Speaking Notes

Roundtable on Regional Integration and Liberalisation of Trade in Services in SADC

South African FDI in Southern Africa – The impact on Services
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18 September 2006

Good morning Ladies and Gentlemen,

Thank you for this opportunity to address you on the impact of South African FDI in our immediate region, and in particular on the critical issue of services. I have to state at the outset that the focus of my presentation today is firmly on companies as critical stakeholders and actors in regional integration.

I hope to spark some discussion on whether there is from a company perspective, a closer alignment of policies happening in support of regional integration – in particular as it relates to the role of services. As this audience knows, services are critical enablers in the operational activities of companies within the national domain. As intermediary inputs they are also important drivers of costs.

Within a regional context, services assume an even greater importance, especially if the goal is to posit the entire region as a viable market, attractive to the external investor not only in terms of actual market size, but also in terms of the ease of doing business. As to be expected, this requires congruence in both business practices and economic policies across borders.

The foundation of some of the findings presented here is the result of a three-year study by SAIIA's Business in Africa project looking at the experiences of South African companies across the continent. The rationale of the study is that although aid is an important ingredient in the attempt to address the continent's chronic under-development and performance, the growth of Africa's private sector is the only effective way to achieve the continent's vision of a long-term and sustainable development growth path.

The survey methodology followed by the institute was thus directed at understanding the constraints that businesses faced in individual markets, as well as asking for recommendations from companies to policy makers on how the private sector could be strengthened. SAIIA has concluded 9 country studies over this three-year period. They are: Egypt in North Africa; Nigeria, Ghana, Senegal and Mali in West Africa; Kenya in East Africa; and Botswana, Mozambique and Zimbabwe in Southern Africa.

Whereas my presentation will focus on the broad conclusions drawn from across all nine country studies it will also touch more in depth on two of the three countries that are members of the Southern African Development Community. Between them they offer a rich field of study, firstly from within the context of the Southern African Customs Union, which one assumes represents a form of deeper integration, namely

Botswana: and secondly, from the perspective of one of South Africa's most important trading partners in Africa and also one of the largest recipients of South Africa FDI, namely Mozambique.

South Africa is today counted amongst the top five investors in Africa along with France, the Netherlands, the United Kingdom and the United States. In 2004, these five countries accounted for over half of total investment flows into Africa of $18bn. According to UNCTAD the growth of South African investment into the region has been impressive from around R6 billion in 1994 to R24 billion in 2004. However, these figures are substantially understated given that reinvestments are not captured.

South African investment in the region is unique in four ways.

Firstly, the increase of South African investment, albeit from a low base and small if measured against total South African investment into Europe, does run counter to the global decline in investment flows into Africa. Africa (South Africa included) received less than 3% of global FDI in 2004.

Secondly, and more significantly, South African investors are distinguishing themselves from other foreign investors in their willingness to invest in areas beyond the extractive sector. As you might know, 80% of total investment into Africa has traditionally flowed into energy and mining. However, apart from investing in these two sectors, South African firms are also investing in retail, financial services, telecommunications, franchising, tourism, construction, infrastructure, property development, manufacturing and agriculture. In most SADC countries except for a few exceptions, South Africa is the leading overall investor.

Thirdly, it is also critical to look at which companies have been at the forefront of investment in the region. Eskom is involved in 33 African countries, making it the largest power utility in Africa and Transnet has managing contracts in 20 African countries. But despite the not inconsiderable involvement of state enterprises it is important to recognise that South Africa's investment push into the region is largely private sector-driven and led. Our surveys found a fairly small group (in global terms) of about 40 listed South African companies that are highly visible throughout the continent. More closer to home, in our immediate neighbouring states, a much larger spread of smaller and medium-sized companies are also expanding into the region.

Fourthly and most surprisingly, despite the willingness of South African firms to invest in a broad range of sectors, the surveys also established that South African companies do not necessarily assess risk or view the business environment that differently from other investors. In fact there was almost an uncanny resemblance in our findings to other business climate surveys which included a much larger foreign investment survey pool conducted by the World Bank, UNECA, UNCTAD and others.

The critical question would thus be: why have South African companies been so much more willing to investigate business opportunities in the region in areas that are considered more risky, and what has the impact been on the services sector in the region?

Before I attempt to address these questions it might be useful to look at the findings of the first business climate survey on regional integration conducted on behalf of the Association of SADC Chambers of Commerce and Industry in 2004. In it the private sector identified numerous steps that need to be taken to overcome obstacles to greater integration of the region. They included:

- stabilising exchange rates across the region;
- effectively combating crime and corruption;
- ensuring greater security of investments;
- improving infrastructure; and
- improving and simplifying regulatory frameworks.[1]

Two of these recommendations touch directly on the supply of services, moreover, in achieving the goals outlined above, both the private sector and government have critical, mutually reinforcing roles to play.

In trying to understand the motivations for the outward expansion of South African investors into the region we specifically asked companies why they chose to invest in particular countries. The answers were, whilst closely aligned to the underlining opportunities in the business environment, often very firm and sector-specific. As researchers this once again emphasised for us the unique characteristics of individual markets, the specific requirements of firms and the challenge of adopting a regional approach.

