The North-South Institute

The Missing Link? Capital Account Management and African Industrial Policy

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Presentation Outline

- Capital Account Management (CAM) and Industrial Policy (IP) in East Asia – with a focus on China.

- Comparative Framework Typology, based on proxy measures of integration into global financial markets, to identify countries with the 'policy space' to conduct industrial policies.

- International Investment Positions (IIPs): Angola, Rwanda, Zambia

- Concluding Discussion

Burning Question: China applied "micro-first" "dual-track" strategies in opening up. What options are open to African countries after having opened up at a quicker pace?

At the core of the development issue in Asia (1997/98) and for Africa … today?

“But to carry over the legitimate approbation of freer trade in particular to the altogether more volatile financial sector, which represents the soft underbelly of capitalism, was surely unwarranted.” – **Jagdish Bhagwati** (2009).

“Is there a way out? Yes, there is, but it is a solution so unfashionable, so stigmatized, that hardly anyone has dared suggest it. The unsayable words are ‘exchange controls’”. – **Paul Krugman** (1998).

Put Another Way

- Of course, many countries have industrial plans and ambitions.
- Less well understood are the key factors that renders one IP framework configuration different from another in terms of:
  - the availability of instruments, and the ability to sustain mobilization of domestic resources (developing financing);
  - which influences the effectiveness of implementation and the way IP objectives are attained and adjusted over time.

- The paper contends that (as was the once the case in Asia) (re)consideration of free capital mobility, or the degree of openness of the capital account, as part of the macroeconomic framework should be at the crux of discussions of African industrial policy.

Re-Visiting the Impossible Trinity

Chinese policy-makers have operated away from the **'hard corners'** of the trinity, previously held to be best practice advice.

- **Orthodox configuration:** open capital flows, floating exchange rate, independent monetary policy (? with inflation targeting)

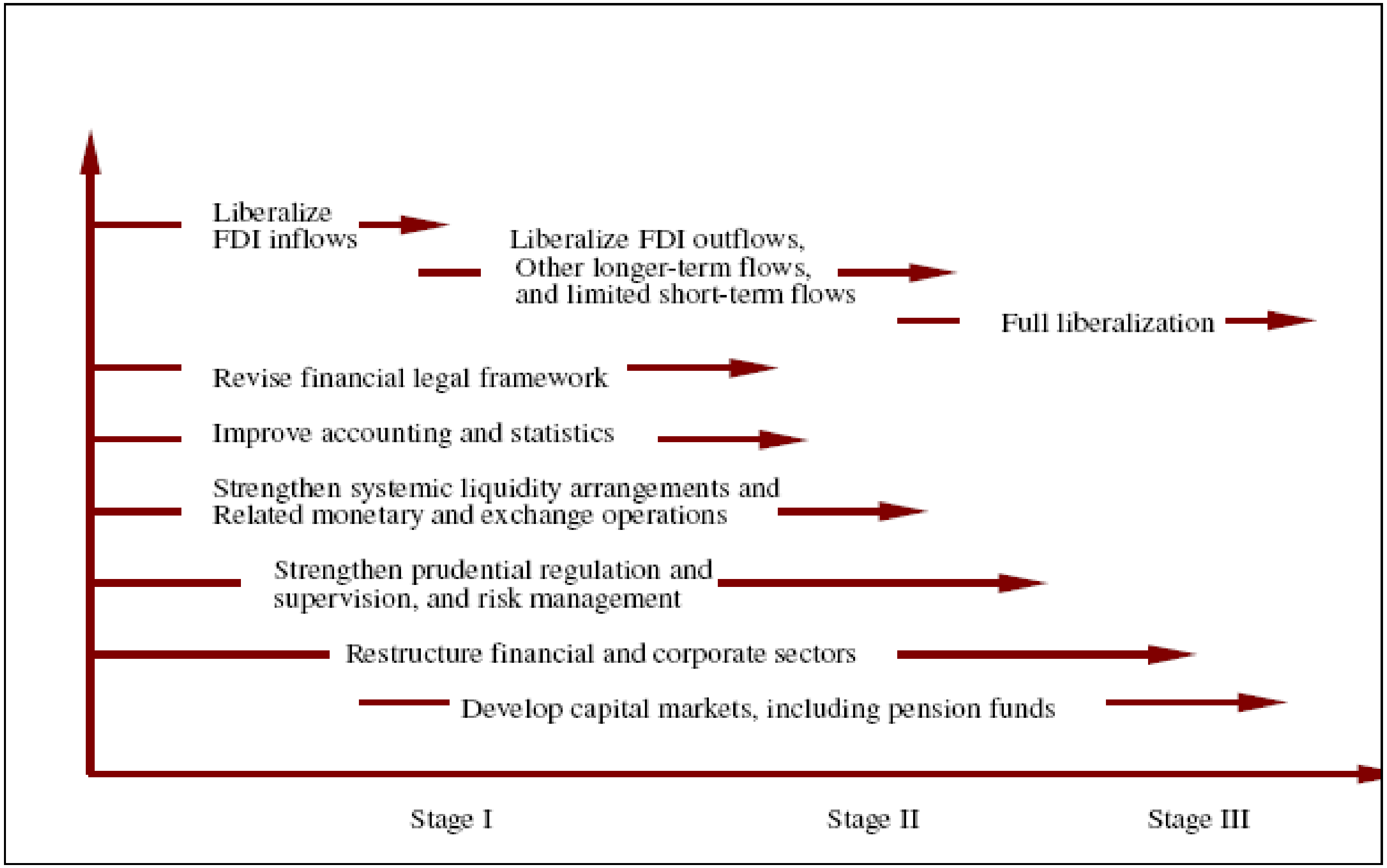
But it's been remarked that China's (and India's) rapid growth not driven by policy-makers operating strictly at the hard corners of the trinity:

