



Diversion and Agglomeration:

Regional Dimensions of South Africa's Investment Promotion Policies

EXECUTIVE SUMMARY

South Africa's investment strategy aims to both grow and diversify the economy, with particular emphasis on the development of manufacturing industry. While traditional approaches such as investor protection are included in the strategy, it is strongly focused on strategic industrial policy aimed at encouraging investment in priority sectors. This has implications for South Africa's neighbours. As by far the largest economy in the region, South African policy has potential as both a catalyst for investment flows into Southern Africa and to divert investment from regional partners. This paper investigates this duality and the central role South African policy plays in the direction of investment flows in Southern Africa. It is in four parts. First, it explores trends in South African investment; second, it examines the three pillars of South Africa's investment policy – investor protection, investment incentives and special economic zones. The third part looks at the regional impact of these policies and the final section considers efforts to co-ordinate investment policy in the region.

INTRODUCTION

The 'Africa Rising' narrative is defined by diversity. While some threads – such as infrastructure bottlenecks and diversification challenges – are common to Africa's 54 states, each country's

development path is different. The legacy of a complex political history, arbitrary colonial boundaries and difficulties in civic development is seen not only in Africa's continued developmental challenges but also in the creation of markedly different economic structures among close regional neighbours.

This disparity is especially notable in the case of South Africa. South Africa accounts for 63% of the total gross domestic product (GDP) of the 15 member countries in SADC, a dominance reinforced by the country's much more diversified economic structure supported by a far more developed infrastructure network. South Africa's gross fixed capital formation is eight times that of its immediate neighbours Botswana, Lesotho, Namibia and Swaziland (BLNS). Domestic income inequalities in the larger economies further complicate the picture and despite its size, the number of people in South Africa living on less than \$2 a day is almost twice the total population of the BLNS.

The relationship between diversity in economic scale and base competitiveness on the one hand, and investment patterns on the other, is complex. More competitive countries, including those with the ability to undertake large incentive programmes, may divert investment from their less developed neighbours. At the same time, however, these major 'hub' economies also offer their smaller neighbours large export markets, direct investment spillovers and linkages into global supply chains that would otherwise be too competitive for them to enter. Large developing states in underdeveloped regions must calibrate their regional integration efforts so as to balance these spillovers, guarding against excessive dominance while stimulating investment flows into their neighbours.

This paper will explore that challenge with reference to South Africa as a hub economy in the Southern African region and its role in diverting and catalysing investment flows, especially as regards ways in which South African investment promotion policies distort the already unbalanced flow of investment to the region. There are four parts. The first gives a brief account of recent South African investment, detailing investment patterns and policy since 1994; the second examines South African investment promotion policy. The third explores the possible regional impacts of investment policies, with particular focus on the Motor Company of Botswana as a case study in the risks and opportunities of investment projects in unequal regions. Fourth and finally it considers some possible scope for South African regional investment co-operation.

SOUTH AFRICAN INVESTMENT TRENDS

Investment patterns since 1994

Promotion of foreign direct investment (FDI) was identified as a government priority as South Africa emerged from international isolation in the early 1990s. Towards the end of the apartheid regime the country had experienced rapid outflows of capital, particularly during the 1980s. Between 1984 and 1988, 20% of UK firms and 225 US companies left the country and in 1985 portfolio investment inflows virtually ceased.¹ Isolation gave way to uncertainty during the 1990s as investors awaited the outcome of the political transition and attempted to gauge the economic direction the newly elected ANC government would take.

In an effort to rebuild confidence in South Africa as an investment destination after the transition, the administrations of presidents Nelson Mandela (1994–1999) and Thabo Mbeki (1999–2007) embraced a raft of liberal reforms. These included broad reforms to the macroeconomic environment – such as the reduction of import barriers and the loosening of capital controls – and the introduction of specific investment protection and promotion measures. These included safeguards on property rights under the constitution, the development of a non-discriminatory legal regime and the conclusion of a range of bilateral investment treaties (BITs). Twenty-seven BITs were signed in the five years following 1994 and by the end of the Mbeki administration a total of 45 treaties had been agreed.² These arrangements were complemented by South Africa's accession to a series of multilateral international agreements such as the General Agreement on Trade in Services, the Agreement on Trade-Related Investment Measures, and the Agreement on Trade-Related Aspects of Intellectual Property Rights concluded in the run-up to the establishment of the WTO in 1995.

