SOUTH AFRICAN INSTITUTE OF INTERNATIONAL AFFAIRS

AUGUST 2018

POLICY INSIGHTS 65

FOREIGN DIRECT INVESTMENT: LESSONS FROM SADC

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EXECUTIVE SUMMARY

With the financial support of the Konrad Adenauer Foundation (KAS), the South African Institute for International Affairs (SAIIA) conducted research on the interplay between foreign direct investment (FDI), trade liberalisation and regional integration (RI) in SADC. At first, the FDI regimes of four SADC member states – South Africa, Namibia, Angola and Mozambique – were examined. The research team then focused on Tanzania's FDI regime. It also analysed the transport infrastructure sector and the energy sector, both of which are crucial in attracting FDI. Donor support in developing regional value chains in Tanzania was also explored, leading to an examination of nascent regional value chains in the soybean and macadamia nut sectors, as well as access to finance as a trade barrier.

INTRODUCTION

SAIIA has been receiving support from KAS for a number of years. Funding received from 2014 onwards was aimed at unpacking and understanding the interplay between FDI, trade liberalisation and RI in SADC. Initially, authors explored the FDI regimes of South Africa, Namibia, Angola and Mozambique. Subsequently the research team focused on Tanzania to further unpack its FDI regime. It complemented this work by taking a look at key enabling sectors that play a critical role in attracting FDI, namely the transport infrastructure sector and the energy sector. In addition, donor support in developing regional

ABOUT THE AUTHORS

This paper is a compilation of work done by 10 authors over a period of four years. These include Talitha Bertelsmann-Scott, Azwimpheleli Langalanga, Chelsea Markowitz, Aurea Mouzinho, Zinhle Ngidi, Asmita Parshotam, Cyril Prinsloo, Palesa Shipalana, Mark Schoeman and Lesley Wentworth. They were all associated with the Economic Diplomacy Team at SAIIA between 2014 and 2018.

value chains in Tanzania was explored. This research spurred additional efforts to examine specific nascent regional value chains in the soybean and macadamia nut sectors. Finally, access to finance as a trade barrier was examined. Collectively the work highlights the various stumbling blocks that exist in the region towards RI and economic development. This policy insight briefly unpacks the insights gained over the last four years.

INSIGHTS FROM THE FDI REGIME PAPERS

Mozambique

In 'Mozambique: Options for Multi-sector Approaches to FDI',[1] Lesley Wentworth argued that historically, Mozambique had relied heavily on aid flows to finance post-war reconstruction. It is also Africa's biggest recipient of overseas development assistance (ODA) – about 50% of government spending is financed from ODA. Post-war economic reconstruction efforts came mainly in the form of large projects focused on rebuilding the country's infrastructure. These projects were financed for the most part by foreign debt and equity, aided by multilateral and regional development banks. Large FDI projects, therefore, became an important driver of economic growth, especially in the extractive industries and the supporting infrastructure sector. Investments in these sectors were aided by liberalisation and stable macroeconomic policies on the one hand and widespread donor support on the other.

The country's economic growth showed positive momentum from the mid-1990s until the real impact of the sustained slump in commodity prices was felt, beginning in 2011. Public debt increased from 40% of gross domestic product (GDP) in 2011 to 56.8% in 2014 and a staggering 112% by end 2017. The government arguably borrowed money in anticipation of its large natural gas deposit and other mineral finds' translating into government revenue, but these profits are only expected in 2023.

Despite its having large mineral resources that could be exploited lucratively, poor governance has resulted in investors becoming cautious and Mozambique's political outlook becoming increasingly unstable

It is possible to transform mineral resources into long-term sustainable development, but this only happens when these operations are embedded in secure and prosperous communities. Environmental impacts must be addressed and risk mitigation and management strategies applied. Joint committees that include private company representatives, government agencies and the community should have continuous engagements. Unfortunately, the country seems to be in economic decline, which is starting to affect political stability, thus making investors more skittish to invest.

