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PROSPECTS FOR INDUSTRIAL TRANSFORMATION IN SADC

Towards a Regional Strategy and Roadmap

SARDC
Southern African Research and Documentation Centre

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Considerations for Financing Industrial Development

Introduction

The SADC region is well-endowed with natural resources, and most economies are dominated by the extractive industries. Exports from the region have largely been of primary commodities and there has been little investment in beneficiation and development of the industrial sector. This is partly due to the risks associated with the high cost of doing business, which is linked to inadequate transport, communication and energy infrastructure.

A corollary to the risks highlighted above is the weak domestic financial markets, which lack capacity to provide the requisite support to financing industrial development. The depth of the banking system, as measured by the deposits mobilised and credit extended, tends to be low in most countries in the region, except for South Africa and Mauritius.The non-banking financial system has not provided meaningful funding for industrial development. This comprises the securities market, insurance, pension and collective savings institutions.

Funding from the financial system in the region has been short term and yet financing industrial development requires medium- to long-term financing. Thus there is need for SADC to focus on designing medium- to long-term mechanisms that are suitable for funding industrial development in the region.

Opportunities and Challenges

A report by the New Partnership for Africa's Development (NEPAD) and the United Nations Economic Commission for Africa (UNECA) underscores the fact that Africa has the resources to fund its own development and reveals the following statistics:

- Africa generates more than US$520 billion in domestic taxes annually;
- Africa earns more than US$168 billion from minerals and mineral fuels annually;
- Africa's Diaspora remittances rose to more than US$40 billion in 2012;
- Africa's stock market capitalisation rose from US$300 billion in 1996 to US$1.2 trillion in 2007;
- Africa's private equity market is worth about US$30 billion; and,
- Resource-rich African countries have established Sovereign Wealth and Stabilisation Funds. In 2014 several countries including Ghana, Kenya, Nigeria and Rwa nda, raised US$10 billion by floating sovereign bonds.

This data confirms that funding for Africa's development can be sourced from the continent and a slice of these funds can be targeted for development of the industrial sector. However, the African continent is seriously affected by the menace of Illicit Financial Flows (IFF), estimated to top US$50 billion each year. Financial leakages have been estimated to amount to some US$528.9 billion over the decade ending in 2012, compared to US$348.2 billion in official development assistance and US$284 billion in net inward Foreign Direct Investment (FDI).

A joint study by the African Development Bank and Global Financial Integrity indicated that most illicit financial flows in Africa are associated with the extractive industries. Most of this illicit capital flight is through tax evasion and mispricing of goods and services by multi-national companies, according to a recent study commissioned by the African Union, but are also associated with other criminal activities such as drug trafficking, money laundering, racketeering and counterfeiting. These activities are aided by corruption and weak institutions at national and continental levels to monitor and curb criminal activities.

The support by governments, regional entities and UN agencies has been increasing since the UN High-Level Conference on South-

South Cooperation, held in Nairobi, Kenya in 2009. The UN Industrial Development Organisation (UNIDO) has strengthened its role as a global convener on South-South cooperation and has been supporting technical cooperation projects that promote South-South platforms, networks and partnerships.

South-South cooperation initiatives supported by UNIDO include:

- the Industrial Knowledge Bank (IKB)/*Banco de Conocimiento Industrial (BCI)* which promotes the exchange of knowledge and expertise on industrial development;
- Networks for Prosperity (N4P), which is targeted at creating a global management system for the development of the private sector; and,
- the African Agribusiness and Agro-industry Development Initiative (3ADI) targeting sustainable reduction in poverty and hunger on the continent.

The declining wage competitiveness in China may entice Chinese companies to relocate labour-intensive industries to low-income countries while upgrading their industries towards more sophisticated products with higher value addition (Lin and Wang, 2014; Brautigam 2010). This could create opportunities for additional Chinese support to industrial development in Africa, already active in infrastructure development, and help with job creation on the continent.

SADC Member States need to take advantage of these efforts targeted at increasing the volume of South-South trade, FDI, technology transfer and sharing of solutions and expertise to ensure that they are used to full advantage in the development of a regional industrial development strategy and requisite financing mechanisms.

A number of challenges still persist that have the potential to inhibit mobilisation of resources for funding industrial development in the SADC region. As already intimated earlier, both banking and non-banking sources of financing are constrained by the lack of depth and suitable products to address the needs of this market segment.

The SADC Protocol on Finance and Investment emphasises the importance of FDI in the development of the region and encourages Member States to promote entrepreneurship in industries. However, FDI flows are constrained at times because some Member States have restrictions on foreign ownership in sectors such as mining, oil, gas, transport, telecommunications, banking, insurance or media.

Statistics indicate that global FDI flows stood at US$1.45 trillion in 2013, up from US$1.33 trillion in 2012 (UNCTAD 2013). Africa's share in the FDI flows in 2013 stood at US$57 billion, with southern Africa attracting the largest share. Most of the inflows to the SADC region went to South Africa and Mozambique, receiving US$8.2 billion and US$5.9 billion respectively. The FDI into Africa was mainly driven by market-seeking flows and investments for infrastructure projects.

SADC, and indeed the whole of Africa, also face competition for investment resources, with a number of initiatives with the potential to affect global trade and investment flows taking shape in other parts of the world, including the proposed free trade area between the European Union and the United States, and the proposed Trans-Pacific Partnership (TPP) regulatory and investment treaty being negotiated by 12 countries – Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam.