These reforms were successful in building confidence during a very uncertain transition period. FDI stocks increased 537% in the first 10 years of democracy and continued to grow in the following decade (see Figure 1).³ Those initial high investment levels were perhaps to be expected as the country emerged from its long period of international isolation and the disinvestment that had accompanied it. Much of the post-1994 investment boom should therefore be understood as the market's adjusting to the end of isolation, largely reflecting investors' assessment of the fundamentals of the South African economy rather than their response to the new government's policy; the period after the end of apartheid

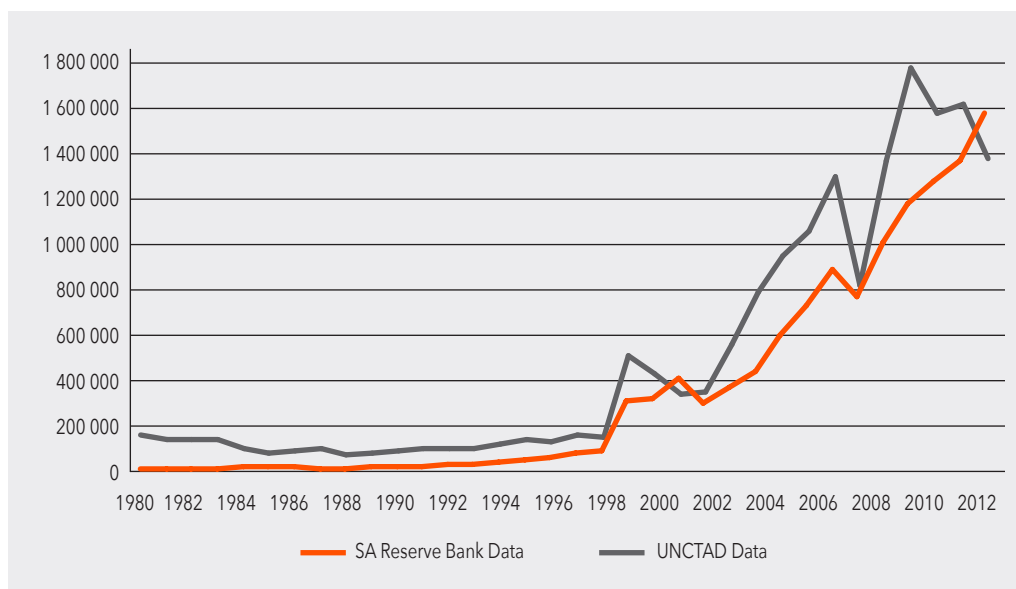
1 Gelb S & A Black, 'Foreign direct investment in South Africa', in *Investment Strategies in Emerging Markets*. Cheltenham: Elgar Publishing, 2004.

2 UNCTAD (UN Conference on Trade and Development), 'International Investment Agreements Navigator', UNCTAD Investment Policy Hub, <http://investmentpolicyhub.unctad.org/IIA>.

3 Due to the unreliable nature of FDI data, figures from both the South African Reserve Bank and UNCTAD are given. For further information on problems associated with collecting FDI data, see Fujita M, 'A critical assessment of FDI data and policy implications', in *Transnational Corporations*, 17, 2. Paris: UNCTAD, 2008.

also coincided with growing internationalisation of finance and an increased interest in developing economies as possible investment destinations.

Figure 1: FDI stocks in South Africa



Source: South African Reserve Bank, Online Statistical Query, 'KBP5550J: Foreign liabilities: Total direct investment'; UNCTAD FDI/TNC database, 'Inward and outward foreign direct investment stock, annual, 1980–2013

FDI patterns after the initial adjustment were very unpredictable. A number of substantial headline deals account for the spikes in the graph in Figure 1; the 1997 surge reflects the partial privatisation of the state telecommunications company Telkom, while the post-2001 upswing was due largely to Anglo American Corporation's acquisition of diamond producer De Beers.⁴ The upward trend after 2007 partly reflects the purchase of 20% of leading banking and financial institution Standard Bank Investment Corporation by Industrial and Commercial Bank of China and Walmart's purchase of a controlling stake in retail chain Massmart. The downturn after 1998 reflects the after-effects of a crisis sparked by the rapid depreciation of the South African rand and the subsequent imposition of capital controls, while the 2008 dip reflects the slowdown associated with the global financial crisis of that year.⁵

4 Arvanitis A, 'Foreign direct investment in South Africa: Why has it been so low?', in *Post-Apartheid South Africa: the First Ten Years*. Washington, DC: IMF (International Monetary Fund), 2005.

