Save the Children UK:
Southern Africa scenario planning paper

SOUTHERN AFRICA REGIONAL ECONOMIC OVERVIEW

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Introduction to Southern African Regional Economic Overview

In line with the terms of reference, this paper is not an orthodox situation analysis, but provides instead both an impressionistic and predictive analysis on the main economic factors affecting children's security and well being in the region. Thus it is not just a narrative of the issues now, but an interpretation of the most important changes which could occur in southern Africa over the next 4 years.

It does not outline the impact of each set of economic issues on children's welfare, as the impact of each concern is accumulative in terms of its impact on the wider economy. The point at which economic outcomes impact on the lives of children is the point at which economics meets politics. The critical factor here is the constraint which economic performance places on political choices. This analysis outlines the key economic processes which will set the limits of political choice in the region over the next four years, and highlights the main economic challenges which Save the Children's regional programme will need to consider.

1. Executive Summary

In aggregate the southern Africa region has experienced slow growth over the last decade, with declining levels of GDP per capita. While inflation and fiscal deficits have been successfully reduced in recent years as a result of the neo-liberal macroeconomic stance adopted by governments across much of the region, the resultant fall in government spending, together with increased exposure to international competition has had negative growth effects. Only Angola, Mozambique, Botswana and Mauritius are showing sustained growth rates which are likely to be maintained throughout the next half decade, while Zimbabwe and DR Congo are experiencing seriously deteriorating negative growth rates.

It is unlikely that most countries in the region will meet the 6% growth levels required to achieve the reduction of poverty by half by 2015, and while government spending on education and health as a percentage of GDP has increased marginally in most countries over the last decade, with the notable exception of Zambia, actual spending levels remain extremely low, with seven of the eleven countries for whom there is data spending significantly less than the WHO recommended $60 annual per capita on health spending, with Malawi, Mozambique and Zambia allocating $5, $4 and $9 respectively. Under five malnutrition rates have increased in the majority of countries in the region over the last decade, with a regional country average rate of 22%.

Increased regional integration through the SADC Free Trade Area is unlikely to offer significant benefits to the wider area, and will consolidate South Africa's regional economic dominance, while the customs revenue loss implications of increased regional economic integration are serious for many countries in the region, for whom customs revenue is a major source of state funding. The SA-EU Agreement is likely to have modest spill over benefits within the region and the African Growth and Opportunities Act offers some additional market opportunities to the region, but continued OECD trade protectionism renders any significant increase in exports to the north unlikely. South Africa is likely to continue as a major source of investment within the region, but this investment is primarily oriented to natural resource extraction, or market penetration, rather than productive investment.

Peace in Angola, and to a lesser extent DR Congo, would offer a significant stimulus to the regional economy but while Zimbabwe remains unstable international investor confidence in the region will remain low, and there are unlikely to be major increases in foreign investment flows, particularly given the current global recession. The muted international response to the NEPAD also implies that increases in aid, trade and debt concessions to the region are not to be anticipated.

Economic prospects for the region as a whole are not positive, and despite some increases in industrialisation and trade diversification, the region remains heavily dependent on primary commodity exports, whose terms of trade continue to fall. This situation is compounded by the impact of AIDS, which is reducing per capita growth by between 0.5-1.2%.

2. The State of the Regional Economy

Before examining future prospects for the southern African economy a sketch of the current economic situation in the region is outlined, examining regional economic trends, macro-economic policy, trade, aid, GDP growth and government spending patterns.

2.1 Southern Africa Regional Economic Trends

For the last decade economic growth in the southern African region has been positive, see table 1, however this aggregate figure conceals a considerable variation in performance across the region, with some countries such as Angola, Malawi and Mozambique experiencing significant levels of growth, with others such as the DR Congo, South Africa, and latterly Zimbabwe experiencing sluggish or negative growth. GDP per capita has decreased throughout the region over the last decade, and southern Africa still lags behind other regions in Africa. The region's GDP growth remains far below the target of 6% defined in the New Partnership for Africa's Development (NEPAD) as a minimum requirement for sustained economic development, and the reduction of poverty by half by 2015 in line with the international development goals.

Table 1: Macroeconomic Trends

Indicator	1990	1995	2000
Real GDP Growth Rate (%)	0.6	3.2	2.6
GDP per capita (US$)	1640	1801	1464
Inflation (%)	33.9	70.7	23.0
Fiscal Balance (% of GDP)	-4.4	-5.7	-2.6

Source: African Development Report 2001, quoted in Pillay 2002

The economic prospects for the region in the coming half decade are poor, as there are no reasons to anticipate a positive change in the current negative economic trends given the negative global economic environment and the lack of international response to the NEPAD proposals.

Summary

- GDP per capita has decreased throughout the region over the last decade
- The economic prospects for the region in the coming half decade are poor

2.2 Macro-Economic Policy

The BLNS countries (Botswana, Lesotho, Namibia and Swaziland) South Africa, along with Zambia, Malawi, Mozambique and Angola continue to adopt macro-economic policy measures broadly in line with the neo-liberal reforms instituted under structural adjustment packages promoted by the World Bank and IMF, with the objective of stimulating economic growth and attracting external investment to the region, although with varying degrees of commitment and varied economic impact. South Africa, the regional hegemon, has worked to promote the adoption

of this macro-economic agenda throughout the region, and also to the African continent more widely through the policy prescriptions of the NEPAD, despite the dismal and contractionary impact this policy has had on the South African economy, and the associated rise in unemployment and poverty. A degree of macroeconomic convergence is occurring within the BLNS countries, due to the de facto control of SACU economic policy by the South African Reserve Bank and the extension of the South African macroeconomic policy agenda in the BLNS countries. The Zimbabwean policy environment remains unstable.

Positive outcomes of the regional neo-liberal economic stance have been a general reduction of fiscal deficits throughout the region, and a significant curbing of inflation since 1995 in South Africa and the BLNS countries and also in Zambia and most spectacularly Mozambique, although levels remain high in Angola, DR Congo, Malawi and are rising in Zimbabwe. The current regional food deficit and the high costs of food and fuel imports are likely to increase inflationary pressures throughout the region and have a negative impact on the balance of payments, particularly in Mozambique where agricultural production was significantly adversely affected by the floods of 2000 and 2001, and Zimbabwe, where the fuel and food scarcity is exacerbated by the severe shortage of foreign currency.

However, despite macroeconomic advances in inflation control and fiscal deficit reductions, trade balances were negative for all countries except Angola, the DR Congo, Malawi and Zimbabwe in 2000 (from 2001 onwards the Zimbabwean trade balance is expected to shift into deficit), and the anticipated positive foreign direct investment (FDI) and growth outcomes of the various liberalisation and macroeconomic austerity programmes of the last five years has been negligible.

It is questionable whether the benefits from sound macroeconomic fundamentals are commensurate with the sacrifices arising from the resultant stifling of domestic demand, reduced government expenditure particularly in the social sector, de-industrialisation (due to reduced industrial protection), and reduced state support for small producers, which has led to significant increases in formal sector unemployment throughout the region, and increases in poverty and inequality in many countries. The potential benefit of improved macroeconomic fundamentals (low inflation and a low fiscal deficit) and a liberalised trade regime would accrue largely from increased policy credibility and hence increased investment flows, but in many instances this been undermined by the deterrent influence of continued low domestic demand (arising from limited state expenditure and increased unemployment), and poor governance which acts as a negative contagion throughout the region.

