the United Kingdom and the World Bank), is to build and strengthen the capacity of developing country government and private sector institutions to monitor and analyse stocks and flows of foreign direct and portfolio investment, private sector external debt, and the perceptions and intentions of investors in contribution to sustainable growth and poverty reduction. DFI is its non-profit implementing organisation, in partnership with BCEAO (Banque Centrale des Etats de l'Afrique de l'Ouest), BEAC (Banque des Etats d'Afrique Centrale), CEMLA (Centro de Estudios Monetarios Latinoamericanos), MEFMI (Macroeconomic and Financial Management Institute of Eastern and Southern Africa) and WAIFEM (West African Institute for Financial and Economic Management). For more details of the programme, see Annex 2.

The aim of the series is to present particular topics in a concise, accessible and practical way for use and implementation by developing country governments. Each publication is intended to be self-contained. We welcome any comments on this publication or suggestions for other topics to be included.

The views expressed in the publications are those of the authors and not necessarily those of the FPC CBP donors or the participating countries. Nevertheless we thank all of the participating countries and donor representatives for their contributions to methodology and analysis over the last eleven years, as well as their financial contributions to the success of the programme.

More particularly, we would like to thank the country teams from the 22 countries which have received assistance from the FPC CBP for all their hard work in conducting the surveys and producing the analytical reports on which this publication is based, former DFI Researchers Gill Rogers and Cleo-Rose-Innes for contributions to earlier drafts of this publication, DFI Programme Manager Jeannette Laouadi for coordinating the publication and, together with Sue Akroyd, for formatting and proofreading the text, to Anna Jurgis and Shose Kessi for their invaluable administrative support to the FPC CBP, and to Solange Jonsson, Francisco Susena and Anita Vettier for translation and Michael Stafford for design.

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## BIBLIOGRAPHY



# ACRONYMS AND ABBREVIATIONS

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<b>AfDB</b>	African Development Bank	<b>IADB</b>	Inter-American Development Bank
<b>AfDF</b>	African Development Fund	<b>IDS</b>	Institute of Development Studies
<b>BCEAO</b>	Banque Centrale des Etats de l'Afrique de l'Ouest	<b>IFS</b>	International Financial Statistics
<b>BIS</b>	Bank for International Settlements	<b>IIF</b>	Institute of International Finance
<b>BOP</b>	Balance of Payments	<b>IIP</b>	International Investment Position
<b>BOPSY</b>	Balance of Payments Statistics Yearbook	<b>IMF</b>	International Monetary Fund
<b>CAFTA</b>	Central America Free Trade Agreement	<b>IP</b>	Investor Perception
<b>CBG</b>	Central Bank of The Gambia	<b>IPA</b>	Investment Promotion Agency
<b>CDG</b>	Center for Global Development	<b>LAC</b>	Latin American Countries
<b>CEMLA</b>	Centro de Estudios Monetarios Latinoamericanos	<b>LICs</b>	Low Income Countries
<b>CEPAL</b>	Comisión Económica para América Latina	<b>MEFMI</b>	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
<b>CNZF</b>	<i>Comisión Nacional Zona Franca</i> (Nicaragua's Free Zone Commission)	<b>MDG</b>	Millennium Development Goals
<b>COMSEC</b>	Commonwealth Secretariat	<b>MIGA</b>	Multilateral Investment Guarantee Agency
<b>CS-DRMS</b>	Commonwealth Secretariat's Debt Recording and Management System	<b>NTF</b>	National Taskforce
<b>CSO</b>	Civil Societies Associations	<b>ODI</b>	Overseas Development Institute
<b>CSR</b>	Corporate Social Responsibility	<b>OECD</b>	Organisation for Economic co-operation and Development
<b>DFI</b>	Development Finance International	<b>PNG</b>	Private Non-Guaranteed Debt
<b>DGA</b>	Dirección General de Servicios Aduaneros	<b>PPG</b>	Public and Publicly Guaranteed Debt
<b>DMFAS</b>	UNCTAD's Debt Management and Financial Analysis System	<b>SDDS</b>	IMF Special Data Dissemination Standard
<b>FDI</b>	Foreign Direct Investment	<b>SSA</b>	Sub-Saharan Africa
<b>FPC</b>	Foreign Private Capital	<b>UEMOA</b>	West African Economic and Monetary Union
<b>FPC CBP</b>	Foreign Private Capital Capacity Building Programme	<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>GDDS</b>	IMF General Data Dissemination Standard	<b>WAIFEM</b>	West African Institute for Financial and Economic Management
<b>GDF</b>	Global Development Finance	<b>WEO</b>	World Economic Outlook
<b>GFCF</b>	Gross Fixed Capital Formation	<b>WTO</b>	World Trade Organisation
<b>HIPC</b>	Heavily Indebted Poor Countries		

Until very recently, many thought that low-income and African countries receive very little investment from overseas. It is still common to read authors lamenting that virtually no FDI is going to the poorest countries, especially in Africa. However, while small in terms of global flows, the amounts countries have been receiving are very large compared to their economies, and as volatile as they are in larger emerging markets. As a result, as we have pointed out in earlier work (Bhinda and Martin 2006, Martin and Rose-Innes 2004), many countries have been suffering from financial-flow induced crises, without receiving much attention or financial support from the international community.

At the onset of the global economic and financial crisis, many experts suggested that such countries would be “insulated” from the impact of the crisis, because of the small scale of their flows. However, many of the countries had conducted analysis of the scale and types of flows they were receiving, and therefore knew the crisis would hit them hard.

As a result of their own analysis, the countries began to see the major impact on their economies almost immediately: it took the international community many months to catch up, but now it is commonly accepted that the crisis is dragging many low-income countries further away from attaining the Millennium Development Goals. This book traces the impact of foreign private capital on low-income countries in Africa and Latin America in more detail, and shows why, if analysis by the countries themselves had been more widely understood, the international community might have responded faster and prevented the impact of the global financial crisis from being so pernicious.

G20 leaders at their summit in March 2009 pledged US\$1.1 trillion to combat the impact of the crisis on emerging and developing economies, but only a maximum US\$50 billion of this was available for low-income countries. This US\$50 billion is made up of US\$19 billion of IMF Special Drawing Rights, which will be used principally to boost country reserves; a potential US\$6 billion of extra IMF concessional lending; and accelerated commitments and disbursements by the African Development Bank and World Bank through the African Development Fund and International Development Association windows. These amounts fall well short of the additional financing gap resulting from the crisis, which the IMF has estimated for LICs (IMF 2009), and similar calculations made by the African Development Bank (AfDB 2009) and World Bank (2009).

At the same time, it is not clear at the time of writing (December 2009) whether many OECD members of the G8 and G20 will be able to fulfil their earlier pledges of increasing aid, made at the Gleneagles 2005 summit or by the EU as a group; or to provide much larger new replenishments to the AfDF and IDA so they can maintain their future lending levels. So there could be even larger financing gaps for LICs. As shown by the analysis in this book,

such public funding is also essential to the long-term education, health and physical infrastructure which investors consider vital in order to increase their future flows. Private investment relies on public development finance to succeed.

More fundamentally, in spite of recent G20 efforts, the international architecture for financing development remains woefully inadequate at protecting countries against all types of economic and financial shocks. The IMF’s lending capacity remains tiny compared to the scale of shocks hitting LICs, and even its slightly streamlined conditionality puts many countries off using its funds. The World Bank’s complex allocation and approval procedures give it little ability to respond rapidly enough to shocks, though including a needs-based and rapid-disbursing anti-shock facility in the current IDA replenishment could help immensely. The African Development Bank and other regional development banks, though often more sensitive to their member states’ needs because those states have a stronger say in their governing bodies, need a much larger increase in their relative lending capacity if they are to make a major difference. It is also vital that all anti-shock financing be much more related to need (ie impact of the shock) rather than country “performance”, have no economic policy conditions attached to it, and come as grants to avoid accumulating new unsustainable debt burdens. It is not clear that even the most open-minded G20 members have heard these messages from LICs – indicating that LICs need to be strongly and permanently represented in the G20.

Beyond the architecture of anti-shock financing, there has been a lot of recent discussion of the need to move countries away from aid dependence and pay more attention to other types of financing for development. While some of this has been driven by a wish to justify renegeing on earlier aid commitments, for others it results from a frustration with the conditionalities, slow or unpredictable disbursements, and perceived corruption risks of aid. The implication is that other types of flows can be treated as equally positive (or even better) for development than aid.

The country analysis presented in this book might at first sight be seen as reinforcing that assumption in that it shows in Chapters 1 and 2 larger amounts, and in Chapters 3 and 4 more diversified source (especially Southern) countries, and sectors (including manufacturing and even agriculture) receiving the flows, spreading risk and enhancing stability. It also shows in Chapter 5 that investors are remarkably positive in their intentions to increase future investment, even in relatively risky countries, having overcome negative perceptions and confronted a reality of very high investment returns.

However, it also raises some clear warning flags about assuming private flows are automatically or sufficiently positive for development. First, in terms of stability. The analysis in Chapters 1 and 2 finds a high degree of

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volatility for all private flows (including the supposedly “more stable” FDI) before the crisis hit: even aid is less volatile and more predictable in most countries. The crisis has underlined that private flows are not a stable and predictable source of finance.

Second, the country analysis in Chapter 2 emphasises the high degree of debt financing used for what appear to investment promotion agencies and international analysts to be “equity” projects. This emphasises the high debt risk which foreign private capital is bringing, which the international community needs to monitor closely to avoid future private debt crises. It also made countries vulnerable to FPC falls as the crises hit loans.

Third, the detailed analysis of country sector case studies in Chapter 4 shows that many of the “boom sectors” for FDI were not – even before the crisis – providing sustainable benefits for growth and poverty reduction, in terms of employment, budget revenue, and transfer of technology and skills. It also shows the volatility of the boom sectors, going well beyond commodity vulnerability because of close links to sectoral booms and busts in source countries and global markets.

Fourth, investors realise that MDG progress is essential to their business success – because it increases labour skills, reduces disease prevalence, provides more local inputs, and fights climate change and other environmental degradation. But most of them are not doing anywhere near enough to pay taxes so that government can spend more on the MDGs, or (as indicated in Chapter 5) to contribute their own funds to these goals.

Fifth, in spite of major improvements in monitoring, analysis and policy formulation discussed in Chapter 6, many countries still do not know reliably what is happening to flows, or how to design policies to maximise their contribution to development of the types discussed in Chapter 7. So they remain highly vulnerable to future crises.

To communicate these lessons, the book is structured as follows:

- Chapter 1 covers regional trends and the impact of the financial crisis
- Chapter 2 discusses in more detail the national scale and composition of the financing
- Chapter 3 analyses the sources and destinations of the flows
- Chapter 4 looks at case studies of dynamic sectors and the impact on them of the global recession
- Chapter 5 examines investor reasons for investing, perceptions about factors encouraging or discouraging investment, and social responsibility trends
- Chapter 6 draws lessons for future monitoring of foreign private capital; and
- Chapter 7 presents overall policy conclusions and recommendations.

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## REGIONAL TRENDS AND IMPACT OF THE CRISIS

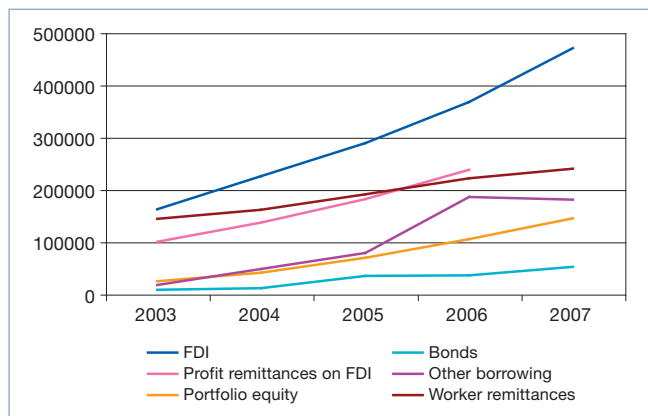


# REGIONAL TRENDS AND IMPACT OF THE CRISIS

## 1.1 PRE-CRISIS TRENDS AND IMPLICATIONS<sup>1</sup>

Until the financial and economic crisis, net FPC flows to developing countries had surged in recent years (Chart 1.1). FDI increased fastest, and was the most important investment channel. Profits remitted on FDI also rose, but at a slightly slower rate, implying (positively) that a higher percentage of profits were being reinvested as FDI increased. Portfolio equity also rose quite sharply. Bonds and worker remittances rose steadily, but their share of total flows declined in relative terms. However, net non-guaranteed borrowing by the private sector from commercial banks and other sources was somewhat more volatile, raising potential concerns over volatility in less favourable circumstances.

**Chart 1.1 Net Flows to LDCs (2003-7, USD m)**



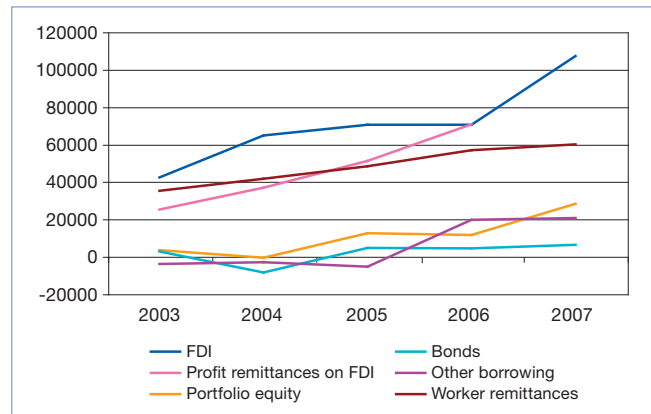
Source: World Bank *Global Development Finance* (2008)

Charts 1.2 and 1.3 show more detailed regional analysis. In Latin America and the Caribbean, FDI reached record levels by 2007, but by 2006 profits repatriated equalled the inflows. This indicated that any reduction of new investment might cause problems for balance of payments sustainability. As other large gross financing sources were also making little net contribution to financing, worker remittances represented 30% of total gross flows and two thirds of net flows (once profit remittances on FDI are included), making Latin America surprisingly dependent on worker remittance flows for net finance.

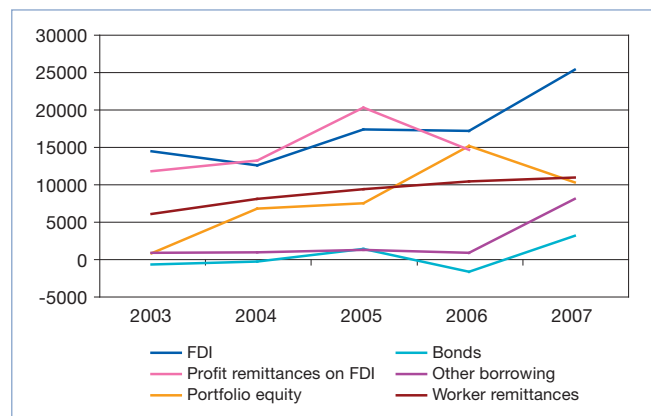
Sub-Saharan Africa also witnessed record FDI inflows (Chart 1.3), but these were often exceeded or matched by profits remitted, raising serious questions about the sustainability of FDI. Portfolio equity was also important, although concentrated in only a few countries, and bonds and other borrowing were insignificant. This left most countries dependent for net financing on remittances,

which doubled over the period. The year 2007 saw a sharp increase in new FDI, loans and even a rise in bonds, marking increasing integration of even some low-income SSA economies into the global financial system.

**Chart 1.2 Net Flows to LAC (2003-7, USD m)**



**Chart 1.3 Net Flows to SSA (2003-7, USD m)**



Source: World Bank *Global Development Finance* (2008)

As shown in Table 1.1, in spite of the growth in FDI in Latin America, its importance in relation to gross fixed capital formation fell after 2004, though it remained very important for the Caribbean sub-region. In contrast, the FDI contribution to gross fixed capital formation rose in SSA, and it was especially important for West Africa.

<sup>1</sup> As discussed in Martin and Rose-Innes (Private Capital Flows to Low Income Countries: Perception and Reality, Canadian Development Report (2004) and Bhinda et al (1999), international data sets have historically considerably underestimated private capital flows of all types (especially reinvested earnings, portfolio flows, remittances and private sector debt) - though they have recently been improving somewhat in quality. However, international sets are used in this chapter for consistency of series.

**Table 1.1 FDI Flows compared to GFCF (2003-7, %)**

FDI Inflows to...	2003	2004	2005	2006	2007
LAC	11.2	24.1	15.4	15.4	18.0
South	8.7	17.1	15.4	12.0	15.4
Central	n/a	17.0	13.2	11.6	15.3
Caribbean	n/a	170.0	34.0	95.8	78.2
SSA	15.8	13.8	16.5	18.6	22.0
West	n/a	22.6	21.3	52.7	45.2
Central	n/a	26.3	28.3	21.8	24.0
East	n/a	11.1	10.8	14.3	19.5
Southern	n/a	8.3	12.8	2.1	10.4

Source: UNCTAD *World Investment Report* (2004, 2007 and 2008)

FDI has also risen sharply in stock terms, coming to represent around one third of GDP in most SSA and LAC sub-regions and 112% in the Caribbean (Table 1.2). This can potentially make GDP trends vulnerable to a reduction in equity valuation, or net outflow.

**Table 1.2 FDI Stock to GDP (%)**

Region	1990	2000	2007
LAC	9.9	24.5	32.4
South	9.6	23.6	27.7
Central	9.7	17.7	30.6
Caribbean	14.3	86.7	111.5
SSA	10.7	30.7	31.6
West	13.5	31.8	33.1
Central	10.1	20.2	36.3
East	4.4	14.8	20.3
Southern	10.6	36.6	32.5

Source: UNCTAD *World Investment Report* (2008)

The causes of these increased flows have been covered elsewhere (see Bhinda et al). In summary, flows were driven on the supply side by the diversification strategies of multinationals and international fund managers, and on the demand side by a whole range of factors, which varied according to whether investors were seeking resources or markets. Market and efficiency seekers are drawn by political and economic stability and the rule of law, potential domestic market (market seekers) or the ability to export to regional or international markets (efficiency seekers). They are more vulnerable to infrastructure constraints (especially electricity), but can get around this if they are large enough, by building their own infrastructure. Many potential foreign investors, lacking quality information, want to see demonstrated success by local businesses before they consider investing. Some actively seek out joint venture partners. Resource seekers simply need access to identified raw materials. They can get around the constraints market seeking investors face with respect to political and economic stability, infrastructure etc (Bhinda et al 1999).

In 2007 and early 2008, flows were further accelerated by rapid GDP growth in China and India, and their increasing demand for raw materials, as well as for export markets. These led to a perception of an increasing number of low-income developing countries as "frontier markets", which were even accessing (or planning to access) international capital markets by issuing public and private sector bonds. However, the need for raw materials was potentially vulnerable to demand for these commodities in source countries, while that for export markets was vulnerable to global financial crisis and recession.

## 1.2 IMPACT OF THE CRISIS

There was a general perception during 2007 and early 2008 that the outlook was very favourable for continued growth in private flows to LAC and SSA, as well as other developing countries (World Bank 2008 and World Bank 2009). In spite of the appearance of the international financial crisis from the end of 2007, and its dramatic acceleration with the Lehman Bros collapse in September 2008, up until late 2008 (and even in a few cases in early 2009), many international experts were of the view that low-income countries would escape relatively unscathed from the impact of the combined financial and economic crises.

However, those views have increasingly been reappraised, in publications by the AfDB, CEPAL, IMF, UNCTAD and World Bank among many others. More recent analysis by such international organisations, as well as research institutions (CGD, IDS, IPD Columbia, ODI), CSOs (Action Aid and Oxfam), private sector associations and many media reports show that low- and lower-middle income countries in Africa, Latin America, and the Caribbean hit as hard if not harder by the crisis. Its impact on their prospects for growth and poverty reduction has been transmitted via multiple channels, which include collapsing commodity prices and trade in goods and services (including tourism), as well as potentially lower flows of foreign aid than previously hoped. However, the remainder of this chapter focuses on the impact on foreign private capital flows (AfDB 2009a; CEPAL 2009; IMF 2009h; UNCTAD 2009; World Bank 2009; Center for Global Development; Institute of Development Studies 2008; Initiative for Policy Dialogue; Overseas Development Institute: Action Aid 2008; Oxfam).

### 1) Foreign Direct Investment

FDI is being affected in two ways. First, flows are in decline. The Institute of International Finance (IIF) indicates that LAC emerging markets<sup>2</sup> (the only countries for which latest estimates and forecasts are available), have seen net FDI inflows greatly reduced (Table 1.3). The IMF (REO Apr 09) estimates that new gross FDI inflows to Africa have stagnated,

<sup>2</sup> LAC emerging markets include Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru and Venezuela

and net flows of FDI have fallen by more than 0.5% of GDP in 2008. It foresees a further fall of around 25% in 2009. This confirms that profit remittances and outflows have accelerated in the crisis period.

**Table 1.3 Net FDI Inflows to LAC Emerging Markets (USD bn)**

2006	2007	2008 estimate	2009 forecast
26.2	65.7	58.9	43.7

Source: IIF (2009a)

Secondly, the market valuation of equity stock is falling as profitability is hit, and stock exchange prices fall drastically. This (if reflected accurately in reporting of FDI) should have a major negative impact on FDI's proportion of GDP (and on GDP itself). In turn it is also reducing companies' ability to raise new capital.

Interviews with countries participating in the FPC CBP confirm that FDI inflows on new projects are being reduced to a trickle, as many new investment projects are being cancelled or postponed, and this is attributed directly to the effects of the crisis. These trends have also been covered in the media and by the AfDB, as shown in Table 1.4.

**Table 1.4 Disruptions to Projects Involving FDI**

Country	Project
LAC	
Brazil	Cellulose plant (USD 2.2bn) on hold; oil fields delayed
Chile	Regional retail outlets on hold (USD 300m)
Mexico	Port (USD 6bn) and airport (USD 150m) delayed
SSA	
Botswana	Power project (USD 6bn) delayed
Burkina Faso	Mining companies struggling to raise finance
DR Congo	Withdrawal of finance for mining projects
Ethiopia	Hydropower project (EUR 1.5bn) bank finance withdrawn
Ghana	Collapse of VALCO sale
Guinea	Mining investments delayed
Kenya	Toll road (USD 800m) and energy project delayed
Liberia	Iron ore mine investment delayed
Mozambique	Delay in expansion of various mining projects
Senegal	Airport (EUR 400m) and toll road delayed
Sierra Leone	Construction projects under threat
Tanzania	Mining investments postponed
Uganda	Many medium sized company closures
West Africa region	Telecommunications project under threat (USD 240m)
Zambia	Major copper, mining and other projects scaled back

Sources: Financial Times, various editions; AfDB (2009b)

As this list shows, among these best reported casualties are projects in mining, petroleum and infrastructure. However, as will be discussed further in the following chapter, other sectors are under severe strain, including manufacturing,

agro-industry, tourism, finance, and unincorporated FDI in real estate.

Mining and petroleum have suffered particularly due to their high reliance on debt finance – by both being unable to mobilise loans for new projects due to the global cuts in bank lending (see 3 on page 15), and suffering from a debt “overhang” accumulated from overpriced mergers and acquisitions in the boom years. They have also been affected by sharp falls in commodity prices – many African countries which had been told they would soon have oil industries are seeing these projects mothballed now that prices have fallen by half. A final key factor has been lower growth in source countries, reducing demand for raw materials.

SSA (and to a lesser extent LAC) are infrastructure-deficient, with existing services expensive. Africa has an infrastructure financing gap of USD 50 billion, and LAC faces shortages of power, ports and roads, in addition to the need to rebuild infrastructure after natural disasters (especially in the Caribbean) and adapt to climate change (World Bank 2009). Investment cuts, especially through a virtual disappearance of Build-Operate-Transfer, and Public-Private Partnership deals, are extremely detrimental to long-term growth prospects.

Given that many of these projects are huge in relation to the size of their host economies, lower-income and smaller countries will be highly vulnerable to negative effects on employment, income and poverty. This is especially true because their economies tend to be much less diversified, and depend on 1-2 sectors or large projects.

New projects are not the only ones to suffer. Though it is true that not many investors are withdrawing entirely from existing projects, this is not stopping them from slowing or reversing their inflows. Again according to FPC CBP participating countries, parent companies are restricting intra-company direct loans, and provision of new equity capital to their subsidiaries, because they need the money themselves, and are also demanding faster capital repatriation in the form of loan repayments, profits and dividends. This explains why net flows have fallen more sharply than gross new inflows.

## 2) Portfolio Investment

Huge amounts have been wiped off the value of portfolio equity, witnessed in plunging share prices, and the collapse in the market capitalisation of stock exchanges in both regions. Taking July 2008 as the benchmark for assessing the impact of the crisis, Table 1.5 shows that both regions were as severely hit as developed country stock markets.

**Table 1.5 Impact on Selected Financial Markets**

Country (Index)	Value 31/7/08	Value 13/2/09	Loss %
LAC			
Argentina (IBG)	107,220	64,617	-40
Brazil (BOVESPA)	59,505	41,674	-30
Chile (IGPA)	14,340	12,430	-13
Peru (IGBVL)	13,765	6,898	-50
Venezuela (IBVC)	39,758	35,833	-10
SSA			
Cote d'Ivoire (BRVM CI)	243	169	-30
Kenya (KSE)	4,868	2,856	-41
Mauritius (SEMDEX)	1,736	1,006	-42
Nigeria (NSE)	52,917	23,814	-55
South Africa (JALSH)	27,553	20,650	-25
Other			
USA (DJ)	11,378	7,850	-31
France (CAC40)	4,392	2,998	-32
Japan (N225)	13,377	7,779	-42

Sources: LAC: Bloomberg; SSA and Others: AfDB (2009b)

Over the same period, the Merrill Lynch Africa Lions Index (exposed to oil, gas, mining, financial services, telecommunications and private consumption) saw its price almost halved (Merrill Lynch). According to the IMF, portfolio equity flows to Africa turned sharply negative (from + US\$10 billion in 2007 to - US\$17 billion in 2008). According to the IIF (June 2009), the same happened in LAC emerging markets, with flows falling from +US\$16.3 billion in 2007 to -US\$14.3 billion in 2008.

In mid-to-late 2008, international demand virtually disappeared for "exotic" corporate bonds issued by LAC (especially) and SSA companies (as well as for sovereign bonds). As a result, many large corporations initially turned to domestic markets for bond finance, but by early 2009 there was little appetite even in most domestic markets. This was partly because non-resident investors in these markets were also withdrawing their funds: emerging market investor trades in "local" markets fell by 31% in the last quarter of 2008 before recovering by 18% by March 2009 (Trade Association for the Emerging Markets). Some corporations turned instead to loan financing alternatives, thereby crowding smaller-scale borrowers and households out of local markets. By mid-2009 there has been some recovery in international and domestic corporate bond markets, but buyers are available only at much higher spreads (3-12% more than pre-crisis levels), making bonds prohibitively expensive for most enterprises. There are also concerns about corporate ability to roll over the large amounts of bonds falling due in LICs during 2009-10.

### 3) Borrowing and Trade Credit

Credit available from international banks and their local subsidiaries, enterprise headquarters in OECD countries, and trading partner companies, has collapsed in many countries,

and in some cases has turned negative in net terms. Table 1.6 demonstrates the effect on LAC emerging markets.

**Table 1.6 Private credit to LAC Emerging Markets (USD bn)**

	2006	2007	2008 Estimate	2009 Forecast
Private creditors (net)	22.6	102.1	40.7	1.0
Commercial banks	9.0	30.8	8.6	-11.7
Non-banks	13.5	71.3	32.1	12.8

Source: IIF (2009b)

This effect has been felt most acutely with respect to trade credit. Over 90% of trade transactions depend on short-term credit or insurance, especially in developing countries. For low-income countries, trade credit dropped 18% in the last quarter of 2008, and the terms of the financing tightened with interest spreads widening by more than 4%, and repayment periods shortening. Latin America relies extensively on overseas borrowing to finance foreign trade, and there has been a sharp negative two-way interaction between falling trade levels and falling trade credit.

Letters of credit have traditionally been relatively stable and secure. However, the freeze in inter-bank lending, and commodity price falls, have led banks to question the ability of their correspondent banks to honour an obligation when due, and question the value of dry cargo as security for the credit. Additional pressure is due to the fact that banks, in a rush to cut overall exposure, find trade finance easier to target than longer term, harder to renegotiate assets such as mortgage-backed securities, collateralised debt obligations and credit default swaps.

However, the worse impact is on smaller and domestically-owned enterprises: even before the crisis they had trouble getting bank credit, but now multinational enterprises are turning to local banking systems and crowding them out entirely.

Local banks have also been forced to cut lending by: rises in the cost of capital from their headquarters; falls in their own share prices; withdrawal of equity stakes by foreign shareholders; their own (and clients') risky investments in local equity markets (especially in Kenya and Nigeria); and their exposure to risky and potentially loss-making ventures hit by FDI, portfolio and loan reversals. Other financial institutions such as insurance companies and microfinance institutions are also facing growing funding constraints. Overall, historical greater volatility of loans compared to other financing has been borne out in the current crisis.

### 4) Remittances

In the past, remittances have been largely counter-cyclical, offsetting local financial and economic crises. However, after an initial forecast that they might stagnate during the crisis, they are taking a pounding as the crisis hits the economies of the source countries.



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At the end of 2008, remittances had fallen sharply in some Latin American countries (including Argentina, Ecuador, Guyana and Mexico), and stagnated in most others. SSA countries were hit slightly later, beginning in the first quarter of 2009 according to African central banks including those participating in the FPC CBP (ODI 2009). However, the IMF and World Bank now project falls of 4.5-8% in remittances to both LAC and SSA regions, which will represent a sharp reversal compared to recent double-digit annual rises. Figures from individual countries such as Bolivia indicate falls as high as 20%.

Workers overseas are remitting smaller amounts, and less frequently, as they suffer reduced incomes and lost jobs. The impact is greatest where the diaspora is concentrated in sectors and countries suffering most from the crisis (e.g. Mexican unemployment in the US construction sector). The human cost is very high as remittances are mostly used for consumption and subsistence, with many communities depending almost entirely on the money relatives send home. The high dependence of many countries on remittances rather than other types of FPC is resulting in major negative effects on their economies.

### 1.3 CONCLUSION

Overall, the impact of the crisis has confirmed many earlier lessons of FPC CBP work. In particular, the CBP had already underlined since the late 1990s that FPC was a major and rapidly growing part of GDP and GFCF in low-income countries, but that it was vulnerable to exogenous macro and micro (enterprise-specific) shocks. It was therefore clear immediately the crisis broke that there would be negative effects on LIC economies.

The CBP had also found that FDI can be volatile, due to its large components of intra-company borrowing and the ability of equity investors to offset investment in fixed capital with higher remittances of capital and dividends. It had confirmed that portfolio flows were intrinsically volatile and highly affected by contagion from global capital markets; and that private sector borrowing was very volatile and related to prices of commodities. However, nobody could have foreseen the scale of collapse in international markets and trade in 2008.

The programme continues to track interesting additional effects such as the fall in market value of equity, the reduction of new FDI commitments to a trickle in many countries, the slowing of FDI flows to existing projects, the crowding out of domestic and smaller enterprises from local financing sources, and the cuts in availability of local bank financing. The main additional factor (not tracked by the CBP but highlighted by other international efforts – see [www.remesas.org](http://www.remesas.org)) exacerbating the crisis has been the high dependence of some countries on worker remittances, and their high vulnerability to the crisis.

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## SCALE AND COMPOSITION OF THE FINANCING



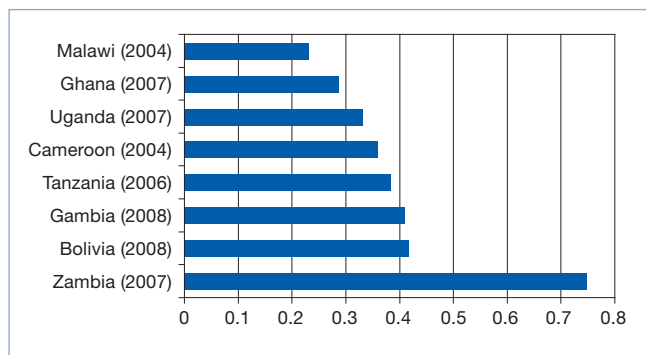
# SCALE AND COMPOSITION OF THE FINANCING

## 2.1 SCALE AND COMPOSITION OF STOCKS

### 2.1.1 FPC to GDP

Chart 2.1 shows the high degree to which low-income countries have become integrated into the global economy, and hence how vulnerable they might be to any private capital related shocks. Zambia had by far the highest exposure, at 75% of GDP thanks mainly to its mining sector. However, for all countries except Ghana and Malawi, stocks reached 30% of GDP, making them exposed to any global shocks. Primary products also contributed to high FPC in Bolivia (gas and mining), Cameroon (oil), Ghana and Tanzania (gold).

**Chart 2.1 FPC Stock to GDP (%)**



In many countries, though data have improved considerably in recent years, stocks are still somewhat underestimated, and improvements such as scaling up data to reflect non-response (e.g. in Uganda), better monitoring of FDI equity in market value terms (in most countries), better sector coverage (e.g. mining in Tanzania), and more recent data (in Cameroon and Malawi) will show higher levels of exposure.

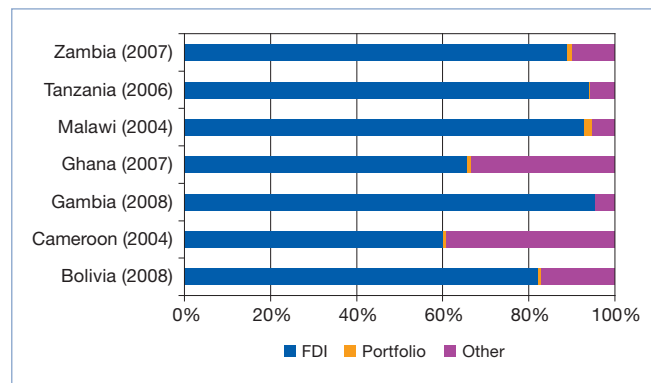
The exposure of several countries is anticipated to increase in future due to:

- Large new projects (e.g. mining and/or oil in Ghana, Tanzania, and Uganda)
- Upswing in FPC after the current global economic crisis

### 2.1.2 Stock by Type

Chart 2.2 shows that FDI (including equity and borrowing from related companies) was by far the most important form of finance. Borrowing from unrelated entities exceeded 20% only in Cameroon and Ghana. Portfolio investment was virtually non-existent in all countries.

**Chart 2.2 FPC Stock Composition**



### 2.1.3 Foreign Debt to Equity<sup>3</sup>

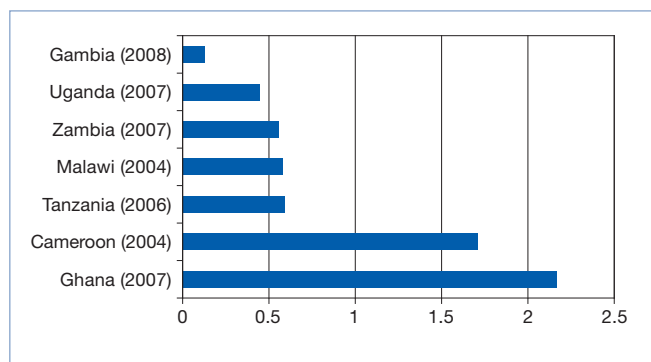
Another key way to analyse the composition of FPC is to look at the relative weight of financing provided by debt and equity. This has proven particularly important in most LICs, which often assumed that all promises of foreign investment were 100% equity. The ratio of debt to equity measures the enterprise's financial leverage (or that of a sector or the economy). A ratio of greater than 1 means more debt than equity financing. Enterprises, sectors and economies with high ratios have potentially greater risks and rewards. Risks arise in times of rising interest rates or shortening maturities, which may make debt unsustainable and risk bankruptcy or major shortfalls of foreign exchange and exchange rate falls at a national level. Conversely, higher rewards may accrue if additional earnings generated through extra borrowing exceed interest due – but close monitoring of debt-equity ratios is essential to assess whether any enterprise, sector or the whole economy is behaving too riskily.