Insight gained: Governance matters. Despite its having large mineral resources that could be exploited lucratively, poor governance has resulted in investors becoming cautious and Mozambique's political outlook becoming increasingly unstable.

Namibia

In 'Namibia: Towards a Logistics Hub for Southern Africa',[2] Mark Schoeman argued that Namibia's New Investment Bill represented an FDI regime that was in line with the recent shift in the developing world away from liberal FDI regulation, which favours foreign investors and restricts the state's right to regulate in the public interest. As in South Africa (where all bilateral investment treaties were cancelled), the bill creates provisions to reserve investment in certain sectors for Namibian citizens and introduce performance requirements for foreign investors. Critics were concerned that mandatory equity, joint ventures, and employment and skills development requirements could greatly increase the cost of FDI, particularly where local capacity and skills were in short supply. In sectors where the state does not have much bargaining power, these requirements can deter foreign investors. Incentive schemes can reduce this cost and increase Namibia's attractiveness as an investment destination, but at the expense of forfeited state revenue.

The bill provided an interesting platform for a discussion on FDI, its role in the Namibian economy, and the potential impact of FDI policy on development. This paper used FDI in Namibia's logistics sector as a case study to investigate these issues. Logistics development was identified as a priority for inclusive economic growth in Namibia, with a focus on the Port of Walvis Bay and its associated transport corridors. FDI has played an integral role in the construction and operation of the port and corridors. The paper concluded that the Namibian government should have a flexible approach to FDI. In sectors such as extractives, the government has more leeway to negotiate around joint ventures and skills development than in manufacturing, for instance. Infrastructure is such a critical development enabler that Namibia should not lose sight of the long-term development benefits, which could be curtailed if investors were to be put off by strict FDI legislation.

FDI legislation should be flexible to take sector-specific characteristics into account

Insight gained: FDI legislation should be flexible to take sector-specific characteristics into account.

Angola

In 'Understanding the Angolan FDI Regulatory Landscape',[3] Aurea Mouzinho explored the regulatory framework for FDI in Angola, with the objective of broadening understanding of the barriers to foreign investment in the country. The regulatory environment in Angola is unpredictable, and foreign investors experience high levels of inefficiency in the execution of the various investment policies. As a result, and coupled with corruption, bureaucracy and inadequate transport infrastructure, Angola is viewed as one of the least hospitable places to do business. This has severely hindered foreign investment outside of the oil and mineral sectors. In the wake of the global downturn in oil prices, the Angolan government desperately needs FDI to promote diversification of the economy and broad-based economic development. In order to attract investors it needs to undertake serious institutional reforms to improve investors' perceptions of the country's business environment, particularly with respect to transparency, fiscal management and the rule of law.

Insight gained: Unless SADC member states improve the ease of doing business in their countries and make concerted efforts to lessen their dependency on commodities, FDI will not support broad-based economic development.

South Africa

In 'Foreign Investment Promotion and Domestic Protection: A Balancing Act',[4] Azwimpheleli Langalanga and Chelsea Markowitz examined South Africa's balancing act of promoting FDI that brings inclusive economic development while remaining an attractive FDI destination for investors. The paper gave a brief overview of South Africa's current FDI context, with particular focus on the dynamics of international mergers and acquisitions and how South Africa's competition and domestic policy frameworks affect these types of investments. Walmart's acquisition of Massmart was used to demonstrate the challenge of ensuring that FDI has positive spillover effects for South Africans within the context of increasingly globalised production chains. Ultimately, the paper focused on South Africa's future path towards more sustainable FDI, and the government's efforts to create a domestic FDI regulatory framework. It further explored additional efforts to promote sustainable FDI, such as the one-stop shop for investors and new public interest guidelines on competition, as well as prospects for a mechanism to support small, medium and micro-sized enterprise suppliers. It concluded that South Africa's bold approach to stricter regulation of investment, in the hope of ensuring more inclusive growth in the country, had resulted in serious concerns over certainty and transparency among potential investors. The uncertainty that prevailed in 2016 has since been aggravated by the state capture scandals of the Zuma presidency and the ongoing debates on land expropriation without compensation.

