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Policy Brief

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MONITORING FOREIGN PRIVATE CAPITAL FLOWS IN GHANA - 2008 SURVEY FINDINGS & POLICY ISSUES

MAIN ISSUES

This policy brief highlights the findings of a cross border capital survey conducted by the Bank of Ghana.

The survey had a threefold objective to (i) monitor the scale and nature of private capital flows; (ii) establish a monitoring system for cross border capital and investor perceptions; and (iii) improve coverage of the private sector's foreign investment in Ghana for the compilation of Balance of Payments and International Investment Position (IIP) statistics in Ghana.

We draw useful lessons from the survey findings and suggest some policy recommendations to enhance effective management of foreign capital flows in the domestic economy.

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BACKGROUND

Over the last decade, emerging and developing countries have attracted significant amounts of private capital flows to augment low levels of domestic savings and government revenues. These flows typify important financing sources which support infrastructural development and expand economic opportunities in recipient economies.

According to the World Investment Report (2007), foreign direct investments (FDI) increased from US$400 billion in 2000 to a record US$1,833 billion in 2007. Of this, FDI inflow to Africa increased by 16.0 per cent to a record US$53 billion, bringing the region's FDI stock to US$393 billion which provided the needed capital to expand economic opportunities. The increased pace of capital flows to Africa in particular, is attributed to several factors including improved economic conditions, increased investment opportunities, and abundant natural resources.

Increasingly, Ghana is emerging as one of the 'frontier' economies with a potential to attract private capital flows spurred on by improved investment climate, economic and political stability, increased investment opportunities, and rising corporate profitability. While acknowledging the invaluable benefits of capital flows in reinforcing the growth process, it is important to note that without efficient management and strong economic fundamentals, such flows can instigate macroeconomic imbalances and financial instability posing challenges for policy making.

Against this background, cross border capital flow surveys have gained prominence in a number of developing countries including South Africa, Uganda and Tanzania. The main objective of such surveys is to collect statistics on cross border capital flows, aimed at providing information on the scale and scope of such flows for effective policy making.

THE CROSS BORDER CAPITAL SURVEY

Bank of Ghana conducted the first foreign private capital flow survey in 2000, which provided an essential step towards establishing a monitoring system for cross border capital. In 2008, the Bank embarked on the second cross border capital survey to monitor the scale and composition of private cross border

Private Cross Border Liabilities (Stocks and Derived Flows) from Survey Estimates (GH¢ millions)

	IIP	BOP	IIP
	31-Dec-06	2007	31-Dec-07
Liabilities	**2,789**	**1,538**	**4,328**
Direct investment in reporting economy	**1,994**	**854**	**2,847**
Equity capital & reinvested earnings	997	330	1,327
Equity capital	*501*	*132*	*632*
Reinvested earnings	*496*	*198*	*695*
Other capital	997	524	1,520
Portfolio investment	**24**	**15**	**39**
Equity securities	*24*	*15*	*39*
Financial derivatives			
Other Investment	**772**	**670**	**1,442**
Trade credits	265	304	569
Long-term	*91*	*110*	*202*
Short-term	*174*	*193*	*367*
Banks	0	0	0
Long-term	0	0	0
Short-term	0	0	0
Other sectors	265	304	569
Long-term	91	110	202
Short-term	174	193	367
Loans	413	361	774
Long-term	*350*	*76*	*426*
Short-term	*63*	*285*	*348*
Banks	202	366	568
Long-term	153	80	233
Short-term	49	286	335
Other sectors	211	5	26
Long-term	197	4	193
Short-term	14	1	12
Currency and deposits	94	5	99
Banks	94	5	99
Other sectors			

Notes: All estimates are from the survey with the exception of loans, currency and deposit liabilities of banks, which were obtained from the consolidated balance sheet of banks.

capital assets and liabilities; and improve its coverage in compiling BOP estimates as well as the country's value and composition of external financial assets and liabilities (IIP).

