

# **SADC FINANCE AND INVESTMENT SECTOR**

**Study on**

**Development Finance and the Need for a Sub-Regional  
Development Financing Institution in SADC**

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## **RESEARCH PROJECT:**

### **Development Finance and the Need for a Sub-Regional Development Financing Institution in SADC**

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**The Southern African Development Community (SADC)**  
Finance & Investment Sector Co-ordinating Unit (FISCU)

**FISCU Research Project**

**Study on Development Finance and the Need for a Sub-Regional  
Development Financing Institution in SADC**

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**FISCU**  
**South Africa**

# **FISCU RESEARCH PROJECT:**

**STUDY ON DEVELOPMENT FINANCE AND THE NEED FOR A SUB-REGIONAL DEVELOPMENT FINANCING INSTITUTION IN SADC**

**Editors: Percy S Mistry & Lolette Kritzinger-van Niekerk**

The views expressed in this document do not necessarily represent those of either FISCU or the financiers of the project, i.e. the European Union, Delegation of the European Commission in South Africa.

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## **PREFACE**

FISCU's mandate is to facilitate the process of 'community-building' in the sub-region through the: (a) gradual, progressive integration of the sub-region's financial systems; and (b) harmonisation and co-ordination of the efforts and key policies of individual governments to permit capital to flow freely within SADC as well as encouraging increased inflows of capital from outside the region. After its establishment in 1995, FISCU embarked on building the foundations for its future work-programme by initiating a project comprising research on:

- *structural adjustment* and *convergence* in SADC;
- the climate and outlook for expanding *investment* in SADC; and
- *development finance* in SADC with specific focus on examining the need for a sub-regional development bank and/or fund.

Attracting adequate levels of development finance, and establishing a regional institution for dispensing it, have preoccupied members of SADC since its emergence in 1992. The question was legitimately raised during Treaty deliberations about whether a development-oriented *economic community* in Southern Africa needed a mechanism for: (i) enabling intra-regional resource transfers between its richer and poorer members; and (ii) mobilising and allocating financial resources from international and local sources for sub-regional purposes.

These two related but distinct notions were based on analogies from other sub-regions. The need for a sub-regional development bank (SRDB) assumed further significance in the context of rapidly diminishing creditworthiness of several over-indebted but populous SADC members between 1985-95, when they came under intense pressure to adjust. Their public finances were out of balance and subject to controls, which were externally imposed. Such discipline constrained their ability to undertake discretionary public investment. Concomitantly their national DFIs had, by then, become virtually insolvent with a debilitating proportion of non-performing assets in their portfolios. These unfortunate realities led several SADC members to advocate a SRDB, which might be better placed to raise resources from multilateral development banks (MDBs) and from capital markets for financing their contributions to regional investments - particularly in infrastructure. Since 1992, the issue of a SRDB or Fund has been re-visited *inter alia*, in:

- the African Development Bank's study on Economic Integration in Southern Africa (1993);
- exercises which have taken place after the RSA 1994 elections on defining the future role of South Africa's own network of national development finance institutions (DFIs). The transformation team working on one particular institution - the *Development Bank of Southern Africa (DBSA)* - specifically looked into the possibility of that institution playing a wider regional role;
- the 1995 Theme Document, prepared for discussion by ministers at the Annual Consultative Conference in January 1995 in Malawi, recommended the establishment of a Finance and Investment Sector, and of a sub-regional development bank, identifying the DBSA as a likely candidate for this role. At the Conference, recommendations on the creation of a sub-regional development bank (taken out of the AfDB Study) were debated at length between the Member States and the International Cooperating Partners. The latter rejected from the outset the creation of a new institution. Consensus was reached, though, on the need to adapt existing institutions - in particular the DBSA - for regional purposes. The discussions resulted in agreement that there was need for a further study to assess the particular role that such a sub-regional bank/fund would play, and that in the meantime it was premature to establish one. It was agreed that the Minister of Finance of the RSA would call a meeting of Finance Ministers of SADC to determine the terms of reference of the newly created Finance and Investment Sector, which would *inter alia* address the feasibility of having a sub-regional development bank, and look at the establishment of a fund as provided in the Treaty; and

- the Phase I Study for the SADC-FISCU Research Project (May 1996), which subsequently investigated the issue without reaching any firm conclusions but posing the questions that needed to be asked in Phase II.

The SADC ministerial discussion of the Phase I Report in late 1996 framed the *Terms of Reference* (ToR) for the Phase II DFS which specified these *objectives*:

- establish how development finance should flow to productive sectors;
- identify institutional capacity for managing development finance;
- develop a co-ordinated policy on financing sub-regional projects;
- identify categories of projects and sources of funding;
- use SADC Programme of Action projects as examples to substantiate funding mechanisms;
- explain why sub-regional projects are not being implemented;
- explain why the sub-regional bank option is being excluded; and
- explain the development finance experiences of other sub-regional groupings.