- **Unorthodox configuration:** degrees of capital account management to maintain policy autonomy over ensuring a competitive exchange rate, and a pro-growth (low) interest rates.

Sadly, much African IP literature barely touches on the relevance of capital account management.

IMF's Stylized 'Integrated Approach' to CAM

Figure 6: A Stylized Representation of Sequencing



Source: Shogo Ishii and Karl Haberneirer, 2002.

Why Capital Controls?

Magud *et al.* (2011) outline the rationale for capital account management with respect to “four fears” associated with global financial integration:

• **Fear of Appreciation:** Capital inflows put upwards pressure on exchange value of country’s currency, which makes domestic manufacturers relatively less competitive in international markets, in turn impacting on exports (and economic structure – ie. tradeables vs. non-tradeables).
• **Fear of “Hot Money”:** A surge of short-term capital inflows into a small market can cause distortions and can ultimately lead foreign investors to suddenly withdraw their funds after a change sentiment and investors leave on masse.
•**Fear of Large Inflows:** Not all capital inflows represent “hot money”, but large volumes of capital inflows can cause distortions and dislocation in the financial system, especially in the fuelling of asset price bubbles.
• **Fear of Loss of Monetary Autonomy:** In light of “impossible trinity” considerations, the desirability of retaining a degree of monetary policy flexibility by policy-makers means that giving up the option of free capital mobility is an attractive policy trade-off.

‘Four Fears’ and ‘Model Uncertainty’

El-Erian and Spence (2008)

More accurate account of China’s (and India’s) approach to reform has been described as a form of **‘model uncertainty’**, in which:

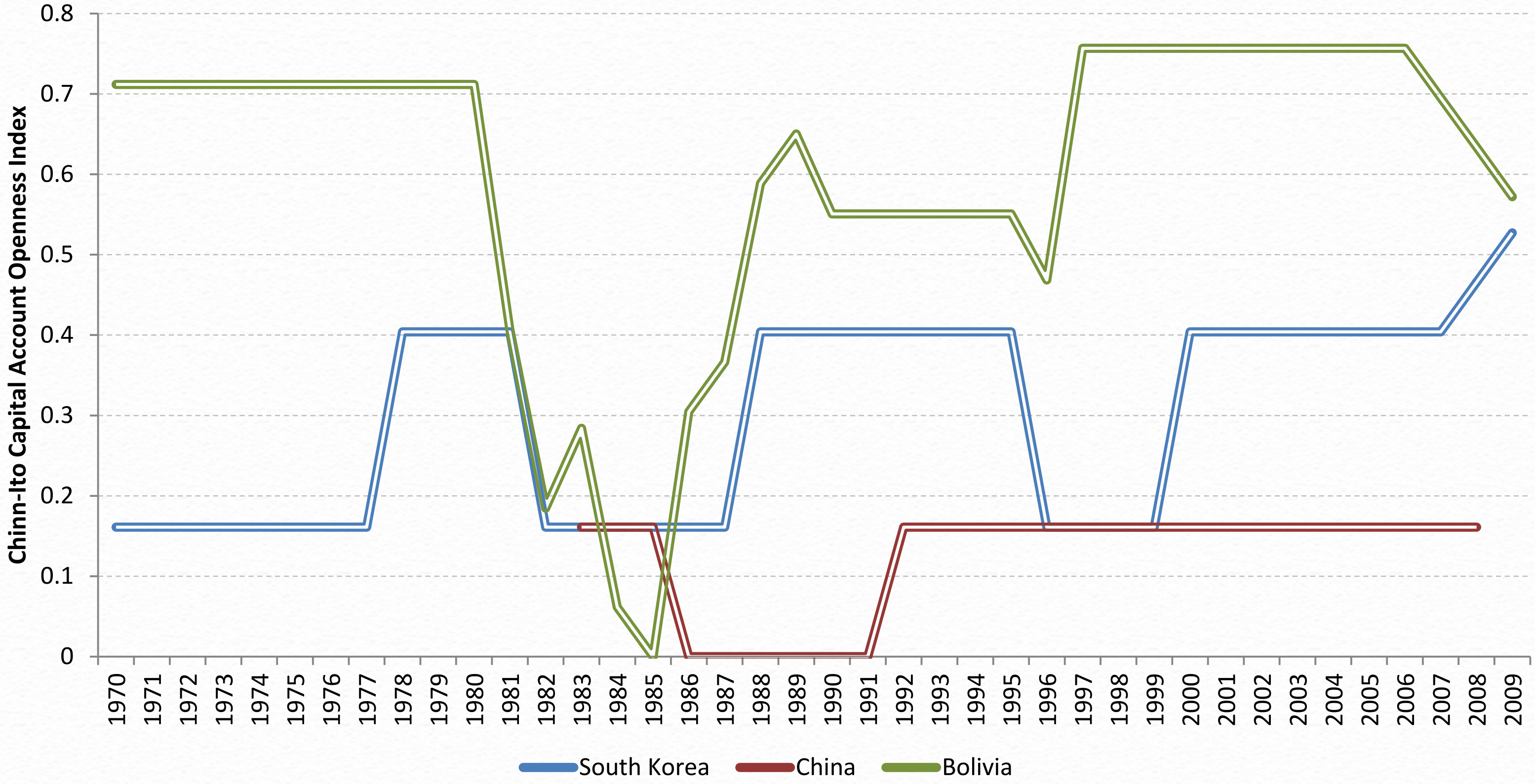
•Leaders treat policy advice from advanced economy models with great caution, which instils a form of pragmatism in weighing risks,