5 Bhundia A & L Ricci, *op. cit.*

Discontent with investment trends

Despite these positive trends, the broader investment picture attracted substantial criticism from elements in government and the ruling party, which laid the foundation for a shift in investment promotion witnessed at the start of the administration of President Jacob Zuma in 2008. Three complaints in particular came to the fore.

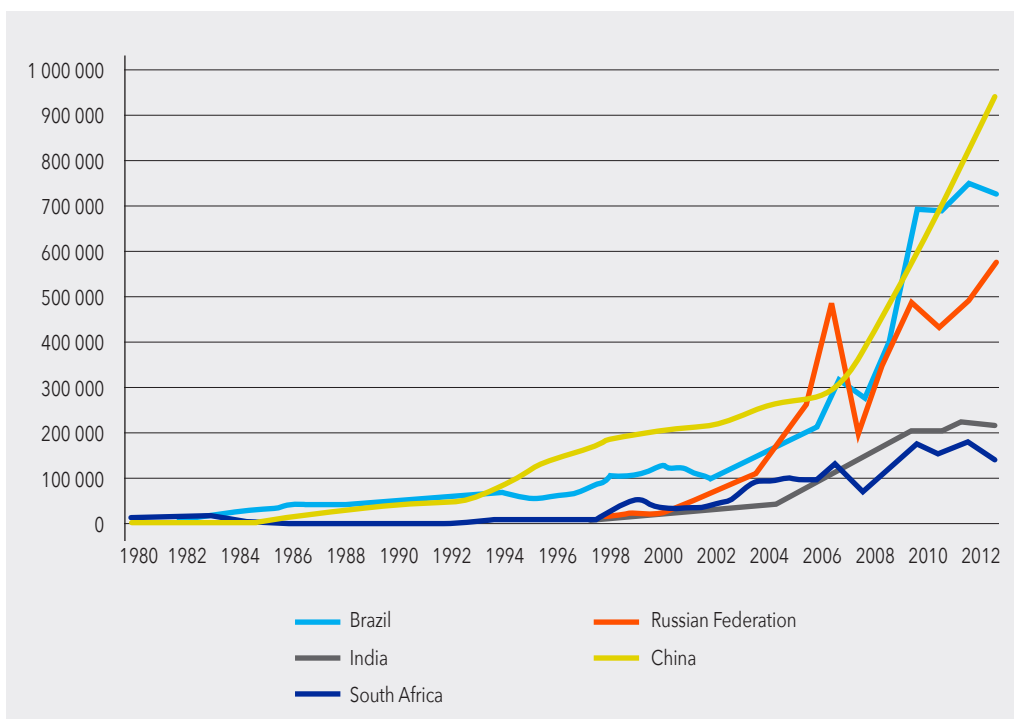
The first is the relatively small scale of investment and its weak social impact. Although investment into South Africa is positive and growing it lags behind that of leading emerging countries, particularly other members of BRICS. Figure 2 shows how South Africa's FDI, seen alongside that of its fellow BRICS members, compares favourably with India but trails the rest. Deflating the FDI figure to account for the differing GDPs of the other member countries, however, shows that South Africa leads the group (see Figure 3). Although this logic is perhaps somewhat circular (that is, higher FDI flows would tend to increase GDP), the position nevertheless demonstrates that South Africa reached a level of FDI attractiveness relatively early in its post-1994 development.

