UNITED NATIONS UNIVERSITY

UNU-WIDER

World Institute for Development Economics Research

Research Paper No. 2008/68

The Liberalization of Capital Outflows in CIBS

What Opportunities for Other Developing Countries?

Ricardo Gottschalk[1]
and Cecilia Azevedo Sodre[2]

August 2008

Abstract

This paper examines the implications of the liberalization of capital outflows in China, India, Brazil, and South Africa (CIBS) for other developing countries. It focuses on their prospects of attracting not only foreign direct investment (FDI), but also portfolio capital flows from CIBS. To inform the discussion, two steps are taken: first, in order to identify the type of capital flows that might come from CIBS, the paper briefly describes capital account liberalization measures undertaken by CIBS to date and future intended liberalization. Second, it maps geographic distribution of outward FDI and foreign portfolio investment in the recent past, which are taken as possible predictors of future flows. The paper shows that portfolio investment goes mainly to OECD countries and offshore financial centres, and only a small share to developing countries. But, within developing countries, CIBS' neighbouring countries have shown a greater ability to attract this type of investment, compared with other developing countries.

Keywords: capital account liberalization, FDI, portfolio capital flows, south–south capital flows, developing countries

JEL classification: F21, F32, F37, G18

[1] Institute of Development Studies, University of Sussex; R.Gottschalk@ids.ac.uk; [2] Independent Economic Consultant, Brazil.

This study has been prepared within the UNU-WIDER project on the Southern Engines of Global Growth.

UNU-WIDER gratefully acknowledges the financial contributions to the research programme by the governments of Denmark (Royal Ministry of Foreign Affairs), Finland (Ministry for Foreign Affairs), Norway (Royal Ministry of Foreign Affairs), Sweden (Swedish International Development Cooperation Agency—Sida) and the United Kingdom (Department for International Development).

ISSN 1810-2611 ISBN 978-92-9230-122-4

Acknowledgements

The authors would like to thank Gustavo Bagattini for his effective research assistance. The usual caveats apply.

UNU World Institute for Development Economics Research (UNU-WIDER)
Katajanokanlaituri 6 B, 00160 Helsinki, Finland

Typescript prepared by Adam Swallow at UNU-WIDER

Introduction

CIBS are becoming major players in the global economy due to their trade relations with the rest of the world and their growing political assertiveness on the international stage. Moreover, China and India also matter because they have accumulated large amounts of international reserves, thereby becoming major sources of official capital to the rest of the world.

In each CIBS country, the opening of trade has been followed by the liberalization of the capital account. However, capital account liberalization (CAL) has not been completed. Although liberalization on the side of capital inflows by non-residents has been significant, in some CIBS countries the liberalization of capital outflows by residents has been fairly limited. It will be seen later in this paper that this has especially been the case in China. What will happen if these countries promote further CAL on the outflow side? For China, from its current position as a holder of massive amounts of international reserves, the most likely outcome will be that it will increasingly export private capital, rather than official. Thus, in China, and in CIBS more broadly, it will not be Central Bank officials but private agents who will decide where, how and for how long to invest abroad.

Who will gain and who will lose from this shift from official to private capital flows, and from capital invested domestically to capital invested abroad? Can we predict the future destination of private capital flows from these countries? Which countries will be able to attract such flows, by how much and in what form?

This paper examines the implications of the liberalization of capital outflows in CIBS for other developing countries. It focuses on their prospects of attracting not only FDI, but also portfolio capital flows from CIBS. It asks the question: Will the latter group of countries have the ability to attract part of the portfolio capital flowing from CIBS, or will these flows go only to developed countries? Will CIBS capital flows be invested in other developing countries from the same region—for example, China's capital flows being invested in developing Asia—or will these be invested in other developing regions as well? What initiatives could developing countries take to obtain access to these flows? Would such flows be desirable in the first place? These questions are about future developments, which, in turn, depend on an array of factors, including future policy decision-making and portfolio allocation decisions made by domestic private investors in the CIBS countries. Thus, to address these questions, this paper takes an exploratory approach, with the aim of offering a preliminary idea of potential trends in private capital flows from CIBS towards the rest of the world.

The paper's approach consists of two parts: first, it briefly describes capital account liberalization undertaken by CIBS to date and intended liberalization in order to have a more concrete idea of what sort of capital flows might come from this group of countries in the future. Second, it maps geographic distribution of outward FDI, and foreign portfolio equity and debt assets held by the CIBS countries in the recent past, so as to give us indications of the possible direction of capital flows in the future.

The next section describes capital account liberalization for each of the four CIBS countries. This is followed by an analysis of trends in the stocks of assets held abroad by the CIBS countries and the changes in their composition in the period 1990–2004. The paper goes on to examine the direction and location of FDI and portfolio assets held abroad in the early 2000s, and then provides a summary analysis and suggests a few policy ideas to enhance developing country ability to attract portfolio flows from the CIBS countries. The paper closes with an overview and conclusions.

Capital account liberalization in CIBS

This section describes the steps CIBS have undertaken towards liberalization on the side of capital outflows by residents.[1] It shows that the liberalization in these countries has occurred in diverse ways and at different speeds, but all have been sequenced. In discussing sequencing, the categorization used is the type of resident—not the type of flows, as usually is the case in analysis of liberalization of capital inflows.

Of the four countries under analysis, Brazil began liberalization first (in the early 1990s) and has gone furthest in opening the capital account for residents to invest abroad, especially corporations and individuals. South Africa and India can be considered intermediate cases, in that they have been somewhat more cautious than Brazil. Unlike Brazil, South Africa has prioritized liberalization of financial outflows by institutional investor. India has adopted a gradual approach linked to meeting preconditions. China was the last to commence liberalization and has been the slowest, liberalizing in only a very limited way, although the process has been speeded up more recently.

Despite the differing rates of liberalization, CIBS have signalled their intention of further liberalizing outflows to a major degree in the future, Brazil again going furthest in considering full capital account convertibility. As in the past, India has signalled that further liberalization will be dependent on meeting key preconditions, such as the strengthening of its financial system. In China, it is probable that further liberalization will continue to be not only gradual, but also experimental and responsive to the country’s macroeconomic circumstances.[2]

In what follows, liberalization on capital outflows is described for each of the CIBS countries in a summarized form. The summary begins with Brazil, followed by South Africa, India, and China.

Brazil

Brazil took major steps towards liberalization, especially on the side of capital inflows, during the Collor government in 1990–1992.[3] On the outflows side, which is our

1 The analysis comprises the liberalization of bank lending and portfolio flows only, thus excluding FDI. It draws on Gottschalk and Sodre (2008).

2 Zhao (2006) argues that, in China, liberalization of the capital account has not been gradual but, rather, experimental. The difference between the two forms of liberalization is that the latter is not committed to an end goal of full liberalization, is based on experiments with small liberalization steps, and can be reversed when is it is shown that such steps do not work well.

3 These steps included further opening of the domestic capital markets to foreign portfolio investment (involving both the stock and derivative markets and fixed income) following limited opening in

interest here, in early 1992 the government permitted foreign banks to transfer resources abroad through a mechanism called Carta-Circular No. 5 (hereafter CC-5). The CC-5 was, until very recently, the main means by which residents could invest abroad. It was created in 1969 to allow non-residents with business in Brazil to send money abroad.[4] Specifically, the CC-5 established that non-residents could only use national currency to buy foreign currency and send this abroad if the resources in domestic currency were the result of previous conversion from foreign currency brought by the non-resident to the country.

In February 1992, the Brazilian government deepened the liberalization process by permitting foreign banks to create a sub-account in order to send dollars abroad without the need for previous internalization of an equivalent amount of resources.[5] The additional relevant element was that corporations and individual residents in Brazil could use these sub-accounts to make a direct investment abroad or to send money to their own account abroad. In the case of individuals, there was no limit to the value of resources sent abroad, nor restrictions as to how such resources could be used or invested. For transactions involving values above R$10,000 or more, individuals were expected to provide information on it origin and destination, and the purpose of the transaction. Moreover, operations had to be registered with the Central Bank.[6] Individuals then made use of this mechanism to send resources to their own accounts abroad, the intention being to acquire real estate and/or invest directly in stocks or through an investment fund. For corporations, investments above US$5 million required previous authorization from the Central Bank. These agents reportedly sent resources abroad as investment in fixed capital and for lending to other corporations.[7]

The liberalization of capital outflows took further steps in 1994 with the creation of the special investment funds abroad, known as Fiex (now called *Fundos de Divida Externa*).[8] The Fiex is a fund that domestic institutional investors, financial institutions, non-financial corporations, and individuals can use to invest abroad. The rules that initially governed the fund were that at least 60 per cent of the total resources had to be invested in Brazilian foreign debt, with the remainder permitted to be invested in other securities, derivatives or held in the form of bank deposits abroad (in January 1999, the limit was increased to 80 per cent).[9] For monitoring purposes, all investments made via the Fiex had to take place through financial institutions authorized to operate in the foreign exchange market and all operations had to be registered with the Central Bank. The fund clearly represented an additional mechanism through which resources could be sent abroad. Besides investments made through Fiex, residents could invest in stocks from Mercosur countries. Institutional investors were also permitted to invest in the

---

1987, and permission given to Brazilian companies to issue different types of securities abroad (Prates 1998).

4 See Carta-Circular No. 5, 27 February 1969.

5 Cartas-Circulares 2.242, 7 October 1992.

6 Resolution 1.846, 29 July 1992, and Carta-Circular 2.242/92.

7 Information obtained from interviews with foreign banks in Brazil.

8 Fiex is the acronym for *Fundos de Investimento no Exterior*, which we translate into English as special investment funds abroad. *Fundos de Divida Externa* can be translated as External Debt Funds.

