Introduction

Why study private capital flows to Sub-Saharan Africa? For the last two decades, international financial markets have perceived most of Africa as a "basket case" region. When the research underlying this book began (in 1996), donors, international organisations, investors and even African governments did not believe that private flows to Africa were significant or increasing.

Yet senior African government officials from 14 African countries, and especially South Africa, Tanzania, Uganda, Zambia and Zimbabwe, were telling a different story. They knew that a surge of flows to emerging markets, and the liberalisation of their economies, were prompting unprecedented inflows of private capital. These flows — and their occasional sharp reversals — were having dramatic macroeconomic effects and demanding urgent policy responses. But with few data on the level or composition of these flows, and no thorough analysis of their causes and effects, African governments were virtually powerless to react. It is their convictions and hard work which have made this book possible. The Swedish and Danish governments had the sense to listen to them, and we are also most grateful for their sponsorship of this research.

In setting out to explore and explain the dichotomy between international perception and African reality, we had to use an innovative methodology. Most of the literature on private capital flows has used international data sets to analyse their scale, composition, causes, sustainability, macroeconomic effects and policy responses, using largely econometric methods. It has focussed particularly on the so-called external or "push" factors which motivate the flows — mainly US interest rate trends and subjective sentiment-based factors in international markets (for a more comprehensive literature survey see Martin, Griffith-Jones, Kasekende and Kitabire 1995).

We realised rapidly that international data sets were not tracking the increase in private flows to Africa, and that most of their causes were region- or country-specific. Therefore the bulk of our research was undertaken by teams of senior government officials in five African countries. They collected local data and analysed the scale and composition of private capital flows, their locally-driven causes and sustainability, their macroeconomic impact, and the policy measures needed to influence their future scale, composition and effects on the economy. In addition, the central

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team conducted more than 150 interviews with major providers of private capital (investors, bankers and fund managers) in the UK and Africa, as well as international experts in the IMF, World Bank, UNCTAD and Commonwealth Secretariat and senior academics, to identify the "supply" side factors — international trends and perceptions of Africa — which have a major influence on the flows.

This resulting book is organised in four sections.

Part 1 (The Scale and Monitoring of Capital Flows) presents the facts on the scale and composition of private capital flows to Africa and the difficulties in monitoring them. It confirms the views of African policymakers — that flows are increasing sharply, and that foreign direct and portfolio investments are large relative to their economies, and therefore of critical concern in formulating economic policy. It explains how difficulties in measuring and monitoring flows (compounded by the liberalisation of controls) have led to substantial under-reporting of flows to the international organisations.

Part 2 (Perception and the Causes of Flows) looks at what motivates people to invest. It is based on surveys of more than 150 investors, in their home countries or in African recipient countries. It describes why they are increasingly diversifying FDI and portfolio flows (both geographically and sectorally), but warns against their potential volatility. It details the factors preventing medium-term bank lending (notably the continuing debt overhang), and describes why short-term bank flows are rising. It shows that flawed credit ratings short-change the region. Throughout, it finds that the best-informed investors are increasing their holdings, while the less informed are not.

Part 3 (Reality: Impact and Policy Responses) focuses on the macroeconomic impact and policy implications of capital flows. Drawing on the data and analysis presented in the country studies, together with the recent international literature, the analysis contrasts the generally positive impact on investment and growth with the destabilising effects on monetary policy and interest rates, the real exchange rate and financial markets. The chapter on policy responses highlights the urgent need to manage the sequencing of reforms more effectively, and to adopt a broader range of policy instruments to influence the impact of flows on the economy.

Part 4 (Conclusions and Recommendations) identifies measures which will help African governments to attract more development-oriented private flows, and to manage the economic impact of growing and more volatile flows. By introducing these measures, governments will encourage a wider group of potential investors to ignore superficial perceptions and to make their decisions more objectively, and enable international institutions and donors more successfully to promote flows to Sub-Saharan Africa. At

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the same time, they will help to prevent destabilising effects on their economies and to enhance the positive impact on investment and growth.

African governments, donors and the international community can all act to make flows more sustainable and less volatile. Insofar as many African countries are suffering cuts in aid flows and need to mobilise large private flows, and nearly all have suffered from the instability of private flows, this book should be of interest to anyone concerned about the role of private capital in Africa's future development.

However, this book also has lessons beyond Africa. Since the "Asian Crisis" of 1997, international financial institutions and investors have been obsessed with the need for greater "transparency" in information provision by developing countries, which is often seen as a panacea for stabilising flows. But this book shows that gathering information on private capital flows is not easy, and that — as many developed countries with excellent information flows have found — complex investor perceptions rather than objective data guide most investment decisions. The macroeconomic effects of the flows and the appropriate policy responses are equally multi-faceted.

Emerging market governments (and the donors or international organisations which support them) need to realise that, though they can identify objective factors which attract "desirable" or "long-term" capital flows, growing integration into international financial markets is likely to exacerbate the volatility of such flows. This increased volatility heightens the need for an expanded range of policy tools to enhance the positive economic impact of private flows and to avoid repeating the recent instability suffered by so many emerging economies. By presenting the first systematic analysis of the recent African experience with private capital flows, this book aims to provide a rich source of new ideas for rapid policy responses by national and international policymakers.

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