Economic Policy, Institutional Environment and Capital Flows

5.1 Introduction

According to conventional economic wisdom, capital should flow from developed countries where it has lower returns on the margin to Africa and other developing areas where it has significantly higher marginal returns. Unfortunately, this is not the case as capital flows to Africa have been low, unstable and concentrated in a few sectors and a few countries. There are many reasons for this phenomenon. First, both in terms of perception and reality neither the global nor the regional environment has been friendly to Africa.

Furthermore, many African countries have yet to take the proactive action and establish the preconditions, policies and strategies needed to attract more beneficial international capital. Indeed, the market has failed, at least in the conventional sense, to allocate capital to Africa. Nor have the macroeconomic policies adopted by African countries favoured the inflow of international capital. Non-market institutions and macroeconomic polices should, therefore, be used to address the shortcomings and imperfections of the international capital markets.

"For African countries to increase capital flows significantly, they must adopt appropriate macroeconomic policy measures"

The inadequate inflow of capital to African countries results not just from market failure but also from a fundamental policy failure, institutional inadequacy and failure. As with sound macroeconomic policies, the norms governing human interactions, including organizational entities, procedural devices, and regulatory frameworks[1] constitute an important determinant of capital flows. For African countries to increase capital flows significantly, to make them sustainable and minimize financial crises, they must adopt appropriate macroeconomic policy measures.

Next, they need to understand how to strengthen the process, substance and outcomes of macroeconomic policies to create a more attractive environment for capital flows. They must also establish strong institutions and improve the quality of existing ones. In particular, African countries need to develop institutions that enforce

1 Institutions come in a variety of dimensions and levels: economic, social, political, and corporate institutions; public and private institutions; and national and sub-national, subregional, regional and global. Notwithstanding their value, institutions are hard to grasp and have been defined in a variety of ways by different authors. Most notably, Douglas North (1990) defines institutions as the formal and informal rules governing human interactions (see also Kasper and Streit, 1998; World Bank, 2000; and Alfaro et al., 2003). Unlike institutions, policies are choices made within a political and social structure - within a set of institutions. Institutions might also explain differential capital-labour ratios in terms of differences in cultural context and technological capacity

property rights and the rule of law so as to minimize uncertainty about returns on investment.

This chapter examines the implications of macroeconomic policy regimes for capital inflows to Africa, and the problems that such inflows have posed for macroeconomic policy management as well as the different policy options pursued by African governments to deal with macroeconomic challenges of capital inflows. It also assesses the reform dividend— that is, whether economic and institutional reforms have been accompanied by increased capital flows to the region. Finally, the chapter discusses the importance of effective institutions for attracting capital flows and the need to identify, build or strengthen capital-friendly institutions.

"African countries need to develop institutions that enforce property rights and the rule of law"

The chapter is organized as follows: The next section discusses the orientation and evolution of macroeconomic policies in Africa. Section 5.3 examines the benefits of economic reforms, including macroeconomic policy reforms for capital flows. Section 5.4 analyses the macroeconomic effects of capital inflows and the policy responses pursued to deal with capital inflows. Section 5.5 highlights further measures needed to consolidate macroeconomic stabilization while section 5.6 discusses the important role of effective institutions for attracting capital flows and how to achieve such institutions. Finally, section 5.7 concludes the chapter.

5.2 A sound macroeconomic environment is essential for attracting capital flows

Following independence in the 1960s, most African countries pursued populist policies with an emphasis on expanding social services, especially education and health. They also undertook massive public investment projects in infrastructure often financed through expansionary policies. These policies led to rising inflation, budget deficits and mounting external debt. Capital inflows diminished as investors became wary of the ability of developing countries to meet their debt-servicing obligations. These policies slowed down economic growth in Africa considerably. The oil and debt crises and the ensuing recession in developed countries served to aggravate the economic crisis in Africa (World Bank 1981). The magnitude of the economic stagnation was so profound that the 1980s came to be known as 'the lost decade' for SSA.

The events of the 1970s and the first half of the 1980s have demonstrated the need for sound macroeconomic policy management as a necessary condition for resumption of growth and mobilization of external finance. It was against this realization that African countries implemented macroeconomic stabilization policies in the mid-1980s and early 1990s. The focus of macroeconomic stabilization was on demand management through expenditure reduction and domestic credit ceilings. The objective of stabili-

zation programmes was to correct balance of payments disequilibria and to contain inflation. They have included fiscal, monetary and exchange rate policy reforms.

Fiscal policy reform

Fiscal policy has been an important instrument for managing aggregate demand and alleviating imbalances in African economies. The objective of fiscal adjustment in Africa in the mid-1980s and early 1990s was to bring fiscal deficits under control and rationalize public investment (Husain and Faruqee 1996). To the extent that public investment programmes exerted significant pressures on the fiscal balance, fiscal reforms in many African countries also sought to reduce the size of public investment programmes. This was also to be complemented by public sector reforms, including privatization and restructuring of state-owned enterprises and tax reform.

Considerable efforts have also been expended at improving revenue mobilization and tax administration

Apart from reducing fiscal deficits and achieving fiscal stability, another explicit objective of fiscal policy in recent years has been to support poverty reduction. This is the case particularly for countries that are implementing PRSPs. Mozambique, Tanzania and Uganda, have increased expenditures to priority social sectors such as health, education, and water provision (ADB 2005). Considerable efforts have also been expended at improving revenue mobilization and improving tax administration. For example, VAT exemptions for the government and its institutions have been abolished in Tanzania.

African countries have also implemented institutional reforms intended to increase the efficiency of tax collection, strengthen the independence of tax authority and curb corruption in the tax system. Ghana, Kenya, and Uganda have established autonomous tax authorities and have, as a result, experienced substantial improvements in tax collection (see Ndikumana and Nannyonjo 2005 for evidence on Uganda).

Monetary policy reform

The general focus of monetary policy has been to complement fiscal policy in taming inflation through controlling domestic credit (Husain and Faruqee 1996). The overall objectives of monetary reform undertaken in Africa were to reduce inflation, improve balance of payments and promote resource mobilization through stable real interest rates. However, with respect to monetary policy instruments used to achieve the defined objectives, there were some variations across countries, depending on the source of monetary growth. In Ghana, for example, the source of monetary growth was excessive lending from the central bank to public enterprises (Leechor 1996). Therefore, monetary policy sought to control bank lending. This was successful, as inflation fell to single digits in 1991. The improvement in fiscal balance made monetary policy manageable.

Since 1986, monetary policy in Kenya shifted from a direct monetary policy control system to indirect measures such as reserve requirements, variable liquidity ratios and market-based interest rates. Reform also sought to strengthen the central bank's control over non-bank financial institutions that have mushroomed in the 1980s.

Inflation targetting involves tradeoffs between price stability and growth and employment creation

In recent years, some African countries, notably South Africa, have adopted an inflation-targeting monetary policy framework in order to gain credibility[2]. Under an inflation-targeting regime, the overriding objective of monetary policy is the maintenance of stable prices (Agénor 2001). This has been a departure from the old tradition where monetary policy relied on intermediate targets such as monetary aggregates or exchange rates. South Africa has been relatively successful in stabilizing inflation (see box 5.1).

