Floor Discussion of the Lyakurwa Paper

Mohsin Khan from the IMF began the discussion by relating the issue of trade integration to foreign direct investment. "There are two separate issues here. One is, what drives foreign direct investment in Africa? While some individuals are looking to South Africa as a conduit for investment, I'm less optimistic. One of the things we discover consistently in reading the surveys of businessmen is that they are looking for areas which have political stability, currency convertibility and flexible labour markets. What does flexible labour markets mean? To be candid, it means low-wage economies and lack of unionisation. That's what they're looking for. And so the chances of large-scale foreign direct investment taking place in South Africa from multinationals are slim. Most of the capital coming into South Africa right now is like the capital going into Uganda. It's short-term money; it's basically taking advantage of rates of return. There is foreign direct investment but not a whole lot.

I know of no serious study surveying businessmen who are either actually in the market in Africa or are looking to Africa as a possible market. I would propose that this type of survey be conducted. Now it's unlike me to say, 'Hold off on the econometrics, let's go for surveys.' But in this particular area, the survey evidence could be much more persuasive.

The second area concerns regional trading arrangements. As I mentioned earlier, from my own institution's point of view there is a greater openness to this concept of regional trading arrangements, but I hasten to add, provided this is leading to liberalisation. I think the problem that you're observing right now is that countries are at very different stages of liberalisation. Uganda, for example, has an effective tariff right now of 20% which continues to decline. If the tariff comes down to 10% over the next few years, it's not going to make a big difference to Uganda whether it joins a regional trading arrangement or doesn't. It didn't even matter when it was 200%. Do you want to use regional trading arrangements in order to integrate in a better way with the rest of the world, from a stronger position? Or is it a question of self-reliance in that you want to hide behind walls because you don't want to integrate?

Let me end by saying that it's a bit difficult for me still to be optimistic about the future success of regional trading arrangements in Africa, partly because history hasn't been very good in that context. Some people really feel that South Africa will lead the way and yes, now you've got a big player that has its act together in some sense and could provide the impetus for regional integration. But one might question whether it is entirely

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in South Africa's interests to be a member of regional trading arrangements. Politically, it is of course, but from an economic standpoint, it is a worthwhile question."

Percy Mistry suggested that along with surveys, industry studies should be conducted as well in Africa. "When we were doing our African Development Bank study, we noticed that Africa is very short of industry studies and inter-industry and intra-industry linkages. People keep tossing out numbers about factor productivity efficiency based on aggregates, without any appreciation of what really is there on the ground, and much of it is hidden. There are some extremely efficient private sector firms in Africa who simply operate outside the recorded economy. We need to know far more about it. Trade economists should look at the residual linkages, stripping out what I call the Africa-with-the-world colonial economy type trade, which actually hasn't changed much in 45 years, and that's the tragedy of Africa.

Point number two. I'm a bit confused by your projections for 1996, Mohsin, on FDI. You've talked about $55 billion to developing countries. I assume that's net because the gross figures are much larger. Now if that's net and you say 33 for Asia and 17 for Latin America, that's 50, plus 3 for Africa; only leaves 2 for Eastern Europe and other regions. That can't be right. Apart from which, what worries me is, out of the 3 to Africa, 2 will go to South Africa and the rest will really be distributed between Kenya, Côte d'Ivoire, Mauritius and Zimbabwe. Here again to talk about Africa *qua* Africa, as opposed to the four or five countries, really leads to fallacies of aggregation, and one needs to be careful about that. But I'd really like a relook at that number.

The third thing is most econometricians give too much attention to prima facie numbers, and perhaps Bill falls into that problem as well, because one of the things about econometrics is you're desperate for a data series that makes some sense, even if in reality it conveys nothing. In Africa, outside of SACU, stated tariffs mean nothing. Because most of the cross-border trade that actually occurs on both exports and imports is through negotiated tariffs at the border. Looking at nominal tariffs and making a whole series of postulations based on nominal tariffs for Africa is very misleading.

Also, Africa suffers from something that no other developing country or region suffers from and that is both tariff exemptions and massive trade distortions caused by tied aid imports. This has been particularly high during the import-support period. Again, if you're going to do econometric analysis, you obscure a lot when you don't take those distortions into account. The southern African region, excluding SACU, is a major victim of this because for Zambia and Mozambique, foreign aid accounts for such

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a huge volume of import financing that you really can't make much sense out of it unless you actually analyse the distortions that take place.

