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Manufacturing in SADC: Moving Up the Value Chain

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The Southern African Development Community (SADC) has 16 member states namely Angola, Botswana, Comoros, the Democratic Republic of the Congo (DR Congo), Eswatini, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, United Republic of Tanzania (Tanzania), Zambia and Zimbabwe. Comoros, the latest member, was admitted to SADC at the 37th SADC Summit of Heads of State and Government in August 2017. It then became a full member at the 38th SADC Summit of Heads of State and Government in August 2018.

The SADC countries are integral part of the African region comprising 35.4 percent of Africa's total land area, 31 percent of Africa's GDP, and 28.4 percent of Africa's total population (does not include Comoros). Among the major regional trading blocs in Africa, SADC is the largest contributor (in terms of nominal GDP) to the African region in 2018, followed by COMESA and ECOWAS. SADC's combined GDP stood at an estimated US$ 716.8 billion in 2018. South Africa is the largest economy in the region, accounting for 51.3 percent of the region's GDP in 2018, followed by Angola (15 percent), and Tanzania (8.1 percent). The region is one of the world's most mineral-rich regions. It is endowed with numerous non-renewable resources such as coal, crude oil, natural gas and minerals.

Service sector represented more than half of SADC's GDP in 2018, and is the main driver of the region's growth. However, in countries such as Comoros, Madagascar, Malawi, and Tanzania, agriculture accounts for a significant share in the GDP, while mining and utilities account for a major share of economic value added in countries like Angola, Botswana, DR Congo and Zambia. Eswatini and DR Congo have a strong manufacturing sector. The average economic growth of SADC has remained relatively sluggish in the last few years, with growth estimated at 1.3 percent in 2018. While there were declines in prices of agricultural raw materials, mineral and fuels post-2011, overall SADC real GDP growth showed sign of resilience. Yet, it had moderated across the years, indicating dependence of the region on commodity exports. However, although prices have started recovering from 2016, the economic growth of the region has remained modest over the last few years as some of the major economies continue to remain in recession or debt distress due to loss of revenues. In spite of market diversification to emerging and developing economies like China and India, from saturated markets like OECD countries, the composition of export basket continues to remain the same with more than 80 percent of commodities exported, whereas industrial products and manufactured goods are largely imported.

International Trade of SADC Countries

Observing SADC's foreign trade pattern reveals the dependence of the region on commodity exports. After peaking in 2013 at US$ 423.4 billion, SADC's total trade declined until 2016 and recovered since 2017. The commodity price downturn had a significant impact on the region's trade; declining to a seven-year low in 2016. Slowdown in major economies like South Africa and Angola also affected SADC's regional trade. SADC's total trade increased by 12.3 percent from US$ 331.2 billion 2017 to US$ 371.8 billion in 2018, mainly on the back of strong exports. SADC's exports grew at 12.7 percent from US$ 171.8 billion in 2017 to US$ 193.7 billion in 2018, due to increased export of petroleum products, pearls, precious stones and metals and copper and articles. Imports of the region stood at US$ 178.2 billion in 2018, an increase of 11.8 percent from US$ 159.4 billion recorded in the previous year, due to increased imports by South Africa and Angola. SADC's share in global trade has remained fairly constant in last ten years at around 1 percent.

Reflecting the significant rise in export of crude petroleum from SADC, mineral fuels were the largest export item, accounting for 27 percent of SADC's total exports in 2018. Other major export items were pearls and precious stones, ores and slag and copper and articles. These cumulatively accounted for 60 percent of SADC's exports in 2018. SADC accounted for 2.1 percent of the world exports of mineral fuels in 2018 (majorly crude petroleum), of which Angola alone accounted for 1.5 percent.

While developed countries such as the USA and Germany, among others, continue to be the traditional destinations for SADC's exports, developing countries such as China and India have emerged as major export destinations in recent years. In 2018, China and India were the largest export destinations for the region accounting for 21.6 percent and 6.3 percent of SADC's global exports.

In contrast to SADC's export basket, which is largely dominated by crude oil, SADC's imports are relatively diversified. Mineral fuels and machinery are the two largest import items, followed by electronic and electrical equipment, vehicles other than railway or tramway, plastics and its articles and pharmaceutical products. SADC's import of mineral fuels, oils and its products, was mainly dominated by petroleum oils not crude (HS 2710). China has emerged as the leading supplier to SADC, accounting for as much as 15.8 percent of SADC's total imports in 2018, followed by South Africa and Germany. India is the fourth-largest source for SADC's imports, accounting for 4.9 percent in 2018.