Summary

- Macroeconomic goals of reduced inflation and reduced current account deficits have broadly been achieved in the BLNS countries
- Negative consequences of macroeconomic reform and the removal of domestic protection are deindustrialisation and reduced formal sector employment
- Reduced domestic demand is contributing to slowing national economic growth

- Poor governance continues to be a negative contagion throughout the region undermining potential gains from macroeconomic austerity

2.3 Trade

The region remains heavily trade dependent, with exports accounting for over 60% of GDP, compared to a range of 8-28% in the rest of the world, and highly dependent on commodity exports. Southern Africa (excluding South Africa) is a very small player in the global economy, accounting for only 0.3% of world exports. Its highest export shares are in primary products (1.7% of total world exports), and energy and mining (1.5%), while South Africa accounts for 0.8% of total exports with its highest export shares in energy and mining (2.7%) and primary products (1.3%). In general South Africa has a larger share of total exports than the rest of southern Africa. Manufacturing in the region is still largely dependent on the performance of the mining and agricultural sectors as well as the size of investment inflows into the region, which have remained low.

One factor underlying the failure of the region to diversify its exports is that manufacturing as a share of GDP has declined considerably in the region, except in Mauritius. The fall in domestic demand emanating from the decline in government spending, which in some countries is a major domestic consumer, and the partial liberalisation of trade carried out to date, in particular the lifting of import controls which subjected domestic industry to external competition are the key causes of this decline in manufacturing output. Previously protected regional industries have not succeeded in competing effectively in a liberalised market, resulting in falling manufacturing outputs and employment in the sector, due to the low competitiveness of domestic producers.

Consequently little significant trade diversification has occurred during the last decade, in terms of the development of non-traditional or manufactured exports, leaving the region reliant on continued commodity exports for which terms of trade have continued to deteriorate significantly. Africa has lost market share to other regions, significantly reducing the region's foreign exchange earning capacity, and maintaining its vulnerability to global commodity price fluctuations. In the case of Zambia this commodity dependency has proved disastrous, with the collapse of the copper price in 2002 rendering its copper industry non-viable in the international market place. Revenue fluctuations arising from vulnerability to global commodity prices continue to undermine prospects for good economic governance throughout the region.

During the latter half of the 90s only Angola and Mozambique experienced significant average export growth, with the rest of the region showing negative growth in both exports and imports. In 2000 all countries except Angola, the DR Congo, Malawi and Zimbabwe maintained negative trade balances.

In the long term, sustained economic growth prospects are dependent on rejuvenating the manufacturing sector through deliberate policy interventions with emphasis on the diversification of export products. Investment in new plant and machinery, labour skills and infrastructure is

required. However, with the possible exception of Angola which has access to substantial oil revenue, diversification of the manufacturing sector is largely contingent on both considerable external investment, which is not currently forthcoming, and concessions permitting significant protection for fledgling industry. World Bank unwillingness to tolerate short-term protection in the context of the post-conflict redevelopment of the Mozambican cashew processing industry during the late 1990s led to the collapse of the industry, and the reversion of trade to the export of unprocessed cashews, rather than value-added commodities. This does not bode well for the trade diversification aspirations of the southern African region.

Summary

- Trade balances are predominantly negative
- There is still a high dependence on mining and agricultural commodity exports
- Little significant trade diversification has taken place
- Terms of trade for commodity exports from the region have continued to deteriorate
- Significant export growth is limited to Angola and Mozambique
- Trade diversification is contingent on FDI and WTO/Bretton Woods acceptance of interim protection measures for industry

2.4 Aid

Aid to Africa has decreased by 43% over the last decade, and residual aid flows focus increasingly on humanitarian, conflict resolution and structural adjustment initiatives, reducing funding available for conventional development. Accordingly aid as a percentage of gross domestic investment has decreased significantly across the region in the second half of the last decade, particularly in the post-conflict countries of Mozambique and Angola, although despite this decrease countries such as Lesotho, Malawi and Zambia remain highly dependent on concessional aid flows. Zambia reduced its aid dependence significantly in the late 90s, but still remains highly dependent on aid which comprises more than 40% of total government revenue, while in Malawi aid accounts for more than 30% of total revenue, and in Lesotho 10%.

NEPAD calculated that aid/investment flows of $35 billion a year would be required to rejuvenate the Sub Saharan African regional economy onto a sustainable growth path wherein the international development goal growth target of 6% would be met. Given the secular downward trend of aid over the last decade, and the negative response of the G8 to the NEPAD proposal in June 2002, it is unlikely that the downward trend of aid to Africa will be reversed in the coming years. While vertical interventions against specific issues such as HIV or Malaria may attract additional funding, it is unlikely that there will be significant additional aid flows for social or infrastructural development. The addition of only US$1billion to the HIPC fund by the G8 in response to the NEPAD proposal for an extended debt relief programme also indicates that increased resource flows to the region are not a G8 priority.

- Aid flows to Africa are likely to decrease further over the coming decade
- Substantial additional debt relief is not likely in the near future.

2.5 GDP Growth

The countries with the lowest levels of per capita GDP in the region are DR Congo, Malawi, Mozambique and Zambia (shaded in table 2 below).

Table 2: Basic Economic Data by Country

SADC Members	Population (millions) 2001*	GDP US$ Billions 1998**	GDP/ capita (PPP, US$) 1998**	Average Annual Real Growth Rate % p/a***		
				1990-94	1995-99	2000
Angola	10.4	7.5	1,821	-5.9	6.8	4.9
Botswana	1.6	4.9	6,103	4.6	4.8	6.0
Congo, DR	53.6	7.0	822	-8.6	0.9	-15.0
Lesotho	2.2	0.8	1,626	4.4	3.9	2.5
Malawi	10.5	1.7	523	1.0	7.3	3.0
Mauritius	1.2	4.2	8,312	5.4	5.2	7.5
Mozambique	19.4	3.9	782	2.6	8.7	3.8
Namibia	1.8	3.1	5,176	4.3	2.8	4.0
South Africa	43.6	133.5	8,488	0.2	2.3	3.0
Swaziland	1.1	1.2	3,816	3.8	2.9	2.4
Zambia	9.8	3.4	719	0.2	1.3	4.0
Zimbabwe	11.4	6.3	2,669	2.1	3.1	-6.1
SADC Average				1.5	4.0	2.8

Sources: * Robertson 2002, (from CIA World Factbook)
** UNDP Human Development Report 2000
*** Lewis 2001 (from World Development Indicators and World Bank staff estimates)

During the late 90s only Angola, Malawi, Mauritius and Mozambique attained the 5% growth floor estimated as a prerequisite to prevent an increase in the number of their citizens living in poverty, while the other countries in the region fell below this floor, see shading in table 2. Angola, Malawi and Mozambique also reached the 6% growth target estimated as the condition for reducing poverty by half by 2015, although Angola and Mozambique, along with Malawi, DR Congo, and Zambia fall into the low Human Development Index category, indicating that their growth in GDP is not being translated into improvements in the lives of the poor.

