

ANNUAL REPORT ON INTERNATIONAL FINANCE & DEVELOPMENT IN AFRICA

Background: the “why” of the project and its innovative approach

Marco Zupi

Data is the raw material of applied statistics and is a key point in the analysis of development processes throughout the world and, hence, in Africa.

A key point – and not a “starting” point – because data does not precede but is integral to the other two building blocks which, to quote Erik Thorbecke, constitute the foundation on which development policies and strategies are built: (1) development objectives, which reflect the prevailing view of development and the very definition of development processes; and (2) the conceptual state of the art of the body of theory, models and hypotheses concerning development.

The system of available data for analysing the real situation and gauging the results achieved in terms of development is, in other words, interdependent with development objectives and theories and models.

At any time during recent history in which cooperation policies have been linked to development, namely from the 1950s onwards, the statistical data system in existence and employed to chart and analyse the state of development has always been a direct product of the body of theory and models used to test the principal development hypotheses and to come up with new ones, while at the same time influencing and determining the theoretical orientation and contributing, with the latter and with the prevailing objectives, to steering national and international development policy and strategy decisions.

In the 1950s, the available data system consisted almost exclusively of aggregate national income accounts. In the 1960s, more disaggregated data was collected in the form of intersectoral (input-output) tables. Then, gradually over time, the statistical harmonisation of the elements of the balance of payments, the use of employment censuses, nationwide household surveys on economic behaviours and on the informal economy, population statistics, a resort to social accounting matrix (as well as to general equilibrium models), national surveys in the area of demography and health, sample surveys and analyses into poverty, contributed to augmenting the statistical information available on development at a national level, in an ongoing and productive exchange with the development of theories and objectives.

This sheds an interesting light on the debate over the stability and rise in the number of sources of international financing that may prove to be additional to the national resources of developing countries, particularly in Africa, for the purposes of meeting the Millennium Development Goals.

This debate had its origins in the General Assembly of the United Nations in 1997, owing to a draft resolution presented by the Group of 77, and grew lively following the Monterrey Conference on Development Financing (2002). From Monterrey onwards, the international community realised the importance of a joint and coherent effort with regard to the principal financial flows (foreign debt, official development assistance -ODA- and remittances, as well as foreign direct investment, portfolio investments and trade-related financial flows).

While in terms of theory and modelling, as well as in terms of objectives, debate is animated and multifaceted, the issue of the statistical information on the principal financial flows gathered and used internationally seems to have been relegated to the field of technicality and left in the hands of the statistical offices responsible for collecting the information, thus conferring the data with an “air of eternity” and depriving it of its natural and close relationship with theory, objectives and policy. And yet Pierre Bourdieu, referring back to Durkheim and after careful and in-depth studies, reached the conclusion some fifteen years ago that the categories in terms of which we think – in our case aid, foreign debt, remittances, investment and trade-related flows – are not merely (scientific) constructs susceptible to empirical and theoretical testing, but also constitute an integral part of the structures of society. Statistical classifications constitute the background and the horizon from which we see and analyse ourselves and others. Resorting to apparently “objective” categories is an enticing and less dubious position from which to portray ourselves as “unbiased”, thus affording ourselves the satisfaction of being in a position to describe what is really happening.

While acknowledging the enormous difficulties faced by international organisations and the indisputable praiseworthiness of their invaluable work in gathering statistical information on the principal financial flows towards Africa systematically and in a standardised manner (for comparative purposes) and making it available, which – it bears repeating – is one of the essential building blocks for discussing human and economic development in that continent, it is nevertheless important not to conceal the inevitable partial nature of the said data.

(a) Foreign debt

Despite the fact that the foreign debt of African countries is a topic of great significance and the subject of permanent monitoring both internationally and nationally and that there are truly many sources today which regularly collect and present related data, the reliability and veracity of the available data is nevertheless debatable - at least as regards the specific case of the continent in question.