While inflation targeting contributes to price stability through building credibility and anchoring inflation expectations more rapidly and durably, it involves costly tradeoffs between price stability on the one hand and growth and employment creation on the other hand. Inflation-targeting countries are committed to hit a pre-defined inflation target, which may unnecessarily restrain growth (See Blanchard 2003). This has been the experience with inflation targeting in South Africa.

Box 5.1
Experience with inflation targeting in South Africa

South Africa adopted a full fledged, inflation targeting regime in February 2000. The motivation for this was the growing instability of money supply growth, and inflation following financial liberalization. The objective of inflation targeting was to instil monetary discipline and enhance the central bank's accountability. The inflation target was expressed in terms of headline CPI excluding mortgage interest costs. Since 2000, the inflation target has been set at 3 - 6 per cent. The institutional framework gives the Reserve Bank greater instrument independence in conducting monetary policy.

To enhance transparency in the conduct of monetary policy, the Reserve Bank publishes the monetary policy statements after each Monetary Policy Committee meeting. Monetary Policy Forums are also convened by the Reserve Bank twice a year and members of the public and important interest groups such as trade unions, businesses, and academia are invited to attend.

How has inflation targeting fared? When it was introduced in 2000, the actual inflation averaged 10 per cent, 4 percentage points above the upper limit of the target range. Thereafter, inflation declined to 5.4 per cent in September 2003 and then to 4.4 per cent in 2004. Consistent application of the inflation-targeting framework has strengthened the Reserve Bank's mandate to focus on price stability and has contributed to reducing inflation.

***Source**: Van der Merwe, E. J (2004).*

2 The shift to floating exchange rates in many developing regions, including Africa has necessitated the adoption of an alternative nominal anchor of price stability (Agénor 2001).

The country faces a serious problem of unemployment partly resulting from slow growth. The pursuit of inflation targeting takes away government's ability to boost growth through demand-side macroeconomic policy. The benefits of inflation targeting in terms of credibility and price stability should be carefully weighed against the losses in terms of employment creation.

Exchange rate policy reform

In addition to fiscal and monetary policy, exchange rate policy was a key element in macroeconomic stabilization (Husain and Faruqee 1996). The objective of exchange rate reform was to establish market-determined exchange rates and to eliminate parallel markets.[3] Although some African countries opted for a gradual approach to exchange rate reforms, most pursued an "overnight" approach, which essentially involved a shift to a floating exchange rate regime through the removal of foreign exchange controls (Agénor and Montiel 1996). In Ghana, for example, large and widely spaced devaluations were implemented in a four-year period (April 1983-September 1987) with an "overnight" float occurring in the last phase. In the case of Nigeria, currency devaluation was implemented overnight in September 1986.

Many countries have also moved towards greater capital account convertibility through relaxation or elimination of restrictions on capital-account transactions. Following its transition to democracy, the South African Government introduced measures to liberalize the capital account. This included the unification of the exchange rate system; immediate elimination of exchange controls on non-residents while those relating to domestic residents were to be removed gradually and eventually eliminated (Stahl, 1995).

5.3 The gains from economic reforms for capital flows have been small

Although performance has varied considerably across countries, the successful implementation of economic reforms, including macroeconomic stabilization, had brought positive results for a number of countries.[4]

Inflation rates have been reduced; twin deficits narrowed; exchange rates have stabilized, parallel market premiums have declined, and economic growth, albeit slow and erratic, has returned to many countries in Africa.

---

3 With respect to exchange rate policies in Africa, there has been a marked shift from soft pegs towards independently-floating and managed-floating exchange rate regimes. For example, out of 27 African countries that were in the soft-peg category in 1991, 15 were classified as independently floating regimes in 1999 (Ndikumana 2003).

4 See chapter 1 of this report for a detailed discussion of recent economic performance.

However, countries that have undertaken the most ambitious and sustained reforms, notably Ghana, Mozambique, Tanzania and Uganda, have experienced significant growth. In Uganda, for example, GDP growth has averaged 6 per cent per annum since the early 1990s while inflation has been brought down to single-digit levels. However, despite the improvement in growth, for most African countries, growth remains far below the 7 per cent target considered necessary for meeting the MDGs.

"Macroeconomic environment remains weak in many African countries"

Economic reforms, including macroeconomic stabilization, were expected to lead to increased capital inflows by raising risk-adjusted returns on investment. However, the evidence shows that African countries have not reaped substantial benefits from economic reforms. For example, over the period 1989-94 and 1995-1999, FDI inflows into Africa grew by an average 72 per cent. This is not that remarkable considering the very low base from which FDI grew. By comparison, FDI flows to Latin America and the Caribbean grew by nearly 200 per cent and to the Asia-Pacific region by 150 per cent (UNCTAD 2001, 2002 and 2005). Global inward FDI flows registered an average growth rate of 197 per cent over the same period.

The marginalization of Africa in global financial markets is manifested in the continent's stagnant share in global FDI flows. For example, over the period 1989-1994 and 1995-1999, and 2000-2004, SSA's share in the world's FDI flows averaged 1 per cent compared to 10 per cent and 17 per cent for Latin America and the Caribbean and Asia and the Pacific, respectively. Therefore, the surge in private capital flows to developing countries witnessed in the early 1990s did not reach most of the African countries (Ndikumana 2003).

A number of factors explain Africa's limited success in reaping the benefits of economic reforms in terms of capital inflows. Despite the implementation of macroeconomic reforms, the macroeconomic environment remains weak in many African countries. This is due to a number of factors, including low resource endowment, political conflict, and inappropriate macroeconomic policies that have accentuated the adverse effects of external shocks (Ndikumana 2003). In many countries, reforms were incomplete and were not underpinned by a strong institutional mechanism to sustain their implementation.

As a result, policy reversal was common, and this may have undermined the benefits of reforms for capital flows. For example, 150 foreign investors operating in East Africa ranked the risk of policy reversal as the most important risk factor (World Bank 1994). The impact of policy reversal is particularly more profound for FDI than for other types of capital flows given its irreversibility. Asiedu (2005) found FDI to Africa to be less responsive to trade liberalization than in other regions. A plausible explanation for this is that foreign investors perceive reforms as transitory and therefore subject to reversal.

Furthermore, institutional frameworks for macroeconomic policy management in Africa are weak. In most African countries, as in other developing regions, a triumvirate of institutions is responsible for the formulation and implementation of macr-

oeconomic policy. These include the central bank, Ministry of Finance and national planning bodies. Each of these institutions has a distinct mandate and power, and goes about implementing their mandates separately, with limited coordination in the formulation and implementation of macroeconomic policies.

Apart from policy coordination among the triumvirate institutions, coordination and policy harmonization between the triumvirate institutions and sectoral ministries is also weak. This complicates macroeconomic policy management. The lack of coordination leads to policy inconsistency, which undermines efficiency and institutional credibility in macroeconomic policy formulation and implementation. Therefore, African countries need to strengthen their institutional framework for macroeconomic policy management.