However, the ratios quoted in this study apply only to foreign debt and equity, excluding the domestic components. They are therefore more an indication of foreign exchange debt risk due to potential devaluation and foreign exchange shortage, or failure of international markets to renew debts which are rolling over. They also indicate enterprise and sector preferences for raising foreign capital.

Chart 2.3 shows that experiences have been mixed for selected countries and years. The Gambia, Uganda, Zambia, Malawi, and Tanzania were especially dependent on foreign equity. Conversely, Cameroon and Ghana have been much more debt dependent. As discussed in more detail in Chapter 3, this reflects the concentration of their FPC in the oil and gold sectors.

<sup>3</sup> Debt includes long and short-term debt owed to affiliates and non-affiliates, and equity includes direct and portfolio equity.

**Chart 2.3 Foreign Debt to Equity Stock**



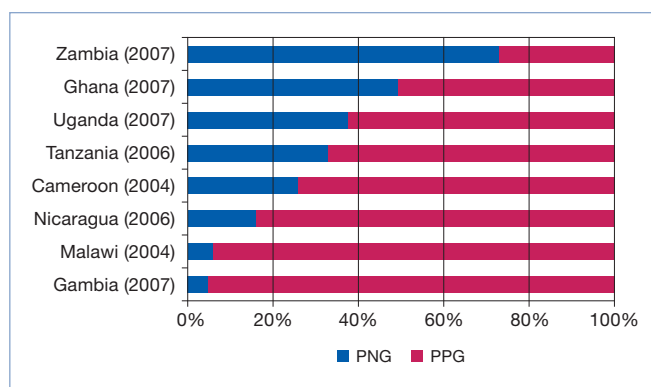
Over time, ratios in Cameroon, Ghana and Zambia have risen, reflecting increased concentration of their FPC in debt-dependent sectors, whereas ratios in The Gambia, Malawi, Tanzania and Uganda have fallen, reflecting diversification into less debt-dependent sectors such as manufacturing and telecoms.

#### 2.1.4 Private Debt Grows Sharply

Two other key assessment factors used by countries participating in the FPC CBP have been to compare external private non-guaranteed debt (PNG) with public and publicly guaranteed debt (PPG), and to compare it with GDP.

Both indicators show how private sector debt has become very important in several countries. As shown in Chart 2.4, its share of total external debt stock increased, while PPG debt declined as a result of HIPC debt relief. In 2007, PNG made up about 75% of total external debt stock for Zambia, 50% Ghana, 40% Uganda, and in 2006, 33% for Tanzania. This trend is on the rise for several countries, and the ratio is expected to be higher for Malawi and Cameroon, once more recent data become available. In The Gambia (which has not yet reached HIPC completion point) and Nicaragua, the share has remained low.

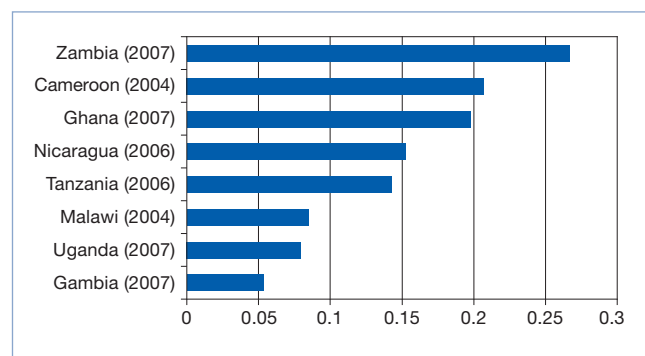
**Chart 2.4 External Debt Stock Composition**



Sources: PPG from World Bank 2008; PNG from FPC CBP country databases.

Chart 2.5 also shows the increasing significance of private sector debt compared to GDP, as a result of greater FPC inflows. It reached 20% or higher in Cameroon, Ghana and Zambia.

**Chart 2.5 PNG Debt to GDP**



## 2.2 SCALE AND COMPOSITION OF FLOWS

### 2.2.1 Pre and Post Survey Estimates and Impact on BOP

Throughout the FPC CBP programme, results of investor surveys have often borne little relation to pre-survey estimates made by the authorities or the IMF. These differences have tended to be more acute for countries conducting surveys for the first time, or after a long gap. In general, initial surveys have tended to result in data which are much higher than pre-survey estimates, by anything between 50% and 500%, largely because non-survey methods were able to capture only a small fraction of FPC. Table 2.1 shows an extreme example from Malawi, where survey data exceeded pre-survey estimates of FDI and total flows by up to five times, and captured other investment (which proved to be relatively significant and volatile) and portfolio flows (which were negligible) for the first time.

**Table 2.1 Malawi: Survey vs. Pre-Survey Estimates (USDm)**

Inflow (net)	2002		2003		2004	
	Survey	Pre-Survey	Survey	Pre-Survey	Survey	Pre-Survey
FDI	28	6	35	7	39	22
Portfolio	..	0	..	0	..	0
Other	-14	0	-2	0	11	0
Total	14	6	33	7	50	22

Source: National Statistics Office (2008)

However, surveys conducted after long gaps (or other later surveys) may find higher or lower data, depending on the degree to which earlier survey results were used to forecast future trends, and whether there have been changes in FPC trends. Table 2.2 shows two cases in point, allowing for a comparison before and during the global economic crisis. The Zambia survey covered 2007, before the global crisis. Due to substantial increases in flows since its last survey in

2004, reflecting boom years for FDI, its results greatly exceed earlier estimates. However, the Gambia's survey of 2008 (reflecting the start of the global downturn) found much lower flows than pre-survey projections (which reflected pre-crisis optimism). Both underline the need for regular accurate surveys to avoid data which misrepresent trends dramatically.

**Table 2.2 Zambia and Gambia: Survey vs. Pre-Survey Estimates (USDm)**

Inflow (net)	Zambia (2007)		The Gambia (2008)			
	Survey	Pre-Survey	Survey	Pre-Survey	Survey	Pre-Survey
FDI	1,324	836	58	36	59	-63
Portfolio	44	42	5	0	-8	-
Other	565	276	105	2	23	-907
<b>Total</b>	<b>1,933</b>	<b>1,154</b>	<b>68</b>	<b>38</b>	<b>73</b>	<b>-91</b>

Sources: Survey data from FPC CBP databases; pre-survey estimates from IMF/Central Banks.

Such changes can have a major impact on the overall balance of payments picture, making it difficult to get "new" or improved data accepted by international organisations. A good example is in Ghana, where Table 2.3 shows the BoP items which changed as a result of survey findings (i.e. unchanged or zero items are omitted).

**Table 2.3 Ghana: Impact of Survey Results on the BoP (USDm)**

BOP - Selected Lines	2007 (Pre-survey)	2007 (Survey)	Impact
<b>Current Account Balance</b>	<b>-2,151</b>	<b>-2,615</b>	<b>-464</b>
Services and Income	-301	-764	-463
<b>Capital and Financial Account Balance</b>	<b>2,591</b>	<b>3,505</b>	<b>914</b>
Financial Account (excl. financing items)	2,403	3,317	914
Direct investment	970	1,244	274
Abroad	0	-21	-21
In Ghana	970	1,265	295
Portfolio investment	800	807	7
Liabilities	800	807	7
Equity securities	14	21	7
Other investment	633	1,267	634
Assets	0	45	45
Trade credits	0	-8	-8
Currency and deposits	0	52	52
Liabilities	633	1,222	589
Trade credits	-94	450	544
Loans	474	766	292
Currency and deposits	253	5	-248
<b>Overall Balance</b>	<b>440</b>	<b>890</b>	<b>450</b>
<b>Reserves and Related Items</b>	<b>-440</b>	<b>-890</b>	<b>-450</b>
Errors and omissions	-27	-477	-450

Source: Bank of Ghana (2009)

Survey findings revealed the Current Account deficit to be 22% worse than previously believed, due to repatriated

dividends and interest payments. On the other hand, the Capital and Financial Account surplus was 35% higher, due to higher FDI, trade credit and loans. The combined effect more than doubled the Overall surplus to USD890m. Bank of Ghana has reflected this increase fully in Errors and Omissions, without a corresponding increase in the use of funds, but believes that increase is likely to reflect imports. Improved data for the Financial and Income Accounts are thus guiding Ghana to review its Trade Account data.

### 2.2.2 Scale and Composition of Flows

The charts present trends for 22 low-income countries covered by the CBP:<sup>4</sup>

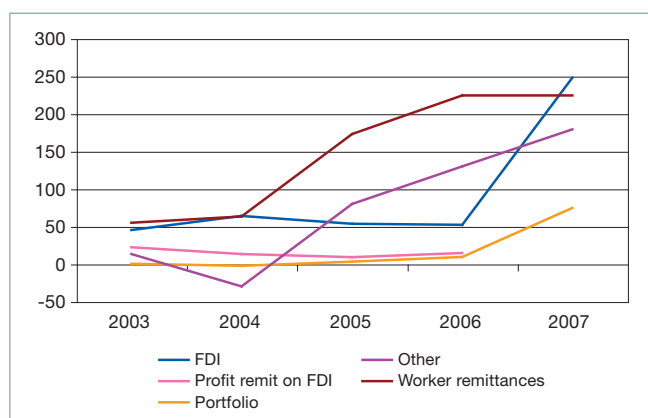
- FDI has been the most significant type of flow in 12 of the 22 countries, reflecting positively on their investment climate. It increased from quite a low level, and accelerated rapidly during 2006-7 in 14 of the 22 countries which benefited directly from the global FDI boom, especially in mining and petroleum. However, it has been quite volatile in eight countries, reflecting peaks in oil investment in Cameroon, Chad, and Gabon, large individual projects in Gambia and Mali, and political instability in Bolivia, CAR and Togo.
- Remittances have been the most significant flows (according to World Bank data) in seven of 16 West African countries (The Gambia, Benin, Guinea Bissau, Mali, Niger, Senegal, and Togo), as well as Bolivia, Nicaragua and Uganda. With the exception of Benin and Niger, the flows have been fairly stable year on year: however, initial reports indicate that they have fallen sharply during the crisis (eg by 24% for Uganda), as expatriates lose income or become unemployed.
- Profits repatriated on FDI were high in most countries, with several countries seeing income payments in excess of FDI inflows (Bolivia, Cote d'Ivoire, Mali, Senegal, Cameroon, and Gabon), to offset political and economic uncertainties or to ensure that projects repaid their investments rapidly.<sup>5</sup> Outflows were lower where investors were confident enough in the investment climate and future opportunities to reinvest their profits (eg Nicaragua, Tanzania and Uganda), but even countries with rapid FDI increases in mid-decade saw sharp increases in repatriation in the crisis, as parent companies asked for higher repatriation of profits and dividends, or faster repayments of loans. This confirmed earlier analysis which laid to rest the theory that FDI is a long-term, stable investment.

<sup>4</sup> Bolivia, Ghana, Malawi, Nicaragua, The Gambia, Tanzania, Uganda, Zambia and the 14 Franc Zone countries.

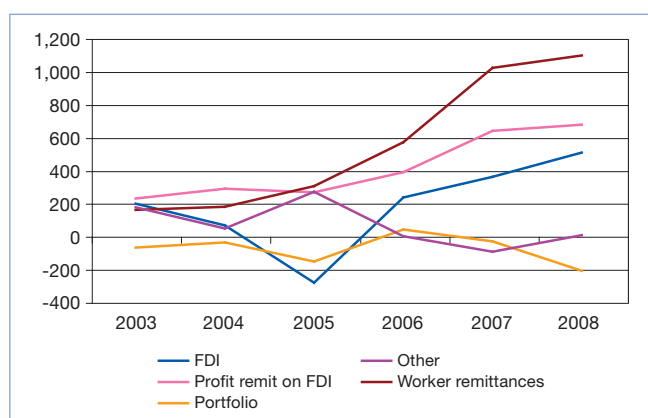
<sup>5</sup> Some profit remittance data (for countries which had not finished FPC surveys by the time of this publication) are taken from World Bank GDF, but survey results confirm high levels of profit remittances.

- Enterprises' borrowing from unassociated sources ("other") has been the most volatile flow in virtually all countries, whether it rose sharply (as in Benin, Burkina, Cote d'Ivoire, and Niger) or stayed at lower levels (as in Malawi and Zambia). It tracked the FDI trend closely in around half of the countries, reflecting the high element of borrowing in investment projects; and even exceeded FDI flows in five countries. However, in Bolivia, it moved in the opposite direction to FDI as companies replaced scarce equity finance with borrowing.

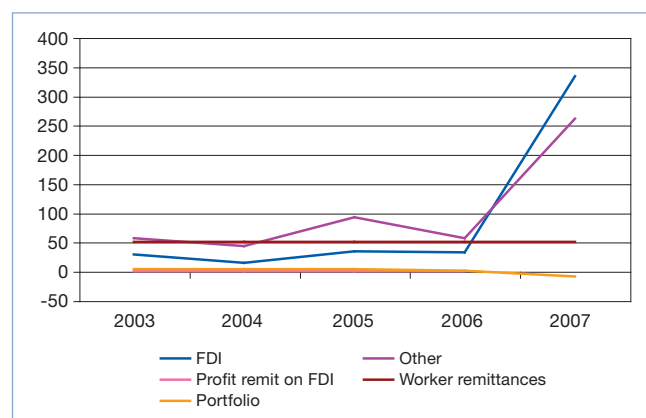
**Chart 2.6 Benin: Private Flows (2003-7, USDm)**



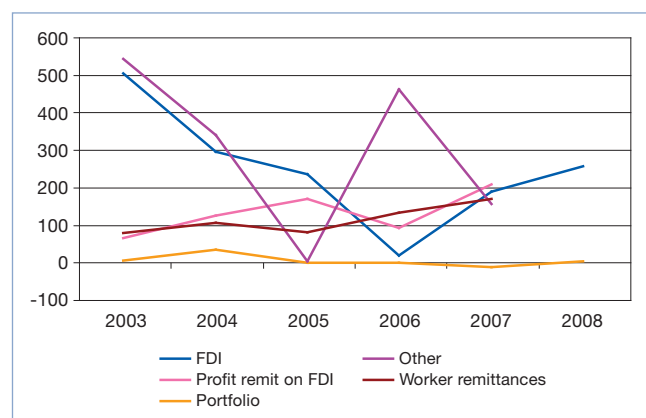
**Chart 2.7 Bolivia: Private Flows (2003-8, USDm)**



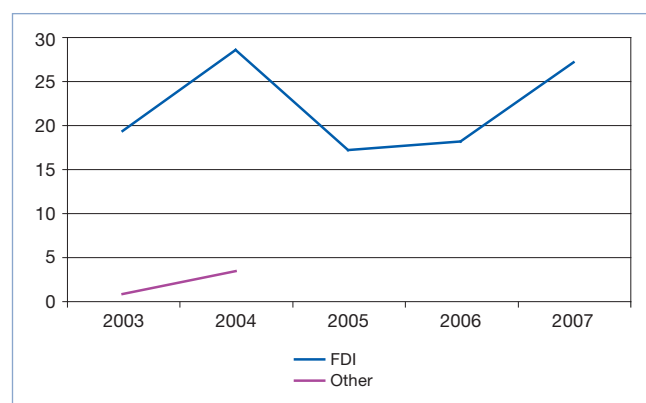
**Chart 2.8 Burkina: Private Flows (2003-7, USDm)**



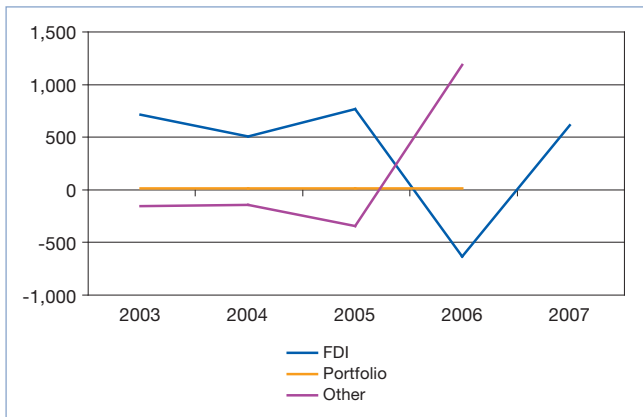
**Chart 2.9 Cameroon: Private Flows (2003-8, USDm)**



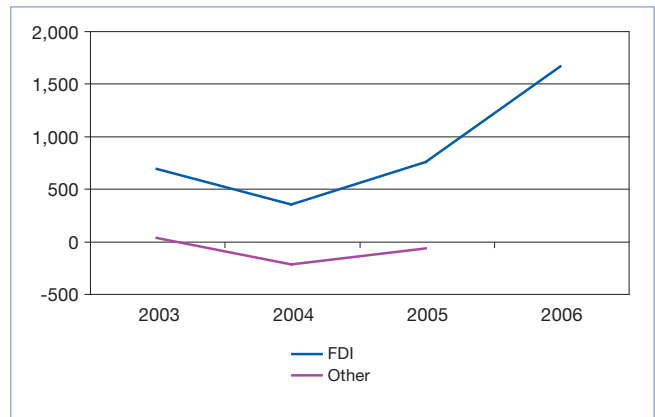
**Chart 2.10 Central African Republic: Private Flows (2003-7, USDm)**



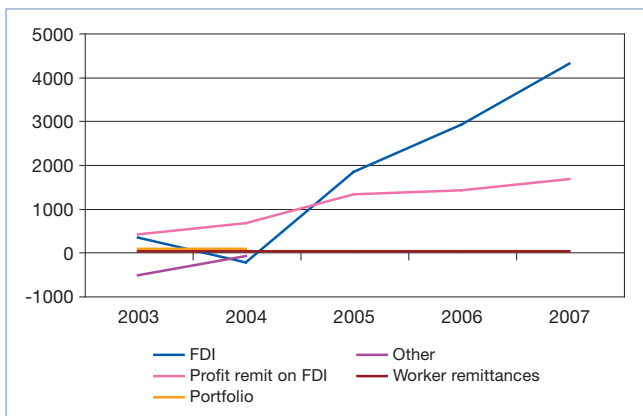
**Chart 2.11 Chad: Private Flows (2003-7, USDm)**



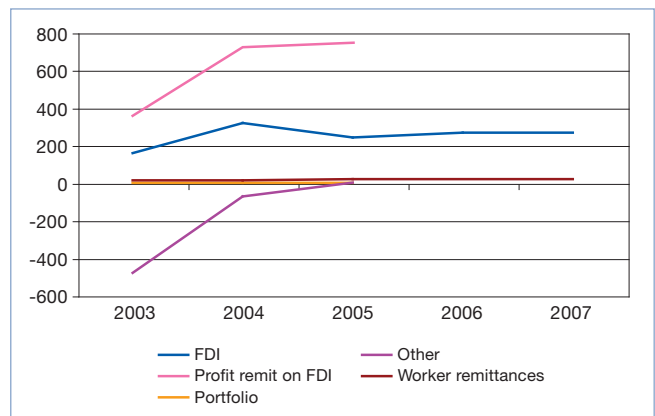
**Chart 2.14 Equatorial Guinea: Private Flows (2003-6, USDm)**



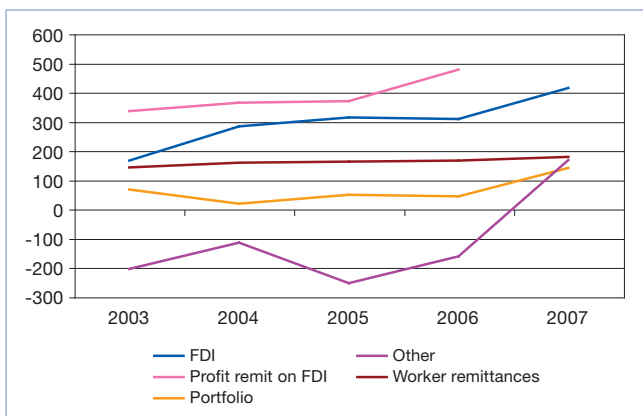
**Chart 2.12 Congo, Rep: Private Flows (2003-7, USDm)**



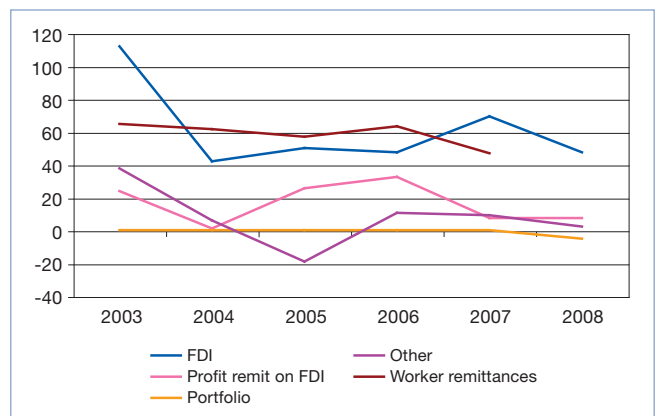
**Chart 2.15 Gabon: Private Flows (2003-7, USDm)**



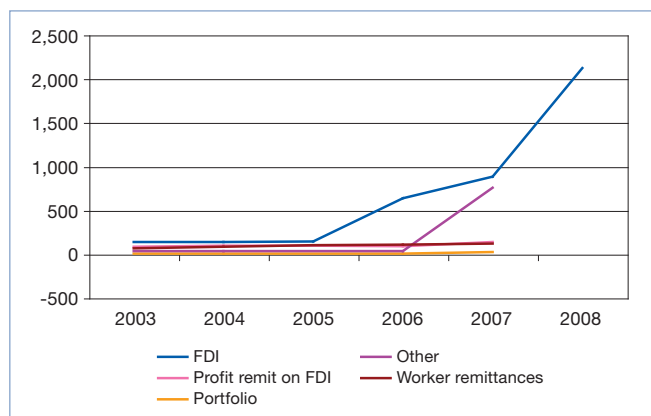
**Chart 2.13 Cote d'Ivoire: Private Flows (2003-7, USDm)**



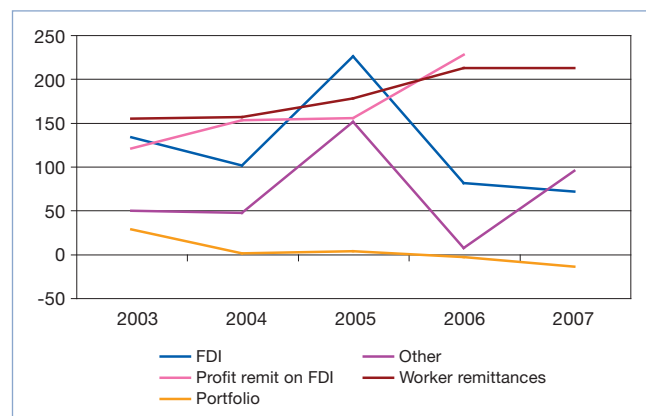
**Chart 2.16 Gambia: Private Flows (2003-8, USDm)**



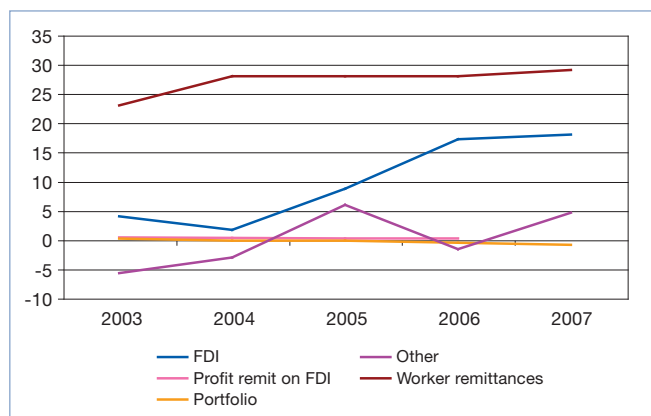
**Chart 2.17 Ghana: Private Flows (2003-8, USDm)**



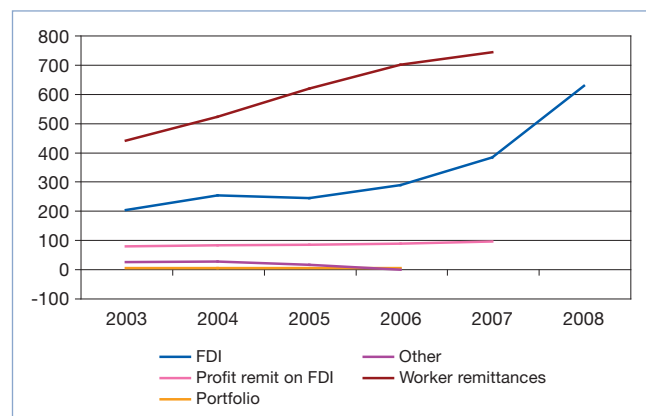
**Chart 2.20 Mali: Private Flows (2003-7, USDm)**



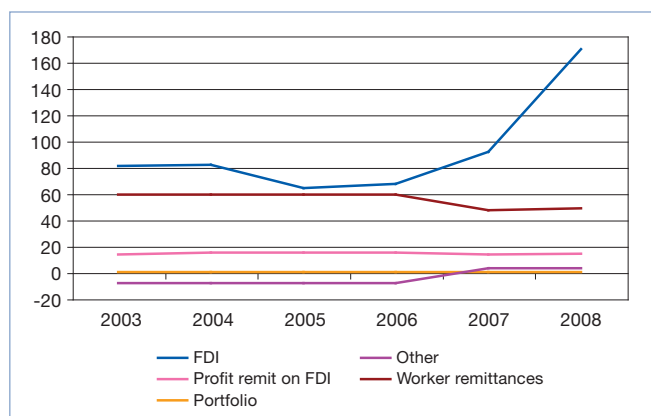
**Chart 2.18 Guinea Bissau: Private Flows (2003-7, USDm)**



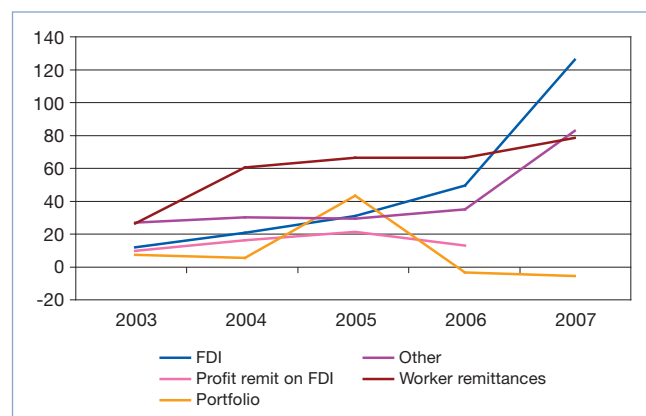
**Chart 2.21 Nicaragua: Private Flows (2003-8, USDm)**



**Chart 2.19 Malawi: Private Flows (2003-8 USDm)**

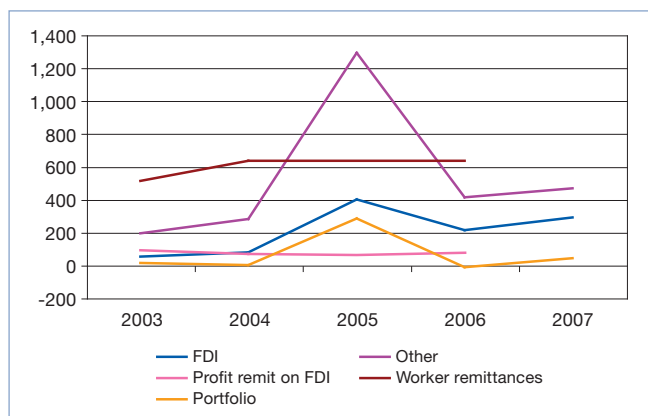


**Chart 2.22 Niger: Private Flows (2003-7, USDm)**

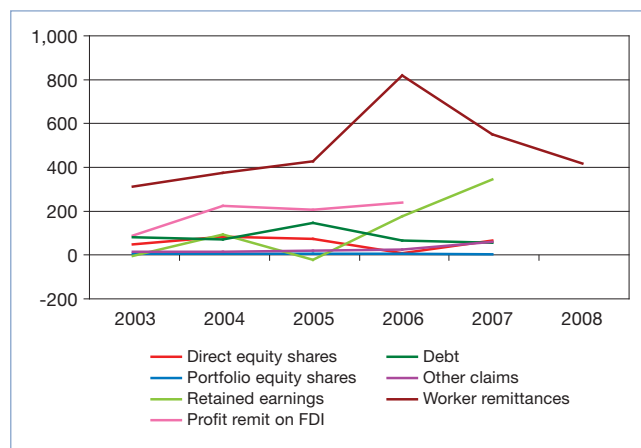




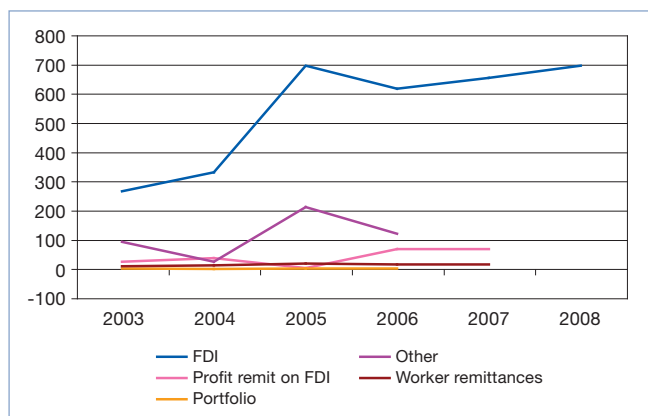
**Chart 2.23 Senegal: Private Flows (2003-7, USDm)**



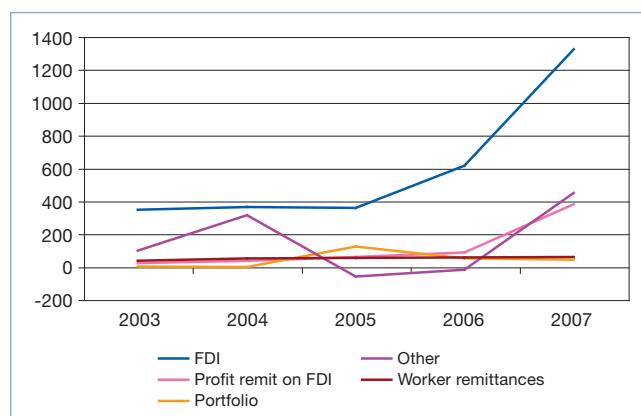
**Chart 2.26 Uganda: Private Flows (2003-8, USDm)**



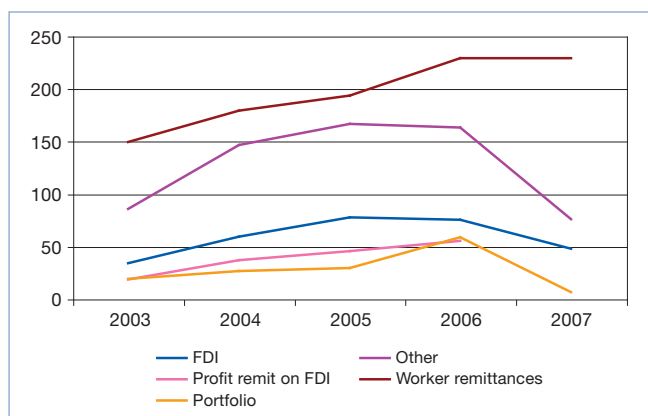
**Chart 2.24 Tanzania: Private Flows (2003-8 USDm)**



**Chart 2.27 Zambia: Private Flows (2003-7, USDm)**

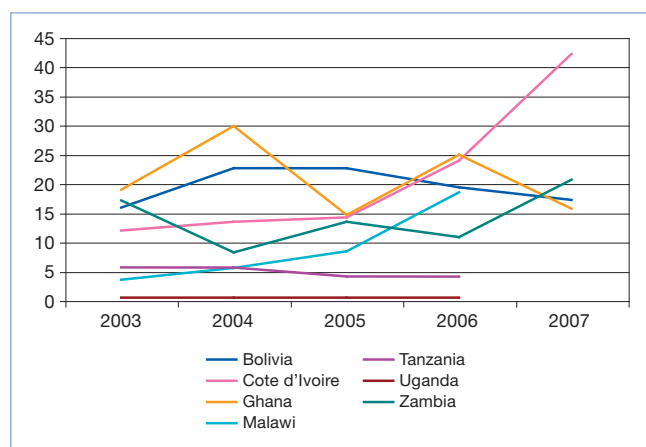


**Chart 2.25 Togo: Private Flows (2003-7, USDm)**



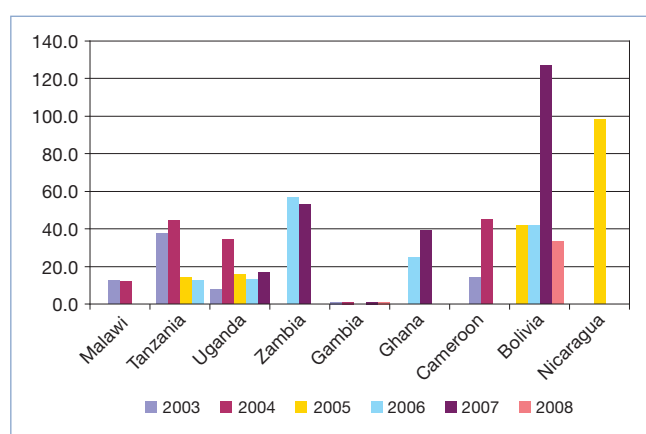
- Net portfolio flows are of marginal significance, with important and volatile transactions in only 5 countries. This is partly because most countries are only slowly developing formal organised capital markets, and there are few "portfolio" equity transactions (ie transfers of less than 10% of an enterprise's equity). Portfolio flows may bring growing instability in future, if capital markets increase their capitalisation and turnover, which makes the markets poorly capitalised and highly illiquid. Chart 2.28 on page 25 shows how important organised capital markets are relative to GDP for selected countries (Cote d'Ivoire's higher market capitalisation reflects the trading of many non-Ivorian shares and bonds on its regional market. However, levels of stocks (though generally low) can fluctuate significantly as shown in Chart 2.29, as can flows as shown in Chart 2.7 for Bolivia.

**Chart 2.28 Stock Market Capitalisation to GDP (2003-7, %)**



Source: World Bank World Development Indicators (2009)

**Chart 2.29 Portfolio Investment Stock: (USDm)**



However, portfolio flows may be significantly underestimated due to the difficulty in tracking the flows invested via international portfolio funds and non-resident investors (in some cases through resident nominees), especially in debt instruments such as treasury bills, and in unlisted enterprises or over-the counter markets.

The fact that portfolio investments remain small is a blessing in that it limits potential volatility. This is especially true given that all regional stock markets were hit by the crisis: the Lusaka Stock Exchange fell by 29.2% in 2008 (Zambia 2009b) and the Uganda Securities Exchange by 29% between June 2008 and June 2009 (Uganda 2009b). However, after an initial fall in September-November 2008, the Dar es Salaam stock exchange has been more stable. See Chapter 1 (Table 1.5) for more information on stock exchange trends.