It may perhaps seem surprising, but a figure such as the amount of the total external debt stock of an African country is rarely unambiguous. The international sources most used are the World Bank, the IMF, the OECD and the Bank for International Settlements, which publish the following reports respectively: *Global Development Finance*, *International Financial Statistics*, *External Debt Statistics* and the *Quarterly Review: International banking and financial market developments*. The items analysed and the details relating to total foreign debt stock do not correspond. This problem led the four organisations to set up a common statistical database in 1999, the *Joint BIS-IMF-OECD-WB Statistics on External Debt*, replaced at the end of 2006 with the new *Joint External Debt Hub (JEDH)* in an effort to standardise and share the relevant information.

The main problem, in terms of reliability, is that the statistical information is collected almost exclusively by sources in the creditor countries, who are clearly essential, but which results in frequent discrepancies with the statistics published, on the other hand, by national government authorities of African countries. These differences are not solely attributable to the fact that some African governments do not recognise the validity of certain debts contracted previously for and on behalf of governments (due to irregularities in form or substance attributable to either one or other of the contracting parties or both), which gives rise to disputes over debt and would lead to the amount

indicated by creditors being an overestimate. They are also due to some accounting gaps in the systems of the abovementioned international institutions, which in particular:

- in the case of debts due to commercial banks, refer only to the banking systems existing in 38 countries (leaving out many other banking scenarios);
- do not take into account supplier credit finance facilities not guaranteed by the public sector, when they are not obtained through commercial banks (such as, for instance, the financing of direct investment through debt, as in the case of inter-company loans);
- do not take into account debt stock (that is, stock representing a sum of money, the holder of which pledges to repay within fixed time periods and according to previously established terms) which is offered as a private placement;
- do not take into account debt stock issued and circulating within the country held by non-residents; and
- do not take into account deposits made by non-resident citizens in African banks.

In these cases, the international statistics tend to underestimate, sometimes significantly, the amount of total foreign debt. Having said this, detailed checks carried out on documents held by African national authorities often indicate figures which conflict with those of international sources. Even authoritative independent sources, such as the periodic reports of the Economist Intelligence Unit, cross-checking national and international figures, arrive at estimates of total aggregate figures which differ from both the sources considered.

(b) Official development assistance

At the beginning of the 1970s, the Development Assistance Committee (or DAC) of the OECD laid down precise accounting criteria for ODA, adopted by all member countries of the OECD. The responsible administrations (in Italy, Office I of the Directorate-General for Development Cooperation of the Ministry of Foreign Affairs) are called on to use them in preparing statistical tables that are submitted to the DAC which formally gives notice of them and makes them publicly available through two databases accessible online since 1998 and freely accessible since 2003 on the institution's website (updated, midway through 2006, with a new look and search interface). These are the aggregated statistics database (*DAC on-line*) and a database with more detailed information on individual aid activities (the *Creditor Reporting System*, established in 1967); two very useful classification systems that do not, however, assist in defining and assessing the resources directly allocated to help reduce poverty with any great clarity - which should constitute a priority objective for ODA - and that leave room for discretion on sectoral matters and in respect of unallocated aid. Above all, the data risks being quite misleading considering that:

- ODA is based on data furnished by only some donors: 22 member countries of the DAC, the European Commission, agencies of the UN (through UNDP, UNICEF, UNFPA and IFAD) and of the World Bank (the IBRD and the IDA) and the African Development Bank. The information relating to other donors is provided by these organisations solely on a voluntary basis. Thus, the risk of underestimating the volume of flows is considerable.
- ODA overestimates actual aid when a donor country resorts to making subsidised loans. Indeed, ODA measures the total face value of grants and loans, without taking into account the fact that loans require the future repayment of the capital with interest.
- ODA overestimates actual aid when a donor country transfers goods and services as a grant (as well as in the form of soft loans) on conditions that are less favourable than those prevailing on the market. This is the so-called "tied" aid situation.