•Leads policy-makers to take gradual and experimental steps in areas such as the **timing and sequencing of opening up the current and capital accounts**, as well as in proceeding with **export diversification**.

Sequencing Capital Account Opening

Three Country Experiences, 1970-2009

(0 = Closed, 1 = Open)



Landmarks in China's Capital Account (CA) Liberalization

- **1986** – Foreign exchange controls relaxed for foreign funded enterprise.
- **1994** – Exchange rate depreciation and unification.
- **1996** – Currency convertibility for current account transactions.
- **1997/1998** – Asian Crisis halted further liberalization.
- **2001** – China's entry into WTO, fully liberalize financial sector in 5 years.
- **2003** – Liberalization accelerated to reduce pressure for appreciation of the RMB, encourage outward investment, improve resource allocation.
- **2009** – Increasing RMB internationalization, structural shift towards consumption-led growth.
- **2012** PBoC unofficial report proposing three-step plan for CA liberalization: 5-10 years for greater openness of stock and bond markets to foreign investors. Full convertibility is 'final step', no date given.

China's Capital Controls

Capital account management techniques have been integral to China's development and industrial policies. Policy goals have included:

- To retain savings;
- To help mobilize savings to desired end-uses;
- To help insulate China's managed exchange rate regime;
- To reduce avoidance of other controls (ex. tariffs);
- To strengthen China's macroeconomic policy autonomy;
- To insulate economy and financial institutions from external shocks and financial crisis;
- Concerns over money laundering and asset-stripping;
- To defend against possible predatory attacks from international speculators.

