Investment Policy in South Africa

– An Agenda for Action

Institute for Global Dialogue

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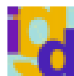

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LIST OF ABBREVIATIONS

ANC	African National Congress
BEE	Black Economic Empowerment
COSATU	Congress of South African Trade Unions
DTI	Department of Trade and Industry
FDI	Foreign Direct Investment
GATS	General Agreement on Trade in Services
GEAR	Growth, Employment and Redistribution
ICT	Information Communication Technology
IDZ	Industrial Development Zone
IGD	Institute for Global Dialogue
IIC	International Investment Council
IMC	International Marketing Council
IPO	Initial Public Offering
MIDP	Motor Industry Development Programme
NAFTA	North American Free Trade Agreement
NEDLAC	National Economic Development and Labour Council
NEPAD	New Partnership for Africa's Development
NRG	National Reference Group
PPP	Public-Private Partnership
RISDP	Regional Indicative Strategic Development Plan
SA	South Africa
SACU	Southern African Customs Union
SADC	Southern African Development Community
SATUCC	Southern African Trade Union Coordinating Council
SIP	Strategic Industrial Project
SMME	Small, medium and micro-enterprises
STC	Secondary Tax on Companies
TISA	Trade and Investment South Africa
TNC	Trans-national Corporation
TRIMs	Trade Related Investment Measures
TRIPs	Trade Related Aspects of Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organisation

PREFACE

South Africa represents the 'full-mix' of problems that afflict a typically developing country in attracting investment – both foreign and domestic. These relate to the size and nature of the economy, the regulatory and legal environment, the attractiveness of particular sectors, the investment incentive structure, the human capital and natural resource base and so on. But what perhaps sets South Africa apart is that it is a country of a special type. It emerges from the scourges of a tragic past, with the new government inheriting a panoply of policy and institutional challenges in managing a daunting transition process, one which at least breaks irrevocably with its past and ushers in a democratic dispensation in all aspects of its national life.

The economic growth and social development imperatives are of particular importance in addressing the legacies of racially engineered deprivation and privilege. In this regard, the nexus between investment and economic growth is consequential for the country's social welfare. It is for this reason that the government has initiated an institutionalised dialogue with its social partners in business and labour in order to craft a 'consensual' public policy. While outcomes of such processes do not always yield optimal outcomes, they promote a virtuous circle of embedding consultation on key policy issues.

As is evident from this report, South Africa has evolved policy instruments and introduced macro-economic reforms which are far-reaching in their implications for investment. Yet, given that it has a highly integrated policy and regulatory super-structure and the right economic fundamentals, South Africa has not fared consistently well as a preferred destination for foreign investment, particularly of the type which would be a boon to its export sector. The bulk of foreign direct investment rather makes its way into non-productive merger and acquisition activities while that which has the potential for growth and efficiency gains tends to be concentrated in certain sectors.

This report wrestles unambiguously with these conundrums. It is based on a careful diagnosis of South Africa's investment climate and regime in the context of its economic environment and policy framework. But perhaps more important is the report's utility as an investment policy manifesto, which is based on reflections and discussions on how South Africa may improve its investment performance. This is drawn directly from a systematic engagement with relevant

constituencies from the government, civil society and business on the basis of three National Reference Group meetings held in South Africa. These interactive exercises provided a platform for a rich combustion of ideas and debates which have critically informed and enriched the report's advocacy programme; hence the sub-title, 'An Agenda for Action'. This agenda points to actionable policy recommendations for the government, civil society and inter-governmental organisations.

This report is part of a comparative study of seven developing countries' investment regimes. The study has been initiated and managed by the Consumer Unity & Trust Society in Jaipur, India. The Institute for Global Dialogue was responsible for the South African country-study. It is indicative of how analytically rigorous work which also resonates with the voices of stakeholders can be marshalled to provide a template of extremely useful and relevant policy guidelines. What is particularly important, in this regard, is that this study sets out practical paths to addressing many of South Africa's investment conundrums.

Dr Garth le Pere
Executive Director
Institute for Global Dialogue

CHAPTER-1

Introduction

The Need for Foreign Direct Investment

Most developing countries today consider Foreign Direct Investment (FDI) as an important channel for obtaining access to resources for development. This is a very different attitude from only 20 years ago, when FDI in most developing countries was either prohibited, or the industries in which they could invest limited. Furthermore, restrictions were placed on profit remittances and capital repatriation, and stringent performance requirements were imposed on transnational corporations (TNCs).

Since the beginning of the 1990s, developing countries have started liberalising their rules and regulations in this respect. Today, most countries have reduced obstacles for TNCs, strengthened the standards of treatment of foreign affiliates, opened up most industries of the economy to TNC investment, and eliminated or relaxed limitations on the repatriation of capital and profit remittances. Many countries no longer impose performance requirements (earlier used as a condition to have access to incentives) and most grant access to incentives available to domestic firms. In some countries, foreign firms benefit from incentives that are not even available to domestic producers. In most countries, foreign companies have access to domestic capital markets, whereas in the past they were denied this access on the grounds that this would induce them to bring scarce foreign exchange into countries. Nationalisation, which peaked in the 1970s, has given way to the privatisation of state-owned enterprises.

South Africa's (SA) regulatory regime and enabling environment for FDI have similarly undergone progressive transformation and liberalisation since the country's successful transition to democratic governance in April 1994.[1] The government has continually stressed the importance of FDI for economic development and growth, and subsequent efforts to image, brand and market the country have followed. FDI is not, however, the only source of capital: domestic investors (private and public) in individual countries also have a very important role to play, in most cases more important than foreign investors.

Since 1994, the central economic objectives of the African National Congress (ANC) -led government (re-elected in 1999) have been job creation, the reduction

of poverty and inequality, and the overall sustainable growth of the wealth of the country. Although a broad range of economic and social policies have been crafted and implemented since 1994 to address these transformation challenges, the levels of poverty and inequality in SA remain extremely high. The foundations for higher economic growth are, however, now in place and the macro-economic performance (or the big picture) of the economy has significantly improved since the early 1990s when SA was still inwardly focused, protected and on the verge of crisis. A central challenge for the government is to now raise the levels of long-term investment, both from foreign abroad and domestic sources. The government is currently addressing a number of micro-level constraints to investment.

The Investment for Development (IFD) Project

In light of the importance of FDI in the framework of developing countries, the 'Investment for Development' Project endeavours to study the investment regimes of selected developing/transition economies and build capacity on investment policy. The emphasis is on co-operation between countries and regions, sharing information and experience, and engendering joint initiatives. This two-year project, launched in September 2001, is being co-ordinated by the Consumer Unity & Trust Society (CUTS) India, in collaboration with the United Nations Conference on Trade and Development (UNCTAD) and is supported by the Department for International Development (DFID), UK. The project involves fact-finding and advocacy work on investment regimes in seven developing and transition economies, namely, Bangladesh, Brazil, Hungary, India, South Africa, Tanzania and Zambia. The Institute for Global Dialogue (IGD), Johannesburg is working with CUTS as the partner organisation in SA for this project.