Perhaps more pressing than the overall figures are perceptions of the social impact of growth, particularly regarding employment creation. South Africa suffers from persistently high unemployment. At present this stands at 24.3%,⁶ a figure that rises to 35.8% under an expanded definition that includes discouraged labour, and is even larger for previously disadvantaged and vulnerable groups such as black Africans (39%) and the young (63.6% for those aged between 15 and 24).⁷ There is some evidence, including the results of a recent study by the consultancy Deloitte South Africa, that South African FDI does have a substantial social impact; the Deloitte study ranks South Africa second among the BRICS in this respect. The persistence of high unemployment during periods of booming FDI growth, however, has created a perception that current investment patterns are ill fitted as a means of combating South Africa's social challenges.

⁶ StatsSA (Statistics South Africa), *Quarterly Labour Force Survey*, Quarter 4. Pretoria: Government Printer, 2014.

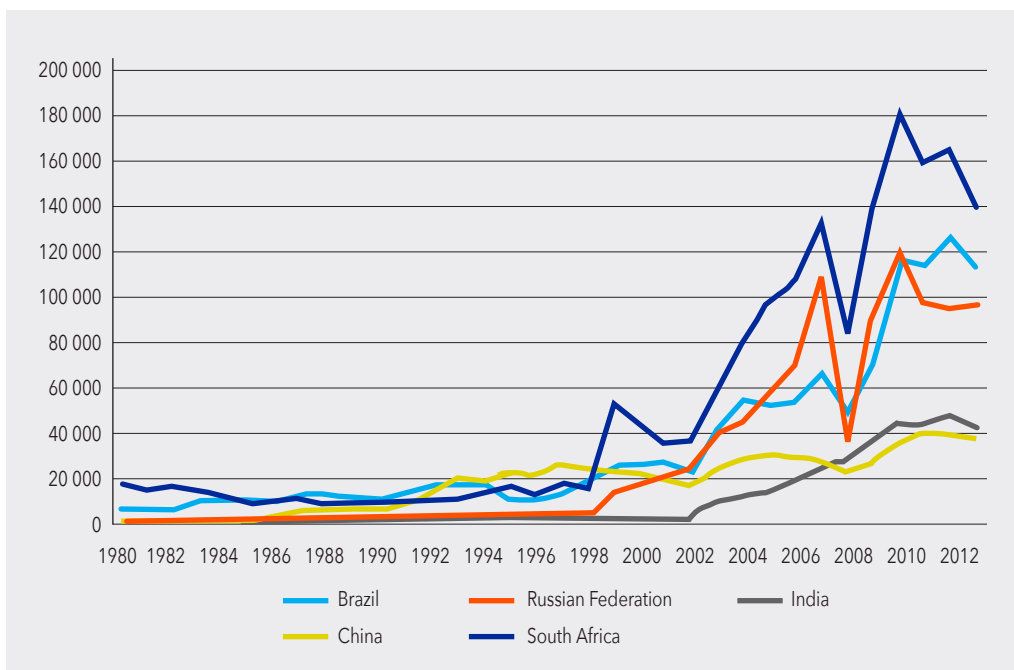
⁷ *Ibid.*

Figure 2: FDI stocks in BRICS



Source: UNCTAD FDI/TNC Database, 'Inward and outward foreign direct investment stock, annual, 1980–2013'

Figure 3: FDI stocks in BRICS, deflated for GDP size



Source: UNCTAD FDI/TNC Database, 'Inward and outward foreign direct investment stock, annual, 1980–2013'; World Bank World Development Indicators, 'GDP (Current US\$)'

The second common complaint concerns sectoral imbalance. Investment tends to flow towards the established mining, finance and retail sectors, which together account for 60% of total investment since 1994.⁸ Although it is acknowledged that investment in these sectors can create efficiency gains and may provide resources for expansion, its direct impact on job creation is uncertain. It is also uncertain to what extent this investment creates additionality, given that these sectors are driven respectively by natural resource availability and domestic demand and that there is a robust and under-utilised domestic financial services industry that itself could have facilitated domestic investment in these sectors. Encouraging growth in high-employment sectors, notably manufacturing, is a central priority of the government's development strategy. The perception of weak investment in manufacturing is one of the primary driving forces behind a shift of emphasis towards the sectoral distribution of FDI rather than FDI growth per se; yet this concern is not fully reflected in the data, which shows manufacturing as comprising an impressive 28% of total FDI stocks.⁹ A large proportion of this manufacturing investment, however, is in capital-intensive projects such as the construction of large steel smelters, which do not have the job- and skills-creation benefits of higher value-added production. This imbalance within manufacturing, broadly defined, might therefore drive concerns about sectoral distribution as great as those over an excessively narrow distribution of FDI as a whole.