Another factor contributing to Africa's inability to attract capital flows relates to the "image problem" (Asiedu 2005). International investors have a negative perception of Africa that tends to undermine the effects of economic reforms on capital flows. For example, 56 per cent of firms surveyed in an UNCTAD study reported that the actual business environment in SSA is better than the continent's image would suggest (UNCTAD 2000). This is also corroborated by empirical evidence which suggests that credit-rating agencies tend to rate African countries as riskier than warranted by fundamentals (Haque et al. 2000).

As a result, SSA countries receive on average less FDI inflows than countries in other regions, even though the continent offers some of the highest rates of return on investment in the world[5]. Arguably, it is unlikely that economic reforms would lead to increased capital inflows as long as the investors perceive the region as risky.

> *It is unlikely that economic reforms would lead to increased capital inflows as long as the investors perceive the region as risky*

Furthermore, due to lack of information on individual African countries and their investment opportunities, investment decisions are often based on inferences from the environment of neighbouring countries rather on country-specific conditions (Asiedu 2005). Thus, in the eyes of foreign investors, Africa is 'one big country' rather than a continent made up of different countries. This calls for more efforts on the part of individual African countries, international organizations and Africa's development partners to change the image of Africa and to develop among foreign investors a more differentiated view of the continent and its opportunities" (UNCTAD 1999).

Other factors having a positive impact on FDI include good physical infrastructure, an educated labour force, openness to FDI, an efficient legal system, low corruption and political stability. On this count, the majority of African countries do not fare well either. Physical infrastructure in most African countries is weak, energy supply is unreliable, corruption is rampant, and a number of countries suffer from political conflicts.

Despite the limited benefits of economic reforms for capital flows to Africa, capital flows have nonetheless posed considerable challenges for macroeconomic policy management in a number of countries.

5 For example, the average return on US investment in Africa was 30 per cent over the period 1991-1996 compared to 21 per cent and 14 per cent for Asia-Pacific and Latin America, respectively (UNCTAD 1999).

5.4 Capital inflows have posed challenges for macroeconomic policy management

While increased capital flows have had positive effects on the economies of developing countries, including Africa, they have also been associated with adverse effects. In general, policymakers have been confronted with three sets of problems:

- Excessive expansion in aggregate demand due to capital inflows, leading to overheating, thus undermining hard-won gains in macroeconomic stability;
- Vulnerability to abrupt reversal in capital flows due to changes in investor perception, especially for countries that have attracted sizeable amounts of short-term capital flows; and
- The premium that greater financial integration imposes on macroeconomic policy management (World Bank 1997).

The macroeconomic effects of capital flows have varied across countries depending obviously on the type of flows (private versus official, short versus long-term) and their associated volatilities, volume and magnitude in relation to domestic absorption of the recipient as well as the usage of inflows. Capital flows to Africa have been predominantly in the form of ODA, with FDI being the major component of private capital inflows to Africa (see chapter 2). The increase in capital inflows and their associated volatility has posed challenges for macroeconomic management. According to Osei *et al.* (2002), private inflows to Africa in the 1990s exhibited a higher degree of volatility than those to Asian and Latin American countries (see also chapter 2 of this report for measures of volatility).

One of the common effects observed in African countries has been an expansion in domestic credit and liquidity arising from financing of large budget deficits. For example, following successful adjustment in the mid-1980s in Ghana, net aid flows grew from nearly $1 million in 1984 to over $650 million in 1992 (Leechor 1996).[6] This led to an increase in Ghana's foreign exchange reserves, which were mainly used to finance government expenditures. Although foreign aid has played an important role in supplementing declining export earnings due to worsening terms of trade it also became an important source of monetary expansion. For example, the rate of growth in broad money supply rose from 40 per cent in 1983 to 52 per cent in 1992. Thanks to an aggressive credit restraint policy, inflation declined considerably from 122 per cent in 1983 to 10 per cent 1992 (Leechor 1986).

Since early 2000, some African countries, for example Mozambique, Tanzania and Uganda, have formulated and implemented PRSPs. These countries have also experienced increases in capital flows related to PRSPs and debt relief under the HIPC Initiative. These are mostly low-income countries with fledgling financial sectors which limit the menu of policy choices available to them to deal with massive aid inflows.

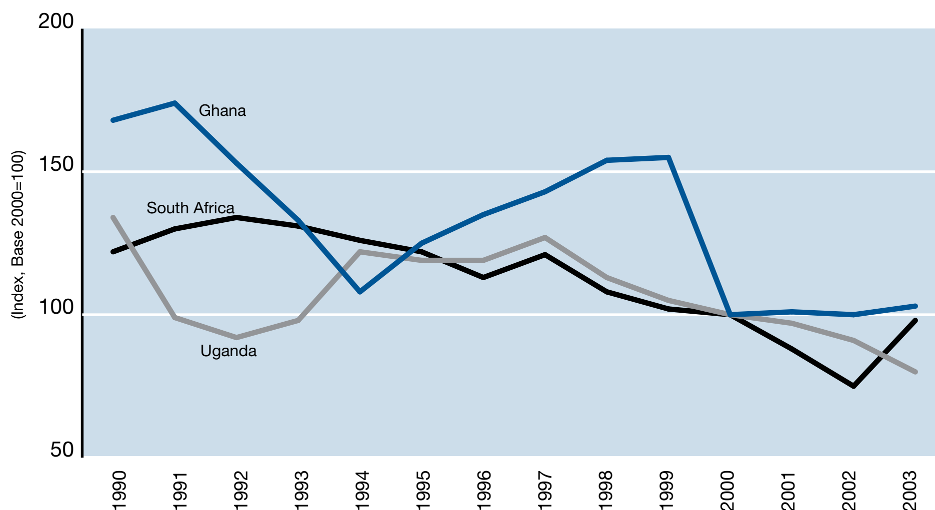
6 Foreign aid has been considered an important factor in Ghana's successful adjustment programme.

Since the public expenditure priorities embedded in country PRSPs are biased in favour of non-tradable goods and services, PRSP-related aid inflows exerted pressure on the real exchange rate while the simultaneous inflow of private capital has led to an expansion of the monetary base (Buffie, Adam, O'Connel and Pattillo 2004). Real Effective Exchange Rates (REER) are depicted in figure 5.1. That rate for the Ghanaian Cedi depreciated from 1990 to 1994 and thereafter appreciated until 1999. The same rate for the Ugandan Shilling showed considerable appreciation, especially from 1992 to 1997. According to Kasekende *et al.* (1997) real exchange rates appreciated by more than 11 per cent between 1994 and 1997. For Tanzania, the cumulative overvaluation was estimated at 20 per cent for the period 1994-1996 (Leape 1999). Real exchange rate appreciation tends to have a detrimental impact on the tradable sector.