## 2.3 COMPOSITION OF EACH INSTRUMENT

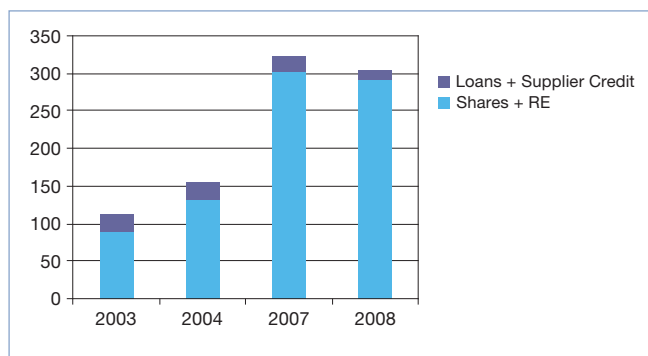
### 2.3.1 FDI

FDI is made up of equity (shares, retained earnings and other capital reserves) and debt (long and short-term borrowing, and supplier credits) from affiliated enterprises. Until the work conducted under the FPC CBP, most country authorities had assumed that FDI was largely new equity flows, and had believed the theory that FDI is long-term and stable. The FPC CBP surveys have found that:

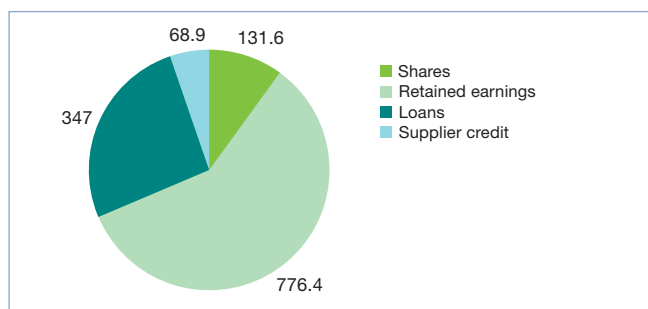
- countries were dramatically underestimating FDI, largely by not tracking reinvestment of retained earnings, but also underestimating profit remittances.
- existing equity capital is perhaps the most stable component. However, it may be withdrawn, especially if capital equipment and land were provided by government as part of an incentive package. Light manufacturing businesses for example might thus be very footloose.
- new equity may be postponed or cancelled at short-notice (see Chapter 4 for examples of mega-projects cancelled or postponed in the wake of the current economic crisis).
- retained earnings may be reinvested in boom times, but may just as easily be remitted as profits and dividends in times of crisis.
- it is very difficult (and misleading analytically) to distinguish between short and long term borrowing from affiliated companies. Most businesses indicate that their borrowings have no fixed terms and conditions, and depend on cash flow. Short-term loans may roll over for longer periods, and long term loans may be recalled by a parent company at short notice (as many are finding in the crisis).
- affiliated short-term supplier credits are difficult to track in annual surveys, and are therefore likely to be under-estimated.

Most country experiences illustrate how FDI flows have been primarily composed of these potentially more volatile elements, with new equity being a lower proportion. In the Gambia, recent increases in FDI have been financed primarily by equity and reinvested earnings, but in Uganda and Zambia by reinvested earnings; and in Ghana and Tanzania by loans and supplier credits, to the point where loans have reached more than half of FDI stock in Ghana, though they are only around 1/3 in Tanzania.

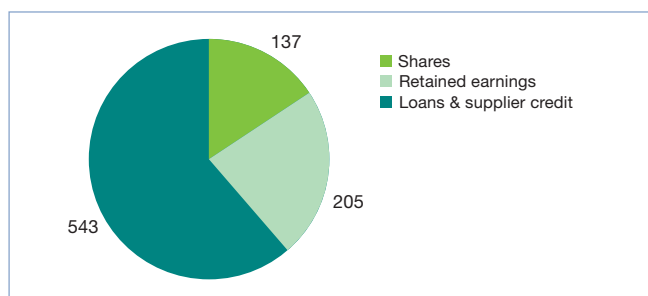
**Chart 2.30 Gambia: FDI Stock Composition (2003,4,7,8, USDm)**



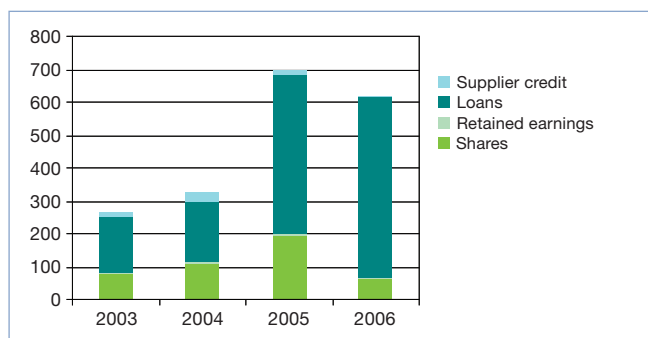
**Chart 2.31 Zambia: FDI Flows Composition (2007, USDm)**



**Chart 2.32 Ghana: FDI Derived Flows Composition (USDm, 2007)**

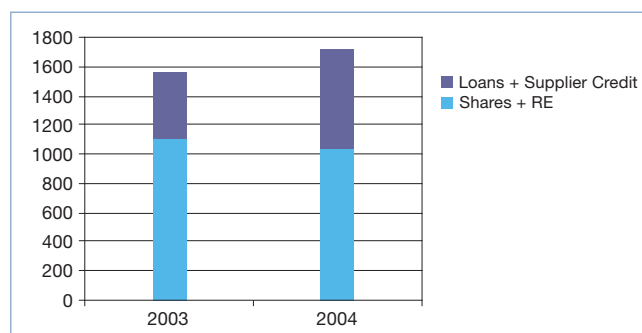


**Chart 2.33 Tanzania: FDI Flows Composition (2003-6 USDm)**



Several countries involved in the FPC CBP have experienced sharp switches from positive to negative FDI. Chart 2.34 shows in Cameroon equity flows accounting for half of total FDI in 2003, but turning negative in 2004. Ghana and Zambia have also experienced sudden negative flows due to developments in individual enterprises.<sup>6</sup>

**Chart 2.34 Cameroon: FDI Stock Composition (2003-4, USDm)**



### 2.3.2 Borrowing from Non-Affiliates vs. Affiliates

Borrowing consists of long and short-term loans, and (usually short-term) supplier credits. This may be from affiliated entities such as a parent or a subsidiary (in which case they are treated as FDI) or from non-affiliated entities (in which case they are treated as "Other Investment" in the BOP and IIP).

Businesses in Nicaragua rely more on borrowing from non-affiliates. This is primarily in the form of loans, although supplier credits are quite significant. Ghana's debt stock, almost doubled in only one year, and became more balanced between affiliates and non-affiliates. Enterprises in The Gambia have come to rely more on borrowing from non-affiliates, though affiliates remain predominant. Malawian enterprises continue to rely more heavily on borrowing from affiliates. Businesses in Cameroon by contrast relied more on borrowing from non-affiliates, of which supplier credits made up a significant share. Among BCEAO members, debt flows have been primarily from non-affiliates for all countries except Mali in 2003 and 2005.

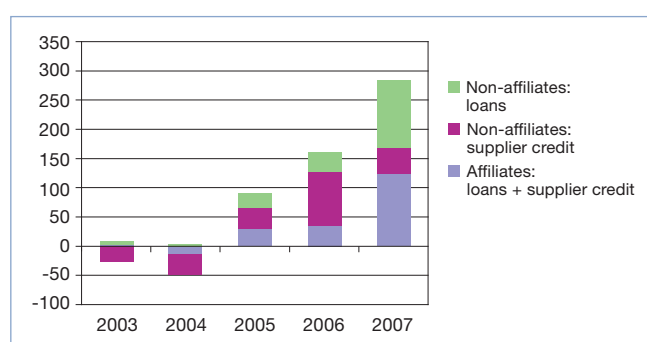
Many foreign enterprises tend to favour borrowing from an affiliate (e.g. a parent) because the terms are cheaper and far more flexible. Where this option is not available, they borrow from non-affiliated sources. Foreign enterprises tend also to prefer borrowing from non-affiliated sources abroad rather than domestically. Foreign debt is often cheaper, and long-term debt is much more readily available. Banks in several low income countries may not be geared to the size of borrowing that enterprises require. Even when domestic debt is available, foreign investors may find it difficult to

<sup>6</sup> As portfolio data were very low and almost entirely equity, this study does not attempt to disaggregate them further.

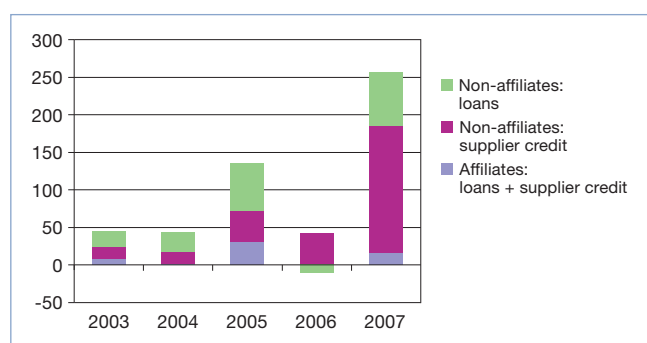
obtain it if certain restrictions exist (e.g. if domestic loans are tied strictly to domestic collateral).

Conversely, domestic enterprises (mostly small and medium scale), tend to borrow domestically, owing to the difficulty in borrowing from international sources (they are not known to many foreign banks and therefore do not have a track record). Where domestic borrowing is not an option, enterprises rely on equity (share capital, reinvested earnings, and other capital reserves), to finance their operations.

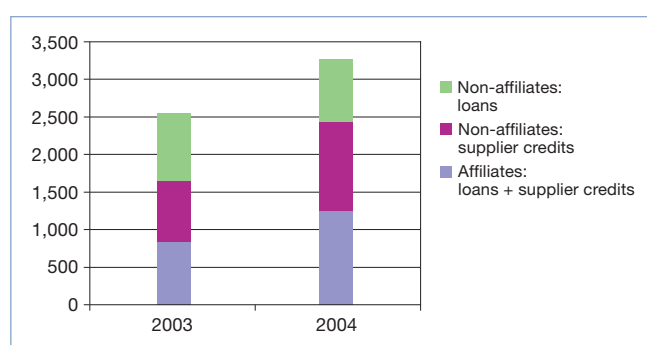
**Chart 2.35 Benin: Composition of Debt Flows (2003-7, USDm)**



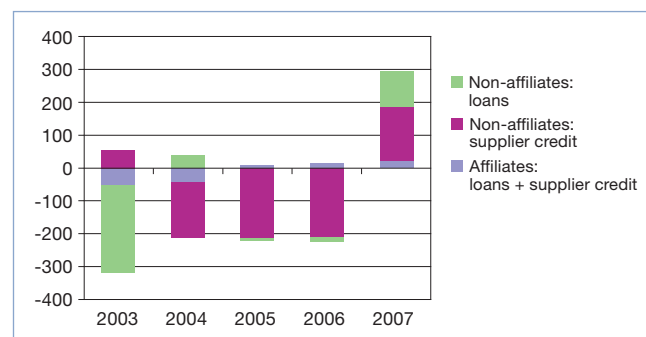
**Chart 2.36 Burkina: Composition of Debt Flows (2003-7, USDm)**



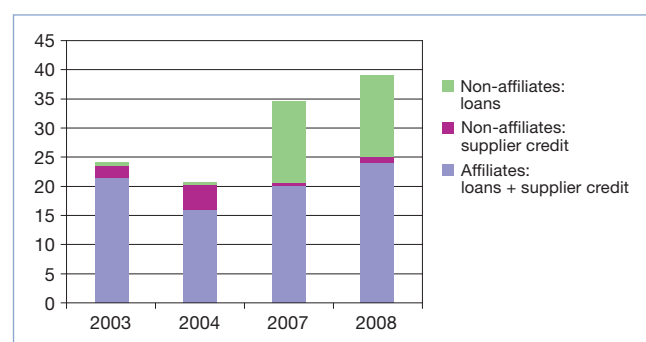
**Chart 2.37 Cameroon: Debt Stock Composition (2003-4, USDm)**



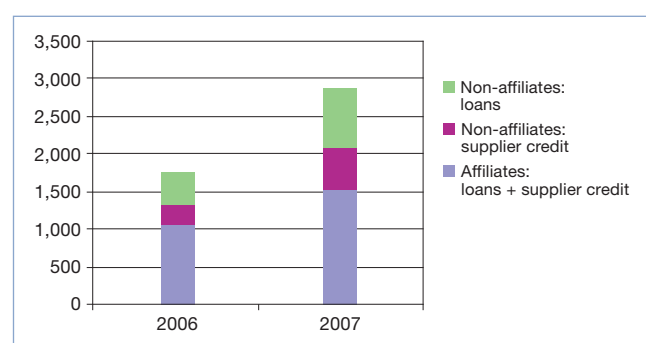
**Chart 2.38 Cote d'Ivoire: Composition of Debt Flows (2003-7, USDm)**



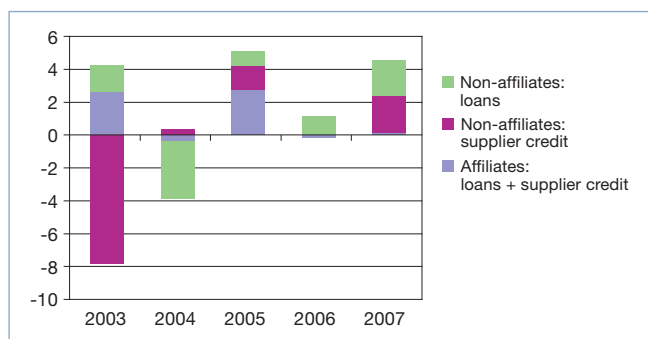
**Chart 2.39 Gambia: Debt Stock by Type (2003,4,7,8 USDm)**



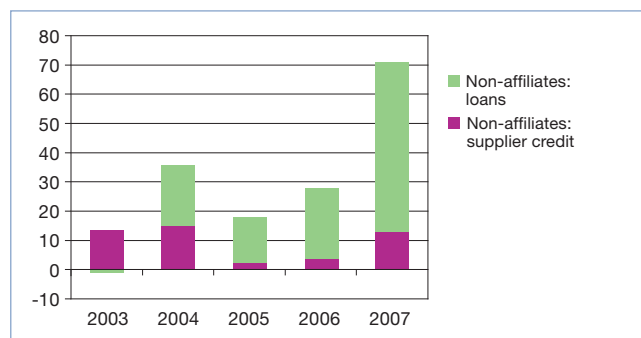
**Chart 2.40 Ghana: Debt Stock by Type (2006-7, USDm)**



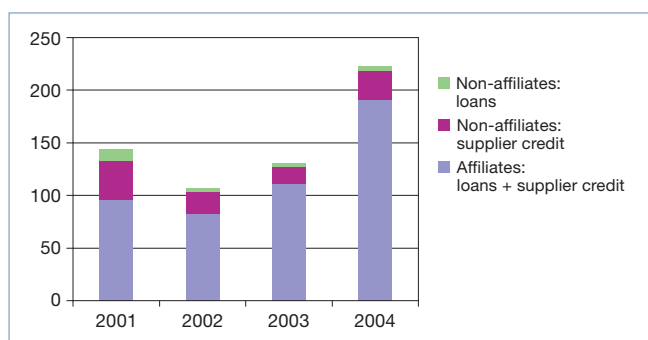
**Chart 2.41 Guinea Bissau: Composition of Debt Flows (2003-7, USDm)**



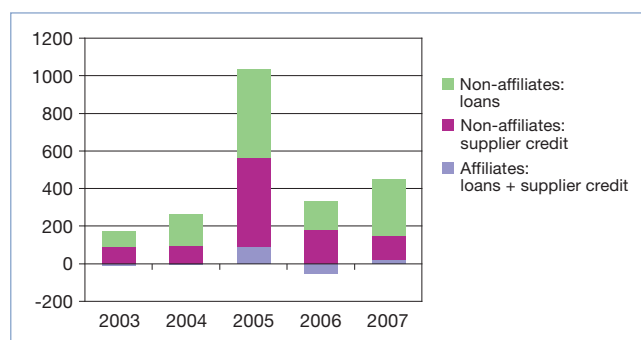
**Chart 2.45 Niger: Composition of Debt Flows (2003-7, USDm)**



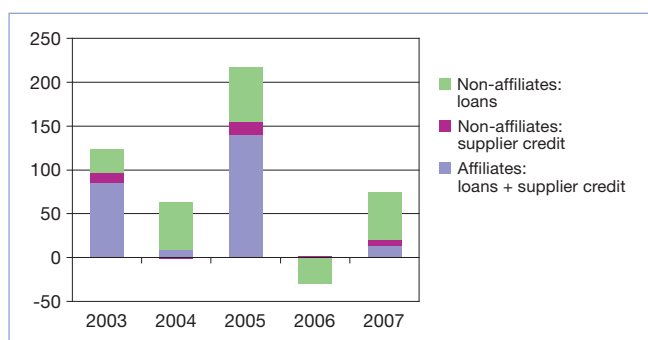
**Chart 2.42 Malawi: Debt Stock by Type (2001-4, USDm)**



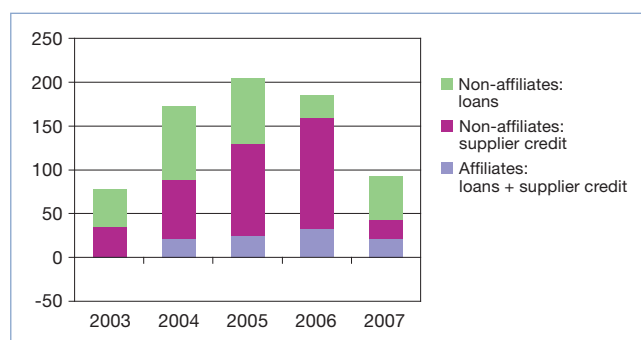
**Chart 2.46 Senegal: Composition of Debt Flows (2003-7, USDm)**



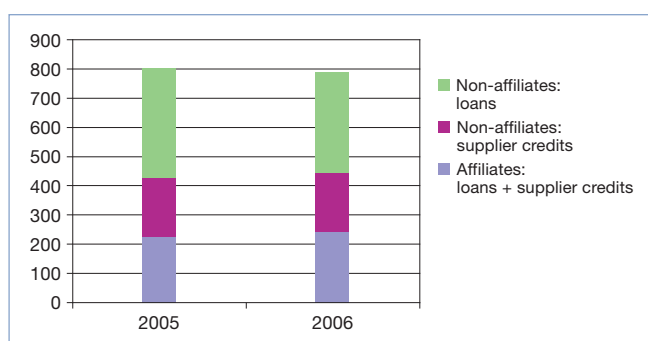
**Chart 2.43 Mali: Composition of Debt Flows (2003-7, USDm)**



**Chart 2.47 Togo: Composition of Debt Flows (2003-7, USDm)**



**Chart 2.44 Nicaragua: Debt Stock by Type (2005-6 USDm)**



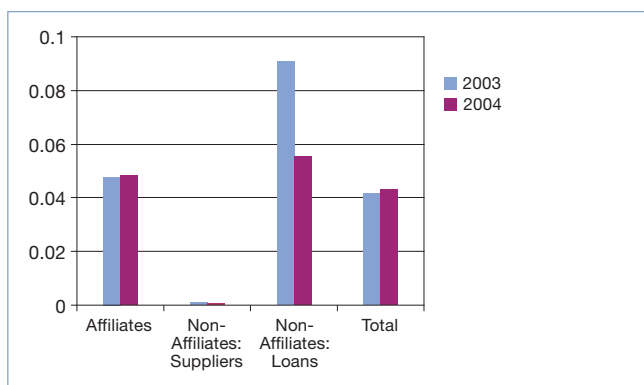
Another significant feature emerging from the charts above is the relative volatility of debt flows. Both the Gambia and Malawi saw significant (20-30%) outflows on loans in 2004 and 2002 respectively. All countries in the UEMOA zone saw at least one type of negative debt flow since 2003, with large overall negative flows for Cote d'Ivoire and Guinea-Bissau during political instability, indicating a need for even closer monitoring. For the reasons discussed in 2.3.1, there was no major difference between the volatility of affiliated and non-affiliated borrowing.

### 2.3.3 Cost of Borrowing

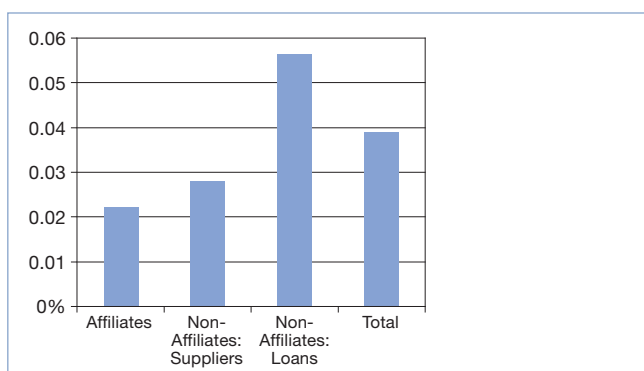
All countries tried to capture information on interest paid on various types of loans, but most experienced problems in collecting complete or reliable data. The charts below present findings for four countries which managed to obtain this information, of which three succeeded in distinguishing the costs of different types of debt.

Findings from Malawi and Nicaragua confirm previous results that borrowing from affiliates is more concessional than from non-affiliates. Non-affiliate supplier credits were also more concessional than loans in both countries. The interest cost of overall debt in Tanzania, and non-affiliated debt in Malawi also varied greatly over time. However, while Zambia's debt from affiliates cost around the same as that in other countries, non-affiliated loans were cheaper, probably reflecting rapid increases in stock in the year, on which interest will be paid only starting in the following year.

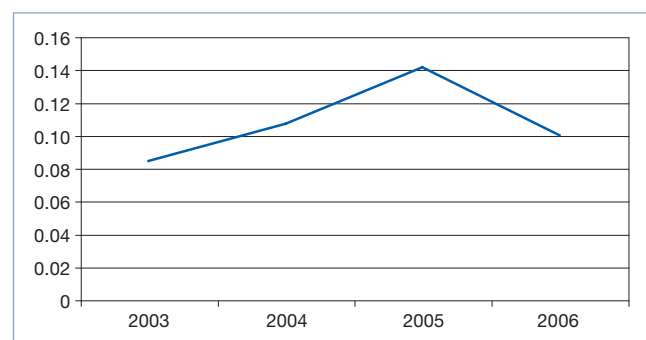
**Chart 2.48 Malawi: Cost of Debt by Type (2003-4)**



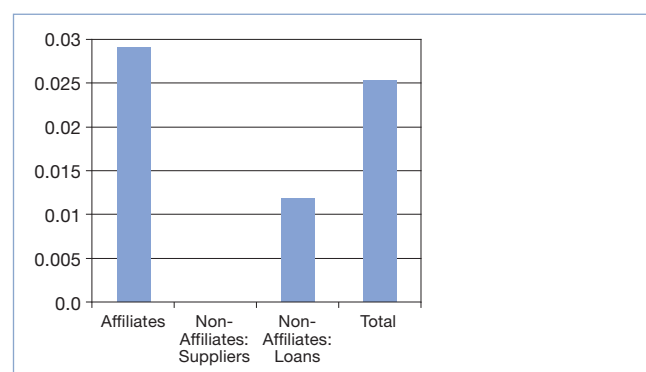
**Chart 2.49 Nicaragua: Cost of Debt by Type (2006)**



**Chart 2.50 Tanzania: Cost of Debt (2003-6)**



**Chart 2.51 Zambia: Cost of Debt by Type (2007)**

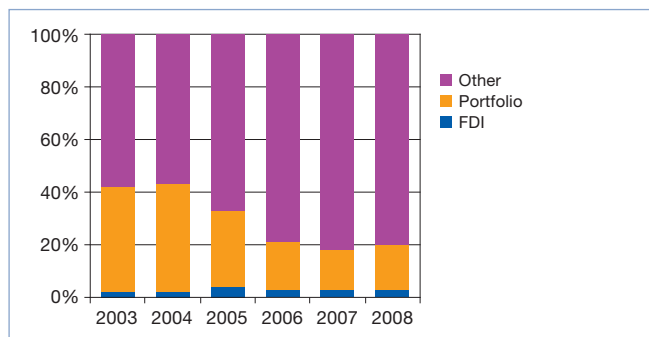


## 2.4 FOREIGN ASSETS

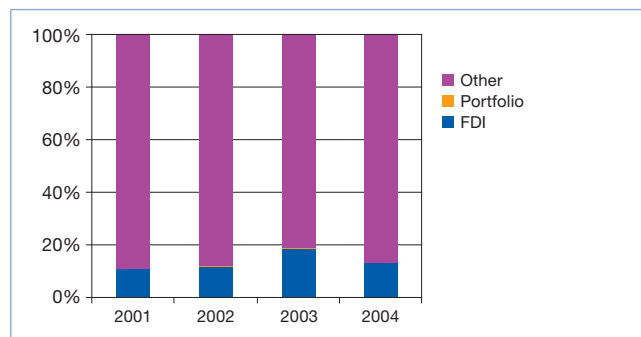
Almost all countries collect data on foreign assets (except Tanzania, where exchange controls on investments in foreign assets still exist). This has proved a much greater challenge than liabilities data, as investors (whether enterprises or individuals) have proved more difficult to identify. More attention to assets is needed in future, to collect more complete data for a more accurate International Investment Position, together with analytical breakdowns by recipient country, and sector of economic activity.

The following charts present foreign asset stocks for Bolivia, Cameroon, Ghana, Malawi and Zambia, excluding currency and deposits, which are presented separately. All countries saw rising foreign asset stocks, driven by FDI in Ghana, but lending to non-resident non-affiliates ("other") elsewhere. Portfolio assets were negligible in almost all cases, except for Bolivia especially during 2003-4 (where they comprised 40% of stock).

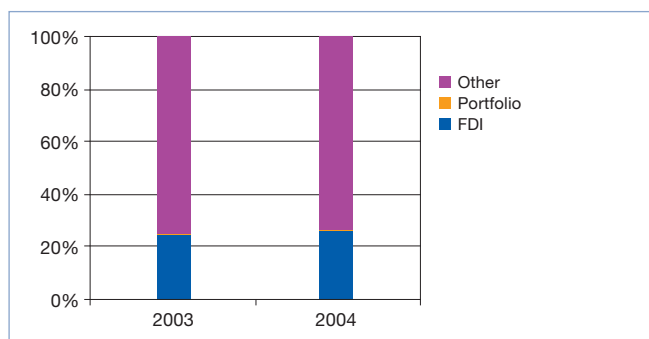
**Chart 2.52 Bolivia: Foreign Assets Stock Composition (2003-8, %)**



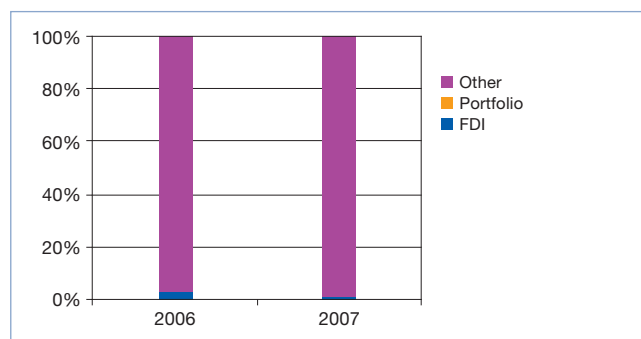
**Chart 2.55 Malawi: Foreign Assets Stock Composition (2001-4, %)**



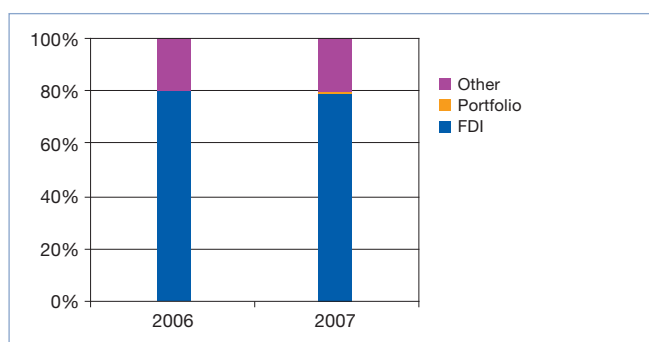
**Chart 2.53 Cameroon: Foreign Assets Stock Composition (2003-4, %)**



**Chart 2.56 Zambia: Foreign Assets Stock Composition (2006-7, %)**

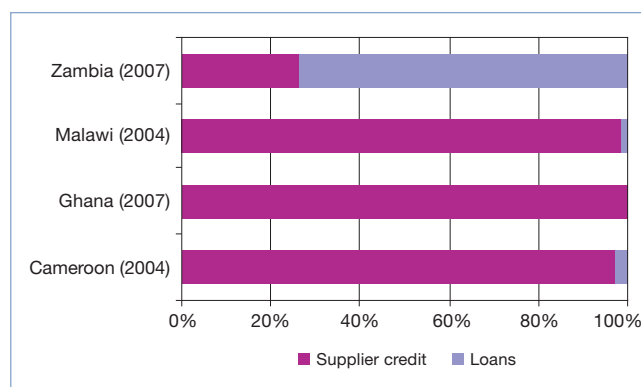


**Chart 2.54 Ghana: Foreign Assets Stock Composition (2006-7, %)**

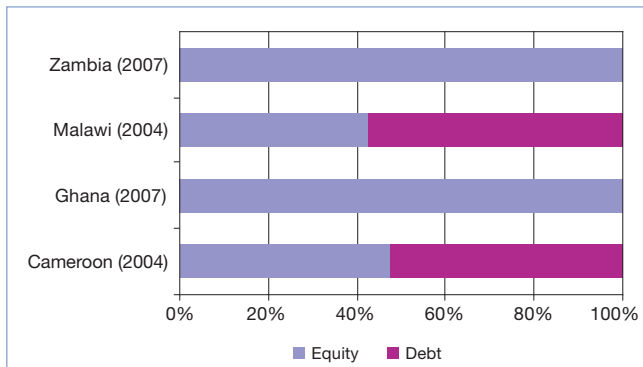


Lending to non-affiliates was almost entirely supplier credit in Cameroon, Ghana and Malawi, but banking sector loans in Zambia. FDI assets were evenly split between equity and loans for Cameroon and Malawi, but 100% equity for Ghana and Zambia.

**Chart 2.57 Stock of Other Assets**

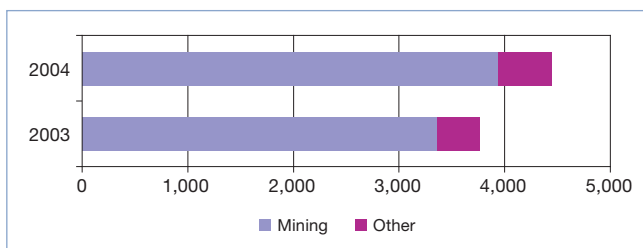


**Chart 2.58 Stock of FDI Assets**

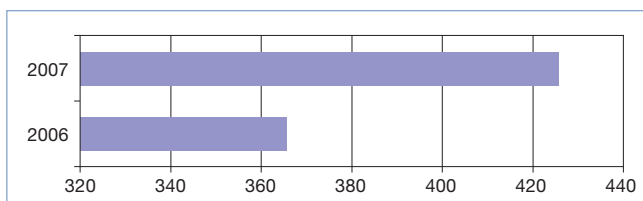


The charts below present findings on currency and deposits held abroad for Cameroon, The Gambia and Ghana. Levels increased for all three countries over the period. All Gambian and Ghanaian deposits were made by the finance sector, but in Cameroon's case this was mainly from mining enterprises. In the Gambia's case, all deposits (with the exception of a small amount in 2003) were short-term.

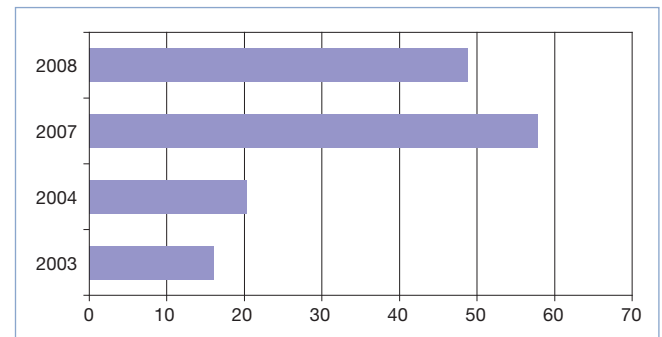
**Chart 2.59 Cameroon: Stock of Currency and Deposits Abroad by Sector (USDm)**



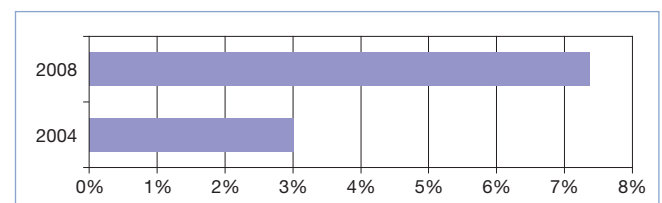
**Chart 2.60 Ghana: Stock of Currency and Deposits Abroad (USDm)**



**Chart 2.61 Gambia: Stock of Currency and Deposits Abroad (USDm)**



**Chart 2.62 Gambia: Rate of Return on Currency and Deposits Abroad**



The chart also shows that The Gambia's finance sector enjoyed a rate of return<sup>7</sup> on its deposits of 7.4% in 2008, which is very reasonable given international interest rates prevailing at that time. This was much higher than the return obtained during 2004.

<sup>7</sup> Rate of return was calculated by dividing the interest received during 2004 and 2008, by the average of the opening and closing period stock for those years.





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## WHERE FROM AND WHERE TO? SOURCES AND DESTINATIONS OF THE FLOWS

The background of the page is a vibrant, abstract composition of overlapping, curved shapes. The colors include a deep blue at the top, a bright orange on the right, various shades of green (from light lime to dark forest green) in the lower-left and bottom-center, and a bright yellow in the bottom-right corner. The shapes are layered, creating a sense of depth and movement, reminiscent of a stylized landscape or a dynamic flow.

# WHERE FROM AND WHERE TO? SOURCES AND DESTINATIONS OF THE FLOWS

This chapter develops the findings presented in Chapter 2, by looking at analytical breakdowns by sector of economic activity, source country, and recipient region.

## 3.1 SECTOR OF ECONOMIC ACTIVITY

The international literature generally assumes that the bulk of foreign investment into Low Income Countries goes into primary resources (mining and petroleum). Our previous study (Bhinda et al) found to the contrary, that several economies had successfully diversified into new and dynamic sectors (e.g. agro-industry, manufacturing, telecommunications and finance), and away from natural resources.

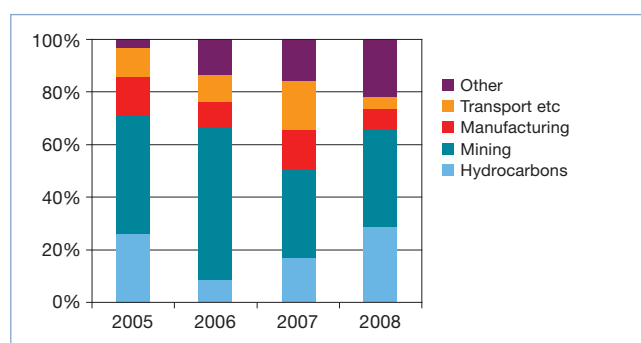
The latest findings of the analysis by country teams present a more mixed picture:

### Foreign Direct Investment

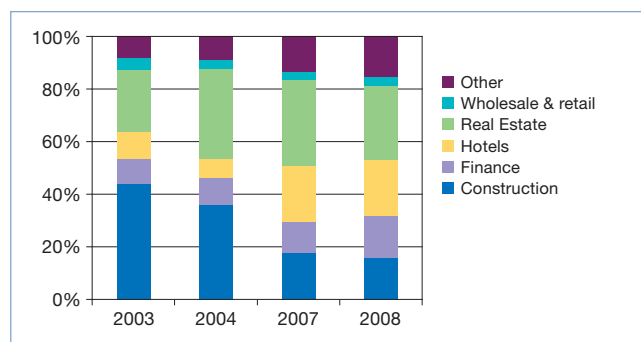
- FDI is continuing to go into non-resource-based dynamic sectors in many countries. These include real estate, banking and tourism in the Gambia; construction in Ghana; manufacturing in Malawi; new industries in its Free Zone in Nicaragua; finance, manufacturing, telecoms and commerce in Uganda; and transport, finance, manufacturing and commerce in Zambia.
- Nevertheless, transactions data show how volatile the dynamic sectors have been. In the Gambia, unincorporated FDI in real estate dominated in 2004, hotels in 2005-07, and the financial sector in 2008. In Bolivia, where uncertainty about investment laws and expropriation in 2006-07 reduced investment in oil and gas, and mining. A third is Malawi, where commerce rose sharply in 2002, and manufacturing in 2004. In the smallest economies such as the Gambia and Malawi, a few large projects can explain dramatic changes in trends.
- As a result, some countries have enhanced the diversification of their FDI (the Gambia, Ghana, Nicaragua, Uganda, Zambia) or kept it well-diversified (Malawi, or Tanzania which has only a third in mining and high commerce/manufacturing).
- Other countries remain highly dependent on natural resources for FDI – notably Zambia, with 68% of FDI in mining; and Bolivia, with two-thirds in minerals and oil/gas (though this marks a considerable diversification from only minerals in the early 1990s).
- Even a country which had diversified away from mining (such as Tanzania) saw mining investment rise sharply again in 2006-08, responding to booming global minerals prices and a government policy to promote the sector aggressively. Though the financial crisis has taken some of the shine off the sector, it might accelerate again once global mineral demand recovers from the crisis. This underlines the need for government to keep a close eye on concentration.
- All countries have identified scope for further diversification into “under-invested” sectors. In all

countries these include agriculture, which has suffered from under-investment due to lack of credit, infrastructure, inputs and fertiliser, and extension services, poor information for foreign investors on the sector, and land rights issues. Other priorities are tourism in Zambia, manufacturing in the Gambia and Zambia. In some cases this involves further building on recent rapid rises in FDI; in others these sectors have received virtually no investment.