The third frequently voiced complaint refers to the nature of investment into South Africa. 'Greenfield' investment (ie, new productive organisations and facilities) represents a small fraction of the country's total FDI. The overwhelming preponderance flows into the country as portfolio investments, which are often criticised as having weak job-creation benefits and sub-optimal effects on productivity improvements. The government has shown particular scepticism as regards the benefits of portfolio investment, noting in the second paragraph of a 2011 review of cross-border investment:¹⁰

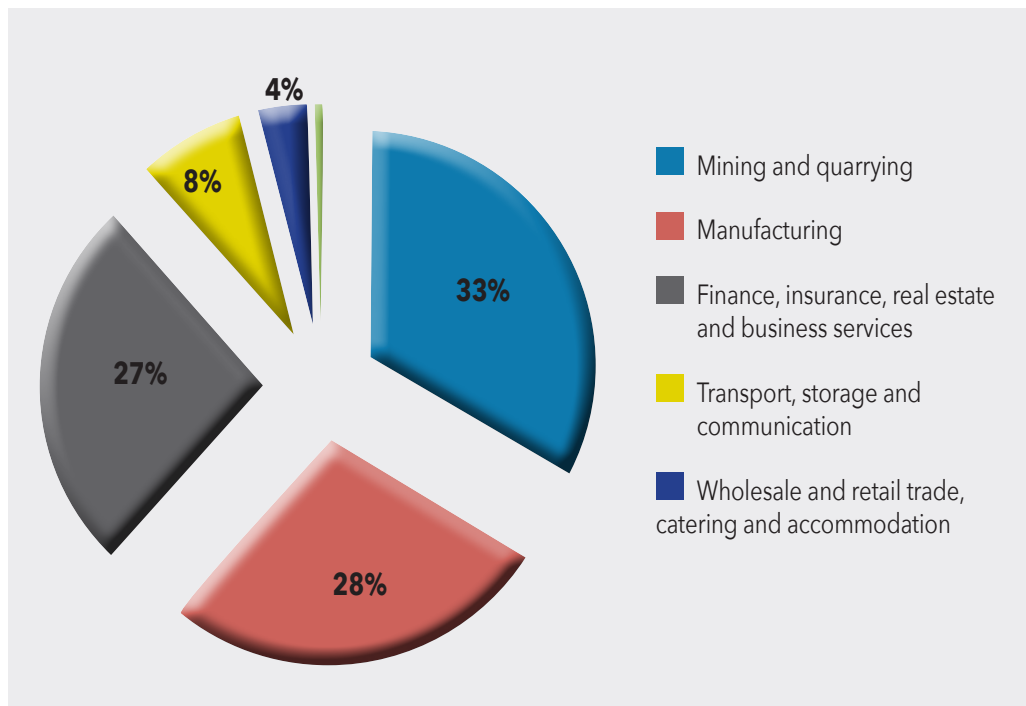
However, while greenfield investment (which mainly involves the establishment of a new business and investment in new productive capacity) is generally beneficial for the host economy, there are other forms of investment as well, some of which carry costs for the host economy. In particular, in the acquisition of existing domestic businesses, the benefits of foreign investment must be balanced against possible risks for local employment and production as the domestic firm is integrated into the foreign parent company or even re-domiciled, as well as broader economic concerns that may arise from a shift in ownership and control of successful local firms.

8 Wocke A & L Sing, 'Inward FDI in South Africa and its policy context', *Columbia FDI Profiles*. New York: Vale Columbia Center on Sustainable International Investment, 2013.

9 *Ibid.*

10 South Africa, National Treasury, *A Review Framework for Cross-Border Direct Investment in South Africa*, discussion document. Pretoria: Government Printer, 2011, p. ii.

