

EXECUTIVE SUMMARY

Perceptions of Sub-Saharan Africa in the business community and the wider public are dominated by images of poverty and political instability. But change is underway in this region, just as it is in less developed parts of East and South Asia. Some economies in Sub-Saharan Africa have either grown quite strongly for a decade or more, or have undertaken reforms which suggest a capacity to do so. These warrant closer examination by Australian business.

Botswana, Kenya, Mozambique, South Africa and Uganda, which are the subject of this report, have good economic growth prospects. Over the past decade, by embracing economic and governance reforms, they have improved their economic growth and business environments. Botswana, Mozambique, South Africa and Uganda in particular share a common commitment to strong economic growth, full employment, macroeconomic stability and a business friendly environment. Kenya's newly elected Government is developing and implementing key economic reforms.

The five economies account for most of Australia's trade and investment with Sub-Saharan Africa; they account for 76 per cent of Australia's trade with the region while South Africa alone receives 64 per cent of its investment.¹ However, similarities in resource endowments mean these economies often compete with Australian export markets. Nonetheless, their improved performance is generating new investment and to some extent trade opportunities for Australian business.

ECONOMIC PERFORMANCE IMPROVES STRONGLY

Botswana, Mozambique and Uganda are Africa's standout economic performers, achieving higher economic growth than many East Asian economies over the past decade. Since the end of the apartheid regime in 1994, South Africa also has adopted significant reforms and boosted its economic growth. After decades of economic decline, Kenya's new Government offers hope of economic reform. If fulfilled, this could generate business opportunities.

Macroeconomic Management Improves

All five economies have improved their macroeconomic management in recent decades. They have contained inflation and all economies except Mozambique employ inflation targeting. However, for a variety of reasons, real interest rates remain high, constraining private sector investment. Non-performing loans in Kenya, efforts to sterilise the impact of aid in Uganda, monetary policy objectives in Botswana and South Africa and ongoing financial sector problems in Mozambique are responsible for high interest rates. Governments have reduced their budget deficits, but they remain vulnerable to fluctuating growth and external shocks. Botswana is the only economy with a budget surplus, while significant donor flows to Mozambique and Uganda finance their budget deficits. However,

¹ No Australian outward investment statistics are available for other individual African economies.

all five governments have broadened their revenue bases, including introducing value added taxes and abolishing tax exemptions. South Africa also is drafting a bill to introduce mining royalties. All economies are reducing their external debt exposure.

Financial Systems Strengthening

Better prudential regulation has supported stronger financial markets in these economies. Kenyan, Mozambican and Ugandan authorities are strengthening their prudential control and privatising state owned banks, while South Africa and Botswana have generally sound financial systems. Banks also have broadened their services to clients; for example, credit card use is rising rapidly in Botswana, Kenya and South Africa.

Better Governance

All five economies are undertaking reforms to improve governance and strengthen institutions; most now compare favourably to East Asia. South Africa and Botswana have the most transparent and efficient governance in Sub-Saharan Africa. Uganda, Mozambique and Kenya are undertaking judicial and public sector reform; Kenya began to focus on these areas only since its new government was elected in 2002.

BUSINESS ENVIRONMENT GENERALLY FAVOURABLE

Relatively stable, democratic governments characterise all of Southern and East Africa's success stories. This has provided the legitimacy required to undertake economic reforms and increase investor confidence. Ratings institutions have recognised these efforts, giving investment grade ratings to Botswana and South Africa.

Australians doing business in Africa encounter modest cultural differences. International business people generally find their counterparts in these economies professional, accessible and courteous.

The legal and regulatory environments in each of the five economies differ but, with the exception of Kenya, mostly are straightforward. Few business regulations actively inhibit investment. However, judicial and bureaucratic inefficiency in Kenya and Mozambique can make enforcing contracts and registering businesses difficult and time consuming. With a few exceptions, foreigners may invest in most sectors; authorities generally allow 100 per cent foreign ownership and do not enforce performance requirements on foreign owned businesses.

