

Development Policy Research Unit
University of Cape Town



What are the major trends and determinants of foreign direct investment in SADC countries?

DPRU Policy Brief No. 00/P2
July 2000

**Industrial
Strategy
Project**
REGIONAL INTEGRATION,
ECONOMIC COOPERATION
IN SOUTHERN AFRICA

D P R U

Foreword

The Development Policy Research Unit (DPRU), located within the University of Cape Town's School of Economics, was formed in 1990 to undertake economic policy-oriented research.

The aim of the unit's work is the achievement of more effective public policy for industrial development in South and Southern Africa.

The DPRU's mission is to undertake internationally recognised policy research that contributes to the quality and effectiveness of such policy.

The unit is involved in research activities in the following areas:

- Trade and Industrial policy
- Technology policy
- Labour market policy
- Industrial organisation

These policy briefs are intended to catalyse policy debate. They express the views of their respective authors and not necessarily those of the DPRU.

They present the major research findings of the **Industrial Strategy Project (ISP)**. The aim of the ISP is to promote industrial development in the *Southern African Development Community* (SADC) through regional economic integration and cooperation. It is a three-year project that commenced in August 1998 and is funded by the International Development Research Centre (IDRC). Ultimately, this project will identify the policies and programmes that support regional interactions that contribute to the industrialisation of SADC national economies.

This policy brief is a shortened version of the following paper:
Foreign Direct Investment in Sub-Saharan Africa
Paul Kalenga

If you have any questions, or comments pertaining to the content of this policy brief, please do not hesitate to contact us:

Trudi Hartzenberg

Deputy Director

E-mail: trudi@hiddingh.uct.ac.za

Tel: (021) 480 7155/62

Fax: (021) 423 2501

Introduction

This policy brief seeks to outline major trends, patterns and determinants of foreign direct investment (FDI) in the Southern African Development Community (SADC).

The importance of FDI

FDI is important because it:

- supplements low domestic savings
- provides substantial parts of the shortfall in capital needed to finance economic growth and development

FDI deterrents

The following factors deter FDI:

- hostile policy frameworks
- civil strife and political instability
- high-perceived risks
- high transaction cost
- fear of policy reversals
- high degree of economic volatility

Possible instruments for attracting FDI

Possible instruments for attracting FDI include:

- political stability
- steady economic growth
- high returns on investment
- attractive and profitable locations for FDI
- SDIs and transport corridors (focus on stimulating investment potential and opportunities of different transport routes and areas)

Although aggregate FDI inflow data for SADC countries can be misleading when it comes to individual countries, it can be argued that ***the 1990s have seen positive developments as far as the ability of the region to attract foreign investment is concerned.***

Characteristics of countries that have attracted FDI

It is difficult to generalise about factors that promoted positive FDI trends in these countries. However, the countries that have attracted large amounts of foreign capital have:

- sustained economic policy reforms
- improved their macroeconomic environment towards greater stability and predictability of policies
- maintained political stability
- implemented effective privatisation programs

Why has the international business community renewed their interest in SADC countries?

One of the reasons why the international business community has renewed their interest in SADC countries is because some SADC countries have displayed **encouraging economic performance**. Compared to other Sub-Saharan African states, the SADC region has recorded positive growth rates since the middle of the last decade.

Some SADC countries have also undergone positive **political changes**, for example, the independence of Namibia in 1990, the end of civil conflict in Mozambique since 1992, and the end of apartheid and international sanctions in South Africa in 1994.

Another reason for the renewed interest in SADC countries is the **sub-regional integration arrangement** that is underway, in particular the **SADC Trade Protocol**, which aims to establish a free trade area (FTA). The **SADC Finance and Investment Sector Co-ordinating Unit** (FISCU), being coordinated by South Africa (established in 1995) is also contributing to renewing interest in the international business community. This unit aims to promote sound investment policies, financial harmonisation, and macroeconomic stability in the sub-region.