Commodity Dependence of SADC Countries

According to the UNCTAD, a country is

considered "commodity-dependent" if the commodities exported by the country account for more than sixty percent of its total merchandise exports in value terms. Based on this calculation, Sub-Saharan Africa is the most commodity dependent region in the world with 89 percent of the countries being dependent on commodity exports. This was followed by Middle East & North Africa with 65 percent of its countries, East Asia and Pacific, Latin America and the Caribbean, South Asia, and Europe and Central Asia. North American countries were found to be commodity independent.

During 2013-17, mineral fuels and oils (majorly crude) accounted for 96 percent of its total merchandise exports in Angola. Similarly, countries like Seychelles, being an island economy, is highly dependent on fishery products. Zambia on the other hand is heavily dependent on copper exports. Countries like Eswatini, Lesotho, Mauritius and South Africa are commodity independent.

Commodity price volatility generates uncertainty within and about an economy when the economy is heavily dependent on exports. These price fluctuations not only slow down the growth, but also affect the domestic demand in the economy due to reduced income thereby leading the country to debt distress and poverty, typically more observed in case of LDCs. The correlation between annual growth in commodity price indices (all groups including agricultural commodities, minerals, metals and ores and fuels) and real GDP growth rate of SADC for the period 1996 to 2018 using UNCTADStat data averaged at 0.56. However, a much higher correlation is observed when we consider SADC annual export growth and growth in commodity prices (all groups). The correlation goes up to 0.9 therefore revealing the high price sensitivity of the region's exports to commodities.

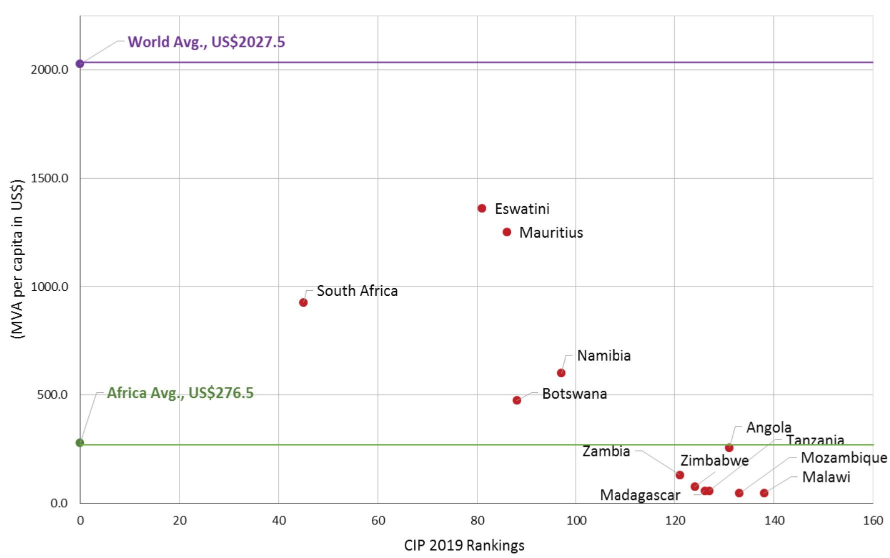
When individual categories of commodity price indices are considered over the same period of time, while the agricultural commodity price indices' correlation with SADC's GDP growth stood at 0.5, its correlation with export growth of SADC is much higher at 0.86. Similarly, minerals, ores and metal price indices' correlation with export growth is much higher at 0.82 compared to its correlation with SADC's GDP growth, which stood at 0.47. When it comes to fuel price indices, its correlation with SADC's GDP growth was 0.61 whereas with exports growth, it shows a higher correlation of 0.86. The movement in primary commodity prices can be associated with similar movement in export revenue causing instability in foreign exchange earnings of the SADC countries, thereby leading to growth volatility and a slower recovery.

Foreign Direct Investment in SADC

SADC countries have encouraged foreign direct investments (FDIs) by developing various pro-investment policies. Agro-processing, downstream processing of mineral resources, and industry- and service-driven value chains were identified as the potential avenues to drive economic growth in the region.

