

# **Foreign Investment in SADC**

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## **Abstract**

This paper explores some of the key issues related to FDI in Southern Africa. It takes a look at comparative patterns and trends of investment flows in developing regions (including the SADC). In addition, an account of the institutional and regulatory framework in the SADC region and consequences for investment flows into SADC, is provided. No doubt SADC countries face major obstacles to achieving greater investment levels and as such, the paper looks at the major constraints within SADC in attracting sustainable FDI flows, and the reasons behind the slow growth in domestic investment within those SADC economies. Case studies are employed to illustrate the key issues at the micro-level that affect investment decisions in the SADC. In the final part of the paper a discussion follows on some of the policy conclusion that are derived from the analysis of foreign direct investment flows in the SADC region.

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## **The Facts about Foreign Investment in Southern Africa**

*"Dutch brewing giant, Heineken International, is committing about US\$700 million in Africa over the next three years. The money will be used to increase the firm's equity holding in Nigerian Breweries Plc to 54.2 percent. Heineken will also build a US\$200 million brewery in Enugu, Southeast Nigeria, and a US\$150 million brewery in Ghana".<sup>1</sup>*

### **1 Introduction**

It goes without saying that the 'Heineken-type' investment mentioned above is desperately needed in many parts of sub-Saharan Africa. The key to economic growth, sustainable development, and socio-political stability is investment. It may be domestic investment (private sector or government), foreign direct investment (such as Heineken's foray into West Africa), or even joint ventures and 'smart' partnerships. All these forms of investment are good for the economy. They all provide a sound basis upon which infrastructure is improved, jobs created, poverty alleviated and redistribution activities strengthened.

The SADC region has performed relatively poorly with respect to attracting FDI and this is cause for concern among member states. Various reasons can be attributed to this dismal investment performance - small size of domestic (and even regional) market(s), property rights, political instability - to name a few. The SADC Trade Protocol, which seeks to extend market boundaries by further liberalising intra-regional trade, is being implemented, with various consequences for individual member states with respect to investment, industrialisation, trade and economic growth.

This paper explores some of the key issues related to FDI in Southern Africa. It takes a look at comparative patterns and trends of investment flows in developing regions (including SADC). In addition, an account of the institutional and regulatory framework in SADC region and consequences for investment flows into SADC, is provided. No doubt SADC countries face major obstacles to achieving greater investment levels and as such, the paper looks at the major constraints within SADC in attracting sustainable FDI flows, and the reasons behind the slow growth in domestic investment within those SADC economies. Case studies are employed to illustrate the key issues at the micro-level that affect investment decisions in the SADC. In the final part of the paper a discussion follows on some of the policy conclusions that are derived from the analysis of foreign direct investment flows in the SADC region.

The paper is based on the premise that for tangible benefits to be gained from trade liberalisation in Southern Africa, significant investment needs to flow into these economies. South Africa aside, the fragile state of Southern Africa's small economies require that productive investment flows accelerate or else very little gain from a Free Trade Area (which is what the SADC Trade and Investment Protocol seeks to create) will be realised. In the worst case scenarios, some countries such as Zambia (and more recently Zimbabwe) have suffered from de-industrialisation as a result of trade liberalisation not being complemented by sufficient investment and therefore leading to the wholesale import of goods and services that could have otherwise been produced locally. Indeed, strong linkages exist between trade, investment and industrialisation, and it is imperative to understand that any desired level of industrialisation is derived from investment that is facilitated by the existence of trade.

Before analysing some of the empirical data on global and regional FDI, it is important to understand what foreign investment is. Sometimes there can be an increase in foreign direct investment in an economy but with no new jobs created and no output produced. And in some cases foreign investment does create employment and output. So we need to understand these facts carefully. Take for instance South Africa, where R200 billion between 1994 and 1998 was investment in the Johannesburg Stock Exchange (JSE) through the buying of shares. This kind of investment does not go into the productive capacity of the economy. In the same time period, R36 billion was invested in mergers and takeovers, which are again not immediately productive investments. Only R10 billion went into new productive investments that expands capacity, creates job, and increases national output.

### Box 1.1 Understanding Foreign Investment

Generally speaking, there are two types of foreign investment: portfolio (indirect investment) and foreign direct investment (FDI). Portfolio investment involves the purchase of a stake in an enterprise by a foreign equity investor, or the purchase of financial securities that normally have a short time horizon. Foreign direct investment on the other hand involves more than just the purchase of shares and securities. It involves an investment made for the purpose of acquiring an ongoing interest in an enterprise (or setting up a new enterprise) in a country other than the investor's home country. We can therefore differentiate between two types of FDI: *Greenfield investment* where the foreign investor establishes a new venture in the host country that creates jobs and output. The second type of FDI is *Mergers and Acquisitions (M&As)* which involves the purchase of all or part of an existing enterprise or project in the host country by the foreign investor (such as privatisation). This type of foreign investment is unlikely to result in any substantial job creation. Of concern is that quite substantial amounts of the FDI activities taking place in SADC refer to M&As: For example, 60 percent of South Africa's FDI inflows are M&As.<sup>2</sup>

By considering the different types of foreign investment, it becomes quite clear that for Sub-Saharan Africa, substantial Greenfield investments are required to arrest poverty, combat stagnant growth, and promote sustainable development.

## 2 Global FDI Trends

Global flows of foreign direct investment soared by 18 percent in 2000 to a record US\$ 1.3 trillion (UNCTAD, 2001). This growth is attributed to the increase in mergers and acquisitions (Mergers and Acquisitions) that constitute a substantial share (85 percent) of FDI worldwide. As in previous years, in 2000 the top ten FDI recipients, as well as the top ten largest sources of FDI, were dominated by developed countries (Table 2.1).

Table 2.1: The Ten Largest Sources and Recipients of FDI, 2000, US\$ billions

| RECIPIENT COUNTRIES:   |            | SOURCE COUNTRIES:      |            |
|------------------------|------------|------------------------|------------|
| USA                    | 281        | UK                     | 250        |
| Germany                | 176        | France                 | 173        |
| UK                     | 130        | USA                    | 139        |
| Belgium and Luxembourg | 87         | Belgium and Luxembourg | 83         |
| Hong Kong              | 64         | Netherlands            | 73         |
| Canada                 | 63         | Hong Kong              | 63         |
| Netherlands            | 55         | Spain                  | 54         |
| France                 | 44         | Germany                | 49         |
| China                  | 41         | Canada                 | 44         |
| Spain                  | 37         | Switzerland            | 40         |
| <b>TOP TEN TOTAL</b>   | <b>978</b> | <b>TOP TEN TOTAL</b>   | <b>968</b> |

Source: UNCTAD, 2001

<sup>2</sup> Tagg, S (2001). "FDI in SADC: Who is investing in what and where?" Unpublished Policy Brief, DPRU, Cape Town.

Developed countries remain the prime destination of FDI accounting for more than three-quarters of global totals. Although flows to developing countries were also up in 2000 to US\$240 billion (Table 2.2), these countries' share of global inflows has fallen to 19 percent, from a high of 27 percent in 1998. FDI inflows to the world's 49 least developed countries (LDCs) are also on the rise but, with only 0.3 percent of world inflows, are extremely marginal!