The massive inflows of capital to South Africa since 1994 has made the economy vulnerable to sudden reversals of capital flows

Figure 5.1

Real Effective Exchange rates for Selected African countries



***Source**: IMF, 2005*

***Note**: An increase in the rate means appreciation of the national currency.*

Capital flows expose countries to risk of currency crisis, especially arising from sudden reversal of capital. For example, the massive inflows of capital to South Africa since 1994, most of which were of short-term maturity, has made the economy vulnerable to sudden reversals of capital flows. This has led to a series of exchange rate crises. The first such wave occurred in February 1996 and lasted to July 1996. The main contributing factor was investor uncertainty about the direction of economic policy given the inherently conflicting policy objectives among key stakeholders, especially between the government and the labour movement represented by the Congress of South African Trade Unions (COSATU).

The second wave occurred in October 1996 and November 1997, caused largely by the contagion effects from the Asian financial crisis. The decline in the price of gold and other metals also contributed to the exchange rate crisis during this period. The third currency crisis came in April 1998 as rising current account deficits, coupled with poor growth prospects, dampened investor confidence in the South African economy (Aron and Elbadawi 1999).

"Increased financial integration reduces the policy space for countries to conduct independent monetary and exchange rate policies"

Another effect of capital inflows relates to the challenges that increased financial integration imposes on macroeconomic policy management. Increased financial integration reduces the policy space for countries to conduct independent monetary and exchange rate policies. This is the well-known policy trilemma, the observation that a country can attain only two of the three objectives of exchange rate stability, monetary independence and financial integration.[7] While these three objectives are worth pursuing, it is nearly impossible for policymakers to pursue them simultaneously. Therefore, if policymakers opt for exchange rate stability and capital mobility, they have to forego monetary independence. If monetary policy independence and capital mobility are opted for, then the country has to choose floating exchange rates and give up the objective of exchange rate stability (Taylor 2004).[8] Throughout history, policymakers have been preoccupied with finding choices to resolve this policy trilemma.

In some African countries, policymakers have opted for exchange rate stability and capital mobility at the expense of monetary independence. This is the case for CFA countries and the member countries of the Common Monetary Area [9] (CMA). A good number of African countries have opted to pursue the objectives of independent monetary policy and capital mobility. They have chosen to forego the objective of exchange rate stability by floating their exchange rates. Ethiopia, Ghana, Kenya, Nigeria, South Africa and Uganda are some of the countries that have floated their exchange rates.

With respect to policy responses to address the effects of capital inflows, African countries have pursued a wide range of options. For example, the Ghanaian Government introduced an aggressive domestic credit policy in 1989 to mitigate the macroeconomic effects of foreign aid inflows (Leechor 1996). The policy had a noticeable impact as it generated fiscal surpluses, which were used to repay the Government's debt at the Central Bank.

African countries have also used sterilized interventions through the sales of bonds to limit the effects of monetary expansion on aggregate demand. Given the shallowness of debt markets, this type of intervention is costly, as rising interest rates increased debt servicing costs for both the Government and the private sector. Rising interest rates also discourage private sector borrowing while investment in bonds by banks crowd out lending to the private sector. While sterilization is necessary and effec-

7 For a detailed exposition of this theorem, see for example Obstfeld, Taylor and Shambaugh (2004).

8 Taylor, A.M (2004), "Global Finance: Past and Present", *Finance and Development*, March 2004.

9 The members of the CMA are Lesotho, Namibia, South Africa and Swaziland.

tive in offsetting the potential expansionary effect of increased capital inflows on the economy, there is a limit to its application. The fiscal cost could be high due to rising interest rates needed to entice investors to hold more of the newly issued bonds (Aron and Elbadawi 1999).

In addition to bond sterilization, central banks resort to more direct intervention in the foreign exchange market to limit the pressure on the nominal exchange rate. The transfer of government deposits from the banking system to the central bank is also used as a means of containing exchange rate appreciation due to aid inflows. This method has been used in Mozambique, South Africa, Uganda, and many others.

5.5 African countries need to further consolidate macroeconomic stability

As indicated in the preceding section, the implementation of macroeconomic stabilization policies has contributed to macroeconomic stability in a number of countries. However, the macroeconomic environment remains weak in many African countries. A number of factors, including low resource endowment, political conflict, inappropriate macroeconomic policies and narrow export base with volatile terms of trade[10] combine to undermine macroeconomic stability.

> *"African countries need to enhance their capacity for macroeconomic policy formulation and implementation"*

Given their weak institutional framework for macroeconomic policy management (especially the limited degree of coordination among the triumvirate institutions responsible for macroeconomic policy management) African countries need to enhance their capacity for macroeconomic policy formulation and implementation. This should be complemented by granting central banks sufficient autonomy to resist the temptation of inflationary deficit financing. What makes this particularly important is the increasing tendency of countries to move towards inflation control as the primary goal of monetary policy. Central bank autonomy must become an essential precondition for the successful control of inflation.

Countries seeking to gain much needed credibility may consider adopting an inflation-targeting approach to monetary policy. Some African countries, including South Africa, have adopted inflation targeting in recent years and have had relative success in reducing inflation. While inflation targeting leads to price stability, it involves costly trade-offs between price stability, growth and employment creation. Therefore, in considering the choice of an inflation targeting approach to monetary policy, countries should carefully weigh the benefits of inflation targeting in terms of credibility and price stability against the cost to output and employment creation.

10 External shocks, especially trade shocks contribute significantly to macroeconomic fluctuations in African countries. Koze and Riezman (1999) estimate trade shocks to account for 44 per cent of variations in aggregate output.

While macroeconomic stabilization policies are necessary for attracting steady and predictable flows of external finance, they will be more entrenched and sustainable if underpinned by a sound institutional environment.

5.6 The institutional environment for increasing capital flows to Africa

Institutions are important for attracting capital flows

The importance of institutions and the mechanism through which institutions affect capital flows were not clear until recently. Empirical evidence suggests that institutional differences are a major source of the differences in economic performance across countries.[11] Acemoglu, Johnson and Robinson (2001) found that as much as three-fourths of the income gap between the top and bottom of the world income distribution may be due to differences in their institutions.[12] The argument is that the structure of incentives determines economic performance and institutions provide the incentive structure of the economy (Olson 1996). Moreover, institutions affect economic performance through their effect on investment decisions, by protecting the property rights of entrepreneurs and favouring the adoption of new technologies.

> *Three-fourths of the income gap between the top and bottom of the world income distribution may be due to institutional differences*

Research shows that institutions play a key role in facilitating private investment and that institutional quality is the most important factor that explains why capital does not flow from developed countries, where it has a lower return, to developing countries where it has a higher return (Olson 1996). Institutions can affect capital flows directly by providing the enabling environment, good governance and sound financial institutions that encourage the flow of capital and facilitate long-term investments. Indirectly, institutions affect capital flows through their impact on other variables that affect capital flows, in particular their impact on economic growth and the business environment, including the quality of public infrastructure, policy environment, political stability, labour costs, exchange rates, and price and exchange rate stability.