During the last decade, FDI inflows to SADC region peaked in 2015, mainly due to large investments inflows into Angola. With the fall in investments in Angola, FDI declined in the subsequent year till 2017. In 2018, FDI into SADC region recovered three-fold from US$ 1.4 billion in 2017 to US$ 7.7 billion, largely driven by higher investments in South Africa. As a result, SADC's share in Africa's FDI inflows, which declined from a peak of 40.9 percent in 2015 to 5.8 percent in 2017, increased to 16.7 percent in 2018.

Chart 1: Manufacturing Value Added (MVA) Per Capita for SADC Countries



Note: Manufacturing value added per capita is for 2017 at constant 2010 US$ prices; Data for Comoros, DR Congo, Lesotho and Seychelles are not available.
Source: UNIDO Database; Exim Bank Analysis

Manufacturing Export Profiles of SADC

According to the World Trade Organisation (WTO), Africa contributed to 1.9 percent in world's manufacturing value added, and nearly half of Africa's contribution originated from the SADC region. In fact, SADC ranks first among African RTAs in value terms, representing 37.3 percent of total African exports in 2017. SADC also shows the highest share of manufacturing exports to the continent vis-à-vis its exports to the world, which mainly includes fuels and mining products. SADC's manufacturing exports to Africa mainly comprised machinery and transport equipment from South Africa. According to a report by African Export-Import Bank (Afreximbank), in the Southern Africa region, fuel and manufactured goods enter the continent through South Africa's ports and are re-exported by road to, among others, Botswana, DR Congo, Lesotho, Eswatini, Zambia and Zimbabwe. Cobalt, copper and gold, on the other hand, go in the other direction.

Machinery and transport equipment account for the largest share of manufacturing exports in both cases (35 percent to the world and 36 percent to Africa, respectively). SADC's export of machinery and transport equipment comprised automotive products (51 percent of machinery and transport equipment in 2017), followed by semi-manufactures (26 percent) and chemicals (15 percent). Pharmaceutical products account for a meagre share of 6.3 percent within the chemicals category. Textiles and clothing combined accounted for roughly 6 percent of total manufacturing exports.

SADC's export to Africa also follow a similar pattern with machinery and transport equipment accounting for the bulk of manufacturing exports (36 percent). Within this sub-category, automotive products accounted for 26 percent share in export of machinery and transport equipment in 2017. Pharmaceutical products accounted for 7.5 percent in total export of chemicals.

To understand the domestic situation of a country and its competitiveness in terms of manufacturing, an analysis of the manufacturing value added per capita (constant 2010 US$) allows for comparing a country independent of its size thereby revealing its stage of development and is expected to be higher with higher structural change. Also the more technology intensive the goods the lesser the vulnerability towards international commodity price shocks. The world average of manufacturing value added (MVA) per capita stood at US$ 2,027.5 in 2017. Africa has the lowest MVA per capita of US$ 276.5, as compared with that of other regions in the world. MVA per capita of SADC members averages to US$ 440.4 in the same period.

An analysis of the Competitive Industrial Performance (CIP) Index 2019 by UNIDO for SADC member countries reveals that of the 150 countries ranked, SADC member rankings range from 81 to 138, with South Africa being an exception ranking 45th. Eswatini that was ranked 81stwas the second best performer among the SADC countries, whereas Malawi ranked 138th **(Chart 1)**.

SADC's Potential for Moving up the Value Chain

According to the Southern Africa Economic Outlook 2019, the sectoral composition of the region, suggests a greater need for structural transformation through value addition and manufacturing and job creation. Africa's working-age population is projected to increase from 705 million in 2018 to almost 1 billion by 2030.

The economic composition of the SADC region is dominated by the services sector. However, in service sector the output per person is just twice that of agriculture whereas manufacturing output per worker is six times that of agriculture. Presently, only one out of five workers in Africa gets employed in the formal sector. Thus, for this rising population, there is a major need for employment generation for which a strong value-added manufacturing base would be required.

Most African economies produce goods that require low level of complexity. This is also reflected in the export structure of these economies. Average per capita income generated by African industrial sector stands at US$ 700, much lower compared to US$ 2,500 for Latin America and US$ 3,400 in the case of East Asia. The importance of private sector in fostering industrialisation and employment is undeniable. It is projected that Africa is going to witness a threefold increase in business to business spending in manufacturing from US$ 201.3 billion in 2015 to US$ 666.3 billion in 2030. According to AfDB statistics, private sector accounts for an average 70 percent of the GDP in the Southern African region. A healthy private sector would help in job creation, employment generation, provides wider variety of goods and services along with infrastructure development which would indirectly unblock the public sector funds for other uses.