The National Reference Group (NRG) Meetings

To achieve the above goals, a National Reference Group (NRG) has been formed in each of the selected developing countries of the IFD project in general, and SA in particular, to provide a sounding board and quality check on the research outputs. Specifically, the NRG is expected to serve the following functions:

- To monitor the quality and content of research outputs generated;
- To create a sounding board which could be used for advocacy on foreign investment regimes in these countries;
- To discuss international investment agreements (IIAs) and other investment-related issues at the World Trade Organisation (WTO), and deliberate on strategies to be adopted by developing countries at international fora; and
- Above all, to attract attention to the project at a national level.

The NRG held three meetings to deliberate on these issues and matters. These were well attended, and represented different viewpoints on FDI generally, and in SA more specifically. This document is a synthesis of the views of the NRG participants, and ultimately contains a set of policy recommendations for circulation and advocacy work at the national level.

Highlights of the Report

The present report belongs to a series of seven monographs, prepared by the individual partner organisations in the project countries as part of this project. They seek to build understanding and capacity on investment-related matters among civil society and consumer groups, and are therefore, crafted in non-technical, non-economic and easily accessible terms. The report contains the following:

- Highlights of discussions in the NRG meetings;
- Background and analysis of key areas of the debate on FDI; and
- Prioritised policy recommendations emerging from the project research and the meetings.

The report will contain policy advocacy points on FDI for civil society, governments and inter-governmental organisations (IGOs). It will be distributed widely in the country among policy-makers, civil society organisations and business groups.

Organisation of the Report

This report consists of six sections, the 'Introduction' being the first. Section two deals with investment policy, performance and perceptions in SA; section three deals with the stakeholders' views on FDI; and sections four, five and six outline possible actions and recommendations for government, civil society and IGOs respectively.

CHAPTER-2

Investment Policy, Performance and Perceptions in South Africa

Investment Policy Measures

SA's regulatory regime for FDI has undergone progressive transformation and liberalisation since the country's successful transition to democratic governance in April 1994. This has been in line with the global trend towards greater liberalisation of national FDI and trade regimes. SA's investment climate reform in its broadest sense can be represented as follows:

Table: Policy Instrument Guiding the SA Investment Climate

	Economic Policy Instruments	Components
1.	Macro-economic policy: • Reconstruction and Development Programme (RDP) • Growth, Employment and Redistribution Strategy (GEAR) • Micro-economic Reform Programme • Integrated Manufacturing Strategy	• Economic environment • Fiscal policy • Monetary policy • Restructuring/Privatisation • De-regulation, improved regulatory quality • Trade and industrial policy • Competition policy • Labour market • Best practice corporate governance • Security of property and contractual rights • Black Economic Empowerment
2.	Incentives, industrial support and supply-side measures	• Fiscal and Monetary • Spatial interventions (SDIs, IDZs) • Public-Private Partnerships (PPPs) • Infrastructure • Skills, training and education • Other
3.	Voluntary and Obligatory Performance Requirements (PRs)	• Export PRs • Technology transfer PRs • Research and development PRs • Employment and training PRs • Joint venture or domestic equity PRs

	Economic Policy Instruments	Components
4.	Bilateral and multilateral legal instruments	• Bilateral Investment Treaties • Avoidance of Double Taxation Treaties • WTO: Trade Related Intellectual Property Rights (TRIPs), Trade Related Investment Measures (TRIMs), General Agreement on Trade in Services (GATS)

5.	Investment facilitation and promotion	• Trade and Investment SA (DTI TISA)
		• Provincial investment promotion agencies
		• International Marketing Council
		• Presidential Working Groups:
		  • Trade Unions
		  • Big Business
		  • Black Business
		  • Commercial Agriculture.
		• Presidential International Advisory Structures:
		  • International Investment Council
		  • International Task Force on Information Society and Development.

6.	Socio-political context, governance and institutions	

Adoption of the GEAR Strategy

GEAR was adopted in 1996 as the government's main strategy for economic development, overriding the often-contradictory macro-economic principles and objectives of the RDP, which was the initial socio-economic policy framework adopted in 1994. GEAR was conceived within and oriented towards a competitive global economy, with strong emphasis on fiscal discipline, investors' confidence, economic stability and a restructured public sector that would raise the efficiency of both capital expenditure and service delivery. GEAR rested on two 'motors' for economic growth: (i) an expansion of non-traditional (non-gold, manufactured) exports; and (ii) an increase in private sector investment.

According to GEAR, for growth to take place, gross domestic investment had to increase from 20 to 26 percent of gross domestic product (GDP), which required capital inflows equivalent to 4 percent of GDP, or more than five times the 1994 level. Policy-makers viewed an increase in direct investment (DI) relative to portfolio investment (PI) as crucial in maintaining low interest rates, since DI is generally less volatile than PI, and also in encouraging domestic investment.[2] The GEAR emphasised economic growth as a powerful stimulus of FDI (SA Government, 1996). One of the key objectives of GEAR, economic stability, has been achieved. Since 2001, the government has therefore, shifted its economic policy focus to address the remaining micro-economic obstacles to economic growth and investment, and to bolster the country's international competitiveness (a mix of factors).

Micro-economic Reform

The SA government has been implementing a micro-economic reform strategy since 1991 to complement progress made on the macro-economic front. This strategy is focused on removing factors that limit accelerated growth and development within the country's micro-economy. It prioritises six key performance areas, namely: economic growth; employment; small business development; BEE; competitiveness; and the geographical spread of growth and development in SA. Key input sectors such as transport, telecommunications and energy have been targeted to improve micro-economic competitiveness. Other reforms to date include: the negotiation of a new labour relations dispensation; the development of new legislation and an institutional framework for skills development; and the development of a new small business development institutional framework and supporting legislation.

Liberalisation, De-regulation and Public Sector Restructuring

Trade liberalisation and the gradual relaxation of capital controls (there are no exchange controls on foreign companies operating in SA) were implemented. State-owned enterprises (SOEs), such as the Airports Company SA, SA Airways[3] , Telkom and others were fully or partially privatised. In the process of restructuring state assets and liberalising markets previously controlled by state monopolies, new systems of regulation have been established. These include a range of new sector-specific regulators in the transport, telecommunications and energy sectors.

Strengthening Competition and Corporate Governance Regimes

The competition regime and corporate governance were strengthened. Competition is regulated in SA in order to promote efficiency, adaptability and development of the economy; to provide consumers with competitive prices

and product choices; to promote employment and advance the social and economic welfare of South Africans; to promote international competitiveness; to promote the participation of small, medium and micro enterprises (SMMEs) in the economy; and to promote a greater spread of ownership, particularly of historically disadvantaged persons (*i.e.* BEE).