9 See Circular of the Central Bank of Brazil 2.111, 22 September 1994, and Circular 2.714, 28 August 1996.

Fiex; however, they could only invest 10 per cent of their total resources. This limit applied for pension funds as well as insurance companies, amongst other institutional investors. In addition, in 1996 Brazilian investors were permitted to acquire Brazilian Depositary Receipts (BDRs) from foreign corporations. BDRs are securities representing shares issued by foreign public corporations.[10]

In March 2005, the Central Bank brought the CC-5 to an end. In its place, it authorized individuals and corporations to transfer resources abroad through their own bank accounts, with permission to obtain foreign exchange through foreign exchange contracts with authorized dealers, there being no quantitative limits. The only remaining restriction faced by residents has been to specify the purpose of the transfer. This measure took place together with the merging of the foreign exchange markets, which until then were split into the free rate market and the floating rate segment. In September 2006, further liberalization for residents took place. Corporations and individuals have been allowed to send resources abroad through the foreign exchange market in order to acquire stocks, derivatives and other investments in the international capital markets. Until then, explicitly, residents could only acquire stocks from Mercosur countries and securities issued by Brazilian corporations abroad (for example, ADRs), by foreign corporations domestically (BDRs), or through Fiex.

In sum, Brazil was the first to liberalize outflows by corporations and individuals (via changes in the CC-5 in 1992), and did so to a major degree. More recently, the new measures brought the CC-5 to an end as a vehicle for capital outflows for residents by permitting non-financial corporations and individuals to buy and sell foreign currency through their own bank accounts. These changes represent a further reduction of barriers to capital outflows. The liberalization of capital outflows by institutional investors, however, has been more limited, with the imposition of quantitative and other restrictions.

In what follows, we discuss liberalization in South Africa where, contrary to Brazil (and, as will be seen, to China and India also), outflows by institutional investors has been given priority over other resident investors.

South Africa

Since 1994, when the South African economy was reintegrated into the world economy, the liberalization of capital outflows by residents has been gradual and sequenced. As from mid-1995, institutional investors were granted permission to invest abroad by means of an asset exchange mechanism, amounting to 5 per cent of their total assets. According to this mechanism, the resident investor had to find an external counterpart interested in investing in South Africa’s financial assets, and this investment had to be equivalent in value to the financial investment of the South African investor abroad. The aim was to ensure balance of payments neutrality (National Treasury 2001). The 5 per cent limit was increased to 10 per cent in 1996, coupled with the option that investors could transfer resources abroad amounting to 3 per cent of the net inflows of funds during the previous year. Moreover, corporations were allowed to expand their offshore

[10] In the case of DRs, see Resolution 1.848, 10 August 1991, later replaced with Resolution 1.927, 18 May 1992. In the case of BDRs, see Resolution 2.318, 25 September 1996.

investments, provided that these were financed from profits generated or financed abroad.

Since then, significant steps have been taken regarding the liberalization of capital outflows. The limit on institutional investors' external assets was increased to 15 per cent of total assets in 1999, with the limit of foreign exchange purchase increasing from 3 per cent to 5 per cent of the net inflows of funds during the previous year. In 2001, the asset exchange mechanism was eliminated, as were restrictions relative to annual inflows. This applied for long-term insurers, pension funds, and fund managers. Unit trusts could hold external assets up to 20 per cent of their total assets, subject to the upper limit of 10 per cent of annual net inflows in the previous period (Hviding 2005; IMF 2002; National Treasury 2001). Corporations and individuals are also permitted to hold financial assets abroad, although the limits they face were initially more restrictive, especially for individuals. Corporations have permission to invest in fixed capital abroad, but there is no specification for financial investments. As for individuals, initially they could invest up to 750,000 rand, and maintain foreign-earned income abroad. Today, they are allowed to invest up to 2 million rand abroad. Finally, in 2004 South Africa gave permission for residents to hold foreign instruments listed on South African exchanges (Bond Exchange South Africa and JSE Securities Exchange South Africa; IMF 2005).

We can see from this that liberalization of capital outflows (not inflows) has not only taken place in a gradual fashion, but has also been sequenced, as institutional investors have been subjected to fewer restrictions to invest abroad than corporations and individuals. As we can note, this sequence of liberalization is opposite to that followed in Brazil, where liberalization took place first, and to a deeper degree, for corporations and individuals.

India

India has taken steps towards CAL since June 1997, when the first Tarapore Committee (Tarapore I) recommended a timetable for implementation (Reserve Bank of India 2000). Until then, India's capital account was fairly restricted, as a result of a very slow liberalization process that had started back in the early 1990s. According to the proposed timetable by Tarapore I, the capital account in India would be liberalized gradually, in three phases over the course of three years: 1997–98 (phase 1); 1998–99 (phase 2); and 1999–2000 (phase 3). The proposed liberalization included both capital inflows and outflows. Thus, an important feature was the concomitant liberalization of these flows, though at different speeds.

With regard to capital outflows—the focus of this paper—the proposal made by the committee involved the following categories of residents: (i) corporations; (ii) the Security Exchange Board of India (SEBI), which registers Indian investors (including mutual funds); and (iii) individuals. Corporations would initially be permitted to transfer up to US$25,000 of financial capital abroad. Later, this limit would be raised to US$50,000, and US$100,000 in the second and third phases of the proposed liberalization. Banks, in turn, would be permitted to invest up to US$10 million in overseas money markets, mutual funds, and/or debt instruments. This limit was increased to US$25 million in November 2002.

For the Security Exchange Board of India (SEBI), from an initial position in which no investment abroad was permitted, Tarapore I proposed that investors be permitted to invest in overseas financial markets, subject to an overall ceiling of US$500 million in the first phase, US$1 billion in the second phase and US$2 billion in the third phase. The committee observed that it was important to ensure that the total amount was not met by just a few large-sized funds. Similarly to institutional investors, until 1997 individuals were not permitted to invest abroad. Tarapore I changed this by proposing that individuals be able to invest in financial markets and/or hold deposits abroad up to US$25,000 per annum in the first phase, US$50,000 in the second phase, and US$100,000 in the third phase. (The same limits were applied to Indian non-residents regarding any assets in India not capable of repatriation.) They were also permitted unlimited investment in overseas corporations listed on a stock exchange and having a shareholding of at least 10 per cent in an Indian company listed on a local stock exchange, as well as in rated bonds/fixed income securities. Among institutional investors, in practical terms there was no liberalization of capital outflows for pension funds and insurance companies, as these are nearly all public and therefore controlled and/or managed by the government.

It is widely known that the timetable proposed by the Tarapore I was not fully implemented. Admittedly, the main reason for this was the fact that the East Asian crisis occurred shortly after the Tarapore I report was released. Indeed, the Asian crisis led to a change in the whole situation.

More broadly, with regard to the effective capital controls observed in the 1990s, which do not necessarily correspond with Tarapore I intentions, Nayyar (2000) emphasises the existence of a complex and asymmetrical structure of capital controls: asymmetry between capital inflows and outflows, with a wide range of controls on capital outflows compared with the more liberalized capital inflows; asymmetry between residents and non-residents, with more liberalization of capital by non-residents and strict controls by residents (showing that this was an area where the Tarapore I guidelines were not really implemented); and asymmetries between individuals and corporations, with individuals facing more controls, while corporations benefited from significant liberalization.

The macroeconomic conditions in India have improved in recent years and the financial system has become stronger and less repressed. As a result, in certain areas the country has undertaken liberalization steps beyond those proposed by Tarapore I. International reserves reached a comfortable position of US$151.6 billion in 2005–06, an amount equivalent to about 11.6 months' of imports. In terms of total external liabilities (which include portfolio stock), India's reserves cover over three times the value of such liabilities. This high level of reserves has given the country the confidence to move further with the liberalization process.

Reflecting this, a new Tarapore Committee on CAL (Tarapore II) was set up in March 2006 and a report was made public at the end of July 2006. It recommended a phased increase in the ceilings on outward transfers of resources according to the different types of investors. As in the previous report, Tarapore II recommended a three-phase approach over a five-year period for further CAL in India: 2006–07 (phase 1); 2007–09 (phase 2); 2009–11 (phase 3). As established by Tarapore I, the latest report has included further liberalization of outflows:

- *Corporations* will initially be permitted to invest up to 25 per cent of their net worth in overseas corporations having at least a 10 per cent shareholding in listed Indian corporations and in rated bonds/fixed income securities. It is intended that this restriction should be abolished at the end of phase 1. Banks should maintain the same limits previously established by Tarapore I without any changes.
- *SEBI registered Indian investors* (including mutual funds) should be allowed to invest from an overall ceiling of US$2 billion to US$3 billion in phase 1. It is anticipated that an overall ceiling of US$4 billion will be observed in phase 2 and of US$5 billion in phase 3.
- The annual limits of transfers of money abroad by *individuals* should be raised to US$50,000 in phase 1 from the existing limit of US$25,000 per annum; to US$100,000 in phase 2 and to US$200,000 in phase 3. The present rule regarding limitless investments in overseas corporations listed on a stock exchange (and having a shareholding of at least 10 per cent in an Indian company) should be banned in the context of the large increase in the new limits. Should there be any difficulties in managing the new scheme, it is anticipated that Tarapore II will review the situation.

The Tarapore II report also suggests a road map for fuller capital account convertibility (FCAC), which does not necessarily mean zero capital restrictions. The report addresses some important FCAC implications for monetary and exchange rate management, the financial system, and for the fiscal revenues and deficits of both central government and Indian states. It also addresses the need for strengthening the financial sector, which is still not sufficiently well developed in India.

In sum, the Tarapore II report has proposed further steps towards liberalizing capital outflows by, in particular, granting corporations greater freedom to invest abroad. It can be expected that, in an environment of full capital account convertibility, the existing limits on corporations' and individuals' acquisitions of financial assets and other capital assets abroad will be banned. This will especially benefit companies that intend to leverage acquisitions overseas to broaden their position in the global market. However, there are still some concerns related to the liberalization of outflows, especially for individuals, due the threat of waves of capital flight. Reflecting this, the increase of the limits for individuals' investments abroad has been moderate.

China

Since the commencement of the open door policy in 1978, China has undergone significant capital liberalization. This has occurred mainly on the inflow side, initially with the liberalization of FDI and bank lending, followed by portfolio flows. On the outflow side, liberalization only really started, very timidly, in 2004, when domestic insurance companies were permitted to invest their own foreign exchange in the international capital markets. The next liberalization move took place soon afterwards, with a foreign firm being allowed to list on the Shanghai stock exchange (Zhao 2006).