GVC Participation

An analysis of the Global Value Chain (GVC) participation rate for SADC countries, highlights the high rate of Domestic Value Added (DVA – downstream component) embedded in other countries' exports **(Chart 2)**. Foreign value added (FVA) – upstream component) in exports is much lower in the SADC region, where natural resources and commodities exports have little foreign inputs. The GVC participation rate indicates the portion of a country's exports that is part of a multi-stage trade process, capturing both upstream and downstream integration.

The SADC value chain is essentially of Hub and Spoke model, with South Africa remaining as the centre point with lead firms and corporates. This limits the participation of the other countries within the region. Weak logistics, inadequate physical infrastructure and skill deficiencies act as constraints to the integration of the SADC economies to regional as well as global value chains.

Another factor is the scale of economy. Countries like Botswana, Lesotho, Namibia and Eswatini, Mauritius and Seychelles are smaller economies with limited scope of industrialization which inhibits cluster development. On the other hand, South Africa, which is relatively more industrialized and accounts for almost 50 percent of the regional GDP, creates an imbalance due to its larger scale.

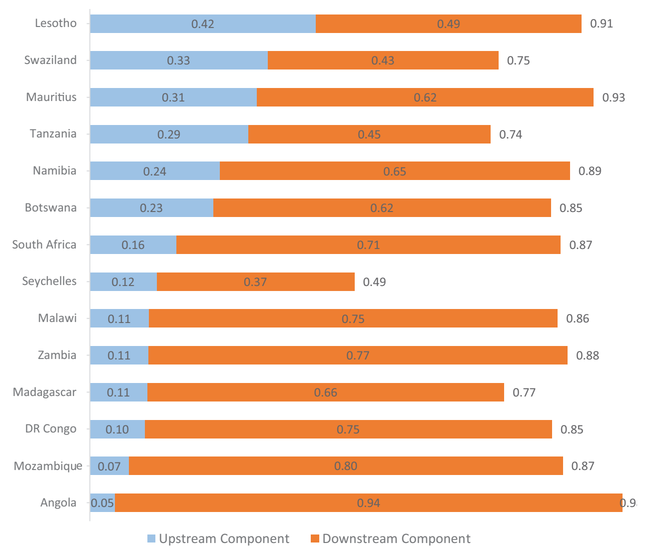
The share of MVA is positively correlated to the value chain participation of a country. However, MVA as a percentage of GDP for SADC has declined in the last 20 years. FDI inflows, on the other hand, have remained consistent because of the region's resource richness.

Opportunities and Key Sectors

Areas for cooperation in the agro-processing industry: Agribusiness is one of the potential sectors where India can look to invest in SADC. The agricultural sector of both India and SADC are largely characterized by labour intensive farming, small landholdings and diverse nature of agricultural production. India's stance on the agricultural sector of Africa has been more towards providing technology expertise to Africa. The African agribusiness sector needs support in terms of finance, market information, logistics and adequate infrastructure in the form of cold storage facilities, warehouses, etc. Investment opportunities have been identified in the following segments:

a) Processing factories for soya, oil seeds, rice, pulses and other products.
b) Fruits, vegetables and spices: cold storage and relevant transportation infrastructure; processing factories for processed food products like purée, spices, pastes and juices; cleaning and grading facilities; market development; and contract farming.
c) Large scale commercial farming may

Chart 2: GVC Participation of SADC Countries, 2018



GVC Participation Index= [foreign value added (FVA)/ Gross Exports] + [domestic value added (DVA)/ Gross Exports]
Note: Data for Zimbabwe is not available
Source: UNCTAD-Eora Global Value Chain Database; and Exim Bank Analysis

be explored for fruits, vegetables, spices and tea.

d) Sugar: Large scale production of sugarcane in the areas under the Green Belt Initiative (GBI) could be utilised for processing sugarcane thereby setting up sugar factories and ethanol factories.

International markets including South Africa, Kenya, Asia and Europe may be explored for exporting the processed products.