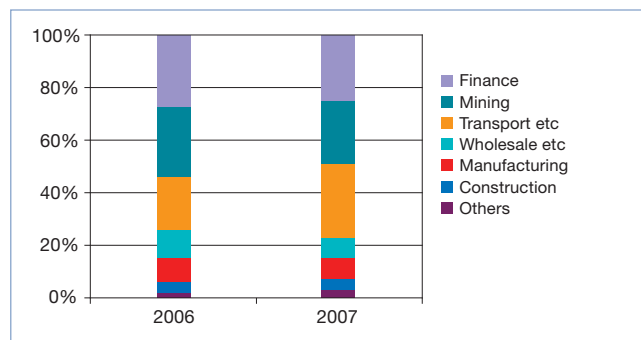
**Chart 3.1 Bolivia: Share of FDI Gross Inward Transactions by Sector (2005-8, %)**



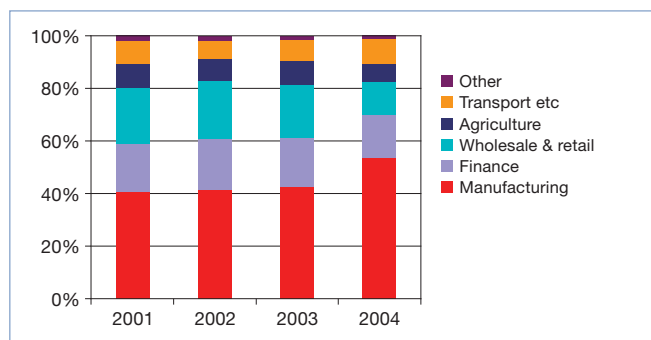
**Chart 3.2 Gambia: Share of FDI Stock by Sector (2003, 4, 7, 8 USD)**



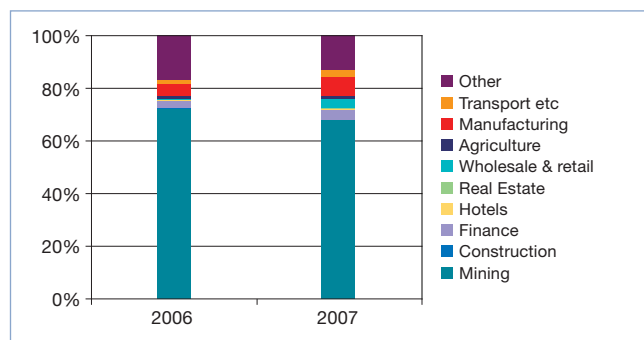
**Chart 3.3 Ghana: FDEI Stock by Sector (2006-7)**



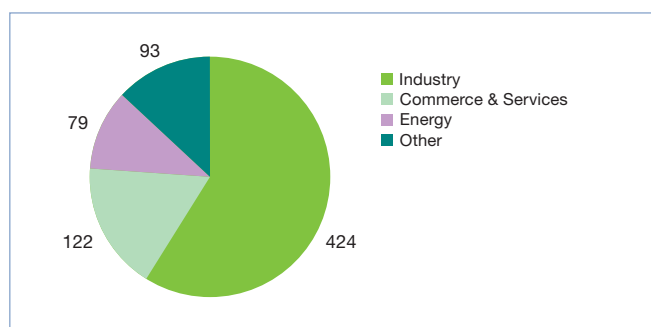
**Chart 3.4 Malawi: Share of FDI Stock by Sector (2001-4, %)**



**Chart 3.8 Zambia: Sector Share of FDI Stock (2006-7, %)**



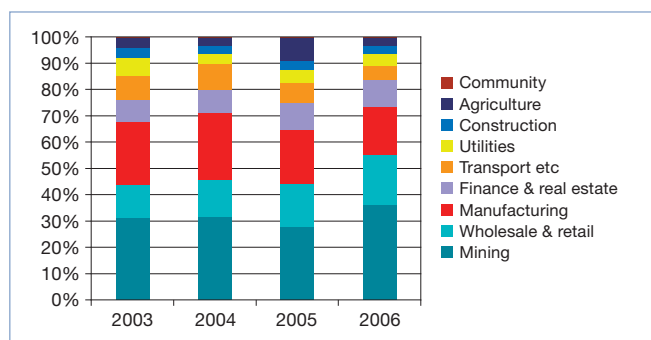
**Chart 3.5 Nicaragua: FDI Stock by Sector (Excl. Free Zone, 2005, USDm)**



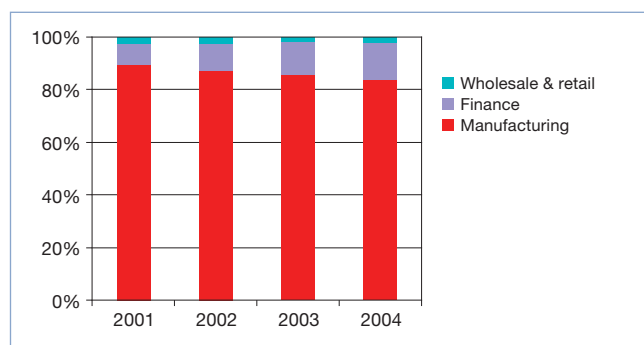
**Portfolio Equity and Debt**

Given its very small scale, and the fact that in most countries it was limited to a few enterprises, sectoral breakdowns for portfolio equity are hard to analyse. Where there were stock exchanges, portfolio equity matched to a considerable degree the sectoral composition of the companies listed on the exchange (such as in Zambia, where it was 90% in mining, with most of the rest in manufacturing; Ghana, where it was dominated by mining; or Malawi and Uganda, where it was in manufacturing and finance). Elsewhere it tended to be more volatile, reflecting trends in dynamic sectors, and therefore concentrated in tourism and finance in the Gambia.

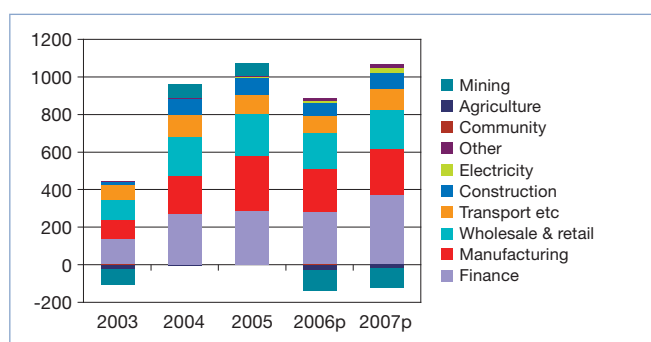
**Chart 3.6 Tanzania: Share of FDI Stock by Sector (2003-6, %)**



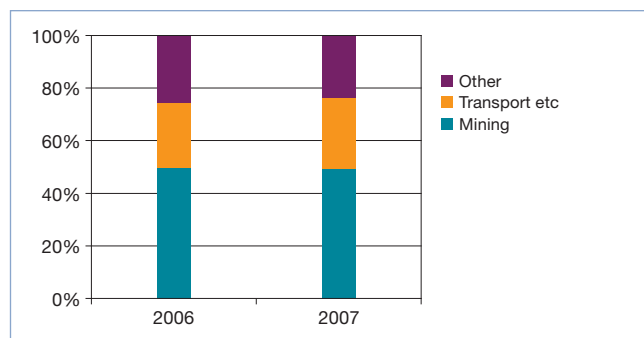
**Chart 3.9 Malawi: Foreign Portfolio Equity Stock by Sector (2001-4, %)**



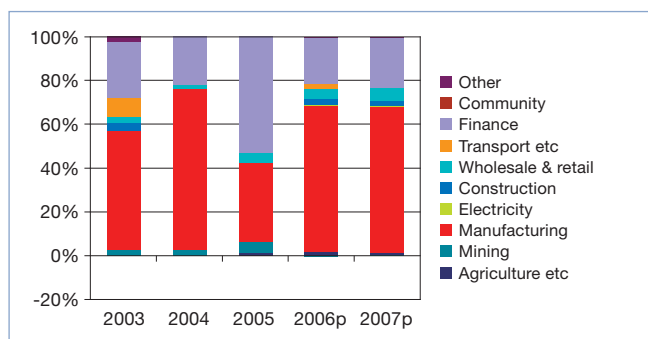
**Chart 3.7 Uganda: FDEI Stock by Sector (2003-7, USDm)**



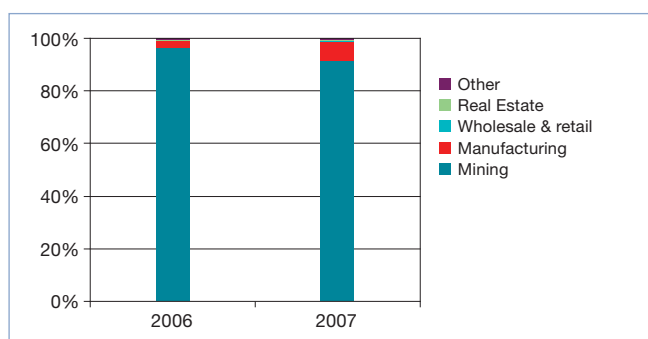
**Chart 3.10 Ghana: FPEI Stock by Sector (2007, %)**



**Chart 3.11 Uganda: Foreign Portfolio Equity Stock by Sector (2003-7, %)**



**Chart 3.12 Zambia: Portfolio Equity Stock by Sector (2006-7, %)**



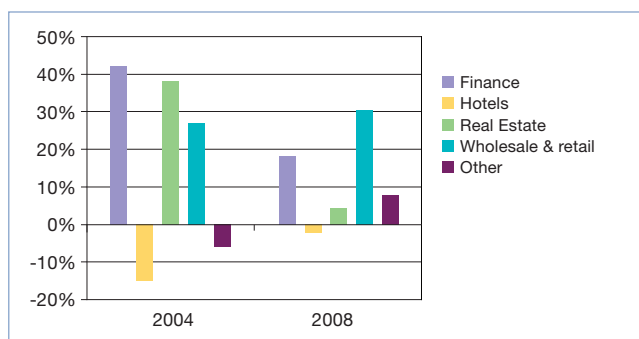
### Return on Equity

Countries have analysed the profits enterprises are making on equity investments.

- Overall, the most profitable sectors are construction, finance and commerce, with average profit levels of over 20%. Agriculture, mining, tourism and real estate also exceed 20% in peak years, and manufacturing 15%, but are more volatile.
- There have been highly profitable opportunities to be had in all countries. Average profit rates across the economy ranged from over 21% (Malawi and Zambia) to only 1% in Nicaragua. In the Gambia, commerce and finance have replaced real estate as the most profitable. All sectors (especially agriculture and finance) have been profitable in Malawi; industry, commerce, construction and fishing in Nicaragua; and construction, transport, finance and commerce in Zambia.
- A very important factor distorting profit levels is the state of advancement of individual large projects. Big new hotels in the Gambia and Tanzania, factories in Malawi and Zambia, and housing projects in Zambia, at times sharply reduced sectoral profitability rates, and future analysis could exclude projects which are in their "start-up" phase to give a more accurate picture of sectoral profits.

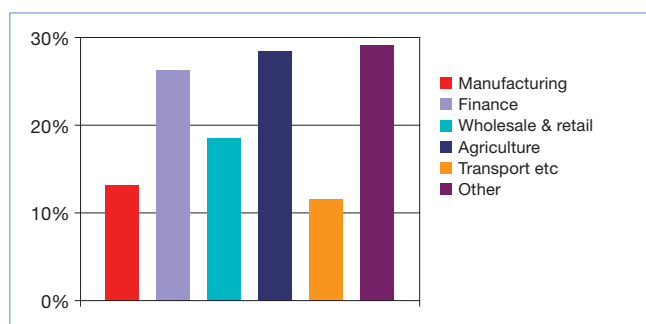
- Other factors reducing profitability have included: growing competition in sectors over time (for example in the banking sector in the Gambia); higher input costs and drought in agriculture, and reduced mining and manufacturing output due to energy shortages.
- There is no necessary correlation between the level of profitability of a sector and the amount of FDI it receives. Manufacturing received most FDI in both Malawi and Nicaragua, but it was much less profitable than other sectors in Malawi. In Nicaragua, there was net disinvestment from fishing due to poor access to domestic credit, and legal changes, in spite of very high profit rates.
- The global financial and economic crisis is hitting almost all sectors. Those cited particularly in recent reports and interviews with investors are real estate in the Gambia (fewer foreigners buying new homes, falling property and land prices, and fewer visitors putting a squeeze on rental incomes); finance in the Gambia; tourism in the Gambia, Nicaragua, Tanzania and Zambia; mining in Tanzania and Zambia; agriculture in Nicaragua and Tanzania; and construction in Zambia. To mitigate the crisis, several governments have resorted to measures to stimulate key sectors, notably the Zambian government which introduced a raft of budget incentives in 2009, to reduce operating costs of mining companies
- However, all countries have some sectors which are doing well despite the crisis, largely because they are dependent on regional and domestic demand, or dominated by export products whose global prices have not fallen. These include commerce in the Gambia; mining in Ghana, and transport and telecommunications in Zambia.

**Chart 3.13 Gambia: Return on Equity by Sector (2004 vs 2008, %)**

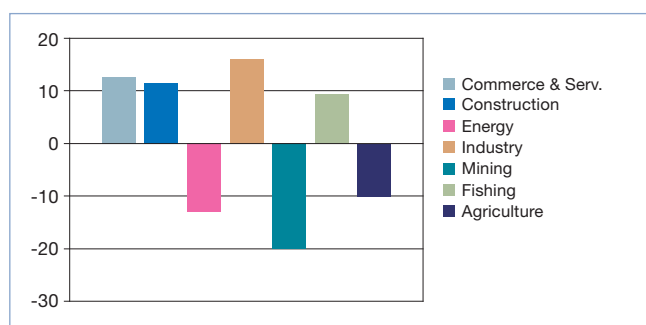


## WHERE FROM AND WHERE TO? SOURCES AND DESTINATIONS OF THE FLOWS

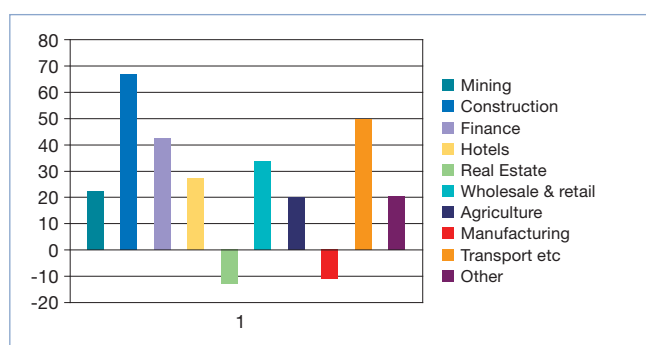
**Chart 3.14 Malawi: Return on Equity by Sector (2004, %)**



**Chart 3.15 Nicaragua: Return on FDI by Sector (Excl. Free Zone, 2005, %)**



**Chart 3.16 Zambia: Return on Equity by Sector (2007, %)**



### Borrowing from Non-Affiliates

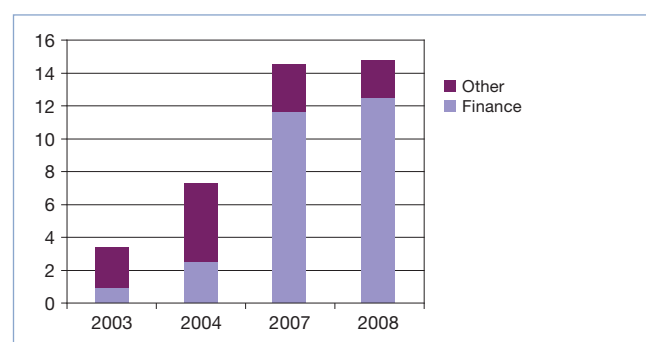
Borrowing from non-affiliates showed a rather different sectoral pattern than FDI and portfolio flows. It increased along with the FDI boom in 2007, showing that enterprises anticipated the returns on higher investment would outweigh the risks of interest rate shocks.

Overall, the highest proportion of loans went to mining (Ghana, Tanzania, Uganda and Zambia), financial sector (the Gambia), and manufacturing (Malawi, Tanzania). Commerce was also prominent in the Gambia, Tanzania and Malawi, utilities in Tanzania, and telecoms in Zambia.

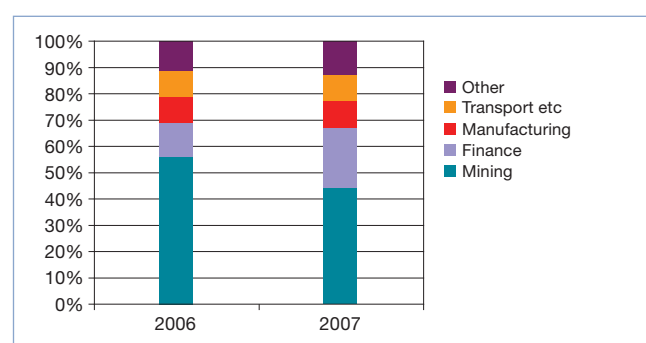
However, the pictures for long-term loans and supplier credits were rather different (where this breakdown was available). Long-term loans went mainly to tourism in the Gambia, mining in Ghana and Tanzania, Uganda and Zambia, and telecoms in Zambia. Supplier credits went to the financial sector, tourism, agriculture and commerce in the Gambia; and to manufacturing, commerce and transport in Malawi.

Sectoral trends have been mainly influenced for long-term loans by the rise and fall of project investment loans (especially large mining projects in Ghana and Tanzania), and for supplier credits by global trends in export and import prices.

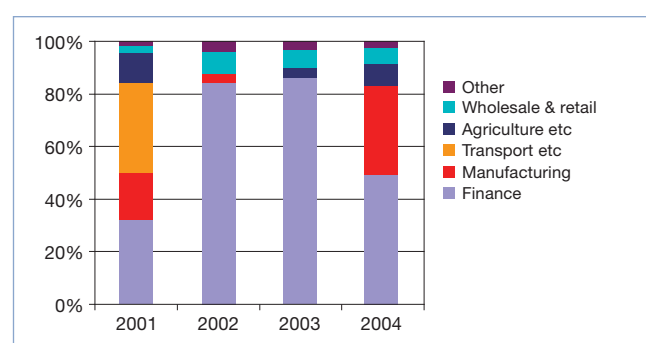
**Chart 3.17 Gambia: Debt Stock from Non-Affiliates by Sector (2003,4,7,8, USDm)**



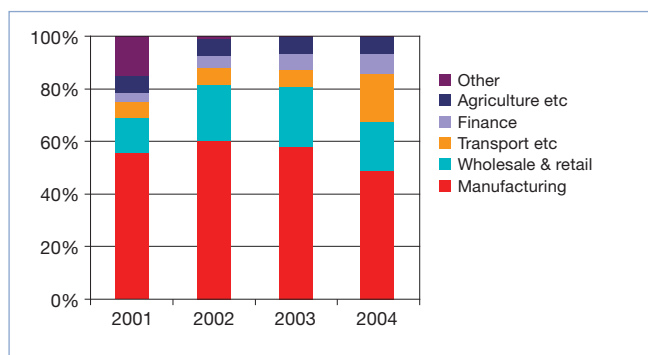
**Chart 3.18 Ghana: Total Debt Stock by Sector (2007, %)**



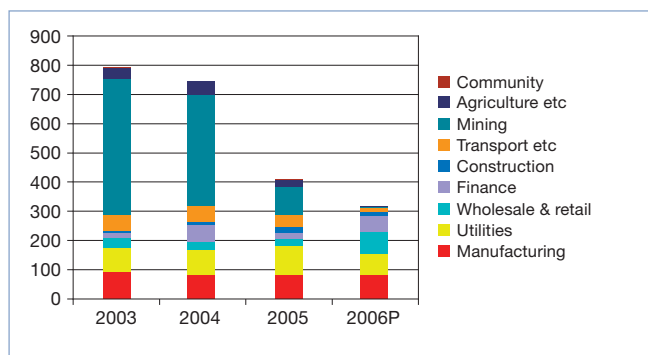
**Chart 3.19 Malawi: Loan Stock from Non-Affiliates (2001-4, %)**



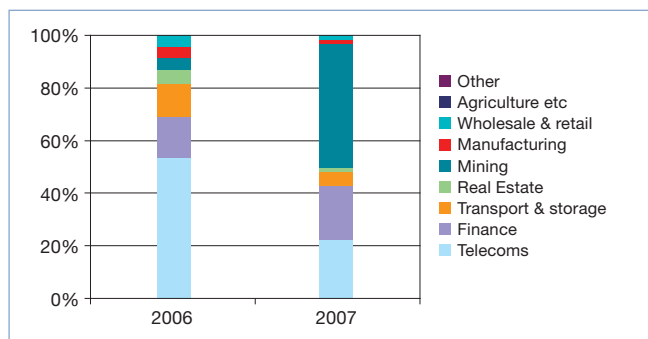
**Chart 3.20 Malawi: Supplier Credit Stock from Non-Affiliates (2001-4, %)**



**Chart 3.21 Tanzania: Stock of Borrowing from Non-Affiliates by Sector (2003-6, USDm)**



**Chart 3.22 Zambia: Stock of Debt from Non-Affiliates by Sector (2006-7, %)**



### 3.2 COMPOSITION BY SOURCE COUNTRY

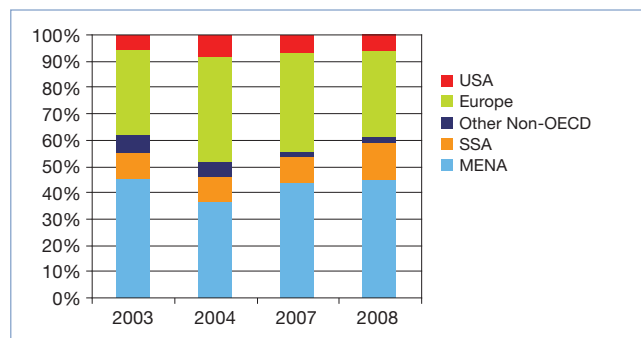
Our previous study (Bhinda et al) found that, contrary to previous perceptions that most investment was coming from OECD sources, countries have found significant shares of FDI and borrowing coming from non-OECD sources. This trend has accelerated in the last decade.

As a result, the shares of non-OECD countries in total FDI stock vary from 30% in Malawi to as high as 60% in the Gambia. All countries have seen a considerable increase in the proportion of their foreign private capital coming from non-OECD countries, though this slowed in some countries in mid-decade (eg Tanzania).

Much of the focus in the international literature has been on increased Chinese and Indian investment, but four other strong trends are evident from our data (and shown in the country graphs below and on page 39):

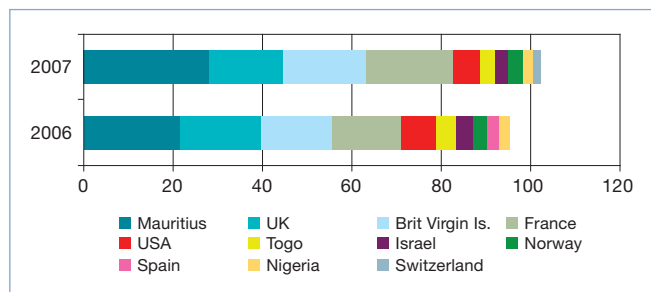
- Rapidly growing intra-regional investment in Africa and Latin America. In Africa, South Africa dominates (especially in Eastern and Southern Africa), but there are also significant flows from Ghana, Kenya, Mauritius, Nigeria, Senegal and Togo. In Latin America, Argentina, Brazil and Venezuela are investing significantly into Bolivia, and El Salvador, Guatemala, Mexico and Venezuela into Nicaragua.
- Some countries are also succeeding in attracting non-regional flows other than from China and India, notably the Gambia (which has achieved a 45% share of investors from the Middle East and North Africa) and Nicaragua (18% from Asian countries – Singapore, South Korea, Taiwan), but also for example, Malawi from Malaysia, and Tanzania and Zambia from Saudi Arabia.
- Many countries continue to record significant amounts channelled via tax havens such as Bermuda, the British Virgin Islands, the Cayman Islands, Luxembourg and Panama. This reflects the registration of OECD, and increasing numbers of non-OECD investors, as well as enterprises owned by residents of the host country, in these jurisdictions in order a) to avoid tax scrutiny or higher tax rates levied by their own national authorities or b) (for residents) to benefit from investment incentives which are available only to “non-residents”.
- There has also been growing diversification of OECD investment source countries, away from ex-colonial relationships, with countries such as Australia, Canada and Switzerland increasing mining involvement in Zambia, Canada also in Nicaragua, and France in Ghana.

**Chart 3.23 Gambia: FDI Stock by Source Region (%)**

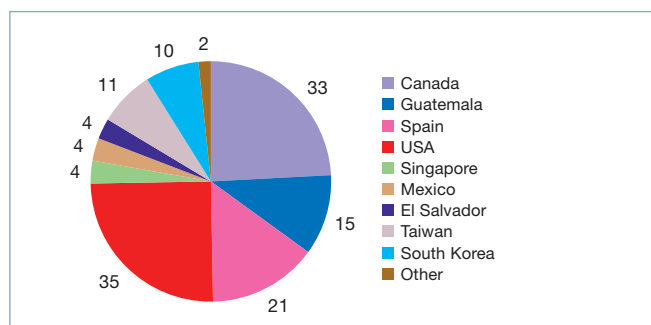


## WHERE FROM AND WHERE TO? SOURCES AND DESTINATIONS OF THE FLOWS

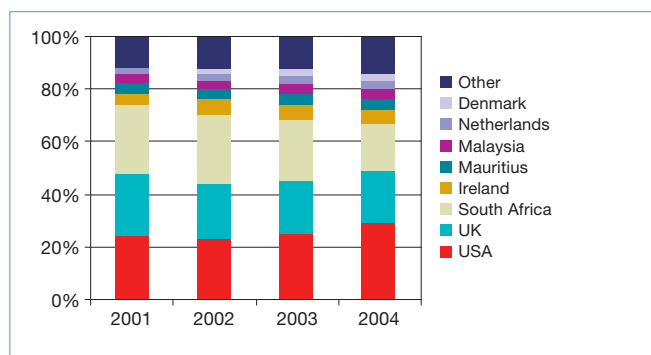
**Chart 3.24 Ghana: Source of Direct Equity Flows (2006-7, USDm)**



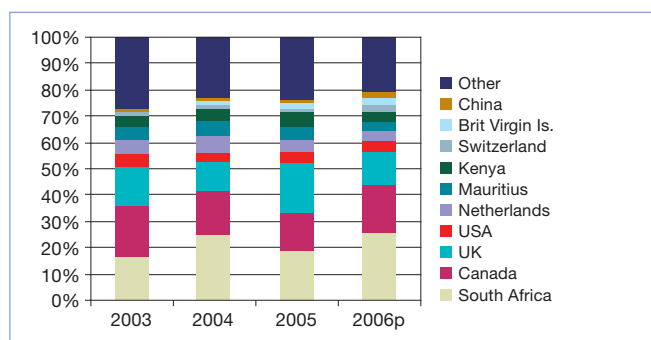
**Chart 3.25 Nicaragua: Composition of FDI Flows by Source Country (2005, USDm)**



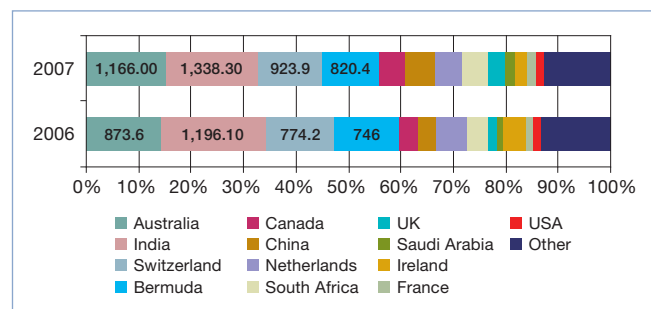
**Chart 3.26 Malawi: Source of FDI Stock (2001-4, %)**



**Chart 3.27 Tanzania: Source of FDI Stock (2003-6, %)**

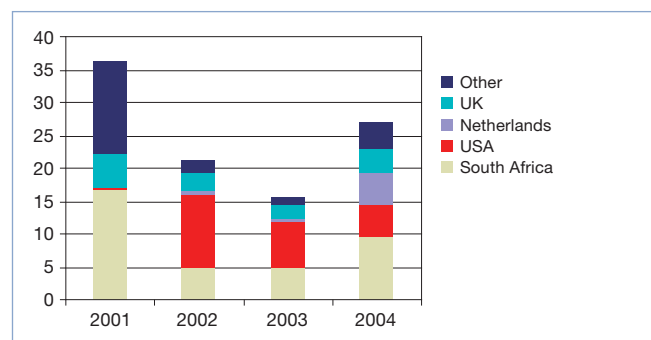


**Chart 3.28 Zambia: Source of FDI Stock (2006-7, USDm & %)**

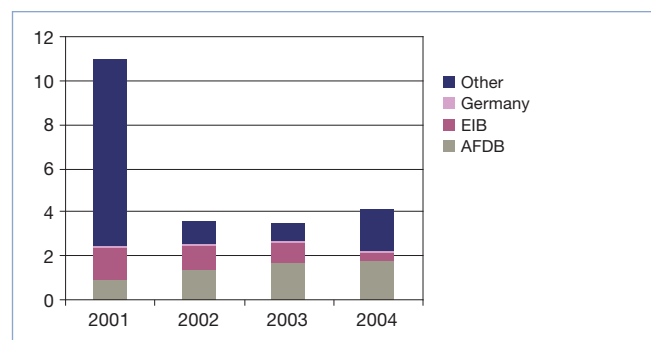


**Other types of investment do not necessarily come from the same countries.** For example, Malawi gets most of its FDI from the US, UK and South Africa. Among its unrelated debt flows, as shown in the graphs below, supplier credits match the FDI pattern (South Africa, US, Netherlands and UK), but loans came primarily from multilateral organisations (African Development Bank, European Investment Bank).

**Chart 3.29 Malawi: Stock of Supplier Credit from Non-Affiliates by Source Country (2001-4, USDm)**



**Chart 3.30 Malawi: Stock of Loans from Non-Affiliates by Source Country (2001-4, USDm)**



Equally, source countries of portfolio equity flows are very different, depending on those enterprises with minority shareholdings or which are traded on local stock markets, as well as which source country residents have knowledge



of local portfolio debt markets. Malawi's portfolio equity therefore came mostly from Danish residents, while Zambia's was held by Australians (92%) and South African enterprises with branches in Zambia (6%). Zambia's portfolio debt securities were held by residents of the UK, Kenya, and Bahrain. Two-thirds of Nicaragua's portfolio investment stock was held by Panamanian residents, a third by USA, and 1% by the Cayman Islands.

This variation in source countries implies that countries need to analyse the sources of all different types of private capital flows carefully (as well as the relationship between source countries and sectors, which is discussed in Box 1), in order

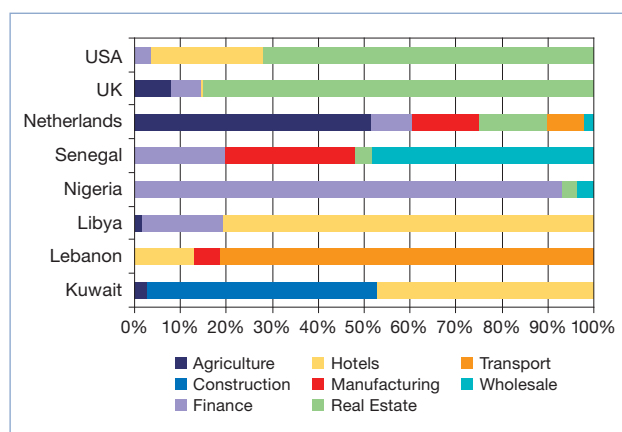
to assess more accurately how they need to diversify sources, as well as the potential risks from economic downturns or changes in other "push" factors from different investing countries.

This change in source country composition also has some major implications for the sustainability of flows, and for investment promotion policies.

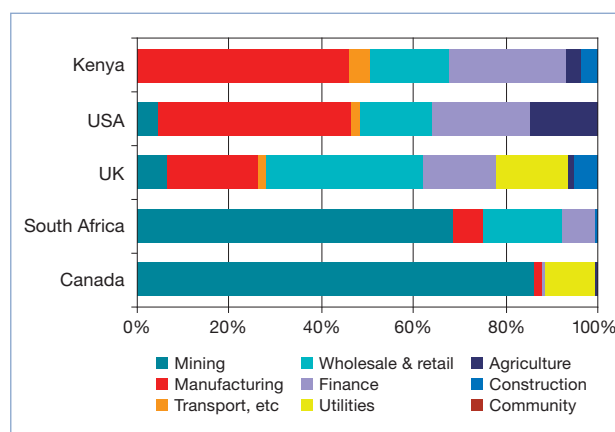
- **Some countries have more need to diversify sources than others.** While Ghana, Malawi and Nicaragua have more than 75% of their FPC coming from 3-4 countries, and are therefore in principle more vulnerable to

### BOX 1 - DO DIFFERENT COUNTRIES INVEST IN DIFFERENT SECTORS?

**Chart 3.33** Gambia: Sector Distribution of FDI Stock (2008)



**Chart 3.34** Tanzania: Sector Distribution of FDI Stock (2006)



Some countries also analysed the links between the source country and the sector of economic activity each country is investing in. This is yielding valuable information for investment promotion agencies seeking to diversify sectors as well as source countries, to help identifying future promotion priorities. It is also allowing private sector associations and businesses to target opportunities for joint ventures.

In the Gambia, several countries have been investing in numerous sectors, but most in only one or two. UK and US FDI is heavily skewed into real estate (though their debt funding goes into the financial and hotel sectors). Senegalese and Dutch FDI are the most multi-sectoral, whereas Nigerian FDI goes largely into finance (banks), Libya into hotels, Lebanon into transport, and Kuwait into construction and hotels. Overall, non-OECD investors appear to focus less on real estate, and more on other sectors.

In contrast, Tanzania's source countries show no clear pattern of different behaviour among OECD and non-OECD investors. Canada and South Africa were heavily focused on mining. FDI from the UK, USA and Kenya was far more diverse but seemed to favour manufacturing, wholesale and retail, and finance respectively.

Overall, investors from some countries tend to invest in numerous sectors (e.g. Kenya, Netherlands, Senegal, South Africa, UK, USA), while others are more limited (e.g. Australia and Canada largely in mining, Nigeria in the financial sector). However, it is difficult to generalise across countries. While China, India and South Africa's investments have been increasing considerably, their behaviour varies - in some countries they concentrate largely in resource sectors, but in others their investments are much broader (in manufacturing, commerce and finance as well as agriculture). This indicates scope for countries to learn much more from one another about "best practices" to encourage source countries to diversify their investments across sectors.

downturns in individual source countries, others have a more diversified portfolio of investors. However, countries cannot assume that investment sources will continue to diversify – Tanzania and Zambia have seen increased concentration (albeit including some new countries) in the most recent years.

