

Commonwealth's Role in Enhancing Private Capital Flows

116 In this section we examine the role of Commonwealth in enhancing and sustaining private capital flows and consider ways in which its activities in this area can be further strengthened. As a group of countries at different stages of financial integration but with many common features in legal and administrative systems, Commonwealth countries have much to learn from each other. Acting through the Secretariat, Commonwealth countries can provide technical assistance and policy advice to help member countries attract private capital flows. And acting together, Commonwealth countries can bring pressure to bear on international institutions in the kind of ways discussed in section V.

1 Existing Activities

117 Through its ongoing policy development and technical assistance programmes, the Commonwealth Secretariat seeks to assist member countries in promoting private capital flows and private sector development. These overall objectives have been pursued through specially designed investment funds; organising advice on developing and sustaining capacity in member countries, particularly small states; helping member countries create the enabling environment to attract and sustain capital flows; and strengthening the role of market forces and the private sector. The following areas have been of special focus:

- ❖ assisting governments in creating the right enabling environment; and in developing appropriate strategies and policies relating to fiscal, financial and regulatory regimes to promote private investment;
- ❖ playing a catalytic role in mobilising long-term capital through the establishment of investment funds;
- ❖ assisting the development of domestic capital markets including the establishment, maintenance and regulation of securities markets;
- ❖ assisting governments in negotiating with foreign investors, especially in mining and petroleum projects, where the Commonwealth has developed special expertise;
- ❖ providing a range of specialised and targeted capacity building programmes on corporate planning, strategic management, enterprise restructuring, competitiveness and foreign investment promotion strategies;
- ❖ advising on country – specific policy issues relating to private sector development and strengthening the functioning of markets by establishing appropriate legal and institutional frameworks, including intellectual property rights;
- ❖ preparation of feasibility studies for new enterprises and restructuring and modernisation of existing small scale enterprises across sectors; and
- ❖ advising on formulating policies on commercialisation and privatisation, including strategy and individual enterprise-level assistance, and post - privatisation management to strengthen enterprises.

- 118 The Secretariat has developed a comparative advantage in providing an assistance package which covers the full range of activities described above. It has the advantage of deploying in a cost-effective manner multi-disciplinary teams, drawing on in-house as well as outside expertise, and on the familiarity it has with the laws and policies of Commonwealth countries. It has been able to tap effectively a wide range of experience amongst Commonwealth countries to help other Commonwealth countries, as well as catalysing the various sources of private finance for development purposes. The Secretariat has built up the confidence of its members in these activities over a period of time through close interaction with member governments and by avoiding any apparent conflict of interests.
- 119 Much of this support is demand driven and provided to member governments on request or in response to ministerial mandates; in certain cases the Secretariat also considers requests from governments to enhance the capacity of the private sector itself, an area which may require more emphasis. The Commonwealth Fund for Technical Co-operation (CFTC) is an important instrument for supporting programmes in these areas.

2 Future role of the Commonwealth

- 120 The Group agreed that the Commonwealth and its Secretariat, working within existing resources, should continue to play a strong role in assisting countries to mobilise private capital flows, specialising in areas where it has a comparative advantage. This is particularly important at a time when member countries are facing new challenges to remain competitive in attracting foreign capital.

- 121 First, it should build on the conclusions of this Report in advising member countries on the policies needed to attract and sustain private capital flows. In this regard, the Group has a number of proposals, under this heading:

- (i) **A Commonwealth Code of Good Practice** for national policies that attract and sustain private capital flows. It suggests that the conclusions to section 3 and section 4 be incorporated into a code of good practice that could be adopted and promulgated by the Commonwealth. Box 3 summarises the principles that might underlie such a code. The Secretariat might usefully incorporate this into a handbook for use by Commonwealth countries. It would provide a framework for more detailed work by the Commonwealth Secretariat in the specific areas mentioned below.
- (ii) **Regional strategies for promotion of investments:** The Secretariat already provides assistance for country-specific investment promotion activities. It can enhance its effectiveness by developing appropriate regional strategies to attract investment and leveraging its limited resources by collaborating with other partners both at regional (i.e. SADC) and international level (i.e. the World Bank, MIGA) to avoid duplication. Experience in East Asia suggests that a regional strategy should attempt to:
- ❖ develop a targeted promotion strategy to attract investment on a regional or a sub-regional basis: this model could be especially relevant to African economies with small markets and poor infrastructure;
 - ❖ establish a network of major firms in the region which could serve as joint venture partners and provide information on local/regional market conditions;

- ❖ co-ordinate a programme of regular sector reviews to assist investment promotion agencies with targeting, and the identification of emerging prospects; and
- ❖ promote an “information interchange” capable of exchanging information and intelligence between Agencies, and also provide information and other materials to private sector companies in a given region.

(iii) Improving the regulatory framework for banking and securities markets: In

light of the report of the working party on financial stability in emerging market economies and the call by the G7 summit at Denver to assist emerging market economies to strengthen their financial systems and prudential standards, there is a need to encourage sharing of experiences and provide technical assistance and training to Commonwealth regulators and supervisors.