- ODA overestimates actual aid, incorporating the full face value of technical assistance, a grant component, which assigns prices that are not necessarily market prices, and takes the form of a net benefit for the economy of the donor country that is easily quantifiable while being more difficult to quantify for the economy of the developing country that is the beneficiary.
- ODA overestimates actual aid as it does not distinguish between cases where administrative expenses are reduced to a minimum and cases where, on the other hand, the administrative costs significantly eat into the budget of individual projects, programmes and the overall management of the administration of development cooperation policies.
- ODA overestimates actual aid by treating initiatives aimed at reducing debt as additional forms of development cooperation, in the form of grants (as in the case of cancellations of foreign debt) or new soft loans (in the case where foreign debt payments are rescheduled), even though they do not constitute the actual provision of new resources.
- ODA underestimates actual aid by not taking into account the cost of amortisation which the donor country bears when it applies heavily concessional repayment terms to soft loans.
- ODA underestimates actual aid by not including loans that have concessional terms of less than 25 per cent.
- ODA underestimates the financial commitment of State administrations in relation to development cooperation when it neglects to take account of the activities carried out within their sphere of activity by ministries not directly having jurisdiction in the area but which are, in substance, classifiable as development cooperation actions.
- ODA underestimates the financial commitment of State administrations when, in limiting itself to taking into account activities carried out by central administrations, it does not include items relating to the activities of local self-governing authorities (namely, the Regions and local administrations in Italy).
- ODA adopts a classification of beneficiary countries (the List of ODA Recipients) which is not always convincing.
- For that matter, a further misleading factor is the fact that no different weight is assigned to initiatives aimed at fighting extreme poverty in marginal areas compared to advanced and specialised training interventions in cities. The fact that the definition of development remains an undifferentiated entity can conceal great qualitative differences in development cooperation policies, which differences interact with the quantitative component.
- ODA overestimates actual aid since it measures the degree of concessionality of soft loan flows on the basis of misleading conventional parameters, such as the conventional discount rate of 10 percent used to calculate the grant component of a loan, without distinguishing between recipient countries and the periods of application. In reality, the more appropriate rate to calculate the donor country's opportunity cost of investing the capital should at the very least be that prevailing on the market in the beneficiary country, moreover variable over time, in accordance with the specific repayment schedule and specifically with reference to the loan currency (with interest rates varying as the exchange rate varies)

What the OECD ODA statistics, in the same way as those used internationally for African foreign debt, systematically do not show owing to their source, is the growing phenomenon – including in relation to investment and trade-related flows – of financial resources which Africa receives from (non-OECD) emerging countries, particularly China and India, which is shaping up to be the most significant economic, political (and statistical) factor of recent years, capable of significantly

determining the nature – whether it be positive or negative – of the impact of international relations on African development.

(c) Remittances

The statistical data on remittances, which have become an international financial flow of specific interest for *Global Development Finance* only since 2003 (Chapter 7), is particularly affected by the difficulty of defining the phenomenon of international migration itself, to which the data relates, since the types of people mobility are more numerous than they are difficult to identify. Crossing the border, changing residence and maintaining a foreign nationality in a host country, which are the three characterising criteria of international emigration, are not necessarily connected.

As the World Bank's *Global Economic Prospects 2006* report points out, the coverage and quality of the data is not very satisfactory. There is no consensus as to what should be considered remittances. Should they only include remittances of emigrant workers resident abroad, income from work abroad and one-sided transfers by migrants?

On the basis of the instructions contained in the fifth edition of the *Balance of Payments Manual*, published by the International Monetary Fund in 1993, among the entries recorded in the Balance of Payments, income of emigrants comes under so-called "Current transfers" and "Income" categories (which are in turn included under the category "Current Account", namely those that are income and production – not financial – related). Today, this is a very important heading for African countries that export labour. The emigrant exports his/her work skills, selling them abroad (an import for the host country) and sends to his/her family, or in any case repatriates, resources which effectively cross the border (representing the net remaining after consumption and savings *in loco* by emigrants). Pensions received from abroad by residents who have returned to the country of origin after a period of time spent working abroad should also be included under this same heading.