With regard to FDI, the Cross-Border Initiative and privatisation, I think Mohsin has pointed to one very important feature, which is actually characteristic only to Asia and nowhere else. The Japanese, Koreans and overseas Chinese have very powerful herd instincts and competitive instincts. If they see family member X investing somewhere, they're there right after him. In fact one even sees it in Mauritius, which leads to an over-investment in things like knitted gloves, of which Mauritius now provides 97% of the world's supply. But that is not true of European and American investors and it is certainly not true of Indian investors. It is not even true of South African investors, although there's a South African predilection for things like breweries, mining companies, food processing companies, hotels and those kinds of related investments.

I think there will be cascade effects. I actually agree with Louis Kasekende that there will be a lot of volume FDI coming into South Africa, not just repatriated South African capital, but also companies that exited South Africa in sanctions, which are going to rebuild their market base. I mean basically it's an asset swap in the sense that it's not new FDI – it's new incoming investment taking over assets which already exist with a cash swap. Second, India has a very important economy for Africa, especially the Eastern and Southern seaboard is much more liberal than it ever used to be. Third, I think African approaches to Indian investment, or sub-continental investment, are changing as one sees in Uganda. And there is some of that repatriation, not only of the Ugandan and Kenyan and Tanzanian Asians, but Indians from India now wanting to invest in these countries. And you're beginning to see Mauritius become an entrepole for that.

One also has to look at two other kinds of behaviour as far as FDI is concerned, which is the FDI-related enclave investments in minerals and plantations, and FDI-related privatisations where Africa has really shot itself in the foot. Africa could have competed much more for FDI, particularly from Asia, if it had privatised faster, particularly in utilities."

Jeffrey Fine, formerly with the International Development Research Center in Canada, brought up the issue of debt overhang in relation to foreign investment behaviour. "One question is rather critical in terms of the foreign investment behaviour and that is the whole issue of debt overhang, which I think requires a lot of work. Because clearly it means that depending on who is driving public policy, to what extent the policy is actually going to remain credible in the long-term and of course whether you can repatriate; a number of issues rest on the overhang issue and the flow of investment.

The second key issue which Percy mentioned is privatisation. It certain-

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ly is a key issue for South Africa at the moment, particularly with regard to public utilities and the telecommunications field. This is a domestic policy issue, but a lot of future investment flows will hinge on it. I also think that it is driving a lot of South African investment in certain sectors into the rest of the region.

A third issue has to do with resource-based commodity production in Africa. Percy says that Africa needs to get out of this type of production and look at the residuals, but the fact is that growth is going to be based on resources, renewable and non-renewable. Another issue in this context is the whole question of transaction costs of this type of trade. With the revolution that is occurring in informatics and telecommunications, the marketing chain is collapsing. I can sit with my Internet in Canada and pick off a trade base which is literally a huge database that will tell me by sector, by country, by manufacturer, the particular business opportunities. I sit and I say, 'Well if I'm in Africa, where's my opportunity?' The transactions costs of doing trade in what are relatively small markets is extremely high. So I raise that as an issue on the regional integration front in terms of what's driving it, at what we might call a micro level or technology level.

My last point is what I would call the opportunity cost of international trade agreements. Countries in this region have very limited expertise and capacity to negotiate international agreements. That's a fact. Trade law and knowledge of the country takes a long time to cultivate. Certainly this is the case when you go into something like a NAFTA. This is an enormous investment of very skilled time and personnel. So I ask from a point of view of countries that are sitting in this region and even South Africa, given this high opportunity cost, where do you put your first eleven in terms of negotiation and the work of time? Do you put it into negotiating a *regional* agreement which has very limited value and is quite problematic? Do you put it on international agreements, where you see major markets? Or do you put it also on bilateral agreements within the region with countries that want to negotiate with you, say Zimbabwe in the case of South Africa?"

Uka Ezenwe from the Department of Economics at Ahmadu Bello University suggested that it was not the politicians who are involved in the integration of trade, but market men and women. "Once they find economic opportunities, they will exploit it, whether or not you have integration. You have to ensure that they have proper exchange rates, that the tariff system is right, the political environment is good and that people can move about. It's not whether people are willing to buy. People are willing to buy if they find they are going to make profit at the end of the day. In fact, most of the time, particularly in that massive region, the most active operators are women in most of the countries of the sub-region. They buy

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all sorts of things from one country to another to sell. The problem is not political economy or political differences between individual countries. Peasants are definitely not interested in politics, they are interested in survival, and integration is for them and should be made to serve their purpose.