There remains major gaps in many emerging markets of the Commonwealth. These

Box 3 Key elements for a Commonwealth Code of Good Practice

There are a number of measures that national governments can take to facilitate and attract private capital flows and to minimise the risk of sudden surges in capital movements.

- ❖ sustained implementation of sound macroeconomic and structural policies, which are as important for attracting and sustaining private capital flows as they are for promoting healthy domestic economic development; and which can help to reduce the risk of volatile swings in private capital flows.
- ❖ stability in the political process, and stable and transparent legal, accounting, regulatory, and tax systems.
- ❖ the early establishment of robust and well regulated financial and banking systems, which are an essential safeguard against financial stress in the event of a reversal of capital inflows
- ❖ open trade and investment policies, particularly in well-integrated and rapidly growing regions. The relaxation of foreign exchange restrictions can in itself help to attract private capital flows.
- ❖ regional integration, but not at the expense of wider multilateral trade and investment liberalisation.
- ❖ where it is prudent to do so, allowing institutional investors to take advantage of increasing opportunities for portfolio diversification through the relaxation of restrictions on the share of their assets that can be held in overseas markets.
- ❖ governments should be careful about imposing restrictions on foreign ownership and consider whether existing restrictions are necessary or useful
- ❖ privatisation programmes, and private involvement in domestic infrastructure projects, as a way of attracting foreign investors and improving the quality of infrastructure
- ❖ more and better investment in physical infrastructure
- ❖ a skilled and trainable workforce. National programmes to invest in human capital are critically important to enhance competitiveness and attract investment in higher value added activities.
- ❖ good marketing in the form of investment promotion and targeting strategies, which can help to establish credibility with investors

In handling capital inflows, and in particular in dealing with capital surges, countries have three basic economic policy choices: permitting flexibility in the exchange rate with some nominal appreciation; fiscal policy tightening; and sterilised intervention and controls on capital flows.

- ❖ there are limits on the extent of possible fiscal tightening in the short run; and on the effectiveness of sterilisation and capital controls in the event of large and persistent capital surges
- ❖ countries will therefore want to use a combination of policies according to their circumstances
- ❖ monetary expansion to counter any nominal exchange rate appreciation is not recommended
- ❖ after capital account liberalisation has taken place, governments should continue to monitor both capital flows and their financial sectors – and to do so more carefully than in the past.

In addition to action at the national level, the international community has a key role to play, both in facilitating private capital flows and in putting in place the multilateral infrastructure to help countries cope with volatility of capital flows.

gaps relate mainly to delays in payments and settlement and weaknesses in the legal and regulatory basis for compensation funds, takeovers and insider trading. Sharing of experiences between the mature developed markets and emerging markets within the Commonwealth can help the latter group of countries to further strengthen their regulatory framework.

In many Commonwealth member countries banks remain highly fragile. While virtually all developing countries have adopted the capital requirements that meet the Basle Accords' minimum standards, these countries face a much higher degree of risk and a more volatile environment. Similarly there is need for greater national and regional level co-operation among different types of regulators despite the increasing co-operation between the Basle Committee and International Organisation of Securities Commissions (IOSCO). There is however no forum for regular discussions on banking supervision among Commonwealth countries. The Commonwealth can assist by organising such a forum to encourage discussions amongst member countries and different types of regulators. These discussions could also help identify the needs for technical assistance and training for capacity building with respect to

developing infrastructure and regulation for the financial sector as a whole, especially for the smaller and weaker member countries in the Commonwealth.

- (iv) ***Creating an enabling environment:*** The Group recognised that providing legal protection is vital for investment, both foreign and domestic. In many countries the legal system are weak, inefficient and often slow and there are difficulties in enforcing contracts. Commonwealth countries can help each other in improving the functioning of countries' judicial systems and provide advice and technical support to facilitate good business practices.
- (v) ***'Best Practice' handbook on investment promotion:*** Commonwealth countries seeking investment in an increasingly crowded and sophisticated market must be able to compete effectively. In this environment, the investment promotion agencies can help attract investment, particularly to those countries less familiar to the international investment community. Four of the world's ten most successful agencies in the last decade have been in Australia, Malaysia, Singapore and the UK. The experiences of these countries indicate that investment promotion agencies perform best in an environment that has the right economic

and regulatory framework. But their performance also depends on a number of other factors, such as (a) ability to target and reach investors; (b) being “client-oriented”; (c) having longer term strategic plans; and (d) promoting close co-operation between relevant public sector bodies, the private sector and investment promotion agencies. The successful experiences of Commonwealth countries could be used to develop guidelines of ‘Best Practice’ for the benefit of investment promotion agencies in other countries.