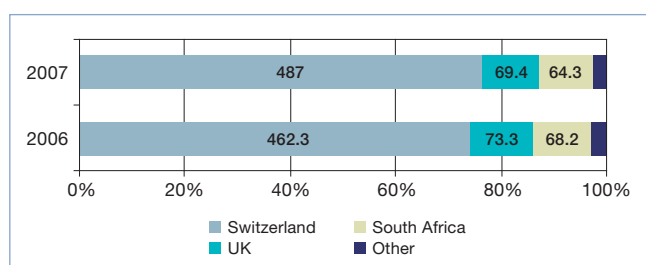
- Though there was no major difference in the composition of FDI coming from different countries (composition patterns were far more determined by the sector of the investment), **OECD investors tended to fund a considerably higher proportion of their investment with unaffiliated debt.** On the other hand, Middle Eastern and Indian investors often used little or no debt funding. This implied more debt vulnerability for countries relying on OECD investors, as well as potentially more concentration of borrowing in a few source markets (making countries more vulnerable to “credit crunches” in those markets). The two graphs from Zambia below show much higher concentration of debt sources than the FDI graph 3.28 on page 39, in particular with almost 80% of trade credit from Switzerland (compare also Malawi’s FDI and debt in graphs 3.26, 3.29 and 3.30 on page 39).

### 3.3 FDI BY RECIPIENT REGION

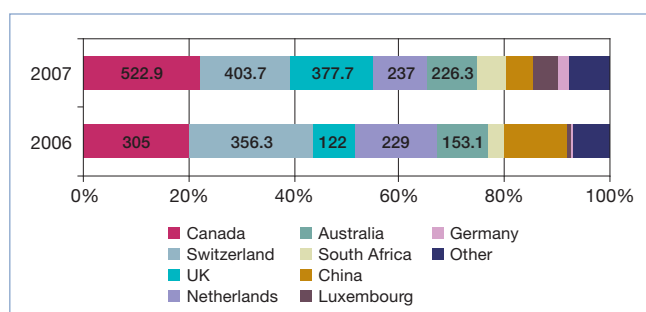
Most countries participating in the FPC CBP found that FDI was concentrated in or around a single centre – usually the capital city and its surrounding region. This reflected higher quality infrastructure, access to transport (ports, airports, rail), and the concentration of the national commercial market in the city. More widespread regional distribution of investment was largely determined by the location of major mining and petroleum resources (eg Bolivia, Tanzania, Zambia), or other natural resources such as wildlife for tourism (The Gambia, Tanzania). In some countries, the second city was the main commercial centre (Blantyre in Malawi, Douala in Cameroon) and so provided a hub for investors. Even in countries with high concentration in one region, large individual mining investors (eg in Ghana, Nicaragua) tended to attract their own infrastructure to less well-endowed regions.

To the degree that FDI generates employment, infrastructure and other services, its absence from the poorer regions of countries is a severe hindrance to overcoming income inequality, and an encouragement to greater migration to urban centres. In the absence of countervailing policies, it complicates the execution of many countries’ national development or poverty reduction strategies, which aim to reduce regional income inequalities. Box 2 on page 42 discusses the cases of Malawi and Tanzania.

**Chart 3.31 Zambia: Stock of Supplier Credit from Non-Affiliates by Source Country (2006-7, USDm & %)**

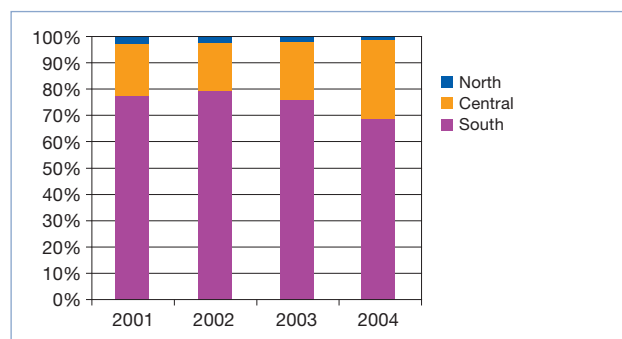


**Chart 3.32 Zambia: Stock of Loans from Non-Affiliates by Source Country (2006-7, USDm and %)**



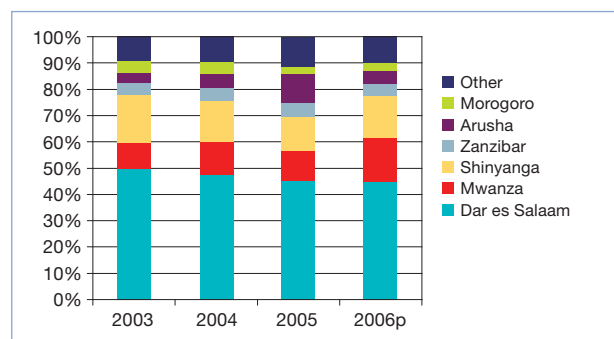
## BOX 2 – REGIONAL DISTRIBUTION OF INVESTMENT

**Chart 3.35 Malawi: FDI Stock by Recipient Region (2001-4, %)**



Malawi's FDI was highly concentrated in the Southern region, in particular in and around Blantyre, which is the country's commercial centre, with relatively favourable essential infrastructure. The poorest Northern region has remained heavily under-invested, in spite of efforts by the Government to attract investment there, complicating government's efforts to reduce income inequality among regions.

**Chart 3.36 Tanzania: FDI Stock by Recipient Region (2003-6, %)**



In Tanzania, almost half of FDI was in the capital city, Dar es Salaam, reflecting better infrastructure, proximity to the port and its predominance as the national commercial centre. A further 30% went to Mwanza and Shinyanga, owing to gold and diamond mines, and fishing and fish processing in Lake Victoria. Tanzanian Regions with poorer natural resource endowments, infrastructure and utilities saw insignificant FDI. Tanzania is making major efforts to improve the attractiveness of poorer regions, through infrastructure development and regional investor forums.

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## DYNAMIC SECTORS AND THE GLOBAL RECESSION: COUNTRY CASE STUDIES



# DYNAMIC SECTORS AND THE GLOBAL RECESSION: COUNTRY CASE STUDIES

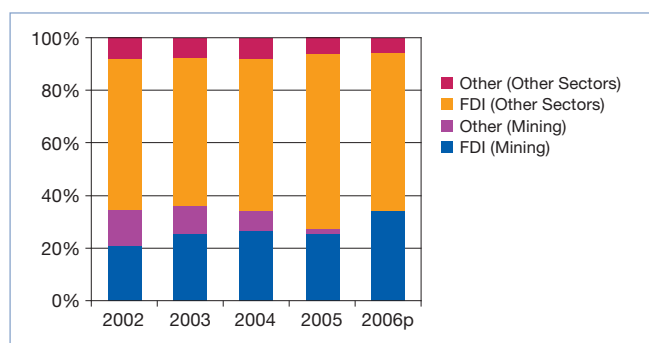
This chapter builds on the analysis of the first section of Chapter 3, by examining several case studies of “dynamic sectors” which are attracting foreign private capital. It looks in turn at mining in Tanzania, manufacturing in Nicaragua’s Free Zone, real estate, and tourism in The Gambia, and telecoms in Uganda. For each sector, it describes and explains their dynamism and analyses problems in each sector as well as threats (some from the global recession) to their future growth.

## 4.1 MINING IN TANZANIA<sup>8</sup>

Mining is Tanzania’s fastest growing sector, with growth averaging 14% in 2004-08, twice the overall GDP growth rate. Tanzania is Africa’s third largest gold producer after South Africa and Ghana, and is among the world’s top diamond producers, as well as mining large amounts of other gemstones. Nevertheless, because mining started from a low base, it contributed only 3.5% to GDP in 2007.

As shown in Graph 4.1, this growth has been almost entirely financed by FPC, largely FDI, in the form of either equity, or borrowing from affiliated enterprises. During 2002-06, an average of 49% of all FDI to Tanzania went to the mining sector (though only 33% of FPC due to the large debt repayments). As a result, mining rose from 27% to 36% of total FDI stock.

**Chart 4.1 Tanzania: Mining Contribution to FPC Stock**



Source: Bank of Tanzania database, DFI office estimates

As was found in previous CBP studies, the mining sector remains highly exposed to debt especially during expansion. As shown in Graph 4.1 and table 4.1, borrowing from non-affiliated sources (“other” FPC) spiked during 2002-04, to supplement enterprises’ own resources and finance large capital investments, but dropped to almost nil by 2006, as these debts were repaid. As a result, the sector’s debt: equity ratio was especially high during 2002-04. However, the ratio is still relatively high, because debt from affiliated sources (largely for working capital, and a component of FDI) remains. It typically comes with extremely flexible terms and

conditions: it may be rolled over if short term, or recalled prematurely if long-term, depending either on the cash flow of the enterprise, or the priorities of the parent.

**Table 4.1 Debt to Equity Ratio (USDm)**

Item	2002	2003	2004	2005	2006
Total	1,304	1,589	1,614	1,413	1,882
Equity stock	450	440	481	911	1,269
Debt stock	854	1,149	1,133	502	613
from affiliates	332	683	755	408	610
from non-affiliates	522	466	378	94	3
Debt: Equity Ratio	1.9	2.6	2.4	0.6	0.5
Affiliated/Non-Affiliated	0.6	1.5	2.0	4.3	203.4

Source: Bank of Tanzania database, DFI office estimates

The mining sector showed strong profits over 2003-04, but these fell to modest losses in 2005-06, as shown in table 4.2. These losses largely reflected high start-up investment costs in new projects, offset by highly profitable existing projects.

**Table 4.2 Return on Equity (2003-6, USDm)**

Item	2002	2003	2004	2005	2006
Net profit/loss	28	70	62	-31	-9
Total Equity	450	440	481	911	1,269
Return on Equity	6%	16%	13%	-3%	-1%

Source: Bank of Tanzania database, DFI office estimates.

The investment outlook is generally positive, largely because gold prices have held their value during the economic crisis. The government wishes to see the contribution of this sector expand to 10% of GDP by 2025. Significant uranium deposits have also been identified, and are anticipated to attract further capital inflows.

On the negative side, the benefits to Tanzania have been limited, and more action needs to be taken to mobilise resources for poverty reduction and development. The sector is dominated by a few foreign investors, because only they can mobilise the capital needed for large-scale projects. For the same reason of scale, financing is largely external, because Tanzanian banks and financial institutions do not have the capital. As a result, there is minimal local investment or joint venture partnership, limiting any prospects for technology transfer or skills development.

Beyond wages and salaries, revenues to Tanzania are also minimal. The Mining Act (1998) sets variable (depending on the stage of advancement of a project) fees for license preparation and renewal at a maximum of US\$600, and land rent at a maximum of US\$1500 per km. These are minimal returns to Tanzania. In addition, mining enterprises are exempt from import duty and VAT on equipment and essential materials until the end of the first year of production, after which duty is limited to 5%. By the end of

<sup>8</sup> Non-CBP information is from: Business Monitor International (2009); The East African (2006); The Citizen (2009); IMF (2009c).

2008, only one company, AngloGold Ashanti, had paid any corporate income tax, 10 years after industrial mining began. These tax exemptions cost Tanzania at least 181 billion Shillings (USD140m) in 2005-08.

To mobilise more revenue, Government has decided to table an amended Mining Act in October 2009, proposing: a 10-15% ownership stake by government in those mining companies it deems to be "strategic" (e.g. gold) (Reuters 2009); increased royalties on metals from 3% to 5%; ending tax relief on fuel imports for gold mines; increasing royalties on rough diamonds and gemstones from 5% to 7% and on cut and polished stones from zero to 3%; levying a fuel tax and use the revenue towards road building; calculating royalties based on gross value; and establishing a Minerals Authority to supervise all activities. The move is popular, given the perception that mining enterprises in Tanzania have been under-paying, and Civil Society Organisations are lobbying to channel the resources to tackling poverty. However, mining companies have been lobbying hard to moderate the legislation, arguing that it would harm a growing sector especially during the current global recession (Mines and Communities 2009 and Sunday Observer 2009).

## 4.2 MANUFACTURING IN NICARAGUA'S FREE ZONES

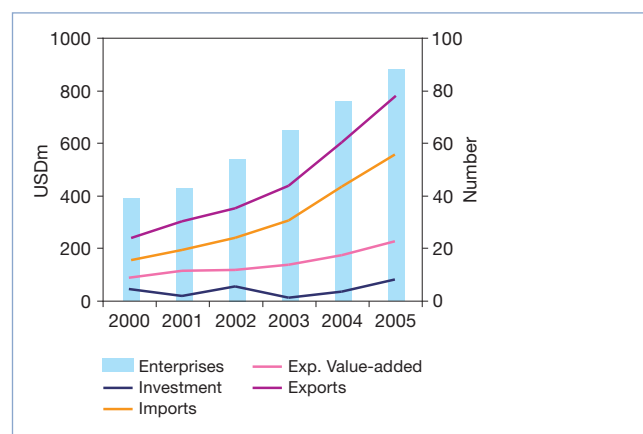
The manufacturing industry which has operated in Nicaragua since 1992 under the special regime of the Free Zone with preferential trade status, has become one of the most dynamic activities of the economy. It grew rapidly from 1 industrial park to 25 by 2005 containing 88 enterprises.

By 2005, the Free Zones produced exports of USD 774 million, including USD 222 million of value-added in Nicaragua, and generated 74,908 jobs. The textile and clothing sector was the largest sector, in terms of exports, jobs and value-added, and attracted USD 64 million of new investment in 2005. Activities mainly focus on assembly for export to the US market.

In the 1990s, FZ investment rose by an average 40% a year, reaching USD 16 million in 1999. However, in 2000-05, it reached an average of USD36 million, partly due to rising costs in competing nearby countries such as Guatemala and El Salvador.

This growth withstood the liberalisation of world textile markets in 2005, because the cost of transport to US markets offset lower production costs in China. In addition, Nicaragua benefited from higher security levels than its neighbours, and the extension of Free Zone conditions to agroindustry, services and supply chains.

Chart 4.2 Nicaragua's Free Zone



Source: BCN, DGA, CNZF

These investments have come mainly from the United States (38%), Canada (19%), Taiwan (14%), Korea (13%), Spain (10%) and El Salvador (5%). However, almost all of the US investments came in the initial years, and most recent investment has come from Taiwan and South Korea.

Free Zones textile exports will also be one of the few sectors to have benefited from the CAFTA treaty, because Nicaragua has been the only country granted free trade in textiles and clothing for 10 years up to 100 million square metres. Free Zone investment will also continue to rise as long as Nicaragua maintains conditions such as: 1) WTO agreements; 2) US market access; 3) political and social stability; 4) government support; 5) labour supply; and 6) competitive production costs.

Nicaragua's Free Zone (and elsewhere) has come under fire from civil society organisations, for its perceived negative impact on the development of women and poverty reduction (Working Capital for Community Needs, 2002), the suppression of labour unions, and infringements to worker rights (Harford Web Publishing World History Archives). In an effort to improve the terms and conditions of workers, the Government increased the minimum wage by 33% in 2007. During 2007-8, this led to the decision to relocate 13 predominantly Taiwanese-owned factories to China or Viet Nam, where labour was cheaper (Nicaragua Network 2008). (Ironically, several enterprises had initially relocated to Managua from Costa Rica to take advantage of low labour costs!). (Caribbean Update 1996). This contributed to a reduction in employment in the Zone from 88,629 in January 2008, to 73,224 towards year end (US Department of State 2009). The Government is currently under pressure to ensure that other enterprises do not follow suit (Nicaragua Network 2009).

While this sector has been very dynamic, these developments highlight some cautionary lessons for countries seeking to encourage this type of FDI:

- The sector is vulnerable to the hard-nosed economic decisions of footloose industries that see worker rights as an impediment to doing business. This vulnerability might be heightened during economically troubled times
- It shows the speed with which FDI may flow in or out in response to a policy decision (in this case, the minimum wage)
- If enterprises are largely geared to assembly rather than the other stages of the production process, the level of value added and technological transfer to the country is limited and the ability to withdraw rapidly heightened.

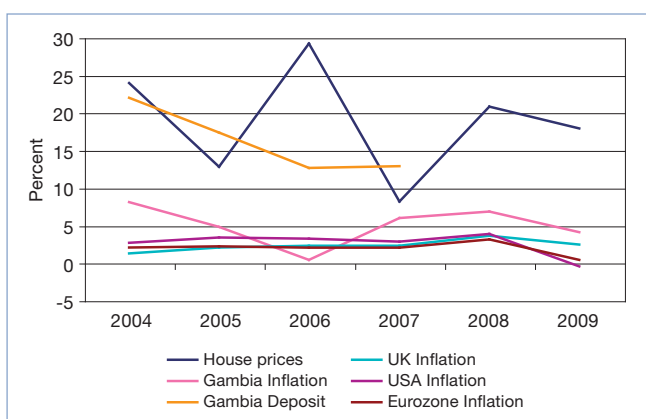
Under these circumstances, the value-added from this type of investment is limited in meeting a country's medium to long-term development goals. Perhaps not surprisingly, workers in Nicaragua have set up their own free trade zone, sewing organic and fair trade cotton clothing for export to the US and Europe (Sustainable Design Update 2008).

### 4.3 REAL ESTATE IN THE GAMBIA

The real estate sector has been a dynamic recipient of FDI in many countries, including the Gambia in 2003-8. Much of the FDI flows recorded in real estate during 2004-8 were from individuals resident primarily in OECD countries. These individuals were buying properties as second homes, for retirement, or as buy-to-let investments. The market is known to include expatriate Gambians.

Investors see property in the Gambia as a sound investment, anticipating much higher future rental or sale income. The chart below shows how house prices have changed to the present day, compared against Gambian deposit rates, and average annual inflation in the main purchasing locations. House prices reflect selected high-end properties targeted at both Gambians and foreigners (well located with sea views, fully paved roads, guaranteed 24 hour electricity and water supply, and matured and maintained landscaping and gardens), and should not therefore be taken as indicative of the wider market.

**Chart 4.3 Gambia House Prices and Deposit Rates and Inflation Rates in Client Regions**



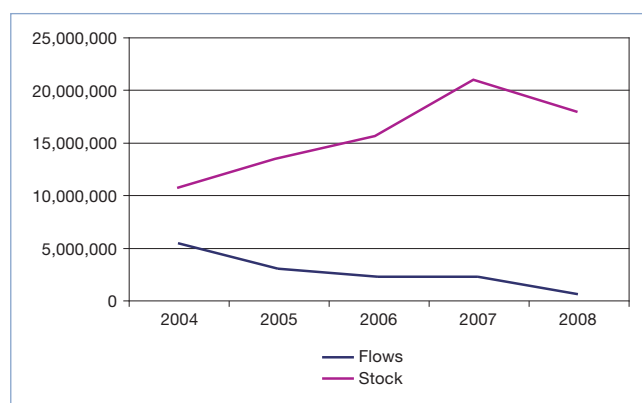
Clearly, the prices of these selected properties have performed very strongly and well above the inflation rates in the main purchasing countries. As an estimated 62% of houses are tenanted, this would imply (rental income aside) a very favourable return on investment. It is interesting to note however, that the house price trend compares closely (with the exception of 2007) with the return one would obtain if one had simply deposited the money in a Gambian bank.

This is helped by several factors.

- The Gambia is an established holiday destination served by cheap charter flights.
- it has an established expatriate community providing information to friends and family back home.
- land and property law ensures secure ownership.
- utility rates and taxes are locally and centrally fixed, and controlled by national companies and government bodies.
- government has been investing in infrastructure, sport and conference facilities.

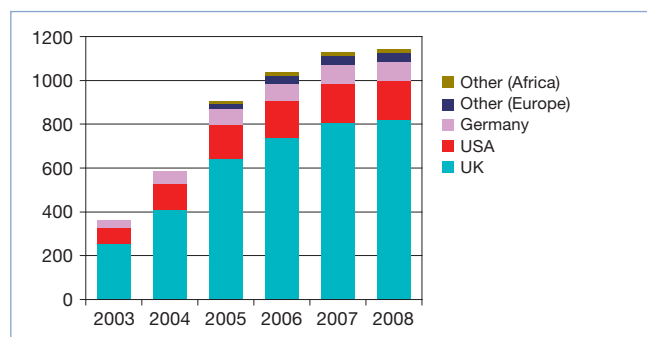
However, the dynamic nature of the sector may be wearing off, at least in the short-term. Chart 4.4 shows that the rate of FDI flows has been declining over the period. The sharp drop in 2008 was attributable directly to the global financial crisis, which also reduced the valuation of existing FDI stock. The initial surge reflects the fact that this started from a low base (with stock doubling in only 3 years to 2007). Property price inflation may also have played a part.

**Chart 4.4 Gambia: Unincorporated FDI in Real Estate (USD)**



As noted in Chapter 3, the return on equity for this sector (based on estimated rental income) declined substantially from almost 40% in 2004 to only 5% in 2008. Again, this can be attributed to the impact of the crisis. It may also be partially attributable to the fact that the number of properties increased dramatically in 2003-05.

**Chart 4.5 Gambia: Number of Foreign-Owned Properties (By Owner Origin)**



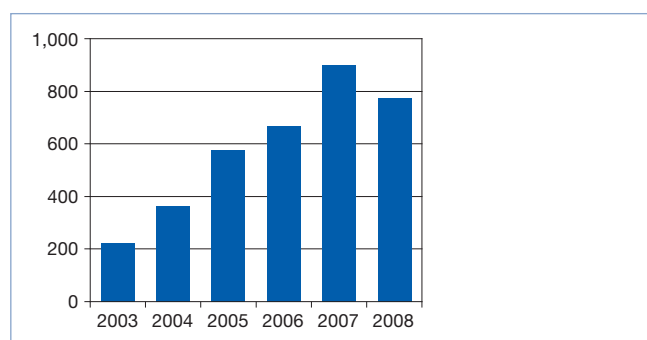
Source: CBG Database, and office estimations based on interview material.

Most properties have been built to order. This has involved the development of several districts around the capital city, with corresponding demand for improvements in infrastructure and utilities.

The chart also shows that the market has been dominated by the UK, with the USA and Germany following far behind. The African property owners come mainly from Nigeria, Senegal, and South Africa.

The chart below presents the estimated “profit” or rental income on the properties. Most of this return has been repatriated to the owners’ country of residence, not reinvested in the Gambia. The development impacts of unincorporated FDI in real estate would appear to be more indirect than direct in the form of: using local construction companies and agencies, employing of service staff, developing of local infrastructure, and a growing expatriate community spending money in the local economy.

**Chart 4.6 Gambia: Estimated Rental Income (US\$ Thousands)**



Source: CBG Database, and office estimations based on interview material.

The most immediate risk to this sector would thus stem from the vulnerability of the main investment source countries to recessions. Indeed income has already declined as a result of the global recession. One of The Gambia’s main property developers revealed that there had been a few “distress sales” by people who have suffered from the effects of the global depression, and this would need to be insulated against

through continuous and “vibrant” marketing strategies, the targeting of new markets, and the extension of new and flexible payment plans. Thus, given the concentration of ownership in the UK, a more prolonged crisis in the UK would hit this sector very hard. A longer term challenge might be new preferred locations for rental property.

#### 4.4 CASE STUDY: TOURISM IN THE GAMBIA

Tourism has been a dynamic sector in several countries participating in the FPC CBP – notably The Gambia, Tanzania and Zambia. It contributes 16% to the Gambia’s GDP, and is a major employer. The country has long been a popular destination, with most visitors arriving on charter flights, and has seen the construction of several large new hotels in recent years, provoking a significant visitor increase.

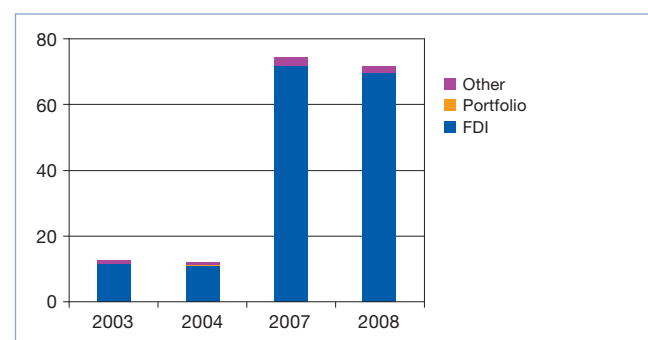
**Table 4.3 Arrival of Air Charter Tourists in The Gambia (2003-8)**

Year	2003	2004	2005	2006	2007	2008
Total	89,116	90,098	107,904	124,800	142,626	134,569
Change on previous year		13%	1%	20%	16%	14%
						-6%

Source: Central Bank of The Gambia

Much of this development has been taking place through FDI. Between 2004 and 2007, FDI grew by an average 86% a year (other and portfolio investment remained minimal).

**Chart 4.7 Gambia: FPC Stock in Tourism (USDm)**



Source: Central Bank of The Gambia Database.

In 2003 and 2004, FDI was primarily in the form of borrowing, and this was 2-3 times the amount of equity. However, in 2007 and 2008, FDI was entirely in equity, implying a radical shift in the way enterprises financed their operations. This is somewhat surprising, given the rapid growth in the sector, and the need to obtain finance for this growth, and implies that foreign investors had “deep pockets”.

However, the sector has been hit hard by the financial crisis, with the stock of FDI stagnating in 2008, and visitor numbers declining during 2008-09. Based on an average daily expenditure of 500 Dalasis (about USD19) per visitor, this is having significant negative effects on the local economy from



sole traders to large hotels, as well as reducing proposed new developments. Profitability has also been hit by a combination of the visitor fall and repayment of financing for project capital development costs, with negative returns of 2% on equity in 2008.

The crisis is producing acute challenges during the 6-month low-season in 2009. One major international hotel indicated in an interview that some tour operators are disinvesting, 14 hotels have closed for the season, and staff have been laid off.

In the longer-term, developing the tourism industry is integral to The Gambia's Poverty Reduction Strategy, with the following challenges needing to be addressed (ODI 2006 and Gambia Investment Promotion and Free Zones Authority):

- Diversify source of arrivals (87% come from only 4 countries)
- Boost income and employment: the sector is dominated by a few European operators running low-spending package tours. Most revenue accrues to the operator, airline, and hotel, and most management staff are expatriates. The contribution to development is therefore limited to salaries and employment for non-management level hotel staff, and out of pocket expenditure for food and beverages
- Address seasonality by aiming for year-round tourism: 70% arrive during November to April, meaning large numbers are laid off for much of the year
- Encourage the main operators to reinvest rather than remit their profits
- Diversify product away from sun, sea and sand holidays, by improving quality to target more up-market, higher spending tourism
- Develop transport access inland, power supply and running water
- Strengthen linkages between tourism and other productive sectors: presently much food is imported, and there is scope to source from local horticulture, fisheries, and agriculture
- Tailor marketing in line with national development objectives, rather than leaving it largely to international companies.

#### 4.5 UGANDA'S MOBILE TELECOMMUNICATIONS INDUSTRY<sup>9</sup>

Liberalisation has enabled Uganda's telecommunications to develop rapidly. Five providers cover the mobile telephone sector (Zain commencing in 1995, MTN 1998, Uganda Telecom 2001, Warid in February 2008, and Orange Uganda in March 2009), and a sixth (Anupam) is due to commence shortly. In spite of new competition, the market remained fairly concentrated at end-2008, dominated by three

operators, MTN, Zain, and Uganda Telecom, although Warid had managed rapidly to gain a 15% foothold.

This sector is growing at 50-100% per year. In 1999, Uganda became the first African country where the number of mobile subscribers passed the number of fixed-line users, and the ratio now exceeds 40:1. The pace of growth during 2008 was no exception, as the following table shows.

**Table 4.4 Uganda's Telecommunications Sector during 2008**

	Mar -08	June -08	Sept -08	Dec -08
Mobile Subscriptions	5,704,506	6,140,822	7,460,011	8,554,864
Fixed Lines	166,552	160,768	167,011	168,481
Number of Payphones	34,177	37,595	52,515	56,918
Tele-density	20.6	21.3	25.8	29.5

Source: Uganda Communications Commission (2009)

Nevertheless, relatively low mobile penetration (only 37% in 2009) means there is tremendous scope for further growth, and the growth rate is expected to be second on the continent only to Cameroon, reaching 71% by 2014 (Pyramid 2009).

Reflecting the potential for growth, the sector has highly profitable opportunities. Mobile telecoms generated USD 540 million in service revenue in 2008 and, in spite of the financial crisis, this is forecast to grow to USD 630 million in 2009. Zain's revenues increased by 50% to USD 137m during 2008. However, it reported a net operating loss after tax in both 2007 (USD 12.6m) and 2008 (USD 22.4m), due to strong downward pressure on prices from competition, and significant investment in upgrading its infrastructure to reduce congestion and increase capacity. MTN Uganda also plans to invest USD 170m in a network upgrade in the face of growing competition (Wireless Federation 2009) and a "volatile" market due to price competition. And the new entrant Orange plans to invest around USD 200m over the next three years.

As shown in the table below, the sector is dominated by foreign investment (even in Uganda Telecom, which perceives itself as a Ugandan company). This raises the risk of high levels of profit repatriation once initial investments are completed.

**Table 4.5 Foreign Investors in Uganda's Telecoms**

Operator	Parent (Uganda stake)	Residency
MTN Uganda (MTN financial report 2008)	MTN Group (95%)	South Africa
Orange Uganda (The East African 2008)	France Telecom (53%)	France

<sup>9</sup> Uganda Communications Commission (2009); Communication Pty Ltd (2009); Pyramid Research, Inc. (2009).

Operator	Parent (Uganda stake)	Residency
Uganda Telecom Telegeography (2008); Lapgreen Networks 'Profiles'; All Africa Global Media (2007)	Lap Green Networks (69%)	Libya
Warid Telecom Uganda (Warid Telecom)	Warid Telecom International (100%)	Abu Dhabi
Zain Uganda (Zain 2009)	Zain Africa BV (100%)	Netherlands (Kuwait)

The table also hints at the increasingly complex ways in which foreign investment is taking place throughout the region and beyond. Zain is a case in point:

- Zain Uganda (Celtel Limited Uganda) is a subsidiary 100% owned by Zain Africa BV Netherlands
- Zain Africa BV Netherlands is a Dutch holding and finance company, 100% owned by Zain International BV, also registered in the Netherlands
- Zain International BV is a subsidiary 100% owned by the Mobile Telecommunications Company KSC (the "Ultimate Controlling Parent"), which is registered in Kuwait, and listed on the Kuwait Stock Exchange.

This complexity poses difficulties for monitoring and analysis. While these are publicly listed, many data are in consolidated form, necessitating follow up with the enterprise for details of investment in Uganda. In terms of source country, the question also arises as to whether investment is from the Netherlands (only a holding company), or Kuwait (the headquarters where business decisions are taken).

The sector would also appear to be rather robust in the face of the global recession, based on the amount of acquisitions taking place during 2008-9, although there is a risk of reduced investment. A recent survey of companies in Europe, the Middle East and North Africa found that 60% of respondents do not expect any large-scale declines in demand among end customers, or the possibility of price wars. However, the economic environment is having a major impact on costs, and capital expenditure liquidity bottlenecks are a threat to sustained growth. This may lead companies to reconsider or postpone larger investments (Technology Marketing Corporation 2009). For the African market, these attitudes are reflected in France Telecom's perception that growth in Africa will remain high despite the economic crisis, because the demand is there (TradeInvest Africa 2008).

If there is any risk to the telecoms sector, it might be from "looming saturation". Mobile operators in some African markets are beginning to doubt the returns they might obtain, and this is driving current consolidation efforts through mergers and acquisitions (Light Reading Communications Network 2009).

#### 4.6 CONCLUSIONS

All the above sectors have been hit by the current global recession to varying extents. Telecoms would appear to be the least affected, although the risk of the postponement or cancellation of large scale investment looms. Mining (non-gold) has been hit due to the fall in commodity prices. Reduced demand and uncertainty especially in the key US and European markets, has hit manufacturing, tourism, and real estate hard.

The impact on some sectors (e.g. mining and manufacturing) has been exacerbated by Government moves to reduce incentives where they feel enterprises are contributing too little government revenue, or to enhance labour conditions where they feel social costs are too high. Experiences in mining and manufacturing show that the theoretical benefits of FDI for development (technological transfer, increased resident wealth, fiscal revenues, large-scale local employment and skills training) are by no means guaranteed.

After many years of paying less attention to revenue or development contributions, or labour or environmental conditions, provided by investors, many governments have raised this up their agendas, unfortunately at the time when some companies can legitimately claim they have falling (albeit in most cases still very high) profits. This makes the negotiation between government and non-resident investors – especially on whether conditions can be changed for existing investors – a difficult and lengthy one. Governments often perceive their position as weak – and the case of Nicaragua shows that industries which are not dependent on local natural resources can move elsewhere rapidly. However, mining and other natural resource sectors have fewer options, especially given enhanced global investor competition for resources, from non-OECD sources. Most low-income countries no longer need to provide major incentives for foreign private capital. Governments will have to stand firm on their new measures, as well as relying on agreements with regional neighbours and enforcement in international law, if they are to maximise the future development contribution of dynamic sectors.



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## WHAT DRIVES INVESTMENT? INVESTOR PERCEPTIONS, INTENTIONS AND RESPONSIBILITY



# WHAT DRIVES INVESTMENT? INVESTOR PERCEPTIONS, INTENTIONS AND RESPONSIBILITY

It is impossible to design policy to promote foreign private capital without knowing what drives foreign investment, as well as its current and likely future contribution to national development. As a result, the FPC CBP has surveyed (resident and non-resident) investors' perceptions of government policies and other factors, their intentions in terms of future investment, and the degree to which they are implementing corporate responsibility policies. Joining the "perception surveys" to the surveys on scale and composition of foreign private capital has had the added bonus of increasing the response rate by the private sector by 30-40%, because private sector actors feel that they are being asked more directly questions which will have an impact on government policy.

This chapter analyses the findings of work in this area in 11 countries. It looks in turn at the initial decision to invest, followed by current attitudes and future intentions, the sources of information investors use, and their corporate responsibility policies.

## 5.1 INITIAL DECISION TO INVEST

What were the initial "pull" factors prompting the decision to invest? The most important in order were:

- 1) Domestic political stability (topping the list in Burkina Faso, the Gambia and Nicaragua)
- 2) Domestic economic stability (most important in Senegal)
- 3) Labour productivity, low cost and availability (especially in The Gambia, Nicaragua and Senegal)
- 4) Pro-investment legal system (especially in Bolivia)
- 5) Access to markets (especially in Bolivia, Burkina Faso, the Gambia, Nicaragua and Senegal) – though emphasis on different markets varied, with international markets most vital in Bolivia and the Gambia, and domestic and regional markets elsewhere.

Some other factors varied considerably in their importance for different countries. For example, natural resources linked to mining and tourism were paramount in Zambia, but less important elsewhere. Infrastructure was important in the Gambia and Nicaragua but less so elsewhere (interestingly given that investors subsequently complained about it loudly). Investment incentives were important in Nicaragua and

### BOX 3 – SHOULD COUNTRIES OFFER INCENTIVES TO FDI?

FPC CBP country findings confirm that the role of incentives in attracting investment has been limited, yet many countries pay them high attention. Governments frequently offer FDI incentives as part of a wider promotion strategy. These can be fiscal (subsidies or tax relief), financial (grants, credits, equity etc), or other (subsidised infrastructure, market preferences, labour training, R&D etc).