Partnerships and Initiatives

Public-Private Partnerships (PPPs), Spatial Development Initiatives (SDIs) and Industrial Development Zones (IDZs) have been introduced. There has been a general move away from demand-side measures towards supply-side measures. There are, however, valid concerns that cross-subsidies, which previously benefited poor people, have been destroyed by privatisation or corporatisation, leading to unaffordable services in areas such as telephony, electricity, water and transportation.

Industrial Support and Performance Requirements

There has been a revamp of industrial support measures moving away from demand-side measures (*i.e.* export subsidies provided under the General Export Incentive Scheme) towards supply-side measures. The latter is geared to support higher-value added manufacturing projects as well as strategic industrial projects, IDZs, critical infrastructure development, among others. Harmful tax incentives (*i.e.* tax holidays and other ring-fenced measures) have also been replaced with more effective and internationally acceptable investment measures (*i.e.* accelerated depreciation for qualifying production assets). For example, the tax holiday scheme was phased out in September 1999 and replaced with an overall reduction in corporate tax rates from 35 to 30 percent of profits. The Secondary Tax on Companies has also been reduced.

SA does not impose performance requirements apart from the legislated requirements in the areas of training and employment, and equity requirements promoting BEE for the state procurement process and awarding of licenses in de-regulated industries. Performance requirements are obligatory where companies voluntarily opt for an advantage from the state, such as an incentive scheme, and requirements are attached to that particular scheme.

Investment Facilitation

The government has sought to enhance South Africa's investment credentials, and promote and facilitate investment through institutional innovation and bilateral negotiations, *inter alia*:

i) Negotiating Bilateral Investment Treaties (BITs) and Avoidance of Double Taxation Agreements with key trading partners, as well as Free Trade

Agreements (FTAs) with the European Union (EU) and other countries of the Southern African Development Community (SADC). SA has a number of bilateral negotiations lined up beyond the Southern African Customs Union (SACU) US FTA, the European Free Trade Area (EFTA)[4], Mercosur, India, and possibly China, Nigeria and Egypt.

ii) The establishment of a national investment promotion agency, Trade and Investment SA (TISA), now part of the Department of Trade and Industry (DTI), as well as provincial investment promotion agencies.

iii) The creation of President Mbeki's International Investment Council (IIC), the International Task Force on Information Society and Development, and the International Marketing Council (IMC) to promote SA's investment credentials, image and brand the country, and help create a subjective preference for SA among foreign investors. Several other structures have been established to advise the government on issues of local economy.

Emphasis on Exports in Trade Relations

The diversification of SA's trading networks, coupled with a continuing expansion of value-added manufactured exports from SA (exports over the last five years have registered an average annual growth rate of five percent in real terms). The government has been particularly keen to attract export-oriented FDI, in so doing hoping to stimulate innovation and exports in local firms through the technology, skills transfers and competitive pressures associated with FDI, and to integrate domestic companies into global supply chains. A successful case in point is the local motor and components industry.

Performance of FDI in SA

Despite improved macro-economic conditions and success in some sectors, foreign and domestic investment levels in SA remain below the average for other comparable developing and emerging markets. SA is still lagging in the 'global beauty contest' for foreign capital. Job shedding (and its related social costs, which have been borne by the state) has also accompanied privatisation and liberalisation. Some aspects and problems raised in the NRG meetings regarding FDI in SA are listed below:

- FDI has been concentrated in five sectors: telecommunications; energy and oil; motor and components; food and beverages; and hotels, leisure and gaming;
- The bulk of foreign investment into SA has been natural resource- and market seeking FDI, as evidenced by the high value concentration in the telecommunications, oil and energy, and food and beverage sectors;
- Efficiency-seeking investment, where TNCs locate part of their value-added chain abroad to improve the profitability of their overall economic

operations in SA's export-oriented manufacturing sector has been very low. The notable success story has been SA's motor industry, which has attracted considerable investment by German and Japanese companies;

- FDI is often attracted with the idea of stimulating job creation and increasing exports. It was noted that a country should develop comparative advantage in export-oriented FDI. For example, the relatively low cost of electricity in SA gives the country a comparative advantage for aluminium production, which requires extraordinary amounts of cheap energy. Aluminium production is a capital-intensive process, rather than labour-intensive. Comparative advantage is not always in areas that will grow employment fast enough or on the scale required;
- There has been little greenfield investment in new plants and factories; approximately 60 percent of FDI into SA takes the form of mergers and acquisitions (M&As) transactions, largely as a result of state-leveraged deals and the privatisation of state assets. On the one hand, this points to the highly developed nature of SA's equity markets, enabling asset purchases of this kind. A study by the Edge Institute has found that a relatively high proportion of investors interested in SA see the country's asset base as broadly similar to what they are familiar with (Gelb, 2002). On the other hand, this mode of entry is often associated with rationalisation and job losses, and does not generally expand the productive capacity, in terms of changes in the physical stock of capital in the economy;
- It is to be noted that continued upgrades in SA's currency ratings by international investment rating agencies, coupled with high interest rates (relative to its main trading partners in the North) have improved SA's credentials for FDI. The bulk of these inflows have been absorbed by the private sector. Although there has been an accompanying surge in private sector access to credit, Mohamed (2003) finds that the private sector has not utilised its improved access to credit for productive investment. Easier access to credit has instead supported existing negative trends in the economy, including growing household consumption and imports, higher share prices and capital flights. He argues that the surge in inflows is cause for concern because of the potential for instability it produces in the economy;
- The concern was raised in the NRG meetings that the main damage done by FDI in the privatisation process has been to destroy the potential for cross-subsidies (which often benefits poorer consumers). The case of telephony and the high cost of domestic calls relative to international calls, a product of rate rebalancing, was cited as an example;
- Certain industries and economic sectors in SA have greatly benefited from FDI in terms of new capital formation, enhanced competitiveness, technology and skills transfers, and foreign exchange, and would not have performed as strongly as they have without the foreign participation

they have attracted. A case in point is SA's automobile and components sector – one of the largest employers in the country and a major contributor to GDP – as well as the local ICT industry;

- FDI has, however, also effectively displaced some local producers and companies through the so-called 'smash-and-grab' or 'raiding' investment. This trend is particularly visible in the dairy, chemicals, pharmaceuticals, engineering, and electric and electronics sectors, all of which have seen several big investments in the past few years. Foreign companies have, at times, purchased local competitors, closed them down and expatriated their assets (*Business Day*, 31 October 2001);
- The foreign partners of some firms in SA have used the opening of the economy to reshape productive local affiliates largely into warehouses for imported goods. Production capacity has thus not been utilised, and value-added in real terms is effectively taking place outside SA. This problem has been noted in such sectors as capital and consumer equipment, pharmaceuticals and dairy;
- *Business Map* (2003) has noted a rising trend in disinvestment from SA, although small in absolute terms. Disinvestment is often related to BEE, which provides foreign firms with an exit strategy for disinvesting and selling off local operations to empowerment and management groupings; and
- Issues such as transfer pricing, depreciation, taxation, and currency volatility complicate calculations and measurements of FDI.