Central to both institutional environment and capital flows is the role of governance, that is, the manner in which a government discharges its responsibilities in an effective, transparent and accountable manner that conforms with internationally accepted good practices. This determines the amount of capital that flows into a country. Good governance has been shown in the literature to affect economic growth positively, implying that

11 See for example, Knack and Keefer, 1995, or Hall and Jones, 1999.

12 The authors argue that the legacy of colonialism and the institutional differences it caused persisted even after colonialism ended. Using the exogenous variation in institutions across former colonies, due to mortality rates faced by Europeans at the time of colonization, they argue that Europeans introduced extractive institutions in colonies where they did not settle, while developing effective property rights in colonies where they settled in large numbers. This explains the better performance in the latter group relative to the former.

governance indirectly affects capital inflows.[13] This may occur as a result of productivity-enhancing effects exerted by good governance on inputs in the production process. However, an important challenge is how to establish the mechanisms of good governance, which characterize the capable State, including its ability to enforce contracts, property rights and the rule of law, all of which have been found to have positive effects on growth. The crucial issue is determining what institutional arrangements are capable of fostering a capable State and hence good governance. This task is undertaken in the next section.

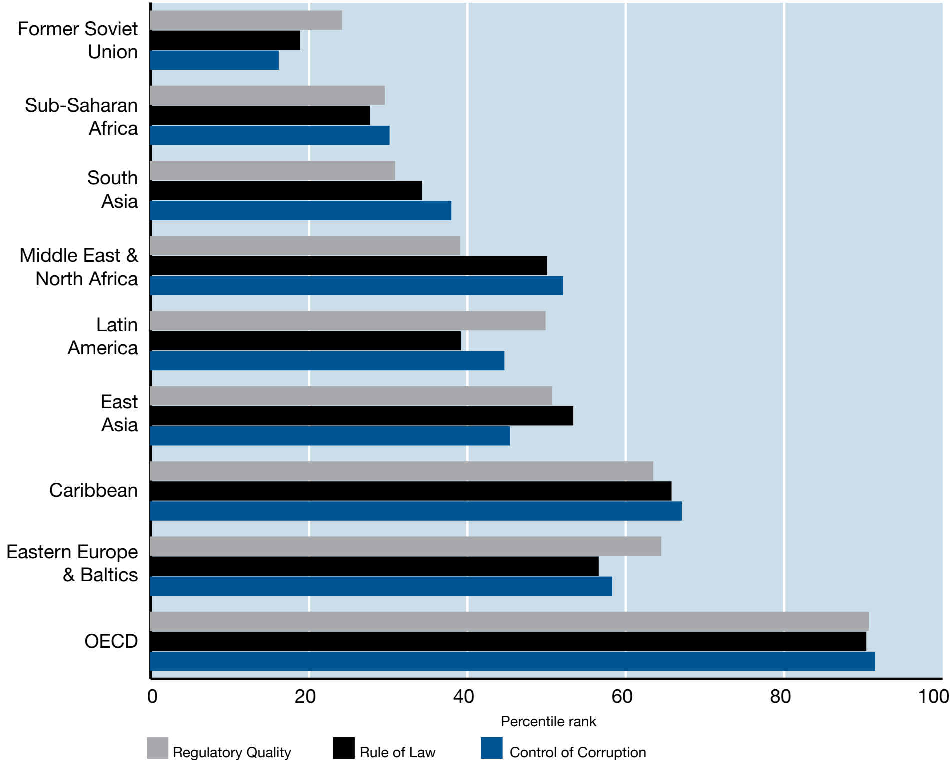
> *The crucial issue is determining what institutional arrangements are capable of fostering a capable State and hence good governance*

African institutions have not performed well in attracting capital flows

Institutional quality can be measured by the quality of governance, including the degree of corruption, political rights, public sector efficiency and regulatory burdens; the extent of legal protection of private property and how well such laws are enforced; and the limits placed on political leaders (Acemoglu, 2003).

Figure 5.2

Corruption, Rule of Law and Regulatory Quality in Africa and Other Regions, 2004



***Source**: Kaufmann et al., 2005.*

13 See Ndulu and O'Connell (1999) for evidence on the role of governance in economic growth in Africa. Also see Barro (1997) and IMF (2003).

> Corruption has negative effects on capital flows and overall economic development

Figure 5.2 depicts the percentile rank of the various regions with respect to three indicators of institutional quality: control of corruption, rule of law and regulatory quality. Higher values imply better governance ratings. Regions are presented on the chart ranging from 'best' (top of the chart) to the 'worst' (bottom of the chart) for year 2004. Sub-Saharan Africa scores worse than other regions (only higher than the former Soviet Union) in the three selected indicators of institutional quality. The quality of the business environment indirectly measures the quality of African institutions for the market. The World Bank's *Ease of Doing Business Index*, which ranks economies from 1 to 155, shows that African countries rank predominantly at the bottom of the scale. Twenty-five African countries rank between Zimbabwe, which ranked 126, and the Democratic Republic of Congo (which ranked 155 out of 155). It is not surprising that the countries with good institutions - the ones that, among other things, enforce contracts and property rights and protect investors - rank high on the list, with Mauritius ranking 23 and leading the way, followed by South Africa (28), Namibia (33) and Botswana (40).

Corruption is a serious problem in many African countries and, as in many other parts of the world, is the bane of good institutions. It has negative effects not just on capital flows but also on overall economic development. Corruption prevents the emergence and sustainability of strong institutions and deters foreign investment in countries where it is rampant. Corruption also constitutes a significant challenge to capital flows to Africa even though countries such as Nigeria, which has significant corruption problems, attract capital in the natural resource extraction sector.

However, FDI outside the natural resource extraction sector appears much more responsive to macroeconomic, political and institutional variables (Nnadozie and Osili 2005). Table 5.1 shows the *Corruption Perception Index*, with lower ranking indicating higher levels of corruption perception. The table shows that Africa has the second-lowest ranking after non-EU South and Eastern Europe and Central Asia.

Table 5.1

Comparison of Corruption Perception Index across Regions, 2005

Region	Index
Non-EU South and Eastern Europe and Central Asia	2.67
Africa	2.86
North and South America	3.86
Global Average	4.11
Asia and Pacific	4.28
Middle East	4.37
EU plus Iceland, Norway and Switzerland	6.67

Source: *Transparency International, 2006*

Because the institutional environment, good governance and sound financial institutions directly play a positive role in encouraging the flow of capital, it is important to establish an institutional environment that will enhance the flow of good-quality capital and minimize the volatility of inflows that can cause severe macroeconomic imbalances.

In Africa, the preponderance of extractive institutions is the legacy of colonialism. Indigenous administrations could not modify this legacy, mainly because once they are entrenched, extractive institutions are hard to change. Yet, the key hindrance to effective institutions is the entrenched interests of the elites or particular groups favoured by the existing institutional arrangements. Hence, the problem of institutional reform and that of the persistence of bad institutions lie in the fact "that any major change creates winners and losers and the potential losers are often powerful enough to resist change" (Acemoglu 2003:130). Institutional change will occur when groups that favour change become powerful enough to impose it on the potential losers. Alternatively, societies can reach an agreement to compensate potential losers after the change takes place, or perhaps shield them from the adverse effects of these changes (Acemoglu 2003).