What does the literature say? The OECD (2003) finds that the advantages offered by FDI incentives are very limited: they "at most tip the balance in favour of one location among a group of economies that are perceived to have broadly equivalent enabling environments" (OECD 2003). Incentives may also be wasteful if they are ineffective (cost exceeds benefits), inefficient (if benefits are not fully realised or costs not minimised), have high opportunity cost, incur deadweight loss (the investment might have taken place anyway), or trigger competition with other nations. The danger of the latter is a "race to the bottom" where countries under-cut each other at the cost of lower health, safety, labour, or environmental standards. FDI incentives are also by nature discriminatory and a potential source of inefficiency, as they do not offer the same terms to domestic investors. For this reason the IMF and other international organisations such as UNCTAD and the World Bank are generally urging regional groupings such as the East African Community (IMF 2008)

to agreed coordinated "codes of conduct" to providing incentives. (IMF 2008f)

Blomstrom & Kokko (Blomstrom and Kokko 2003 op cit) argue that policy makers should consider incentives as part of the national industrial policy, make them available on equal terms to all investors (foreign and local) and target them to sectors or regions with the greatest potential to generate development impact, consistent with national development strategies.

The OECD offers a 20-question checklist for countries to decide whether to use them (OECD 2003). The International Institute for Sustainable Development has developed a broader checklist which looks at the impact of incentives on sustainable development (International Institute for Sustainable Development 2009). Both conclude incentives should be:

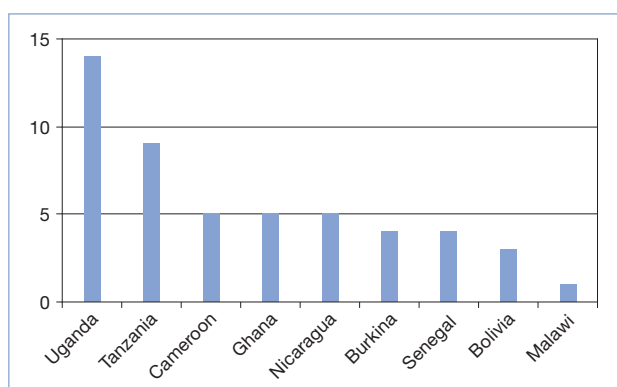
- available to foreign and domestic investors equally
- offered only under very specific circumstances, where investment is shown to have net contribution to sustainable development efforts
- cost-benefit reviewed before a project commences, and regularly thereafter
- integrated into a wider national development plan, and agreed on a regional level

## BOX 4 - IMPACT OF PRIVATISATION

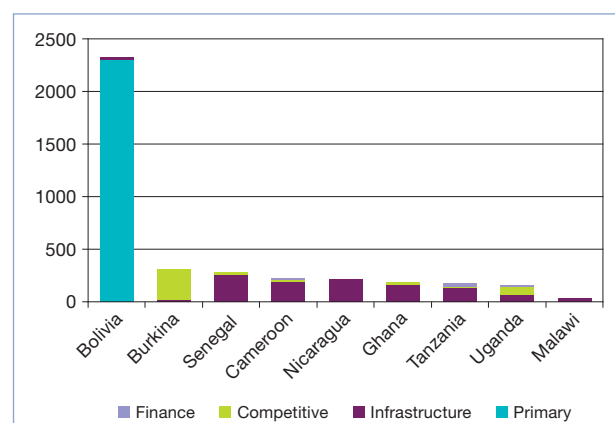
Privatisation was found to be relatively unimportant as a stimulus to FDI (as previously, see Bhinda et al (2000)). This is hardly surprising when one considers the low

number of privatisations, except in Tanzania and Uganda, and low revenue except in Bolivia (due to one mining company).

**Chart 5.1** Number of Privatisations (2000-7)



**Chart 5.2** Privatisation Revenue (2000-7, USDm)



Source: World Bank Privatisation Database

Senegal, but elsewhere not, raising questions as to their utility, as discussed in Box 3.

Some factors were consistently less important. These included liberalised exchange controls (which may have been taken for granted somewhat), and access to loan finance – reflecting the fact that foreign investors tend to borrow offshore via parent companies. Mergers and acquisitions were unimportant, showing the predominance of investment in new enterprises, as were privatisations (discussed in Box 4).

Factors also varied considerably for different types of investors. For example, exporters were much more concerned about access to regional and international markets (for example Latin American and US markets in Bolivia and Nicaragua, and European – especially for tourism – and regional African markets in Africa). On the other hand, non-exporters were more interested in the size and growth of the domestic market. Senegal further distinguished between investors from primary, secondary and tertiary sectors. Primary investors were most drawn by domestic economic stability and access to international markets, secondary investors by access to regional markets and trade, and tertiary investors by access to national markets. Preliminary analysis indicates a similar pattern in other countries. Moreover, investor motivations varied by source country, with investors from Asian countries and other developing countries states being much less concerned by legal, regulatory or tax issues, and much more with labour quality and infrastructure effectiveness and cost (for similar

## BOX 5 - DETERMINANTS OF CHINESE FDI

Investor motivations and pull factors differ for different source countries. A good example is China, which has become rapidly more important since 2000. A recent study (Gugler and Boie 2008) found that Chinese FDI was mainly **market-seeking** (85% of responding firms), needing to invest abroad due to over-capacity for the home market. **Strategic asset seeking** was the next most important motivation (for 51%), mainly for FDI into more developed economies. **Resource-seeking** FDI was important for 39% of respondents and this was to countries rich in oil and gas (with three major companies involved), and mining in mineral resource sectors (characterised by many smaller enterprises). **Efficiency-seeking** was less important for most Chinese multinationals, but will become more important over time as wages in China rise relative to transport costs.

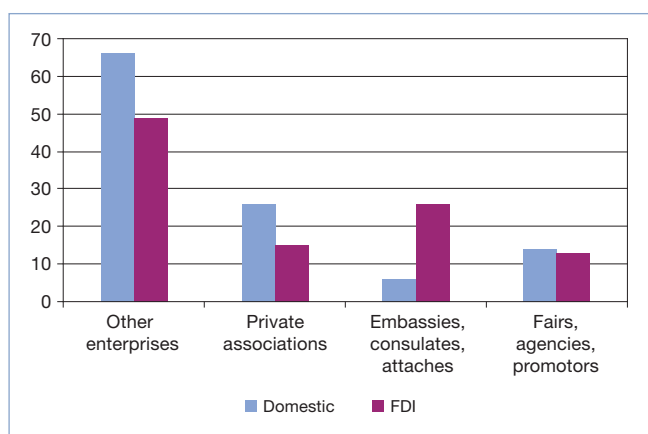
earlier findings see Bhinda et al). These findings are broadly consistent with other analysis of Chinese investment – see Box 5.

How do these findings compare with other studies? The international study which comes closest to asking the same types of questions is UNIDO's Africa Foreign Investor

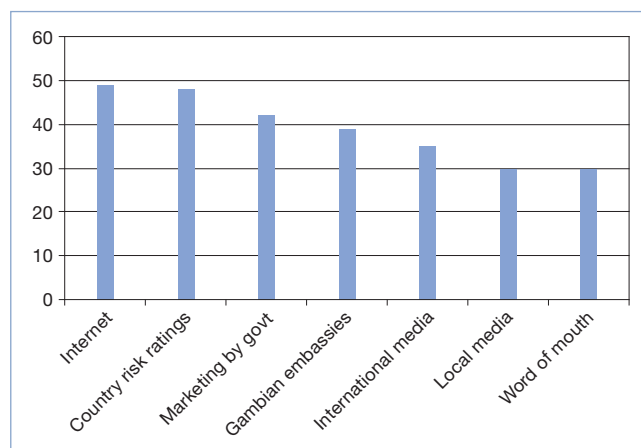
Survey (UNIDO 2007), which covered a much smaller number of investors in each of 15 African countries. It had the same top two factors – domestic political and economic stability, though in reverse order. Physical security (which was not asked about in the CBP survey) came 3rd, followed by access to markets, availability/low cost of skilled labour (which were respectively 5th and 3rd in our surveys), infrastructure and the legal framework. Incentives and acquisition of existing enterprises (M&A or privatisation) were much lower down the list. So broadly the same trends emerge with slight differences. In terms of individual countries, Burkina Faso and Senegal were the only two countries in both samples. Political and economic stability, market access and positive labour factors were shared by CBP and UNIDO surveys, while physical security emerged more strongly in UNIDO's Burkina survey and infrastructure in its Senegal survey.

Bolivia and The Gambia asked about information sources that led to the initial decision, and came up with rather different findings. In Bolivia's case, other enterprises and private associations were most important, reflecting the high degree of organisation of the private sector, with an umbrella body representing associations dedicated to particular economic sectors and regions. However, in The Gambia the internet dominated, especially for investors in tourism, real estate and finance. The host government's embassies overseas were important for foreign investors in both countries. Marketing by government (via fairs, promotion agencies etc) was also important in The Gambia.

**Chart 5.3 Bolivia: Information Sources Guiding Initial Decision to Invest (% , 2005)**



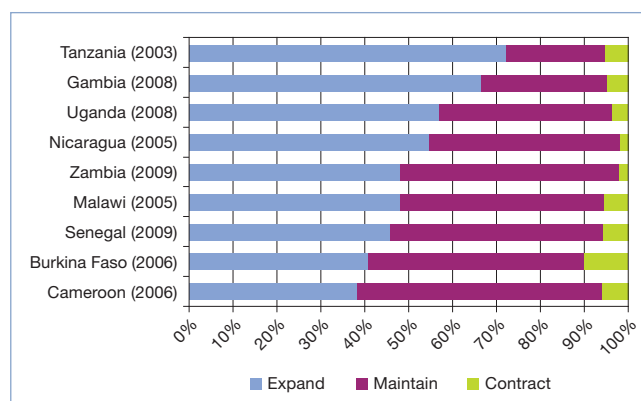
**Chart 5.4 Gambia: Information Sources Guiding Initial Decision to Invest (2009)**



## 5.2 FUTURE INVESTMENT AND OUTLOOK

When asked about their medium-term plans and outlook, on balance investors were very favourable, with the vast majority planning to expand or maintain their investments. Investors were especially optimistic in Tanzania, The Gambia, Uganda, and Nicaragua (with over 50% planning to expand). Only small minorities in each country planned to contract their investment. These positive findings were true even during late 2008 and early 2009, as the global economic crisis hit (when surveys were taking place in the Gambia, Senegal and Zambia), showing a high degree of resilience among investors.

**Chart 5.5 Future Investment Decisions**



However, country findings also show different trends among different groups. For example, in Bolivia, exporters were more inclined to expand future investment than non-exporters, implying higher potential for growth in international markets. Domestic investors were also more positive than foreign investors, some of whom were worried about expropriation.

## WHAT DRIVES INVESTMENT? INVESTOR PERCEPTIONS, INTENTIONS AND RESPONSIBILITY

The most important areas for expanding future investment were labour (staff training and recruitment of nationals), boosting technology, and diversification by product within the same economic sector. There were mixed prospects for diversification to new countries, within the country, and into new economic sectors. Least likely was the recruitment of expatriates: most planned to maintain levels, but many planned to scale back. Investors also mostly anticipated that profits and turnover would increase. Only Uganda and Ghana asked about gender balance in the workplace, and nearly half the respondents indicated the intention to improve upon this (for more details, see section 5.5).

Beyond this, investors had diverging priorities among countries, such as:

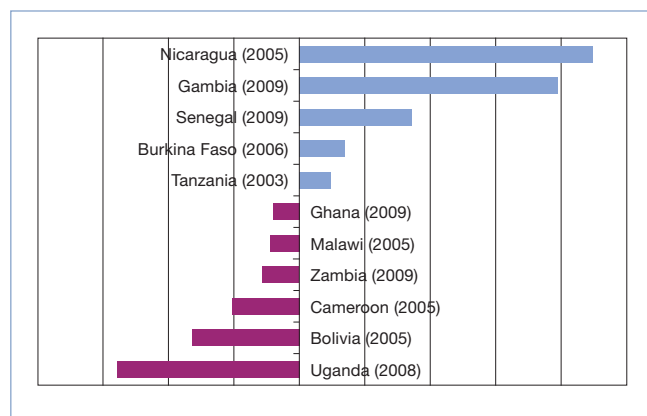
- Higher imported inputs in Burkina Faso and Senegal
- Product diversification in Cameroon, the Gambia, Ghana, Nicaragua, Senegal and Uganda
- Diversification into new sectors in Senegal and Zambia
- Investment in new regions of the country in the Gambia
- Establishment in or exports to regional countries bordering Cameroon, the Gambia, Malawi and Senegal
- Maintenance/upgrading of existing facilities in Ghana and Uganda

### 5.3 FACTORS AFFECTING CURRENT DECISIONS

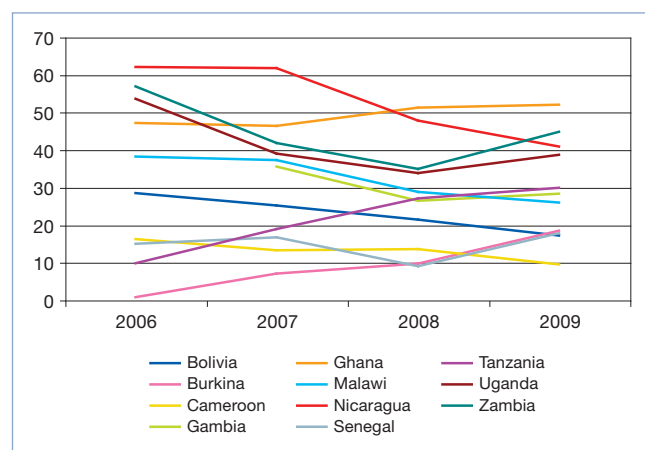
#### 5.3.1 CBP Overall Results

This section presents findings on factors affecting the current decision to invest. As can be seen below, the overall investment climate was judged to have had a positive influence on the decision to invest in Nicaragua, The Gambia, Senegal, Burkina Faso and Tanzania; but a negative impact in Uganda, Zambia, Bolivia, Cameroon, Ghana, and Malawi.

**Chart 5.6 Perception of Investment Climate**



**Chart 5.7 Doing Business: Ease of Doing Business**



These findings must be treated with some caution. The fact that Zambia and Ghana were rated negatively may partly reflect the impact of the unfolding economic crisis. However, this contrasts with positive ratings of The Gambia and Senegal, who conducted their surveys around the same time. Uganda's very negative preliminary results are surprising, given its recent progress, and may reflect a close focus on known investor concerns.

As a contrasting study of overall investment climate, Chart 5.7 presents weighted rankings for "ease of doing business"<sup>10</sup> in the same countries, using the World Bank "Doing Business" survey. Only Ghana, Burkina Faso and Tanzania saw their position improve relative to other countries: the Gambia, Nicaragua and Senegal notably did not. It is not surprising that the two assessments differ markedly for several reasons. The Doing Business survey has more focus on procedural and bureaucratic rather than policy and other broader issues; its samples are much more limited; and it focuses on non-resident investors whereas the CBP includes residents. At the level of individual factors constraining business, the Doing Business data also frequently disagree with CBP findings: for example, Doing Business suggests that getting credit is relatively less difficult in Malawi, and that tax is less of a problem in Malawi and Uganda than in other countries, whereas investors complained in CBP surveys more about low credit and high tax in these countries than in others.

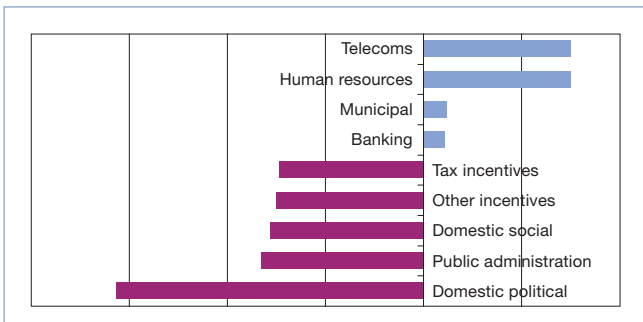
Looking in more detail, the charts on pages 56 and 57 present the top five most positive and negative factors for each country. Among the most important catalysts feature

<sup>10</sup> The "Ease of Doing Business" rank draws together 10 separate areas including: Starting a Business, Dealing with Construction Permits; Employing Workers; Registering a Property; Getting Credit; Protecting Investors; Paying Taxes; Trading Across Borders; Enforcing Contracts; and Closing a Business". Ranks were obtained from various reports available via <http://www.doingbusiness.org/>. To account for distortion caused by the varying number of countries covered each year (2006 = 155, 2007 = 175, 2008 = 178, 2009 = 181), we divided each country's Doing Business rank by the total number of countries, and multiplied this by 100, to give a consistent scale of 1 to 100. The result was then subtracted from 100, in order to more clearly show progress over time: a rising trend denotes an improvement in the rankings, and vice versa.

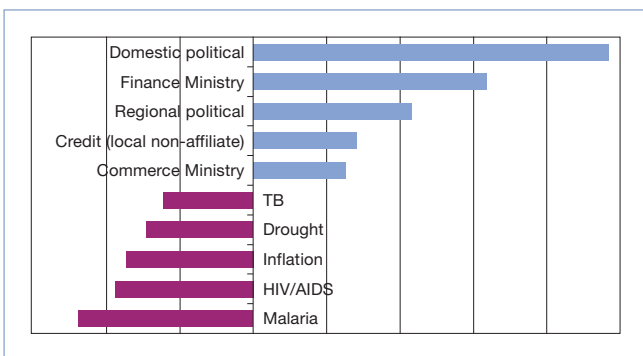


domestic market size or access (most countries); human resources, and domestic institutions (in six); banking services (in four), domestic political situation (in three), and domestic economy (in two). Among the most important constraints were electricity factors (in six countries), corruption, interest rates, and inflation (in five), tax-related issues (in four), diseases, and smuggling (in three).

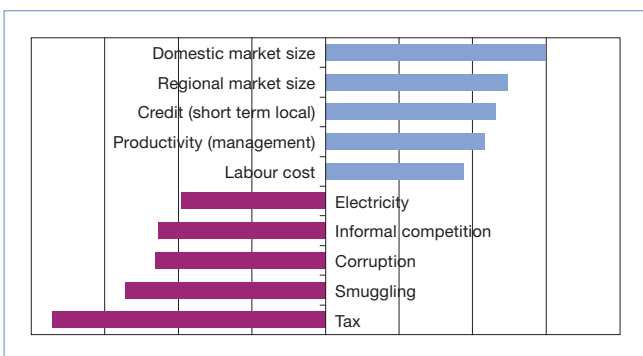
**Chart 5.8 Bolivia: Top Catalysts and Constraints**



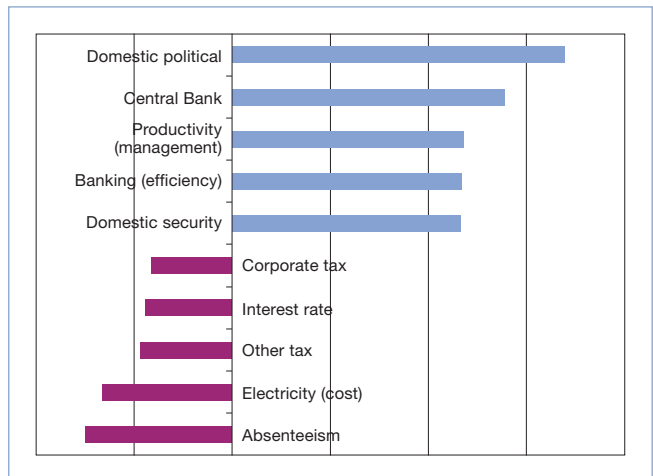
**Chart 5.9 Burkina: Top Catalysts and Constraints**



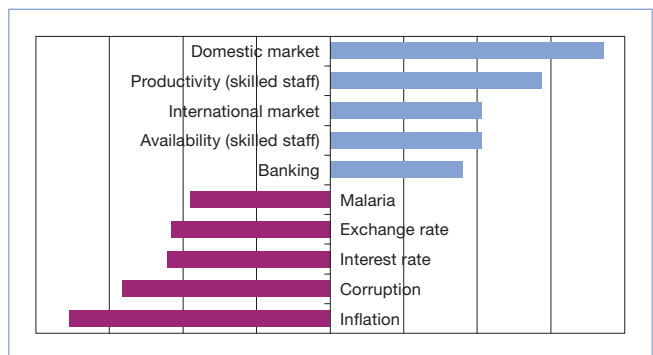
**Chart 5.10 Cameroon: Top Catalysts and Constraints**



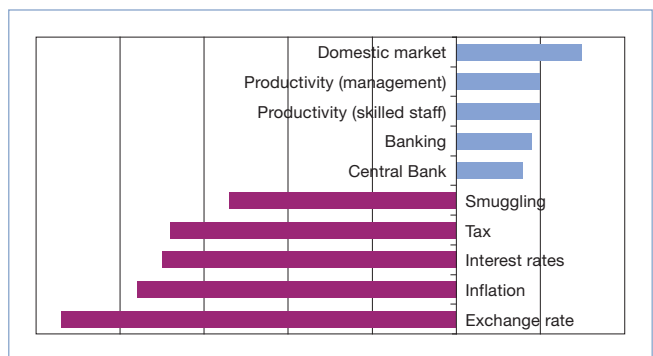
**Chart 5.11 Gambia: Top Catalysts and Constraints**



**Chart 5.12 Ghana: Top Catalysts and Constraints**

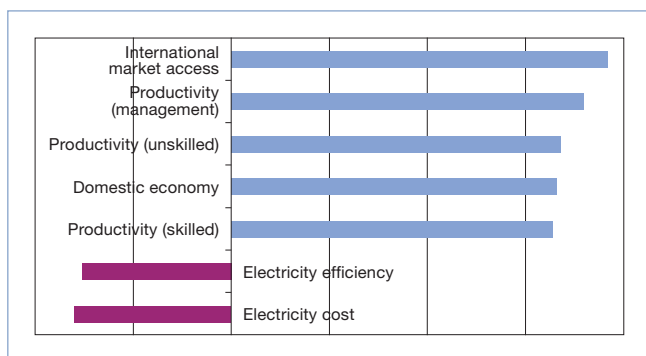


**Chart 5.13 Malawi: Top Catalysts and Constraints**

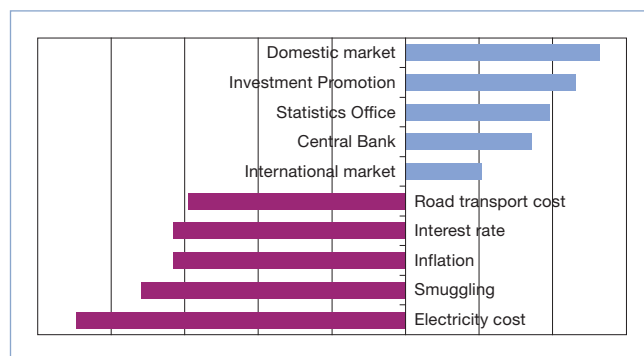


# WHAT DRIVES INVESTMENT? INVESTOR PERCEPTIONS, INTENTIONS AND RESPONSIBILITY

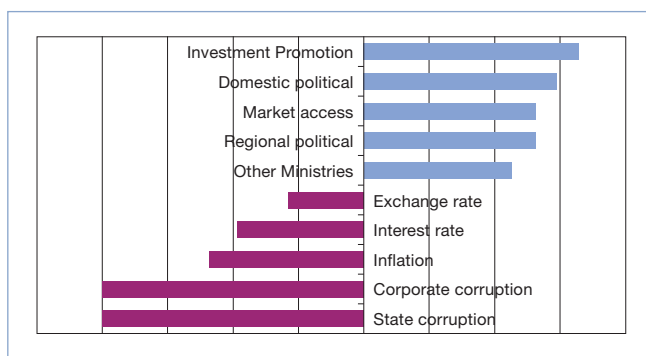
**Chart 5.14 Nicaragua: Top Catalysts and Constraints**



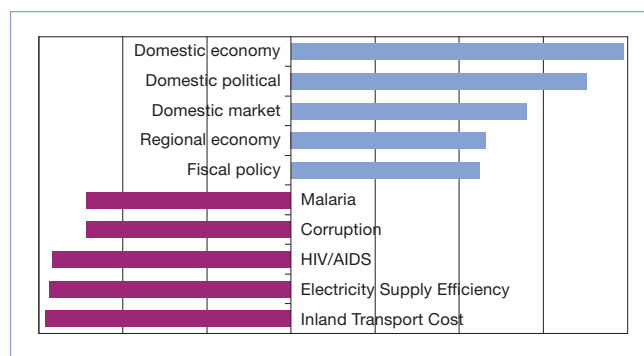
**Chart 5.17 Uganda: Top Catalysts and Constraints**



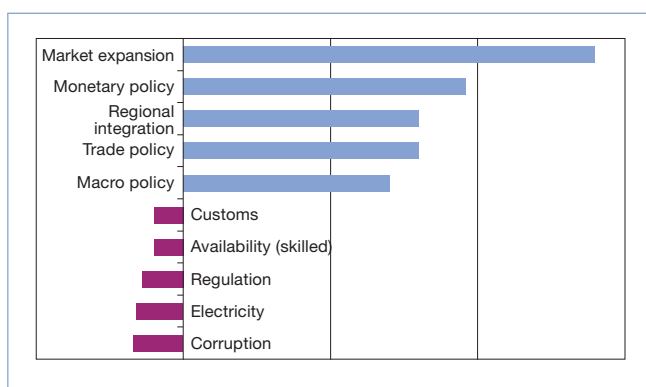
**Chart 5.15 Senegal: Top Catalysts and Constraints**



**Chart 5.18 Zambia: Top Catalysts and Constraints**



**Chart 5.16 Tanzania: Top Catalysts and Constraints**



## 5.3.2 Comparisons with Other Studies

A comparison of CBP country-specific findings with the WEF *Africa Competitiveness Report* (which also includes different results from World Bank Investment Climate Profiles) and *Global Competitiveness Report*, reaches many similar conclusions in terms of the 5 most problematic factors for investment (which are the focus of the WEF reports). Generally they concur that unreliable electricity, and high levels of corruption and tax were major problems in most countries, and political instability in a few. However, CBP findings stress far more the real economy and social factors such as labour, transport, health and environment-related issues, as well as in 2008 higher inflation levels and interest rates; and place much less emphasis on regulatory and bureaucratic problems.

**Table 5.1 Comparison of the Top 5 Constraints: WEF, World Bank, CBP**

Country	WEF Competitiveness Index	WB Investment Climate Profile	CBP
Bolivia	(2008) Policy instability Inflation Government instability Inefficient government bureaucracy Corruption	n/a	(2005) Domestic political Public administration Domestic social Other incentives Tax incentives
Burkina Faso	(2007-8) Corruption Access to financing Tax regulations Tax rates Inflation	(2006) Access to financing Electricity Tax rates Corruption Informal sector	(2006) Malaria HIV/AIDS Inflation Drought TB
Cameroon	(2007-8) Corruption Access to financing Tax regulations Tax rates Inefficient government bureaucracy	(2006) Tax rates Electricity Access to financing Informal sector Licensing and permits	(2005) Tax Smuggling Corruption Informal competition Electricity
Gambia	(2007-8) Access to financing Inadequately educated workforce Tax rates Inadequate supply of infrastructure Poor work ethic	(2006) Electricity Access to financing Tax rates Land access Informal sector	(2009p) Absenteeism Electricity (cost) Other tax Interest rate Corporate tax
Ghana	(2007-8) Access to financing Inadequate supply of infrastructure Inefficient government bureaucracy Poor work ethic Corruption	(2007) Electricity Access to financing Tax rates Access to land Informal sector	(2009) Inflation Corruption Interest rate Exchange rate Malaria
Malawi	(2007-8) Access to financing Inadequate supply of infrastructure Foreign currency regulations Tax rates Corruption	(2005) Access to financing Electricity Licensing and permits Tax rates Political instability	(2005) Exchange rate Inflation Interest rate Tax Smuggling
Nicaragua	(2008) Policy instability Corruption Inflation Inefficient government bureaucracy Inadequate supply of infrastructure	n/a	(2005) Electricity (cost) Electricity (efficiency)
Senegal	(2007-8) Access to financing Corruption Tax rates Tax regulations Inflation	(2007) Electricity Access to financing Access to land Informal sector Tax rates	(2009p) State corruption Corporate corruption Inflation Interest rate Exchange rate
Tanzania	(2007-8) Inadequate supply of infrastructure Inadequately educated workforce Corruption Access to financing Inefficient government bureaucracy	(2006) Electricity Access to financing Tax rates Transportation Access to land	(2003) Corruption Electricity Regulation Availability skilled staff Customs

# WHAT DRIVES INVESTMENT? INVESTOR PERCEPTIONS, INTENTIONS AND RESPONSIBILITY

**Table 5.1 (Continued)**

Country	WEF Competitiveness Index	WB Investment Climate Profile	CBP
Uganda	(2007-8) Access to financing Corruption Inadequate supply of infrastructure Tax rates Poor work ethic	(2006) Electricity Access to financing Access to land Informal sector Tax rates	(2008p) Electricity (cost) Smuggling Inflation Interest rate Road transport (cost)
Zambia	(2007-8) Access to financing Corruption Inadequate supply of infrastructure Tax rates Tax regulations	(2007) Tax rates Informal sector Access to financing Electricity Access to land	(2009p) Inland transport (cost) Electricity (efficiency) HIV/AIDS Corruption Malaria

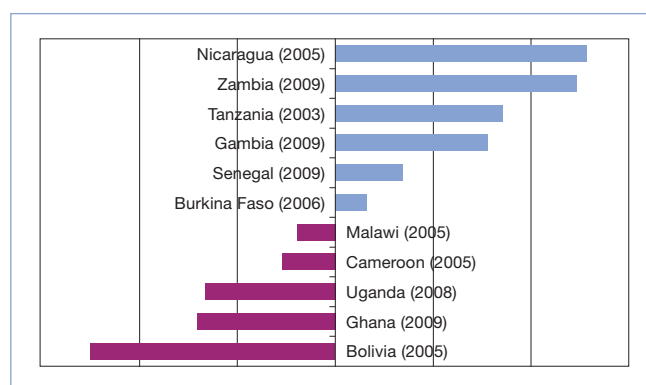
Sources: World Economic Forum *Global Competitiveness Report 2009-10* and *Africa Competitiveness Report 2009*

MIGA's *Enterprise Benchmarking Programme* instead highlights the positive factors driving investment. A comparison with CBP findings indicates that it identifies somewhat different factors, apart from skilled labour in Ghana (MIGA 2006). Again this is partly due to methodology, including a focus on enterprise establishment procedures, infrastructure and transportation, and omission of macroeconomic factors.

### 5.3.3 Economic and Financial Factors

Economic and financial factors were perceived to be having a strong positive effect in six countries, notably Nicaragua and Zambia, and a negative effect in 5 (especially Bolivia).

**Chart 5.19 Economic and Financial Factors**



### Economic factors

The domestic economic situation was perceived very positively in most countries, but negatively in Bolivia and Malawi. The regional economy was less strongly positive in most, but negative in Malawi (due to the impact of Zimbabwe). The global economy had a positive impact in Burkina Faso and Zambia, but negative in Malawi and Senegal (in the latter case reflecting the timing of the survey during the global crisis).

Trade factors were positive for the Gambia, Senegal and Tanzania, but caused problems via import competition and smuggling especially for Cameroon, Malawi and Uganda.

Foreign exchange liberalisation was viewed positively in the Gambia and Senegal, but negatively in Cameroon and Malawi. High inflation, high interest rates and a volatile or uncompetitive exchange rate had negative effects in Burkina, Cameroon, the Gambia, Malawi, Senegal, Tanzania and Uganda, partly reflecting high food and fuel prices. However, responsible monetary policy boosted investment in Nicaragua and Tanzania.

### Access to markets

Domestic market size was of great importance in Cameroon, The Gambia, Malawi, Senegal, Tanzania, Uganda and Zambia. Supplying international markets was also important in the Gambia and Nicaragua.

### Access to credit

Access to credit was conducive to investment for foreign investors in Burkina Faso, Cameroon, The Gambia and Malawi, and for local investors in Nicaragua, Senegal and Uganda. However, Malawi's domestic and Uganda's foreign investors lacked credit.

### Incentives and tax

High tax was among the most negative factors in Cameroon, The Gambia, Malawi, and Uganda, but lower tax was seen positively in Nicaragua, Tanzania and Zambia. Tax and non-tax incentives were generally also viewed negatively (because investors thought others were getting higher incentives!), except in Zambia where they were generous.

### 5.3.4 Political and Governance Factors

Political factors were perceived very positively in The Gambia and Burkina Faso, and very negatively in Bolivia and Uganda.

## BOX 6 – ARE PERCEPTIONS ACCURATE? INTEREST AND EXCHANGE RATES

Investors complained about high interest rates in Cameroon, the Gambia, Malawi, Tanzania and Uganda. As shown in the charts below, both spreads between lending and deposit rates, and real lending rates above inflation, were relatively high in 2003 (10% or higher), reflecting imperfect information, and high perceived risk compared to government debt. Reduction of non-performing loans, lower perceived risk and higher returns, and increased competition from new foreign-owned banks, did reduce spreads and real rates somewhat by considerably over time in many countries, but not by as much as hoped because new banks mostly financed blue-chip transnational corporations.

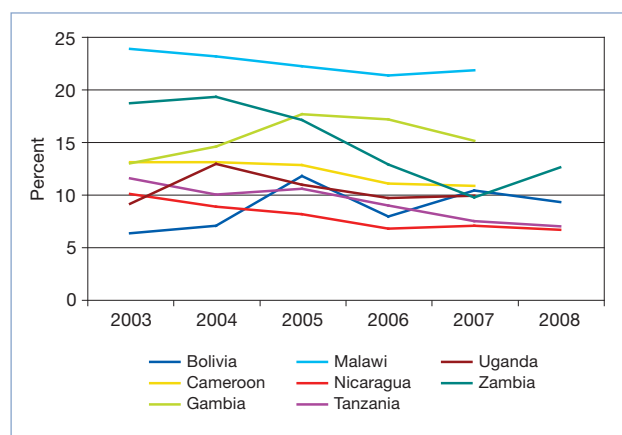
However, comparing among FPC CBP participating countries, both spreads and real rates were much lower in Tanzania and Uganda than in the other countries where they were a concern. Spreads and rates were also not significantly lower in Bolivia or Zambia, where interest rates were not as much of a concern to investors.

Interest rates also continued to be a worry even in countries where they had come down sharply.

Similarly, perceptions of volatile exchange rates also do not always tally with reality, typically showing a “hangover” effect of 1-2 years where volatility continues to be a concern well after stability has been restored. On the other hand, exporter concerns about overvalued exchange rates are usually borne out by recent prior trends in most countries. However, in countries where investors are mainly for the local market, and rely on imports, they prefer exchange rate appreciations as these reduce their import costs: so investor perceptions may not match government policy to maintain competitiveness.

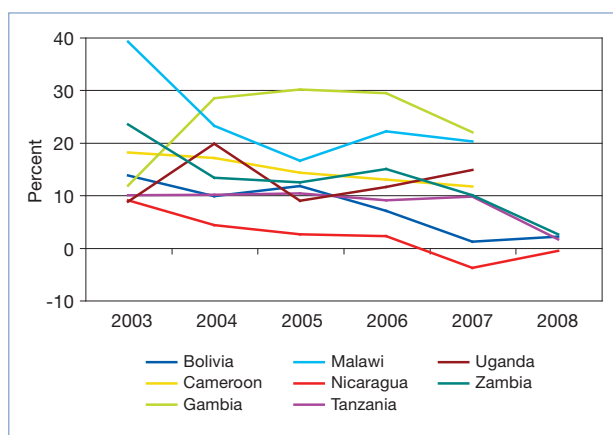
Overall, investor perceptions are not always an accurate reflection of economic conditions or a good guide to policy priorities: they always need to be analysed carefully and in detail, and compared with economic data, before making recommendations.