Perceptions of FDI in SA

Like in all other developing countries, the issue of FDI generates considerable debate in SA. The following are some of the issues and concerns raised:

- FDI is not necessarily superior to local investment, and should not be courted as an alternative to the domestic investment deficit in the SA economy. Domestic investment is critical for stimulating economic growth, enhancing capital, generating jobs and promoting social development. For SA to win the confidence of foreign investors as a viable market to invest in, domestic firms need to lead the way and show trust in the economy. This will involve addressing the underlying confidence issues in the economy;
- Foreign investors are said to be delaying investing in SA due to domestic corporate excess savings which are not being productively re-invested. In turn, the private sector is awaiting its trigger from efficiency improvements in government investment spending, particularly on infrastructure (constrained in the past by the tight fiscal policy and SOE restructuring). The government recently announced that it will launch a massive investment drive over the next 3 years, focused initially on roads, rail and

ports, which is meant to unlock obstacles to the country's export-led economic growth. The move, to be undertaken in conjunction with state enterprises, is expected to lead to the state taking over from the private sector as the prime driver of gross domestic fixed investment. Further investment will flow into social infrastructure under an expanded public works programme. The government will also continue to pursue options such as private sector concessions, equity sales and PPPs where necessary *(Business Day, 4 August 2003);*

- Some have argued that SA's low inward investment is a sign of strength of the SA economy. Firstly, SA does not have a technical shortage of capital as widely reported, but rather lacks viable, bankable projects. SA's national savings exceed its national fixed investment, so that there is no savings or resource gap (although some dispute this). Secondly, SA's domestic capital markets are so well developed that TNCs can raise all their capital requirements for viable projects in SA, rather than bringing in capital from their home countries. This, however, contradicts the expressed intention to use FDI to bring more foreign exchange into the country. Nevertheless, as capital markets integrate globally, projects are increasingly financed with a mix of local and FDI capital (Standard Bank Economics Division, 2003). It should be noted that inflows of FDI capital (often one-off) are quickly swamped by outflows or profits/dividends, as well as the problem of transfer pricing;
- Another view holds that the low level of domestic private sector investment in SA is not so much due to the argument of an 'investment strike', but because of an 'investment lock-out'.[5] Both local and foreign investors are willing but not able to find profitable or viable projects for greenfield investment. This lockout thesis is premised on the fact that SA is highly concentrated in virtually all industries, with anti-competitive practices over several decades responsible for amongst the highest four-firm concentration ratios in the world. The problem here includes not just horizontal oligopolisation, but also vertical integration that leads, through tied contracts, to a lock-out of any foreign investor in the main inward-oriented production, warehousing, distribution, marketing and retailing networks;
- In addition, SA is industrially diversified, with generally good provision of infrastructure; there are capital controls on domestic investors; there is ease in entry/exit of portfolio investment; the Competition Commission and Tribunal is said to be 'protective' of local monopolies, which are not being broken up despite plenty of opportunities and cause; there is low public spending on infrastructure, regulatory uncertainty, and limited business expertise to expand beyond core business into other sectors. Some would argue that this 'lock-out' is doubtful and does not hold for

investment in the manufacturing sector (particularly for export purposes). Others argue that the above problems are a classic case of over-accumulation; and

- As part of the IFD project, the partners in the project countries conducted a civil society perceptions survey. The survey in SA shows that, on the whole, SA civil society appears to be positively inclined towards FDI. Most of the respondents believe that foreign investment has contributed to SA's national economic development objectives in the past 2 to 5 years. Further, civil society respondents generally do not believe that any sectors of the economy should be closed to FDI. Many of them also believe that particular sectors should be strategically targeted for FDI (particularly export-oriented sectors).

  The respondents generally believe that apart from imposed requirements, there are other policy options to influence the behaviour of foreign firms for the benefit of the economy, performance requirements should not be imposed or legislated, but TNCs should rather be incentivised to create jobs, employ local managers (where possible and depending on skills availability), transfer technology, export from the economy and train local technical and managerial manpower. While it is felt by most respondents that environmental regulation, intellectual property rights laws and competition policy can be strengthened, there is negligible support among the respondents for strengthening the current labour market regime. The survey shows that the civil society opinion is that the focus of action in SA ought to be not so much FDI-targeted interventions, but generally macro and micro policies that enhance sustainable economic growth, domestic investment and the market.

CHAPTER-3

Stakeholders' Views on FDI

The following is a sample of the views expressed during the IFD project's first, second and third National Reference Group (NRG) meetings, along with other investor surveys, to account for the low level of FDI inflows in various sectors of the SA economy, and problems with FDI policy more broadly:

Problems in the South African Economy

(i) Domestic Market Structure and Potential (size and growth)

The SA market, although well structured, is comparatively small. The size of SA's consumer market and its purchasing power – as well as the SADC market of 190 million people – is said to be too small and indigent for many products and services, particularly by the market-seeking FDI. The SA market is also not growing fast enough to induce mass production type investment projects. Investors seeking growth markets are more likely to invest in Asia or the North American Free Trade Agreement (NAFTA) region.

The impact of SA's geographic distance from world markets on attracting investment depends on the type of FDI and the nature of the industry, *i.e.positive* (*e.g.* counter-seasonal production, business process outsourcing, high 'value to weight ratio' products, location-specific benefits, etc.) or *negative* (*e.g.* low 'value to weight ratio' products, tight lead times to world markets, business spillovers, etc.).

The growth rate of the SA economy, while relatively stable, is still deemed to be too low to attract long-term investment (particularly SA's potential growth rate). The link between economic growth and FDI in SA is ambiguous. It is argued by many that FDI, once attracted, will stimulate economic growth, as opposed to the obverse where SA actually needs a significant amount of economic growth to attract FDI in the first place.

(ii) Volatility, Uncertainty and Market Intelligence

SA is also affected by the uncertainty and risk factor generally associated with investing in emerging markets. The high price of oil, slackening commodity prices, and growing concerns of a global recession are also forcing fund managers to cut their exposure to emerging markets (indirect

investment), and this can play an important signalling role for direct investment. Certain foreign investors also do not distinguish between SA and its neighbours, which means that problems in these countries translate into negative perceptions for SA. Politically volatile events in the Southern African region (particularly, events in Zimbabwe from mid-2000) have led to concerns over, for instance, the enforcement of property rights and contracts in SA, although the government has clearly stated that it will uphold and enforce the law. Jenkins and Thomas (2002) find that while negative perceptions are likely to deter new investment, this is not the case with investors who have invested in SA before.

A T Kearney (2000) suggests that SA's main challenge is to define and project its identity as an investment destination distinct from the rest of Africa. Potential investors often view SA as another African commodity exporting country, rather than a country that is diversifying and strengthening its capacity in high-value manufactures and a greater services component in GDP.