Questionnaires were administered to a representative sample of 286 enterprises across the Accra-Tema metropolis, Eastern, Western, Central, Brong Ahafo and Ashanti Regions. The survey had a high response rate of 81.47%, having received feedback from 233 questionnaires. The survey covered enterprises in nine (9) major sectors of the economy including Agriculture, Banking, Business services, Community services, Construction, Electricity, Gas and Water, Insurance, Leasing Companies, Manufacturing, Microfinancing, Mining and Quarrying, Real Estate/Property Services, Tourism, Transport, Storage and Communication, and Wholesale Retail Trade, Catering and Accommodation services.

SURVEY FINDINGS

1. Private Cross Border Liabilities

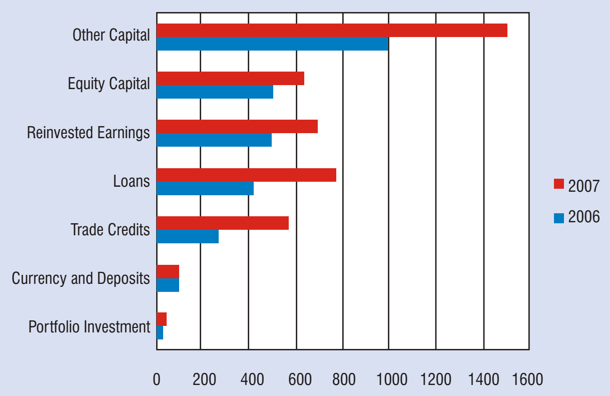
The survey results indicates that by the end of 2007, Ghana had a sizeable liability position of about GH¢4,328 million. The accumulated liability position reflects gross inflows of private cross border capital of GH¢1,538 million between 2006 and 2007. The composition of the liabilities includes foreign direct investment, portfolio investment and other investments.

Of the total, direct investment liabilities amounted to GH¢2,847 million in 2007, up from GH¢1,994 million in 2006 and reflecting an increased flow of Gh¢854 million. Of this amount, GH¢ 330 million was in equity capital and reinvested earnings, and GH¢524 was in 'other' capital (or inter-company borrowing). Inter-company borrowing remained the dominant component of direct investment with the stock increasing from GH¢997 million in 2006 to GH¢1,520 million in 2007.

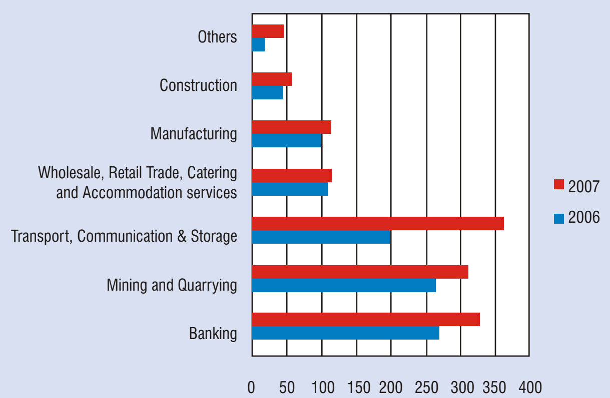
In addition to direct investments, the composition of 'other' investments consisted of trade credits

Cross Border Capital

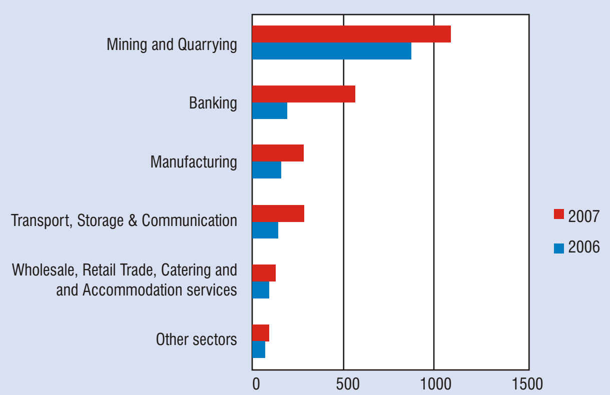
A. Composition of Private Cross Border Liabilities (GH¢ millions)



B. Sector Distribution of Equity Capital (GH¢ millions)



C. Sector Distributrion of Private Debt[1] Stocks (GH¢ millions)



[1]*including inter-company debt stocks*

provided to finance imports (supplier's credit) and exports (pre-finance); loans; and currency and deposits of non-residents held by domestic banks. In 2007, trade credits increased by GH¢304 million from the stock level of GH¢265 million in 2006. The stock of loans also went up to GH¢774 million in 2007 driven mainly by bank loans. The bulk of the stock of loans had long-term maturities estimated at GH¢426 million. However, the increase in the stock of loans by GH¢361 million from GH¢413 million in 2006 to GH¢774 million in 2007 was due to an increase of GH¢285 million in short-term loans compared to an increase of GH¢76 million in long-term loans.

