Foreign investment and regional integration in Southern Africa

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How to Reduce Debt Costs in Southern Africa
OECD Seminar, Johannesburg, 25-26 March 2004
Outline

• Savings and investment in Africa
• The composition of long-term capital flows in Africa
• Foreign direct investment in SADC
• South Africa’s investment relationship with Africa
• Regional integration arrangements and implications for investment
Savings and investment in Africa

Domestic savings and investment as a percentage of GDP, 1995-2001

<table>
<thead>
<tr>
<th></th>
<th>Gross domestic savings</th>
<th>Gross fixed capital formation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>16.3</td>
<td>17.3</td>
</tr>
<tr>
<td>East Asia &amp; Pacific</td>
<td>36.5</td>
<td>31.9</td>
</tr>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>19.3</td>
<td>19.3</td>
</tr>
<tr>
<td>South Asia</td>
<td>20.2</td>
<td>21.3</td>
</tr>
<tr>
<td>Low &amp; middle income</td>
<td>24.4</td>
<td>22.8</td>
</tr>
</tbody>
</table>

Source: World Development Indicators database, World Bank

- Domestic savings and investment rates in Africa are low by developing country standards

- Increased investment rates are part of the strategy for encouraging higher rates of economic growth: growth rates of 7 percent will require investment rates of around 33 percent (NEPAD)

- Improved access to foreign capital will be an important component.
The composition of long-term capital flows to Africa

Net long-term resource flows to Sub-Saharan Africa, excluding South Africa
Average annual flows in US$ millions

<table>
<thead>
<tr>
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<tr>
<td>Aggregate net resource flows</td>
<td>17,484</td>
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</tr>
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<td>-1</td>
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<td>-805</td>
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Source: Global Development Finance database, World Bank; see also Leape (2004)

- Private capital flows to Africa increased in the second half of the 1990s at the same time as official flows declined.

- The increase in private capital flows is due to higher levels of inward FDI. Leape (2004) shows that half of FDI to Sub-Saharan Africa has been to oil exporting countries, mainly Angola and Nigeria.
The composition of long-term capital flows to Africa (cont.)

Net long-term resource flows to Sub-Saharan Africa, excluding South Africa
Average annual flows in US$ millions

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Source: *Global Development Finance* database, World Bank; see also Leape (2004)

- Portfolio equity investment is especially low, while net outflows of private debt finance have been recorded over this period.

- In contrast, resource flows to South Africa are mostly private, and portfolio (equity and bond) investment has been more important.
### The composition of long-term capital flows to Africa (cont.)

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</tr>
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<tbody>
<tr>
<td>SADC¹</td>
<td>5,226</td>
<td>3,401</td>
<td>5,237</td>
<td>2,893</td>
<td>10,387</td>
</tr>
<tr>
<td>Angola</td>
<td>412</td>
<td>1,114</td>
<td>2,472</td>
<td>879</td>
<td>2,146</td>
</tr>
<tr>
<td>South Africa</td>
<td>3,811</td>
<td>550</td>
<td>1,503</td>
<td>969</td>
<td>7,162</td>
</tr>
<tr>
<td>Rest of SADC¹</td>
<td>1,004</td>
<td>1,737</td>
<td>1,262</td>
<td>1,046</td>
<td>1,079</td>
</tr>
<tr>
<td><strong>SADC as a % of developing countries</strong></td>
<td>3.10%</td>
<td>1.90%</td>
<td>2.90%</td>
<td>1.80%</td>
<td>6.00%</td>
</tr>
</tbody>
</table>


Notes: 1. Excludes FDI in Namibia; these data are not published in *World Development Indicators*.

- Southern Africa attracts less than 3% of total FDI to developing countries
- South Africa and Angola attract most of the FDI in SADC
- South Africa dominates the region as a location for large multinational enterprises. But inflows are low by emerging economy standards
- For some countries, FDI inflows have been large relative to GDP: infrastructure projects, natural resource investment, and mega-projects.
Determinants of FDI in SADC

- Jenkins and Thomas (2002) find that market seeking FDI is important in SADC. Growth of the domestic market may be a precursor to higher levels of FDI.

- Regional integration may help to create larger markets in the region. But mechanisms are needed to spread the gains from FDI:
  - liberalisation of exchange controls
  - regional infrastructure development

- Jenkins and Thomas find limited export capacity amongst non-primary sector foreign-owned firms. More recent evidence suggests that AGOA has encouraged export-driven investment. The effects of trade initiatives on FDI in the region are yet to be quantified.