South Africa has become a primary source of FDI flows to a number of SADC countries

There is strong resentment about lack of openness of South African markets, however **the SADC Trade Protocol is likely to result in improved access to the South African market for SADC exports**.

Benefits of South African FDI flows to SADC countries

Cross-border investment flows from South Africa can play a critical role in:

- **counteracting existing trade imbalances**, which exist between South Africa and the rest of the region
- contributing to the **transfer of skills and technology**
- increasing **extra-regional export capacity**

Mineral resources remain a dominant attraction

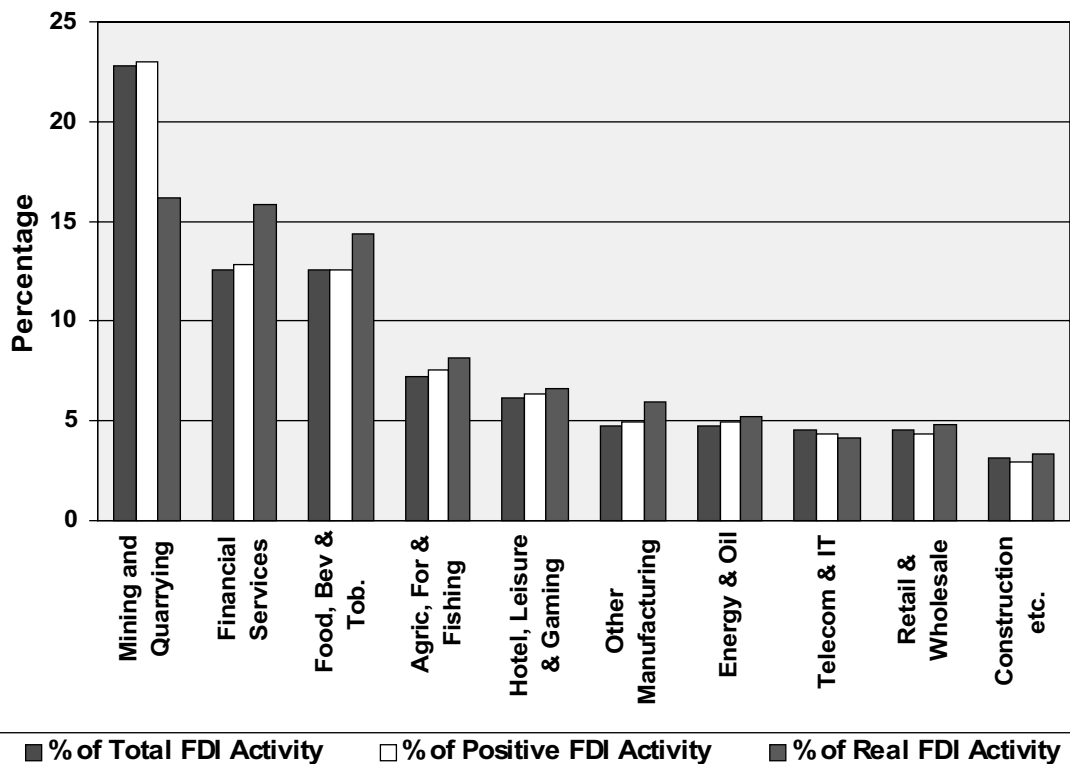
Mining has been a major FDI determinant during the 1990s in a number of SADC countries including *South Africa, Angola, Botswana, Zambia, Zimbabwe and Namibia*. The recent discovery of huge gold deposits around Lake Victoria has made *Tanzania* an attractive site for gold exploration and development activity.

Why is mining attracting FDI?

The boom in mineral exploration is due to:

- improved political stability
- better mining codes
- privatisation
- aggressive promotion activities
- reasonable production costs, particularly the cost of power and labour
- legal and regulatory reform

Ten sectors attracting the highest shares of FDI activity in SADC



Notes:

Positive FDI activity: All activity which has led or will lead to an inflow of investment into the target country.

