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An overview of South Africa's investment regime and performance

by
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Introduction

South Africa's regulatory regime for foreign direct investment (FDI) has undergone significant transformation and liberalisation since the country's successful transition to democratic governance in April 1994. This has been in line with global trends towards greater liberalisation of national FDI regimes (no doubt reflecting the dominant neo-liberal influence of economic globalisation and its attendant 'best practice').

South Africa's macro-economic policy, the Growth, Employment and Redistribution (GEAR) strategy, is conceived within and oriented towards the competitive global economy, with strong emphasis on fiscal discipline, investor confidence and macro-economic stability. GEAR rests on two 'motors' for economic growth: (i) a rapid expansion of non-traditional (non-gold, manufactured) exports and (ii) an increase in private sector investment. New inward FDI is regarded as an essential source of savings, needed to finance increased investment and therefore an important engine of economic growth. The South African government has been particularly keen to attract export-oriented FDI and in so doing hopes to stimulate innovation and exports in local firms through the technology and skills transfers from and competitive pressures associated with FDI. For this reason the government has established a national investment promotion agency, Trade and Investment SA (TISA), with the mandate to provide one-stop shop services to potential investors. South Africa's investment credentials have also been promoted by president Thabo Mbeki's prestigious International Investment Advisory Council. The President hopes to attract FDI to the country through his direct interventions with international business leaders. However, in the 'global beauty contest' for scarce capital, South Africa has not fared very well.

FDI flows to and from South Africa

Despite sound macro-economic fundamentals, South Africa is performing rather poorly in attracting FDI, especially when compared to other emerging markets in the world economy. Its geographical anchor, Africa, also appears to be a lost cause: Africa attracted less than 1 per cent of global FDI flows in 2000, symptomatic of the highly iniquitous world economy.

UNCTAD's World Investment Report 2001 estimates that in 2000 S A attracted inward FDI of US$ 877 mn (compared to US$ 1502 mn in 1999 and US$ 3817, in 1997). The poor FDI figures for 2000 are partly a reflection of the decrease in government activity, such as privatisation, which attracts foreign inflows. Approximately 60 per cent of FDI into South Africa takes the form of mergers and acquisitions, largely as a result of state-leveraged deals and the privatisation of state assets such as the Airports Company SA, SA Airways, Telkom and others. The most important investors in South Africa have been the US, UK, Australia, Germany, Japan, Malaysia, Switzerland, China and Canada. FDI has been concentrated in four sectors: energy and oil; motor and components; food and beverages; and hotels, leisure and gaming.

The bulk of FDI into South Africa has been natural resource-seeking and market-seeking FDI, as evidenced by the high value concentration in the telecommunications, oil and energy, and food and beverage sectors. The (presumed) cornucopian benefits of FDI have not always been forthcoming in South Africa; in particular, FDI has had a crowding-out effect on some local producers. This is particularly so in the dairy, pharmaceuticals, steel, and electric and electronics sectors. Most FDI into South Africa is capital-intensive and goes to already established service sectors and new manufacturing sectors.

Efficiency-seeking investment in South Africa's export-oriented manufacturing sector has been very low. This is where TNCs locate part of their value-added chain abroad to improve the profitability of their overall economic operations. This is the type of investment that the GEAR programme hoped to attract as part of its industrialisation strategy. An

exception is South Africa's automobile and components industry. The government's much-vaunted Motor Industry Develop-ment Programme (MIDP) has been at the heart of this industry's export gains. The MIDP provides for a system of export incentives for local car and component makers, while gradually reducing tariffs on exports. Today BMW exports 36 000 units a year, Daimler Chrysler exports 30 000 units, and Volkswagen 29 000 units. The industry is also a significant and stable employer, with an estimated 33 000 jobs in vehicle manufacturing and 47 000 in component and tyre production. This highlights the potential of efficiency-seeking investment to contribute towards South Africa's development objectives (such as job creation), although there is the danger of export-oriented stagnation, namely, an increase in manufacturing exports but a stagnation/decrease in productivity.