- Greater economic stability is a priority for encouraging FDI. The strengthening of institutional capacity is also essential.

- Policy agenda is familiar for developing countries. African countries face a particular challenge in addressing perceptions of endemic instability amongst potential investors.

“Foreign investment and regional integration in Southern Africa”
Lynne Thomas, CREFSA

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South Africa’s investment relationship with Africa

- South Africa is a significant investor in the SADC region.

  - South African investment represented more than 70 percent of the net inward flow of FDI in Swaziland between 1995 and 2001.

  - Castel-Branco (2002) estimates that 35 percent of FDI flows to Mozambique in 1990-2001 were from South Africa.

  - Pilot surveys of stocks of foreign assets and liabilities in Mozambique, Tanzania, Uganda, Zambia, and Zimbabwe from the late 1990s found that *intra*-regional investment was growing.
South Africa’s investment relationship with Africa (cont.)

- What does South African data tell us about regional investment?

- South African Reserve Bank has published a more detailed country breakdown of assets in and liabilities to Africa as part of the IIP for 2001

- IIP data can be problematic in assessing the extent of South Africa’s FDI linkages with the rest of Africa
• Direct investment in Africa accounts for just six percent of the total direct investment assets of South African residents. Much of this (77 percent) is recorded as investments in Mozambique and Mauritius.

• Africa is a negligible share of South Africa’s foreign portfolio investment

• “Other investment” in Africa consists of a mix of loans and trade finance. SACU economies represent just over a third of these assets.

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South Africa’s investment relationship with Africa (cont.)

<table>
<thead>
<tr>
<th>South Africa’s foreign liabilities to Africa, end-2001, millions of rand</th>
<th>Direct investment</th>
<th>Portfolio investment</th>
<th>Other investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>5,049</td>
<td>12,031</td>
<td>11,395</td>
</tr>
<tr>
<td>SACU</td>
<td>1,381</td>
<td>11,707</td>
<td>5,720</td>
</tr>
<tr>
<td>As percent of Africa</td>
<td>27.4%</td>
<td>97.3%</td>
<td>50.2%</td>
</tr>
<tr>
<td>Total foreign liabilities</td>
<td>370,695</td>
<td>320,168</td>
<td>247,703</td>
</tr>
<tr>
<td>Africa as percent of foreign liabilities</td>
<td>1.4%</td>
<td>3.8%</td>
<td>4.6%</td>
</tr>
</tbody>
</table>

Source: Quarterly Bulletin, December 2003, South African Reserve Bank

- Does South Africa’s more developed financial system act as a potential magnet for regional capital? CREFSA research has found that trade and monetary integration arrangements may influence the nature of intra-regional capital flows.

- Portfolio investment from Africa is almost wholly accounted for by Namibian holdings of South African securities, illustrating close economic and financial linkages.

- Deposits in the South African banking system from SACU economies are a substantial fraction of other investment from Africa.
Regional integration and implications for investment

- How successful are regional economic arrangements in Southern Africa?

- Conflicting memberships of regional economic agreements create uncertainty and increase the resources required for cooperation.

- Jenkins and Thomas (1997) found evidence of long-term economic convergence in SACU: poorer members grew faster between 1960 and 1989 in terms of GNP per capita. There has also been convergence in key economic policy indicators.

- Jenkins and Thomas found no evidence of economic convergence in SADC. A later study (Harvey et al, 2001) has similar findings for COMESA. These findings are not surprising: economic integration initiatives are relatively recent.

- Policy indicators vary across SADC, although significant progress towards greater stability has been made in several economies.
Regional integration and implications for investment (cont.)

- Pre-requisites for increased cross-border trade and investment in SADC:
- Macroeconomic stability - SADC initiative on macroeconomic convergence
- Strengthening of institutions and consistent policy frameworks
- Mechanisms to spread the gains from regional integration
Spreading the gains from regional integration: Broadening the sources of foreign capital

- Outward investment from South Africa into the rest of SADC should help to improve the balance of trade and capital flows in the region.

- Accelerated liberalisation of exchange controls on South African companies for FDI in Africa has already contributed to this process.

- South Africa as a magnet for regional capital? Is there a risk that capital inflows from the region may partially offset outward investment from South Africa as economies become more integrated?
Spreading the gains from regional integration: Broadening the sources of foreign capital (cont.)

- Can South Africa’s more developed financial markets act as a source of capital for the region?

- Promoting South Africa as a regional financial centre? Channelling South African and foreign capital into African investment?

- The quality and regularity of information on African investments will be important: portfolio investors are likely to be demanding in terms of their assessment of risks.