Gelb (2002) suggests that some investors perceive that there has been deterioration in the institutional and regulatory environment in SA. There is also considerable uncertainty surrounding BEE policies, equity targets and the state procurement practice, as witnessed with last year’s leak of the draft Mining Charter attached to the Minerals Act (which investors read as ‘expropriation’). This led to capital flight and the sell-off of SA resource shares. However, although the Mining Charter is onerous, it is not obstructionist and has not deterred investors. Added to this is uncertainty around private sector participation in deregulated industries (particularly in the telecommunications, electricity and transport sectors). This is related to slow regulation and inertia in some areas of reform.

The depreciation and volatility of the SA Rand (particularly in late 2001, although it has appreciated dramatically since the end of 2002 and start of 2003) is said to be a disincentive to investment; a stable and predictable SA Rand is more important to investors than a strong SA Rand. Gelb (2002) notes that investors have limited the number of greenfield investments in SA as a way of mitigating the adverse effects of exchange rate fluctuations, which can result in asset devaluations in home currency terms. He lists other potential strategies which investors use to mitigate this risk, including favouring partial acquisitions and investing in services so that their investment is not in physical capital and is more easily reversible.

(iii) Labour Related Problems

SA suffers from a dearth of skilled human resources for particular industrial sectors (*e.g.* ICT, engineering and financial services). SA's opaque immigration policy for skilled persons aggravates this shortage of skills, although new legislation has been introduced to facilitate the employment of expatriate professionals in SA. Attracting foreign skills to SA has in recent years been a top priority for the government.

It is believed that the SA labour market is oppressive, inflexible and over-regulated for an economy at its stage of development. The main regulatory risk for companies is complying with local labour market regulations, particularly employment equity legislation, which can raise the cost of implementing a commercial strategy. There is, however, a total lack of understanding of the new labour regime due to inadequate training; employers simply want to return to more convenient 'hire-and-fire' policies.

The National Enterprise Survey (2001) also suggests that the perceptions about labour regulations are the problem, rather than their actual impact on firm employment and profitability.

(iv) High Costs of Production

User cost of capital is high due to high interest rates, although the long-term trend in interest rates is downward (depending on whether the Reserve Bank's inflation target of 3-6 percent can be met). Interest rates have been prohibitively high for SMMEs, and historically disadvantaged South Africans have struggled to assemble the necessary skills and collateral required to build successful businesses. The borrowing restrictions placed by the exchange control authorities also deters foreign investors. It is therefore, apparent that like SMMEs, foreign investors face a lack of access to capital, although for different reasons.

Hidden costs and poor trade facilitation are a major disincentive to investment. These include: transport costs; congestion and backlogs at major ports; bureaucratic costs; lengthy bureaucratic procedures; and labour costs. SA's ports have not been able to meet the challenges posed by the increase in volumes and changes in the composition of SA's trade. Government is now in the process of concessioning the Durban container terminal to remedy the situation.

(v) Other Problems Faced by Investors

- Foreign investors are reluctant to invest in countries or regions where domestic investors do not. It has thus been argued that foreigners are delaying investing in SA because local firms have corporate savings in excess of US$300bn. Added to this, it is argued that SA lacks bankable projects (*Abedian, 2003*). The private sector, in turn, is said to be awaiting its cue from increased government spending on infrastructure and a shift in the balance of state spending away from consumption. Private fixed investment has tended to move in the same pattern as public fixed investment. The question asked by foreign investors is: *if South Africans, who enjoy a better understanding and intimate knowledge of local markets and conditions, do not invest in the SA economy, why should we as non-nationals?*
- A low return on investment in certain sectors;
- SA's maximum effective corporate tax rate of 37.88 percent is substantially higher than the global average of 30.84 percent. SA has followed the global trend in reducing its basic corporate tax rate to 30 percent, although STC, which encourages re-investment, has boosted SA's effective rate (*Business Day*, 12 September 2003);
- Published information on DTI incentive schemes is readily available. Investors and their agents, however, claim that it is highly problematic to get hold of the appropriate person who can explain the technicalities of the incentive scheme; and
- The high levels of crime in SA raise the costs of doing business (security, etc). However, while crime – which is being actively addressed by the government – is a red flag for investors, it has not deterred a dramatic upsurge in tourism to SA, which is one of the fastest growing tourist markets worldwide.

It should be noted that SA is also a capital exporting country as local companies internationalise following the confines of apartheid isolation, or transfer their financial headquarters abroad. Inflows of foreign capital are partly offset by outward investments by SA companies expanding their activities in foreign markets, particularly in Southern Africa, or listing on the London and New York Stock Exchanges to access more capital. A recent study by Liquid Africa has found that SA is now the largest source of FDI into Africa, far outstripping the US, UK and France (*Business Day*, 3 July 2003).

Most SA investment in the Southern African region is of a resource – and market-seeking kind. The expansion of South African retail firms into the region has in some cases led to de-industrialisation, as these firms discontinue locally produced products and import SA goods due to economies of scale and long-

standing supplier arrangements (especially in Zimbabwe and Zambia). This is reinforcing the traditional 'core-periphery' division of labour in the region, where SA continues to supply Southern Africa with manufactured goods and inputs through trade, and to source mostly raw materials or low value-added goods from the region. This has led some analysts to depict SA firms as 'new exploiters' or 'hegemons', while others argue that these firms are the 'market developers' and 'market leaders', which increase competition and trade in under-developed markets.

The Purpose of FDI in SA

The challenge in SA is to craft a working social accord between government, business and labour which creates a socially acceptable and investor-friendly framework for FDI inflows, and which augments increased domestic investment by the private and public sectors. Increased domestic investment should, however, be the first priority. In particular, FDI in SA could serve the following purposes:

- Shifting the economy away from the export of primary commodities towards manufacturing and higher value-added goods;
- The transfer of knowledge, technology (particularly ICT) and management skills;
- Integrating SA firms into global production and supply-chains through efficiency-seeking or strategic asset and capability-seeking FDI;
- Employment creation, skills training and human capital development enabled by such public policy instruments as labour market and education policies, and performance requirements;
- Public-private partnerships for the delivery of social services and the provision/maintenance of key infrastructure;
- Black Economic Empowerment (BEE), in terms of *ownership* – rather than mere *control* and employment *mobility* – of economic assets. The main policy instruments for advancing BEE are: legislation; preferential procurement by the state; restructuring of SOEs; institutional support; financial and other incentive schemes; and regulation. The latter employs a 'balanced scorecard' approach to measure and benchmark progress in achieving BEE by enterprises and sectors in respect of direct empowerment through ownership and control of economic assets, human resources development and employment equity, and indirect empowerment through preferential procurement and enterprise development;
- Private sector development, particularly SMMEs, whether through joint ventures or sub-contracting and outsourcing of non-core business;
- Lessening monopoly power in SA through increased competition among private economic agents;

- HIV/AIDS awareness and support programmes;
- Participation in business against crime initiatives to reduce the crime-related costs of doing business in an insecure environment;
- Corporate social responsibility programmes and sponsorships in underprivileged rural areas; and
- An ongoing commitment to ethical investment (sound labour and environmental practices).