Capital Controls Broadly Defined

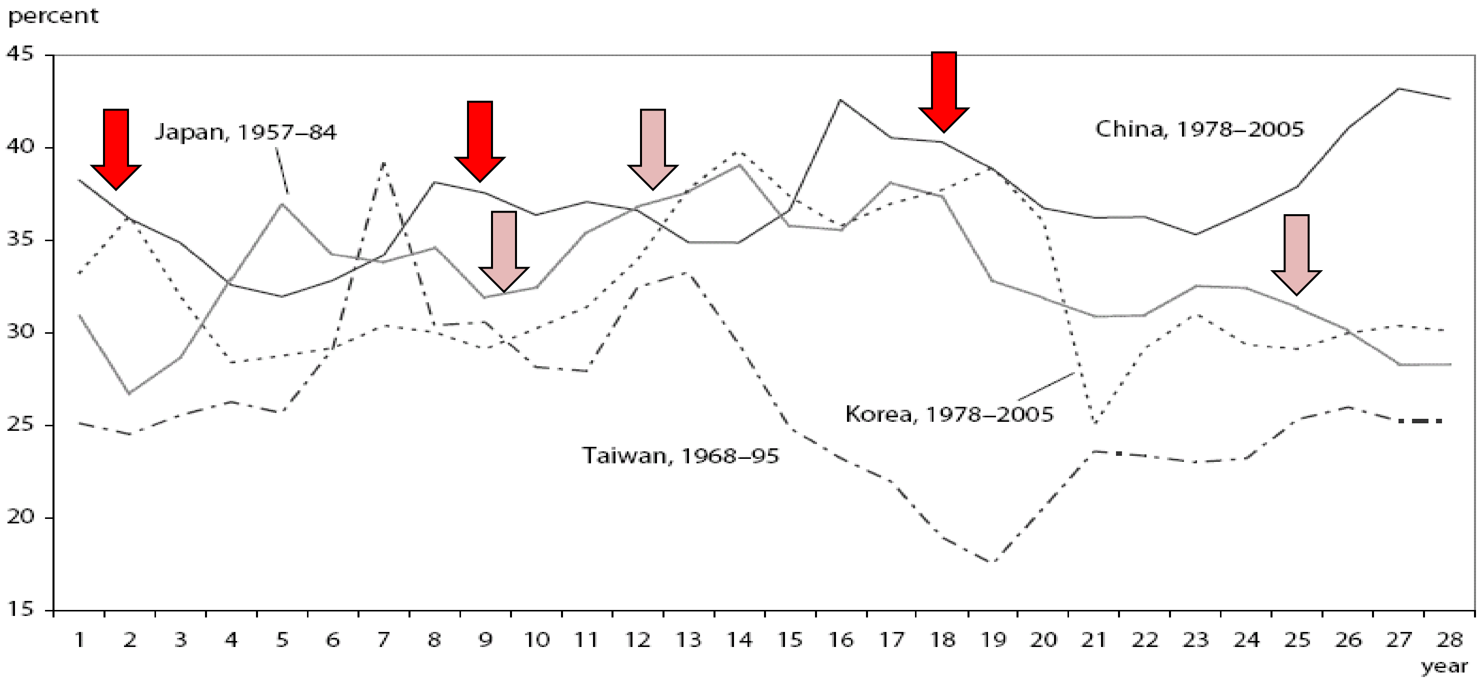
China's monetary policy framework includes a wide array of other instruments – also knows as macro-prudential regulations – that manage the availability of credit and liquidity:

- setting administered deposits, and minimum lending rates,
- reserve requirements,
- lending quotas,
- window guidance
- administrative measures on investment and production.

These tools + capital controls provide the 'room for manoeuvre' in setting short-term interest rates, and maintaining a degree of price stability. Stephen Roach (Morgan Stanley Asia) calls China's approach "classic central banking at its best".

Investment-led Growth

Figure 1 Capital formation as percent of GDP



Note: For each country the time period is when the average rate of capital formation was the highest.

Sources: National Bureau of Statistics of China, China Statistical Yearbook 2006; Council for Economic Planning and Development of Republic of China, *Taiwan Statistical Data Book*, 1997 and 2006; International Monetary Fund, *International Financial Statistics*, http://ifs.apdi.net/ (accessed September 27, 2006).