In 2006, further relaxation took place. Qualified domestic financial institutions were permitted to invest in international capital markets—in both fixed income and stocks, on behalf of domestic institutions and individuals (Lane and Schmukler 2006; Zhao 2006).

This latest liberalization took place in response to pressure to ease outflows of capital in the context of rapid accumulation of international reserves. The expectations are that China will continue to liberalize outflows by residents. However, as argued by Zhao (2006), this will be done in a controlled manner and according to the macroeconomic circumstances at the time, as has always been the case in the past with the liberalization steps undertaken for capital inflows by non-residents.

Summary

Table 1 summarizes the main liberalization measures for each of the CIBS countries.

Table 1 Liberalization of financial outflows by residents

	Institutional investors	**Corporations**	**Individuals**
Brazil	Investment funds have no limits to investment abroad; end-use restrictions. Pension funds can invest up to 10% of total assets abroad; end-use restrictions.	Until 2005, investment through CC-5 accounts beyond US$5 million required previous authorization from the Central Bank. Since then, transfer can be made directly, and restrictions have been removed. Need to specify purpose of transfers.	Until 2005, transfers could be made through CC-5 accounts. Since then, transfers can be made directly, with no limits. Need to specify purpose of transfer.
China	Domestic insurance companies permitted to invest their own foreign exchange in the international capital markets. Permitted to invest abroad both in fixed income and stocks, via qualified domestic financial institutions.	Not specified.	Permitted to invest in the international capital markets, via qualified domestic financial institutions.
India	Aggregate limit of US$2 billion per annum set by Tarapore I. Recommended by Tarapore II to be increased to US$5 billion by 2009–11. This is, in practice, valid for investment funds, but not pension funds or insurers, which are mainly public-owned.	Restrictive quantitative limits. Tarapore II indicates they will be permitted to invest up to 25% of their net worth in overseas companies having at least 10% shareholding in listed Indian companies and in rated bonds/fixed income securities. In 2002, Banks permitted to invest up to US$25 million.	Current limit of US$25,000 per annum to be increased to US$50,000, US$100,000, and US$200,000 by 2006–07, 2007–09, and 2009–11, as recommended by Tarapore II. Existing permission to invest without limits in overseas companies listed on a stock exchange, and having at least 10% shareholding in an Indian company should be banned.
South Africa	Pension funds, insurers, and mutual funds permitted to invest abroad subject to the aggregate limit of 15% of total assets (20% for unit trust industry). Limits of up to 5% of total net inflows in the previous year (but removed since 2001, except for unit trusts, which still face a higher limit, of up to 10%).	Not specified.	Upper limit of R750,000—later increased to R2 million; they can also maintain foreign-earned income. Residents permitted to invest in foreign instruments listed on South African exchange

Source: Modified from Gottschalk and Sodre (2008).

It is interesting to observe the contrasting liberalization experiences between the four countries. Whilst South Africa has prioritized liberalization of financial outflows by all institutional investors, India and, especially, Brazil have liberalized outflows by corporations and individuals to a greater extent. With regard to financial outflows by institutional investors, Brazil and India have both maintained some restrictions, including end use restriction in the case of Brazil. It will be seen that, in the case of Brazil, such restrictions have clearly affected the direction of capital flows. In India, mutual funds face overall upper limits to investment abroad, while institutional investors (such as pension funds) are public owned, investing mainly in domestic assets, and the insurance industry is almost totally public owned, only very recently being subject to reforms involving privatization.[11] From an initial position of very limited liberalization, China has more recently taken a significant step towards liberalization for institutions and individuals.

Today, all four countries are either signalling or effectively undertaking further liberalization steps. Brazil has done so in the recent past, India is proposing a timetable to further the process, and China is debating possible further liberalization to ease macroeconomic pressures arising from the accumulation of large reserves.

Trends in assets and liabilities stocks

CIBS began to liberalize capital outflows by residents from the early 1990s, as noted earlier. In the early 1990s, Brazil was the first to begin liberalization, followed by South Africa in the mid-1990s, India in 1997/98, and China in 2004.

We commence the analysis by looking at the trajectories of stocks of assets held abroad by these countries in the period 1970–2004. The aim is to see how liberalization of capital outflows affected such trajectories. For that purpose, we use the data set on stocks of foreign assets and liabilities constructed by Lane and Milesi-Ferretti (2006) (hereafter L-M).[12] The L-M estimates of assets and liabilities comprise FDI, portfolio equity investment, external debt, and international reserves.[13] We plot the data on assets together with liabilities (and international reserves) to gather a sense of proportion, and because over certain periods both trends are strongly correlated—for example, in China since the early 1990s.

Figures 1(a)–(d) show that stocks of assets grew strongly for CIBS in the period 1990–2004, although less so in Brazil—229 per cent, against 559 per cent in South Africa, 1,728 per cent in China and 1,721 per cent in India. Growth of total assets in Brazil was driven mainly by FDI; in China and India, by international reserves, with a far smaller contribution from debt assets; in South Africa, by portfolio equity assets, and to a lesser extent, debt, and FDI. Table 2 shows the contribution of each type of asset stock to total

---

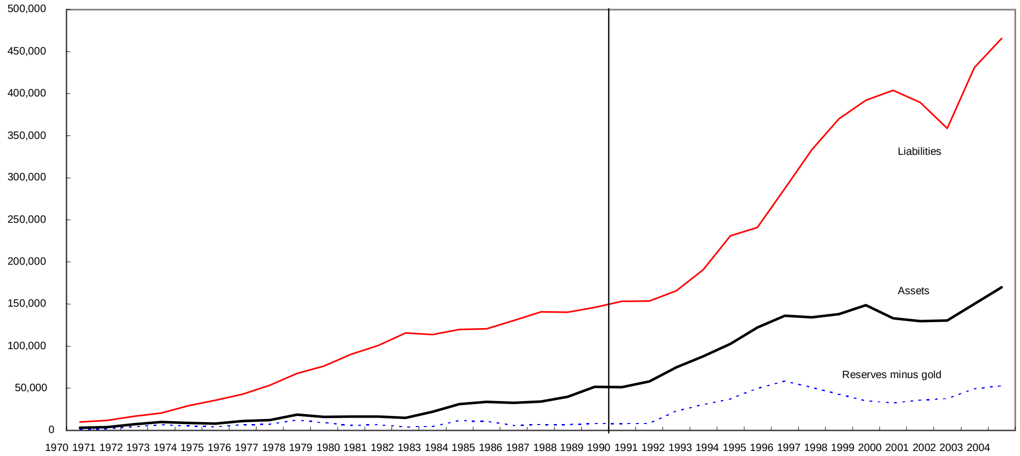
11 Interview material.

12 The database for Lane and Milesi-Ferretti (2006) is available at http://www.imf.org/external/pubs/ft/wp/2006/data/wp0669.zip

13 The cut-off point to differentiate FDI from portfolio equity is holdings of at least 10 per cent of an entity’s equity; in turn, debt comprises portfolio debt securities, bank loans and deposits and other debt instruments.

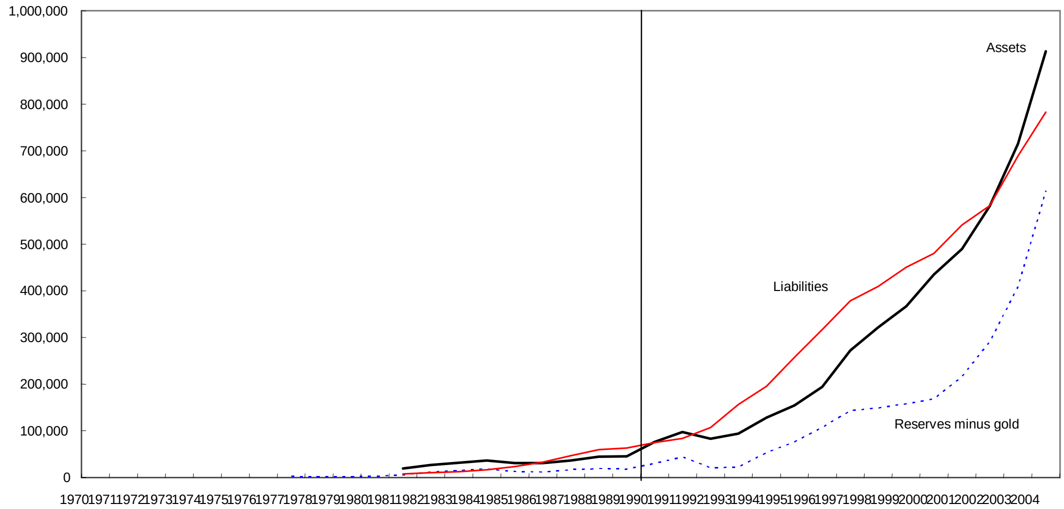
asset stock accumulation for each country. Figures 1(a)–(d) and Table 1 thus show that accumulation of total assets in China, and especially India, mirrors accumulation of international reserves, while in Brazil and South Africa, accumulation of total assets is driven by non-reserves assets. This indicates that capital account liberalization during 1990–2004 was more significant in Brazil and South Africa than in China and India.