Policy uncertainty is not fertile ground for FDI, despite a country's enormous potential

Insights gained: Policy uncertainty is not fertile ground for FDI, despite a country's enormous potential.

INSIGHTS FROM DELVING DEEPER INTO TANZANIA

Tanzania's FDI regime

In 'Exploring Tanzania's Investment Competitiveness in East Africa',[5] Aurea Mouzinho and Azwimpheleli Langalanga argued that Tanzania had made some strides in attracting FDI since its transition away from a purely socialist approach to economic governance. Given its negligible domestic saving culture, the answer to capital formation, job creation and general social upliftment lies in large part in foreign investment. The Tanzanian government can achieve this through instituting regulations and providing a foundation for its own people to emerge as entrepreneurs with the capacity to partner with foreign investors. In addition, the government has to invest in human capital development. The authors argue that Tanzania's political stability, its membership in the East African Community and SADC, and its physical location constitute a positive platform on which it can build its competitive advantage. Further, Tanzania's liberal regulatory regime on FDI, as encapsulated in various domestic statutes and bilateral investment treaties, is a positive attribute. Nevertheless, if the country is to realise its full potential as an investment destination it must deal with those structural challenges that impede the attraction and retention of FDI. It should update its bilateral investment treaty network; harmonise all investment regulatory instruments; empower the Tanzania Investment Centre as an institution; take primary responsibility for developing Tanzanians' skills; facilitate the integration of its small and medium enterprises into regional and global value chains by encouraging foreign firms to set up in its export processing zones; incentivise locals to integrate into agricultural and agro-processing value chains by providing them with title deeds to their land; and link incentive schemes to the integration of locals into value chains and skills development.

Insights gained: A new government does attract initial positive FDI as it tries to position itself as 'different' to former regimes. However, to create lasting impact and attract the necessary FDI for economic development, large-scale national reform is necessary. It is here where governments often fail, resulting in FDI decline.

Investing in transport

In 'Tanzania's Transport Hub: What Prospects for Regional Trade and Local Economic Development?',[6] Chelsea Markowitz analysed investments in the transport infrastructure in Tanzania, in terms of the country's ability to foster regional economic integration and drive sustainable economic growth that spills over into local communities. The paper examined the relevant legislation governing investment in transport infrastructure, such as the Tanzania Development Vision, five-year development plans, national transport policy, transport sector investment programmes and the Big Results Now Initiative. It then reviewed the current state of transport infrastructure in Tanzania, with a particular focus on the port and rail sectors, given their ability to foster both national and regional trade. It also looked at how these infrastructure developments fit into Tanzania's regional commitments. Markowitz then turned to the challenge of mobilising finance to build this infrastructure, analysing public–private partnerships (PPPs) within the context of promoting FDI. Finally, the paper considered how such investments could be sustainable as well, in terms of their ability to build local capacity and support equitable growth.

Insight gained: Governments' capacity to plan, coordinate and implement various plans and policies (including regional plans) is key to unlocking the promise of FDI and its spillover potential for broad-based economic development.

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Energy sector

In 'Power and the Private Sector in Tanzania: Prospects for the AfDB's High Fives Strategy',[7] Cyril Prinsloo and Talitha Bertelsmann-Scott argued that a stable, affordable energy supply underpinned economic development by enabling infrastructure development and investment, and ultimately increased industrialisation and enhanced competitiveness. Ensuring electricity security is therefore vital for all countries.