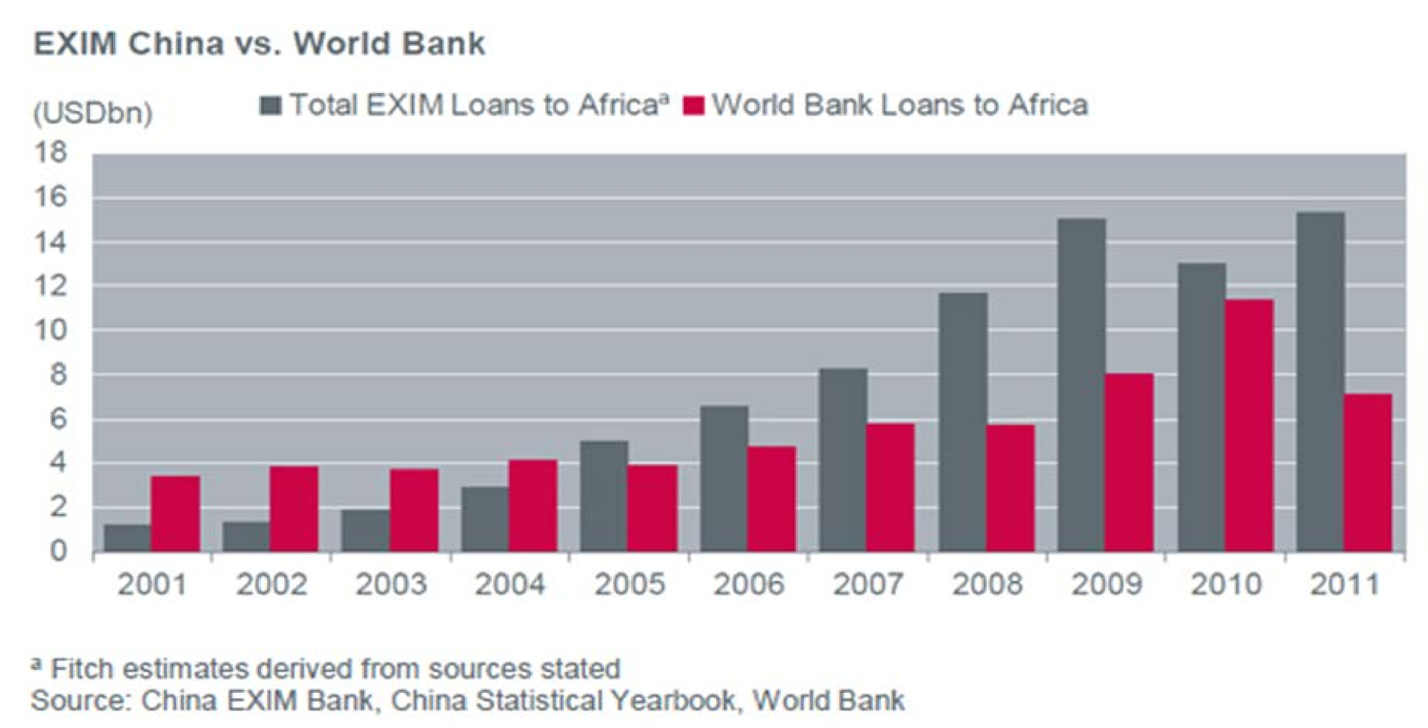
Source: Lardy 2006

Sectoral Industrial Policies: Renewable Energy

Instrument	Measure	Example
Creating markets and driving demand	Energy conservation targets;	Generate 15% of primary energy from nonfossil fuel sources by 2020; requires power generators (>5GW) to produce renewable non-hydro sources for 3% of electricity by 2010, 8% by 2020.
Financing	Grants, tax breaks and other incentives (favourable land pricing)	2004 Wind Power Concession Project, utilities enter into long-term power purchase agreements with developers, while utilities allowed to raise rates on end users.
Infrastructure	Incentives/subsidies	Golden Sun Demonstration Program, investment subsidies equal to 50% of investment cost for grid-connected solar power systems;
Support for domestic manufacturers of RE equipment	Domestic content requirements	2005 regulation mandating Chinese wind farms have at least 70% local content.
State-owned enterprises (SOEs)	Key ‘agent’ and conduit of state objectives	End 2008, big 5 state power companies accounted for 55% of installed wind capacity.

Source: Dewey & LeBoeuf LLP (2010)

Investment/Loans Driving Trade



Source: Financial Times.

Industrial Policy Trends (Nov. 2008 – Jun. 2013, GTA)

	Number of Implemented Measures			
Groupings (# of countries)	**Green**	**Amber**	**Red**	**Total**
Developed (6)	65	35	306	**406**
Latin America (19)	61	23	270	**354**
Asia (11)	156	100	327	**583**
BRIC (4)	221	100	477	**798**
Africa (52)	73	48	143	**264**

	Number of Implemented Measures				Income Category *
Jurisdiction	Green	Amber	Red	Total	
Brazil	60	8	77	**145**	UMIC
Russia	69	30	221	**320**	UMIC
India	51	28	102	**181**	LMIC
China	41	34	77	**152**	UMIC
Total	**221**	**100**	**477**	**798**	

	Number of Implemented Measures				Income Category
Jurisdiction	Green	Amber	Red	Total	
Algeria	2	0	10	**12**	UMIC
Egypt	5	5	12	**22**	LMIC
Ethiopia	1	0	5	**6**	LIC
Ghana	0	0	7	**7**	LMIC
Kenya	3	8	7	**18**	LIC
Nigeria	8	13	19	**40**	LMIC
South Africa	24	6	39	**69**	UMIC
Uganda	3	2	2	**7**	LIC
Tanzania	3	1	5	**9**	LIC
Zambia	0	4	2	**6**	LMIC
Zimbabwe	3	3	6	**12**	LIC
Total	**52**	**42**	**114**	**208**	

De Facto Financial Globalization, 2003-2011

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Brazil	0.98	0.90	0.74	0.77	0.95	0.66	0.96	0.99	0.88
China	n.a.	0.82	0.91	1.01	1.04	0.98	1.08	1.10	1.05
India	0.47	0.52	0.49	0.55	0.60	0.61	0.66	0.62	0.57
Russia	1.56	1.39	1.39	1.52	1.80	1.06	1.70	1.56	1.26
Australia	2.48	2.29	2.15	2.61	2.91	1.91	3.03	2.88	2.41
Canada	1.83	1.76	1.64	1.65	1.79	1.65	2.17	1.99	1.94
Germany	3.28	3.37	3.40	3.98	4.30	3.65	4.21	4.93	4.58
Japan	1.30	1.41	1.54	1.74	1.96	1.85	1.82	1.96	2.00
South Korea	0.93	1.03	1.08	1.18	1.36	1.11	1.63	0.15	1.42
U.S.	1.57	1.77	2.12	2.40	2.85	3.05	2.92	3.08	3.18