Outward FDI is both larger and growing at a faster rate than inward FDI. Inflows of foreign capital are partly offset by outward investments by South African companies expanding their activities in foreign markets, particularly in southern Africa. Most South African investment in the region is of a resource-seeking and market-seeking kind. The share of South African investment in total investment into the 14-member Southern African Development Community (SADC) is significant, amounting to about 47 per cent of all deals made in the region. South African companies are also concentrated in Europe and the amount of direct investment in Oceania has increased by over 400 per cent since 1994.

Features of SA's investment policy

Rights to entry and establishment:
The South African government actively encourages investment in the SA economy. There are generally no restrictions on the type or extent of investments available to foreigners. Restrictions would usually relate to a particular industry. In banking, for example, a foreign bank establishing a South African branch may be required to employ a certain minimum number of local residents and maintain a minimum capital base of at least R 1 million. Restrictions also exist regarding the ownership of immovable property by foreign companies.

Investor protection, guarantees and insurance:
South Africa has signed over 30 bilateral investment treaties (BITs) that extend protection to both portfolio and direct investment. South Africa is also a signatory to the World Bank's Multilateral Investment Guarantee Agency (MIGA). The Overseas Private Investment Corporation (OPIC) also has commitments in South Africa.

Dispute settlement mechanisms:
South Africa is a member of the New York Convention of 1958 on the recognition and enforcement of foreign arbitration awards, but is not a member of the International Center for the Settlement of Investment Disputes.

Restrictions on outward capital flows:
There are no exchange controls on foreign investors or restrictions on the repatriation of profits and dividends. Royalties, license fees and certain other remittances require approval of the South African Reserve Bank.

Transfer pricing:
South Africa has no laws regulating transfer pricing. The government deals with this practice in large companies (such as BMW) on a case-by-case approach.

Double taxation treaties:
South Africa's double taxation treaties encompass most of Europe (also eastern European countries) and a number of African and Asian countries.

Requirements:
South Africa does not impose performance requirements, local content requirements (labour and suppliers) or require new investments to comply with specific criteria.

Investment incentives:
The Department of Trade and Industry (DTI) has developed a number of incentive schemes and continues to introduce new ones. South Africa is offering R3 bn worth of incentives for strategic projects that will apply up until 2005. There are however no significant tax incentives (incentives that are granted are: depreciation of plants and machinery, buildings and improvements, wear and tear allowances; lease premiums; scientific research; and double tax avoidance). The tax holiday scheme was phased out in 1999 and replaced with a reduction in corporate tax rates from 35 to 30 per cent of profits. Four broad categories of incentives are distinguishable:

- Innovation – Research and Development.

2

• Enterprise/Manufacture – establishment/expansion of a manufacturing concern.
• Competitiveness – improving efficiency of existing operation.
• Export – exporting and marketing of manufactured goods.

South Afria's industrial development programme:
South Africa's industrial development programme is based on private-public partnerships, spatial development initiatives (SDIs), industrial development zones (IDZs), and cluster studies.

Why is South Africa not attracting FDI?

Although South Africa's macro-economic fundamentals are sound, the country is struggling to attract FDI. There is no exact explanation for this discrepancy. The political economy of investment and the decisions of TNCs concerning where and how to invest are strongly affected by cognitive perceptions of economic and other risk factors in particular host economies (including South Africa). The following factors have been said to retard private capital flows to South Africa:

• South Africa's market of 44 million people – as well as the SADC market of 190 million people – is considered too small and underdeveloped to attract FDI, particularly market-seeking FDI

• South Africa's poor economic growth rate (2.2 per cent in 2001, expected to rise to 2.3 per cent this year). The link between economic growth and FDI in South Africa is ambiguous. It is argued that FDI, once attracted, will stimulate economic growth as opposed to the obverse where South Africa actually needs a significant amount of economic growth to attract FDI in the first place. Economic growth in South Africa – and the attraction of FDI – therefore requires greater levels of long-term domestic fixed investment by both the private and public sectors.