**Table 2.2: FDI Inflows by Region, 1998-2000, US\$ billions**

| REGION                          | 1998       | 1999         | 2000          |
|---------------------------------|------------|--------------|---------------|
| Developed Countries             | 483        | 830          | 1 005         |
| <b>Developing Countries</b>     | <b>187</b> | <b>222</b>   | <b>240</b>    |
| South, East and South-East Asia | 86         | 96           | 137           |
| Rest of Asia, and the Pacific   | 10         | 4            | 7             |
| Latin America and the Caribbean | 83         | 110          | 86            |
| Africa                          | 8          | 10           | 11            |
| Transition Countries:           |            |              |               |
| Central and Eastern Europe      | 22         | 25           | 27            |
| <b>WORLD TOTAL FDI</b>          | <b>693</b> | <b>1 075</b> | <b>1 2171</b> |

Source: UNCTAD, 2001

Traditionally, most of the FDI in Africa originated in a few OECD countries (Table 2.3), but from the 1990s onwards, this pattern has changed. Although FDI into Africa continues to be dominated by OECD countries, new countries within the OECD group have emerged as key players in FDI in Africa; Canada, Italy, Netherlands, Norway, Portugal and Spain. Between 1988 and 1998, these six countries have substantially increased their share in African inflows from some 8 percent to more than 22 percent, making up for the decline by some of the traditional OECD investors, namely Japan and the UK (UNCTAD, 1999).

Investors from other developing countries/regions, particularly South East Asia have also emerged as 'new kids on the block' with respect to FDI in Africa. There has been significant interest in Africa by Asian countries and this is confirmed by Fujita (1997), who notes that FDI from Asia into Africa is growing, with South Korea as the largest investor, followed by China, India, Malaysia and Taiwan. For example, Malaysia has emerged as a significant new source of FDI in South Africa, contributing between 21 percent of total FDI in South Africa between 1994 and 1998. The two largest Malaysian investments in South Africa were the acquisition of a stake in Telkom (R2.2 billion) and petroleum giant, Engen (R1.9 billion) by Telkom Malaysia and Petronas, respectively. Other investments are in the property, leisure and banking industries.

**Table 2.3: FDI Outflows From Selected OECD Countries into Africa, 1983-1998  
(cumulative in US million dollars)**

| COUNTRY 1983-87 | COUNTRY 1988-92 | COUNTRY 1993-97   | COUNTRY 1983-97   |
|-----------------|-----------------|-------------------|-------------------|
| USA 1 091       | UK 3 077        | USA 5 710         | UK 5 751          |
| France 1 002    | France 1 329    | France 2 654      | USA 5 327         |
| Germany 416     | Japan 995       | UK 2 381          | France 4 985      |
| UK 292          | Australia 412   | Netherlands 1 512 | Netherlands 1 763 |
| Italy 280       | Germany 330     | Germany 666       | Germany 1 412     |
| Sweden 200      | Switzerland 306 | Canada 658        | Italy 1 047       |
| Norway 48       | Netherlands 206 | Italy 621         | Japan 1 011       |
| Netherlands 45  | Belgium 190     | Japan 383         | Canada 698        |
| Austria 41      | Italy 145       | Portugal 239      | Portugal 268      |
| Denmark 30      | Canada 38       | Spain 184         | Norway 254        |
| Finland 2       | Finland 35      | Norway 172        | Sweden 218        |
| Canada 2        | Norway 34       | Denmark 58        | Spain 184         |
| Portugal 0      | Portugal 29     | Austria 23        | Switzerland 113   |
| Spain 0         | Austria 20      | Sweden 16         | Denmark 95        |
| Belgium -35     | Denmark 7       | Australia 5       | Austria 84        |
| Switzerland -73 | Sweden 3        | Finland 3         | Finland 41        |
| Japan -367      | Spain 0         | Switzerland -120  | Belgium 28        |
| Australia -617  | USA -1 474      | Belgium -128      | Australia -200    |

Source: UNCTAD, 1999

Padayachee et al (1999) argue that the emergence of Malaysia as a key foreign investor in South Africa transcends traditional North-South FDI patterns in developing countries and gives some credence to arguments about emerging South-South development linkages and strategies. However, Padayachee et al (1999) do concede that political considerations appear to be a major determinant of Malaysian investment in South Africa. As such, it is unsurprising that perceptions about their sustainability in the long term have arisen.

At this point we turn our attention to the foreign investment scenario in Southern Africa, especially against the background of a changing institutional, regulatory and general business environment.

### 3 A Brief Analysis of Investment Patterns in SADC

The SADC Trade Protocol recognises the need for newly liberalised economies to benefit from investment flows to reduce the real possibility of weaker economies simply becoming 'retail outlets' for goods and services produced in the relatively stronger economies, such as South Africa and Zimbabwe. To some extent this is already happening and in later sections of this paper, its consequences are analysed.

Angola and South Africa dominate as the countries that received the largest share of FDI flows into SADC (Table 3.1). South Africa's FDI is dominated by M&A activity whereas FDI in Angola is concentrated in the petroleum extraction industry, and mining. South Africa also accounted for 43 percent of Africa's US\$1.3 billion FDI outflows in 2000, making it the continent's most important source of FDI.

**Table 3.1: FDI Inflows into Individual SADC Economies, 1987-2000, US\$ millions**

|              | 1987 -1992     | 1993       | 1994       | 1995         | 1996         | 1997         | 1998         | 1999         | 2000         |
|--------------|----------------|------------|------------|--------------|--------------|--------------|--------------|--------------|--------------|
|              | Annual average |            |            |              |              |              |              |              |              |
| Angola       | 178            | 302        | 170        | 472          | 181          | 412          | 1 114        | 2 471        | 1 800        |
| Botswana     | -29            | -287       | -14        | 70           | 71           | 100          | 96           | 37           | 30           |
| DRC          | -11            | 7          | -2         | 1            | 2            | 1            | 1            | 1            | 1            |
| Lesotho      | 11             | 15         | 19         | 275          | 286          | 269          | 262          | 136          | 223          |
| Malawi       | 12             | 11         | 9          | 25           | 44           | 22           | 70           | 60           | 51           |
| Mauritius    | 25             | 15         | 20         | 19           | 37           | 55           | 12           | 49           | 277          |
| Mozambique   | 12             | 32         | 35         | 45           | 73           | 64           | 213          | 382          | 139          |
| Namibia      | 44             | 55         | 98         | 153          | 129          | 84           | 77           | 111          | 124          |
| Seychelles   | 19             | 4          | 15         | 40           | 30           | 54           | 55           | 60           | 56           |
| South Africa | -24            | -17        | 334        | 1 241        | 818          | 3 817        | 561          | 1 502        | 877          |
| Swaziland    | 62             | 72         | 63         | 33           | -62          | -48          | 165          | 90           | -37          |
| Tanzania     | 3              | 20         | 50         | 150          | 149          | 158          | 172          | 183          | 193          |
| Zambia       | 102            | 2          | 40         | 97           | 117          | 207          | 198          | 163          | 200          |
| Zimbabwe     | -8             | 38         | 41         | 118          | 81           | 135          | 444          | 59           | 30           |
| <b>TOTAL</b> | <b>396</b>     | <b>269</b> | <b>878</b> | <b>2 739</b> | <b>1 956</b> | <b>5 330</b> | <b>3 320</b> | <b>5 304</b> | <b>3 964</b> |

Source: World Investment Report, 2000, www.unctad.org

During 2000, the SADC region received close to US\$4 billion out of the US\$11 billion that flowed into Africa, representing about 36 percent of the African total. Angola accounted for over 45 percent of total SADC FDI inflows, and South Africa just over 22 percent of the SADC total FDI inflows. Close to 42 percent of total FDI inflows into SADC were Mergers and Acquisitions and portfolio investments. This figure is significantly lower than that for South Africa alone, where Mergers and Acquisitions /portfolio investments account for over 60 percent of total FDI inflows into that country.