Figure 1(a) Brazil: assets, reserves, and liabilities, 1970–2004 (US$ million)



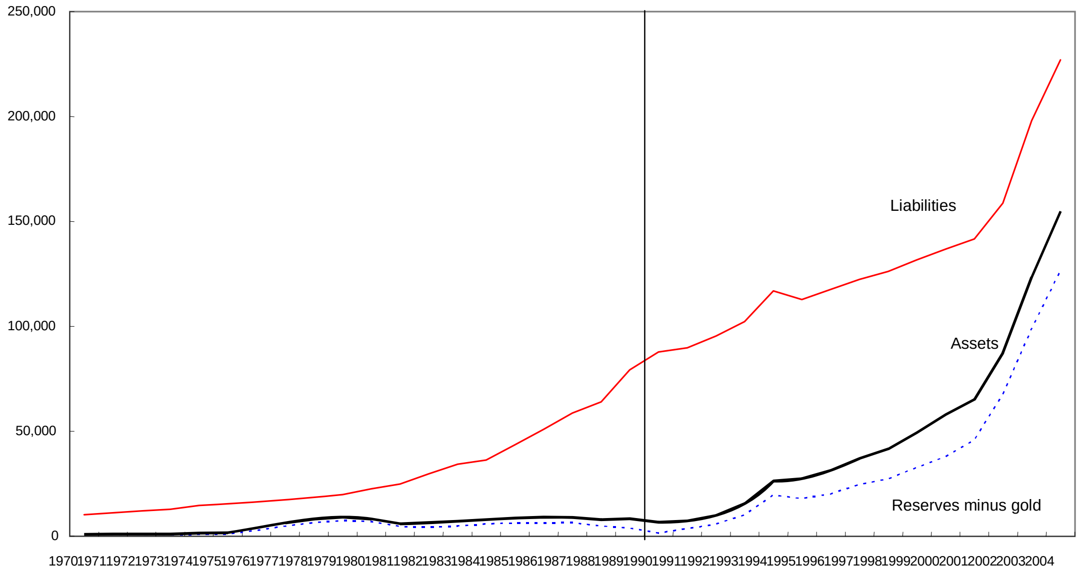
Source: Author's elaboration, based on data from Lane and Milesi-Ferretti (2006).

Figure 1(b) China: assets, reserves, and liabilities, 1981–2004 (US$ million)



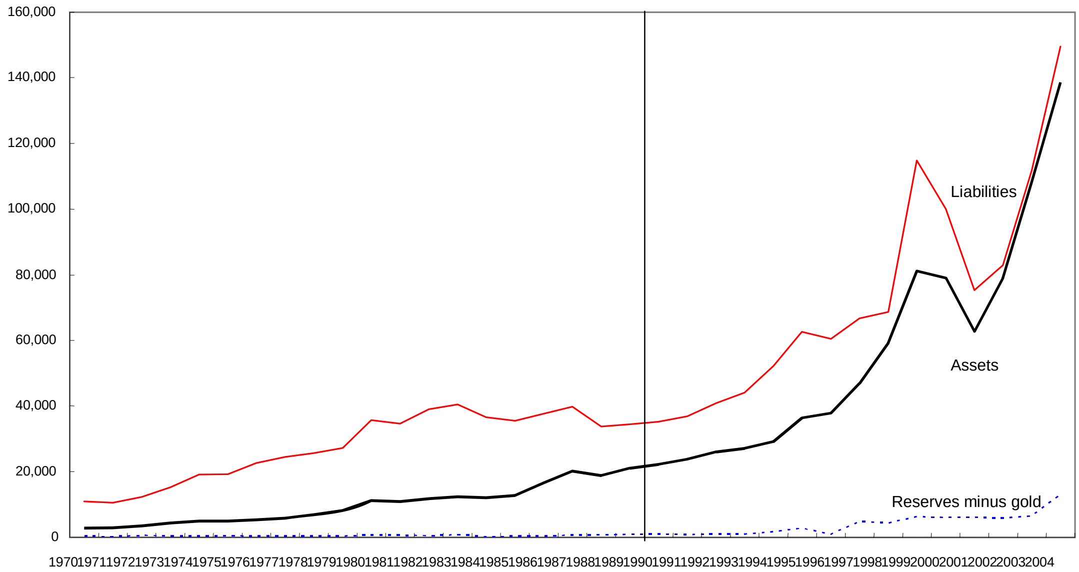
Source: Author's elaboration, based on data from Lane and Milesi-Ferretti (2006).

Figure 1(c) India: assets, reserves, and liabilities, 1970–2004 (US$ million)



Source: Author's elaboration, based on data from Lane and Milesi-Ferretti (2006).

Figure 1(d) South Africa: assets, reserves, and liabilities, 1970–2004 (US$ million)



Source: Author's elaboration, based on data from Lane and Milesi-Ferretti (2006).

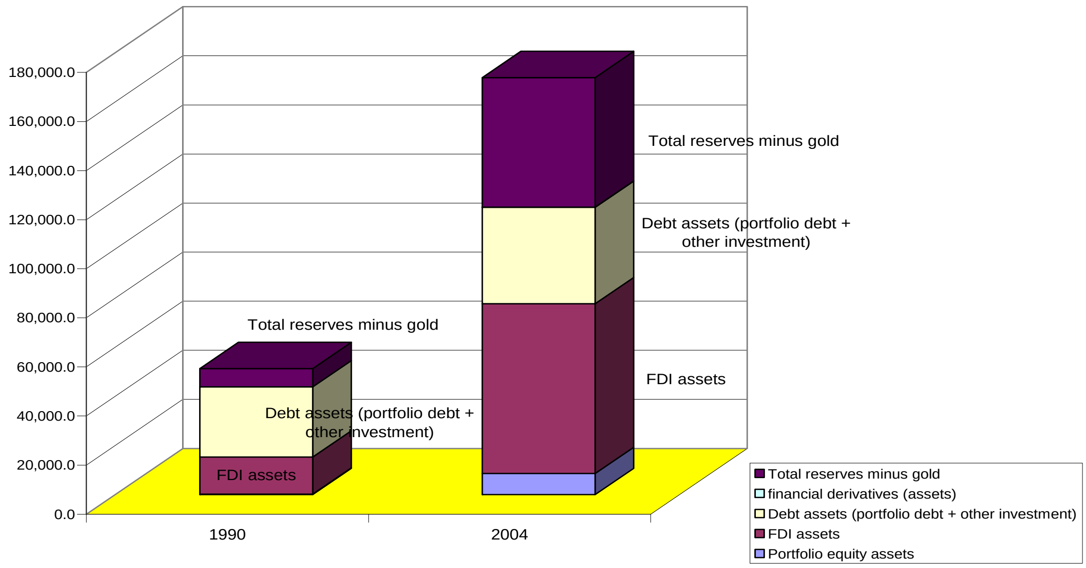
Table 2 Contribution of different categories of assets to growth of total asset stocks (1990–2004, %)

	Brazil	**China**	**India**	**South Africa**
FDI	43.8	3.7	6.4	21.6
Portfolio equity	7.0	0.7	0.6	43.9
Debt	10.9	27.0	9.2	24.2
International reserves	38.2	68.7	83.8	10.4

Source: Author's elaboration based on data from Lane and Milesi-Ferretti (2006).

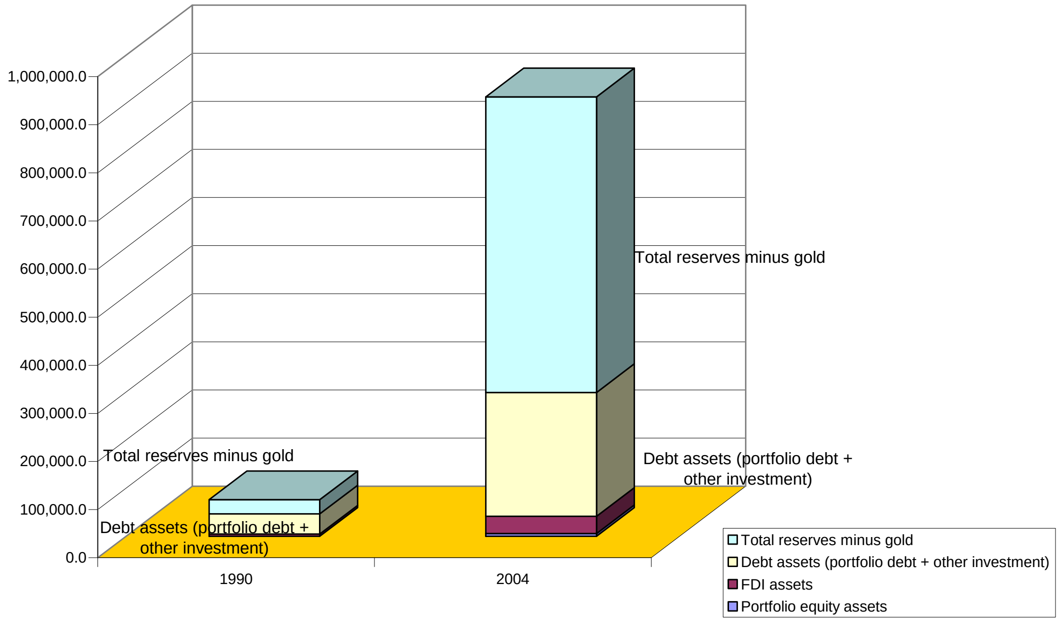
As one might expect, growth of assets has been accompanied by a change in their composition. Figures 2(a)–(d) show that, between 1990 and 2004, the main change in Brazil has been a shift towards FDI assets; in China and India, towards international reserves, and in South Africa, portfolio equity. Table 3 displays growth of total assets in the period 1990–2004, which includes international reserves, and growth of the non-reserves assets. It shows that accumulations in China, and especially India, were smaller when international reserves are excluded, although still high, partly because of initial low levels of non-reserves assets held abroad by these two countries. For Brazil and South Africa, accumulation of assets, both with and without international reserves, took place at similar growth rates, especially for South Africa.