Negative FDI activity: All activity which has led or will lead to an outflow of investment or which results in the cancellation of an inflow of investment.

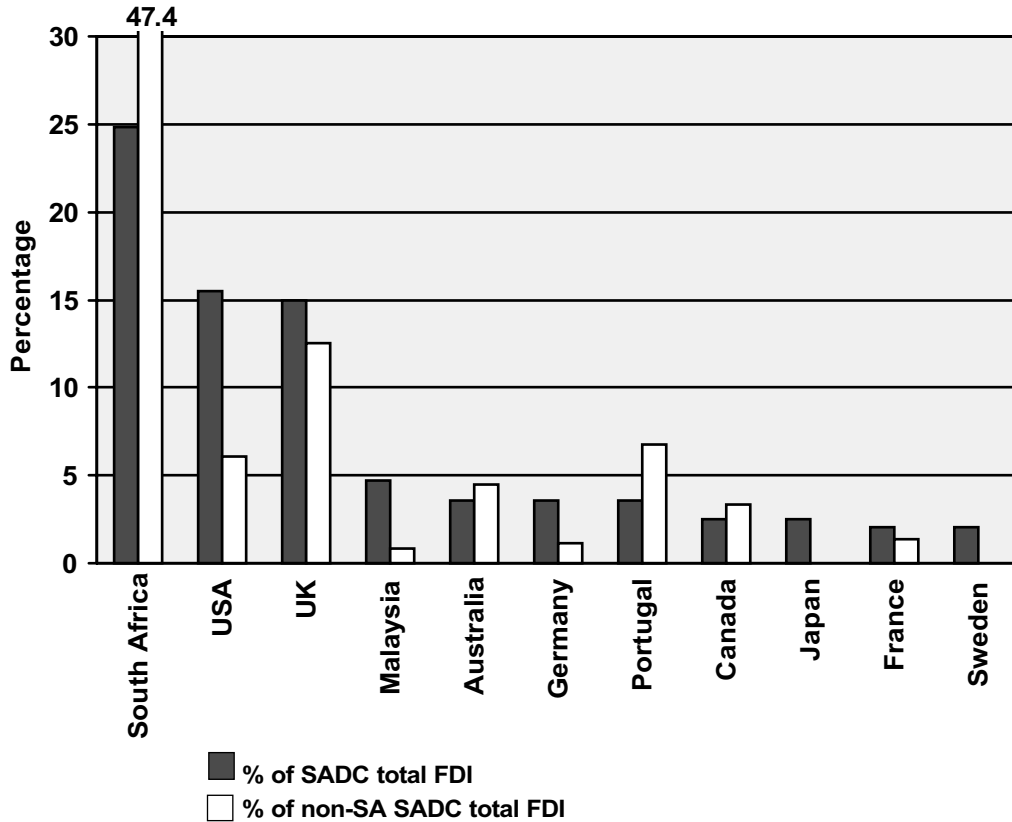
Real FDI activity: Activities which have been implemented or have already led to an inflow of investment.

Source : Business Map On-Line Database on FDI Activity in SADC.

Cross-border mergers & acquisitions are emerging

The 1990s have seen a global trend towards cross-border mergers and acquisitions (M&As), mostly geographically concentrated in developed countries. ***Although M&As are not substantial in other SADC countries, M&As have been a dominant mode of a number of South African FDI flows into the region.***

Source countries' shares of SADC and non-SA SADC investment activity



Source: Business Map On-Line Database

Leading home countries for FDI in SADC

A total of eleven source countries were each responsible for at least 2 per cent of total FDI activity in SADC. South Africa accounts for about a quarter of FDI activity in the region, followed by the USA and the United Kingdom.

Privatisation - an emerging catalyst for FDI in SADC

Privatisation programs have strongly attracted FDI in SADC over the last ten years.