Despite Mozambique's strong aggregate growth performance Mozambican poverty data are not showing a commensurate reduction in poverty levels in the country, indicating that the benefits of aggregate growth are not being shared equitably among the population, reinforcing the concern that economic growth does not necessarily mean improvements for the poor, without state policy intervention.

Slower growth rates during 2000 and 2001 however indicate that the secular downward trend in the price of commodities, the declining world market share of African commodity exports, the

reduction in global trade and capital flows, and the diversion of investment away from developing country economies resulting from the events of September 11th and the associated global recession, all combine to suggest that the slowdown of the southern African regional economy will continue throughout the next four years.

Growth rates for 2000 indicate that within the region only Botswana and Mauritius may be able to sustain GDP growth above the 6% target in the near future. All other countries are currently facing low growth scenarios, indicating a continuing fall in GDP per capita, with the SADC average for 2000 falling to 2.8% GDP growth, while in the same year DR Congo and Zimbabwe experienced severe growth reductions, of –15.0 and -6.1% respectively. The spectacular collapse of GDP in the Zimbabwe economy in 2000 is likely to accelerate in 2001 and 2002, causing a negative contagion in the regional economy, deterring potential FDI and aid flows and undermining regional policy credibility, thereby undermining the potential international investment benefits countries such as South Africa were hoping to gain from their austere macroeconomic policy stance, assumed at a considerable cost in terms of reduced public expenditure and the constraint of domestic demand.

2.6 Government Spending Trends in Southern Africa

In addition to the gross resource base available to governments the critical question is how national revenue is distributed, and the outcomes of government expenditure in terms of key indicators such as literacy and nutrition. Summary data on allocation trends in the region over the last decade is presented in table 3 and briefly discussed below.

Table 3: Selected government spending in southern Africa by country

	Public expenditure on education as % of GDP		**Public expenditure on health as % of GDP**		**Actual health spending per capita 1998 (US$)**	**Military expenditure as % of GDP**	
	1990	**1995-7**	**1990**	**1995-7**		**1990**	**1998**
Angola	4.9	-	1.4	-	-	5.8	14.9
Botswana	6.9	8.6	1.3	2.7	97	3.9	3.5
Congo, DR	-	-	-	1.2	2	-	-
Lesotho	3.7	8.4	2.6	3.7	18	4.1	3.2
Malawi	3.4	5.4	-	2.8	5	1.3	0.8
Mauritius	3.6	4.6	-	1.9	77	0.3	0.2
Mozambique	4.1	-	2.1	2.1	4	10.1	4.2
Namibia	7.5	9.1	3.8	3.8	81	-	2.6
South Africa	6.5	8	3.1	3.2	125	4.0	1.6
Swaziland	5.5	5.7	1.9	2.5	35	1.6	-
Zambia	2.6	2.2	2.6	2.3	9	3.7	1.8
Zimbabwe	8.0	7.1	3.1	4.5	22	4.5	2.6

Source: Saunders and Meus 2002 (from UNDP Human Development Report 2000)

Social sector spending as a percentage of GDP has experienced stagnation or only modest growth in the region during the 1990s, partly due to the fiscal limitations included within the structural adjustment conditionality. State spending on education has seen modest growth in all countries

between 1990 and 1995-7, where data is available, with the exception of Zambia and Zimbabwe which have experienced declines (see shaded cells). While the region has experienced an overall increase in education spending, this has not yet compensated for the falls in spending during the 1980s in many countries. Health sector spending has been stagnant or experienced only modest increases in all countries with the exception of Zambia, where spending declined in line with the reduction in education spending. When translated into actual per capita health expenditure, seven of the countries (shaded in the table above) are spending significantly less than the $60 identified by the WHO as the requirement for the provision of a reasonable minimum service, with the health sector being most acutely under-resourced in DR Congo, Malawi, Mozambique and Zambia. This indicates an ongoing crisis in health sector provision in the region.

In terms of outcomes of government expenditure in the region, where data are available they indicate that trends in adult literacy, sanitation access and water access were generally positive across the region between 1990 and 2000. However, under five child malnutrition rates only decreased in Mozambique during this period, while they remained constant in Lesotho and Zambia, and increased in Zimbabwe, Angola and Malawi, where the under five malnutrition rate was 30% in 2000. The regional average for countries offering data in 2000 was 22%, indicating a severe and deteriorating regional nutrition problem existed even before the 2002 food deficit crisis, which has significantly worsened the situation.

Data indicate that all countries for which data is available, except Angola, experienced a reduction in military expenditure as a percentage of GDP between 1990 and 2000. The ending of the conflict in Angola should offer a significant peace dividend, as petrol and diamond export revenues previously used for military expenditure become available for alternative sectoral usage.

3. Regional Economic Integration and Benefits for the Region

What will be the most likely developments in terms of regional economic integration (SADC/SACU). Will the RSA/EU trade accord bring benefits to the wider region?.

3.1 Regional Trade and South African Economic Dominance

Levels of national trade liberalisation vary significantly across the region, with Zambia Mozambique, Malawi and SACU representing significantly reformed trade regimes, while Zimbabwe and South Africa (despite the simplification of its tariff structures), still have barriers significantly higher than those of the “reformer” group. Despite these varying levels of liberalisation, South Africa maintains a profound trade dominance in the region. The dominance of South Africa within the regional economy is illustrated by table 4, which indicates that while the South Africa share in total world exports is 0.8%, that of the rest of the region totals only 0.3%. The combined southern Africa share of world exports totals only 1.1%, with the strongest showing in the energy and mining sector, which represents a 4.2% share of global markets. This table confirms the relative insignificance of the region in the global economy, and underscores the limited negotiating power of the region as a bloc, even when acting in concert as SADC.

Table 4: Disaggregated Southern African World Trade Shares

	South Africa	Rest of southern Africa	Total southern African share
Shares in World Exports			
Primary Products	1.3	1.7	3
Energy and Mining	2.7	1.5	4.2
Food Processing	1	0.6	1.6
Textiles and Apparel	0.3	0.5	0.8
Other Manufacturing	0.7	0.1	0.8
Services	0.8	0.3	1.1
Total	0.8	0.3	1.1
Shares in World Imports			
Primary Products	0.6	0.3	0.9
Energy and Mining	1.1	0.1	1.2
Food Processing	0.9	0.6	1.5
Textiles and Apparel	0.5	0.3	0.8
Other Manufacturing	1	0.3	1.3
Services	0.8	0.3	1.1
Total	0.9	0.3	1.2

Source: Lewis 2001

3.2 The nature of Southern African trade

Table 5 illustrates the significant ongoing dependence of the southern Africa region on commodity exports. Together energy, minerals and primary products account for 47% of total regional exports (excluding South Africa), highlighting the continued non-diversification and low value added of most regional economic activity, and also the ongoing vulnerability of the region to global commodity price fluctuations.