In particular, within the "Current Account", a distinction is made between the remittances of emigrant workers resident abroad on the one hand, and the income earned by non-residents from working abroad on the other. The first case refers to emigrants who have lived in a foreign country for not less than a year and who are considered resident abroad regardless of their legally-recognised immigration status. Their "Current transfers" to the country of origin are defined as "Workers' remittances" (within the "Other sector" section). In the second case, if the emigrant has lived in the foreign country for less than a year, then all income earned in that period abroad (and not just the amounts transferred) is defined as "Income" from work abroad and included under "Compensation of employees".

On the other hand, featured among the entries which come under the category of "Capital transfers", relating to payments without any *quid pro quo* (that is, those where in contrast with "Goods" and "Services" entries and all the other categories, there is no reciprocal flow) and which relate in any case to income, for which reason they appear in the "Capital and Financial Account" section of the balance of payments (they were, in effect, included under private transfers in the "Current account" of the fourth edition of the Balance of Payments Manual, but are now considered as capital transfers in the fifth manual), there are also "Other sectors" transfers which include "Migrants' transfers". This entry should not be confused with remittances of emigrant workers, in that migrants are those who work abroad for a sufficiently long period but have not lost their original nationality, while emigrants have lost it. Migrant transfers are, thus, the net value of capital flows transferred from one country to another during a migration phase (a period, however, not less than a year). The increase, in recent years, of the number of temporary workers, for instance in Europe, has led to a significant increase in this item.

Despite the fact that the International Monetary Funds' manual recommends including the three different items mentioned above (namely, the two included in the "Current Account" and the one in the "Capital Account"), the statistical discrepancies between countries of origin and destination countries in relation to remittances figures are quite significant.

Many countries do not include any information on remittances within balance of payments statistics. Other countries variously show one, two or all of the three items mentioned. Some countries make reference to citizenship instead of residence (the latter criteria being the one adopted by the International Monetary Fund). Certain countries add remittances to the foreign "Direct Investment" heading, others to "Travel" under "Services". In many African countries, regular annual statistical information on remittances is rare.

In many cases, Europe first and foremost, the central banks which collect the information on remittances restrict themselves to using data provided by commercial banks and not that also provided by money transfer and postal operators. In addition, often methods of calculation are used whereby the number of immigrants is multiplied by an estimated average annual value of financial transfers to the country of origin.

Above all, there is a problem of the lack of valuation or underestimation of flows transferred through informal channels and of the value of goods declared by these citizens when going through customs during periodic trips back to their country of origin.

It was for this reason that, in January 2005, the International Monetary Fund and the World Bank organised an international seminar on the issue, during which it was decided to set up a Technical Sub-Group (TSG) on the Movement of Persons, presided over by the Statistics Division of the United Nations, with the involvement of central banks and national and international statistics agencies.

By way of example, a simple comparison of a figure relating to the same item – such as, for instance, remittances of Tunisians who live in Italy – recorded in the Italian and Tunisian balance of payments, reveals a discrepancy in the order of 1:150, yet again symptomatic of the partial nature of the data already noted with regards to the figures on foreign debt and official development assistance.

In addition to including transfers effected through banking channels and currency flows recorded by exchange bureaux at border posts, the law in force in Tunisia on currency exchanges makes it possible to record flows which, by contrast, do not appear in statistics published in other countries (including Italy), such as those transferred by postal services or non-banking institutions specialised in money transfers (such as Western Union, MoneyGram, etc.), to which is added the value of goods declared by the said Tunisian citizens when going through customs during trips back home. For the year 2000, the Italian balance of payments reported only transfers made through banking channels by Tunisians resident in Italy for more than 12 months as remittances, showing an amount of 737,000 euro. By contrast, the total amount of remittances from Italy to Tunisia calculated according to the criteria for compiling statistics adopted by the Central Bank of Tunisia, revealed a situation of a quite a different magnitude: around 109 million euro.

(d) Foreign direct investment, portfolio investment and trade-related flows

With respect to international financial flows for development in Africa, there are three other types of flow which we will consider now, limiting ourselves here to expanding the observations made regarding the partial nature of the available information in relation to foreign debt, official development assistance and remittances.