Figure 4: Sectoral distribution of inward FDI stock in South Africa, 2009



Source: Wocke A & L Sing, 'Inward FDI in South Africa and its policy context', *Columbia FDI Profiles*. New York: Vale Columbia Center on Sustainable International Investment, 2013

Two factors account for the perceived weakness of greenfield investment. The first is that only a small fraction of investment outside the primary sector is export-orientated (that is, of the kind which tends to lead to the development of additional physical infrastructure). Market-seeking investment, which dominates in South Africa, is more likely to favour the purchase of local firms. Secondly, the South African market is relatively concentrated, characterised by large competitive oligopolies in sectors such as retail trade, banking and telecommunications. Entry by foreign investors into such markets without a local partner would be prohibitively expensive; recognition of this encourages the purchase of existing commercial infrastructure rather than the construction of new facilities.

SOUTH AFRICAN INVESTMENT POLICY AFTER 2008

In response to these and other criticisms, South Africa's approach to FDI promotion has changed significantly under the Zuma administration. Focus has shifted from attempting to maximise the flow of FDI to attracting certain types of desirable investment that target social problems. The highest priority within this shift is an attempt to attract more value-added production, with industrialisation regarded as essential to overcoming chronic

unemployment. A 2013 estimate calculated that the manufacturing sector received 94.6% of total investment incentive spending.¹¹

This shift and its impact on neighbouring states can best be understood with reference to three major policy areas: investor protection regimes, investment incentives, and the rise of special economic zones (SEZs). This paper's focus on these three issues naturally omits a great many important investment promotion initiatives; those not considered include the Gateway into Africa programme (which offers preferential rules for companies headquartered in South Africa, with the aim of enlarging the country's role as an entry point to doing business in Africa), local government investment promotion policies (at provincial and municipal levels), the creation of marketing schemes and one-stop investment hubs, and more general fiscal policy measures such as certain preferential tax rates, rebates and write-offs.

Investor protection

The regulatory cornerstone of South Africa's new approach to investor protection is the Promotion and Protection of Investment Bill, currently undergoing revision pending a vote in Parliament. The bill codifies a domestic legal regime to protect investors and replaces the existing BIT network. South Africa's BITs are gradually being allowed to expire; thus far agreements with the Benelux countries, Germany, Spain and Switzerland have been allowed to lapse. Some members of the international community, notably from those countries that did not have BITs with South Africa, have praised the bill but it has also encountered significant criticism.

Two of its provisions have come under particularly strong censure. The first is its removal of recourse to investor–state dispute settlement, against the background of concerns about the unbalanced nature of international arbitration and fears that the international Investor–State Dispute Settlement (ISDS) legal mechanism might be used to challenge policies aimed at redressing the injustices of apartheid. The second is a provision in the bill that allows the government to take action in the 'public interest', a contested term that critics fear gives the government too much scope to act against investors.

These concerns are set against a political backdrop in which more radical political parties call for the nationalisation of South Africa's mines and in which the government has previously attached conditions on major investments. The purchase of local retailer Massmart by

11 Calita E, Wallace S & L Burrows, 'The Impact of Tax Incentives to Stimulate Investment in South Africa'. Working Paper, 19. Stellenbosch: University of Stellenbosch, 2013.

the US-based retailer Walmart is a notable example. Although investors such as Walmart do not require prior approval to enter South Africa the government made use of various mechanisms, notably the Competition Commission, to block the deal until assurances on worker protection and local content sourcing were in place. Other legislative efforts may be regarded as indicative of a move away from an unconditional accommodation of international investment. Recent legislation concerning the private security industry, for example, includes provisions restricting foreign companies from owning majority stakes in any firm associated with the industry; and blanket restrictions on foreign ownership of land were recently announced to great applause in Zuma's 2015 'state of the nation' address.

Despite such concerns, evidence suggests that BITs and related investor protection efforts have had little impact on investment patterns in South Africa; indeed there is very little evidence of BITs promoting investment anywhere.¹² The global political consensus on ISDS seems to be fracturing; countries with open economies such as Australia are raising concerns in the context of the Trans-Pacific Partnership (TPP) and various European countries are opposing ISDS in the Trans-Atlantic Trade and Investment Partnership. The South African court system remains relatively independent and operates within a legal framework generally sympathetic to business, in which property rights are protected in the constitution. The political will required to embark on expropriation of private property seems weak and the ruling ANC has consistently rejected talk of any form of nationalisation.