Overall, the survey results on the cross border flows show that Ghana attracted significant levels of private cross-border capital in 2007.

2. Type and Sector Distribution of Cross Border Liabilities

- **Foreign Direct Equity Investment (FDEI)**

The net FDEI transactions between 2006 and 2007 stemmed from significant flows of GH¢163.5 million, GH¢58.9 million and GH¢48.1 million to the Transport, Storage and Communication; Banking; and Mining and Quarrying sectors. Cumulatively, these three sectors accounted for 82 per cent of all FDEI flows between 2006/07 as well as 73.3 per cent and 75.5 per cent shares of total FDEI stocks in 2006 and 2007 respectively. Substantial flows of FDEI were also registered in the real estate/property services, construction and manufacturing sectors increasing by GH¢20.8 million, GH¢12.4 million and GH¢13.8 million respectively between 2006/07.

- **Foreign Portfolio Equity Investment (FPEI)**

Out of the 9 surveyed sectors, only 4 attracted FPEI. FPEI stocks (in terms of book value) showed that Mining and Quarrying attracted the highest portfolio investment contributing about 49.6 per cent of total portfolio investments in 2006, followed by the Transport, Storage and Communication sector with 24.9 per cent. Similarly, in 2007, the above mentioned sectors contributed 49.3 per cent and 26.9 per cent respectively.

Overall transactions on portfolio investment during the two year period increased by GH¢14.5 million (60.4% growth), from GH¢24 million in 2006 to GH¢38.4 million in 2007. During 2006 and 2007, the Insurance and Leasing sectors contributed only GH¢0.4 million to portfolio investments.

- **Private Sector External Debt (PSED)**

The stock of PSED increased by 58.0 per cent from GH¢1,563.03 million in 2006 to GH¢2,469.55 million in 2007. Notably, the bulk of PSED had long-term maturities accounting for 79.3 per cent of the total, with short-term debt constituting the remaining 20.7 per cent.

By sector classification, Mining and Quarrying recorded the highest share of PSED, equivalent to GH¢876 million and GH¢1,094 million or 56 and 44 per cent of the total debt in 2006 and 2007 respectively. The Banking sector had the second largest share with GH¢202 million in 2006 increasing to GH¢568 million in 2007, and accounting for 13 per cent and 23 per cent of total debt stock respectively. The Manufacturing and Transport, Storage and Communication sectors had almost equal shares of about 10 per cent for the two consecutive years.

During 2007, the largest debt flow of GH¢366 million was recorded in the Banking sector, followed by the Mining sector with GH¢219 million. The Transportation, Storage and Communication as well as the Manufacturing sectors also recorded increased debt stock of GH¢145 million and GH¢131 million respectively between 2006 and 2007.

3. Grossed Up Foreign Liabilities

The grossed up private cross border liabilities (based on a derived gross up factor obtained from equity capital of surveyed enterprises among the top 100 corporate taxpayers that reported foreign liabilities in 2007) indicate that, total liabilities expressed in book value terms increased from Gh¢3,173 million in 2006 to Gh¢4,803 million (representing 51.4% growth) in 2007.

All the components of foreign liabilities covered in the survey registered growth. Eighty-two per cent

Private cross border assets (stocks & derived flows) from survey estimates (GH¢ millions)

	IIP	BOP	IIP
	31-Dec-06	2007	31-Dec-07
Assets	**499**	**98**	**597**
Direct investment abroad	123	14	137
Equity capital and reinvested earnings	**123**	**14**	**18**
Portfolio investment	**0.35**	**0.00**	**0.35**
Equity securities	0.35	0.00	0.35
Debt securities			
Financial derivatives			
Other investment	**375**	**84**	**459**
Trade credits	*30*	*5*	*35*
Banks	0	0	0
Other sectors	30	5	35
Loans	*0*	*0*	*0*
Banks	0	0	0
Other sectors	0	0	0
Currency and deposits	*345*	*79*	*424*
Banks	345	79	424
Other sectors			

Notes: All estimates are from the survey except loans and currency and deposit liabilities of banks which were obtained from the consolidated balance sheet of banks.