• The risk factor generally associated with investment in emerging markets also applies to South Africa. Politically volatile events in the region (culminating with recent events in Zimbabwe) have spawned concerns over property rights, the rule of law and governance in South Africa.

• The high levels of crime in South Africa.

• A shortage of skilled labour - South Africa's bureaucratic and complex immigration policy for skilled persons aggravates this dearth of skilled human capital.

• The high user cost of capital, although the long-term trend in interest rates is downward (depending on whether the Reserve Bank's inflation target of 3-6 per cent can be met).

• South Africa's labour regime is perceived to be inflexible and over-regulated. The difficulty of laying off workers and complying with employment equity legislation is perceived by global multinationals as a disincentive to investment. (This perception does not represent reality; in South Africa one out of seven workers has been fired over the last six years. There is a whole lack of understanding of the new labour regime due to inadequate training. It is easy to fire workers if they are incompetent; the employer just needs to follow a paper trail).

• Regulatory uncertainty, particularly in the telecommunications, electricity and transport sectors.

• Poor domestic confidence in the South African economy. The low level of domestic savings, domestic investment and low confidence by domestic investors in the South African economy deters foreign investment. The question asked by multinationals is: if South Africans do not invest in the South African economy, why should we as non-nationals?

Policy considerations

1. *Provincial investment promotion agencies should formalise their relationships with TISA through the signing of memorandums of understanding***.** Trade and Investment Kwazulu-Natal is the only agency that enjoys a working relationship with TISA. A formalised relationship between national and provincial levels on investment facilitation and promotion could have many benefits, inter alia, developing and packaging investment opportunities (particularly for IDZs), sharing of resources, simplifying bureaucratic procedures, and participation in investment roadshows.

3

2. *South Africa should support regional efforts to attract FDI, which should include the negotiation of a regional investment code that supports development objectives. The government should second appropriate persons to SADC headquarters in Gaborone to support the work of the new Trade, Industry, Finance and Investment directorate.* A regional investment framework could lead to greater FDI inflows to South Africa and its neighbours. Such a code should provide region-wide incentives for large companies to invest in labour training, health and education, given that it is in their interest to have a 'stable' workforce, and create employment. Some responsibility also lies with the SA government to create an incentive framework that would reconcile the investment ventures of South African firms with regional development priorities. It could include incentives that would encourage South African firms to source from local suppliers, favour labour-intensive productive enterprises, and encourage infrastructure investment linked to the comparative strengths of a country and regional development needs.

3. *TNCs must include corporate social responsibility programmes in their South African operations.* This could relate to HIV/AIDS awareness and support, black economic empowerment, skills development, business against crime, and ethical investment (sound labour and environmental practices).

4) *Civil society actors in South Africa need to become more involved in decision-making on investment-related issues.* In particular, it is necessary to develop a working social accord between business, labour and government outside the institutional framework of the National Economic Development and Labour Council (NEDLAC). A social accord – one that establishes both a socially-acceptable and investor-friendly labour market regime, supports skills development and raises productivity – and agreements negotiated between business, labour and government in the sector job summits would provide a more enabling framework for investment.

4) *FDI is not an alternative for the poor levels of domestic investment (private and public) in the economy.* Domestic investment, particularly by the private sector, is critical for stimulating economic growth, enhancing capital, generating jobs and promoting social development in South Africa. The private sector however appears to be waiting for its investment cue from increased government spending on infrastructure.

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Suggested Reading:

Business Map, Regional Investor Survey 2001. Opportunities in Waiting (Johannesburg 2001).

See the official website of Trade and Investment South Africa at: http://www.tisa.org.za

UNCTAD, 2001 *World Investment Report: Promoting Linkages* (New York 2001).