Current Efforts at Funding Industrial Development in the SADC Region

The major source of funding for industrial projects in the region comes from Development Finance Institutions (DFI), which typically offer products such as medium- and long-term loans with maturity profiles varying between three and twelve years, as well as trade, finance and equity investments. South Africa is a dominant player in the DFI market in Africa. The country has a strong financial sector, which has capital resources, technology and infrastructure as well as a strong regulatory and supervisory environment. The World Economic Forum (WEF) Global Competitiveness Report 2013/14 ranked South Africa third out of 148 countries for financial markets development.

South Africa is also a major player in the investment market in Africa. The South African Treasury estimates that the country's investment in Africa is more than R36 billion, which makes it one of the top two developing-country investors on the continent. A report by *FDI Intelligence* in 2013 noted more than 500 percent increase in project activity by South African companies in cross-border investments across the continent. Most of this activity is in the financial, retail and telecommunication sectors.

The Industrial Development Corporation (IDC) of South Africa provides funding for industrial development in South Africa and the continent at large. IDC also provides support to other DFIs in the region and implements regional projects through collaborative efforts with local partners.

The Development Bank of Southern Africa (DBSA), wholly owned by the South African government, provides funding for domestic and regional projects. The DBSA hosts a number of financing platforms which include:

- The SADC Project Preparation and Development Facility (PPDF) to assist SADC in implementation of the SADC Regional Infrastructure Development Master Plan with focus on regional projects in the six priority sectors of energy, transport, tourism, information technology, meteorology, and water;
- The Pan African Capacity Building Programme (PACBP), which is run in partnership with the IDC and French development organisation *Agence Française de Developpement*. The PACBP focuses on building capacity for infrastructural development through regional DFIs, government departments, quasi-government institutions and other development stakeholders in sub-Saharan Africa; and,
- Two domestic programmes — the Infrastructure Investment Programme for South Africa and the Green Fund.

Most countries in the SADC region do have DFIs but most are undercapitalised and have an inward focus, providing largely working capital finance. South Africa's sixth annual Industrial Policy Action Plan 2014/17 emphasises the importance of regional integration to the economy and points to investment in the development of regional infrastructure and projects that promote regional value chains as vital to the attainment of sustainable growth in the region. This offers opportunities for strengthening synergies by DFIs in the SADC region to develop funding mechanisms for industrial projects at a regional level.

The majority of banks in the region shy away from funding Small and Medium Enterprises (SMEs) as they are seen as high-risk investments. This has resulted in the proliferation of micro-finance institutions, which are coming to fill an intermediation vacuum. A segment of the SME sector that is significant for industrialisation is the Small and Medium-scale Industries (SMIs.) These are a group of SMEs that specialise in high-value industries such as mining and manufacturing. Microfinance credit available to the SMEs sector is not suitable for SMIs as its focus is on short-term loans for working capital requirements whereas SMIs require investment in plant and machinery. SMIs offer a good opportunity for involving the SME sector in the overall industrialisation strategy for the region.

Policy Considerations

The analysis above shows that there is scope to use existing financing mechanisms and to develop new mechanisms to fund industrial development in the SADC region.

The presentation below explores policy considerations for the development of these mechanisms.

DFIs in the region have an important role to play in supporting industrial development despite the generally inward orientation toward domestic/local activities.

The SADC Development Finance Resource Centre (DFRC) should be at the centre of assisting Member States to strengthen DFIs by improving capacity to deliver on their mandates, pushing for more and closer collaboration, and increasing the size of projects that can be funded.

Efforts by the DFRC should be buttressed by the operationalisation of the SADC Development Fund.

The fund should be capitalised with contributions from SADC Members States, the private sector and cooperating partners to an extent that will allow it to meet its intended objectives in the short-term, and to be transformed eventually into a regional DFI for the SADC region.

Governments in the SADC region need to show their commitment to industrialisation by making setting aside a percentage of national budgets for financing industrial development at the regional, national and local levels.

The framework for a prescribed budget allocation model to financing industrial development needs to be backed by an appropriate tax and foreign exchange regime that is supportive to industrial development and is part of an incentives package targeting expansion of the industrial sector.

Funding for industrial development can also be looked at from the perspective of value chains. This can be achieved through intermediate funding from a third party to clients in the chain.

In some cases, the mere fact of being within a value chain may be sufficient for the chain actor to obtain funding from financial organisations.

SADC Member States need to use existing UN platforms and opportunities presented by China to increase the volume of South-South trade, FDI, technology transfer and sharing of solutions and experts to ensure that they are used to full advantage in the development of regional industrial development strategy and requisite financing mechanisms.

The capacity of existing funding mechanisms needs to be enhanced. These include:

- In the more mature markets in the region, pension/mutual funds, sovereign wealth funds and insurance funds can be potentially good sources of domestic funding for industrial development;
- There is room to develop long-term local capital markets, which include government and non-government bond markets and equity markets. New instruments, such as Diaspora bonds and commodity-linked bonds, are already in use;
- Domestic stock markets can be strengthened to absorb large Initial Public Offerings (IPOs) of shares in order to increase availability of long-term financing.

Special consideration should be given to the funding of SMEs that are related to the industrial sector in the SADC region. Such measures include:

- Creating more specialised financial institutions that understand the needs of the sector;
- Developing alternative stock markets that are more suitable to the needs of SMEs;
- Developing cluster models for raising funding that build greater confidence between lenders and SMEs based on provision of collective guarantees to financial institutions; and,
- Provision of specialised lines of credit targeting the SME sector.

Conclusion

The development of a robust industrialisation strategy hinged on beneficiation and value addition can help to address economic growth and sustainability in SADC. The strategy needs to be supported by appropriate financing mechanisms that take account of the economic realities in the region and seize opportunities offered by potential global partners.

A comprehensive mapping exercise is needed to identify institutions involved in financial intermediation in all SADC Members States, with a focus on medium- to long-term funding and sector-specific facilities.

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