(82%) of total foreign liabilities in 2007 were in the form of foreign direct investments.

4. Cross Border Capital Assets by Resident Enterprises

Ghana's total stock of cross-border capital assets of the private sector was estimated at GH¢597 million in 2007, up from GH¢499 million in 2006. Direct investment was obtained from the survey results in the form of equity capital and reinvested earnings. No information was provided on other capital assets. An increase in equity capital and reinvested earnings of GH¢14 million was recorded in 2007, adding to the stock of GH¢123 million estimated for 2006.

The stock of portfolio investment in equity securities was marginal while the bulk of 'other' investments was in the form of currencies and deposits held by non-residents. The total stock of currency and deposit assets of banks held by non-residents in 2006 amounted to GH¢345 million, increasing by GH¢79 million to GH¢424 million in 2007.

Trade credit assets increased from the 2006 stock level of GH¢30 million to GH¢35 million in 2007. The much lower level of the asset position relative to the liability position indicates that on a net basis, Ghana has been a recipient of financial flows.

5. Origin of FDEI Stocks

Europe emerged as the leading source of FDEI to Ghana in 2006, with a relative share of 57.72 per cent, followed by Africa with 33.78 per cent, America (6.85 per cent) and Asia (1.64 per cent). In 2007, Europe again accounted for 60.68 per cent of the total, Africa 38.02 per cent, Asia 1.40 per cent and America with a negative 0.11 per cent. The observed negative book value recorded in FDEIs originating from America partly reflects the long-term nature of investments emanating from this region directed mainly at mining and quarrying. Such investment activities involve huge capital outlays at the implementation phase but with a high projected stream of income in the long run.

By country of origination, Mauritius accounted for the highest FDEI inflows (book value terms) of 27.9 per cent in 2007. Other important sources of FDEI flows were France (19.36 per cent), British Virgin Islands (18.44 per cent), United Kingdom (16.92 per cent) and the United States (5.95 per cent).

6. Comparison of Gross Survey Estimates and the BOP

A balance of payments statement was compiled incorporating the grossed up survey estimates for comparison purposes. To allow for a comprehensive assessment of the grossed up survey results on the BOP, additional data from the monetary and financial statistics and the Bank for International Settlements (BIS) were incorporated with the survey data.

- **The Current Account**

The comparison of the 2007 survey-based revised BOP, with the non-survey based BOP showed a deterioration in the current account of US$463.5 million arising from an increased deficit on the income account. The current account deteriorated from a deficit of US$2,152 million in 2006 to a deficit of US$ 2,615 million in 2007. The increased deficit on the income account was due to the inclusion of estimates of US$276 million reinvested earnings debits provided by the survey and estimated interest payments on the stock of private debt of US$158.6 million. These estimates worsened the services and income balance from a deficit of US$300.7 million to a deficit of US$764.4 million.

- **The Capital and Financial Account**

The capital and financial account reflected major changes after incorporating the survey results on the balance of payments estimates. Overall, the financial account improved when the survey estimates were incorporated from a surplus of US$2,591.4 million to a surplus of US$3,505.4 million.

The increase in the surplus on the financial account was equivalent to an additional inflow to the balance of payments of US$914.0 million. These additional flows were attributed to higher estimates of foreign direct investment in Ghana, trade credit liabilities and loan liabilities of US$ 295.0 million, US$544.2 million, and US$292.0 million relative to the initial estimates respectively.

- **Overall Balance**

In general, the with-and-without survey result comparisons showed a higher overall balance surplus of US$890.2 million compared to US$440.0 million, suggesting additional inflows of about US$450.3 million in 2007. Net errors and omissions increased on account of higher net inflows to the BOP without a corresponding increase in the use of funds. The increased errors and omissions could hint at lower estimates for some of the outflows on the current account, such as imports of goods and services, considering the importance of the sector to the economy as suggested by the sector distribution of FDI.