Over the past two decades Tanzania has been struggling to achieve electricity supply security owing to erratic droughts; over-reliance on expensive hydrocarbon-generation sources; a lack of ongoing investment in and maintenance of generation, transmission and distribution infrastructure; and significant financial difficulties at the national energy utility. Electricity security is a key development priority not only for countries but also for development partners focusing on developing countries. The African Development Bank's (AfDB) programmatic and development finance focus is a key example of this concern, highlighted in its 'High Fives' initiative focusing on five key themes: 'Light up and power Africa', 'Feed Africa', 'Industrialise Africa', 'Integrate Africa' and 'Improve the quality of life for the people of Africa'. It has also developed the New Deal on Energy for Africa, with the ambitious goal of ensuring universal access to electricity on the continent by 2025. This paper examined this ambition within the context of Tanzania's electricity environment and prospects for broader coverage. Attracting investors to the energy sector to address its supply gap has been a key objective of Tanzania's national development policies. However, major challenges remain that are likely to hinder greater participation by investors. These include institutional, regulatory and legal barriers, knowledge and capacity limitations, and economic and financial constraints. The paper explored the complementarity of domestic and AfDB efforts to support greater private sector investment in Tanzania's electricity sector. Throughout the paper, specific reference was made to the renewable energy sector, an area that has attracted significant private sector and government interest, given its far-reaching socio-economic benefits.

Insights gained: Governance matters. Despite concerted efforts by the donor community and private sector to improve energy supply in Tanzania, the disjointed nature of Tanzanian policies and regulations makes attracting FDI difficult.

Donors' role in creating regional value chains

In 'Harnessing Investment in Tanzania's Agricultural Sector for Inclusive Growth: Where to From Here?',[8] Asmita Parshotam unpacked Tanzania's investment laws and their impact on the development of the country's agricultural sectors. She analysed the current government-led policies and initiatives aimed at stimulating growth in Tanzania's agricultural sector while improving the socio-economic conditions of smallholder farmers.

Tanzania is attracting significant private sector and donor interest in its agricultural sector; whether these initiatives are successful at balancing investors' needs with development goals remains questionable. The paper discussed some of the successes and difficulties surrounding PPPs and their inclusion of smallholder farmers in growing value chains.

Tanzania is uniquely positioned owing to the majority of its farmers' being smallholders, and the country must find strategies that enable their inclusion in agricultural value chains. Policies and investment measures that better involve smallholder farmers, increase their involvement and participation through technical capacity building and knowledge enhancement, and facilitate their active participation in understanding the demands and constraints of the marketplace can contribute to their growing participation. Evidence shows that PPPs can be harnessed to incorporate smallholder farmers into value chains and facilitate their socio-economic development and larger role within the system. The government and private sector both have a role to play in enhancing systemic approaches to efficiencies. Providing affordable inputs and access to financing, and reforming the tax regime to be less onerous on smallholder farmers are all policy changes that must be explored further in the coming years.

Insights gained: Government must work closely with the private sector to ensure that investments have the anticipated impact. Creating regional value chains is critical for regional integration and economic development in SADC.

Creating regional value chains is critical for regional integration and economic development in SADC

REGIONAL VALUE CHAINS

Over the past decades, world trade has been characterised by the fracturing of manufacturing and production processes, with different goods and services provided in different geographical locations, ultimately forming part of a single commodity. This global phenomenon, referred to as global value chains, is also credited with increasing RI if regions can collaborate to create regional value chains. However, few of these chains exist in SADC. SAIIA explored where such chains could be developed with the assistance of FDI and trade liberalisation.

Macadamia nut value chain

In 'Cultivating Smallholder Inclusion in Southern Africa's Macadamia Nut Value Chains',[9] Asmita Parshotam examined the potential for developing a macadamia nut value chain in Southern Africa, while also exploring the potential for incorporating smallholder producers into the macadamia nut industry. Using the country case studies of South Africa, Mozambique and Malawi, the paper studied the development of the macadamia nut sector in each country, highlighting the challenges faced and positive developments made in incorporating smallholders into the sector, and examining the role of African markets and producers in the international trade in macadamia nuts. The paper concluded with an understanding of the specific requirements policymakers would need to implement if a regional value chain were to be developed for the macadamia nut industry.