**Chart 5.20 Interest Rate Spreads**



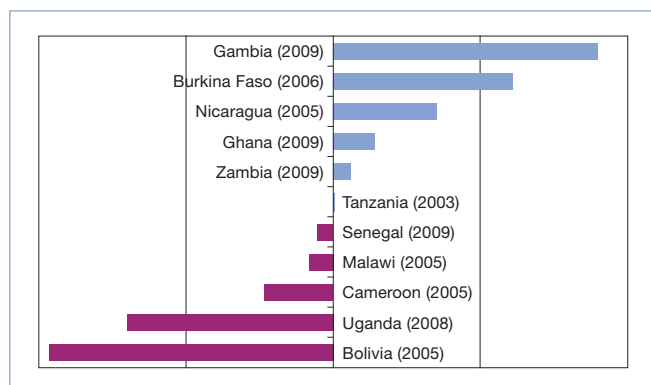
Sources: IMF IFS and WEO

**Chart 5.21 Real Interest Rates**



## WHAT DRIVES INVESTMENT? INVESTOR PERCEPTIONS, INTENTIONS AND RESPONSIBILITY

**Chart 5.22 Political Factors**



### Political stability

Domestic political stability was the most important factor driving investment, although regional political stability also featured prominently. Almost all countries saw a positive effect of stability, though Bolivia's instability was negative. Overall, except in Bolivia, these findings contrast markedly with assessments of potential future "political risk" (such as Control Risks and Lloyds 2009) from expropriation due to a "victim culture", or continual reviews of contracts to increase tax takes which are described as "creeping expropriation". There is little evidence of such a major trend in Africa, except to the degree that increased investment (including from non-OECD sources) offers stronger negotiating leverage to host governments and therefore leads to a more normal level of taxation which can contribute more to national development. Instead such analyses serve mainly to accentuate perceptions of high risk by investors and thereby to discourage investment or encourage rapid repatriation of earnings.

### Corruption

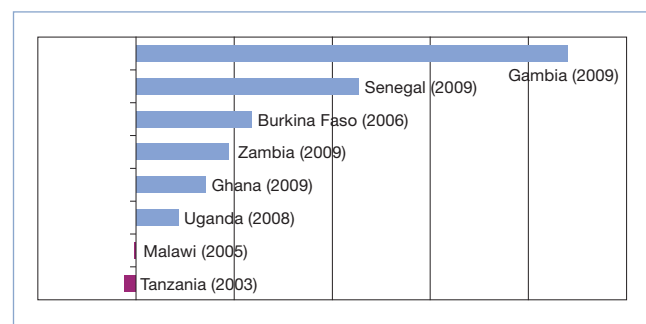
Corruption was viewed as the most negative political and governance factor in all countries. However, in contrast to some other surveys (such as Transparency International 2008) which focus largely on government corruption, corporate corruption emerged as equally important in most countries. This reflected both the lead role played by some corporations in corrupting government officials to win contracts from competitors, as well as bribery and fraud in dealings with other enterprises, as corporations exploit loopholes in international and national law.

### Institutional efficiency

As seen below, the speed and efficiency of agencies overall, in dealing with investors' affairs, was a positive factor in most countries, in particular The Gambia and Senegal. Central banks were seen in very positive terms; and tax offices, customs and infrastructure agencies (unsurprisingly) negatively. There were mixed views on the legal system (positive in Burkina Faso, Cameroon, The Gambia, Ghana and Senegal, but negative in Bolivia, Malawi, Tanzania and

Uganda). In several countries, domestic investors were more negative than foreign investors, because the latter benefitted more from "one-stop shops" – investment promotion agencies which helped them to deal with government.

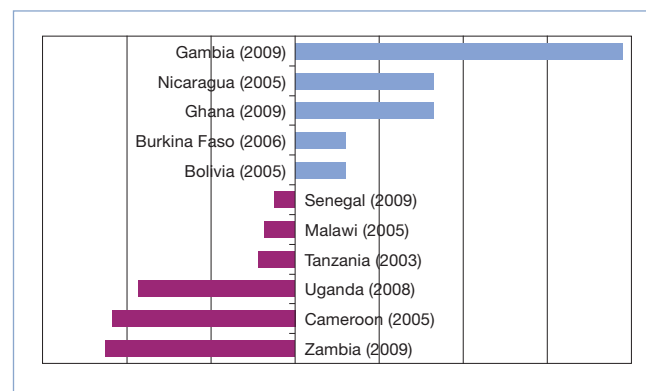
**Chart 5.23 Institutional Efficiency**



### 5.3.5 Infrastructure

Infrastructure is having a mixed impact on investment, notably positive in The Gambia, Nicaragua and Ghana, but more negative in Cameroon, Uganda and Zambia.

**Chart 5.24 Infrastructure Factors**



Several countries distinguished between the efficiency and cost of various types of infrastructure. The most positive factors included banking services (The Gambia, Malawi, Uganda, and Zambia) although their costs were perceived negatively in Malawi and Zambia. Telecoms were seen positively in many countries, thanks to more widespread access to mobile networks and the internet.

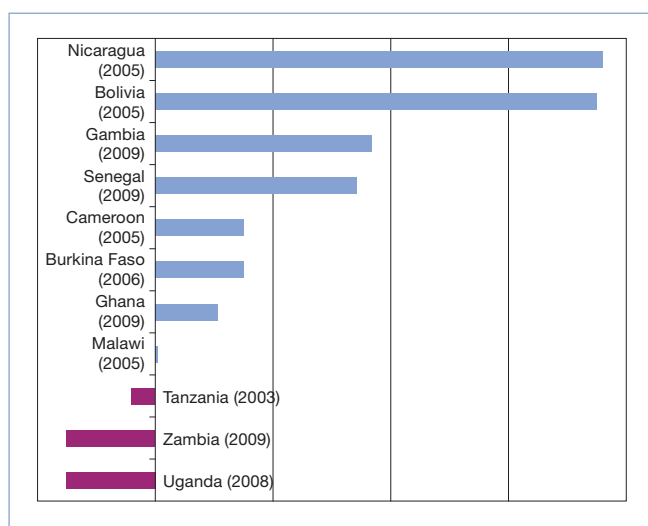
The most negative factor continued to be electricity (Cameroon, Malawi, Nicaragua, Uganda and Zambia), although in The Gambia, it was efficient and prohibitively expensive at the same time. This was followed by road transport (Bolivia, Cameroon, Malawi, Uganda), although positive in The Gambia (due to major recent developments) and Nicaragua. Views were mixed on water supply across countries. Bolivia's findings match a World Economic Forum study (World Economic Forum 2007) in which it had the highest "infrastructure gap" in Latin America, especially

on road transport. While UNCTAD-WAIPA has found that Investment promotion agencies in Africa have been focussing on promoting investment into infrastructure, notably electricity and telecoms, there is much more work to do, notably by promoting public and private investment in less dynamic sectors than telecoms (UNCTAD/WAIPA 2008).

### 5.3.6 Labour Factors

Human resource factors had a strong positive effect in Bolivia and Nicaragua, and were negative only in Tanzania, Uganda and Zambia.

**Chart 5.25 Labour Factors**



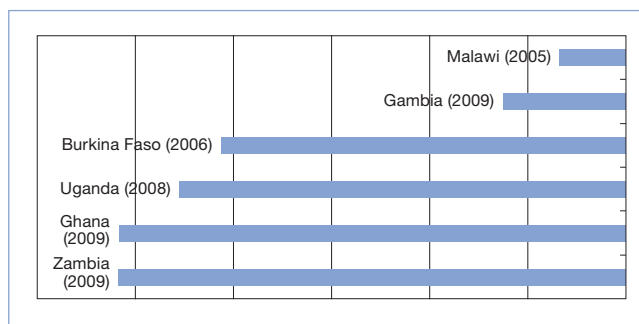
Productivity of management and skilled staff were the most positive factors, with productivity of unskilled labour more mixed (positive in The Gambia and Nicaragua, but negative in Cameroon, Malawi and Zambia). Absenteeism and turnover caused problems in all countries apart from Cameroon, and all countries encountered problems in recruiting expatriates. The relatively low cost of labour was a positive factor in Cameroon, The Gambia, Nicaragua, Senegal, and Uganda. The minimum wage was seen negatively by foreign investors in Malawi (though positively by domestic investors). Good supply of all types of labour was positive in The Gambia, Malawi and Senegal, but skilled staff were lacking in Tanzania, Uganda and Zambia, leading to high dependence on foreign managers. Though it features strongly in the World Bank Doing Business criteria, labour regulation was not raised as a major negative issue in any of the countries surveyed – strengthening the case made by the ILO, ICTU (Bakvis 2006) and CSOs for a more balanced view of labour-related factors.

### 5.3.7 Health Factors

Health factors were rated very negatively in seven of eight countries covering this issue. As shown below, this was especially pronounced in Zambia, Ghana, Uganda and

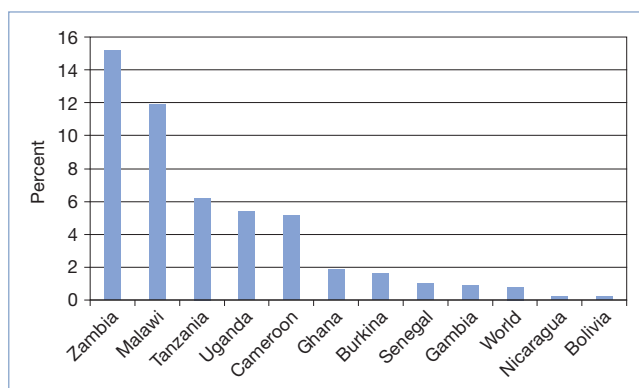
Burkina Faso, with Tanzania also finding a very negative impact from HIV and malaria.

**Chart 5.26 Health Factors**



All countries asked about the impact of more specific diseases. HIV/AIDS was rated very negatively in Malawi, Uganda, Zambia, Burkina Faso, and Tanzania. These findings are borne out by the prevalence rates for adults aged 15-49 for Zambia, Malawi, Tanzania and Uganda as shown in the chart below, but the high negative impact in Burkina was surprising given its relatively low prevalence. In Nicaragua, HIV/AIDS had a low impact, as reflected in one of the lowest prevalence rates.

**Chart 5.27 HIV/AIDS Prevalence Among Adults (2007)**



Source: Central Intelligence Agency

Tuberculosis was a major problem in The Gambia, Malawi, Uganda and Burkina Faso; and malaria in Malawi, Uganda, Zambia, and Burkina Faso – all in line with prevalence, and with the findings of WEF studies on the particularly pernicious impact of malaria on productivity because of the unpredictable recurrence of the disease. (World Economic Forum 2006).

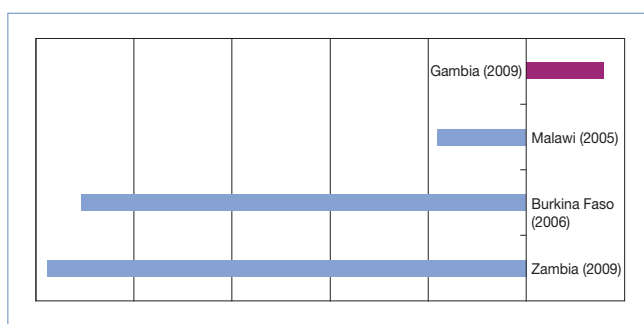
Health factors have been an under-estimated and little understood determinant of FDI, as found in a recent study looking at FDI to SSA during 2000-4. Once market size was accounted for, SSA's FDI shortfall compared to other regions was mainly explained by insufficient provision of public goods: relatively low human capital accumulation, in terms

of education and health in SSA. In the absence of HIV and malaria, net FDI inflows in the median SSA country could have been one-third higher (Azémar and Desbordes, 2009). These effects are worsened by the negative interaction of diseases: research has found that HIV-infected non-immune adults are at increased risk of severe malaria (Cohen et al, 2008), and that dual infection with HIV and malaria is helping to spread both diseases in SSA (Abu-Raddad et al, 2006). The negative influence of HIV/AIDS on human capital has a bearing on which African country an efficiency-seeking business will invest in (but not on the initial choice to invest in Africa). (Estelle Bierman, 2008). These complementary findings imply a high return on businesses' direct investment in promoting the health of their workforce and families, and advocacy and taxpaying support for wider public provision of health services.

### 5.3.8 Environmental Factors

Environmental factors were positive in The Gambia, but negative elsewhere. The positive result in The Gambia was mainly due to the beneficial impact of coastal reconstruction (which has helped to sustain the tourist industry) and the handling of other natural disasters. Nevertheless, there is an ongoing challenge of more widespread coastal reconstruction. Drought and floods had strong negative impacts in the other countries, reflecting also growing unpredictability in weather patterns due in part to climate change, and undermining agricultural and agroindustry sector investment in particular.

**Chart 5.28 Environmental Factors**



### 5.4 INFORMATION SOURCES

Several countries asked questions about the use of various information sources for decision making, some going into more detail to assess the level of awareness enterprises had of government information. Of the most detailed, Cameroon and Gambia found that over half the respondents were aware of each product listed (Burkina only 30-40%). Among the different sources of information, private sector associations were very useful in Bolivia, Burkina Faso, Cameroon, and The Gambia; the "internet" (including web-based versions of government agency publications) in Malawi and Uganda; and the central bank in Burkina Faso,

Cameroon, and Nicaragua. In general, if they were released rapidly, country reports from the FPC CBP ranked very highly.

### 5.5 CORPORATE RESPONSIBILITY

In spite of multiple global initiatives to promote corporate responsibility – related to social, environmental, labour, infrastructure, corruption and governance issues – most developing countries have no means of tracking what companies are doing to implement such initiatives. As a result, countries have been keen to capture this information for the first time, to assess enterprises' wider contributions to national development, so the FPC CBP has recently introduced responsibility questions into its surveys. However, some countries were reluctant to ask questions about responsibility issues in their early surveys, feeling that it might seem too intrusive and reduce response to the wider survey, so only 7 of the participating countries are piloting these new questions.

As shown for the examples of Bolivia, the Gambia and Nicaragua in the graphs on page 64, among the key findings were that virtually all enterprises have staff training programmes on which they are spending considerable sums, around two-thirds have programmes to recruit and promote nationals, but only around 35% have formal programmes to promote gender balance. Many others, while aware of the need and willing to promote more nationals into management and skilled positions, and to improve gender balance, do not have plans designed to reach these goals. Of those which have policies, only half are fully implementing them on promoting nationals, and only a quarter on gender balance. As a result, progress on gender equity and promoting nationals varies dramatically across different types of labour (management, skilled, unskilled) and countries. All countries participating in the FPC CBP had policy aims to promote representation in the labour force by women, and reduce dependence on expatriates. However, female participation continued to lag, averaging 30% but ranging from 25% in Ghana to 35% in the Gambia and Nicaragua. Expatriate dependence averaged only 4%, but ranged from 1% in Ghana to 8% in the Gambia.

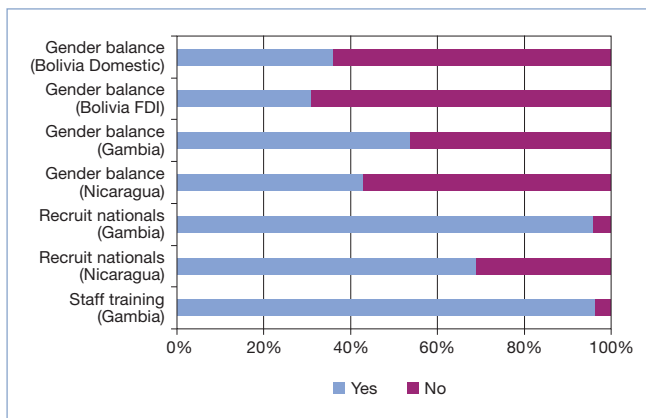
Looking at these findings in more detail, by level of the staff, Nicaragua had almost reached gender parity at management level, and Nicaragua and the Gambia for skilled labour, but The Gambia had some way to go on managers and Ghana on skilled labour. The main gender problem was at the unskilled level, though women were slightly better represented in The Gambia.

There was a strong dependence on expatriate managers in Zambia, The Gambia and Tanzania, and on expatriate skilled staff in Zambia (due to the mining industry), but unskilled staff were almost entirely nationals in all countries.



Did businesses perceive these imbalances correctly? The Gambia and Nicaragua asked about the perceived balance, and found that businesses were broadly correct in their assessment of gender imbalance, but had a tendency to underestimate their use of expatriate labour at management and skilled level. Enterprises therefore acknowledge that there is still a lot of work to be done in both areas.

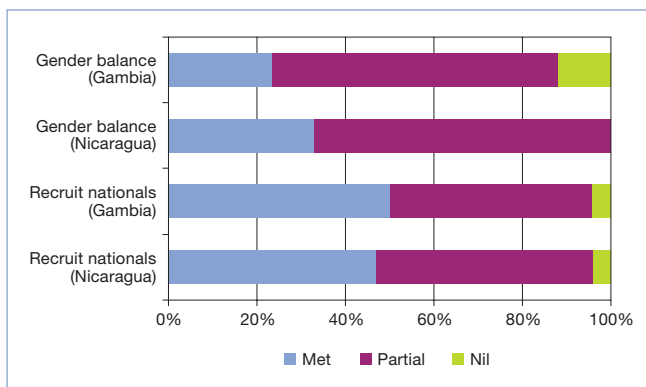
**Chart 5.29 Existence of Formal HR Policy**



costs, providing transport, water or mobile phones, and contributing to charitable initiatives and religious facilities. The relative importance of different types of spending varied dramatically across countries, with health dominant in Ghana and the Gambia, and environment in Zambia.

Domestic investors tend to do more on all these fronts than non-residents. More work is under way to explore the details of policies, the degree of implementation, and the levels of expenditure on corporate responsibility compared to turnover and profits.

**Chart 5.30 Progress towards HR Policy Targets**



The Gambia and Nicaragua also asked whether enterprises contributed to the communities in which they operate, through non-business spending. About half the respondents in both countries made such contributions to the development or maintenance of local infrastructure that did not directly benefit their business: this included roads, water and telecommunications. In addition, about 40% of enterprises in Ghana and the Gambia supported the health costs of their staff. In terms of the total spend health and welfare received the most money in Ghana, and the environment in Zambia.

The proportion of respondents with formal environmental protection policies varied from only 40% (Bolivia) to 80% (the Gambia). In addition, half of enterprises contributed to their staff or communities, by supporting health or education

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MONITORING FOREIGN  
PRIVATE CAPITAL:  
CURRENT BEST PRACTICES,  
FUTURE DEVELOPMENTS



# MONITORING FOREIGN PRIVATE CAPITAL: CURRENT BEST PRACTICES, FUTURE DEVELOPMENTS

## 6.1 CONTEXT

The Asian financial crisis of the 1990s led the international community to enhance efforts to help developing countries to monitor foreign private capital. They introduced demanding transparency standards, largely to ensure that the financial community had the best possible information on flows to and from countries and on a country's International Investment Position (IIP). The IMF was given the role of assessing compliance with these standards and making recommendations for improvement through diagnostic missions.

However, diagnostic missions have generally proven insufficient to change country practices, and (with the exception of the FPC CBP and a few long-term resident advisors or multiple missions organised by the IMF) in most cases the international community has failed to deliver the long-term capacity-building assistance needed to ensure that developing countries track FPC. There has been a virtual absence of assistance in analysing FPC behaviour, so as to make monitoring an effective tool for policy development. Countries participating in the FPC CBP have made significant progress in building enterprise surveys and other collection methods capturing capital stocks, flows, investor perceptions and expectations. Nevertheless, many developing countries are either not meeting global standards at all, or meeting them with data of doubtful quality; and virtually none are using detailed analysis for policy development.

The current financial crisis underlines once again that countries need to have timely and accurate data on capital flows, so as to track the impact of exogenous shocks on capital flows and design policy responses. However, obtaining accurate, timely data remains a challenge, and countries need to go further by developing early warning systems to help policy makers respond to foreign private capital shocks.

This chapter assesses the usefulness of the main international codes and standards in the light of the crisis, provides updates on lessons from current best practice in monitoring (institutional and legal arrangements, data collection methodology, data quality control), and discusses urgent needs for improvements, notably in developing early warning systems to help predict and deal with capital flows related shocks.

## 6.2 OVERVIEW OF CODES AND STANDARDS

Frameworks for monitoring capital flows-related data are presented in the IMF Balance of Payments and International Investment Position Manual 6th Edition, OECD Fourth Benchmark Definition of FDI, and IMF et al External Debt Guide for Compilers and Users. These explain the concepts and definitions, and present frameworks for how data should be presented.

Sources and methods of compilation and certain data quality aspects (coverage, periodicity, timeliness etc) are covered under the IMF Special Data Dissemination Standard, and General Data Dissemination System. Compliance of participating countries is assessed through a system of national Reports on the Observance of Standards and Codes, which use the Data Quality Assessment Framework. Countries are required to update their metadata on the IMF website. Harmonisation of methodology is further encouraged through the IMF Coordinated Direct and Portfolio Investment Surveys.

As has been discussed elsewhere, these provide useful frameworks, and enhance comparisons across countries and over time. Their authoritative nature in terms of concepts, definitions and standards is unquestionable, even though debates continue about the exact classification and definition of various flows and stocks.

The FPC CBP has helped many countries to meet international codes and standards. However, it has also found that many countries apparently meeting the GDDS and SDDS standards are actually submitting data which are of doubtful accuracy and therefore of less use to policymakers (or indeed investors). This is because surveys to collect data are inadequately designed or do not exist, private sector response rates and quality of data submitted in surveys are low, and non-survey mechanisms do not collect accurate data. FPC CBP work in 24 countries has identified dramatic changes needed in data monitoring and quality controlling systems, many of which have now been implemented, but assessments of a further 16 countries also indicate problems.

More importantly, it is doubtful that GDDS meets the needs of policymakers for timely monitoring of flows and stocks. Given the volatility of flows in the recent global crisis, monitoring data annually and submitting them 6 months after the end of the reference period is not timely enough for any accurate policy responses. Policymakers in GDDS countries have indicated that BoP data on FPC are of little use in tracking and responding to the impact of the global crisis, due to delay and insufficient detail. This implies a need for three additional responses: making greater efforts to move all countries to SDDS (quarterly monitoring); if necessary using more stringent sampling to make collection much more rapid; making much greater use of early warning systems on banking and investment project finance; and enhancing resources for building country capacity in analysis and design of policy responses.

## 6.3 LESSONS FROM CURRENT PRACTICE <sup>11</sup>

FPC CBP monitoring exercises in 24 countries, and assessments of 16 other countries, have produced several

<sup>11</sup> Bhinda and Martin 2006

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lessons for ensuring that data are as timely and accurate as possible using existing methodologies.

### 6.3.1 Institutional and Legal Arrangements

The main lesson is that successful monitoring requires the cooperation of all relevant national institutions. Exercises are mostly led by the central bank, which has technical expertise on balance of payments, financial resources to ensure sustainability of the exercises, and often (depending on the degree of capital account liberalisation) access to a wide range of non-survey sources. However, central banks often need to rely on statistics agencies' capacity to conduct surveys, and especially on the direct links with investors maintained by investment promotion agencies, line ministries and private sector chambers of commerce and associations, in order to ensure accurate registers of investors, maximum and timely responses, highest quality of data, and private sector-led input into government growth and development policy responses. This cooperation is particularly vital when surveys are first initiated, but needs to continue thereafter to maximise stakeholder participation in all exercises.

The best way to maximise inter-agency cooperation is through formal coordination structures. National task forces (NTFs) or balance of payments committees in countries have been highly successful in avoiding overlapping or duplicating surveys, sharing data so that analysis useful to all stakeholders can be conducted, and thereby promoting public-private sector dialogue – bringing major benefits to wider private sector and investment promotion exercises. However, it is important that such structures are kept focussed, with participation only by institutions essential to successful monitoring; and clear regularly updated terms of reference which define participating institutions' roles clearly and commit them to supply manpower, and financial or in-kind contributions to ensure the success of each cycle.

Most countries have surprisingly good statistical and central bank laws, which give participating institutions the legal powers they need to collect data and enforce compliance, as well as to guarantee confidentiality of data collected and penalise any disclosure. However, central banks often lack the legal mandate to collect data from non-banks, so their laws need to be broadened to cover non-banks: given that this takes time, countries often use other (eg statistics agency) acts in the interim period. Penalties for non-response should be used only as a last resort for companies which very publicly refuse to respond. Moral suasion has proved most effective in promoting timely, quality response to enterprise surveys; and use of penalties can have wider negative repercussions on public-private relations.

### 6.3.2 Data Collection

Collection needs to rely on both survey and non-survey sources. Surveys need to meet the latest international codes and standards (a surprising number, including some agreed

with the IMF, do not, partly because definitions and codes are constantly changing, and mission recommendations do not always keep up). They are expensive and time consuming, but essential in the absence of exchange controls (some would even argue that they are important to complement exchange controls, which often do not track flows very effectively due to evasion and poor enforcement).

To reduce costs and achieve more timely data, the FPC CBP has made extensive efforts to encourage countries to use other non-survey sources. However, it has found them inadequate – those related to foreign exchange transactions generally lack the necessary detail to make them useful for balance of payments or wider analytical purposes, and are limited to monitoring transactions passing through the local banking system (even though increasing proportions of FPC transactions take place offshore). Among other sources, financial statements have proved most useful as a back-up check for FPC survey results, but rarely conform to international standards or provide sufficient detail. Many investors do not prepare them – or do so with long lags.

One key issue has been the degree of detail and breadth of coverage of survey questions. While always covering the basics necessary for GDDS, this should otherwise depend on what a country needs for its analytical and policy work. For example on detail, surveys should cover loan-by-loan debt data only if private sector debt is large or growing/falling rapidly or held by the vast majority of enterprises: otherwise an aggregate debt data question can best be followed up by additional site visits with more detailed questionnaires, to companies with large amounts of debt. Similarly, in terms of coverage, summary filter questions on different types of stocks and flows (eg portfolio investors, pension funds, foreign exchange bureaux flows, derivatives) can be made more comprehensive as they grow in importance.

Another has been whether to include “non-balance of payments questions”. Here the results are conclusive: monitoring should not be reduced to a BoP data collection exercise (in spite of pressures to do this by international and national BoP experts). Especially in early years of surveys, questions such as those which interest enterprise chief executives and allow them to express their views on policy to government, are vital to enhance participation in the survey and develop public-private sector dialogue – typically increasing response rates by around 30%. So are questions which allow government to conduct deeper analysis and design better macroeconomic and investment promotion policy responses (such as questions on recipient sector/region and source country; and enterprise intentions, in order to predict possible future outflows or inflows). Ideally questions should also be included to track the “quality” of FPC in terms of contributions to employment, poverty reduction and tax revenue.

In addition, surveys should also be directed to resident enterprises and include questions on transactions between residents, to help identify opportunities for joint ventures, and see whether foreign investors are complementing or crowding out domestic investors – as well as tracking any difference between resident and non-resident views of policies, and intentions.

Finally, forms should be comprehensively tested with the private sector (including those less experienced with international transactions) and accompanied by clear explanatory notes. Enterprises often complain that survey forms are too long: though this can partly be remedied by more space-saving design of forms, in reality most enterprises are complaining about the technicality and incomprehensibility of forms and explanations designed by BoP experts. If forms are explained fully (often in person), and linked clearly to terminology company finance officers understand (such as financial statements), response rates and quality improve dramatically. Similarly, if analysis produced based on the forms is written in user-friendly ways which maximise its utility to stakeholders in government and the private sector, response rates will improve significantly in future years.

### 6.3.3 Data Quality Challenges

Data quality, relating to accuracy, coverage, frequency and timeliness, and dissemination are all essential and difficult aspects of successful monitoring. In many cases, including in OECD economies, many of these aspects are still falling short of global standards.

On **quality** issues:

- Many OECD and developing countries do not even try to collect **market value of FPC**. FPC CBP participating countries have made huge progress in collecting or estimating market value, putting them ahead of most OECD economies. However, they are still having problems collecting market value data for enterprises which are not listed on stock exchanges (the vast majority of enterprises in developing countries), indicating that in future NTFs will have to conduct estimations.
- **under-reported reinvested earnings and dividends, short-term debt and trade credits**. Here it is necessary to distinguish between enterprises wishing to avoid full declaration to any government agency (for tax avoidance purposes) which may apply in many cases to reinvested earnings and dividends; and enterprises misunderstanding terminology and considering that trade credits are not debt. The answer to the former is checking company financial statements, and to the latter is a better explanation of the definition of debt.
- **flexible loan terms**. This applies especially to intra-company loans, which often have undefined repayment periods and interest rates.
- **portfolio equity flows outside organised markets**.

- **portfolio debt held by non-residents**. Tracking these transactions is often extremely difficult as non-residents buy such debt through resident nominee banks or companies. Countries need to enhance efforts to track non-resident flows by enforcing reporting of residency among purchasers of such transactions.
- **incomplete external assets of residents**. Residents are often reluctant to declare fully the assets they hold externally, not least for fear of accusations of tax avoidance or capital flight. It is unlikely that FPC surveys will ever capture these assets adequately – so an accurate IIP and BoP will depend on exchanging reports with major recipient countries as well as cross-checking BIS and other international reports on deposits and FPC inflows.
- **remittances**. To classify remittances correctly in the balance of payments, it would be ideal to split them by their purpose – consumption or investment. However, existing foreign exchange transaction data collection mechanisms are highly unreliable in tracking this split, not least because those sending remittances are reluctant to declare small-scale investment in enterprises or construction for tax reasons. Much more detailed work is needed to track and analyse remittances to ensure that they are correctly classified in the balance of payments, in particular through household surveys, and even going beyond the excellent work by CEMLA/IADB in Latin America.

In terms of **frequency and timeliness**, most countries collect data annually, but aim for quarterly. However, with the exception of some relatively well-resourced central banks such as Bolivia and Trinidad, which have been strongly targeting quarterly collection for several years, there is little evidence that countries are progressing towards quarterly collection – even after collecting high quality annual data for several years. Countries need to review such progress regularly to ensure they are constantly aiming much higher than current practice (see also especially 6.4 on page 70). The current crisis should also teach major lessons on the types of flows which need to be monitored much more frequently (eg trade credits, remittances) and whether this should be done through survey or non-survey sources.

A key issue here is the trade-off between accuracy and timeliness. Many countries in recent years have stayed with annual collection because this is the maximum they can manage given low levels of BP staffing in their central banks or statistics agencies. However, as discussed in 6.3.4 and 6.3.6 on page 69, sampling and office estimation can overcome this trade-off and allow countries to achieve both goals.

Finally, there is a major problem with **dissemination**. Both national authorities and the IMF are very reluctant to accept data which disagree with earlier time series, requiring major negotiations and delays before revised data can be disseminated. While countries could be relied upon to resolve their own institutional conflicts, the IMF needs to

ensure that its institutional incentives are consistent, so that GDDS, BoP and country mission demands are fully consistent (instead of demanding respectively meeting standards, fulfilling quality, and maintaining time series).

#### 6.3.4 Survey Sample

A key aspect of surveys is deciding on the size of the survey sample. The larger the sample, the longer and more complicated the survey, with risks to the timeliness of the data; on the other hand, the smaller the sample, the larger the risk of unrepresentative data being published unless large amounts of time are spent on boosting sample results through office estimation.

Country experience indicates that it is initially essential to conduct censuses (surveying all enterprises which might have FPC transactions, ideally identified through filter questions in enterprise surveys) or large surveys (of the vast majority of such enterprises). This is because existing non-survey sources such as investment promotion agency (IPA) lists and company registers are highly unreliable. As a result, it is vital to survey all companies with significant turnover and FPC transactions, based on company turnover or VAT registers. If this is not done, and countries choose just to survey the top 100 enterprises reporting to the IPA (as has often been recommended by IMF or GDDS missions), they risk going forward with FPC monitoring based on unreliable company registers, which will produce very faulty and underestimated data.

To create a reliable register for initial surveys, it is vital to draw on the maximum number of sources. These include previous and other survey lists, as well as those held by government agencies, private sector associations, investment and trade partners, and embassies of potential source countries. In addition, the media, telephone directories and local knowledge can be helpful. Over time, countries narrow down useful sources as they identify the most reliable or representative ones, but it is nevertheless useful to keep contacts with all sources up to date.

Once a reliable basis for future surveys has been established, it can be updated by conducting a census or large survey once every 5 years. In the meantime, the key issue is how to construct a reliable sample of enterprises for interim surveys. The sample must represent enterprises with equity and non-equity assets and liabilities, and all significant sectors of economic activity, as well as other significant and changing factors such as source countries, in order to track major trends in dynamic sectors for promotion efforts, and analyse prospects for sector level sustainability. A 33% sample is recommended but a smaller sample may be feasible when a small number of enterprises dominate FPC amounts.

A smaller sample allows countries to increase the frequency of surveys (to quarterly from annual), nevertheless covering all significant enterprises. It is essential to move to such smaller samples as soon as results from the census or larger

survey are reliable, in order to be sure that results are timely to accelerate policy formulation. This step can reduce costs of each survey, but probably not overall annual workloads.

#### 6.3.5 Survey Administration

The private sector often distrusts the public sector (because it does not know how the data will be used, commonly fearing communication with the tax authorities or with competitors), does not want to receive too many surveys, wants to avoid excessively technical or complex questions, and has peak work periods (e.g. in compiling accounts) during which it does not wish to reply to surveys. As even OECD country experience shows, enterprises encounter technical problems in supplying data. It is therefore essential to guarantee confidentiality of responses, exclude tax departments from NTFs, make strong efforts to rationalise and combine surveys (including those by donors or private sector organisations), simplify questionnaires, and avoid peak company work periods – as well as maximising enterprise training on surveys.

Countries have addressed this in many ways (Strategies for Financing Development Newsletters 32-34), including through awareness creation, better explanation of legal mandate and sanctions supporting data confidentiality, enhanced fieldwork techniques, prioritising largest enterprises, consulting closely with private associations, joint administration with questions on investor perception, and use of non-survey data including financial statements where readily available.

#### 6.3.6 Data Validation, Extrapolation, Recording and Processing

Once raw data are collected, rigorous quality control is essential. Countries need first to edit and check returned forms by using in-office calculations, and where necessary to visit enterprises or return forms to check data. Complex strategies are needed to address non-response through follow-up of groups of enterprises or key individual enterprises. Once all avenues have been exhausted, office estimation (based on sector, size and source country behaviour, as well as non-survey sources) and extrapolation is needed to fill any non-response gaps, as well as to infer any data needed to transform samples into reliable economy-wide data for all enterprises. If there is any gap in the coverage of periods by surveys, intrapolation may also be needed.

Country and regional software systems have proven remarkably incapable of recording FPC data, or of producing adequate analytical reports. The FPC CBP has therefore developed specialised software in Microsoft Access, in consultation with participating countries, which is available in 4 languages, and easily adaptable by country programmers to the needs of each country. Drawing on FPC CBP best practice, several countries have developed their own software systems, and the MEFMI region is finalising development of its own FPC software known as the PCIS.

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Ultimately it is crucial that countries (and where possible regions in order to capitalise on economies of scale) should develop software systems which are adapted to their needs, and maintainable at national level rather than depending on external advice.

Countries continue to use the Commonwealth Secretariat CS-DRMS or UNCTAD DMFAS systems to record data for private sector external debt on a loan-by-loan basis. Further efforts are already underway to adapt the CS-DRMS system to the complexities of each country's private sector external debt, including trade credit and intra-company loans. Ultimately, it will be vital that both of these systems can easily produce analytical reports which can be used to assess national (public/private sector) debt sustainability.

## 6.4 FUTURE NEEDS: MOVING TO RAPID RESPONSE AND EARLY WARNING SYSTEMS

The current global crisis has exposed the need for developing countries to establish rapid response and early warning systems, to monitor recent developments and future potential FPC trends. Most countries have in place the building blocks to develop rapid response and early warning systems, but do not use them systematically. They include overall mechanisms as well as systems specific to different FPC types.

### 6.4.1 Overall Issues

The two most essential steps here are:

- **more frequent and timely collection of actual data.** All countries should move to quarterly data collection using smaller but representative samples.
- **use of forecasting questions.** Quarterly surveys should be used to test investor sentiment, going beyond asking whether investment will expand, maintain, or contract with respect to output, R&D, employment, regional presence; and asking questions about prospect for financing in more detail.