It is quite clear that Southern Africa lags behind other developing regions as being a destination for significant investment flows. But even more damaging is the fact that these small amounts of investment are shrinking, that is, as a percentage of global FDI. So we have a decline in the rate of increase in FDI from a very low base.

What is quite apparent is that the limited optimism that prevailed in the 1990s has not been sustained. There is a plethora of different reasons that can explain this rather disturbing feature. These are dealt with in later parts of this paper.

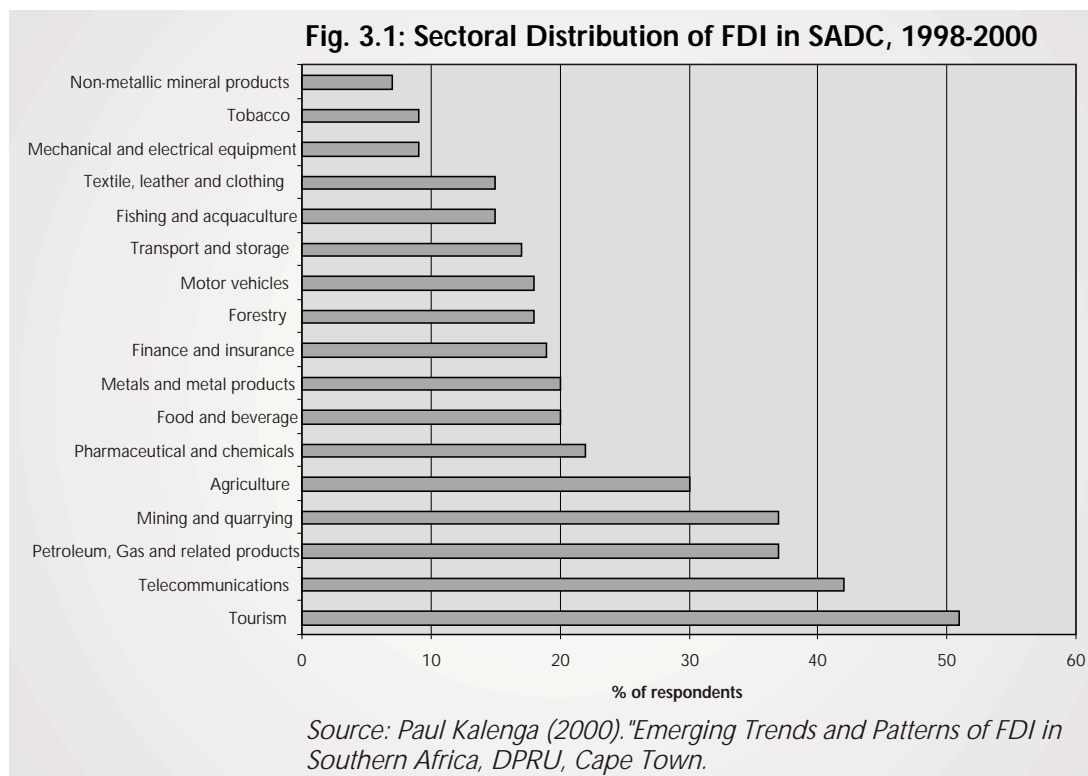
### **Box 3.1 Investment Insufficiency in Africa**

FDI into Africa has decreased in recent years. Angola and South Africa were the hardest hit in terms of the overall loss of over \$1 billion of foreign direct investment into the continent last year. Problems in many of Africa's nations such as ethnic clashes in Nigeria, the problems in Zimbabwe and continuing civil wars have contributed to declining investor confidence in Africa. This slump, which contrasted with a US\$ 2.2 billion rise in 1999, was the biggest downturn since the mid-1990s<sup>3</sup>.

<sup>3</sup> Business in Africa, October 2001, p.15.



The sectoral distribution of FDI in Southern Africa (Fig. 3.1) shows significant increases in services, and mining and quarrying.



The growth in services, especially tourism and telecommunications, has provided much needed employment at a time when the traditional primary and secondary sectors of the SADC economy have been shedding jobs. However, it is important to note that the demand for labour in the services sector, is largely demand for skilled labour, implying that the displaced unskilled (or semi-skilled) workers find it difficult to get jobs in the modern economy.<sup>4</sup> Investment in education and skills becomes a major issue, an issue that needs to be urgently addressed if further job displacement is to be avoided.

A large proportion of the FDI flowing into SADC countries is from South Africa. South Africa is the largest source of FDI in the SADC, accounting for up to 43 percent of Africa's US\$1.3 billion outflows, and accounting for up to 85 percent of total FDI in all other SADC countries in 2000. Large South African companies, long denied the opportunity to invest substantially offshore due to exchange controls, have increasingly sought out opportunities for expansion in SADC, Africa and beyond (Box 3.2).

Another important feature of FDI flows into the SADC region is that those countries that made significant strides towards privatisation of state owned enterprises, such as Mozambique and Zambia, have been able to attract substantial amounts of 'greenfield' FDI that has provided the stimulus for growth in these economies. In this respect, privatisation of state owned enterprises could be seen as a catalyst for foreign direct investment that needs to be carefully considered by SADC countries if efforts to improve the levels of FDI are to be realised.

<sup>4</sup> Referred to as, structural unemployment, that is associated with a mismatch between the supply of labour (say unskilled or semi-skilled) and the demand for labour (skilled labour).

### Box 3.2 South African Trans-National Corporations (TNCs)

South African Breweries has extensive interests in sub-Saharan Africa, China, India as well as in Central and Eastern Europe. Within Africa it operates in at least 11 countries (Angola, Botswana, Ghana, Kenya, Lesotho, Mozambique, South Africa, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe). International expansion by SAB took off in the aftermath of exchange control relaxation, liberalisation and deregulation, and privatisation initiatives in many of the Sub-Saharan African countries. In March 1999, SAB plc listed on the London Stock Exchange. It is the fourth largest brewer in the world by volume. SAB has also acquired two leading brewers in the Czech Republic who jointly control 44 percent of the Czech beer market in a deal worth US\$629 million. This deal has now made SAB a leading brewer in Central Europe (Business in Africa, November, 1999).

Another example is the South African banking giant, Nedbank, with subsidiaries and associated companies in Lesotho, Malawi, Mauritius, Mozambique, Namibia, Swaziland and Zimbabwe. Nedbank also has a 40 percent shareholding in the HSBC Equator Bank based in London, with representative offices in Angola, Cote d'Ivoire, Ghana, Kenya, Mozambique, South Africa, Uganda and Zambia. According to Nedbank, the rationale of moving into Africa was to service South African corporate investors who wished to venture into and around parts of the continent, but now the company is taking advantage of the shift in many African economies from being centrally run to being privately driven.