We are referring to foreign direct investment, portfolio investment and trade-related flows, in relation to which international institutions (starting with UNCTAD, the World Bank and the African Development Bank) have today made invaluable historical data series regarding Africa available.

The perception of information concerning the state of development in Africa is today linked by many with the accounting of these financial flows. The economy of an African nation is considered to be in good health only if the aggregate accounting of these flows is “positive”. Statistics end up greatly influencing the perception of phenomena, giving them an air of objectivity. Nevertheless, there is always a deviation between what is presented as an accounting entry and what is really occurring, especially when the qualitative component of investments and trade exchanges and how it interacts with the quantitative aspect are acknowledged. Essentially, there is a risk related to the “system” and to a blind faith in numbers. Numbers are considered an incontrovertible element of knowledge and a source of wisdom. In Paris, a movement was established against what has been – unfortunately, with an undeniable impact on communication – called a trend towards a “post-autistic” economics, referring precisely to the obsessive attention paid to numbers, the unchecked use of figures, which leads to the prevalence of the abstraction of numbers over reality - of statistics over real life

With respect to the analysis of trade-related flows and foreign investment (both direct and portfolio), we take a statistical, purely accounting, figure and we attribute it with merits and responsibilities which, on the contrary, belong to the party (such as a commercial bank or private enterprise) that uses the various financial channels.

In relation to foreign direct investment (FDI), we imagine a complete overlap between this accounting flow and underlying entrepreneurial skills, considering it a flow that is naturally positive in terms of African development.

More particularly, in the case of FDI, it is interesting to note that a simple transfer of ownership – in terms of equity – which does not involve any transfer of machinery/plant and equipment, is recorded as FDI. The busy season of mergers and acquisitions widely noted in industrialised countries, with possible but not guaranteed benefits in terms of real economics, is proof of what FDI can, in substance, entail. Especially in recent years, FDI has often been a useful and legitimate mechanism for the diversification of share and bond portfolios which, in weak banking and finance systems, can inflate emerging stock markets as well as securities, consumer credit and real estate markets, producing a vicious circle which leads to greater inflation, a drop in savings, a worsening of the balance of trade, pressure and uncertainty over interest and exchange rates, instability in the area of real production, capital flight and financial crisis.

Usually, however, it is assumed that FDI corresponds to greater production capacity, linked to built-in new technology and to the strategy of transnational enterprises geared to increasing their international competitiveness through the delocalisation and strengthening of the export capacity of African countries.

In reality, it is not at all proven that an increase in FDI coincides with greater development in a country, even if in absolute terms - and this is the most quoted statistic - there is always a positive link between FDI and GDP. This is simply the result of an overall increase in capital connected with the process of opening up to trade which accompanies economic growth.

Likewise, attributing a positive influence to FDI and, by contrast, a negative influence to portfolio investments as regards their impact on the development process in a beneficiary country – as one usually reads in the literature and policy recommendations – reveals a discrepancy between the qualitative merits and attributes of financial flows and the statistical data employed.

In terms of statistical accounting, each entry in the “Financial account balance” reveals reporting difficulties, as well as a certain conventionality of classification.

The first important distinction to make is that regarding the separation between short and long-term movements in capital flows. The rationale of distinguishing portfolio investments (usually associated with short-term investments) from long-term investments (as FDI is considered to be) is to highlight capital movements which are in theory more volatile and subject to withdrawal and, thus, risky for development (portfolio investments, in other words) from those that are more stable and long-lasting (positive for development, namely FDI, which it is presumed is undertaken with a long-term perspective and is not withdrawn except after a number of assessments of its underlying strengths).

Today, however, it is increasingly more complex to maintain this distinction. It should, therefore, be used with caution.