Table 5: Total exports from southern Africa excluding South Africa

	Percentage of Total Exports
Energy and minerals	30
Primary products	17
Services	16
Textiles and apparel	11
Capital goods	3

Derived from Lewis 2001

Hence the region is subject to two ongoing sets of trade power inequalities, both of which are growing increasingly entrenched; the one in terms of the relationship between South Africa and the "rest of the region" which South Africa is currently exploiting to its own advantage, and the other in terms of the region's relationship to the global economy, in which the region has very little leverage or autonomy, given the pressure of the major donors for ongoing trade liberalisation. In the first

scenario South Africa has all the power, and in the latter, the rest of the world has all the power; the region's scope for negotiation in the global trade arena is extremely limited.

3.3 Regional FDI Attractiveness

The current shrinkage of domestic demand arising from increased trade openness, contractionary fiscal policy, and low growth makes it likely that the region will continue to be considered an unattractive investment destination. While SADC represents a market of 199 million consumers, it is a market with highly constrained demand, (with the possible exception of Angola, with the latent consumer demand arising from decades of conflict) and hence not attractive for foreign direct investment, given the other negative factors associated with the region including conflict, and both policy and political instability.

Hence in terms of the objective of increasing market power and southern African voice in global trade negotiations, or attracting FDI, SADC may in fact have little to offer the region.

3.4 Multiplicity of Regional Trading Initiatives

The region is subject to a multiplicity of cross cutting and contradictory trading initiatives, with four multilateral economic cooperation schemes operating, and a proliferation of bilateral trade/integration initiatives, which are summarised in table 6.

There are tensions between these various instruments, with inconsistencies between the SA-EU agreement and the pre-existing SADC and SACU initiatives calling into question the viability of the former. Managing such a proliferation of trade initiatives is costly and the attempt to harmonise them within SADC demands considerable human and financial resources. The degree of compliance within each agreement is also varied, with COMESA compliance remaining partial even five years after the final completion deadline.

Table 6: Trade Agreements Impacting on southern Africa

SADC Member Country	Ratified SADC Trade Protocol	SACU	COMESA	AGOA	RIFF (succeeds the Cross Border Initiative)	COTONOU	OTHER
Angola			*			*	
Botswana	Y	*		*		*	
Congo, DR						*	ECCAS, CEPGIL
Lesotho	Y	*		*		*	
Malawi	Y		*	*	*	*	South Africa
Mauritius	Y		*	*	*	*	
Mozambique	Y			*		*	
Namibia		*	*	*	*	*	
Seychelles			*	*	*	*	
South Africa	Y	*		*		EU-SA	Malawi, Zimbabwe
Swaziland	Y	*	*	*	*	*	
Tanzania	Y			*	*	*	
Zambia	Y		*	*	*	*	
Zimbabwe	Y		*		*	*	South Africa

SADC: Southern African Development Community
SACU: Southern African Customs Union
COMESA: Common Market of Eastern and Southern Africa
AGOA: African Growth and Opportunities Act (with US)
RIFF: Regional Integration Facilitation Forum
Cotonou: EU ACP Agreement
Derived from Robertson 2002

3.5 Benefits of Regional Economic Integration in a Context of Unequal Regional Development

In the light of the complexity of the regional trading environment, the critical question is the net effect of these agreements on the economic performance of participating economies.

The SADC trade protocol makes a commitment to "regional efficient production in accordance with existing and dynamic comparative advantage". Unfortunately this may not translate into jobs or economic growth in less developed countries if the real costs and benefits of regional integration are considered.

Experience has consistently shown an inequality in the distribution of integration benefits between countries of unequal size and levels of development. South Africa overwhelmingly dominates the region in terms of the size of its economy and level of development, and it is likely that this regional inequality will lead to divergence through a process of polarised development in favour of South Africa at the cost of smaller and less developed countries.

The fundamentally polarising impact of trade integration in the southern African region was identified as an outcome of SACU in 1969 in terms of the agreement's trade diversion rather than trade creation impact (to the benefit of South Africa), the implicit protection of industries in South Africa, the provision of preferential access to BLNS markets for South Africa, the loss of fiscal discretion in BLNS countries, and the industrial polarisation resulting from the tendency of industries to locate in South Africa.

To counter the skewness in the distribution of the benefits under SACU a system of compensatory fiscal transfers from South Africa to the BLNS countries was developed, based on the division of shared revenue pool generated by a common external tariff to compensate for the unequal distribution of benefits under the free trade area. The resulting compensatory SACU revenue earnings have become key revenue sources for the BLNS countries, and their loss under the SADC implementation in 2005 will cause serious fiscal deficits.

3.6 SADC Free Trade Area

Officially SADC states that substantial growth in intra-regional trade is expected as a result of the implementation of SADC free trade area. The regional market is seen as a spring-board for the SADC Member States to integrate themselves effectively into the global economy. However, intra-SADC is dominated South Africa as a result of South Africa's increased trading integration within the region since 1994, as illustrated in table 7 below.

Table 7: Trade Flows within SADC

	SADC imports/Total imports	**Imports from South Africa/SADC imports**
Malawi	47.4	67.2
Mauritius	17.2	92.8
Mozambique	39.8	-
South Africa	2.5	-
Tanzania	7.7	70.8
Zambia	48	74.8
Zimbabwe	48.7	87

Derived from Tsikata (1999)

Given this level of trade dominance within SADC by South Africa, polarised development arising from the agreement, to the benefit of South Africa is extremely likely.

3.7 The Spread of Economic Benefits

Even within a polarised context economic some benefits may accrue to less developed countries from regional integration through the exchange of goods, and also by extending the region's capacity for growth by expanding the resource base and facilitating structural transformation. These benefits may spread to the less developed countries in the region through cross border flows

of resources, goods and labour, however, within the region this spread is restricted by inadequate transport and communications infrastructure and also by social and political factors. In order to promote this flow within the region the removal of barriers to the flow of labour and capital would be required.

Within the region constraints to the mobility of labour are significant, and it will be primarily through the movement of capital in the form of direct investment, facilitated by South African Reserve Bank, that benefits of integration will be spread beyond South Africa. While South African cross border investment will not contribute to substantial convergence in the SADC free trade area, it is likely to make some contribution to wider regional economic growth, due to the equilibrating forces of cross border investment flows.

3.8 The EU-South Africa Trade Agreement and AGOA

While the EU-South Africa trade agreement will primarily benefit South Africa, the World Bank have calculated that it is also likely to have secondary economic benefits for the wider region in terms of increased regional production and exports. Europe remains the region's top trading partner, although it has lost market share in recent years to Asia, Japan, Italy, Germany and the US, and under the AGOA exports to the US are likely to increase substantially in the next half decade.

3.9 The Fiscal Revenue Implications of Trade Liberalisation

Multilateral trade liberalisation is reducing the option of trade tariffs as sources of fiscal revenue in the region. Implementation of SADC will entail substantial fiscal costs for Malawi, Zambia, Zimbabwe and Mozambique as a result of the lifting of customs duties on imports from SADC countries, a significant source of fiscal revenue. The BLNS countries are heavily reliant on SACU receipts as an important source of public revenue. For these countries substantial fiscal revenue reductions will arise from the erosion of SACU receipts, as a result of both the EU-SA trade agreement, and increased SADC integration during the next half decade. Without increased real growth rates, debt relief or aid flows, countries will find it difficult to compensate for this revenue loss and adjustments in fiscal policy in terms of reduced state expenditure may be the only response.