(vi) **Monitoring Capital Flows:** With the dismantling of foreign exchange controls, mechanisms for collecting detailed information on foreign capital transactions through the banking system have become diffused and uncoordinated. Following these changes minimal amounts of information are being collected on foreign exchange transactions and no single administrative mechanism exists for assembling comprehensive information on foreign capital flows. The responsibility for the collection of various types of information on foreign investment ultimately rests with at least three institutions, each seeking to collect the information that fits its specific needs: the Central Banks, the investment promotion agencies and the national statistical offices; each collect data on foreign and domestic enterprises, with varying degrees of success, for different purposes, using standards and definitions appropriate for their specific needs. The resulting data are incomplete, and inadequate for monitoring capital inflows. The Commonwealth Secretariat with its track record in setting up a debt recording and management system should be able to help countries in designing appropriate data collection systems.

122 Second, Commonwealth countries can act together in promoting specific new mechanisms and activities:

(i) **Commonwealth Private Investment Initiative:** In 1995, the Commonwealth

Finance Ministers launched the Commonwealth Private Investment Initiative (CPII), which was subsequently endorsed by the Commonwealth Heads of Government at their meeting in Auckland.

The main objective of CPII is to mobilise long-term capital for commercial investments in developing member countries. CPII is a collaborative venture between the Commonwealth Secretariat and the Commonwealth Development Corporation (CDC). Under the management of CDC, a co-ordinated series of regional investment funds are being set up to invest in unlisted companies, privatised or privatising companies, new ventures, small/medium private sector businesses, and infrastructure development activities. Simultaneously the funds will attempt to ensure a high rate of return to investors and make a significant contribution to economic development by investing long-term, as opposed to traditional approaches to such funds which tend to focus on short term investments or target blue-chip companies. These funds can also have strong demonstration effects.

The first of these funds i.e., the Commonwealth Africa Investment Fund (Comafin), was launched in 1996 with a paid-in capital of \$63.5 mn. This was raised from a variety of sources within the Commonwealth such as CDC and investment institutions in Brunei, Malaysia, Singapore, South Africa, Botswana, Mauritius and Zimbabwe. Similar funds are being set up in other regions of the Commonwealth e.g. Pacific Islands, South Asia and the Caribbean.

The Group believes that it is in the mutual interest of all Commonwealth countries to actively support CPII by investing in the establishment of these funds. Looking ahead, there seems to be considerable scope for further deepening and strengthening of such initiatives by examining the possibility of setting up specialised sector funds or privatisa-

tion trust funds to assist member countries in their privatisation efforts.

(ii) **Privatisation Trust Funds (PTF):** The PTF concept is increasingly being used as a mechanism for restructuring and privatising public sector enterprises. Such funds can also be set up for interested Commonwealth countries as a natural extension of CPII. These funds help to warehouse privatised assets which can be sold in the local market at a later stage either as individual company shares or as mutual funds. Often domestic investors, both large and small, are unable to participate individually in privatisation efforts at the outset. The PTF can help to generate both domestic and foreign savings and enable local investors to take part in privatisations at a later stage.

(iii) **Risk Insurance and Guarantees:** Typically, such insurance is not readily available to many member countries of the Commonwealth especially the least developed. The recently established Commonwealth Investment Guarantee Agency (CIGA) offers one prospect of filling this gap. The types of investment risks CIGA will cover include individuals or corporations who own equity or have made loans in any Commonwealth country, against confiscation, expropriation and nationalisation and inconvertibility of dividends and/or exchange transfer embargoes.

CIGA has been set up as a private limited company. It will create a partnership amongst Commonwealth Governments, the World Bank through MIGA, existing Government backed investment insurance schemes, the Commonwealth Secretariat, the private insurance and reinsurance market, and investors in Commonwealth countries. A co-operation agreement between MIGA and CIGA has been signed. Host Governments will be consulted during the acceptance procedure to be applied by CIGA when vetting new risks. This will ensure the support of the host gov-

ernment. The establishment of CIGA is not expected to duplicate MIGA activities but will seek to “top up” cover available from MIGA or bilateral government schemes. The Secretariat is well placed to play a catalytic role in supporting such private sector initiatives and making these easily accessible to member countries.

3 Conclusions

123 It is important to strengthen Commonwealth co-operation to enhance and sustain private capital flows. Member countries can help each other and benefit from each others’ experiences. They can also act together to create mechanisms to assist such flows; and to influence relevant decisions made in international institutions.

124 Section V sets out the Group’s conclusions on current relevant debates in the international institutions.

125 The Group agreed that the Commonwealth, acting through its Secretariat, could and should build on its existing role in the following ways.

- ❖ develop a Commonwealth Code of Good Practice for national policies that attract and sustain private capital flows;
- ❖ help groups of countries develop regional strategies for investment promotion;
- ❖ assist countries improve the regulatory framework for banking and securities markets, create an enabling legal environment; and monitor capital flows;
- ❖ draw up a hand book of best practice in investment promotion;
- ❖ extend the Commonwealth Private Investment Initiative to new regions and sectors; and
- ❖ encourage the creation of Privatisation Trust Funds and new mechanisms for risk insurance and guarantees.