Figure 2(a) Brazil: composition of assets; 1990 and 2004 (US$ million)



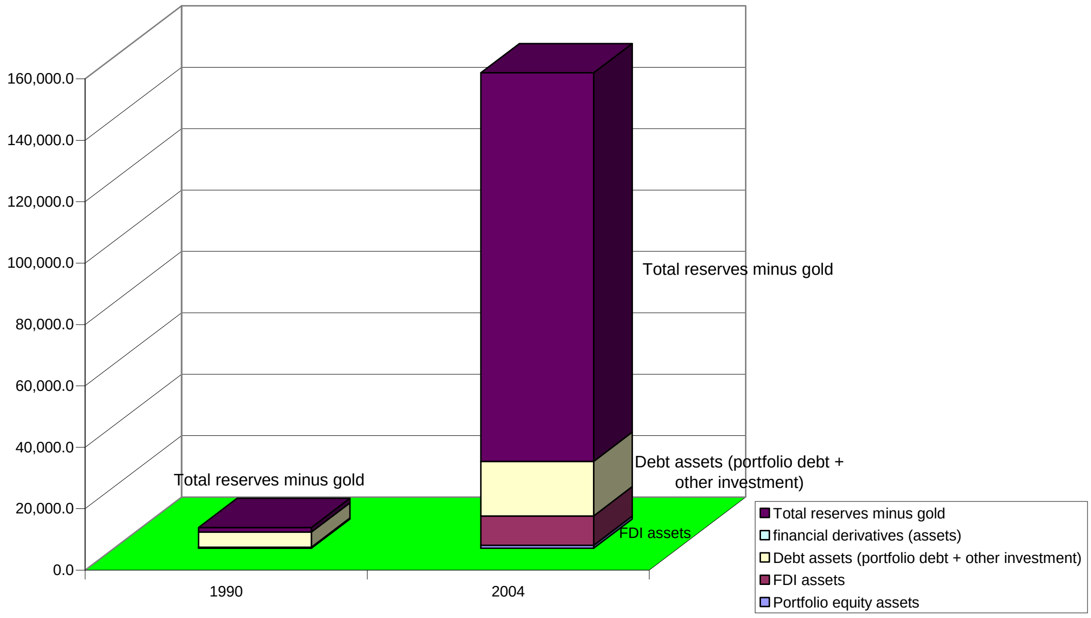
Source: Author's elaboration, based on data from Lane and Milesi-Ferretti (2006).

Figure 2(b) China: composition of assets; 1990 and 2004 (US$ million)



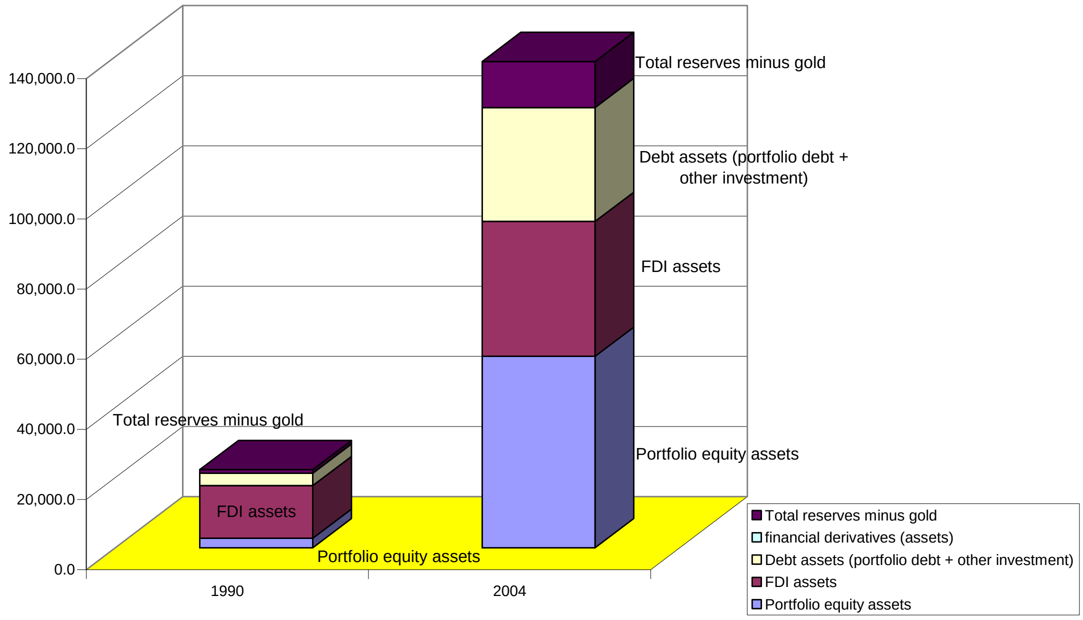
Source: Author's elaboration, based on data from Lane and Milesi-Ferretti (2006).

Figure 2(c) India: composition of assets; 1990 and 2004 (US$ million)



Source: Author's elaboration, based on data from Lane and Milesi-Ferretti (2006).

Figure 2(d) South Africa: composition of assets; 1990 and 2004 (US$ million)



Source: Author's elaboration, based on data from Lane and Milesi-Ferretti (2006).

Table 3 Accumulation of total and non-reserves assets, 1990–2004 (Growth rates %)

	Total assets (includes international reserves)	**Non-reserves assets**
Brazil	229.2	165.8
China	1927.8	1003.8
India	1721.8	509.6
South Africa	558.5	524.6

Source: Author's elaboration, based on data set from Lane and Milesi-Ferretti (2006).

Distribution of assets/flows across regions and groups of countries

Accumulation of non-reserves assets has been strong CIBS, as noted. What has been the geographic distribution of these assets? This section analyses how the different types of assets have been distributed across different regions and/or groups of countries. Most of the analysis that follows focuses on the distribution of assets in the 2000s, although in some cases information on flows is used instead. We start with FDI, followed by portfolio equity stocks and then portfolio debt stocks. FDI is used in addition to portfolio stocks for comparative purposes, and because we are also interested in possible distribution patterns of bank lending and believe FDI may be used as an indicator of where bank lending from CIBS might be heading.

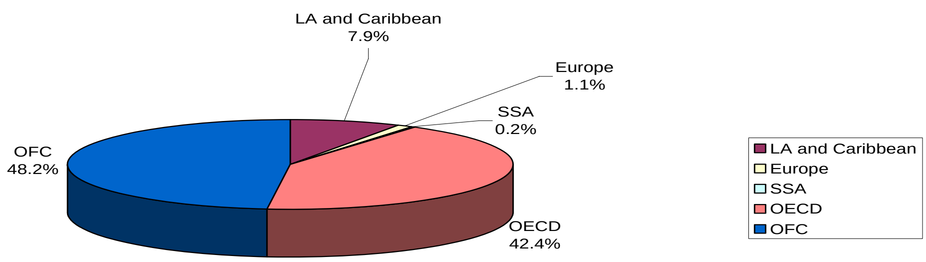
Data on FDI for China and India are displayed in flows and are obtained from the UNCTAD's World Investment Report (WIR). For Brazil and South Africa, data are in stocks and have been obtained from Brazil's Central Bank database and WIR, respectively. Data on portfolio equity and debt stocks are obtained from the Coordinated Portfolio Investment Survey (CPIS), which is available on the IMF website. This data set is available for India, Brazil and South Africa, but not China.

For the analysis of distribution, the categorization used is hybrid: first, countries are divided between OECD and non-OECD countries; Korea, Mexico, and Turkey have been included as non-OECD countries. A separate category is then created, offshore financial centres (OFCs), which includes both OECD and non-OECD countries. Finally, we use the World Bank classification to group the non-OECD countries in the following categories: Asia and Pacific, Latin America and the Caribbean, Europe, sub-Saharan Africa (SSA) and the Middle East and North Africa.

Distribution of FDI

Starting the analysis of direction of FDI for Brazil, given that information used is in stocks, we focus on distribution of the FDI stocks position in 2005, which is the most recent year for which data are available.

Figure 3(a) Destination of Brazil's outward FDI stocks, 2005



Source: Author's elaboration, based on data from Central Bank of Brazil.

Figure 3(a) shows that, of a total FDI stock of US$65 billion held abroad, 49 per cent is located in offshore financial centres (OFCs), a further 42 per cent is in the OECD countries, and the remaining 9 per cent is distributed between Latin America and the Caribbean (8 per cent) and developing Europe (1 per cent).[14] It is reported that nearly all of the FDIs in the OFCs are invested in the tertiary sector, specifically in services provided to companies and financial intermediation (Central Bank of Brazil 2007). In reality, these resources probably go, first, to the OFCs because of tax exemptions, and

---

14 This sub-section is limited to describing directions of FDI from the CIBS countries. For a thorough discussion of the main drivers and motivations of Brazil's outward FDI, and also of China's and India's, see Sauvant (2005). For a recent discussion of outward FDI from emerging economies more broadly, see OECD (2007).

are redirected to other countries to support expansion of large corporations abroad and export operations through funding the establishment of offices, technical assistance, and distribution centres in the importing countries (Barros 2007). If we exclude these and focus on the remaining 51 per cent of FDIs, we can see that 82 per cent goes to the OECD countries, 15 per cent to Latin America and the Caribbean, and 2 per cent to Europe. The distribution is therefore still skewed towards the OECD group of countries.

Of the FDIs in the OECD countries, about 50 per cent is located in just two countries: the USA and Denmark.[15] In Latin America, most of the FDIs are in Argentina (40 per cent) and Uruguay (34 per cent). The concentration of FDIs in these two countries reflects the existence of South America's Mercosur trade area.[16] Most of the FDIs in SSA are in Liberia and Angola. Table 4 displays the largest ten recipients of Brazil's FDI in 2005.

Table 4 Largest ten recipients of Brazil's FDI, 2005*, stocks data

Largest recipients	US$ million
Denmark	9,466
USA	4,163
Luxembourg	3,512
Spain	3,324
Holland	2,936
Argentina	2,068
Uruguay	1,748
Portugal	864
Hungary	840
UK	815
Total	33,844

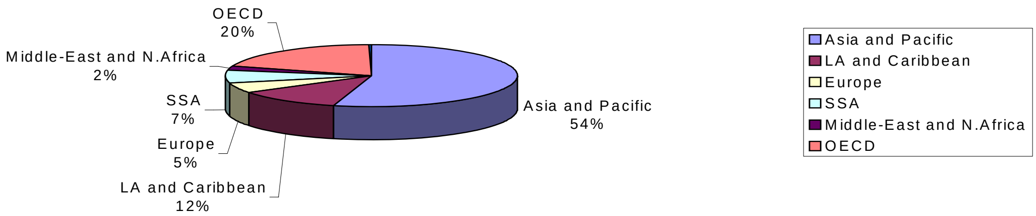
Note: * Excludes OFCs.
Source: Central Bank of Brazil.

15 The high level of FDI in Denmark is explained by the acquisition of Canada's Labatt Brewing Company by Brazil's Ambev in 2004, and the fact that Labatt's controlling company had its headquarters in Denmark (Tavares, 2006).

16 Sauvant (2005) notes that Brazil's FDI in Latin America reflects the country's increasing role promoting regional integration through investment and production in the region.