A mechanism is needed to accommodate the inequality of benefits arising from SADC integration and the loss of SACU revenue. If a mechanism is not found, integration could prove counter-productive for smaller countries, and in the long run restrict the potential gains to all from regional cooperation.

Summary

SADC integration is likely to lead to a reduction in import-competing production in less developed countries as a result of increased competition from South Africa:

- Increased competition from South Africa is likely to lead to a reduction in manufacturing employment in less developed countries is anticipated
- Trade diversion in favour of South Africa will occur
- Trade creation will be limited
- Increased economic divergence within the region with the concentration of production in richer countries
- Regional tensions relating to unemployment and labour movement may be exacerbated
- There is a need for complementary policies to promote the interests of less developed countries
- The negative fiscal impacts of major tariff reforms are substantial

4. South African Regional Investment and Economic Role

What will be RSA's investment and economic role in the region?. Will it "cherry pick" the best investment opportunities in declining economies such as Malawi, Zimbabwe and Zambia? Or will it have a strategic investment plan which will enhance regional infrastructure and employment and ease the migration pressures on South Africa. How much will South African investment exacerbate development/political biases in a country?

4.1 The Nature of South African FDI

South African investment flows are increasingly directed towards the southern African region. Between 1995 and 1998 South Africa invested R2,500 million in SADC counties, becoming one of the dominant sources of FDI in the region. South African FDI is concentrated in the mining, retail and wholesale, hotel and leisure sector and manufacturing as well as the finance sector. This FDI is predominantly market and resource seeking in nature. Market seeking FDI can be characterised as displacing local supply in selected sectors, with the majority of profits repatriated to South Africa, entailing few technology transfers, export expansion or employment benefits for the recipient country. The impact of such FDI is primarily the displacement of local economic activity, and the extraction of capital and savings from the economy of recipient countries. Given the high capital intensity of South African economic activity compared to the rest of the region, South African market seeking FDI is likely to contribute to a decrease in labour demand in the recipient country. Resource seeking FDI focuses on the extraction and export of unprocessed mineral resources from recipient states. This type of FDI offers some employment and capital benefit for the recipient country, but little in terms of skills or technology transfer.

South Africa's regional FDI is driven primarily by national economic interests rather than regional development interests, with South Africa seeking to capitalize on its role as the regional economic hegemon, the size and sophistication of its mining, manufacturing and service industries and its de facto control of the BLNS countries' economic policy.

4.2 South Africa's Regional Development Approach

Given South Africa's domestic prioritisation of market over interventionist responses to infrastructural development and employment, it is unlikely that it will pursue a more dirigisme strategy with regard to regional development. While domestic unemployment rates of 36% and growing regional unemployment are a cause for concern in South Africa, due to the potential for social and political instability they imply, harsh immigration legislation is being used as the primary instrument to deter economic migration into the country, rather than strategic regional investment initiatives to create alternative employment sources in less developed regional countries. In fact structural changes within the South African economy are contributing directly to increased regional unemployment, as the demand for immigrant labour in the South African mining sector continues its secular decline, with serious implications for the remittance-dependent economies of Swaziland and Lesotho.

The nature of South Africa FDI in the region mirrors the poor quality of FDI South Africa is currently receiving, which is heavily concentrated on resource seeking (to gain access to mineral resources) and investment in mergers and acquisitions. Neither source of FDI contributes significantly to economic or employment growth, technology transfer or access to additional overseas markets, which are the primary reasons countries seek to attract FDI. South African FDI is unlikely to shift any of the regional economies onto higher growth paths.

South African FDI has however contributed to major infrastructural development where this will open markets for South African exports or provide access to natural resource deposits, such as the petrol pipeline and aluminium smelter programme in Mozambique, and several regional telecom initiatives. Peace in DR Congo and/or Angola would be likely to provoke substantial FDI flows from South Africa, both market and resource seeking, and also for infrastructural development, where this would facilitate South African market penetration.

Given the power imbalance between South Africa and the other regional economies, the critical question is whether the recipient countries will be able to strategically direct FDI flows to their national priority industries and areas, rather than those prioritized by South African economic interests, and whether they will be able to exact terms of investment which are beneficial to their own economies. Lesotho is currently engaging in a deliberate process of diversifying its trading and investment partners in order to reduce its high dependence on South African FDI flows.

While attracting South African FDI based on manufacturing would offer greater spill over benefits, and potential longer terms growth benefits, the current proliferation of export processing zones in the region may lead to a "race to the bottom" in terms of various taxation incentives, wherein the benefits accruing to the host nation are negligible. However, low taxation and low wages do not compensate for the poor infrastructure, low market demand and low skilled labour which characterises the region, and render any South African investment in production outside the main industrial nodes already developed in the region unlikely. Hence South African investment

patterns may serve to exacerbate current regional spatial inequalities in terms of investment, poverty and job creation in the region.

South Africa is the recipient of the majority of global FDI flows to southern Africa. However, this represents under 1% of total global FDI flows, and less than 1% of total South African GDP. These levels of FDI are significantly less than the South African government had anticipated in response to their macro-economic austerity programme.

Summary

- South African FDI is both market seeking and resource seeking
- Market seeking FDI is likely to displace local supply and entail the repatriation of profits to South Africa
- Market seeking FDI may lead to a decrease in labour demand in the recipient country due to the capital intensivity of South African processes
- Resource seeking FDI will tend to extract unprocessed minerals
- South Africa may invest in infrastructural development where it will benefit South African trade or political priorities
- Manufacturing FDI is likely to enhance current regional spatial inequalities and focus investment in areas already developed
- “Race to the bottom” to attract FDI within the region may undermine benefits to recipients
- Recipient countries need to direct FDI in line with domestic economic and industrial development priorities, but have little bargaining power, due to the size of their economies relative to the South African economy

5. Private Sector Investment

What will be the private sector investment trends in the region if Angola and DRC secure peace?

As discussed in 2 above FDI flows to southern Africa are extremely limited, and are predominantly directed to South Africa. One of the major deterrents to FDI in the wider region is perceived regional instability, resulting in part from the conflicts in Angola and the DR Congo and more recently the political instability Zimbabwe, which has significantly undermined investor confidence in the region. If peace is secured the likelihood of major private sector investment inflows is enhanced, both to the post-conflict countries themselves and the region as a whole, through positive contagion. The peace dividends from a sustainable peace in Angola and/or DR Congo would be substantial, and potentially stimulate positive economic growth throughout the region.

The Angolan economy is currently dominated by oil exports with the US as its main trading partner, and its level of regional economic integration is limited. However, the country has the potential for major diamond, iron ore and manufacturing exports, large scale electricity production, redeveloping

its agricultural sector, and returning to self sufficiency in food production. Angola is already in the processes of economic reconstruction, having established the Joint Angolan Government United National Development Programme to rehabilitate basic infrastructure and promote production, and developed a "Framework for Investment Climate" to promote international investment, pending the formal cessation of the conflict.