The three African TNCs to make it on to the list of 50 largest TNCs from developing countries are South African, namely, Sappi Limited (estimated US\$4 billion in foreign assets), Barlow Limited and South African Breweries plc, both estimated foreign assets of between US\$700 and US\$800. South African TNCs are investing in mining, food processing, financial, telecom, retailing and tourism services in the region (UNCTAD, 1999).

## 4 The Institutional and Regulatory Framework in SADC and Consequences for Foreign Direct Investment Flows Within the Region

*"Investment is about the environment. Once you understand the many facets of the environment, you have understood the required investment!"<sup>5</sup>*

The above statement is instructive, and in the context of the institutional and regulatory environment in the SADC, it is important that we look at the regulatory framework, trade regimes and agreements to the extent that they have influenced FDI decisions, and analyse the key issues that emerge.

### *FDI and the Liberalisation of the Regulatory Framework in the SADC*

We mentioned earlier the importance of a conducive investment environment for attracting substantial amounts of FDI. Against the backdrop of globalisation and the ever-increasing, inter-country competition for FDI, SADC governments have by and large realised the need to liberalise, deregulate and privatise. SADC governments have taken various measures to liberalise their national policies on foreign investment, particularly allowing foreign investors to repatriate profits and dividends, and guaranteeing legal protection of foreign investment.<sup>6</sup>

<sup>5</sup> Interview with Dave Archer, Managing Director of Archer Clothing Manufacturers, in 2000. Archer is one of the leading clothing manufacturers in Zimbabwe with a very high percentage of sales (75%) consisting of exports.

<sup>6</sup> There are obviously some exceptions. The current political crisis in Zimbabwe, which embodies the land question and economic dominance by foreigners (mainly British), can be seen as comprising the rights of investors, and therefore resulting in the economy being perceived as an 'unsafe' or 'high risk' investment destination.

The relaxation of exchange controls, for instance in South Africa, have also formed part of the liberalisation policies that SADC states have gravitated towards. The removal of exchange controls in South Africa has led to a surge in SA investment to the rest of the Southern African region. However, SADC countries are still able to implement temporal exchange control restrictions in the event of balance-of-payments crises.

### ***FDI in Zambia: A Case Study of the Retail Sector***

Investment by South African firms in the retail sector in Zambia dates back to 1996 when Shoprite/Checkers, Dunns Clothing and Pep Stores opened branches in Lusaka. More investment followed that culminated in the rapid expansion of the retail sector in Zambia, with a number of firms opening up other branches (Table 3.2) in and around the capital, Lusaka, but also in other areas such as the Copperbelt region, Kabwe, Kitwe, Livingstone, and Ndola.

#### **Factors attributed to increase in SA retail investment in Zambia:**

- Relaxation of foreign exchange controls in South Africa
- Adoption of 'market-friendly' policies such as privatisation and trade liberalisation in Zambia
- Political stability in Zambia
- 100 percent profit repatriation and other tax and investment incentives<sup>7</sup>
- Profit opportunities in the wake of the collapse of state-run retail enterprises
- Central location of Zambia provides a strategic foundation from which firms can expand further into the African continent

**Table 3.2: South African Retail Firms in Zambia, 2000**

| COMPANY             | START-UP DATE | TYPE OF ACTIVITY                   | NUMBER OF BRANCHES |
|---------------------|---------------|------------------------------------|--------------------|
| Ellerines           | 1999          | Furniture and Household Requisites | 1                  |
| Guys & Girls        | 1999          | Clothing and Footwear              | 3                  |
| Steers              | 1998          | Fast Food Products                 | 5                  |
| Shoprite/Checkers   | 1996          | Grocery/Supermarkets               | 18                 |
| Pep Stores          | 1996          | Clothing and Footwear              | 19                 |
| Nandos              | 1999          | Fast Food Products                 | 1                  |
| Carnival Furnitures | 1999          | Furniture and Household Requisites | 1                  |
| Game                | 2000          | Clothing/Household Requisites      | 1                  |
| Smart Centre        | 1997          | Clothing and Footwear              | 4                  |
| Supreme Furnishers  | 1998          | Furniture and Household Requisites | 17                 |
| Barnetts            | 1999          | Furniture and Household Requisites | 1                  |
| Dunns               | 1996          | Clothing and Footwear              | 3                  |
| <b>TOTAL</b>        |               |                                    | <b>74</b>          |

Source: Kolala (2000)

Thousands of jobs have been created (or re-created) and more investment continues to happen - Woolworths has invested an undisclosed amount in establishing a retail outlet in Lusaka that was due to open at the end of 2001. The 12 South Africa firms have employed close to 2000 workers (Table 3.3). However it is uncertain at this stage how many 'new' jobs have been created if one considers that some of those employed were re-hired after losing their jobs when state-owned supermarket chains such as NIEC and Mwaiseni, ceased to operate.

<sup>7</sup> For more detail on incentives in Zambia, see Kolala (2000) and Tagg (2001).

**Table 3.3: Distribution of Employees by Company**

| COMPANY             | FULL-TIME   | PART-TIME  | EXPATRIATES | TOTAL       |
|---------------------|-------------|------------|-------------|-------------|
| Ellerines           | 15          | 1          | 1           | 17          |
| Guys & Girls        | 11          | 8          | 0           | 19          |
| Steers              | 70          | 3          | 0           | 73          |
| Shoprite/Checkers   | 726         | 182        | 8           | 916         |
| Pep Stores          | 203         | 0          | 3           | 206         |
| Nandos              | 40          | 0          | 1           | 41          |
| Carnival Furnitures | 13          | 0          | 0           | 13          |
| Game                | 38          | 57         | 3           | 98          |
| Smart Centre        | 15          | 0          | 0           | 15          |
| Supreme Furnishers  | 536         | 0          | 0           | 536         |
| Barnetts            | 11          | 0          | 0           | 11          |
| Dunns               | 18          | 0          | 0           | 18          |
| <b>TOTAL</b>        | <b>1696</b> | <b>251</b> | <b>16</b>   | <b>1963</b> |

Source: Kolala (2000)

#### Key issues

- Significant increases in FDI in Zambia coincided with an aggressive privatisation programme in the aftermath of widespread collapse of state-run supermarket chains such as NIEC and Mwaiseni. Therefore the net increase in employment might not be very large because employees who lost their jobs when the state enterprises collapsed could simply have been re-hired when the private sector was invited into the sector.
- Some of the firms (such as Shoprite/Checkers) are actually using the premises that were previously used by the state-run supermarket chains implying very little development in infrastructure on the part of these South African firms.<sup>8</sup>
- The South African retail firms source most of the products they sell in Zambia, from South Africa. Except for certain agricultural produce, Shoprite/Checkers for instance, imports all of its products from the 'parent' company supply chain in South Africa. This does not encourage manufacturing activity in Zambia and in effect turns Zambia into a 'retail province of South Africa'. Sweeping trade liberalisation measures in the 1990s have also contributed to the proliferation of imported commodities.
- The result has been a lack of industrial progress in Zambia. In fact, there is some evidence to suggest that de-industrialisation has occurred: if one considers that large enterprises such as Dunlop Tyres, Lever Brothers, Colgate and Rickett and Colman relocated<sup>9</sup> to Zimbabwe in the 1990s, and Rothmans relocated to Malawi (Kolala, 2000).