The other thing that attracted my attention was the point made on the issue of providing incentives. I am not as optimistic as you are about the importance of incentives. Other factors such as political considerations, the nature of labour markets and so on play a more important role I think. Investments don't come because there's a tax holiday. If they are not sure of political stability, they are not sure they will repatriate their profits. I think those are more important than these incentives you are talking about.

The last point concerns privatisation. What are the limits of privatisation? In some African countries, corrupt politicians and businessmen have bought up public assets at very low prices and they have been encouraged to do so. Also, some countries are selling their basic industries to foreigners. A glaring case is the Ashanti Gold Mine. I'm not providing any answers, but I think the question is an important one. If you're selling all your basic industries to foreigners because you have a foreign exchange problem today, tomorrow that foreign exchange problem will reappear when they start repatriating their profits."

Sam Tulya-Muhika, the director of an Ugandan consultants firm, thought that the paper over-focused on FDIs. "I know this is a new fad, that if you don't get private sector inflows, the economy is not going to grow fast enough. This is probably true, but I think there are other impediments that are detrimental to market integration in Africa, especially the compensation mechanisms.

The paper does not say enough about the importance of trade information. This is one of the major problems in Africa. Most traders in the COMESA do not know what opportunities exist for trade. There's no COMESA information centre in Kampala that provides such crucial information."

Samuel Wangwe, the Executive Director of the Economic and Social Research Foundation in Tanzania, returned the discussion to the issue of resource-based trade raised earlier by Percy Mistry. "Three years ago we did a study for a book which has just come out on African exports looking at industrialisation, technology and industry. In that study we looked at the manufacturing firms which were exporting or had just been pushed out of the export market in order to understand what is it that determines the capability to remain in the world market. We looked at fifty-five firms in six countries: Zimbabwe, Mauritius, Tanzania, Kenya, Nigeria and Côte

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d'Ivoire. I would like to highlight four quick points from that study which are relevant to this discussion.

One, the firms which were competitive had links with the outside world through foreign investment arrangements, market arrangements or by production arrangements in order to keep informed about technological advances and to undertake the same. FDI can have a positive bearing in terms of international competitiveness.

The second point from the study concerns which factors were important to investors. Three factors came out as most important: political stability, the policy climate and the infrastructure – including skills as well as telephones and electricity.

A third point has to do with regional trade in products which appeared to be regional specific for quite a while, like African prints for instance. With liberalisation, the regular markets were being lost to Asian manufacturers which were more dynamic. African prints, Kangas, are now being produced by Asian firms, and some of the African firms were being phased out of production completely. Within regional integration arrangements, if competitiveness is not assured, sooner or later the markets within the region may be lost to the more dynamic producers.

A final point from the study on African exports is that in a number of places, the competitiveness of the firms was not based on the cost level or price they charged, but on the appropriateness of the product to the peculiarities in the region – especially those which are sensitive to the kind of climate and soils we have. For these products, such as agricultural equipment, their competitiveness continues to be assured, even if the prices charged were higher."

Colin McCarthy, from the University of Stellenbosch, expressed concern about the future configuration of the labour market in South Africa. "I think it's still very anecdotal, but there are now signs of a different reason for South African foreign direct investment in the region and that relates to what Mohsin referred to earlier, namely flexibility of labour markets as a determinant of investment. A recent case has been the closure by Pepkor of their clothing plant in Butterworth, relocating it to Malawi. The reason being given is the perception of an inflexible labour market in South Africa.

In view of this, and if this should become a significant factor in investment flows in the region, one can expect that the South African Trade Union Movement will become a major player in the debate and in negotiations and discussions on regional integration. One doesn't need to have a very good crystal ball to forecast that the South African labour market will be the space to watch in the future, not only because of these capital flows at the cost of employment creation in South Africa, but also because

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of the growing inflow of migrants from the region into the South African economy which will tremendously complicate labour affairs in South Africa."

Dan Ndela, from Zimconsult, noted that South Africa has not been a participant in SADC and questioned whether a hub should be created around South Africa. "We've been talking about regional integration. SACU countries have been in a delegation which excluded South Africa, and South Africa is currently raising tariffs. The challenge is how do we create a hub around South Africa when in fact the hub is outside regional integration arrangement." Ndela also questioned the motives behind South African investment in the region. "Are they investing in the region to escape from unionised labour and inflexible labour conditions, or are they going there to exploit regional integration? These are issues we should be looking at."