CHAPTER-4

Agenda for Action – Government

The following advocacy points emerged from the Country Report: Investment Policy in South Africa – Performance and Perceptions; and three NRG meetings hosted by the IGD over a period of 2 years. The following is a synthesis of the inputs made by various members of the NRG at these meetings[6] :

Regional Level

1. ***Implement the SADC Regional Indicative Strategic Development Plan (RISDP) as soon as it is approved and adopted by member states***

   The RISDP is intended to provide SADC member states with a coherent and comprehensive developmental agenda on social and economic policies over the next fifteen years, with clear targets and time frames. The Plan addresses domestic savings and investment, as well as foreign direct and portfolio investment. The RISDP focuses on such enabling factors as: a stable and predictable political environment; macro-economic stability; a favourable regulatory environment; the quality of economic infrastructure; the competitiveness of the regional market; qualified human resources; efficient financial markets; investment protection against expropriation; and transparent legal systems.

2. ***Support the development of a regional code on investment***

   The code – potentially the SADC Protocol on Finance and Investment – should establish internationally compatible investment principles and standards to encourage inward and intra-regional investment. It is important that this code supports development objectives and balances minimum social and environmental standards with investor's rights and protection. Such a code could 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 and skilled workforce. A co-ordinated approach to investment incentives in SADC could also mediate any competitive incentive bidding among member states to attract FDI (*i.e.* members lowering domestic regulatory standards and offering enhanced fiscal benefits, including inefficient tax holidays, to companies). SADC countries should prioritise levels of education, skills and infrastructure rather than employing fiscal resources for providing incentives and tax benefits.

3. ***Adopt a co-ordinated regional approach to investment promotion and facilitation***

   The current 'enclave FDI' mentality and practice among many SADC member states has to be reversed, and the network of investment promotion agencies at national and sub-national levels should be strengthened. A harmonised investment regime and business environment will be important to attract more long-term, productive capital.

4. ***Regional integration in SADC should proceed as planned***

   Regional integration will create a larger market, which will attract greater levels of FDI (particularly if the region registers good economic growth, which then raises local incomes). Given the financing requirements of investment projects, it is important to create larger regional financial and capital markets with higher liquidity levels by integrating national financial and capital markets. However, economic integration in the region is somewhat confused, exhibiting a spaghetti bowl of overlapping arrangements and conflicting designs. These include, *inter alia*: the Southern African Customs Union (SACU), SADC, Common Market for Eastern and Southern Africa (COMESA), and the East African Community (EAC). Many countries are members of two of these schemes, yet the latter three intend to establish customs unions in the future. It is important that policy-makers pay attention to this situation, and debate the merits of rationalising and harmonising these regional projects.

5. Public-Private Partnerships (PPPs) should be encouraged, particularly on trans-national projects in physical economic infrastructure (roads, rails, ports and communication infrastructure). The quality of existing infrastructure should also be upgraded and maintained. This will facilitate greater levels of intra-regional trade and investment.

6. The region should seek to obtain technology that is not necessarily tied to FDI, such as through South-South exchanges of technology (*e.g.* India – ICT, China – hydropower, Singapore – infrastructure, etc).

7. When dealing with FDI, the upward harmonisation to the best practice level in the region should be a systematic approach and support existing labour initiatives such as the Social Charter of Fundamental Workers Rights in Southern Africa, which is propagated by the Southern African Trade Union Co-ordinating Council (SATUCC).

8. Strategic sectors and resources should be identified and designated as 'no-go' areas for FDI, whereas key growth sectors that demonstrate a high potential for growth and employment should be specifically targeted if FDI can contribute to achieving these objectives.

9. A regional sector-specific dispute resolution mechanism could be considered.

10. There is a need in the region for capacity building on investment policy and investment-related issues, as well as competition policy.

11. SADC member states should standardise their FDI data and methodologies for collecting and calculating this data.

National Level

1. ***The balance between foreign and domestic investors in SA***
Too much policy emphasis is given to foreign investors, and not enough to encouraging domestic investment. Domestic investment should be prioritised, particularly as SA's capital markets are said to be capable of financing the current level of bankable projects. The role of the state in economic growth and development should also be revisited and debated.

2. ***Generating economic growth is critical***
Having achieved a modest level of macro-stability, government should now focus its attention on removing the remaining micro-economic obstacles to growth and investment, as it is currently going through the Micro-economic Reform Programme. Investors have unique demands and particular requirements. Ultimately, the focus of action in SA ought to be not so much FDI-related policies, but more generally macro and micro policies that enhance sustainable economic growth, domestic investment and the efficient functioning of the market. It is important to build on the platform of the recent Growth and Development Summit to create a sustainable, growing, job-creating economy.

3. ***SA must image, market and brand itself to develop a subjective preference among investors for investing in the country, although this should also take account of the SADC's development needs and aspirations***
The roles of the International Marketing Council, the International Investment Council, DTI Trade and Investment South Africa (TISA), Tourism SA and the South African diaspora are important in this regard, particularly for reducing SA's risk rating. SA's hosting of major diplomatic

conferences and sports tournaments have also favourably exposed and maintained the country's image in the international media. The expertise and skills of TISA to facilitate trade and investment should be improved. Information on the country's investment policy and incentive schemes should be readily available and easy to understand. Provincial investment promotion agencies should formalise their relationships with TISA through the signing of memoranda of understanding.

4. FDI should be included in a national industrial strategy. There is a need to define what kinds of FDI South Africa needs for its development, and particular sectors and industries should be targeted and incentivised *e.g.* the motor industry and the Motor Industry Development Programme (MIDP).

The identification of niche sectors and opportunities in SA, particularly clusters of industries, is likely to result in greater attraction of FDI than broad-based approaches. At the same time, SA should maintain the right to determine economic fields and areas of activity where activities of foreign investors should be excluded or restricted. FDI in essential social services could possibly be screened before entry to ensure that it will not threaten, damage or delay local social development programmes. It is also necessary to attract smaller and medium scale investments to SA, particularly for the IDZs; at present, the IDZs are only attracting a few capital-intensive mega projects (*e.g.* Coega IDZ – aluminium refinery).

5. It is important to reduce the volatility of the Rand – a stable Rand is more critical than a strong Rand – and moderate interest rates to encourage exporters and investors.

6. Capital controls should be liberalised. The current policy of phased controls distorts the efficient allocation of capital as more money can be invested by SA companies in Africa than elsewhere, where better opportunities and niche markets may exist.

7. Mandatory performance requirements should be kept in place for skills training and employment equity. Ownership requirements should also be maintained for the state procurement process, the awarding of licenses in deregulated industries, and obtaining an advantage through particular incentive schemes, such as the Strategic Industrial Project (SIP) scheme. The role of other performance requirements for developing linkages in the economy and a domestic industrial sector – particularly local content (labour, suppliers, etc) – should be debated, including how compliant this is with WTO regulations.