Because institutions define and enforce the economic rules of the game, they shape economic performance, which means that economic development depends heavily on the establishment of strong and stable political institutions (North, 2005). North argues that "Political institutions will be stable only if they are supported by organizations with an interest in their perpetuation" (North 2005: 7). The implication is that African countries must encourage and create such organizations as an essential part of political and economic institutional reforms within a participatory, consultative, and democratic framework.

"There is a need to establish an institutional environment that will enhance the flow of good-quality capital"

Effective institutions will enable African countries to increase capital flows

To increase capital flows, African countries must acquire and develop effective institutions—those "…that improve the market systems by improving information, lowering transaction costs and improving resource allocation and distributional equity" (Nnadozie 2005). The central challenge, therefore, is how to build and strengthen African institutions and make integration into the global economy work for African countries in achieving development goals through increased flow of stable long-term capital. Making institutions play their rightful role will require a two-pronged approach: identifying critical institutions and building them or improving upon their efficiency and effectiveness.

Identifying institutions that are critical for increasing the flow of beneficial international capital

Having understood and accepted the role of institutions, the logical next step is to identify the institutions that are critical for increasing capital flows. The institutions that will increase capital flows are likely to be the same ones that increase growth, especially those that protect property rights and enforce contracts. These are institutions that will minimize the transaction costs associated with international capital and alleviate information and sovereign risk, thus improving market efficiency. Institutions that will address domestic market imperfections are equally critical and include institutions for developing human capital and improving government policies.

First and foremost, African countries need institutions that will generate the right incentives for an increased flow of international capital by providing good information to investors, and promoting investment opportunities and political stability. Furthermore, they need institutions that will ensure better economic management and create a sound macroeconomic environment. They also need institutions that will not only provide an enabled business environment, including provision of quality infrastructure, and deepening and improving the efficiency of the financial sector in order to unleash the potential of the private sector. Finally, the sector needs institutions that enable its members to establish and implement a national strategy for attracting foreign capital.

"The financial sector needs to establish and implement a national strategy for attracting foreign capital"

- **Institutions for managing conflict and promoting political stability**. Because political stability is important for improving sovereign risk, it is necessary to build institutions that promote political stability and effectively manage conflicts. Examples of such institutions include a good constitution, the rule of law, an independent judiciary, representative political institutions, free elections, independent trade unions, social partnerships, and institutionalized representation of minority groups and social insurance (Rodrik 2000).
- **Regulatory and stabilization institutions.** A capital-friendly environment requires effective institutions to attract foreign capital. These include banks and stock markets and the institutions that regulate anti-competitive behaviour, including anti-trust laws. There is need for efficient prudential regulation and financial supervision such as the central bank. Securities regulation requires securities and exchange commissions. Likewise, institutions for macroeconomic stabilization, especially an independent central bank, will help to avoid financial crises when flows increase.
- **Legal institutions, the rule of law and property rights enforcement.** These are equally important for attracting foreign capital. Property rights enforcement is an important dimension of the rule of law. Incentives play an important role in enterprise formation and growth and property rights are at the heart of the incentive structure (World Bank 1999). For the flow

of capital to increase, these rights, including ownership and control, must be clearly defined by law through a combination of legislation, private and public enforcement, and custom and tradition (Rodrik 2000). Good laws must be passed, they must be applied fairly and transparently and even-handedly to all, by a politically independent judiciary. Above all, they must be enforced. Investors must be protected.

Because of weak and sometimes corrupt courts and regulators, underdeveloped capital markets and a shortage of skilled operators, lawyers and accountants, foreign investors often have difficulty in obtaining information on companies and are therefore wary of investing in African countries (World Bank 1996). There is a need for corporate law and better corporate governance to improve the investment environment, control corruption and increase the level of trust in the State. However laws are only as good as the institutions that enforce them.

> *"Increasing capital flows to African countries will require a heavy dose of strategic institutional development"*

Building and strengthening capital-friendly institutions

The issue is not just what type of institutions are needed to enable each African country to increase its capital inflows but also how they can be built, developed and strengthened. Significantly increasing capital flows to African countries will require a heavy dose of strategic institutional development. The options pursued in terms of desirable institutional arrangement will vary across and within countries over time within the historical realities (Rodrik 2000). Making institutions work for capital inflows requires a definition of national capital-flow objectives, a correct diagnosis of institutional deficiencies in achieving these objectives and a strategy for increasing capital inflow within a well-established national growth and poverty reduction framework.

Diverse initial conditions among African countries imply that their approach to institutional reforms and institution-building will vary from country to country. The strategies will be based on an assessment of the institutional gaps and capacities in each country. In acquiring functional, capital-friendly institutions and improving upon their quality, should African countries focus on best practices and copy existing models or should they engage in local experimentation based on local innovation. They must choose between ready-made blueprints or experiments using domestic historical, social, and political realities and knowledge of local needs and capacity.

Each choice has advantages and disadvantages and therefore entails trade-offs. There should be a country-specific approach. For some countries, it will be the establishment of new institutions. For others, it will be the harmonization of existing ones. There is also need for local experimentation, in recognition that this approach has its own dangers and is costly in terms of time and resources.

The blueprint approach may not be the way to go but use of local knowledge in adaptation of imported models has its own problems. Nonetheless, there is always some-

thing to learn from the institution-building experience or institutional arrangement prevailing elsewhere even if they are often "inappropriate or cannot be transplanted" (Rodrik 2000: 12). Sometimes, institution-building may require combination of orthodox and heterodox strategies in a participatory process. This approach has enabled Mauritius, a stable democracy with regular free elections, to attract considerable foreign investment and generate one of Africa's highest per capita incomes (see box 5.2). Besides, democracy helps build better institutions, which means that the economic strategy needs to be underpinned with social and political arrangements that encourage participation, representativeness and coalition-building (Rodrik 2000).

"African countries can learn from the experience of some of their Asian counterparts and from the success stories in Africa"

Certain steps are required to adapt policy and institutional change to local conditions and there is need for broad-based participation in the process of change. African countries can learn from the experience of some of their Asian counterparts and from the success stories in Africa. Botswana and Mauritius are two African countries that have consistently performed well despite facing many conditions similar to those of their African neighbours.[14] The difference, many studies conclude, lie in good governance, that is, the quality of institutions that encourage participation and transparency in these two countries has been much higher than those on the rest of the continent (Rodrik 2000; Acemoglu *et al.,* 2001).

Box 5.2

The Export Processing Zone in Mauritius

In creating the Export Processing Zone (EPZ), the Government of Mauritius recognized that there would be winners and losers, especially industrialists who for years had been favoured by protectionist arrangements. By addressing the needs of the industrialists through negotiation, the Government earned their support for the reforms. The EPZ generated new trade and employment opportunities, while protecting existing interest groups. As a result, Mauritius benefited from high levels of capital flows that boosted trade and investment.