However, in summarising the key motivations of firms we found that resource-seeking FDI dominated in terms of size of investments; followed by market-driven or market-seeking FDI, and lastly strategic asset investment. In the later case privatisation was a critical factor. Efficiency-seeking FDI was only a factor in terms of special incentives such as tax breaks, which is in itself and indication of underlying constraints, such as cost of finance, utilities, lack of infrastructure, skills and so on.

An analysis of the sectors that attract the most investment in both Mozambique and Botswana, proves that mining and resources are the star attractions. In the case of Mozambique this is best exemplified by BHP-Billiton in Mozal and the building of the Sasol pipeline, and in the case of Botswana through De Beers in Debswana.

Botswana is also a ‘good’ case of how ‘other’ South African investments have tagged on to investment into the mining sector, generally in the following sequence although some investments were concurrent: infrastructure development, transport services, financial services, telecommunications, tourism, retail, franchising and property development. Of course some investments are a response to rising incomes and not necessarily only a reaction to some of the sophisticated services that large multinationals require to operate optimally. However, extrapolation from the Botswana case could be an important indicator of a future development trajectory for Mozambique, especially if the country retains its high growth rate. Mozambique also has the added potential advantage of becoming a significant agricultural producer.

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[1] This is survey is significant as it is the first business-driven survey across the region and it provides a clear private sector perspective on the business climate in the region.

There is no doubt that South African investment in services in both countries has had a significant impact on economic development. However, it should be noted that much remains to be done, especially in a country such as Mozambique with its huge informal sector, unequal economic development and huge income disparities across regions. Companies also listed a litany of constraints in tandem with traditional infrastructure constraints such as the high cost of finance, excessive red tape and petty as well as grand corruption. (Unfortunately Mozambique is not atypical in the region.)

Payment problems have been a major constraint for services. In most of the hard infrastructure and energy projects, and also telecommunications services, government remains a key partner and player. Despite a number of successful public-private partnerships, BOT programmes in the sub-region are rare. In the case of the Maputo Development Corridor South African road and freight users are important stakeholders in ensuring that the project remains viable. It is clear that PPPs have to be connected to an underlying sizable and viable market. However, in some sectors Government is often not only the arbiter, or the client, but can also be a competitor. The start-up of Vodacom's investment in Mozambique was apparently delayed because of a range of hidden subsidies to the majority government-owned mobile operator, MCEL.

Financial services also experience a problem of a poor lending environment with a high credit concentration on a few highly leveraged borrowers, a lack of credit-worthy projects, a weak repayment culture and a number of legal and institutional impediments to effective credit selection and recovery. While deposits are not unusually low (representing 23% of GDP), credit extension as a share of GDP (14%) is very low, and reflects the banking system's difficulty in channelling deposits into loans. Local banks are reluctant to extend credit to customers owing to the absence of an integrated and shared information system that records the credit-worthiness of clients. In addition there are problems with data submission requirements and the retention and distribution of longer payment histories.

In the case of Botswana where it is assumed that payment problems are less of a problem, companies in the services sector, especially the housing and financial services sector complained that individuals are highly indebted and that in fact disposable income is very low. More importantly, even in a well-developed and fairly diversified market such as Botswana, the informal sector still makes a significant contribution to employment. Out of a total labour force of 562,000 in 2001, only 272,000 were employed in the formal sector. About 109,000 people were unemployed (with an unemployment rate of 19.5%), whereas the rest of the labour force was self-employed in the informal sector.

The Botswana case also offers another cautionary note. Botswana is widely regarded as Africa's best managed economy, with an impressive infrastructure grid. However, companies still raised the following two issues in the services sector as presenting significant breaks on further expansion and a higher economic growth path: namely the cost of utilities and a lack of skills, especially operational and technical skills. The latter problem is exacerbated by the government's restrictive foreign labour and immigration policies.

Could more be done to enhance and support inter-services trade? Of course a number of interventions from a regional perspective are possible, amongst them making it easier to invest in cross-border infrastructure through public-private partnerships (with the caveats mentioned above), congruence in regulatory frameworks, and allowing a freer flow of labour for training and cross-posting purposes.

However, an understanding at firm level of the factors hampering closer co-operation across borders is an additional but critical perspective that is often missing in the discourse about why the entry of South African investors into the region has not been more robustly leveraged to foster greater regional integration.

In the case of Botswana, we can draw much food for thought from their experiences in the manufacturing sector, specifically the automobile sector. Despite a whole host of policies and incentives to develop this sector, economic planners have been singularly unsuccessful. Whereas foreign and local investors have responded positively to very generous five-year incentive programmes, their entry did not resulted in significant backward or forward linkages with the local economy, nor has Botswana been successful in developing a viable automobile manufacturing sector.

When quizzed on this companies offered the explanation that for them it is important to be closer to their market, that the land-locked nature of the country posed a particular constraint in tandem with the distance to be covered to the closest port and lastly, that in general, productivity levels and volumes were not satisfactory. This has led to the development of very few regional supply chains.

Of course one has to caution that we are looking at a specific snapshot in time, at a very specific sector and that manufacturing across the region is flagging. However, the useful lesson to be drawn is that although the entry of South African investors in the region has been undoubtedly good from the perspective of acting as a driver of economic growth and development, investment in services will only be optimised if there is a much closer alignment between governments and firms on appropriate policies.

Thank you.