Areas for cooperation in the mineral processing industry: In India, in addition to environmental impact assessments and the initiatives under the sectoral legislation, the private sector is sensitized, and companies report their sustainability performance in addition to financial reporting. There has been an increasing importance of involving artificial intelligence for adopting the Industry 4.0. Smarter technologies, robotics and automation not only make mining safer reducing robotics and automation not only make mining safer reducing casualties, but also develop avenues for optimal mining and recycling, minimizing environmental after-effects and driving sustainable practices. Hence, sustainable mining and metal processing could be undertaken by Indian companies in the SADC region wherein value chains may be develoed for the following sub-sectors.

Areas for cooperation in pharmaceutical industry: Indian generic companies stand to benefit significantly by investing in SADC. Indian manufacturers can take advantage of the international Intellectual Property Rights (IPR) exemptions for the least developed countries (LDCs) until July 01, 2021, as was agreed by the TRIPS Council. SADC countries like Angola, Comoros, DR Congo, Lesotho, Madagascar, Malawi, Mozambique, Tanzania and Zambia could be utilised for this purpose. Secondly, instead of just exporting generic drugs to these countries, Indian pharmaceutical manufacturers could focus more towards production within the partner country, particularly those where they have already established steady supply chains.

SADC countries lack trained professionals due to absence of educational programmes covering topics ranging from drug discovery to marketing of drugs. In this connection, Indian companies may step in by investing in training relatively qualified local staffs for engaging them in clinical research in order to manufacture medicines locally at a lower cost, rather than importing active pharmaceutical ingredients. Secondly, African markets vary enormously in terms of size and economic conditions. Given such a condition, the Indian companies interested in doing business should first target cities in order to optimize the initial set up costs and gradually expand their operations to mid-sized markets as well as rural markets. Developing local sales and marketing team helps in gaining market share.

Areas for cooperation in leather and footwear: Opportunities exist in countries like Lesotho and Botswana. Investment opportunities in this sector include leather tanning and finishing, footwear and footwear components, leather garments, leather goods including bags, car seat covers, wallets, belts, gloves and other accessories.

Areas for cooperation in textiles: Opportunity exists for establishment of higher value added garments, as well as for establishment of knit mills to support the local garment industry. Access to the USA market through the African Growth and Opportunity Act (AGOA) may further facilitate investments in the region. However, there is a need to overcome the bottlenecks faced by the textile and apparel industry in the SADC region such as power shortage, lack of economies of scale and fragmented regional markets. The competitiveness of small enterprises would increase through formation of production clusters. Advanced technology and management techniques may be supplied by the Indian investors.

Areas of cooperation in automotive sector: There are several avenues for Indian automobile manufacturers to tap the SADC automobile market. Regional value chains (RVCs) may be developed in similar lines with the existing RVC where Lesotho produce car seats, Botswana produces ignition wiring sets, while Madagascar has facilities for assembling. Indian investors like Tata and Mahindra have already invested in South Africa, Zambia and Botswana. Exports channelized through the LDCs stand to benefit from the AGOA and various other preferential trade agreements.

India's Investment Potential in SADC manufacturing

According to data from the Ministry of Finance and the Reserve Bank of India (RBI), India's approved cumulative investments in the SADC region during April 1996 to March 2019 amounted to US$ 60.5 billion. Mauritius, Mozambique and South Africa are the top destinations of India's investments in the region. India's investments in the SADC region accounted for nearly 93.8 percent of Indian investments in Africa during April 1996 to March 2019, mainly dominated by investments in Mauritius. During 2010-11 to 2018-19 the cumulative Indian investment in the SADC region amounted to US$ 51.2 billion. The manufacturing sector accounted for the largest share of approved investments from India to the SADC countries (42 percent) of total investments received by SADC) followed by financial, insurance, real estate and business services (24 percent), wholesale, retail trade, restaurants and hotels (9 percent) transport, storage and communication services and agriculture and allied activities both accounting for 8 percent share in total investments by India. Mauritius has received the highest investment in manufacturing (98.7 percent), mainly due to the country's offshore financial facilities and favourable tax conditions. The other SADC countries which have received Indian investments in manufacturing are South Africa, Zambia, Tanzania, Botswana, Zimbabwe and Malawi.

Way Forward

India's engagement with SADC has been mainly private sector driven, resulting in greater integration with the domestic market. India can assume a development partnership role to facilitate growth in manufacturing sector of SADC through areas like skill development, knowledge sharing, designing various training and educational programmes, enhanced credit access through cooperation with development finance institutions (DFIs) in the SADC region and increased interaction between the private sector of India and SADC.

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