The SADC states have also eased restrictions on foreign entry and ownership, although some still maintain restrictions either of foreign and/or private ownership in certain sectors considered as 'strategic'. Unfortunately, some of these sectors such as telecommunications, transport, media and other services are the very sectors that are likely to attract substantial FDI inflows. Some examples will put this point into perspective.

<sup>8</sup> An exception is the construction of Manda Hill, a US\$20 million shopping mall built by South African firm Stocks and Stocks. Most South African firms already operating in Zambia, occupy premises in the mall.

<sup>9</sup> The relocation being referred to is not relocation in its truest sense. These firms simply shut down their manufacturing operations in Zambia and resorted to direct importing which was very competitive for retailers because of trade liberalisation measures. Industrial relocation is when a firm shuts down in one area and re-opens in another. This is not what happened between Zambia and Zimbabwe in the 1990's.

Following the deregulation of the mobile telephone industry, many SADC countries have witnessed rapid growth in the cellular network systems sector, and the associated service providers. This has attracted private sector participation, with considerable investments around the SADC region such as Siemens (Sweden), Vodafone (UK), Cable and Wireless (UK), Nokia (Finland), Millicom (Luxembourg) and others. Deregulation also opened the door to investors from within the SADC region to enter the mobile phone market. Econet Wireless, the largest mobile phone operator in Zimbabwe, is owned by indigenous people of Zimbabwe, and has substantial investments in the cellular industries of Botswana, Lesotho, Mali, Nigeria and others. The investment 'boom' in the telecommunications in the SADC can also be attributed to two more facts:

1. teledensity in Africa is the lowest in the world, and that ,
2. continued stagnation and underdeveloped state owned fixed line monopolies

### *The SADC Trade and Investment Protocol*

The SADC Trade and Investment Protocol seeks to liberalise trade between member countries in an effort to create a free trade area within eight years, with an estimated market of 120 million people. At the heart of the protocol is the need to harmonise trade and economic policies in the Southern African region. The stated objectives of the SADC Trade and Investment protocol (August 1996) are:

- To liberalise intra-regional trade in goods and services in an equitable manner and to establish a free trade area within the region,
- To enhance industrialisation and economic development within the region
- To foster greater production efficiency and to improve the investment climate within the region.

The SADC Trade and Investment Protocol seeks to create a free trade area by removing market boundaries between Southern African states creating an expanded market that ought to encourage more investment in the region. The success of free trade agreements to some extent hinges on the significant increases in fixed investment in some of the economies, especially the smaller ones, to offset some of the negative consequences associated with the re-direction of trade, or trade diversion.

Although the protocol has increased business opportunities in Southern Africa, foreign investors have not fallen over each other in queues to get a stake in the region! As will be mentioned in the next section of the paper, even as a regional grouping, the SADC market is still quite small by international standards. Therefore, even with the benefit of better market access across the region, the market is still relatively small, and income per capita in all SADC economies except Botswana and South Africa, is falling.

However, regional cooperation between SADC member states, and transnational agreements have provided some stimulus for foreign direct investment based on inter-country partnerships between the public and private sectors. Take for instance the Maputo Development Corridor (MDC) and Mozal. Both partnerships between the governments of Mozambique and South Africa, and the South African private sector have resulted in huge investments and generated substantial amounts of employment and income.

### **FDI in Mozambique: A Case Study of the Mozal Aluminium Smelter**

With an initial budget of US\$1.3 billion, Mozal is by far the single largest investment ever made in Mozambique. Mozal is an aluminium project, aimed at producing 250 000 tonnes per annum of aluminium at full capacity. The shareholders of Mozal are: South African conglomerate, Billiton Plc (47 percent), Mitsubishi Corporation of Japan (25 percent), the Industrial Development Corporation of South Africa (24 percent), and the Government of Mozambique (4 percent). Mozal is one of the pillar projects of the Maputo Development Corridor, which involves the governments of Mozambique and South Africa, and which reflects initiatives of regional development.

The Mozal Aluminium Smelter covers an area of over 1, 360, 000 m<sup>2</sup>, the equivalent of about 340 soccer fields, and at the peak of construction of the site, over 9000 were employed, 64 percent of whom were Mozambicans. During construction, some 5 300 people were trained in construction skills, representing a massive transfer of skills and learning processes, and more than 70 local business enterprises have participated either directly or indirectly in the project. The Mozal aluminium smelter is a huge power consumer. At full capacity, the power consumption at Mozal will be 450MW of electricity, compared to a total for the whole of Mozambique of some 220MW.

Before the production of aluminium could become a reality, infrastructure of almost every kind was needed. Mozambique, one of the poorest countries of the world, was to benefit from an aluminium smelter literally carved out of the African bush in Mozambique. Roads and bridges had to be built to make the site accessible, houses were built for both construction and project personnel, electric power had to be supplied by two separate transmission lines that needed to be constructed, telecommunications needed to be established and a new dedicated harbour berth at Matola, had to be built to accommodate the alumina and coke ships that would bring the raw materials in, and those that would carry the finished aluminium ingots to destinations around the world.

#### **Factors Attributed to Increases in Investment in Mozambique**

With the amount of infrastructure required, significantly increasing the cost of doing business in Mozambique, it at first must seem quite surprising why these huge investments actually take place. But the facts tend to explain this apparent anomaly.

- The major factor was that an aluminium smelter was not only a good business decision (in terms of output produced, pay-back period and return on investment), but was envisaged to also be a catalyst to kick-starting growth and sustainable development in Southern Africa.
- Although plagued by backlogs in infrastructure, the government of Mozambique provided crucial support in smaller areas; profit repatriation guarantees, permits/visas for expatriate employees responsible for skills and technology transfer, assistance in land acquisition and compensation for indigenous communities, flexible labour market regulations, customs and tax benefits, and others.

#### **Other Trade Agreements**

As we mentioned earlier, the real benefits associated with greater trade liberalisation are closely linked to the investment opportunities that such liberalisation brings about. The Southern African region has benefited from a plethora of bilateral and multilateral trade, investment and cooperation agreements. For instance, in the textile and clothing sector, the spectacular success of the Mauritian industry has been largely attributed to relatively favourable access to international markets resulting from agreements such as the Lomé Convention, and the Cotonou/Benin agreement (Jhamna, 2000).



Indeed, these trade agreements have led to substantial increases in foreign investment in SADC member states.

### ***FDI in Malawi: A Case Study of the Clothing Sector***

South African clothing chain, Pep Stores, was one of the companies to invest outside of South African borders in the wake of exchange control relaxation, and the 1995 Bilateral Trade Agreement between Malawi and South Africa. While negotiations for a free trade area in Southern Africa (that eventually culminated into the SADC Trade and Investment Protocol) were underway, South Africa and Malawi entered into a bilateral trade agreement that gave Malawian exports better market access into the lucrative South African market. In 1996, Pep Clothing, a leading South African clothing retail chain set up clothing manufacturing operations in Blantyre, Malawi. The clothing factories were to produce garments that were to be supplied (exported) to their retail outlets in South Africa. Under the bilateral trade agreement, there were no stringent rules of origin (roo), enabling Pep to source inputs (fabric, textile, etc.) extra-regionally. What factors led Pep to investment in Malawi?