On balance, the shift to a public interest approach to investment may be understood not as a precursor to nationalisation or excessive government intervention, but rather as an attempt to give the government greater freedom of action in two areas. The first is to legislate on controversial but essential issues such as the government's black economic empowerment (BEE) programme, which places restrictions on hiring and labour sourcing as part of an attempt to redress racial wealth inequalities. The second is to impose conditions on foreign investors in an effort to promote larger domestic spillovers. The model for this approach might be the Walmart deal, in which the government used the competition authority to attach local content and worker protection conditions on the acquisition of Massmart in an attempt to generate wider domestic value from the deal.

Incentives

Table 1 highlights the current batch of incentives that assist in attracting and/or retaining FDI, based on a recent publication from the Department of Trade and Industry (dti). The

12 UNCTAD, 'The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries', UNCTAD Series on International Investment Policies for Development. Geneva: UNCTAD, 2009.

document does not cover all available incentives; in particular it omits those still available but in the process of being discontinued. It does, however, highlight the incentives the government wishes to promote, hence it is a good indicator of broad policy direction.

The dti lists a total of 22 incentive programmes covering four thematic areas: developing small, medium and micro enterprises; empowering women; industrial development; and incentivising trade, export and investment. The 22 programmes come in various shapes and sizes: some cover grants towards the expansion of firms while others focus on research, or on promoting specific industries such as film and television. Of the 22 on offer, eight are available to foreign investors; the remaining 14 domestic programmes roughly divide into incentives aimed at empowering 'previously disadvantaged' groups (including women and racial groups disadvantaged by apartheid) and those aimed at upgrading traditional industries that have struggled to remain globally competitive (notably textiles).

With the exception of the foreign investment grant offered under the dti enterprise investment programme, all foreign investment incentives are targeted, with six incentives focusing on specific sectors (manufacturing, business process services, infrastructure, film and television) and the remaining seven dealing with specific types of FDI such as greenfields and 'brownfields' (ie, the acquisition of existing operations). Five of the seven are aimed at compensating for the costs of upgrading, expanding or maintaining physical business infrastructure. Although these grants are useful in encouraging investment they are notably different from 'flat' industry incentives because they assist in overcoming barriers to initial investment rather than subsidise direct returns from the investment itself. In one sense, therefore, although they may not encourage new investment the grants can support the implementation of a pre-existing decision to invest in South Africa. The remaining two incentives, on the other hand, explicitly attempt to make investment in certain sectors more attractive, assisting in offsetting the costs involved in operating respectively in the business processes and the film and television sectors. The focus is clearly on the manufacturing sector, which attracts slightly less than 95% of all incentive spending.¹³

The most notable omission from the list is the Motor Industry Development Programme (MIDP), first introduced in 1995, which offers incentives to attract manufacturers of finished automobiles and automotive components. It is generally regarded as the most successful investment incentive programme in South Africa and is excluded from the list only because it is in the process of being replaced by a similar but updated scheme. The MIDP's primary incentive is the award of import tax rebate certificates equal in value to the firm's total

¹³ Calita E, Wallace S & L Burrows, *op. cit.*

automotive exports; hence a firm exporting 1 000 cars would be able to import 1 000 cars duty-free, thus circumventing tariffs on light automobiles that ranged from 25% to 65% during the lifetime of the programme.¹⁴ Similar incentives are offered for the export of automotive components, although rebate percentages and tariffs are lower. The MIDP also offers a range of supplementary incentives, such as rebates based on the value of capital investment.

Since the introduction of the MIDP exports of finished light automobiles have grown by a factor of 25 and exports of components 12-fold; industries that are part of the sector's value chain, such as catalytic convertor or leather seat manufacture, have also experienced high growth. Figure 5 shows the growth of various automotive sectors. Automotive exports comprise an impressive 10% of South Africa's total exports, but the sector's importance is far bigger than this figure suggests because the industry is precisely the kind the government wants to promote: industrial manufacturing for export. The MIDP experience is particularly important insofar as it is evidence in support of views within government that favour a strong, direct role for the state in developing new industries.