Practical problems associated with privitisation

While privatisation contributed to positive FDI flows in some SADC countries, the process continues to be riddled with practical problems, such as

- poor implementation and management
- lack of transparency
- high level of politicisation

Growing African transnational companys

Historically, developing countries participated in international production as recipients of foreign investment from developed economies by hosting foreign affiliates of transnational companys (TNCs). This picture is gradually changing. Most African countries are becoming host to foreign affiliates of TNCs from developing countries, not only from Asia, but **also from within the continent**.

South African TNCs are investing in mining, food processing, financial, retailing and tourism sectors of the SADC region.

Mauritius is also emerging as a cross-border investor in Madagascar, Seychelles, South Africa, Ivory Coast and Mozambique.

African TNCs are not only limited to South Africa and Mauritius. The Ghanaian company Ashanti Goldfields has gold operations in Zimbabwe and Tanzania.

Growing FDI in services and manufacturing

FDI activity is becoming increasingly diversified. This includes both primary-intensive FDI in mining and quarrying, food processing and beverages, textile and clothing, financial and other services.

Mauritius has managed to increase significantly the amount of FDI in manufacturing industries such as textiles, clothing and electronic equipment since the 1980s.

Botswana has recorded positive rates of manufacturing growth due to an increase in FDI, particularly Hyundai and Volvo investments in motor vehicle assembly.

FDI in SADC (excluding South Africa), (US\$m)					
	1996	1997	1998	1999	Total
Angola	0	1.78	133.03	0	134.81
Botswana	3.58	14.07	55.25	0	72.9
DRC	0	190	199.7	130	519.7
Lesotho	0	2.43	0.4	0	2.83
Malawi	3.83	363.48	41.22	0	408.53
Mauritius	0	0	7.3	0	7.3
Mozambique	163.99	2936.44	3499.2	1.3	6600.93
Namibia	905.81	265.39	138.28	49.2	1358.68
Swaziland	200.83	208.3	63.28	0	81.38
Tanzania	200.83	208.3	63.28	0	472.41
Zambia	34.5	283.53	375.6	185	878.63
Zimbabwe	3	552.79	321.75	1660	2537.54
Total	1315.54	4850.82	4883.78	2025.5	13075.64
Notes: Amounts include intentions and actual investments. Figures for Mauritius are for South Africa as a source country only. Source: BusinessMap 1999					

Growing FDI flows from non-traditional investor countries

Traditionally, most of the FDI in Africa originated in a few OECD countries. New investors within the group of OECD countries include Canada, Italy, the Netherlands, Norway, Portugal and Spain.

Investors from other developing country regions, particularly from South East Asia have also emerged as new actors on the FDI scene.

Liberalisation of the regulatory framework

Some SADC countries have enacted liberal regimes for FDI, for example:

- national policies on foreign investment have been liberalised, particularly allowing foreign investors to repatriate profits and dividends, and guaranteeing legal protection of foreign investment
- foreign exchange controls have been relaxed

The regulatory system suffers from corruption and lack of transparency.

Investment facilitation and promotion

Investment promotion agencies or 'one-stop shops' have been established in most countries to:

- reduce bureaucratic red tape
- facilitate investors' entry and operations

Even in countries where 'one-stop shops' exist to facilitate investment, there are still vast problems, such as:

- poor institutional capacities and lack of implementation
- specific administrative barriers to FDI - *licensing of business activities and securing property and land rights*
- work and resident permits

Incentives and FDI

Fiscal and financial incentives include:

- corporate tax holidays, ranging between 5 and 10 years
- exemptions from import duties on equipment and inputs or duty drawbacks
- accelerated depreciation allowances
- specific tax deductions or grants related to training and employment of nationals

Are incentives effective in attracting FDI?

Although incentives have been instrumental in attracting 'footloose' and labour-intensive industries in some countries, they seem to have lost their effectiveness - **investors interested in long term investments look at long term profitability without incentives**. A general observation can be made that investments are still concentrated in areas offering **fewer incentives**.