Source*: Rodrik 2000.*

Regional dimensions of institution-building

Aside from mobilizing internal and external resources to fund institutional change, there are also regional and global dimensions. African countries need to develop and strengthen regional organizations that enable them to attract and absorb higher volumes of private capital flows. In particular, subregional and continent-wide initiatives aimed at improving economic and political governance play an important role in improving Africa's image in the eyes of international investors.

For instance, as an integral part of the AU's New Partnership for Africa's Development (NEPAD), the African Peer Review Mechanism (APRM) aims to foster the adoption of policies, standards and practices that lead to political stability, high economic

14 Some of these common conditions include low human capital, commodity dependence, tropical climate and lack of access to the sea.

Box 5.3
China's success in attracting foreign capital

China offers more, incentives to attract FDI than any other country in the world but also offers more legal restrictions. Adopting a pragmatic strategy that has been adjusted over time, China was able to attract significant amounts of capital flows with a mix tilted in favour of FDI.

The country adopted an export-oriented approach targeting foreign capital that could help transmit technical and marketing know-how. It embarked on prudential capital-account liberalization, coupled with a mixed policy of simultaneously discouraging foreign debt and foreign portfolio investment and providing incentives for FDI.

Through the experience of the Asian crisis, China adopted an incentive mechanism and a step-by-step relaxation of restrictions. It promulgated laws governing capital investment at the start of the reform programme and used tax benefits for FDI and capital controls to limit other flows.

***Source**: Eswar Prasad and Shang-Jin Wei (2005).*

growth, sustainable development and accelerated subregional and continual economic integration. This is to be done through sharing of experiences and reinforcement of best practices, while identifying deficiencies and assessing the needs of capacity building in the areas of governance and socioeconomic development. It is believed that as a regional mechanism, APRM will encourage the emergence of sound national institutions and promote economic development in Africa by improving political, economic, and corporate governance.

5.7 Conclusion

African countries have undertaken a number of economic reforms since the early 1980s. Macroeconomic stabilization policies have featured prominently in 'the first-generation reforms' agenda. These policies have been complemented by trade, financial and capital account liberalization. Tax reforms were also included, generally in the later stages of stabilization programmes. Implementation of these policies has brought positive results for a number of African countries, as evidenced by falling inflation rates and narrowing of fiscal and current account deficits. Although growth has returned to a number of countries, it remains below the seven per cent target required for meeting the MDGs.

While Africa as a continent remains on the sidelines of financial globalization, some countries have been able to attract substantial volumes of external capital, including official aid and resource-seeking private capital. These flows have posed considerable challenges for macroeconomic policy management. The common effects observed across Africa have been inflationary pressures and real exchange rate appreciation.

In response to capital inflows, African countries have pursued a number of policy options. These have ranged from sterilization through bond issues, direct foreign exchange intervention and transferring government deposits from commercial banks to the central banks.

Properly managed, the benefits of international capital can outweigh the costs

Notwithstanding the challenges that capital inflows pose for economic policy management in general and macroeconomic policy in particular, they are important for the growth and development of African economies. Properly managed, the benefits of international capital can outweigh the costs. For instance, they can help to reduce the savings gap and provide the resources needed for infrastructure development and for social spending, (both of which are essential for private sector and human capital development) and poverty reduction. To increase capital flows while minimizing their potential negative effects, African countries must design strategies and institutions to reduce transaction costs and investment risk and develop human capital. Property rights must be secured through honest, competent, and reliable administration of justice. This will permit greater investment, which when allocated efficiently, can improve economic growth. Effective institutions can help African countries to pursue better and more sustainable policies, benefit from increased capital flows and maximize their benefits; competent institutions, and the public's trust in them, take a long time to grow.

References

Acemoglu, Daron, Simon Johnson, and James A. Robinson, 2001. "The Colonial Origins of Comparative Development: An Empirical Investigation," *American Economic Review*, 91 (5), pp. 1369–1401

Acemoglu, Daron. 2003. "Root Causes: A Historical Approach to Assessing the Role of Institutions in Economic Development." *Finance and Development*, 27-30 June.

African Development Bank (ADB), 2005. *African Economic Outlook,* Tunis, Tunisia.

Alfaro Laura, Sebnem Kalemli-Ozcan, and Vadym Volosovych. 2003. "Why Doesn't Capital Flow from Rich to Poor Countries? An Empirical Investigation", unpublished paper.

Aron. J., and I. Elbadawi, 1999. "Reflections on the South African Rand Crisis of 1996 and Policy Consequences", Working Paper Series No. 99-13, Centre for the Study of African Economies, Oxford University.

Aron, J., I. Elbadawi, J. Muellbauer and Y. Tsikata. 1999. "Policy Credibility and Currency Crisis in South Africa: An Empirical Analysis", Mimeo, Centre for the Study of African Economies, Oxford University.

Asiedu, E. 2005a. "Foreign Direct Investment in Africa: The Role of Natural Resources, Market Size, Government Policy, Institutions and Political Instability." WIDER Research Paper 2005/24*,* June 2005.

Asiedu, E. 2005b. "On the determinants of foreign direct investment to developing countries: Is Africa different?" *World Development*, 30(1), 107-19.

Agénor, P.R. 2001. "Monetary Policy under Flexible Exchange Rates: An Introduction to Inflation Targeting", Central Bank of Chile, Working Papers*,* No. 124, (Santiago, Chile).

Agénor, P.R. and P.J. Montiel. 1996. *Development Macroeconomics.* Princeton, New Jersey. Princeton University Press.

Barro, J. 1997. *Determinants of Economic Growth: A Cross Country Empirical-Study*. Cambridge, Massachusetts. The MIT Press.

Blanchard, O. 2003. "Comment on *Inflation Targeting in Transition: Experience and Prospects*, by Jiri Jonas and Frederic Mishkin," paper prepared for the NBER Conference on Inflation Targeting, B. al Harbour, Florida, 23-25 January.

Buffie, E., C. Adam, S. O'Connel, and C. Pattillo, 2004. **"**Exchange Rate Policy and the Management of Official and Private Capital Flows in Africa.*"* IMF Staff Papers, 51, (Special Issue), 126-160.

Eswar Prasad and Shang-Jin Wei, 2005. "The Chinese Approach to Capital Inflows: Patterns and Possible Explanations," IMF Working Paper WP/05/79.Fernández-Ariàs (1996)

Hall, Robert E. and Charles I. Jones, 1999. "Why do Some Countries Produce So Much More Output per Worker than Others?" *Quarterly Journal of Economics* 114 (1), 83-116.

Haque, N.U., M, Nelson and D.J. Mathieson, 2000. "Rating Africa: The Economic and Political Content of Risk Indicators" in Paul Collier and Catherine Pattillo (eds), *Investment and Risk in Africa*, 33-70. New York: St Martin's Press, 33-70.

Hausmann, Ricardo and Dani Rodrik, 2002. "Economic Development as Self-Discovery," NBER Discussion Paper No. w8952, May. http://papers.nber.org/papers/w8952

Husain, I.and R. Faruqee, 1994. *Adjustment in Africa: Lessons from Country Case Studies.* World Bank, Washington, D.C.

IMF. 2005. International Financial Statistics, Yearbook 2005. Washington D.C.