Next, we look at China's FDI flows abroad. Taking the average of FDI flows over 1999–2002, we can see that of US$708 million of total flows, 54 per cent went to the Asia and Pacific region, a further 20 per cent to the OECD, 12 per cent to Latin America and 7 per cent to SSA (see Figure 3(b)). The largest recipient by far is Hong Kong, followed by the USA and then several developing countries both from Asia and Latin America, plus Russia. Australia also features among the main recipients of China's FDI. The largest ten recipients of China FDI during 1999–2002 are listed in Table 5. However, the destination patterns are changing very rapidly. Using the classification in Cheng and Ma (2007), in 2005 over half of China's FDI (nearly 53 per cent) went to Latin America. The main factor driving China's FDI towards Latin America is the need for natural resources to sustain her high growth path. In 2005, Asia, as a whole attracted, 36 per cent of total FDI, Europe 4 per cent, and Africa 3 per cent.

Figure 3(b) Destination of China's outward FDI flows, 1999–2002



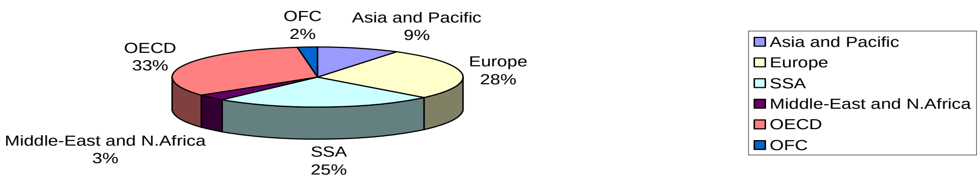
Source: Author's elaboration, based on data from UNCTAD's World Investment Report.

Table 5 Largest ten recipients of China's FDI outward flows, 1999–2002

Largest recipients	**US$ million**
Hong Kong	149.6
USA	77.4
Thailand	32.6
Mexico	29.8
Cambodia	22.5
Laos	22.2
Korea	22.1
Peru	19.7
Australia	17.7
Russia	16.4
Brazil	15.7

Source: UNCTAD's WIR (2004).

Figure 3(c) Destination of India's outward FDI flows, 2001–04



Source: Author's elaboration, based on data from UNCTAD's World Investment Report.

India's FDI destination is better distributed across the different groupings and regions. Of the total average flows of US$1.7 billion over 2001–04, 34 per cent went to the OECD countries. The remaining flows went to developing Europe (28 per cent), SSA (24 per cent), Asia and Pacific (9 per cent), the Middle East and North Africa (3 per cent), and OFCs (2 per cent) (see Figure 3(c)).

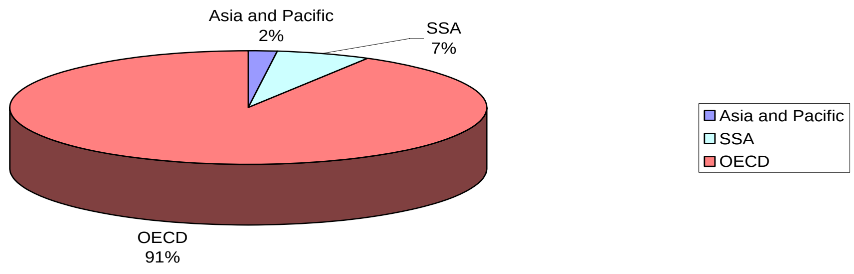
In terms of countries, the largest recipients are: Russia (over 25 per cent of the total flows), the USA (nearly 22 per cent), and Sudan (over 13 per cent). Most of the flows to Asia went to Vietnam, Singapore, Hong Kong, and China; 7.4 per cent of the total, and less than 1 per cent to the neighbouring Nepal and Sri Lanka in South Asia (see Table 6).

Table 6 Largest ten recipients of India's FDI outflows, 2001–04*

Largest recipients	**US$ million**
Russia	436.4
USA	383.1
Sudan	241.5
Mauritius	186.2
United Kingdom	76.5
Vietnam	57.1
Netherlands	41.1
Singapore	32.2
Bermuda	31.1
Hong Kong	21.5
TOTAL	1,772.4

Note: * In order to obtain the averages, values for 2004 were annualized.
Source: UNCTAD's WIR (2004).

Figure 3(d) Distribution of South Africa's outward FDI stocks, 2002



Source: Author's elaboration, based on data from UNCTAD's World Investment Report.

In contrast to India, South Africa's outward FDI is highly concentrated. Using stock data for 2002, it is possible to see that 91 per cent of total FDI is located in the OECD countries, and 7 per cent in SSA (see Figure 3(d)). Among the OECD grouping, the main recipients are the UK, Luxembourg, and Austria, followed by Belgium, Switzerland, and the USA. In SSA, the bulk of FDI can be found in Mozambique and Mauritius, with the remainder distributed among other Southern African countries (see Table 7 for the largest ten recipients).

Table 7 Largest ten recipients of South Africa's FDI, 2002 (Stocks data)

Largest recipients	**Millions of rand**
Luxembourg	46,809
United Kingdom	45,457
Austria	27,039
USA	22,863
Belgium	18,141
Australia	6,997
Mozambique	6,896
Netherlands	6,178
Germany	5,866
Mauritius	3,729
TOTAL	202,829

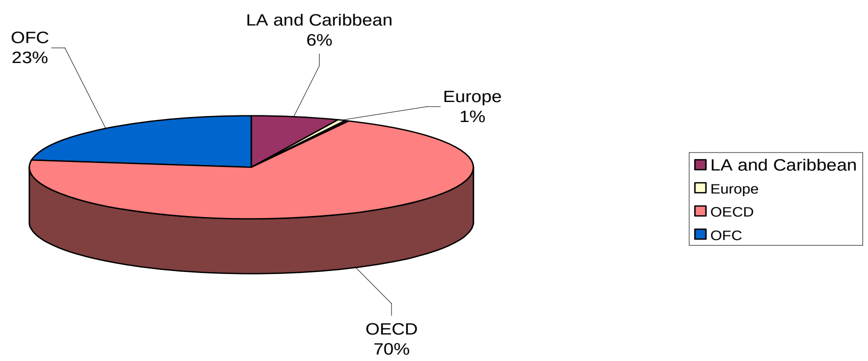
Source: UNCTAD's WIR (2004).

The analysis of the destination of FDI from CIBS shows that for Brazil and South Africa, most FDIs are located in the OECD, although some are in the neighbouring countries. For China, most FDI flows go to Asia, including neighbouring countries such as Cambodia, Laos, and Vietnam, in addition to Hong Kong. India, which has its FDI better distributed worldwide, invests very little in her neighbours from South Asia's sub-region.

Brazil

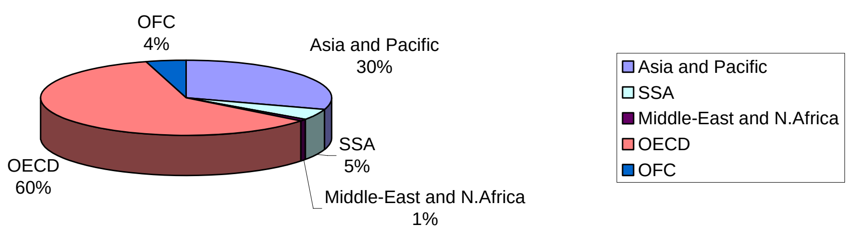
We now look at the distribution of foreign portfolio equity assets held by residents from Brazil, India, and South Africa. How similar or different are their distribution? Figures 4(a)–(c) depict the geographic distribution of portfolio equity assets for these three countries.

Figure 4(a) Distribution of Brazil's foreign portfolio equity asset holdings, 2005



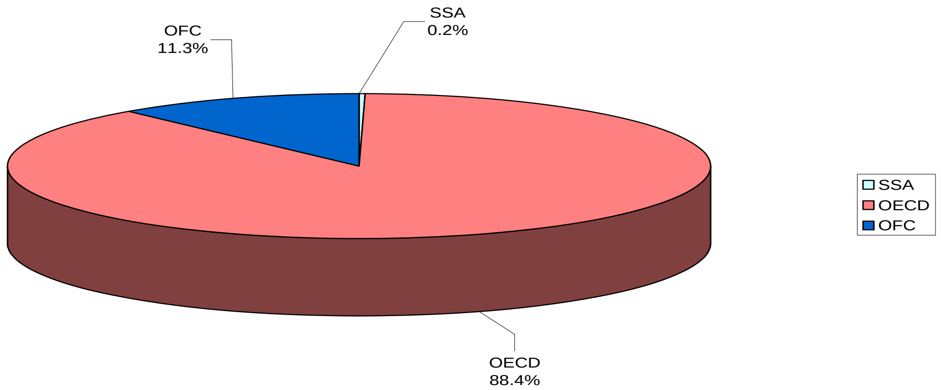
Source: Author's elaboration, based on data from CPIS, IMF.

Figure 4(b) Distribution of India's foreign portfolio equity asset holdings, 2005



Source: Author's elaboration, based on data from CPIS, IMF.

Figure 4(c) Distribution of South Africa's foreign portfolio equity asset holdings, 2005



Source: Author's elaboration, based on data from CPIS, IMF.

Figures 4(a)–(c) show that, in Brazil, the distribution of foreign portfolio equity assets is highly concentrated, with 70 per cent of the total held in the OECD grouping in 2005, a further 23 per cent in the OFCs, and 6 per cent are in Latin American countries. Among the OECD countries, most of the assets are in the USA; within the OFC countries, most assets are registered in the British Virgin Islands and Cayman Islands.[17] Within Latin America, most portfolio equity assets are in Argentina and Uruguay. This bias towards these two countries, and the fact that some of the investment took place in Latin America at all, reflects capital account regulation in place during the period, which determined that Brazilians could only invest in portfolio securities abroad if these were from Mercosur member countries, in addition to ADRs and BDRs or through Fiex.

In India, whilst most of portfolio equity investment went to OECD countries (60 per cent of the total), nevertheless 30 per cent went to Asia and the Pacific region and 5 per cent to SSA.[18] Very little went to OFCs, in contrast to Brazil, and, as will be seen, also South Africa. Among the OECD grouping, the main recipients were the USA, followed by Japan and the UK. In Asia, the largest recipients were Singapore and Hong Kong, followed by Malaysia and Thailand. Neighbouring Nepal and Sri Lanka, taken together, attracted less than 1 per cent of total portfolio equity from India (see Figure 4(b)).