Fiscal incentives cannot be used to offset unattractive aspects of the legislative, regulatory or physical environment. While the provision of investment incentives has been pervasive in Africa since the late 1980s, their effect on attracting FDI flows remains **inconclusive**. **Other policy measures such as privatisation and foreign exchange reforms seem to have produced positive FDI results**.

Export Processing Zones and FDI

Export Processing Zones (EPZs) are generally defined as industrial zones with special incentives to attract foreign investment in which duty-free imported materials undergo some degree of processing before being exported again (ILO 1998).

Generally, EPZs have **not** been successful in Sub-Saharan Africa. **Mauritius** is often cited as an exception to the general failure of EPZs in Africa. An EPZ was established in 1970, providing concessions and incentives to export-oriented enterprises. Mauritius attracted substantial FDI in the EPZ, largely concentrated in the textile and garment industries. EPZ exports were also promoted by duty-free access to the EU markets.

There is **no conclusive evidence that supports the notion that EPZs are successful in attracting FDI**. Countries that are succeeding in attracting substantial FDI inflows are doing so largely **because of other competitive attributes rather than incentives**.

FDI and regionalism

There has been an observed association between regional integration arrangements (RIAs) and FDI, although this depends on particular circumstances, scope and depth of such arrangements.

African RIAs have been ineffective mostly due to lack of implementation and credibility problems. However, there seem to be a renewed interest in this process through seeking to harmonise FDI policy frameworks. Already, within the context of the SADC Finance and Investment Sector Co-ordinating Unit, South Africa had liberalised its capital restrictions in favour of flows to other SADC member countries. This has encouraged South African firms to invest in neighbouring economies, although this is not necessarily the only contributing factor.

African RIAs are still not fully implemented, and as such, it is not possible to make a definite conclusion on their impact on FDI determinants. **In the case of market-seeking investment, it is possible that enlarged regional market may act as a potential determinant of FDI**. **Countries that are likely to succeed in attracting substantial FDI will be those that provide the best opportunities for foreign investors to exploit both country-specific and region-specific advantages**.

Conclusion

The 1990s witnessed an investment trend involving African firms investing in other African countries, notably from South Africa and Mauritius. This represents a clear indication of a new form of ***cross-border economic interaction***.

Privatisation has been an important catalyst for FDI opportunities in Sub-Saharan Africa.

While the region's rich natural resources continue to be a critical factor in attracting FDI, some countries are increasingly receiving a ***diversified mix of FDI***, particularly in the services and manufacturing sectors.

Foreign firms investing in the region are not only attracted by ***natural resource endowments***, but there are also those that are ***efficiency and market seeking***.

Another trend is the appearance of ***non-traditional home country sources of FDI*** on the African scene, both from the developing and developed world.

South Africa is emerging as a major investor in SADC, while acknowledging the tension that prevails within the region, primarily due to the perceived lack of openness of the South African market, ***regional economies are likely to gain by strategically seeking to benefit from the existing capital, skills and technology*** that exist within the region.

Attracting FDI requires:

- macroeconomic reforms to ensure stability and predictability of policy measures
- political stability
- efficient and effective institutions
- good administration
- relatively developed human and physical infrastructure
- an understanding of TNCs' corporate strategies and proactive measures by host countries to benefit from such strategies

The SADC region still trails behind other developing regions in FDI performance. However, the 1990s have brought some optimism. A number of SADC countries have been registering a positive trend in attracting FDI over the last years. The concentration of these countries is gradually widening from those that are endowed with natural resources (mostly oil, minerals and gas) to those that are able to adapt their national policies to TNCs corporate strategies faced with the drive to remain competitive.

Success in attracting FDI goes beyond mere liberalisation of the regulatory and legal environment and the provision of incentives such as tax holidays and EPZs.

Such measures are unable to compensate for fundamental distortions in the economy. In fact, a number of countries that have attracted sustained FDI inflows in the region have ***not*** relied upon such instruments.

Governments should go beyond these traditional FDI promotion measures, and create an environment in which it is profitable to conduct business.