Taxation is not particularly onerous. Corporate taxes range from 10 to 37.5 per cent depending on the economy and industry. Property rights are well protected in all five economies. Foreigners may own freehold land in Botswana, Kenya and South Africa, but not in Mozambique or Uganda and all five economies allow foreigners to own or lease agricultural land. All have laws to protect intellectual property rights and have signed the Trade-Related Aspects of Intellectual Property Rights, TRIPS, Agreement.

The mining business environment generally is strong in Botswana and South Africa and the Ugandan and South African Governments are undertaking further reforms. The South African Government

has passed, or is considering, several new pieces of mining legislation aimed at developing the mining sector and broadening the tax base. It transferred mineral rights from private to government ownership, standardising it with practice in most economies including Australia. The South African Government also introduced the Broad-based Socio-economic Empowerment Charter to promote opportunities for historically disadvantaged South Africans in the mining industry. In practice, this charter means new miners establishing in South Africa need to form a joint venture with a black mining partner. The South African Government currently is discussing with relevant stakeholders a draft Royalties Bill which imposes royalties on minerals extraction. The Ugandan Government has recently opened up its mining regime to foreign investment and is issuing exploration licences.

Despite their generally improving economic and business environment, several problems hinder Southern and East Africa's business environments. Poverty is widespread. Human capital development remains weak. Productivity and social indicators also are under pressure from HIV/AIDS which affects up to 40 per cent of Botswana's population, 20 per cent of South Africans, 15 per cent of Kenyans and 13 per cent of Mozambicans. Labour laws and regulations increase unit labour costs and limit labour market flexibility. Outside South Africa and Botswana, transport infrastructure is poor. National road networks in Kenya, Mozambique and Uganda are weak and all economies' railway systems are deficient to varying degrees. In Kenya and Uganda, companies typically install alternative power supplies because national supplies are unreliable. Governance issues are common in several economies and security is an ongoing concern. Information and communications technology, ICT, readiness is generally poor with relatively low telephony penetration and business and household Internet uptake.

AUSTRALIA'S TRADE WITH SOUTHERN AND EAST AFRICA INCREASING

In all these economies, trade liberalisation has improved export performance despite weak prices for several key commodity exports. However, similar export profiles of Australia and these five economies limit bilateral trade. While South Africa currently is Australia's largest trading partner in Sub-Saharan Africa, it ranks only twenty first out of Australia's global merchandise trade partners. Manufactures are an important part of Australian exports to these economies, although Mozambique imports significant volumes of Australian alumina, South Africa imports large amounts of coking coal and nickel and Kenya imports wheat.

Export Opportunities

Higher value added manufactures such as telecommunications equipment, aircraft and aircraft parts, machinery and electrical equipment are some of the fastest growing Australian exports to the region. Service exports such as education and ICT also offer good prospects. Regional governments and parents are starting to recognise Australian universities can provide quality university education more cheaply than traditional destinations like the United Kingdom and the United States. Opportunities exist for Australian ICT exporters as mobile phone usage expands and financial services reform drives demand for supporting financial software and ICT services.

Trade Barriers

Governments of the five economies mostly are streamlining and reducing complex tariff systems and barriers. The main remaining non-tariff measures in these economies include import quotas on some agricultural products, opaque customs procedures, import and export licensing, export subsidies and local content requirements. All five economies have joined regional preferential trading agreements; while such trading blocs may attract potential investors because they provide access to larger markets and may improve incomes of participants, they also can affect trade with third countries for some products.

GOOD PROSPECTS FOR AUSTRALIAN INVESTMENT IN SOUTHERN AND EAST AFRICA

Over the past decade, reforms in most of these five economies have encouraged a significant increase in FDI inflows; these now form an increasingly important part of total investment. Their governments have relaxed exchange controls, ruled out expropriation, privatised state owned enterprises, avoided policies favouring domestic producers in specific sectors and signed multilateral investment treaties. They also have established investment promotion agencies to reduce foreign investors' establishment costs and regulatory barriers. Regional trading arrangements may attract investors, although in the foreseeable future consumers' disposable income will remain low in most of these economies.