Finally, as can be seen from Figure 4(c), nearly all portfolio equity held abroad by South Africans in 2005 was located in the OECD and the OFCs (88 and 11per cent, respectively).[19] The UK and USA have been the main recipients among the OECD countries, and Jersey and Bermuda the main recipients among the OFCs. Thus, although South Africa's equity assets are substantial, relative to Brazil's and India's, they are highly concentrated, as with Brazil but unlike India.

[17] The distribution analysis is based on a total of US$ 2.8 billion in 2005, as reported by the CPIS, IMF.

[18] Based on a total of US$35.6 million in 2005.

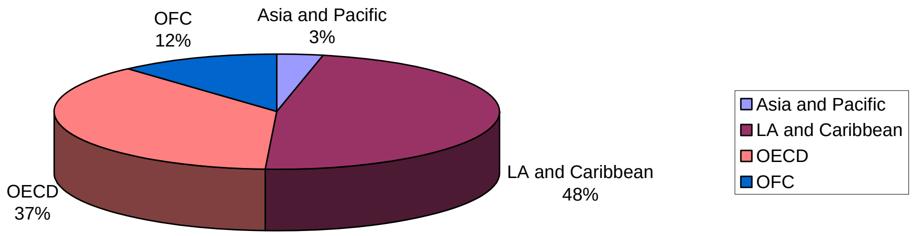
[19] Based on a total of US$60.8 billion in 2005.

What can be seen, thus far, is that distributional patterns for portfolio equity are much more concentrated than for FDI. India's portfolio equity is distributed slightly more geographically, but the value of total stocks that serve as a basis for information on distribution is very low.

Distribution of portfolio debt

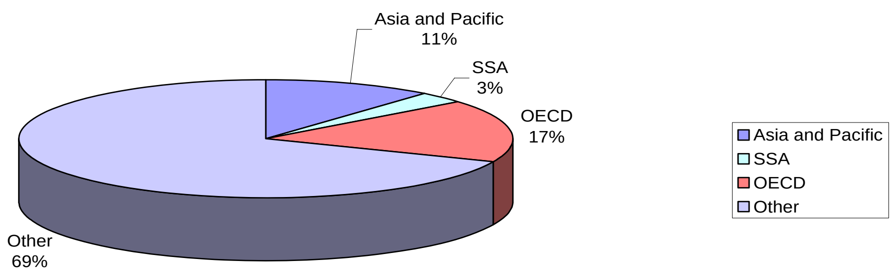
Figures 5(a)–(c) depict distribution of portfolio debt for Brazil, India, and South Africa.

Figure 5(a) Distribution of Brazil's foreign portfolio debt, 2005



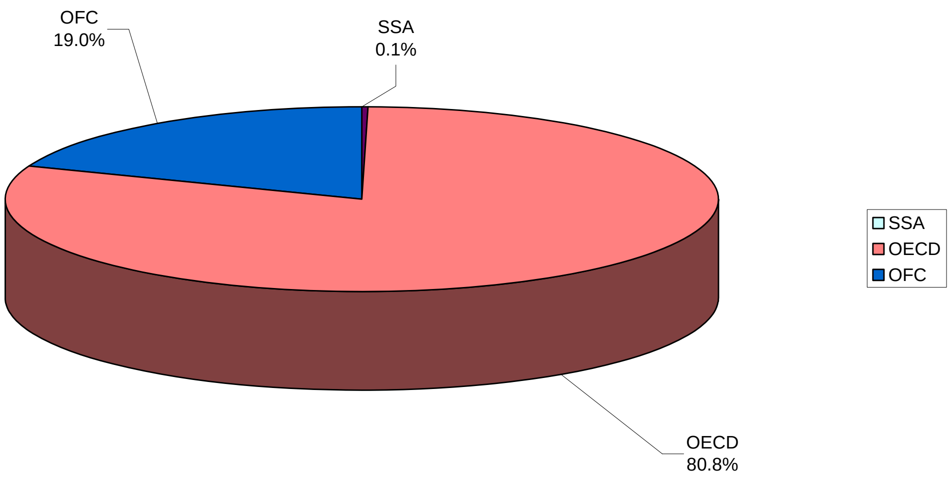
Source: Author's elaboration, based on data from CPIS, IMF.

Figure 5(b) Distribution of India's foreign portfolio debt, 2005



Source: Author's elaboration, based on data from CPIS, IMF.

Figure 5(c) Distribution of South Africa's foreign portfolio debt, 2005



Source: Author's elaboration, based on data from CPIS, IMF.

Figure 5(a) shows that, unlike in the case of portfolio equity assets, nearly half of total portfolio debt held by Brazilians abroad[20] is located in Latin America and the Caribbean region (48 per cent), with the remainder located in the OECD countries (37 per cent), OFCs (12 per cent) and Asia (3 per cent). The reason why so much debt is held in Latin America is that most of it is Brazil's debt, acquired internationally, and reflecting regulation on capital account in Brazil which, until recently, determined that 80 per cent of Fiex funds were invested in Brazil's debt. The other major location of debt assets is the USA, as would be expected. If Brazil's bonds are excluded, then debt assets are be highly concentrated in just the USA, with small portions distributed among the UK, Austria and a few other OECD countries.

In India, most of debt that is specified is held in the OECD countries, and the rest in Asia and the Pacific.[21] However, the largest share (69 per cent of the total) has no specified destination (Figure 5(b)).

Finally, for South Africa, as with the distribution of portfolio equity, the distribution of portfolio debt is highly concentrated in the OECD (81 per cent of the total) and OFCs (19 per cent); 0.1 per cent is held in SSA countries, chiefly in Angola.[22]

---

[20] The total value is US$6.8 billion in 2005.

[21] Based on a total of US$45 million in 2005.

[22] Based on a total of US$3.9 billion in 2005.

Summary analysis

In the previous sections, we have analysed the flows and stocks of assets held abroad by CIBS residents. These are the recorded flows and stocks, which in some cases may be a gross underestimate of the actual flows and stocks. However, the focus of the analysis is not on levels but, rather, on geographic distribution—in that, it is assumed that the distribution of the unrecorded flows and stocks is similar to those recorded.

There is, however, no reason to believe that has been the case. The recorded flows tend to be those that leave the countries through specific legal mechanisms, and these mechanisms usually specify how such flows should be invested, both in terms of type of assets and countries. It is likely that those unrecorded flows will follow a different investment pattern. Moreover, much of the flows and stocks registered in OECD countries and OFCs are probably redirected to other countries. This is especially the case of portfolio assets, which are acquired with resources put in the hands of international investment funds based in OECD countries and OFCs, which are then reinvested by such funds following their own investment strategies.

Having these caveats in mind, we turn to Table 8, which summarizes the distribution of different forms of capital by CIBS. The table shows that the ability of developing countries to attract capital from CIBS varies according to the type of capital and country. In what follows, we analyse distribution by type of capital.

Table 8 Distribution of flows/stocks in total (%)

	FDI			**Portfolio equity**			**Portfolio debt**		
	OFC	OECD	Developing countries	OFC	OECD	Developing countries	OFC	OECD	Developing countries
Brazil	48.2	42.4	9.4	22.8	70.1	7.0	11.7	37.3	51.0
China	0.2	19.8	80.0	N/A	N/A	N/A	N/A	N/A	N/A
India	2.2	33.2	64.6	4.4	60.1	35.4	N/A	N/A	N/A
South Africa	0.0	91.5	8.5	11.3	88.4	0.3	19.0	80.8	0.1

Sources: Author's elaboration, based on Central Bank of Brazil, IMF-CPIS and UNCTAD's WIR (2004).

- *FDI* A significant share of FDI flows from China and India go to developing countries (80 and 65 per cent, respectively). However, very little of the total FDI assets from Brazil and South Africa's residents are located in developing countries (that is, less than 10 per cent).
- *Portfolio equity* Most of foreign portfolio equity assets held by CIBS are located in the OECD and OFCs, with only 7 per cent of the total from Brazil and a mere 0.3 per cent from South Africa located in developing countries. Although most of India's portfolio equity assets also are located in the OECD, a significant share of 35 per cent is invested in developing countries. This somewhat mirrors the more widely diversified pattern of India's FDI.
- *Portfolio debt* Data for debt with complete information on direction are available only for Brazil and South Africa. Although 51 per cent of Brazil's portfolio debt is located in developing countries, if we subtract from this total the portion that

corresponds to Brazil's assets issued internationally, then most assets are located in the OECD countries and OFCs, with 7 per cent in Asia. In the same way as Brazil, South Africa's portfolio debt is highly concentrated in the OECD and OFCs, with less than 1 per cent located in SSA.

In all, developing countries are not a major destination of capital from the CIBS countries. This is particularly true for portfolio equity. Of course, this result probably partly reflects the fact that capital restrictions on portfolio flows in developing countries as a whole are still significantly higher than in OECD countries. What about the ability of neighbouring countries to attract capital from the CIBS countries?

Table 9 summarizes the share of total flows/stocks from CIBS grabbed by neighbouring countries, and the share they have within the group of developing countries. It shows that, in the case of FDI, China's neighbours grab 53 per cent, with 66 per cent of all Chinese FDI going to developing countries. Neighbouring countries to Brazil and South Africa grab just around 7 per cent of these countries' total FDI. However, they grab over 75 per cent of these countries' FDI going to developing countries. India's neighbours are the worst performers; they grab less than 1 per cent of India's total FDI, and a little more than 1 per cent of Indian FDI going to developing countries.