Figure 1. Assessing Policy Space: *De Jure* vs. *De Facto* Financial Globalization/Openness, Selected African Countrise (30)

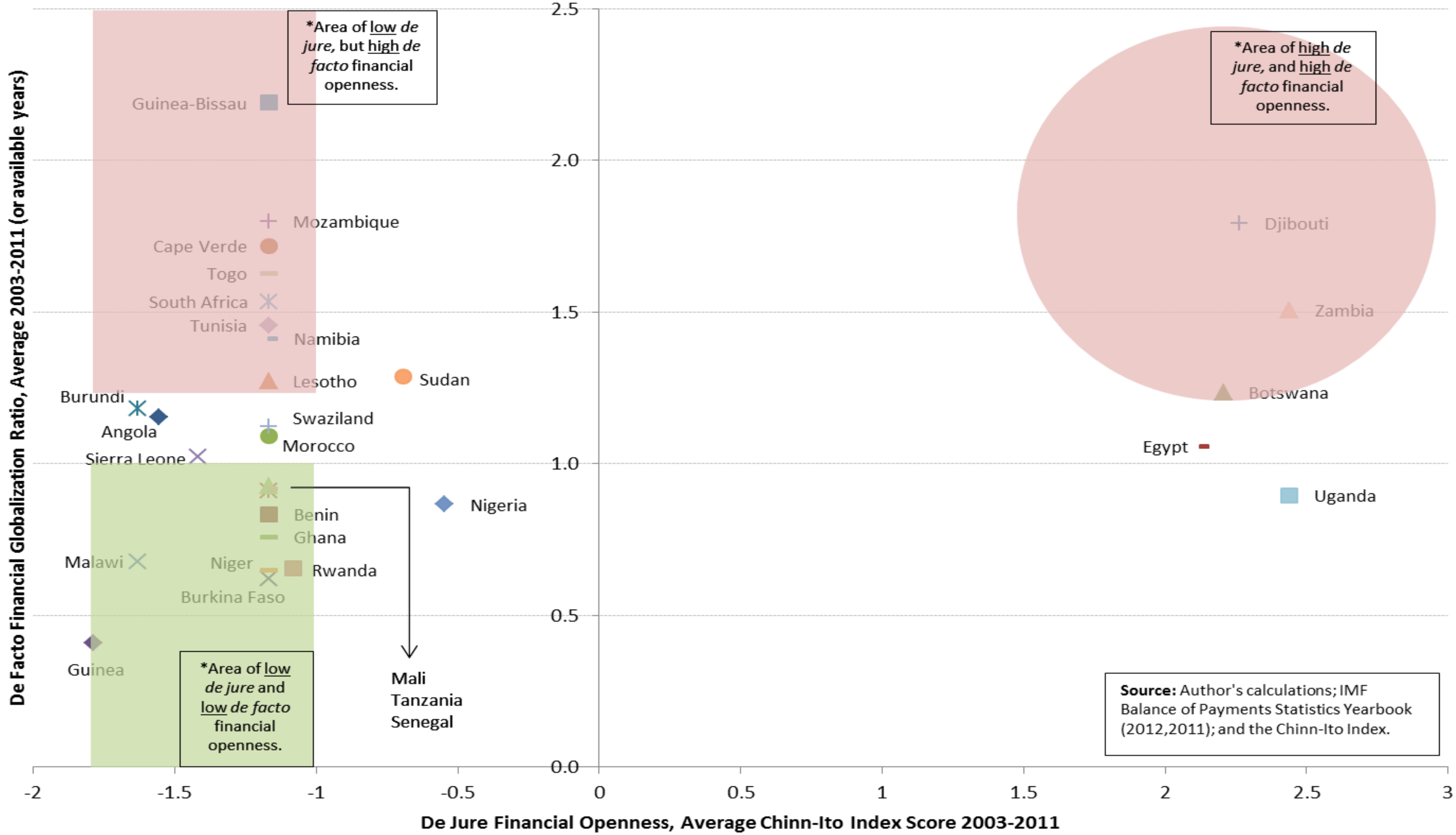


Figure 2.*De Jure* and *De Facto* Financial Globalization/Openness, by Quadrants, Selected African Countries (30)

		***De Facto* Financial Globalization**	
		HIGH	LOW
***De Jure* Financial Openness**	HIGH	Botswana, Djibouti, Egypt, Zambia, Uganda	
	LOW	Angola, Burundi, Cape Verde, Guinea-Bissau, Lesotho, Morocco, Mozambique, Namibia, Sierra Leone, South Africa, Sudan, Swaziland, Togo, Tunisia.	Benin, Burkina Faso, Ghana, Guinea, Malawi, Mali, Niger, Nigeria, Rwanda, Senegal, and Tanzania