A similar post conflict economic growth path could be imagined for the DR Congo, with major natural deposits of diamonds, copper, and cobalt and zinc, hydroelectric potential, and oil, which is currently exported crude due to the lack of industrial capacity to refine it at source. The DR Congo has the potential to play a major role in southern Africa as a huge untapped market and supplier of commodities, and also has the potential to develop a diversified economic base. However, it is unlikely that DR Congo will reach sufficient levels of stability to attract significant private investment within the next half decade.

In the cases of both Angola and DR Congo, a diversified post conflict growth path would be contingent on major levels of investment in the rehabilitation of sectors destroyed during decades of conflict, the retraining of human capital which has been severely depleted, the reconstruction of infrastructure, and, in the case of Angola, widespread de-mining. The development of a diversified economic base, rather than one based on commodity exports would also require negotiation of short term industrial and agricultural protection waivers to enable the countries to re-establish production at competitive levels.

Angola is poised to enter a period of considerable growth and attract increased FDI flows within the coming years, although major regional and international FDI flows will probably be contingent on the formal ending of the conflict. Hence significant positive spill-overs of Angolan growth are not likely to be experienced in the region within the next half decade. However, given the substantial government oil revenues and diamond revenues (formerly controlled by UNITA), which may now be reallocated from military expenditure, Angola has a significant peace dividend which can be used for a major state investment programme of infrastructural rehabilitation. For this reason the initial phase of reconstruction of the Angolan economy is not contingent on external aid or investment flows. State investment in the economy will provide both practical and confidence incentives for increased FDI flows. Medium term exploitation of the huge natural resources within the country, and trade diversification enabling the country to shift to a higher growth path is likely to require flows of external investment, in addition to domestically available revenues. However, continued food aid will be necessary prior to the reconstruction of the agricultural sector and the development of effective government procurement and provisioning mechanisms.

Domestically, for peace dividends to be translated from economic growth into a reduction in poverty, deliberate policy interventions are required. The domestic impact of increased FDI on poverty will be determined by the capacity of the government to direct economic development through its industrial policy. It is also conditional on the government's capacity to develop and implement revenue generation and redistribution policies to ensure that gains from growth are

adequately distributed within the country. Without such policies growth may not translate into reduced poverty or inequality, and could entail a continuation of conflict engendered spatial inequalities. Mozambique illustrates this concern, having experienced impressive post conflict economic growth rates over the last decade, but witnessed little change in terms of the proportion of the population in poverty. Much recent literature has confirmed that growth and poverty reduction are by no means synonymous.

In the medium term peace in Angola would function as an economic stimulus within the region, creating a positive contagion by creating a significant market for regional exports, and enhancing regional fuel and food production. Peace would also promote regional investor confidence, although these effects would be muted as long as the DR Congo conflict and Zimbabwean policy instability persist, due to the international investment community's characterisation of national policy instability or conflict as a regional investment deterrent. Further deterioration of the situation in Zimbabwe could serve to slow Angolan economic recovery.

Notwithstanding the effect of continued regional instability, the size of the Angolan market and its energy endowments will ensure that peace in Angola will attract increased investment from within the region (primarily South Africa) and internationally, including the US. These increased investment flows will focus initially on exploiting the energy and mineral sector, and are likely to be of a sufficient scale to have an expansionary impact on the regional economy, enhancing market buoyancy, and hence stimulating further additional investment flows. Within the region this is likely to primarily benefit South Africa, by virtue of its regional economic dominance, but increased economic activity in Angola will also have spillover benefits through capital and labour mobility within the region. Peace in Angola will also facilitate the development of the Southern African Power Pool, an initiative to develop a regional power production and transmission network which will significantly reduce regional reliance on energy imports.

Summary

- ➢ Significant domestic or regional economic growth arising from peace in the DR Congo is unlikely in the next half decade
- ➢ Angola is positioned to engage in economic redevelopment pending the cessation of the conflict
- ➢ Peace in Angola would;
- ☞ restore investor confidence in the region (however this would be muted by ongoing conflict in DR Congo and policy instability in Zimbabwe)
- ☞ create new markets for regional agriculture and manufactures
- ☞ stimulate regional exports to satisfy latent consumer demand
- ☞ ensure greater regional self sufficiency in agricultural production and fuel
- ☞ attract external FDI (primarily market and resource seeking)

- create the potential for diversified economic development
- Economic diversification and growth is contingent on state and donor investment in infrastructural rehabilitation and short term protectionism for fledgling industries
- Ensuring economic the benefits of increased FDI are used to address poverty is contingent on state capacity to develop and implement effective industrial and redistributive policies
- South Africa will be the main regional beneficiary of peace due to its regional economic dominance
- The rest of the region would experience positive spillover benefits through labour and capital movement and increased capital flows to the region

6. NEPAD

Will a wide donor support of NEPAD translate into higher levels of foreign direct investment into the South African economy and the regional economy?

6.1 NEPAD

The New Partnership for Africa's Development (NEPAD) was proposed by African leaders, as a plan for the integration of Africa into the global economy, and to achieve the 6% per annum growth rate required for the reduction of poverty in line with the international development goals. In order to achieve this the Partnership document offered a mechanism for enhanced governance across the continent in return for trade, debt relief and aid concessions.

The NEPAD proposed;

Trade

- Reductions in the duties imposed on African exports face in OECD markets
- Commitments to reduce OECD agricultural subsidies that depress world commodity prices and render African production non-competitive

Debt Relief

- $15bn-20bn extra debt relief to compensate for falling commodity prices and to extend the relief offered under HIPC

Aid and investment

- $35bn in aid and investment, in line with UN estimates of $25bn-35bn required to stimulate African growth rates of 6%

6.2 The Response to NEPAD

NEPAD was effectively rejected by the G8 leaders in June 2002, who signalled their reluctance to increase aid flows, increase debt relief or reduce trade barriers for African exports in line with the NEPAD proposals. No trade concessions were granted to Africa, and no amendments were made to existing agricultural subsidies. Only $1billion in additional debt relief was allocated to compensate for falling commodity prices and no new aid was agreed. Given this clear signal from the G8 it is unlikely that the initiative will entail significant increases in investment flows to the region.

6.3 NEPAD in Context

NEPAD largely replicated previous attempts to enhance western commitment to African development, such as the 1986 UN Programme for Action for African Economic Recovery and Development and the 1991 UN New Agenda for the Development of Africa, a compact of mutual commitments by African countries and the international community requiring $30bn annual investment by the west.

The primary new component of the NEPAD was its commitment to the neo-liberal economic agenda of the Bretton Woods institutions, and to the ideology of growth through liberalisation and macro-economic stability. The document argued that aggregate economic growth was the necessary instrument to achieve poverty reduction, but did not explore mechanisms to ensure poverty reduction. In this sense the Partnership represented an extension of South African economic policy beyond SACU to the wider continent. Given i) the poor growth performance, and rising levels of unemployment, poverty, inequality and political instability emerging in South Africa as a result of the macroeconomic austerity plan, ii) the lack of ownership of the document by the wider African leadership or civil society, and iii) the failure of the OAU to respond decisively to the crisis in Zimbabwe, the refusal of the G8 to accept NEPAD as a new or credible instrument for the delivery of growth, poverty reduction or good governance was not unexpected.