Comparison of Survey-based and Current BOP Estimates (US$ millions)

	2007 (without survey results)	2007 (with survey results)
CURRENT ACCOUNT BALANCE	-2,151.47	-2,615.16
Trade balance	-3,893.98	-3,893.98
Services and Income	-300.67	-764.37
Current transfers (net)	2,043.18	2,043.18
CAPITAL AND FINANCIAL ACCOUNT BALANCE	2,591.42	3,505.39
Capital account	188.14	188.14
Capital transfers inflows (credit)	188.14	188.14
Financial account (excl. financing items)	2,403.28	3,317.25
Direct Investment	970.38	1,244.00
Direct investment abroad		21.34
Direct investment in Ghana	970.38	1,265.34
Portfolio investment	799.84	806.75
Assets	0.00	0.00
Liabilities	799.84	806.75
Equity securities	14.43	21.34
Debt securities	785.41	785.41
Financial derivatives, net		
Other investment	633.07	1,266.51
Assets	0.00	44.70
Trade credits		-7.58
Loans		
Currency and Deposits		52.28
Other Assets		
Liabilities	633.07	1,221.80
Trade credits	-94.15	450.23
Loans	474.33	766.24
Currency and Deposits	252.89	5.33
Other Liabilities		
OVERALL BALANCE	439.95	890.23
RESERVES & RELATED ITEMS	-439.95	-890.23
Reserve assets	-413.11	-413.11
Use of fund credit and loans		
Exceptional financing		
Errors and Omissions	-26.84	-477.12

- **International Investment Position**

The overall IIP showed a net position of about US$5,427.7 million in 2007 having increased from a net liability position of US$2,550.8 million. This comprised total asset stocks of US$3,779.7 million and US$4,191.4 million and total liabilities of US$6,330.5 million and US$9,614.1 million for 2006 and 2007 respectively. Developments in the IIP generally indicated that Ghana attracted and retained a considerable amount of cross border capital in 2007.

7. Investor Perceptions

The survey requested entities to rate the impact of economic and financial factors, cost of infrastructure/services, labour and regulatory and other government agencies on their businesses.

Economic and Financial Factors: Investors rated inflation as the most important economic factor which impacts negatively on business activities. This was followed by corruption, high interest rates, exchange rates and smuggling. Competition with imports scored the least negative effect on business entities. Factors which impacted positively on business entities included domestic market size, access to international markets, and access to international, regional and domestic finance and credit facilities.

Labour and Health: The results indicate that investors perceive the availability and productivity of labour as having strong positive effects on business operations. However, staff turnover, wage levels and costs associated with skilled labour, as well as restrictions regarding hiring of expatriates had strong negative effects on business entities. On health factors, malaria ranked the highest, with a strong negative effect on business activities.

Cost and Efficiency of Support Services: High costs of support services such as electricity, road transport, taxation, and telecommunication were rated as having negative impacts on business entities. Banking services exerted the least cost on business entities. Although the costs of providing these services were high, the efficiency of providing such services (with the exception of electricity) had strong positive effects on entities. Efficiency in banking, telecommunication and internet services were ranked the highest with strong positive net weighted effects on entities.

Direction of Investment: The survey findings show that perceptions of business entities on the direction of investment over the medium-term were particularly strong and favoured business expansion rather than contraction. For instance, business entities have projected to expand their activities over the next three years by improving existing facilities, investing in technology as well as capacity building. Other activities include diversification of products and services, recruiting more local staff and constructing new buildings and structures. Although business consolidation through mergers and acquisition was not an option for business entities, more than 90 per cent of respondents plan to invest in technology to enhance their operations indicating strong confidence in the Ghanaian economy.

8. Socio-Economic Contribution of Foreign Investments

Employment: The successful implementation of investment projects depends on the availability of a reliable, skilled and productive work force as well as favourable labour market regulatory framework. According to the survey results, employment levels in business entities increased by 12.26 per cent from 58,580 in 2006 to 65,761 in 2007. The number of employed workers was dominated by males with a share of 79.6 per cent and 78.2 per cent in 2006 and 2007 respectively. This notwithstanding, the number of females employed increased by 2,377 over the two year period. The number of foreign workers also increased marginally by 18 employees.