#### **Factors Contributing Towards Pep Investment in Malawi**

- Better access into the South African market via the bilateral trade agreement
- Relaxation of exchange controls by the South African government released 'bottled-up' funds for much needed investment in the poorer parts of the region
- The implementation of the Labour Relations Act (LRA) of 1995 in South Africa also influenced Pep's decision to move manufacturing operations to Malawi. The LRA was seen as reducing flexibility of the labour market through regulations on hiring and firing of employees. Malawi had a relatively more flexible labour market and weaker trade unions made it much easier for firms to hire and fire!
- An important point to make is that Pep was not as much driven by labour cost or productivity differentials, as it was by overall labour market flexibility. In real terms, there wasn't much difference in labour costs and productivity between Malawi and South Africa.
- The Malawi government, eager to attract much needed 'greenfield investment', provided a host of incentives that added to the attractiveness of Malawi as a destination for foreign direct investment.

#### **Some Incentives Provided by Malawian Government**

- The government provided built factories for Pep. The production units, located in Blantyre were part of government efforts to reduce the cost of doing business in Malawi. Note that Pep was the only South African clothing firm that invested in Malawi
- The government also subsidised inputs such as electricity, again reducing the cost of doing business and significantly improving profit margins for the Pep Group.

There were also the standard incentives such as tax holidays, repatriation of profits, etc.

At the height of its operations in Malawi, Pep employed 800 Malawian workers who were producing garments solely for the Pep Group retail outlets in South Africa. Pep management in Malawi was largely South African. The Pep investment not only involved the transfer of management skills to Malawi (in the form of Pep management), but it also involved the transfer of technologies and learning processes that have since benefited Malawians and their economy. There was also some local sourcing of textiles and other inputs from domestic producers that boosted domestic economic activity.

### The Demise of Pep Clothing in Malawi

Towards the end of 1998 and early 1999, South African producers were feeling the pinch of relatively cheaper duty-free imports coming into the market from Malawi. Questions were being asked about the wisdom of the existing rules of origin that seemed to encourage Pep clothing to import fabric and other inputs from outside the SADC more cheaply, and unfairly compete in the SA market. Political forces were also at play; led by the trade union movement that was weary of the possible job losses ensuing from the loss of market share to Pep Malawi.

The Bilateral Trade agreement between Malawi and South Africa was re-negotiated, this time with more stringent rules of origin, and the insistence on a two-stage transformation process. The two-stage transformation process involves; stage 1 sourcing of raw materials, stage 2 the first processing stage of those raw materials. This meant that Pep stores had to undergo at least both stages in Malawi, curtailing their advantage in using imported fabric from the Far East. This significant change to the rules of origin, was responsible for the demise of Pep Malawi. By March 2001, Pep Malawi had closed down, and all the technologies and capital equipment that had been transferred to Malawi from South Africa in the late 1990s, was sold to Malawians when Pep Malawi closed shop.

In a survey of the clothing and textile industry in Zimbabwe, clothing producers cited the Lomé Convention as a critical factor for increasing investment outlays, breaking into export markets, and expanding existing export initiatives (Muradzikwa, 2000). The *Lomé Convention* is a negotiated agreement between ACP countries and the EU that grants preferential access to European markets.

Firms and industries in Southern Africa, and indeed in the rest of Africa, have been presented with better growth and development prospects by the promulgation in the USA of the African Growth and Opportunity Act (AGOA). The Act, which expires in 2008, offers 44 Sub-Saharan African countries duty-free and quota-free status into the USA for those products meeting the eligibility requirements, and for the clothing and textile firms in the region.

The basic premise of the Act is the development of bilateral trade between Sub-Saharan Africa and the USA, implying that products that are eligible for the 'free-entry' status must be manufactured either from locally produced textiles or textiles imported from the USA and then exported as a value-added product to the USA.<sup>10</sup> There is, however, a significant concession for those countries whose per capita income was less than US \$1 500 in 1998. These countries have a four-year window in which to import inputs from a third country, and then export the finished product to the USA. This means that the poorer SADC countries such as Malawi, Mozambique, Tanzania and Zambia have easier market access to the US, and as such should be attracting substantial investments from firms in the other SADC countries and beyond.

Destabilising events in some of the SADC states, such as Zimbabwe<sup>11</sup>, have led to exclusions from the group of countries eligible for improved trade access to the US market<sup>12</sup>. The implication is that Zimbabwe's isolation from the pact has put paid to hopes of increased investment in the country by US companies and revoked preferential trade access to the US market which it has enjoyed for some time. Therefore in the short term, Zimbabwe does not seem likely to reap the potential benefits of the trade pact. Malawi and Mauritius are set to benefit from the greater market access provided under the Act. In fact, what is likely is that some firms will relocate from Zimbabwe to other countries in the region where they have better access into the lucrative US market. Dis-investment in Zimbabwe leading to investment elsewhere in the region!

<sup>10</sup> Business Report 13/08/2000, "US Growth Act Suits Africa's Exports" by Clive Rubin.

<sup>11</sup> Land occupations, human rights abuses and the perception of a deteriorating law and order situation.

<sup>12</sup> Zimbabwe Independent 13/10/2000, "Zim booted out of US trade pact" by Dumisani Muleya.



Time will tell what the consequences of the Africa Growth and Opportunities Act (AGOA) are, but surely foreign firms should be encouraged to set up in any one of the eligible African countries so as to be able to tap into the lucrative USA market. For instance, there has been keen interest in clothing and textile investments in Lesotho by investors from the Far East to take advantage of the benefits under the Act.

## 5 Major Constraints within SADC in Attracting FDI

The debate on the causes of FDI in Southern Africa is far from conclusive. Traditional beliefs that investment tends not to locate in areas of political and policy instability are all but shattered by soaring investment levels in war-torn Angola (in SADC) and politically volatile Nigeria (in ECOWAS). If one looks at a different context, investment in China and other Asian economies such as Singapore, Malaysia and Indonesia for instance, has continued to increase, as a percentage of total FDI stock annually, in spite of questionable human rights records and undemocratic political systems.

Furthermore, the assertion that market-friendly policies alone precipitate significant investment flows is also doubtful - if one considers that various attempts by SADC countries to woo investors in the 1990s through liberalisation and structural adjustment measures have yielded total FDI of approximately US\$25 billion in that decade, which is under 4 percent of the global FDI in 1998 of US\$695 billion.

This section of the paper discusses some of the major constraints in attracting FDI inflows in SADC. Having analysed the 'hard' facts and trends/patterns of FDI in Southern Africa, it is important to understand investment behaviour/decisions by firms because after all, it is at the micro-level - the level of the firm or individual investor - where decisions about investment (type, size, location, etc.) are made and indeed, it is at this level where understanding the constraints matters the most.

### *Market size and economic growth rates*

By world standards, the total SADC market is small (Table 5.1). With fourteen members, the SADC is the second largest grouping but has the second smallest population - only larger than Central Europe that has six members. The small market size in Southern Africa is compounded by high incidences of poverty (especially for women and children in under-developed rural areas), unequal distribution of income, wealth, and opportunities, generally low average per capita income growth rates have all contributed to the relative unattractiveness of the SADC as a destination for investment. In addition, low investment (both foreign and domestic) has generally led to low economic growth, and low economic growth itself has led to low levels of investment. So, the potential of a 'vicious cycle' cannot be down-played.