6.4 Trade, Aid and Debt Relief

However, progress on the trade, aid and debt relief components of NEPAD are critical for future growth in the region, particularly given the inability of southern African markets to extend agricultural exports to Europe or the US, or develop diversified economies due to the dual constraints of OECD protectionism, and WTO tariff restrictions. The need to secure at least the concessions proposed at the Doha round of WTO trade negotiations is critical for the region.

Enhanced aid flows are also critical if the infrastructure development required to support economic development and diversification is to take place, as private investment flows will not be sufficient to develop an integrated regional infrastructure. Without prior investment in infrastructure, prospects for FDI within the region will be significantly limited and it will continue to be skewed towards the most developed countries in the region.

Equally, accelerating and extending the HIPC initiative to address the unsustainable debt burdens still borne by Zambia, Malawi, and Mozambique is of critical importance, particularly given the crisis in social sector spending and the serious child malnutrition problems in those countries.

Given the significant limitations in the potential role of FDI, due to regional poverty, instability, low market demand, poor infrastructure and low skills base, a package of radical aid, trade and debt concessions are the only option for shifting the region as a whole to a higher growth path. Currently FDI inflows to the region are not focused on productive investment, and it is not anticipated that this trend will change in the coming years, as neither South Africa nor the region is seen as an attractive FDI destination, except for resource seeking FDI, in the fuel and mineral sectors. For this reason it is critical that a politically and economically credible alternative to NEPAD is developed as the basis for ongoing discussion with the west. Without aid, trade and debt concessions the economic growth prospects for the region in the coming half decade are poor and continued stagnation is likely.

Summary

- NEPAD called for aid, trade and debt concessions in return for good governance with a commitment to trade liberalisation and macro-economic austerity
- The G8 rejection of NEPAD reflects in part the lack of political and economic credibility of the document and the lack of OAU action on Zimbabwe
- Aid, trade and debt however remain the critical determinants of future growth in the region
- FDI flows to the region are extremely low, and skewed towards South Africa.
- Less developed countries in the region are unlikely to benefit from increased FDI without prior aid investment in infrastructure
- In order to develop diversified economic growth paths and achieve the international development goals aid, trade and debt concessions are critical
- Without increased aid continued economic stagnation across the region is predicted

7. Regional Participation in the Global Economy

What parts of the regional economy will be active within the global economy. What will happen to the more marginal economies of Lesotho, Zambia, Swaziland and Malawi?

7.1 South Africa and the Region

South Africa will continue to dominate the regional economy, and without major new investment flows to the region or OECD subsidy reductions the economic prospects for the more marginal economies are unlikely to show positive change. South Africa will continue its dual economic growth path with a growing services sector based in the metropolitan areas, while the manufacturing and agriculture sectors continue to shed jobs and contract in response to international

competition, leading to increasing unemployment and economic polarisation. Faltering growth in South Africa will be of particular concern to the BLNS countries which are heavily reliant on the South African market. It is possible that the inflation and negative economic contagion arising from the current grain shortages, combined with the economic slow down in South Africa will undermine growth in the region in 2002 and 2003, leading to economic stagnation, and further reductions in per capita GDP.

7.2 Mozambique and Angola

Mozambique and Angola however, are likely to experience continued growth. In the case of Angola this is largely due to the continued strong performance of oil exports, the peace dividend and the resulting predicted increase in domestic economic activity. In the case of Mozambique continued growth is linked to the ongoing stimulus of post conflict reconstruction efforts, industrialisation and the stable productivity of the agricultural sector, although this will depend on the medium term impact of the current food crisis on the agricultural sector. If peace prevails in Angola, substantial FDI and reconstruction aid is likely to start to flow into the country from South Africa and elsewhere, and stimulate a process of diversification and increased agricultural production which would have wider positive regional knock on effects (see section 4 for a more detailed discussion). This may divert South African FDI away from other countries within the region.

7.3 Lesotho

Lesotho faces two negative economic shocks in the coming half decade, i) the ongoing shrinkage of demand for migrant labour in the South African mining sector, which will undermine remittance income and lead to increased levels of unemployment, and ii) the revenue shock of the loss of the SACU customs revenue share, which forms a significant component of government revenue. Both shocks will reduce the fiscal base of the government, and lead inexorably to reductions in government expenditure unless alternative sources of revenue can be identified. In response to this challenge the government is attempting to promote an aggressive programme of industrial expansion.

The major industrial growth sector is clothing and footwear, which accounts for 20% of GDP and dominates other exports, largely due to ongoing investments from Singapore and Hong Kong, capitalising on the benefits of AGOA to export to the US market. Expansion of this sector is the only likely engine of manufacturing growth.

The current dam construction programme is the other engine of economic growth in the country. The project is creating employment, and with the first of the three planned dams already in operation Lesotho is receiving revenue from South Africa for both water and hydro-electricity sales. The completion of the remaining dams during the coming years should significantly enhance future export earnings.

Lesotho is currently diversifying its trading partner portfolio away from SACU in order to reduce its dependence on the regional economy.

7.4 Zambia

Privatisation has been the dominant economic strategy in Zambia in recent years. The national privatisation portfolio was designed to increase the efficiency and competitiveness of Zambian industry in such a way that the private sector would become the driving force behind increased economic growth. However the collapse of the privatized Zambia Consolidated Copper Mines, which alone accounted for more than 80% of foreign exchange earnings, in early 2002 is a major blow for both the privatisation strategy and the economic prospects of the country.

The only major alternative currently under development to reduce Zambian dependence on highly volatile mineral exports is the diversification in to non-traditional exports, such as cotton yarn, copper rods, white spoon sugar and fresh flowers. Non traditional exports increased from 15 to 33% of total exports during the late 1990s, and this trend is likely to be intensified following the collapse of ZCCM.

Prospects for the highly indebted Zambian economy are bleak.

7.5 Swaziland

The Swazi economy is based on trade with and remittances from South Africa. South Africa, accounts for almost 50% of its exports and dominates its other trading partners in scale, and hence Swaziland's export performance is closely tied to South African economic performance. Growth prospects are not positive for Swaziland in the coming half decade without a major new investment programme or increased diversification of its trading partner portfolio away from SACU dependence.

Like Lesotho, Swaziland continues to be adversely affected by the ongoing reduction in demand for migrant labour in the South African mining sector.

7.6 Malawi

Malawi remains highly dependent on the agricultural sector which accounts for over 30% of its GDP and 90% of total export earnings, with tobacco being the dominant export earner. Since the late 90s trade diversification into non-traditional crops (coffee and pulses) has taken place, but this accounts for only a small percentage of total exports. Since the collapse of the textile sector in the mid 90s the country has experienced minimal manufacturing sector growth but is utilizing EU, UNICDO and World Bank support in an attempt to promote manufacturing growth in the medium term.

Malawi is one of the cotton producers in the region with the potential to exploit opportunities under AGOA to develop a cotton processing export industry, to replace raw cotton exports with higher value-added processed products, however it has not yet capitalised on this.