Sam Asante, from the UN Economic Commission for Africa, warned of the potential deleterious effects of foreign direct investment on integration. "We are concerned about attracting FDI, whether at a national level or at a sub-regional level, and we do so without considering its effects on regional integration. In 1981 the ECA conducted a survey of UDEAC to determine whether the member states of that organisation had derived benefit from the large market which UDEAC had brought. We found that the benefits were actually going to foreign investors, transnational corporations, to the detriment of the member states of UDEAC. Why are we anxious to attract FDI when the benefits are scarce?"

Gene Tidrick from the World Bank elaborated on the issue of South African investment in the region. "I think South Africa is itself a major player in investment in Africa. South African companies see themselves as having a comparative advantage because they know how to do business in Africa. Rightly or wrongly, that is the way they perceive themselves. And so you see South African banks moving into the neighbouring countries and feeling very comfortable with competing with banks from Portugal in Mozambique.

Still, there's no doubt that a lot of South African investment would be motivated by lower labour costs for exporting back into South Africa; it has happened in Malawi. Moreover, if there were regional integration within SADC, no doubt you would get foreign investment attracted to the region, not so much to invest in South Africa or export to other SADC countries, but to invest in low-wage countries for export to the South African market. Because foreign investors also see South Africans as having a comparative advantage in dealing with the local situation in Africa generally; a lot of this investment would probably be of a joint venture sort if it is directed to a regional market. Foreign investors typically want to hook up with a local

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firm because they know the country's circumstances.

On an entirely different note, however, I would like to mention that Lesotho has recently been very successful in attracting foreign investment, Taiwanese investment in particular, for export of garments to outside the region. This is essentially a quota-shopping investment. Taiwanese firms who are facing quotas but have market links, can shift production to Lesotho. The attraction is twofold. One is relatively low labour cost in Lesotho – about a third to a half of South African levels – but the policy framework and the credibility derived from being part of the monetary area in South Africa also plays a role. It is a stable policy environment with relatively low wages."

Elty Links, from the South African Department of Finance, brought up the issue of establishing the borders of a region. "What determines the borders of a region that wants to integrate? This is a legitimate question, and it is the same problem that we have everywhere, including Europe, of historical borders being drawn for whatever reasons and then becoming impractical. It seems that our discussion on trade and FDI has led to the conclusion that there is no need to have such defined borders. Trade and FDI go wherever they want and the private sector is not being driven by the fact that we're SADC countries or COMESA countries. We should be concentrating on the question of the investment environment and the enabling environment that we want to create within a region. Financial policies, for instance, among countries must be such as to make it more conducive for investors to come in."

Response by William Lyakurwa

"On the physical complications of tariff reductions, I have examined this particular issue and the conclusions reached from the various country studies on the physical impact of trade policy reforms seem to indicate that it's not really a major issue. Some of the countries have liberalised far more than the regional integration schedules require and the tariffs are no longer binding, even within regional trading arrangements. So it wouldn't really be a big problem in terms of the physical impact. I accept the issue raised with regard to non-tariff barriers. It's an important issue in terms of explaining trade flows. They are not necessarily tariff binding, but non-tariff barriers play a significant role in terms of inhibiting trade flows.

The next issue I want raise is in response to Percy's suggestion of conducting an industrial survey. It might be an extremely difficult task both in terms of the logistics as well as the financial costs. Survey studies will definitely complement the results of economic estimations, but given the costs, I'm not quite sure it is worth the effort.

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In relation to the point raised by Mohsin, the discussion here as far as regional integration is concerned is not a movement towards self-reliance. It is more a movement towards the globalisation of the market. There are merits and demerits associated with moving from regional integration towards globalisation, and measures would need to be taken both at the national and at the regional level to mitigate any factors that will counter this move.

With regard to the point raised on debt overhang, I brought up this particular issue in relation to what role direct foreign investment could play in reducing the debt burden in two ways. One is making foreign exchange available, which would contribute to economic growth and reduce the debt overhang. Second, private sector participation in the national economies will reduce the dependency of governments on both the multilateral and bilateral donor agencies.

I raise the issue of privatisation mainly in relation to what national states can do in terms of their own *national* economic strategies, but they should still try and bring these more in line in terms of harmonisation of policies and strategies at the regional level so that it includes a regional dimension which supports regional objectives. The issue here is, to what extent national policy could be harmonised within regional objectives so that there is compatibility in terms of the privatisation, particularly in relation to strategic points like utilities and security.

On the impact of trade liberalisation on regional integration, national economic policy and growth, there is a significant amount of work that has already been done, particularly from networks relating trade liberalisation to regional integration and national economic policy-making. I didn't think it was necessary for me to summarise the findings of these studies but I may have to bring in a paragraph linking trade liberalisation and regional economic integration."