Another constraining feature inherent in the SADC region is its distance from the major markets in Europe, the USA and Asia. This, combined with the relatively underdeveloped and inefficient port and harbour facilities (and insufficient air cargo facilities) adds significantly to transport costs, and overall transactions costs. This tends to reduce profitability, and hence affect the firm-level investment decision. It is after all, among other factors, proximity to the large and lucrative markets in Europe that has accounted for much of the increase in FDI in Central Europe, in spite of its relatively smaller population. Large European, American and Japanese motor vehicle manufacturers have invested substantially in Eastern and Central Europe in the past decade for, among other reasons, locational advantage.

**Table 5.1: Regional Integration Agreements (Participating Countries and Populations)**

| NAME  | NUMBER OF MEMBERS | MEMBER STATES  | TOTAL POPULATION(Millions) |
|---|-------------------|--|----------------------------|
| Association of South East Asian Nations (ASEAN) | 10                | Brunei, Cambodia, Indonesia, Laos, Malaysia, Burma, Philippines, Singapore, Thailand, Vietnam.   | 525.1                      |
| Central European Free Trade Association (CEFTA) | 6                 | Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovenia.  | 104.6                      |
| European Union (EU)                             | 15                | Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, U.K.      | 379.5                      |
| Mercosur  | 4                 | Argentina, Brazil, Paraguay, Uruguay.  | 216.5                      |
| North American Free Trade Association (NAFTA)   | 3                 | Canada, Mexico, USA.   | 411.8                      |
| Southern African Development Community (SADC)   | 14                | Angola, Botswana, DRC, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe. | 187.7                      |

Source: CIA Factbook, 2000

### Infrastructure Weaknesses

Especially when South Africa is excluded, Sub-Saharan Africa lags behind the rest of the world on almost all dimensions of infrastructure development (Table 5.2). In 1997 Africa (excluding South Africa) had 171 000 kilometres of paved roads, about 18 percent less than Poland and there are about 10 million telephones in Africa - less than Brazil - and half are in South Africa (World Bank, 2000).

**Table 5.2: Infrastructure Indicators by Region, 1997**

|   | ELECTRIC POWER CONSUMPTION PER CAPITA (KILOWATT-HOURS) | TELEPHONE MAINLINES PER 1000 PEOPLE | US DOLLAR COST OF 3-MINUTE CALL TO THE USA | PAVED ROADS (% OF TOTAL ROADS) | % OF POPULATION WITH ACCESS TO SAFE WATER |
|---|--|-------------------------------------|--|--------------------------------|---|
| East Asia and Pacific                   | 624  | 50                                  | 5.60                                       | 10                             | 77  |
| Europe and Central Asia                 | 2 788  | 204                                 | 4.33                                       | 83                             | 91  |
| Latin America and Caribbean             | 1 347  | 110                                 | 4.42                                       | 26                             | 75  |
| Middle East and North Africa            | 1 166  | 75                                  | 6.02                                       | 50                             | 60  |
| South Asia                              | 313  | 18                                  | 5.90                                       | 41                             | 81  |
| Sub-Saharan Africa                      | 439  | 16                                  | 8.11                                       | 16                             | 47  |
| Sub-Saharan Africa (Excl. South Africa) | 146  | 10                                  | 8.65                                       | 9                              | 46  |

Source: World Bank, 2000

The extent of the backlog in infrastructure, influences the overall cost of doing business in Africa, and as such, reduces profitability. With relatively higher communications costs, high percentages of unsurfaced roads and generally lower access to safe water (not mentioning other factors that are discussed in this section) it is small wonder that Africa is the least favoured region with respect to FDI inflows.

For African economies, these infrastructure indicators 'mirror' the underdevelopment of vast areas of the continent that has exacerbated rural and urban poverty, and that have rendered the continent relatively unattractive, if compared to other developing regions of the world.

Infrastructure development in SADC has been constrained by declining levels of public investment on infrastructural projects. Soaring debt burdens, sluggish economic growth, and increased pressure on SADC governments to reduce government expenditure, all continue to worsen the backlog in infrastructure that the region faces. Governments have found it easier, and politically expedient to reduce on capital expenditure (including infrastructure) where they will suffer less of a political backlash than if they were to reduce spending on the public service wage bill.

### **Corporate Governance**

One of the major reasons for low economic growth rates in SADC has been the reluctance of institutional investors as to commit long-term capital to this region. One of the reasons for this lack of commitment can be found in the words of Arthur Levitt, former chairman of the US Securities and Exchange Commission<sup>13</sup>:

*"If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident of the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere."*

The forces of globalisation demand that company boards of directors be transparent and honest, and that they demonstrate a high level of integrity towards both shareholders and other stakeholders. In 2000 the global consulting firm, McKinsey, published an investor opinion survey showing that good corporate governance brings high rewards. The survey involved 200 institutional investors which handled US\$3.5 trillion in funds. 75 percent of the investors stated that board practices were as important as financial performance. In addition, a premium of good corporate governance in an organisation was assessed as high as 27 percent.

#### **Box 5.1 Corporate Governance Practices in South Africa**

*In the context of corporate governance in South Africa, 2001 was a year that hardly proved the country's commitment to strong corporate governance practices. The collapse of LeisureNet and Regal Treasury Private Bank, as well as the debacles that ensnared SAA and Nedcor, the controversial arms deal, and the massive Didata share collapse were serious negative factors that placed integrity and corporate governance in South Africa in the spotlight. The result has been a general weariness among investors to commit long-term capital to South Africa, which is threatening growth prospects in the country.*

<sup>13</sup> Sunday Times Business Times, SA, 24 February 2002, p12

### **Crime and Corruption**

Closely related to corporate governance is another major constraint to attracting FDI in SADC, that is the perception (real or imaginary) of high crime levels (including corruption) that have contributed to the real cost of doing business - if investors do decide to invest, or have simply discouraged the investors all together. In a survey of 45 European and South African Investors<sup>14</sup>, corruption was cited as a critical impediment to investment in South Africa.

Of the 45 respondents who were interviewed during the survey, 30 percent are reported to have refused to discuss the issue of corruption. The remaining respondents generally distinguished between different 'types of corruption' and all agreed that corruption mostly impacts the South African poor, and highlighted police, traffic authorities, customs, prisons, justice system, assorted public procurement, ports and harbours, defence, as areas of anecdotal evidence where corruption is prevalent and is affecting business.

#### **Box 5.2 'Types of Corruption'**

*In the 2001 survey of European and South African investors, the following distinctions were made between the various forms of corruption;*

- *Maladministration and unauthorised expenditure*
- *Ripping off the system or routinised looting*
- *Nepotism and cronyism*
- *Quasi-corruption in procurement through some Black Economic Empowerment deals*
- *Official corruption using control over regulatory mechanisms (tender boards, licensing Departments, etc.)*

The opinion among the respondents in this survey is that in South Africa, people routinely get away with corruption, and this leads to negative perceptions that feed into investor decision-making processes. Crime in South Africa is also cited by the investors in the Butler (2001) survey as a constraining factor in any given investment decision.