7.7 Textiles

The termination of the Multifibre Arrangement in 2005, will expose the region to increased competition, and hence there is an urgent need to increase competitiveness in the textile sector in the interim period. Both AGOA and Cotonou offer temporary opportunities to increase textile exports to US and EU markets, and Lesotho has already benefited from a major textile investment due to AGOA concessions. There are further market advantages for the region under AGOA for clothing and footwear exports to the US which have not yet been exploited.

7.8 Cotton Processing

Malawi, Zambia and Mozambique have the potential to utilise preferential market access under the terms of AGOA to increase the value added component of the their cotton exports, by investing in cotton processing facilities in country, in order to process the cotton into yarn, or fabric. The main factor inhibiting take up of the AGOA concessions is lack of infrastructure and skills.

Summary

- Faltering growth in South Africa will have negative implications for the BLNS countries
- Mozambique and Angola are likely to experience continued growth
- The dam programme and increasing textile exports will be the main engines of economic growth in Lesotho
- Prospects for economies of Swaziland and Zambia are bleak
- Malawi will remain highly dependent on small scale agricultural production, although donor investment in industrialisation may start to have results
- Short term opportunities offered by Cotonou and AGOA for increased textile exports from the region remain underutilised

8. Trends in Commercial Agriculture

What could be the trends in commercial agriculture in the region?

8.1 OECD Subsidies

Given the stance of the G8 in response to NEPAD it is unlikely that any reduction in OECD agricultural subsidies may be anticipated in the next half decade, and as a consequence terms of trade for agriculture in the region will not significantly alter and increased access to OECD markets is unlikely.

8.2 Secular Trends

Terms of trade for all commodities except oil are expected to continue the secular decline they displayed between 1995 and 2000, and the region is likely to continue to lose world share in most commodities.

8.3 Diversification

Agricultural diversification is central to the agricultural strategies of Mozambique and Zambia, which may shift the composition of agricultural exports from the region, although the size of this shift is such that it may not have a major impact on regional economic performance or export composition.

8.4 Regional Grain Production

A strong grain production performance in the region in 1999 and 2000 turned into a regional deficit of 4 million tonnes in 2002. Zimbabwe's production is estimated to have fallen from 1.8 million tonnes to only 0.48 million between 2000 and 2002, compounding the impact of a harvest which failed across the region for a combination of climatic and political reasons, and was exacerbated by reductions in state subsidies for seeds and fertilizer in Zambia and Malawi. The result of these events has been a series of grain shortages of varying degrees of severity in parts of Angola, Swaziland, Zambia, Zimbabwe, Malawi, Lesotho, Mozambique and South Africa. Countries with inadequate foreign exchange to purchase imports on the world market are faring worst, with the shortage contributing to inflationary pressures on the price of staple foods across the region, with serious effects for the poor.

The large scale fall in production in Zimbabwe is likely to be sustained throughout the next half decade, with production stagnating as long as current agricultural and land policies persist, implying an ongoing national grain deficit. If weather conditions are favourable however, and agricultural reforms to support fertilizer and seed distribution are implemented as planned in Zambia and Malawi, a return to normal regional production levels in the rest of the region can be anticipated and the 2002 crisis need not translate into a second year of near famine or regionally inflated food costs.

Summary

- Increased access to OECD markets is unlikely
- Terms of trade for commodities are expected to continue their secular decline
- Agricultural diversification is central to the agricultural strategies of Mozambique and Zambia
- The grain deficit will deteriorate in Zimbabwe as long as current land and agriculture policies persist
- The regional grain crisis can be contained if producer support (seeds and fertilisers) is reinstated and climatic conditions stabilise

9. HIV

What could be the impact of HIV on markets and investment in the region?

HIV is having a devastating effect on the economies of southern Africa, which is occurring though labour force reduction, revenue loss, skills shortages and negative investor confidence. However, despite the evident impact little work has been done to calculate the economic dimensions of the epidemic.

9.1 Labour Force Impact

AIDS is having a major impact on the demographics of the region. The FAO estimates that the worst affected countries in the region, Namibia, Botswana, Zimbabwe, Mozambique South Africa and Malawi are likely to lose up to 15 to 25% of their agricultural labour force to AIDS by 2020. The implication of such a massive loss in the working age population is that populations become increasingly skewed towards the very young and the very old. This effect combines with a reduction in the labour force participation of those infected and affected by HIV/AIDS, to reduce both the absolute size of the labour force and its productivity, which is cut by up to 50% in the worst affected countries.

9.2 Direct Economic Impact

Although AIDS remains much less common in the developing world than diseases such as malaria, its economic impact is greater for two reasons, i) it mainly affects adults in their most productive years, and ii) the infections resulting from it lead to heavy demand for health care. Hence the economic impact of HIV arises from the combined effects of increased demands on public spending and a concurrent reduction in total public funds available.

The loss of productive members of society causes reduced economic activity and hence reduced savings, investment, job creation and GDP growth. It also reduces the revenue available for funding service provision. In Botswana, for example, the government will lose 20% of public revenue by 2010 because of AIDS.

The second direct impact arises from the high costs of treatment, which diverts resources from alternative productive investments; the World Bank estimates that annual basic care and treatment for a person with AIDS, excluding anti retroviral treatment, can cost as much as 2-3 times per capita GDP in the poorest countries in Sub Saharan Africa.

9.3 Skills Impact

The fact that AIDS removes so many skilled adults from the labour force adds to its economic impact, undermining government capacity as civil servants are killed by AIDS. In Zambia nearly two-thirds of deaths in the managerial sector can be attributed to AIDS, and in 1998 the country lost more than 1300 teachers to AIDS, more than two thirds of all new teachers trained annually. The

cost of training additional numbers of skilled workers to replace those lost to AIDS places a heavy economic burden on the state.

9.4 Impact on FDI

In addition to undermining the capacity of government and business, high levels of HIV mortality also serve to deter FDI in the region, particularly investment which entails staff training and skills development, exactly the high value-added investment that the region needs to attract for economic growth. High levels of HIV also serve to undermine investor confidence in the region, and leads to investment decisions favouring alternative investment destinations with lower HIV prevalence.

9.5 Estimated Impact on GDP

Through its effects on revenue, savings, productivity, skills, medical costs, and investment deterrence HIV contributes to poor prospects for economic growth in the region. The World Bank estimates that annual per capita growth in Sub Saharan Africa is falling by 0.5-1.2% as a direct result of AIDS, and that by 2010 per capita growth in some of the hardest hit countries, which include Namibia, Botswana, Zimbabwe, Mozambique, South Africa and Malawi, may drop by as much as 8%. In the context of already poor growth within the region, high and increasing HIV incidence is further undermining economic growth prospects.

Summary

- AIDS is reducing the absolute size of the labour force in the region and its productivity
- AIDS reduces fiscal revenues and increases demand for health care resources, diverting them from alternative productive investment
- AIDS is reducing the availability of skilled labour required for governance and investment
- Annual per capita growth in Sub Saharan Africa is falling by 0.5-1.2% as a direct result of AIDS

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