This study on *development finance and the need for a sub-regional development financing institution in SADC* analyses various aspects of development finance in SADC and other sub-regions: the ‘moving target’ nature of development finance; its complementarity with other sources of funds; investment needs at the national and sub-regional levels in SADC; development finance needs for specific sectors and special purposes; the nature of *sub-regional* projects; the functioning and experience of national and sub-regional DFIs; and problems that have arisen with non-performing assets in national and sub-regional development finance institutions in SADC and Africa. It finds that there is no clear case for such an institution on economic or financial grounds. If a case were to be made it would need to be on political grounds. The study then analyses the purposes of a sub-regional DFI, the burden-sharing issues involved in the event that SADC governments decide to proceed with setting one up; and four institutional options that SADC policy-makers might consider in assuring the adequacy of development finance in the sub-region. These are: (i) converting the DBSA into a SADC-DFI; (ii) setting up a new sub-regional institution; (iii) creating a SADC-wide network of national DFIs; and (iv) establishing a SADC development fund. Apart from the first two, these options are not deemed to be mutually exclusive. If development finance in SADC is to have a regional dimension then a supra-national DFI (whether new or converted) would probably be a step in the wrong direction. A combination of the third and fourth options would be the optimal strategy for SADC. It would thus be better to sub-regionalise development finance by having national DFIs develop sub-regional capabilities through *co-operative* as well as *competitive* strategies. SADC governments should therefore support a SADC-wide DFI-network with a *Development Finance Resource Centre* (DFRC) at its hub. The development finance network solution could be complemented by a *SADC Development Fund* financed by multilateral and bilateral donors to augment *public finance* resources for sub-regional and national projects which have high economic returns, but are not necessarily financially viable.

The three inter-linked studies on convergence & adjustment, investment and development finance in the Southern African region have developed a rich integration, cooperation and coordination agenda for stakeholders of the Finance and Investment Sector and SADC’s policy makers. Indeed, since its completion in March 1998, the analysis, findings and recommendations of the Research Project have guided the Sector, and particularly its Sub-committees on macroeconomic policy, investment and development finance, in its efforts to develop a SADC Finance and Investment Protocol.

Upon completion of the project, a limited number of copies of the studies were distributed to and discussed by the Sector’s senior officials. However, with the development of a SADC Finance and Investment protocol gaining momentum among a broader group of stakeholders, there is a need for a much wider dissemination of these studies in SADC.

FISCU gratefully acknowledges

- the financial support of the EU, Delegation of the European Commission in South Africa, for the translation (of the executive summary document of the three studies into Portuguese and French), printing and distribution of the studies;
- Percy S Mistry, team leader for the three studies and principal consultant for the development finance study, and Lolette Kritzinger-van Niekerk for editing the final draft reports of all three studies as well as the summary document. Unfortunately, Roger C Riddell, the principal consultant for the convergence & adjustment study, was not available for editing his final draft report due to other commitments; and
- the financial support of the DBSA for enabling the editors to meet and work together over a short period of ten days during the initial stage of the editing process.

It should be noted that the editing of the final draft reports did not entail any updating of the data, information and analyses of the studies. It is believed, however, that the publication remains as relevant and rich in its analysis, findings and agenda setting as at the time of the Project's completion.

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2000

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## GLOSSARY OF TERMS

ACP	Africa, Caribbean and Pacific
ADELA	Investment Finance Company for Latin America (English translation)
AfDB	African Development Bank
AFIC	Asian Finance and Investment Corporation
AnDF	Andean Development Fund
AsDB	Asian Development Bank
BDEAC	Banque de Developpement des Etats de L'Afrique Centrale
BLNS	Botswana, Lesotho, Namibia, Swaziland
BOAD	Banque Ouest-Africaine de Developpement
CABEI	Central American Bank for Economic Integration
CBL	Commercial bank lending
CDB	Caribbean Development Bank
CDC	Commonwealth Development Corporation
CTDB	COMESA Trade and Development Bank
DBSA	Development Bank of Southern Africa
DEG	The German Investment Finance Corporation for Developing Countries
DF	Development Finance
DFI	Development Finance Institution
EADB	East African Development Bank
EBRD	European Bank for Reconstruction and Development
EDF	European Development Fund
EIB	European Investment Bank
FDI	Foreign Direct Investment
FISCU	Finance and Investment Sector Co-ordinating Unit of SADC
FMO	The Netherlands Investment Finance Corporation for Developing Countries
FPI	Foreign Portfolio Investment
GDI	Gross Domestic Investment
GDP	Gross Domestic Product
IADB	Inter American Development Bank
IBRD	International Bank for Reconstruction and Development
ICM	International capital markets
IDB	Islamic Development Bank
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IIC	Inter-American Investment Corporation
IMF	International Monetary Fund
JPTC	Joint Permanent Technical Committee
LHDA	Lesotho Highlands Development Authority
LHWP	Lesotho Highlands Water Project
MDB	Multilateral Development Bank
MEDB	Middle Eastern Development Bank
MENA	Middle East and North Africa
MIGA	Multilateral Investment Guarantee Agency
MMA	Multilateral Monetary Agreement
MVA	Manufacturing Value Added
NTB	Non-tariff Barriers
OECD	Organisation for Economic Co-operation and Development
OOF	Other Official Flows
PICA	Private Investment Corporation for Asia
PPI	Private Provision of Infrastructure
PTA/COMESA	Preferential Trade Area/Community of Eastern and Southern Africa
PTAB	Eastern and Southern African Trade and Development Bank (The PTA Bank)

RCM	Regional capital markets
RDBs	Regional Development Banks
RIAs	Regional integration arrangements
RSA	Republic of South Africa
S & P	Standard and Poor
SACU	Southern African Customs Union
SADC	Southern African Development Community
SADCC	Southern African Development Co-ordination Conference
SAR	Southern African Region
SIFIDA	Society for Finance and Investment in Developing Africa (English translation)
SME	Small and Medium Enterprises
SMMEs	Small, Medium and Micro Enterprises
SRDBs	Sub-regional development banks
SSA	Sub-Saharan Africa
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
WADB	West African Development Bank
WB	World Bank
WDR	World Development Report
ZAR	South African Rand
ZCCM	Zambian Consolidated Copper Mines Ltd