Table 9 Share of flows/stocks to neighbouring countries in total/developing countries* (%)

	FDI		**Portfolio equity**		**Portfolio debt**	
	Of total	Of developing countries	Of total	Of developing countries	Of total	Of developing countries
Brazil	7.1	75.5	5.0	71.4	0.1	0.3
China	52.6	65.8	N/A	N/A	N/A	N/A
India	0.8	1.2	0.6	1.6	N/A	N/A
South Africa	6.5	76.5	0.2	59.3	0.0	0.0

Sources: Author's elaboration, based on Central Bank of Brazil, IMF-CPIS, and UNCTAD's WIR (2004).
* The neighbouring countries are specified as follows. *Brazil*: Argentina, Bolivia, Chile, Colombia, Paraguay, Peru, Uruguay, Venezuela. *China*: Cambodia, Hong Kong, Laos, Korea, Myanmar, Mongolia, Thailand, Vietnam. *India*: Nepal, Sri Lanka. *South Africa*: Botswana, Lesotho, Mauritius, Mozambique, Namibia, Swaziland, Zambia, Zimbabwe.

In the case of portfolio assets, the story is somewhat different. Of the total assets, very little is located in the neighbouring countries (less than 1 per cent, in general), although the share in the case of Brazil's portfolio equity is somewhat higher (5 per cent). However, compared with other developing countries, the neighbouring countries of Brazil and South Africa do rather well in attracting investment in portfolio equity (71 per cent in the case of Brazil, and 59 per cent in the case of South Africa). Moreover, in the case of portfolio debt, if one excludes Brazil from the group of developing countries holding debt from Brazil, the share moves up from 0.3 per cent (displayed in Table 9) to 3.7. In the case of South Africa, while no debt holdings in developing countries were registered for the year 2005 (see Table 9), data for the year 2002 that we do not display here show that, at that time, South Africa had debt holdings in developing countries, all of these in just one country: Zimbabwe. But, as the data suggest, a massive pull out took place between 2002 and 2005.

On the whole, although neighbouring countries do not do well in attracting foreign capital from CIBS, they do far better than other developing countries. This suggests that proximity matters in attracting foreign capital, both FDI and portfolio assets. Of course, this assessment should be tempered by the fact that capital account regulations sometimes bias the direction of capital towards neighbouring countries, as was the case with Brazil until recently, concerning regulation specifying that Brazilians could only hold securities abroad from Mercosur countries.

Looking forward

What about the ability of developing countries to attract portfolio flows from CIBS in the future?

As CIBS continue to liberalize the capital account on the side of outflows, it is possible that any existing incentives and rules to invest in neighbouring countries will disappear, as was the case in Brazil when, in early 2006, Brazilians were granted permission to invest in securities abroad. It is therefore possible that future assets data for Brazil from 2006 will show changes in distribution patterns, against neighbouring countries and in favour of OECD and OFCs. However, because, for CIBS, neighbouring countries are able to attract flows from them regardless of existing regulation in their favour, these countries will probably continue to attract flows from CIBS, on the whole.

In the longer term, if neighbouring countries and developing countries more broadly wish to attract larger amounts of private capital flows from CIBS, it is important that they create investment opportunities—in addition, of course, to further liberalizing their capital accounts for portfolio flows, which typically face higher restrictions than FDI. In the specific case of portfolio equity flows, efforts should be made to make their stock exchanges more attractive to CIBS, through encouraging listing of domestic companies and increasing liquidity. Another possible initiative is to encourage regional stock exchanges. In the case of portfolio debt, neighbouring countries could think of issuing bonds on a regional basis. Moreover, the fact that CIBS do invest more in neighbouring countries than in other developing countries indicate that the knowledge they hold on their neighbours is an important factor in their investment decisions. Developing countries could therefore promote their countries among CIBS (for example, by making relevant information available to them), thereby further enhancing the informational advantage CIBS has about them.

It is therefore possible that neighbouring countries will be able to attract larger amounts of private capital from CIBS. This will also happen, to the extent that, with further liberalization of portfolio flows, such flows could follow FDI, which already are invested in neighbouring countries in relatively large proportions. However, while it is possible that their share in total CIBS' flows might increase in the future, this probably will not happen to any major degree. As CIBS further liberalize their capital account, domestic investors will probably place their resources so as to be managed mainly by investment funds based in the OECD countries and OFCs. Although these are only intermediaries, and these resources might end up spread across the globe, the distribution pattern will be not much different than it is today; that is, capital invested mainly in developed countries, with less than 2 per cent going to developing countries.

Is there any advantage in attracting capital from CIBS than elsewhere? To the extent that CIBS based investors have more knowledge on their neighbours, it is possible that they will be able to take better informed investment decisions and hold their assets, even during times of financial turbulence (thus acting as contrarians), thereby contributing to more stable capital flows. Of course, this argument does not hold for developing countries more broadly, as CIBS do not have a particular informational advantage about these countries.

Conclusions

This paper shows that, during 1990–2004, CAL on the outflows side has been significant in Brazil and South Africa but limited in India and, especially, China. The paper also shows that CIBS have accumulated large amounts of foreign assets during that period. In Brazil, foreign asset accumulation has been mainly in the form of FDI and, in South Africa, portfolio equity. In the cases of China and India, accumulation has been mainly in the form of international reserves invested abroad, partly due to their limited degree of CAL.

Further CAL in China and India will probably lead to rapid growth of private capital outflows, with these flows gradually replacing official outflows. This change in the composition of flows will certainly have an impact on the direction of flows. Further CAL in Brazil and South Africa, involving the removal of remaining CAL regulations (including end use restrictions) will also influence future directions of capital outflows from these countries. This paper then asks the question: Where will these flows go?

Drawing on the analysis of geographic distribution of FDI and foreign portfolio asset holdings during the 2000s, the paper shows FDI from China and India have been invested in the developing world to a considerable degree. However, this was not the case with Brazil or South Africa. The analysis of distribution patterns of portfolio asset holdings, in turn, shows that, in nearly all cases for which data were available, most holdings are in OECD countries and OFCs, with very little (within the range of 1 per cent to 2 per cent) in developing countries. This level is similar to portfolio investment abroad by developed countries. Portfolio asset holdings in developing countries are only higher when there is explicit capital account regulation determining country-specific destination. There is therefore a clear bias of direction of portfolio capital from CIBS towards OECD and OFCs.

What about the distribution of FDI and portfolio assets within the group of developing countries? In this case, the data show that a clear bias exists towards capital holdings in neighbouring countries and against other developing countries, especially from outside CIBS' regions. This applies especially to portfolio equity assets: for example, Brazil invests very little in Africa or Asia; India invests very little in Latin America, and so on.

All this suggests that CIBS do draw on their informational advantage to invest relatively more in neighbouring countries. There is therefore potential for this latter group of countries to attract more portfolio and other types of capital from CIBS; for example, by reducing obstacles to investment, by encouraging more flows through increasing liquidity in their stock exchanges, and by issuing bonds at the regional level. As for developing countries more broadly, natural resource rich countries have great opportunities to attract more FDI from China and India in the future. To the extent that bank loans and portfolio flows might follow FDI, they might furthermore be able to attract these latter forms of flows.

References

Barros, J. R. M. (2007) 'O investimento brasileiro no exterior é recorde', Valor Economico, 11 January.

Bhalla, S.S. (2006) ´Dissent Note on the Report on Fuller Capital Account Convertibility´, in 'Report of the Committee on Fuller Capital Account Convertibility´, Reserve Bank of India (2006), 31 July (available at http://www.rbi.org).

Central Bank of Brazil (2007) 'Capitais Brasileiros no Exterior (CBE)', Central Bank's website (accessed 12 August 2007, available at: http://www4.bcb.gov.br/?CBERESULT).

Cheng, L. K. and Z. Ma (2007) 'China's Outward FDI: Past and Present', July, Unpublished.

Gottschalk, R. and M. C. Sodre (2008) 'The Liberalisation of Capital Outflows in Brazil, India and South Africa Since the Early 1990s', in P. Arestis and L. de Paula (eds), *Financial Liberalisation and Economic Performance in Emerging Countries* (Basingstoke: Palgrave Macmillan).

Hviding, K. (2005) 'Liberalizing Trade and Capital Transactions: An Overview', in M. Nowak and L. A. Ricci (eds) *Post-Apartheid South Africa. The First Ten Years after Apartheid* (Washington, DC: IMF).

IMF (2002) International Financial Statistics, July (Washington, DC: IMF).

IMF (2005) 'Annual Report on Exchange Arrangements and Exchange Restrictions', August (Washington, DC: IMF).

IMF (2006) 'South Africa: 2006 Article IV Consultation – Staff Report', Country Report 06/237, September.

Lane, P. and G. M. Milesi-Ferretti (2006) 'The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970–2004, IMF Working Paper, WP/06/69, March (Washington, DC: IMF).

Lane, P. and S. Schmukler (2006) 'The International Financial Integration of China and India', in L. A. Winters and S. Yusuf (eds), *Dancing with Giants: China, India, and the Global Economy* (Washington, DC: World Bank and the Institute of Policy Studies).

National Treasury (2001) 'The Role of the National Treasury in the Economy', Mimeo, South African National Treasury.

Nayyar, D. (2000) 'Capital Controls and the World Financial Authority: What Can We Learn from the Indian Experience?', CEPA Working Paper Series III, Working Paper 14, March.

OECD (2007) ‘Trends and Recent Developments in Foreign Direct Investment’, June (Paris: OECD).

Prates, D. M. (1998) ‘Investimentos de Portfolio no Mercado Financeiro Domestico’, in FUNDAP, *Abertura Externa e Sistema Financeiro. Relatorio Final*, May (Sao Paulo: FUNDAP) ch. 1.

Reserve Bank of India (2000) ‘Recommendations of Tarapore Committee on Capital Account Convertibility’ (available at http:www.rbi.org.in/index/dl...001&secid=21/0/0&archivemode=0).

Reserve Bank of India (2006) ‘Report of the Committee on Fuller Capital Account Convertibility´, 31 July (available at http://www.rbi.org).

Sauvant, K. P. (2005) ‘New Sources of FDI: The BRICs’, *Journal of World Investment and Trade*, October: 639–710.

Tavares, M. (2006) ‘Investimento brasileiro no exterior: panorama e consideracoes sobre politicas publicas, CEPAL Serie Desarrollo 172, November (Santiago: CEPAL).

Zhao, M. (2006) ‘External Liberalisation and the Evolution of China’s Exchange System: An Empirical Approach’, Unpublished (Beijing: World Bank).