### 6.4.2 FDI

Investment promotion agencies need to enhance their efforts to collect information about prospects for financing major individual projects above a certain threshold. This includes tracking time horizons for existing and new projects; and whether there is any risk of disruption or non-realisation (e.g. non-approval of finance, dependence on a joint venture partner etc). Such questions should be disaggregated to cover different types of financing (especially equity and debt), as well as source countries.

Countries may additionally build sector level outlooks by: regularly interviewing major investors or chambers from each sector (if necessary, establishing contact with a foreign parent if the decision to invest is being made abroad), reviewing company annual reports and media cuttings on developments and prospects; and analysing time series

historical survey data on investment patterns (assessing volatility of flows by financing type, sector and source country to distinguish these from crisis effects).

### 6.4.3 Debt

Debt flows are among the most volatile especially in times of crisis. Countries collecting only aggregate data (and where enterprises are highly dependent on debt finance) need to move to loan-by-loan reporting, enabling forecasting based on repayment schedules, as well as risk assessment based on currency, variable interest rates, guarantee status and debt to equity ratios. High risk sectors, types of (especially trade-related) flows and major companies need to be monitored more closely. This raises the following challenges:

- Establishing likely repayment profiles for borrowing between related companies;
- Quarterly and more reliable monitoring of short-term and trade-related debt;
- Analysis of debt which includes amounts owed to residents.

### 6.4.4 Portfolio Flows

These flows have proven among the most difficult to track. Nevertheless, countries need to enhance and accelerate collection of data and intentions on equity and debt flows from primary sources such as stock and bond exchanges, as well as liaising more closely with international sponsors of such flows (stock and bond dealers, especially emerging market fund managers).

### 6.4.5 Remittances

Remittances are especially sensitive to global crises and downturns in source economies. Recent studies indicate that a significant share of total flows is motivated by investment, and therefore should be analysed along with FPC. However, there are no mechanisms (apart from bureaux and bank transaction tracking systems) to analyse trends in such flows and their objectives (investment or consumption). Linkages need to be strengthened between various international, regional and national initiatives, and on a national level between central bank initiatives for monitoring remittances and capital flows, to obtain better estimates obtained on the purpose of flows. All surveys especially those conducted more frequently) need to include forecasts of future flows.

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## CONCLUSIONS AND RECOMMENDATIONS



# CONCLUSIONS AND RECOMMENDATIONS

The analysis from countries participating in the Foreign Private Capital Capacity Building Programme has fascinating implications for global and national policy. These can be grouped into 7 areas.

## 1) Increasing and Stabilising Flows: Implications of the Crisis

In recent years, many low-income countries have been preoccupied with reacting to rapid rises in non-resident foreign private capital flows, especially FDI. LICs knew these booms were happening, and their policy implications were assessed in Bhinda et al (1999). This rise was reaching many of the poorest countries, and flows were coming from a much wider group of source (especially non-OECD) countries, and going to a much wider range of host sectors.

In the meantime, global policy, starting from an incorrect premise that LICs were receiving very little foreign private capital, continued to stress the need to promote it virtually regardless of its development impact. It was only in around 2005 that global analysis began to highlight the increase in flows to LICs, with a resulting increased concern about natural resources, tax payments and corporate responsibility.

At the same time, LICs were worrying about potential instability of the flows. LIC governments spotted signs of volatility (especially in loan flows) well before the global financial crisis. Many were also subject to dramatic reversals of flows, often reflecting external sector- or investor-specific factors rather than host country policies or circumstances. Yet it took a global financial crisis before the international community began to worry about the impact of instability of foreign private capital.

This important lag in international policy discussions, compared to LIC experiences, has two main implications. LICs need to enhance their efforts to monitor and analyse FPC so as to be able to make policies more accurately. They also need to enhance their efforts to disseminate the results of their analysis, and the international community needs to listen much more closely to those results, in order to design a global financial architecture which is better able to protect them against booms and busts in private capital flows.

Even more fundamentally, LICs and those official organisations supporting them need to focus on increasing domestically-funded gross fixed capital formation, to reduce the dependence of the poorest countries on externally-funded investment. However, targeting this goal is becoming more complex because FPC to many countries is now becoming heavily involved in almost all sectors: going well beyond its former concentration in commodities to cover tourism, finance, manufacturing, real estate, construction and even infrastructure, agroindustry and agriculture. This makes it all the more vital to target incentives, so that FDI investors are encouraged to create joint ventures, and backward and forward linkages to local inputs and value-added processes,

so that stronger transfer of technology and employment creation provides a better basis for crowding in domestic private investment rather than crowding it out.

## 2) Changing the Composition of the Flows and Making All the More Stable

In particular, there needs to be much more attention to the composition of the finance LICs are receiving. "Equity" investors have relied heavily on loan financing contracted overseas, also used in boom periods to fund overpriced mergers and acquisitions. This makes LICs much more vulnerable to volatility (because debt is the most volatile type of flow) and to potential debt crises provoked by the private sector (given that in most LICs this debt is between 33% and 75% of public sector debt levels).

The international community and national authorities need to make greater efforts to encourage higher proportions of genuine fresh equity investments, where necessary using more effective cofinancing and guarantees. They also need to monitor the loan-by-loan cost of such debt, as well as its forecast maturity profiles, debt-equity ratios, future foreign exchange and balance of payments sustainability impact, and potential risk exposures from interest rates, exchange rates and refinancing needs. If there is any risk of foreign exchange shortage (using private sector debt to reserves levels as a check), they should begin to set threshold levels for private sector debt and discourage excessively leveraged projects.

Monitoring and analysis should also take place at sectoral and even enterprise levels (as well as for the overall economy), because excessive leverage at sectoral and enterprise levels have frequently caused debt problems which, if large enough, can cause crises for the whole national economy (Anglo-American in Zambia, Ashanti Gold in Ghana). Governments and international organisations could request more information *ex ante* (when approving projects) on financing composition, or make assumptions based on behaviour by investors in similar projects or from the same source countries, and use these to forecast future trends. They could also reduce debt costs by providing cofinancing, by enhancing the negotiating capacity of investors with potential financiers, and by providing more information on comparable deals (average sectoral interest rates and maturities, source banks) to support investors in such negotiations. Finally, they could reduce debt dependence by encouraging diversification to less debt-dependent sectors (ie especially beyond minerals and oil).

Sharp reversals of portfolio flows in times of national or global crisis have underlined earlier lessons about high volatility, but this time spreading contagion further because more small countries have established illiquid stock markets, and allowed or encouraged foreign investors to buy government bonds and treasury bills. There are many lessons from emerging markets on how to use taxes and other incentives to encourage more stability in these flows,

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which LICs need to apply. It may also be time to review the trend for encouraging every country to have its own stock market, given that they can be major transmitters of volatility (and also sharply reduce estimated market value of equity held by companies which are not listed on them), and instead focus on promoting regional markets until private sectors are stronger and would allow national markets to have more listings and be more liquid.

However, it cannot be assumed that direct equity is more stable than loans or portfolio flows. Another early warning sign has been the very high level of repatriation of capital and earnings before the crisis, potentially causing problems for the balance of payments if new flows slowed. The crisis produced sharp increases in repatriation of earnings and reversals of intracompany loan flows, showing that countries and the international community need to invest much more time in analysing the details of equity flows and how to stabilise them. They also need to track sustainability of FPC in net terms, not just (as has been common practice until recently) projecting a percentage growth rate for gross FPC increases. This implies investigating more closely which policy measures (both internationally and nationally) are most likely to reduce the very high perceptions of risk and therefore rates of repatriation demanded by FPC investors, as well as reducing scope for unfettered offshore tax evasion through havens, which is sometimes hidden within repatriation.

Equally, some low-income countries have extremely large private sector financial assets held overseas, owned by enterprises and individuals, leading in some cases to positive International Investment Positions – and in most LICs they have been growing rapidly in recent years. The crisis has led to sharp falls in their value and emphasised that holding assets overseas is no guarantee of protection against volatility. Although most of these assets are not used as a basis for repatriating funds into their source LICs (ie they are held virtually permanently overseas), more analysis needs to be done of the interaction between foreign asset holdings and source country growth – and how to encourage more retention of resident capital in the source country – as well as of course discouraging illicit capital exports and flight.

### **3) Accelerating Diversification of Sources and Destinations**

There has until recently been a major mismatch between where most LICs do their investment promotion (largely in OECD countries) and where investment is increasingly being sourced (largely in non-OECD countries, especially from within the same region). Some LICs have been diversifying their promotion efforts to capture these new sources, but others need to make much stronger efforts, and international institutions need to encourage this rather than focussing on the OECD.

In part, overconcentration on OECD sources may have reflected a perception that OECD investment is higher quality, in terms of its contribution to growth or its social and environmental responsibility. However, the country analysis provides evidence that South-South investment is less volatile than North-South, and has been especially resilient during the global crisis, partly because it is less dependent on debt financing. It also does not indicate any systematic difference in sectors of investment (non-OECD investors being equally if not more likely to invest in non-resource based sectors, and to target markets and efficiency as well as resources), tax payments, employment levels, technology transfer or aspects of corporate responsibility. Nevertheless, more analysis is needed across multiple countries of the relative behaviour of investors from different source countries.

The growth of offshore tax havens as sources for investment (and destinations for repatriated earnings) is a worrying trend. It implies that LICs are becoming increasingly connected to such havens, and underlines the need to crack down more systematically on tax havens, oblige them to report on individual enterprise assets, and assist LIC authorities in pursuing tax evasion claims.

Another weak link in many investment promotion agencies is that they focus on discussions with what look like equity investors – ie enterprises – rather than other sources of finance such as lenders of debt, or fund managers who place money in portfolio assets. This is changing as more LICs get credit ratings, issue international bonds and become aware that foreign private capital is going into their stock markets and domestically-issued government bonds and bills. LIC authorities are having to engage with these investors and respond to their concerns, but it is not clear that this is being done systematically or representatively. To the degree that these financiers are based offshore, there is a need to survey them separately and assess the implications for government policy and potential impact on composition and cost of financing.

In terms of sectors, the analysis shows that common perceptions that low-income countries receive largely natural resource-seeking investment are incorrect. There has been major diversification into the manufacturing, financial, tourism, real estate and construction, and even agro-processing and agricultural sectors. This opens up much wider opportunities for investment promotion, and for analysing why some countries are achieving more sectoral diversification than others.

Nevertheless, some sectors remain largely “orphans” – notably agriculture until recent efforts at land cultivation by farmers from other developing countries, to produce crops for source and host country markets. In addition, most guarantees and cofinancing provided by international organisations and donors go to the highest return sectors, and portfolio investment is concentrated in a few sectors

due to lack of listing on stock exchanges – exacerbating the perception that FPC is not coming to other sectors. Much more effort needs to be made to diversify the sectors benefiting from international support, and to promote over-the-counter and other less formal stock dealings to attract international portfolio investment. One reason for investing in sectors such as manufacturing and agriculture, which tend to rely more on regional or domestic demand, is that such demand is more resilient in the face of global crisis – and this logic should be communicated more to FPC investors.

On the other hand, special efforts are needed to diversify recipient regions within countries. Many investment promotion policies take little notice of the analyses in national development or poverty reduction strategies which target poorer regions for accelerated development to reduce inequality, and could focus on this in designing incentive policies. However, more fundamental change will be achieved by focusing on the resources those areas have and promoting investment into related sectors (eg agriculture) as well as by investing in missing infrastructure.

#### 4) Keeping Up with Changing Dynamic Sectors

The analysis in this book also shows that host countries need to be very nimble in targeting dynamic sectors for foreign private capital investment to avoid being hit by rapid changes provoked by global trends (including those in particular sectors), or by gradual reductions in dynamism due to overconcentration of investors and saturation of markets. Without such fast-footedness, they can easily find themselves promoting the wrong sectors in the wrong source countries to the wrong types of financiers. At the same time, they need to have a clear long-term policy for sectors of concentration for future economic growth – so this implies that their policy needs to be dynamic, flexible and frequently updated.

Targeting dynamic sectors is also particularly problematic because the sheer pace of their development may make them less inclined to maximise benefits to recipient country economies (especially if they are being offered additional incentives) such as tax revenues, technology transfer and skills development. This balancing act calls for very nuanced tax and other incentive policies, to promote technology and skills. It also indicates that any policy for sectors of concentration should take into account the degree to which particular sectors have been seen in other countries to pay taxes, transfer skills and technology, and create forward and backward linkages, and not just the possibilities for expanding foreign private capital flows.

Another factor which might be taken into account in designing promotion policies, is the degree to which investors are transparent and decentralised in making decisions. Some sectors (such as tourism, real estate and mining) often have very complex corporate structures (involving holding companies and powerful head offices),

complicating both analysis of FPC, and policy dialogue to stabilise flows.

The global crisis has also particularly highlighted the need to protect infrastructure projects against volatility, because they are vital for long-term growth. Growing recent reliance on private sector financing for infrastructure in LICs, has led to an urgent need during the global crisis to “rescue” infrastructure projects which have seen their financing stalled or abandoned. This implies that there should be more caution in future about private sector provision where this is funded by loans or expensive public-private partnership arrangements, which might be vulnerable to future crises – and more analysis of potential risks to projects from global volatility.

#### 5) Talking to Investors about Policy Responses to Perceptions

The analysis of factors motivating investors, their perceptions of government policy and other factors impacting positively or negatively on their prospects, and their spending on corporate responsibility, all indicates a need for increased dialogue with the private sector about its perceptions and the impact of its investment on overall national development.

As we found in our earlier analysis (Bhinda et al 1999), the “investment climate”, as often defined internationally in the sense of legal and regulatory frameworks and tax incentives, is less fundamental than other factors, in decisions by those enterprises which do invest in LICs. To take a few examples:

- economic growth to increase market size, and policy stability (ie a stable exchange rate and inflation level) are more important than “stabilisation” (very low inflation) or “competitiveness” (a low real exchange rate, which encourages only exporters), implying important changes in the focus of economic policy
- labour productivity, cost and availability are more vital than liberal labour laws, as also underlined by enterprises’ strong focus on reinvesting in training.
- investment incentives are important only when used selectively, ensuring a level playing field for foreign and local investors, and targeting them to sectors or regions with the greatest potential for development impact.
- corporate corruption and fraud needs to receive as much attention as government corruption. This implies tightening up OECD conventions and individual country laws, extending the Extractive Industries Transparency Initiative to other sectors and industries, and enhancing enforcement of all such initiatives.
- infrastructure – especially availability and cost of energy, non-road transport and water – is a constant top complaint and requires far more investment.
- health and education expenditure are seen not only as basic social services, but also as major contributions to productivity (by reducing absenteeism and turnover) and

improving human resources. The MDGs are therefore fundamental to growth.

- environmental issues (including climate change effects on coastal erosion, drought and floods) are rising rapidly up the list, and adaptation spending needs to be increased rapidly.

Two other characteristics need to be taken into account in designing future surveys. First, different types of investors (exporters, resource/asset/market/efficiency-seekers, primary/secondary/tertiary sectors), residents and non-residents, potential and actual investors, larger and smaller enterprises, and investors from different source countries have very varying motivations and perceptions. So surveys need to include all these different groups and analyse their views in a disaggregated way. Second, perceptions can change dramatically both in their direction (especially moving from positive to negative) and in the relative importance of various factors, especially in light of economic crisis and related media coverage. For example, in many countries in 2007-08, inflation rose up the list of concerns far faster than warranted by events, because of blanket coverage of food and natural resource price increases. This highlights the need for government to conduct very regular surveys and respond rapidly with dialogue to reduce private sector worries.

These findings also have important implications for the way the international community assesses the prospects for doing business in LICs. They suggest a need for fundamental change in the assessment methodologies of the World Bank (Doing Business) as well as credit rating agencies in such areas as labour and tax policy, as well as the relative importance given to growth outcomes, human capital, physical infrastructure and environmental policy. The wide variations in factors investors perceive as vital in different countries also imply that any global index should be questioned for its relevance to individual country circumstances.

However, perceptions should not always lead to knee-jerk policy changes, for two main reasons. First, investors may be wrong or ill-informed: for example, they will always complain about tax levels even when these are lower than in other countries or have recently been reduced. Second, non-resident investors are only one of many stakeholder groups, and their perceptions should not necessarily predominate in making policy: for example, maintaining reasonable minimum wage levels may be important to political stability and poverty reduction (as well as even to enhancing productivity and will by workers to enhance their skills).

Instead, government needs to have a dialogue – especially with those enterprises which have shown themselves willing to take risk – about whether their perceptions are justified. To inform this dialogue, governments need dramatically to improve the usefulness (and user-friendliness) of government

information sources, as well as working with private sector associations to explain policy better to their members.

### 6) Enhancing the Development Impact of Foreign Private Capital

Most essential is improving the ability of host governments and civil society organisations to maximise the positive impact of foreign private capital on development.

This implies enhanced efforts to promote investor corporate responsibility. Responsibility needs to move beyond signing global declarations and issuing broad policy statements, to paying taxes, and undertaking spending on human resources, environmental protection, financing services and infrastructure – integrating taxpaying and spending into their overall corporate policy. The most aware businesses know they can get high returns by supporting public provision, and investing for themselves in health, education, the environment and infrastructure: others need more convincing by sharing best practices and results in areas such as:

- working with government and NGOs to promote awareness, preventive measures and health care for employees, families and wider communities, and encouraging contractors or suppliers to do likewise (see also Nelson 2006).
- promoting greater gender balance in the labour force and more skilled employment for nationals.
- investing in low-carbon energy sources and promoting free or low-cost transfer of these technologies throughout their supply chains.

However, it also means maximising efforts to ensure that FPC bolsters low domestic savings or weak financial intermediation, and realises positive “spillovers” via technology transfer, enterprise development, international trade integration, enhanced competition, and human capital formation. To ensure that this is done in ways which do not crowd out local firms, governments need to invest much more in ensuring local firms have the ability and motivation to invest in absorbing foreign technologies and skills (see also Blomstrom and Kokko 2003).

This also means that IPAs need to look beyond the quantity of FDI they generate, by being given an incentive through more qualitative targets for job creation, exports, budget revenue or technology transfer in their institutional results frameworks and work programmes; as well as sufficient resources to conduct cost-benefit analysis of projects and tailor any incentives to promoting their qualitative goals. The international community could also help by giving more weight to qualitative aspects and contributions to national development goals when assessing IPA efficiency.

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## 7) Enhancing Investment in Building Country Policymaking Capacity

Finally, and most importantly, low-income countries need to be better equipped to monitor and analyse private capital flows, and make policy to achieve the goals described above. Some have come a long way in recent years in introducing reliable annual enterprise surveys which allow them to produce more accurate data on trends. However, they often face problems convincing the IMF to accept these data and to use them as the basis for better forecasts – partly because improving capital flow data generally raises major problems with accuracy of import data.

Very many countries are still not monitoring or analysing flows well (not just LICs but also middle-income countries, which is why the next phase of the FPC CBP will increasingly be working with MICs). In part this reflects excessive concern at the global level with meeting GDDS and SDDS standards for timeliness and comprehensiveness, leading many countries to publish data which they know to be of poor quality. Yet most of the assistance available to countries diagnoses problems and recommends technical solutions. It does not take enough account of the political and institutional constraints to good monitoring. It was surprising at the start of the FPC CBP in 2002 that medium-term capacity-building assistance to countries, to overcome these institutional issues, was mostly not available from other sources: and the FPC CBP has received demands for support from an ever-growing number of countries because it remains unique in resolving local problems for country authorities.

But even more important is assistance on analysis and policymaking. The global financial crisis shows that we cannot assume reporting ex post data transparently to the international and investor community will do anything to prevent reversals of flows. Many developing countries do little more with the data they collect than publish balance of payments and International Investment Position tables which are largely incomprehensible to non-specialists.

The FPC CBP has promoted high-quality and investor-friendly analysis of types of flows, source countries, sectors and regions. It has also allowed investors to answer questions about their concerns and perceptions on government policy at the same time as supplying data on flows. Both of these characteristics have dramatically improved relationships with the private sector. This has generated both 20-40% higher levels of response to data surveys, and an active dialogue which encourages investors to reinvest and contribute to development. Only active policymaking by LICs, based on this analysis will ensure that flows contribute the maximum to development through stability, improved composition, diversification of sources and destinations, and by responding to investor trends and concerns.

There is a lot more to do. Surveys can constantly be made more user-friendly by simplifying and explaining questions,

as well as being updated to take account of new types of flows. Data can be made more timely: many countries struggle to meet the GDDS standard of publishing annual data 6 months after the end of the calendar year, let alone SDDS standards of quarterly data within 3 months. The burden of surveys can be rationalised by encouraging non-government and donor institutions to use the official survey results. Public sector institutions and national taskforces need to continue efforts to reinforce mandates, staff, work procedures and coordination.

Much more can be done to track and promote efforts by investors to impact positively on national development, thereby increasing their own returns. The private sector (including resident-owned enterprises) needs even more sensitisation on why survey response, dialogue and development impact is important, and training in how to complete surveys accurately (especially on market value, reinvested earnings and dividends, short-term debt and trade credit, and assets) and implement corporate responsibility policies. International organisations could also be more proactive in comparing the international data they collect (eg the BIS on private sector debt, IFC on portfolio emerging market fund managers) with national data, and in using the divergences between them to improve both.

Above all, countries and the international community must use more advanced techniques to collect sample data quarterly, and to ask enterprises about current and expected trends. Future surveys and analysis should use forecasting questions on detailed prospects for financing sources and their utilisation, disbursement time horizons, any risks of disruption, and sector and major project outlooks. They can also analyse time series to assess volatility by type of finance, source country and sector, and build the resulting risks and probability analysis into balance of payments and investment projections. It is vital to develop these early warning systems which identify major potential trends, and to adjust policy responses accordingly.

For the last two decades, the failure to track and analyse private capital flows to low-income countries, and to design policies to maximise their contribution to development, has forced LIC economies to cope with unexpected boom and bust, disrupting their growth and reducing their prospects of attaining the Millennium Development Goals. Most recently, it led many to think that LICs would not be seriously affected by the global crisis. This proved to be spectacularly wrong, forcing the international community to acknowledge that globalisation has made the poorest countries as vulnerable to global crises as to recurring national crises. There must now be a more fundamental long-term change in the international financial architecture, supported by dramatic improvements in LIC policies, analysis and monitoring, to avoid repeating these mistakes, and accelerate progress towards the MDGs.

This annex provides an overview of the sources and methods used in compiling the data presented in this report. It is not intended to be a comprehensive record of country practice. Please contact the authors with any questions concerning this report. For further information on country practices, refer to the country reports where available, or direct questions to the country teams. For further information on general best practices, refer to Bhinda and Martin (2005) and on private sector external debt to Baball (2002).

### 1. Institutional and legal arrangements

National inter-agency taskforces conducted the exercises. In most countries Central Banks took the lead, except in Cameroon (Ministry of Finance), Malawi (National Statistics Office), and Zanzibar (Zanzibar Investment Promotion Authority). Teams also comprised other stakeholders, typically including investment promotion agencies, national statistics offices, and occasionally line ministries and private sector associations. The legal mandate to conduct the exercise and protect data confidentiality was underwritten by national Acts typically of the central bank or national statistics office.

### 2. Data sources

Countries sourced most data directly from enterprises and commercial banks. This was supplemented by, and where necessary cross-checked against, other national sources (e.g. direct reporting by commercial banks to the central bank, stock exchanges, complementary surveys by other public and private sector agencies, financial statements etc). Macro-level data was supplemented with information from international sources such as the IMF, UNCTAD and World Bank. In the particular case of the CFA Franc Zone, as the FPC CBP has only recently begun work in most of its member states, BCEAO and BEAC provided data from their existing balance of payments surveys. Data for profits remitted on FDI and worker remittances were obtained from the World Bank's Global Development Finance 2008 Volume 2.

### 3. Sampling frame

Some countries conducted censuses of all investors: this was where the investor community was very small and accessible. Most countries however conducted surveys, which required building a sampling frame, and then drawing the sample from it. The sampling frame consisted of enterprises with foreign assets and liabilities, which included both FDI and non-FDI enterprises. Sampling was done on the basis of economic sectors to ensure the data had analytical value. In most cases, the largest known enterprises in each sector were selected (in order to maximise data coverage), and then sampling techniques were used to decide which other enterprises would be included.

### 4. Awareness creation and dissemination

All countries launched and closed surveys with awareness events targeted at key private and public sector stakeholders.

This was supported by media campaigns, production of analytical reports, and dissemination.

### 5. Data gathering

Surveys were administered primarily through fieldwork: by delivering and explaining the questionnaire in person, and following up intensively thereafter via visits, telephone, fax and email. Prior to launch, field officers were trained to check for data quality, and obtain financial statements where available.

### 6. Data coverage and assessment of quality

The questionnaire captured data on foreign assets and liabilities, investor perceptions, and in some cases, corporate social responsibility.

## Foreign Assets and Liabilities

### Standard BOP/IIP components

Questions were compliant with international best practices (in particular the IMF *Balance of Payments Manual 5th Edition*, and most recently the draft *6th Edition*). The table on page 78 presents the standard components (with related income lines where available) and latest reference year by country presented in this report.

The primary focus of the analysis in this report is on liabilities (non-resident investment into the countries in question), as this is more important in terms of scale. Where available and of a reasonable standard, assets data (investment by residents in non-residents) is also presented. The analysis covers stocks (or balances) and transactions.

The analysis looks at Financial Account items including Foreign Direct Investment (FDI), portfolio investment, and other investment. FDI comprises shareholdings of 10% or more of the total shares in an enterprise, retained earnings (which are assumed to be reinvested) and capital reserves, borrowing and supplier credit. It denotes a say in how an enterprise is run. Portfolio investment comprises equity (shareholding of less than 10% of total shares) and debt in the form of bonds and notes (long term) and money market instruments (short term). Other investment comprises supplier credit and loans from non-affiliated sources. It also looks at Income Account and related items including net operating profit, dividends and profits, and interest. In the flows analysis, workers remittance data are also presented for comparative purposes. All countries collected data that would allow analysis according to this breakdown but not all have reported it publicly. This overall report follows what has been reported nationally, as shown in the table on page 78.

Economic sector: countries used the UN International Standard Industrial Classification, but in national and overall reports some sectors are aggregated in order to protect confidentiality if there were few enterprises in those sectors, and sometimes countries present data for sub-sectors if they are of particular importance to their economy.

Country	Stock	Flow	Liabilities			Assets		
			FDI	Portfolio	Other	FDI	Portfolio	Other
Benin	-	✓	✓	✓	✓	-	-	-
Bolivia	✓	✓	✓	✓	✓	✓	✓	✓
Burkina	-	✓	✓	✓	✓	-	-	-
Cameroon	✓	✓	✓	✓	✓	✓	✓	✓
Central African Rep	-	✓	✓	-	✓	-	-	-
Chad	-	✓	✓	✓	✓	-	-	-
Congo, Rep	-	✓	✓	✓	✓	-	-	-
Cote d'Ivoire	-	✓	✓	✓	✓	-	-	-
Equatorial Guinea	-	✓	✓	-	✓	-	-	-
Gabon	-	✓	✓	✓	✓	-	-	-
The Gambia p	✓	✓	✓	✓	✓	-	-	-
Ghana	✓	✓	✓	✓	✓	✓	✓	✓
Guinea Bissau	-	✓	✓	✓	✓	-	-	-
Malawi	✓	✓	✓	✓	✓	✓	✓	✓
Mali	-	✓	✓	✓	✓	-	-	-
Nicaragua	✓	✓	✓	✓	✓	-	-	-
Niger	-	✓	✓	✓	✓	-	-	-
Senegal p	-	✓	✓	✓	✓	-	-	-
Tanzania p	✓	✓	✓	✓	✓	-	-	-
Togo	-	✓	✓	✓	✓	-	-	-
Uganda p	✓	✓	✓	✓	✓	-	-	-
Zambia p	✓	✓	✓	✓	✓	✓	✓	✓

p = latest data is preliminary

Country	Economic Sector	Source Country	Recipient Region
Bolivia	✓	-	-
Cameroon	✓	✓	-
The Gambia	✓	✓	-
Ghana	✓	✓	-
Malawi	✓	✓	✓
Nicaragua	✓	✓	-
Tanzania	✓	✓	✓
Uganda	✓	-	-
Zambia	✓	✓	✓

Source country: again this is aggregated into OECD and non-OECD sources if there were a small number of responses from individual countries. Up till now, most countries have followed the standard BOP approach of requesting data based on the "immediate" source. As discussed later, often this may not be reflective of the "ultimate" source, and efforts need to be made in future to collect based on immediate and ultimate source.

### Investor perception and intention

The primary objectives of the investor perception/intention exercise were to promote response to the BOP-related part of the form (inclusion of perception/intention has had hugely positive effects on the rate and quality of response), and provide information necessary to enhance the work of stakeholders charged with investment promotion and facilitation, and private sector associations. In order to reflect

the preoccupations of stakeholders in each country, while each country included the same broad areas for questions, sub-questions varied. Hence the list of factors under each category might differ, and one or two questions might be added or removed. The table on page 79 presents the data covered in the investor perception part of the questionnaire. In addition, not all countries conduct the perception part of the survey each year, and some countries distinguish analytically between the perceptions of FDI and domestic enterprises.

On future investment decisions, most countries asked prospects for expanding, maintaining or contracting investment in particular areas in the medium-term: the medium-term was defined up to four years, although some specified the short to medium-term, and Uganda specified a three year time horizon.

### 7. Residency

In line with standard international balance of payments/international investment position methodology, foreign investment is defined according to residency: only stocks held by non-residents in resident entities (and vice versa), and transactions between residents and non-residents apply.

### 8. Reference period

All countries collect calendar year data. Bolivia compiles quarterly data, but annual data are presented in this report for consistency. Years covered differ from country to country depending on where they are in terms of implementing their

Country	Initial	Future	Current factors							Information Products	Corporate responsibility
			Economic	Political	Institutional	Labour	Health	Infrastructure	Environment		
Bolivia	✓	✓	✓	✓	-	✓	-	✓	-	✓	✓
Burkina	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	-
Cameroon	-	✓	✓	✓	-	✓	-	✓	-	✓	-
Gambia	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Ghana	-	✓	✓	-	✓	✓	✓	✓	-	✓	-
Malawi	-	✓	✓	✓	✓	✓	✓	✓	✓	✓	-
Nicaragua	✓	✓	✓	✓	-	✓	✓	✓	-	✓	✓
Senegal	✓	✓	✓	✓	✓	✓	-	✓	-	-	-
Tanzania	-	✓	✓	✓	✓	✓	✓	✓	-	-	✓
Uganda	-	✓	✓	✓	✓	✓	✓	✓	-	✓	-
Zambia	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

p = preliminary

surveys, and availability of funds to sustain the process – they are detailed in the text.

### 9. Data processing and quality control

Returned questionnaires were checked in-office, and closed via office estimations, or returning to the companies themselves. Approved data was entered into software for storage and analysis. Sometimes this was done using a system prepared by the FPC CBP, and sometimes using a national solution. Once this data was finalised, it was “scaled up” to account for non-response, and the full investor register. Where necessary, it was compared against previous years’ data, to ensure a consistent time series.



## ANNEX 2

# THE FOREIGN PRIVATE CAPITAL CAPACITY BUILDING PROGRAMME (FPC-CBP)

In 2001, developing country governments in Africa and Latin America requested assistance to improve monitoring and analysing foreign private capital, in particular:

- to move rapidly forward to meeting international data dissemination standards for data on the balance of payments flows and International Investment Position stocks, such as the Global Data Dissemination Standard and the Special Data Dissemination System;
- to collect not just balance of payments data, but also other analytically useful elements such as source countries, recipient sectors and regions and terms of the flows/stocks;
- to collect data on investor perceptions and intentions which go beyond analysis of motivations to invest, and look at investor policies, especially corporate responsibility issues;
- to be trained in how to use such information to refine macroeconomic and investment promotion policies;
- to conduct more detailed analysis of long-term sustainability and volatility of flows, and the returns demanded on investment, and to integrate such analysis with their analysis of public sector debt sustainability and financing prospects;
- to analyse in more detail the actual macroeconomic effects of foreign private capital, and simulate potential future effects and necessary policy responses, through scenario and risk analysis;
- to analyse for themselves (as opposed to consuming analysis done by donor agencies) the actual and potential contributions of foreign private capital to poverty reduction;
- to collect and analyse all of this information through an integrated national programme which is run by a task force of all relevant government and private sector agencies, who build their own capacity, rather than relying on external consultants or international agencies.

The goal of the resulting Foreign Private Capital-Capacity Building Project (FPC-CBP) has been to develop independent and sustainable capacity within participating countries to monitor and analyse the effects of foreign private capital on their economies.

The programme is run by Development Finance International (a non-profit UK-based company) in partnership with regional organisations run by the countries themselves, to ensure that capacity to assist countries is decentralised and moved closer to the countries.

These organisations are the:

- Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) and Banque des Etats de l'Afrique Centrale (BEAC) in Francophone Africa;
- Centro de Estudios Monetarios Latino-Americanos (CEMLA) in Latin America;
- Macro-Economic and Financial Management Institute of Eastern and Southern Africa (MEFMI) in Eastern and Southern Africa; and

- West African Institute for Financial and Economic Management (WAIFEM) in Anglophone West Africa.

Participating countries have also committed themselves to reinforce their legal and institutional structures, human resources, management and supervision procedures and working environments, to give more political priority to the issues, to increase the transparency of analysis to civil society, and to increase their financial contributions over time to these exercises.

Each country project is structured in the following way:

- Participant countries request a DFI/CEMLA/MEFMI/WAIFEM Demand Assessment Mission where conditions are assessed, a coordination structure between government agencies and other stakeholders is established and a methodology and budget finalised. This approach encourages cooperation and cohesion among government agencies, saves donor money and reduces the number of questionnaires received by the private sector, again increasing responses. In Uganda, for example, government questionnaires in this area have been reduced from 3 to 1 by close cooperation between the Bank of Uganda, the Uganda Investment Authority and the Uganda Bureau of Statistics.
- Prior to the launch of a survey, members of the private sector are invited to an opening conference where these and related macroeconomic issues are discussed raising awareness of the survey process and improving public-private sector dialogue.
- A survey sample targeting key investors is identified and the final survey questionnaire is tailored to country need by the in-country team.
- The survey is (usually) divided into 3 sections with questions on:
  - Foreign Liabilities: equity (stocks and flows of both direct and portfolio investment); retained earnings of FDI; borrowing from non-residents (by debt type and maturity)
  - Foreign Assets: equity (stocks and flows of both direct and portfolio investment); profit data; lending to non-residents (by debt type and maturity)
  - Investor Perceptions: the detailed questionnaire includes questions on economic and financial factors; political and governance factors; the efficiency and cost of services; labour, health and environmental factors; pull factors of initial investment; intentions over the medium term; the utility of information sources for investment decision-making and desired aggregate information from Government.
- The integration of balance of payments and perceptions questionnaires encourages a much higher private sector response rate. Countries that have included both elements of the questionnaire have increased their response rates by 20-30%, producing a 75-80% average response rate among the 7 countries.

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- Country teams receive additional training on interview techniques, non-survey methodology and data enumeration. As returns are collected from respondents the data is checked and entered into a database.
  - Data quality is assessed and when satisfactory (this may require follow-up with respondents) output tables are produced for analytical purposes. The in-country team finalise a report on their findings which is disseminated at a closing conference attended by the country teams, key Government and IPA staff, business leaders, selected respondents to the survey, and the national media. Survey findings often provoke lively debate at such events and the useful exchange of ideas on how the challenges affecting the domestic business climate can be addressed.

For more details on the achievements of the programme, please see its website at [www.fpc-cbp.org](http://www.fpc-cbp.org)

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Several country reports and FPC CBP documents may be downloaded via the Private Capital Publications page of the DFI Group website (<http://www.development-finance.org>), or via the links given. Several countries also upload reports on to their own websites. In case of further enquiries, please contact [dfi@dri.org.uk](mailto:dfi@dri.org.uk).

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