Figure 3.Change in De Facto Financial Globalization, African Countries (29), 2003-2011

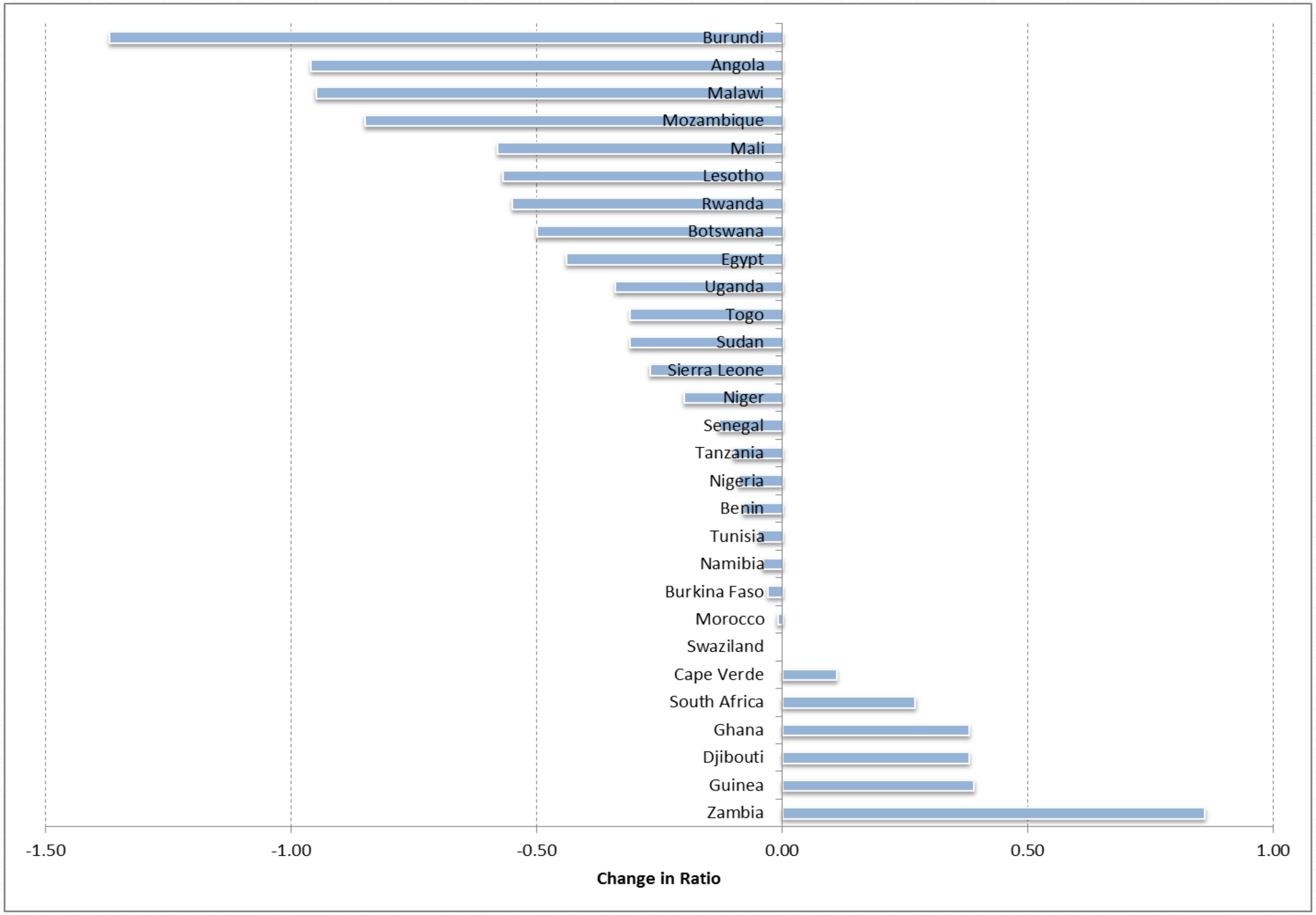


Table 5. Net International Investment Position: PIGS and China (US$ millions)

Country	2005	2006	2007	2008	2009	2010	2011
Portugal	-122,700	-167,093	-221,635	-230,173	-269,743	-248,712	-233,316
Italy	-265,250	-403,540	-562,030	-529,440	-565,210	-505,500	-432,150
Greece	-176,152	-234,805	-315,891	-249,536	-299,665	-293,355	-233,530
Spain	-122,700	-167,093	-221,635	-230,173	-269,743	-248,712	-233,316
China	+413,136	+639,808	+1,187,741	+1,493,451	+1,490,516	+1,688,032	+1,774,746

Source: IMF Balance of Payments Statistics Yearbook (2012).