__________. 2003. Growth and Institutions. *World Economic Outlook*. Washington D.C.

2004. World Economic Outlook- September 2004. Washington, D.C.Kasper, Wolfgang and Streit, Manfred E. 1998. *Institutional Economics: Social Order and Public Policy*. Cheltenham, UK: Edward Elgar.

Kasekende, L. and D. Kitabire, 1997. "Capital Flows Study: Uganda", Paper Presented to EFA workshop on Private Capital Flows and Macroeconomic Policy in Sub-Saharan Africa, Cape Town, 15 July.

Kaufmann D., A. Kraay, and M. Mastruzzi, 2005. Governance Matters IV: Governance Indicators for 1996-2004, http://econ.worldbank.org

Knack, Stephen and Philip Keefer, 1995. "Institutions and Economic Performance: Cross-Country Rests Using Alternative Institutional Measures," *Economics & Politics*, November, 207-228.

Koze, M.A and Raymond Riezman, 1999. "Trade Shocks and Macroeconomic Fluctuations in Africa", Centre for the Study of Globalization and Regionalization, Working Paper No. 43/99, University of Warwick.

Leape, J. 1999. "Macroeconomic Impact", in N. Bhinda, S. Griffith-Jones, J.Leape and M.Martin (eds), *Private Capital Flows to Africa: Perception and Reality*, The Hague: Forum on Debt and Development (FONDAD).

Leechor, C. 1996. "Ghana: Frontrunner in Adjustment", in Husain, I. and R. Faruqee (eds), *Adjustment in Africa: Lessons from Country Case Studies*, Washington D.C: World Bank, 153-192.

Lucas, Robert 1990. "Why doesn't Capital Flow from Rich to Poor Countries?" *American Economic Review* 80, 92–96.

Ndikumana, L. and J. Nannyonjo. 2006. " From Failed State to Success Story?" In Boyce, J.K., ed., *Peace and the Public Purse*. Forthcoming.

Ndikumana, L. 2003. "Capital Flows, Capital Account Regimes, and Foreign Exchange Rate Regimes in Africa", in UNCTAD (ed). *Management of Capital Flows: Comparative Experiences and Implications for Africa*. Geneva: UN, 313-384.

Ndung'u, N.S. 1999. "Monetary and Exchange Rate Policy in Kenya", AERC, Research Paper, RP No. 94, Nairobi: AERC.

Ndulu, B. J. and S. A. O'Connell. 1999. "Governance and Growth in Sub-Saharan Africa," *Journal of Economic Perspectives*, 13(3), 41-66

Nnadozie, E. 2003. *African Economic Development*, Academic Press.

__________. 2005. "Regional Institutions and Development in Africa: The African Peer Review Mechanism", unpublished mimeo.

Nnadozie, E and U. Okonkwo Osili 2005 "What are the Determinants of US Foreign Direct Investment in African Countries?" in *Financial Systems and Mobilization of Resources in Africa*, United Nations Economic Commission, Economic and Social Policy Division, ESPD/NRP/02/05

North, Douglass C. 1990. *Institutions, Institutional Change, and Economic Performance*, Cambridge University Press.

__________. 2005. "Institutions and the Performance of Economies Over Time," in Ménard, Claude and Mary M. Shirley (2005) eds. *Handbook of New Institutional Economics*. Netherlands: Springer, 21-30.

Obstfeld, M., A. Taylor and J. C. Shambaugh. 2004. "The Trilemma in History: Trade-offs among Exchange Rates, Monetary Policies and Capital Mobility", NBER Working Paper No. 10396.

Olson, Mancur Jr. 1996. "Big Bills Left on the Sidewalk: Why Some Nations Are Rich and Others Poor," *Journal of Economic Perspectives* 10 (2), 22.

Osei, R., O. Morrissey and R. Lensink. 2002. "The Volatility of Capital Inflows: Measures and Trends for Developing Countries", *CREDIT Research Paper.*

Prasad, Eswar and Shang-Jin Wei. 2005. "The Chinese Approach to Capital Inflows: Patterns and Possible Explanations," IMF Working Paper WP/05/79.

Rodrik, Dani. 1995. "Getting Interventions Right: How South Korea and Taiwan Grew Rich," *Economic Policy* 20, 53-107. (Draft at http://www.nber.org/papers/w4964.pdf)

__________. 1997. *Has Globalization Gone Too Far?* Washington DC: Institute for International Economics.

__________.1998. "Globalization, Social conflict and Economic Growth", in *World Economy*, March.

__________. 2000. "Institutions for High-Quality Growth: What They Are and How to Acquire them," *Studies in Comparative International Development*, vol. 35, no.3, Fall.

Rodrik, Dani and Arvind Subramanian. 2003. "The Primacy of Institutions (and what this does and does not mean)." *Finance and Development* (June), 31-34.

Stals, C. 1995. "Monetary Policy in South Africa". Address the Second South African 'Economy, Trade and Investment' Conference, London, 17 October.

Stiglitz, Joseph "The New Development Economics," in G. M. Meier and J. E. Rauch, *Leading Issues in Economic Development*. New York: Oxford University Press, 352-355.

Swamy, G. 1996. "Kenya: Patchy, Intermitted Commitment", in Husain, I. and R. Faruqee (eds), *Adjustment in Africa: Lessons from Country Case Studies*, Washington D.C: World Bank, 193-237.

Taylor, A.M. 2004. "Global Finance: Past and Present." *Finance and Development*. March, 28-31.

UNCTAD. 1999. *Foreign Direct Investment in Africa: Performance and Potentials.* New York: United Nations.

__________. 2000. UNCTAD Press Release, www.unctad.org/en/press/pr2854en.htm.

__________. 2001. World Investment Report: *Promoting Linkages*, Geneva: United Nations.

__________. 2002. World Investment Report: *Transnational Corporations and Export Competitiveness*, Geneva: United Nations.

__________. 2005. World Investment Report: *Transnational Corporations and the Internalization of R&D*, Geneva: United Nations.

UNDP. 1999. *Human Development Report 1999*, New York: Oxford University Press.

__________. 2000. *Human Development Report 2000.* New York: Oxford University Press.

Van der Merwe, E.J. 2004. "Inflation Targeting in South Africa", South African Reserve Bank, Occasional Paper, No. 19, Pretoria, South Africa.

World Bank. 1999. *World Development Report 1999/2000: Knowledge for Development*, Washington, DC: The World Bank.

__________. 2000. *World Development Report 2000/2001: Attacking Poverty*, New York: Oxford University Press, 2001.

__________. 1994. *Adjustment in Africa: Reforms, Results and the Road Ahead*, Oxford University Press, Washington D.C: The World Bank.

__________. 1997. *Capital Flows to Developing Countries: The Road to Financial Integration*, Washington D.C: Oxford University Press.

__________. 1981. *Accelerated Development in Sub-Saharan Africa: An Agenda for Action*, Washington DC: The World Bank.

__________.1989, *Sub-Saharan Africa: From Crisis to Sustainable Growth,* Washington D.C: The World Bank.