Australian investors can find rewarding investment opportunities in all five economies. Their on-going reforms (including to FDI policy), sound economic growth and the close match between their investment requirements and Australian expertise and technological capacity drive these opportunities. Mining, agribusiness and related goods and services offer some of the major investment prospects. Other opportunities include infrastructure, education, financial services, tourism and ICT.

Mining and Agriculture

Considerable tapped and untapped mineral wealth exists throughout Southern and East Africa providing mining investment opportunities in Botswana, Mozambique, South Africa and Uganda. Australian companies already mine chrome ores, coal, diamonds, gold, manganese and platinum in these economies. The South African, Botswana and Mozambican governments in particular encourage minerals processing industries. As well, all five governments are keen to promote local and foreign investment in agriculture and agri-processing, particularly in non-traditional agricultural sectors such as floriculture, fruit and vegetables, nuts and cotton.

Infrastructure

As poor infrastructure is a key impediment to growth in the region, all five governments accord priority to infrastructure provision. The World Bank has assigned additional funds for African infrastructure development, while the Development Bank of Southern Africa is funding infrastructure in projects in South Africa and the rest of the region. Projects include developing roads, rail, energy, water, ports and telecommunications infrastructure.

Services

Vocational training presents one of the best opportunities for Australian educators. Shortages of skilled and technically trained labour are widespread and local institutions cannot fill this gap. All five economies have an oversupply of arts graduates, but more limited higher education capacity in the sciences and ICT, providing opportunities for Australian educational institutions. The potential to offer new products, such as electronic funds transfer in the regional financial services sector, provides opportunities for Australian financial institutions to leverage expertise in banking technology and advanced financial products. Africa's diverse wildlife and vast tracts of relatively unspoilt environment generate significant tourism with potential for Australian suppliers including training for local operators. Most of the five economies also are seeking to increase their ICT uptake. Botswana and South Africa have the most developed ICT infrastructure, providing opportunities for sophisticated ventures such as system integration services, business process software and Internet-based business system solutions. Less developed networks in Kenya, Mozambique and Uganda present opportunities to invest in more basic information and communications infrastructure.

SOUND AFRICAN INVESTMENT PROSPECTS IN AUSTRALIA

As most of Sub-Saharan Africa has little surplus capital to export, the great majority of African investment in Australia comes from South Africa; over the past 10 years, the stock of South African investment in Australia has averaged growth of 18 per cent per annum. South African authorities' gradual easing of restrictions on outward FDI over this period permitted this growth. Although the majority of this investment is concentrated in the mining sector, South African FDI is present in finance, insurance, manufacturing, real estate and a range of services.

Australia provides an attractive destination for Southern and East African FDI, offering a productive and skilled workforce, a resilient economy, well developed ICT and other infrastructure, open and transparent regulations and few limitations on FDI. The similar sectoral profile of these economies and Australia, including significant mining and related sectors, agriculture and agri-processing, tourism and business, ICT and professional service sectors, generates investment opportunities for the region's investors in Australia. Australia's close proximity and connections with East Asia also attract regional investors wishing to service both Australia and East Asia from an Australian base.

IMPLICATIONS

The improving economic performance of Botswana, Kenya, Mozambique, South Africa and Uganda should generate increasing trade and investment opportunities for Australian business.

Higher incomes mean that the greatest short to medium term opportunities are in South Africa and Botswana. However, as Mozambique, Uganda and Kenya continue reforming their economies and business environments, Australian business also can consider early investment and trade opportunities in these economies. All five economies are open to FDI with few sectors off limits. However, in the

short to medium term, HIV/AIDS, skilled labour and infrastructure shortages and crime could challenge business. Businesses would do well to utilise the investment promotion agencies in each economy to help expedite investment approval and set-up processes.

Government-to-government links with Southern and East Africa already are significant, although more limited than those in our own region. AusAID, the Australian Government's overseas aid agency, continues to play a modest but constructive role in Africa. Australia has an interest in further efforts to assist reform and development in these economies, through, for example, targeted postgraduate scholarships in key economic and technical disciplines and training to promote public sector reform. Australia also is developing strong links with some of these economies because of shared interests in international trade reform, especially on agriculture.