Table 6. International Investment Position: Angola, 2003-2011 (US$ millions)

Aspect of Position	2003	2004	2005	2006	2007	2008	2009	2010	2011
Net position	-17,159.24	-16,701.62	-11,293.10	-764.30	8,275.20	13,240.60	5,709.00	10,670.20	22,851.90
A. Assets									
Total	3,362.01	5,845.61	11,194.30	19,438.30	30,226.20	43,824.30	41,131.90	48,064.20	61,056.10
1. FDI	23.60	23.90	24.41	215.00	1,126.76	3,696.40	3,703.20	5,043.60	7,136.20
2. Portfolio	47.15	49.81	1,316.84	2,756.31	4,771.73	6,529.25	7,087.40	7,360.90	7,413.10
3. Other investments	2,691.93	4,392.31	6,656.20	8,289.30	13,130.90	16,092.90	17,462.00	17,639.40	20,182.80
4. Reserve Assets	599.33	1,379.59	3,196.85	8,177.70	11,196.80	17,505.70	12,879.40	18,020.40	26,324.10
B. Liabilities									
Total	20,521.25	22,547.23	22,487.42	20,202.60	21,951.00	30,583.70	35,422.80	37,394.10	38,204.30
1. FDI	11,987.47	13,436.70	12,132.86	12,095.15	11,201.81	12,880.78	15,086.10	11,858.90	8,835.10
2. Portfolio	...	...	...	...	...	...	68.00	71.00	71.00
3. Other investments	8,533.79	9,110.53	10,354.56	8,107.40	10,749.20	17,703.00	20,268.80	25,464.20	29,298.20

Source: IMF Balance of Payments Statistics Yearbook (2012, 2011a).

Table 7. International Investment Position: Rwanda, 2003-2010 (US$ millions)

Aspect of Position	2003	2004	2005	2006	2007	2008	2009	2010
Net position	-1,327.43	-1,374.35	-1,207.00	-125.00	-157.00	-193.00	-249.00	-417.00
A. Assets								
Total	318.84	427.51	510.41	567.52	721.11	878.67	1,174.00	1,251.00
1. FDI	…	…	15.00	…	12.95	12.95	13.00	13.00
2. Portfolio	…	…	…	…	…	18.79	19.00	19.00
3. Other investments	75.84	83.78	94.30	127.80	159.51	246.82	249.00	258.00
4. Reserve Assets	243.00	343.73	401.11	439.72	548.66	600.11	893.00	961.00
B. Liabilities								
Total	1,646.27	1,801.86	1,718.00	693.00	878.00	1,072.00	1,423.00	1,668.00
1. FDI	61.57	69.23	77.00	103.23	170.37	273.72	392.00	435.00
2. Portfolio	…	…	…	…	…	…	…	21.00
3. Other investments	1,584.70	1,732.63	1,641.00	589.00	708.00	798.00	1,030.00	1,212.00

Table 8. International Investment Position: Zambia, 2006-2011 (US$ millions)

Aspect of Position	2006	2007	2008	2009	2010	2011
Net position	-7,434.90	-8,100.10	-8,179.90	-7,841.90	-6,707.60	-6,078.40
A. Assets						
Total	1,765.30	3,111.10	4,946.60	7,428.20	11,847.90	15,074.80
1. FDI	1.70	2.40	971.50	1,279.50	2,297.40	3,447.60
2. Portfolio	…	…	40.00	40.00	40.00	40.00
3. Other investments	1,168.50	2,195.80	2,866.00	4,349.90	7,531.70	9,302.70
4. Reserve Assets	595.10	912.90	941.60	1,753.00	1,896.50	2,168.90
B. Liabilities						
Total	9,200.20	11,211.20	13,126.50	15,270.10	18,555.50	21,153.20
1. FDI	6,513.10	7,766.80	8,592.90	9,221.40	10,950.70	12,932.40
2. Portfolio	217.70	273.10	218.80	156.30	254.30	287.90
3. Other investments	2,469.40	3,171.30	4,294.80	5,780.20	7,035.50	7,459.10

Source: IMF Balance of Payments Statistics Yearbook (2012).

Concluding Discussion

- Macroeconomic policies should be well integrated with other areas of economic (and social) policy-making.
- In East Asia, monetary policy was coordinated with financial sector and industrial policies, including directed and subsidized credit schemes and managed interest rates to directly influence investment and saving, whereas competitive exchange rates were considered essential to encouraging exports and export diversification.
- Quadrant analysis shows most African countries declining degrees of financial globalization = increased policy space?
- In country cases, notable increase in external reserve asset accumulation, one of the well known ways to increase policy space.
- Of the three countries which comes closest in terms of forming a ‘developmental state’?
- Keep an eye on Brazil under Rousseff – trying to move from consumption-led to investment-led growth.
- Trends of ‘resource nationalism’ could improve net IIPs of African countries.

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