

4 Capital Inflows and Macroeconomic Policy in Sub-Saharan Africa

Louis Kasekende, Damoni Kitabire and Matthew Martin¹

I INTRODUCTION

During the last three years, there has been an expanding literature on private capital inflows to developing countries. In 1992 and 1993, attention focused on the rise in such inflows, their causes and nature. Gradually, it moved to their potential macroeconomic impact and the policy implications. In 1994 and 1995, following events in Mexico, it has concentrated on the sustainability of the inflows, and the policy implications of potential reversal.

Virtually all of the studies have focused on Latin America, though some authors have also examined East Asian experiences. Analysis of Eastern Europe is extremely rare (Calvo, Sahay and Vegh, 1995; Griffith-Jones, 1995), and that of Africa is virtually non-existent (with the notable exception of the excellent study by Asea and Reinhart, 1995). Even the most comprehensive recent analysis and survey of the literature (Fernandez-Arias and Montiel, 1995) has concluded that there is only impressionistic evidence of private capital inflows to sub-Saharan Africa, where 'capital inflows have not materialized'. Africa has continued to be analysed from the point of view that most of its capital inflows causing 'Dutch Disease' effects are aid inflows (see, for example, Younger, 1992).

The key areas examined in the literature have been the scale and composition of private capital inflows, their causes and sustainability, their effects on macroeconomic stability, and their responsiveness to policy measures. This chapter analyses the characteristics of capital inflows to sub-Saharan Africa in each of these areas, showing the similarities and differences with other regions of the developing world. A debate is also developing as to the nature of capital Africa

should attract. Scholars have warned that short-term capital inflows, subject to abrupt reversal, will be very disruptive to the domestic financial sector, in particular in the presence of existing weaknesses in that sector (Lipumba, 1994; Calvo, Sahay and Vegh, 1995). Some argue for foreign direct investment (FDI) which is less susceptible to transient financial shocks. But counter-arguments have also been made to the effect that FDI is equally volatile, as dividends and retained earnings will be quickly repatriated during a financial crisis.

It is important to emphasize at the outset that both national and international data on capital inflows to Africa are extremely unreliable. Data issues in other regions have centred on distinguishing between private and official inflows; gross and net inflows; short- and long-term capital; bank and non-bank flows; and between debt and non-debt-creating flows. It has been necessary to rely fairly extensively on data from either the IMF (*International Financial Statistics*), OECD (*Financing and External Debt of Developing Countries*) or the World Bank (*World Debt Tables*) (Fernandez-Arias and Montiel, 1995). For many countries in sub-Saharan Africa the data problems are more fundamental: they have poor recording systems for virtually all capital inflow data, and many inflows are recorded in the current account or under errors/omissions.² In addition, even superficial comparison of global and country data indicates huge underestimates and unreliable categorizations of inflows in global data and particularly for those for sub-Saharan Africa.

Because of data and other limitations, the scope of this chapter is limited. It focuses on six countries for which reasonably reliable data are available (Kenya, South Africa, Tanzania, Uganda, Zambia and Zimbabwe), with particular emphasis on the experiences of Uganda, Zambia and Tanzania. The last country witnessed one of the largest surges in capital inflows in the early 1990s with dramatic macroeconomic effects.³ A brief summary of the liberalization process in the above mentioned countries is given in Appendix 4.1.

It also has to be recognized that there are diverse experiences in Africa, not least in the speed and sequencing of countries' policy reforms (Kasekende and Martin, 1995). The policy regime in a number of countries in the region is nevertheless now more conducive to both domestic and foreign investment than it recently was. Foreign-exchange markets have been extensively liberalized to a point where even the capital account has been highly decontrolled. Some countries are currently receiving inflows which are significant relative to GDP, and the less desirable effects of such inflows are emerging. In the