8. A policy should be developed which regulates transfer pricing and creates accountability and transparency. This is most critical and urgent.

9. Since there is a strong link between FDI and trade, it is necessary to expand, diversify and strengthen SA's trading networks (including market access through preferential agreements and bilateral Free Trade Agreements). This strategy should include upgrading SA's foreign commercial representation.

10. Reduce the actual and hidden costs of doing business in SA. Enhanced trade facilitation is critical if SA is to increase its exports and attract more long-term, productive capital.

11. Urgent attention should be given to reducing crime and enhancing security in SA, as these generate negative perceptions of the country.

12. Recruit and facilitate the import of foreign skills into SA where these do not exist locally. At the same time, skills training should be prioritised to reduce the dearth of skilled human resources in the country.

13. Government should seek to attract more investment in ICT by establishing Business Communication Zones and Call Centres for back-office work. Incentives should also be extended to the services sector (including Back-Office and Call Centres).

14. Government should develop lucid and predictable policy guidelines and regulations, particularly clarity on BEE. It should communicate its broad-based BEE strategy both domestically and internationally.

15. It is critical to enhance the regulatory capacity of the state. In particular, it is important to strengthen the capacity and powers of the independent sector regulators, particularly in the telecommunications and power sectors. The regulators should ensure that the conditions of awarded licences in deregulated sectors are complied with and implemented timely (*e.g.* roll-out of telecommunications to disadvantaged areas).

16. SA needs a comparative advantage for export-oriented FDI, and these should be interrogated, identified and matched to potential FDI.

17. ***Competition law and corporate governance***
    SA's competition law and corporate governance regimes should be strengthened and an outreach programme established to educate South Africans about these two policies. The Competition Commission and Tribunal should also pay urgent attention to existing local monopolies and anti-competitive practices. Competition law should, however, be kept to a defined set of objectives; it cannot be a cure for everything.

18. ***A better relationship and open communication channel between business and government, and government and civil society should be established.***
    Effective communication is critical if the private sector is to understand and endorse the government's BEE goals. The questions of privatisation of SOEs and deregulation have in the past caused a rift between government and its social partners. Government needs to explain its privatisation strategy and take up the concerns of South Africans regarding potential job losses and increased cost of services.

CHAPTER-5

Agenda for Action – Civil Society

1. ***Civil society in SA needs to become more involved in decision-making on investment-related issues.***

   It is necessary to develop a working social accord between business, labour and government. A social accord – one that establishes both, a socially acceptable and investor-friendly labour market regime, supports skills development and raises productivity – would create a more enabling framework for investment. Apart from a macro-level social accord, sectoral and firm-level discussions are also necessary.

2. ***There is a need to strengthen advocacy work and monitoring by civil society and consumer groups of the practices and activities of TNCs in SA and SADC.***

   Non-state actors, in particular, should monitor technology transfer, FDI spillovers, employment, etc.

3. ***Civil society groups should monitor the corporate practices of those TNCs, based in SA and SADC which have signed on to the UN's Global Compact.***

   The Global Compact provides a UN seal of approval of its signatories' investment practices, but has no enforcement mechanism. Monitoring by civil society is of paramount importance.

4. ***The capacities of independent consumer-oriented organisations should be developed and improved, and a consumer rights ethos crafted in SA.***

5. ***Resolve the privatisation and deregulation debate with the Government.***

6. ***Civil society must debate the overall orientation of the SA economy.***

7. ***Ensure on true community involvement in identifying strategic sectors and priorities for FDI.***

8. ***Lobby regional policy-makers on the content and scope of a regional code on finance and investment in SADC to ensure that it serves the purpose of sustainable development.***

9. ***Recognise and support SA companies which actively invest in physical and human capital so as to encourage private sector domestic investment.***

10. ***TNCs, particularly those that have signed on to the UN Global Compact, must include corporate social responsibility programmes in their SA operations, notably in indigent rural areas of the country.***

11. ***There is a need for organisations and institutions in all southern African countries that have an interest in or are presently working on investment issues to start sharing their research information and activities, not only to influence regional and national policy agendas, but also to build an alternative body of knowledge around investment issues.***
    This can be done through the Internet (e-mail groups, dedicated website space donated by an organisation) and focused regional workshops. Civil society should particularly interrogate, discuss and debate the merits and problems of the New Partnership for Africa's Development (NEPAD).

CHAPTER-6

Agenda for Action – Inter-Governmental Organisations

1. ***Technical assistance and capacity building (human and institutional) on investment and competition policies and related issues in developing countries.***
   The outcome of FDI crucially depends on how well a host government bargains with international investors. The problem is that host countries often lack the capacity to negotiate with TNCs as the latter have access to superior information and resources (especially to influence international legal regimes).

2. ***Non-binding technical assistance on privatisation, deregulation and public-private sector partnerships.***

3. ***Encourage donor governments to meet their aid targets as pledged following the Monterrey Conference on Financing for Development.***

4. ***Assist with the development and standardisation of FDI data-bases.***

5. ***Conduct research into FDI flows into developing countries, and suggest recommendations and strategies for managing these capital flows in a manner that supports sustainable development and alleviates poverty in the South.***

CHAPTER-7

Conclusion

A central challenge facing the SA government that took office in April 1994 was to build a modern and vibrant economy that is outward oriented and internationally competitive, while simultaneously addressing the massive backlogs in access to social and economic services.

Investment climate reform in SA has led to increased levels of long-term investment by domestic and foreign firms, although the rate of new investment has not met expectations. Foreign capital inflows have not been on par with other competing developing countries or emerging markets with broadly similar risk profiles. Investment as a percentage of GDP has averaged around 16-17 percent, which is low by the standards of successful developing countries, even those in Africa.

SA has sequenced its reform process from first addressing macro-economic issues and then shifting its attention to the micro-economics of investment and the efficient functioning of factor markets.

Although SA is fairly competitive with regard to a raft of generic host country factors, this has not been sufficient to attract investment. The country demonstrates the importance of crafting a unique investment identity for a country by actively marketing its commercial potential, identifying targeted opportunities, and facilitating the investment (hence the roles of the International Marketing Council and the International Investment Council).

Business confidence and market sentiment in SA are highly sensitive to opaque regulations and regulatory uncertainty. This is clearly illustrated by the implementation of the BEE strategy, which has not been adequately and effectively communicated to investors (*e.g.* the leak of the draft Mining Charter in 2002).

Ultimately, for SA to win the confidence of foreign investors as a viable market to invest in, domestic firms need to lead the way and show trust in the economy. This will involve addressing the underlying confidence issues in the economy. The real challenge is thus to ensure an overall socio-economic environment that is conducive to a pipeline of projects, rather than FDI-targeted interventions.