As Salvatore Biasco argues, a non-resident may buy quarterly short-term treasury bonds in Italy and renew them on each maturity date for years. Similarly, he may buy 10-yearly long-term treasury bonds, in anticipation of an imminent reduction in interest rates which will increase their value – a purely speculative investment to be repatriated in the short term. Such securities, when they do not concern the acquisition of a majority interest, are bought and sold depending on market performance forecasts. Portfolios are placed in the hands of professional managers, by joining mutual funds, pension funds or using personal portfolio managers, and thus vary rapidly depending on expected movements in exchange rates and interest rates and on the estimated performance of individual economies or on the measures which official authorities of individual countries have taken or are expected to take.

Thus, the convention often adopted in statistics of considering the contracting of receivables or payables due in over a year as long-term and all financial transactions that concern instruments due in less than a year as short-term, is to be taken as is. It is more descriptive of the type of instrument involved than indicative of stability.

A further problem stems from a mixed classification of transactions and parties to transactions. This creates a disparity in the way that the same transaction is recorded in counterpart countries. In particular, it is necessary to decide in both countries where to record the flows of State securities acquired by foreigners. It is clear that if they are acquired by an official authority, this affects the official position of both the issuing country (which, depending on your point of view, is a debtor or is receiving revenue) and the buyer (the other way round). If they are acquired by private individuals, for the buyer they represent a portfolio choice and as such appear as private movements of capital. For the seller, they represent foreign financing of the public sector and, hence, relate to the position of official authorities.

What the statistics in the balance of payments state is simply that FDI concerns the sale and acquisition of fixed asset stock and thus involve capital transactions for those who engage in them (whether they involve the acquisition of land, equipment for a manufacturing plant – a greenfield investment – or the acquisition of a substantial equity interest – conventionally defined as above 10 percent – of a foreign enterprise), without making any reference to the fact that this financial deployment of an operator's assets may trigger actual demand for investment goods, create jobs and result in a worsening of the conditions of the ecosystem. On the other hand, flows that spring from the portfolio management of residents of the country and, hence, the short or long-term assets and liabilities which they contract vis-à-vis foreign residents, in the form of shares (including units in mutual funds, on the condition that they involve holdings of less than 10 percent of the fund capital), investments in short-term securities (such as treasury bonds, bank acceptances, commercial notes, long-term securities maturing within the year, certificates of deposit etc.), trade credit, long-term bonds and other financial instruments (such as bank loans issued to non-bank private parties) are by contrast reported as portfolio investments for accounting purposes.

Equity participation is thus classified (see page 88 of the fifth BoP Manual) as FDI if it is greater than 10 percent (an arbitrary threshold for classifying a minority equity interest and as a portfolio

investment if it is less than that threshold. In reality, as Biasco again clarifies, it is necessary to distinguish – which is often very difficult – cases in which the equity interest is a controlling one and relates in some way to management, from those in which it is a simple means of investing savings stock. A business may acquire a minority interest, let's say 9 percent of the equity, and consider it strategic, or may gain access to the board of directors or form part of the controlling syndicate with such a holding. There is no need to acquire 51 percent of voting rights to exert management control over a company if there is a considerable fragmentation in the ownership, as is the case with public companies.

Moreover, the threshold suggested by the International Monetary Fund manual has not been adopted by all countries, which approach their reporting differently. For instance, in United States' accounting, investments involving an equity interest of over 25 percent are considered direct investments while those under 25 percent are considered portfolio investments.

Given what has been said so far, in reality it is very difficult to identify which acquisitions of securities constitute portfolio investments, financing of production, cash-parking or otherwise.

The issue of trade-related financial flows is connected with this aspect.

On the one hand, trade credit generally relates to financing production and trade, but this can be achieved through many other instruments, which are then acquired, for instance, by money market funds/cash funds and mutual funds.

On the other hand, in terms of direct links, commercial transactions involving goods and services correspond to trade in tangible goods in the strict sense (tangible consumer and investment goods, finished and semi-finished products) and intangible goods (services, to be precise, such as insurance, freight and transport, tourism, capital gains and other services) which entail financial transfers. However, even in this case the warnings against inappropriately assuming the flow has a positive impact on the development process (that is, assuming the quantitative data indicates positive value in qualitative terms) are applicable.