Further analysis of the employment data show that the manufacturing sector absorbed 20.8 per cent of the total workforce of surveyed entities in 2007, recording a decline in share from 23.9 per cent in 2006. The respective shares of the 2007 workforce in the Banking, and Mining and Quarrying sectors were 17.4 and 12.0 per cent, up from 16.6 and 11.7 per cent in 2006. Together, these three sectors accounted for over 50 per cent of the workforce of surveyed entities in 2007.

Compensation of Employees: Total compensation to resident employees, defined as compensation of employees in terms of salaries and wages, payments in kind, pension fund contributions, director's fees and any other form of payments, increased by 47.4 per cent from GH¢442.0 million in 2006 to GH¢651.3 million in 2007. Comparatively, non-resident employees received GH¢20.6 million and GH¢41.2 million in 2006 and 2007 respectively. Cumulatively, total payments made by foreign investment enterprises increased by GH¢156.3 million during 2007 from GH¢408.6 million in 2006.

Corporate Social Responsibility: All foreign enterprises in the surveyed sectors made social contributions to Ghana's development as part of their Corporate Social Responsibilities (CSRs). The various contributions were directed at Arts and Culture, Education; Health and Welfare; Sports development Environment, Safety and Security; and Water and Sanitation. Cumulatively, funding for corporate social activities more than doubled from GH¢44.01 million in 2006 to GH¢94.49 million in 2007. The increase in social responsibilities was targeted at education, health and welfare, and environmental protection.

9. Policy Issues

The survey of cross border capital flows has provided good quality data and evidential support that after decades of economic, trade and financial sector reforms, Ghana is increasingly attracting foreign investments for economic development. The observed increase in private capital flows in 2007 can be sustained with more openness and better integration into the world economy.

Findings from the 2008 Capital Flow survey have elicited the scale and scope of cross-border capital inflows in Ghana, which underscores the need for continuous monitoring and assessments of investor perceptions. Effective monitoring of such inflows may strengthen the process of building a strong database to accurately gauge Ghana's position as an attractive investment destination. Additionally, it could provide supporting data that will better inform the decision-making process towards attracting increased foreign capital for development activities.

The major challenges encountered by the BOG cross border capital survey included lack of timely and uniform reporting standards of financial statements by enterprises and non-compliance of the survey guidelines by some entities. To this end, concerted efforts from all stakeholders, supported by sensitisation and awareness campaigns, may be required to close data gaps in future surveys.

Against this backdrop, regular monitoring of foreign investment and analysis of investor perceptions must be encouraged to support policies geared at promoting increased flow of capital into the country.

Beyond cross-border surveys, it is important to note that good policies that create conducive economic environment for both local and foreign investors act as strong 'pull' factors in attracting foreign investment as well as safeguarding the economy from the potential downside risks of a surge in capital inflows. To help ensure sustained growth in capital flows to the country, there may be the need to :

- *Improve the domestic investment environment through (i) macroeconomic stability, (ii) stronger regulatory frameworks including protection and property rights, (iii) improved public investment in infrastructure and 'human capital' that complements and 'crowds in' private investment.*

- *Strengthen financial sector supervision and regulation to develop and deepen capital markets to expand prospects for investments.*

- *Closely monitor the high leverage in investment projects, particularly short-term debt as opposed to equity financing which is more permanent. There is evidence to show that capital inflows in the form of debt financing are procyclical and transitory, and subject to sudden reversals which may halt investment projects and/or pose macroeconomic risks.*

- *The concentration of entities within the Accra-Tema metropolis may need to be widened through targeted policy measures and incentives that provide the needed impetus to spread investment opportunities across the country.*

- *Introduce incentives for investment projects in other sectors such as manufacturing to diversify the observed sectoral pattern of investment opportunities in favour of mining and quarrying. This will not only spread investment projects across other sectors but also enhance technology transfer and promote value addition to the country's primary commodity products.*

- *Encourage transparency and proper record keeping especially in firms engaged in foreign transactions. This will ensure access to timely data (compiled from surveys of this kind) for effective monitoring of private capital flows into the country.*