Insight gained: Investing in regional value chains as a SADC strategy is complicated, as few such chains exist in Southern Africa.

Soybean value chain

'Linking Soybean Producers to Markets: An Analysis of Interventions in Malawi and Zambia',[10] by Chelsea Markowitz, is a comparative study of the soybean industries in Zambia and Malawi, both of which have experienced growth and development in recent years, with a further comparison with South Africa. The paper primarily examines soybean development from a producer perspective, focusing on productivity and marketing challenges that hamper buyer–seller linkages in these countries. The analysis is important from a comparative perspective of three SADC countries that have seen growth and/or active policy promotion in soybean value chains. The industries in the three countries are at three different stages of development. South Africa's mechanised production and organised grain and oilseed markets have allowed a highly sophisticated industry. Despite a boom in poultry demand, leading to increased production and now small soybean surpluses in both Zambia and Malawi, the industries in these countries are still small when compared to that in South Africa (let alone globally) and face challenges in growing meaningfully, owing to inefficient production by most smallholders and underdeveloped market systems. A key distinction between the two countries is that difficulties in Malawi's investment environment necessitate a large donor

A regional value chain only becomes viable once the private sector shows significant interest and invests

presence in the industry, while in Zambia top–down investment from traders and processors is beginning to take root.

Insight gained: Although donor assistance can play a catalytic role in starting regional value chains, a regional value chain only becomes viable once the private sector shows significant interest and invests.

Access to finance

In the RI literature reference is often made to the fact that Southern African producers, processors and traders struggle to access finance. In order to examine this challenge further, in 'Can a South African Export Credit Agency Navigate Domestic and Global Headwinds?',[11] Palesa Shipalana, Cyril Prinsloo and Zinhle Ngidi examine whether Southern African trade will be aided by the creation of an export-import (EXIM) bank. Since the UK first established its export credit agency (ECA) in 1919, there has been a proliferation of ECAs across the globe. While no two ECAs are alike, their basic mandate of engendering economic growth by promoting domestic production and facilitating exports is a common attribute. Like other development finance institutions, ECAs tend to be publicly owned (with paid-in capital from governments typically one of their biggest sources of financing), offering concessional and developmentally orientated financing. While some ECAs are inward-focused, offering support only to domestic companies, outward-focused ECAs can provide part or the full range of their services to entities outside their national borders. In almost all cases, there is a close alignment between ECA activities and national trade and industrial policies. However, other entities offer similar products and the conclusion drawn is that a South African EXIM bank will add little to foster RI in Southern Africa.

Insights gained: Southern Africa's stumbling blocks to further and deeper integration rather lie in areas of trade facilitation and exposing the private sector to regional value chain creation opportunities. Where these exist, financing (public and private) is swift to follow.

CONCLUSION

FDI plays a catalytic role in unlocking opportunities that could promote increased regional trade, economic development and integration. Most SADC member states still rely heavily on donor funding in order to unlock economic opportunity. However, once donor funding comes to an end it is critical that the private sector steps in to ensure that sustained benefit accrues. The body of work that SAIIA has done for KAS shows that the region is making little progress in terms of presenting itself as a regional destination that offers markets and economies of scale. Recent attempts by SADC to focus on industrialisation via the creation of regional value chains have not yet borne fruit, as these chains are few and limited in scope and depth. However, there are encouraging signs that regional trade is increasing. Concerted effort is needed to ensure that the region can continue on this path and translate trade growth alongside FDI into broader economic development.

ENDNOTES

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ACKNOWLEDGEMENT

This paper is funded by the Konrad Adenauer Stiftung. SAIIA gratefully acknowledges this support.

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