ANNEXURE

Summary of NRG Discussions

One of the most important activities of the IFD project was the formation of a National Reference Group (NRG) in each project country to provide a sounding board and quality check on the research outputs. The main purpose of the NRG meetings was to attract attention to the project at a national level.

First NRG Meeting

February 8, 2002, Johannesburg

The participants at the meeting interrogated the determinants of global FDI flows, and the reasons why SA is attracting less foreign private capital than it potentially could, given the country's macro-stability and relative lack of barriers to business. The reasons identified by the meeting included an overregulated labour regime, competitiveness factors, small market size and domestic investor confidence, a weak exchange rate, the role of investment incentives, and Afro-pessimism in its many guises. The tension between an ostensible 'investment strike' and an 'investment lock-out' was also raised and debated. While these factors are not exhaustive or necessarily correct, it was generally felt that these are constraints, whether domestic or systemic, in attracting greater volumes of FDI to SA.

The meeting also considered the impact of FDI on the SA economy, and concluded that it has not always been a positive experience. Some participants argued that FDI has also had a crowding-out effect on some local producers. This is one of the problems of globalisation. According to another participant, competition policy can be a sharp instrument to address many of the problems raised in the meeting, particularly the restructuring of the economy in terms of ownership patterns and restrictive business. However, it would be asking a bit too much to expect the Competition Authorities to do everything. Competition Law should be kept to a fairly defined set of objectives.

Another participant made the case that the structure and growth path of the SA economy is a major problem (the legacy of apartheid). The production structure is resource-based (gold and other minerals); domestic demand is limited due to unusually large inequalities in income; there are severe regional imbalances in the South in general, and southern Africa, in particular; the structure of capital is highly concentrated (narrowness in mining and financial

capital); and state action in the past largely shaped the apartheid growth path – providing cheap labour, investment capital, subsidised infrastructure and energy, and tariff protection for domestic manufacturers.

SA needs a growth path that is powered by a mix of budgetary, parastatal, co-operative and domestic private capitals, while seeking to attract FDI at the same time. According to a participant, this growth path should involve a shift in production towards more labour-intensive sectors, built largely on downstream and upstream linkages from mining and agriculture, plus services. There should be increased focus on producing to meet basic needs for the majority, while stabilising export markets in the region and maintaining growth in exports overseas. Programmes should be in place to develop the poorest regions of South Africa and to provide support for a vibrant co-op movement, land reforms, and small and micro enterprises.

It was recommended that civil society should become more involved in decision-making on investment-related issues in SA and that a working social accord – as in the case of Botswana – needs to be crafted. Such an accord and agreements that are negotiated between business, labour and government in the sector job summits could bring about growth and facilitate a more conducive framework for investment. NEDLAC, according to one participant, does not represent a social accord; it represents a forum wherein a social accord could potentially be negotiated, but has not happened.

On possible research problems and questions for the future, the NRG agreed:

- The Motor Industry Development Programme (MIDP) would be an interesting case study for the IFD project. The role of the voice of unions and business in the MIDP process could be explored. This is one of the case studies addressed in the Country Report;
- The relationship between investment flows and the regulatory environment in SA, particularly regulatory certainty, is necessary; and
- An analysis of the impact that SA's GATS commitments in the WTO have had on investment flows to SA would be useful.

Second NRG Meeting

July 5, 2002, Johannesburg

The second NRG meeting focused on the three sector studies, namely the motor industry, telecommunications, food and beverages. The meeting discussed the positive and negative effects of FDI in these sectors. It was noted that large companies dominate investment into SA and that it is important to attract medium-scale investors. The meeting agreed that the real benefit of

FDI lies in backward linkages. In efficiency-seeking FDI, foreign investors are no longer only interested in cheap labour and natural resources. Local sourcing has become increasingly important. It is, however, difficult to get spin-offs from competitiveness-seeking FDI because this type of investment is characterised by a race to the bottom, high value-added and high R&D. The meeting also addressed the constraints to increased volumes of foreign and domestic investment, picking up on the discussion from the first NRG.

The meeting concluded that:

- Intense sector-based research is important;
- Market should be identified. All SA embassies abroad have TISA representatives attached to the embassy. Investors have the choice of other markets. TISA must expand and broaden knowledge of opportunities in SA;
- Reference was made to the 'ethical' investment policies of Dutch TNCs. In the case of SA this largely relates to skills development, HIV/AIDS awareness, training, business against crime, and sound environmental and labour practices. These are, however, highly self-interested strategies;
- Skills development is perhaps the most critical factor in SA. This is particularly important in the ICT sector; and
- The state has a primary role to play in development.

On possible research problems and questions for the future, the NRG agreed:

- It would be very useful to get an analysis of a region with problems similar to southern Africa, but one which has been very successful in attracting FDI (*e.g.* Eastern Europe). This comparative paper should determine what this region has been able to do better compared to SA to attract FDI; and
- It would be useful to compare the structure of FDI in developed, emerging and developing countries. FDI in SA, particularly in the motor sector, has a history of over 40 years. The change in structure of FDI in SA over the last 6 years is mainly due to the change in linkage between SA and the global market.

Third NRG Meeting

March 14, 2003, Johannesburg

The final NRG meeting discussed the draft report: Investment Policy in South Africa – An Agenda for Action. There was a strong feeling among the participants that this document should prioritise domestic investment, as FDI can have a destructive effect on the economy (*i.e.* it is not always positive). The case of the engineering sector was cited, where local industries have been converted from productive industries to warehouses. It was noted that SA

companies are still sitting on huge sums of capital, despite capital flight. The question to be addressed was how SA should mobilise domestic investment without creating an overbearing, authoritarian state.

The regulation of the SA economy was also discussed. It was agreed that it is necessary to find a balance between regulation and deregulation, and to interrogate the business case for a fair level of regulation. The question was also posed whether corporate accountability reduces competitiveness, and whether countries or companies are competitive in the FDI equation. The meeting proposed a number of action points, which have been included in the advocacy part of this Report.

ENDNOTES

1 The Country Report: Investment Policy in South Africa – Performance and Perceptions: An extensively discussed macro-economic scenario and investment regime in SA.

2 A shortcoming of GEAR was that it did not clearly distinguish between direct and portfolio capital inflows.

3 South African Airways (SAA) has been 're-nationalised'. The SA government had sold 20 percent of the shares of SAA to Swissair. When Swissair filed for bankruptcy protection, the government bought back the 20 percent it had sold to the Swissair Group in 1999 for less than 30 percent of what the Swiss carrier had paid. The repurchase or 'renationalisation' of SAA resulted in a net benefit to the state of nearly R1bn (US$21.5bn), although it dampened SAA's strategy of global expansion via a strong equity partner.

4 Switzerland, Norway, Iceland and Liechtenstein.

5 The first IFD-SA-NRG meeting, Institute for Global Dialogue, 8 February 2002. www.cuts.org/ifd-indx.htm.

6 These advocacy points do not necessarily reflect the views of the Institute for Global Dialogue.

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