### **Political/Policy Uncertainty**

Apart from the obvious instability and uncertainty that is caused by wars in Angola and the DRC and political unrest in Swaziland and Zimbabwe, Southern Africa continues to be dogged by practical issues concerning policy uncertainty, or policy contradictions that have tended to affect the perceptions, credibility and ultimately the rate of fixed investment growth in the region. A couple of examples may put these issues into perspective.

**South Africa:** It is widely acknowledged that the key to growth and redistribution is significant increases in productive capacity investment. However, the department of Home Affairs operates laws and regulations that fly in the face of foreign direct investment! In the Butler (2001) survey of SA and European investors, a major feature was that, obtaining work permits for skilled employees and

<sup>14</sup> Butler, A (2001). "Considerations on the Promotion of Foreign Direct Investment in South Africa: Coping with Adverse Perceptions", Political and Policy Uncertainty in South Africa (PUSA) Project, University of Cape Town, South Africa.

management was a cause of exasperation. The following issues were also a hindrance to FDI in South Africa, and indeed the region at large:

- Rampant (and sometimes official) xenophobia
- Intransigence at Home Affairs
- Incompetence and poor administration
- Major investments blocked by 'arbitrary' permit decisions
- An 'unpublished policy' to block other African nationals. Investors complained about the problems obtaining permits for managers/skilled personnel from elsewhere in Africa (especially from Zimbabwe, Botswana, Mozambique, Malawi, Nigeria)

**Zimbabwe:** The US\$2 billion BHP Platinum Mining project undertaken in 1995/6 was at that time, the single largest investment ever undertaken in Zimbabwe, that involved mining giants BHP of Australia, and other smaller foreign investors. Situated on the outskirts of a small town, Chegutu, about 85km south of the capital Harare. This was a massive development that was to become one of the leading platinum mines in the world. Employment opportunities were created for populations living in and around the surrounding small towns of Chegutu, Norton, Selous, Chinhoyi and Kadoma.

The Zimbabwe government policy was to provide the necessary assistance to BHP, such as profit repatriation, duty-free imports of equipment and raw materials, and easy access to permits for expatriate engineers, managers and other skilled personnel. When the practical application of these policies was put to the test, they failed. Large amounts of capital equipment and technology were held up at Beitbridge border post (border between South Africa and Zimbabwe) by customs officials who were merely doing their job of charging duty as per law, unaware of the government concession to BHP.

And when they thought things couldn't get any worse, a moratorium on the renewal of permits for expatriates, and the issuing of new ones. The reasoning behind this was that BHP was not doing enough to empower the indigenous population and that the skills BHP sought were adequately available in Zimbabwe. The arguments raged on, court battles and political interference became the order of the day, and eventually in 1999, BHP left, having suffered huge losses. The mine is now run on a minimal scale basis by the government, operating at one-fifth capacity and employ just a skeleton staff.

### ***Incentives and FDI***

The role of incentives in attracting foreign investment is complex. Incentives are not always suitable in attracting the 'right' kind of sustainable investments. Although there is great competition between countries as they put into place a range of incentive packages to attract FDI, it must be noted that the incentive regimes across SADC countries are not too dissimilar.

The incentives offered include: corporate tax holidays, exemption from import duties on equipment and inputs, accelerated depreciation allowances and specific tax deductions, grants related to training, employment and infrastructure development. There are many others, and although these incentives have been instrumental in attracting 'footloose' and labour intensive industries in some countries, they seem to have lost their effectiveness for several reasons. Do incentives really attract the 'right' investors? Or do they attract the 'incentive-dependent' investors? It is more or less becoming a case where investors who are interested in long-term investments look at long-term profitability without incentives.

Evidence from SADC states such as Botswana suggest that countries with relatively low tax rates and a stable environment, and which do not offer tax holidays, are likely to attract more FDI rather than those that seek to compensate high tax rates with temporary exemptions. However, some 'targeted incentives' have yielded some positive results in terms of increasing investment, employment, output and exports in some sectors of some SADC countries (Box 5.3).

**Box 5.3: The South African Automotive Industry**

*The Motor Industry Development Programme (MIDP) is a targeted package of policies and incentives with the aim of encouraging the growth, modernisation and upgrading of the South African automotive industry. The major policies and incentives include:*

- *A gradual reduction in tariff protection, in order to expose the industry to greater international Competition*
- *There is an import-export complementation programme that allows exporting firms to earn rebates of automotive import duties*
- *A productive asset allowance (PAA) is available to those investors who have invested in productive assets. It provides a duty rebate on imported CBU light motor vehicles to the order of 20 percent of The investment value.*

*The MIDP has been in operation for six years and has not only led to rapid structural change in the automotive industry, but reshaped the future direction of industry through increases in investment, modernisation and upgrading. Investment expenditure by vehicle manufacturers increased from R1 171 million in 1996 to R2 742 million in 2001. It is significant to note that all the vehicle manufacturers have some form of foreign direct investment, especially from the 'parent' companies in America, Europe and Japan.*

*Investment in the component sector has also increased in specific areas, and includes significant foreign investment, particularly in the form of joint ventures. Component manufacturing investment increased by over 25 percent from 1999 to 2001, and the greatest benefits are evident in technology transfer boosting capacity, quality and standards, and investment growth also facilitates Black Economic Empowerment (BEE) development.*

## 6 Conclusion

It is stating the obvious that very large increases in the rates and levels of FDI are required in the SADC region if any meaningful progress towards economic growth, sustainable development and poverty alleviation, is to be achieved. This means putting money into permanent assets such as buildings, machinery, transport and equipment. In other words, investing in fixed assets that lead to the creation of new factories and industries and small businesses. Fixed investment is a long term investment because it takes time before investors get a return on their money, so investors have to be confident about the future of the economy before they commit themselves to long term (and riskier) investments.

As mentioned at the onset of this paper, there is a strong association between regional integration agreements and FDI, although this depends on particular circumstances, depth and scope of such agreements. The credibility of such agreements, manifested in the extent to which there is actual implementation of their provisions, has been identified as a critical factor in determining the impact of regional integration agreements on FDI determinants. Therefore investment location decisions have to consider both individual country-specific and region-wide factors. The problem with regional integration agreements in Africa is that they are largely rendered ineffective due to implementation failure and credibility problems. In the SADC for instance, the Trade and Investment protocol of 1996 has yet to be fully implemented by individual member states; in principle there is agreement whereas in practice there is 'piecemeal' efforts towards liberalisation.

African regional integration agreements are still not fully implemented and therefore it is not really possible to make definite conclusions on their impact on the determinants of FDI. In the case of market-seeking investment, it is possible that an enlarged regional market may act as a catalyst FDI in the SADC. 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. However, not all member states to a regional agreement, benefit from significant increases in FDI. There is a disproportionate flow of FDI between countries in a regional integration agreement. The experiences in the EU and MERCOSUR bear testimony to this claim<sup>15</sup>.

In the final analysis, it is becoming increasingly evident that simply enacting liberal trade policies, and liberal FDI regulatory and legal regimes is not enough, although it remains a basic pre-condition to attract foreign investment. There is also very little evidence to support the view that the provision of financial and fiscal incentives as well as other specific FDI promotion measures, are decisive determinants of FDI. A number of countries that have attracted substantial FDI inflows have not relied upon such instruments. Governments in the SADC should go beyond these traditional FDI promotion measures, and create an environment in which it is conducive to do business.

<sup>15</sup> Kalenga, P (1999).



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