14 Flatters F, *The Economics of MIDP and the South African Motor Industry*. Pretoria: TIPS (Trade & Industrial Policy Strategies), 2005.

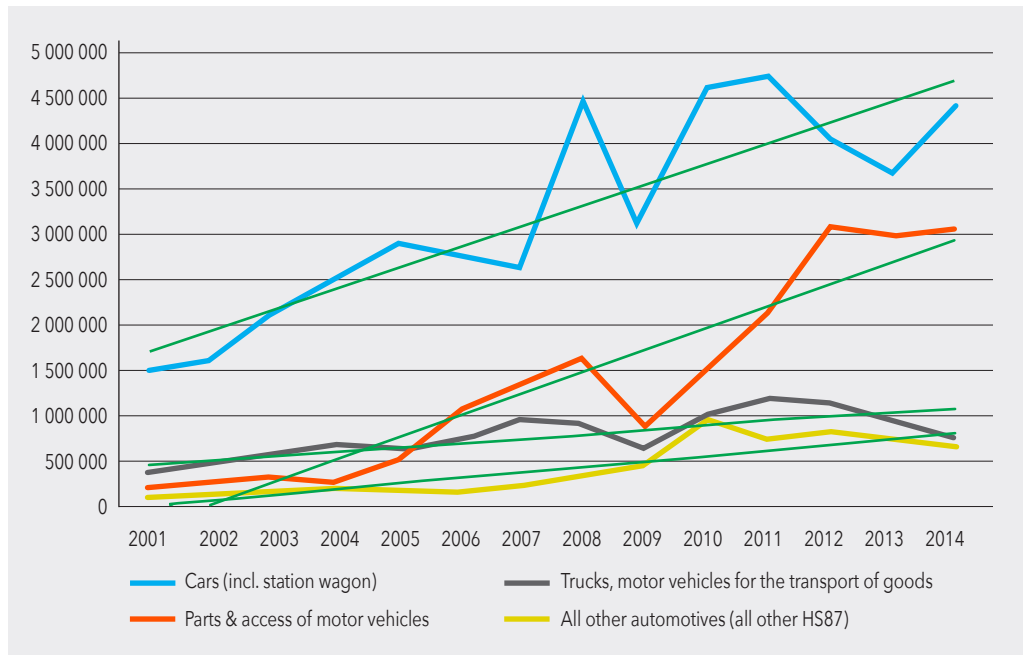
15 Currency code for the South African rand.

Table 1: South African investment incentives

| Incentive | Target industry | Description | Grant scale |
|--|--------------------------------------|--|--|
| Manufacturing Competitiveness Enhancement Programme | Manufacturing and related industries | Assists in upgrading of productive facilities, processes, products and work skills; and assists in Industrial Development Corporation interventions in saving distressed enterprises | Calculated on a tiered percentage of Manufacturing Value Added |
| Business Process Outsourcing and Off-shoring Incentive | Business process services | Base grant incentive paid over three years for each job created, with graduated incentives for jobs created above certain thresholds | |
| Manufacturing Investment Programme | Manufacturing | Reimbursable cash grant for the upgrading, expansion or building of new productive facilities | Up to 30% of cost of investment |
| Foreign Investment Grant | Not targeted | Compensates foreign investors for the cost of moving machinery and equipment to South Africa | Maximum ZAR ¹⁵ 10 million (\$726,674.26), 15% of the value of new equipment, or actual cost of relocation |
| Critical Infrastructure Programme | Infrastructure | Cost-sharing grant for projects designed to improve critical infrastructure, particularly infrastructure to support investments that would otherwise not occur | 10%–30% of total development costs, capped at ZAR 30 million (\$2.18 million) |
| Automotive Investment Scheme | Automotive | Grant assistance for the development of new investment in established automotive and component manufacturers | Taxable grant of 20% of the value of the investment, with additional grant of 5–10% available for projects making a 'more significant' contribution |
| Section 12I Tax Allowance Incentive | Not targeted | Tax allowances for greenfield and brownfield projects | ZAR 500–900 million (\$36.34–65.45 million) for greenfield projects, ZAR 350–550 million (\$25.45–39.99 million) for brownfield projects, with additional allowances for employee training |
| Film and Television Incentive | Media | | 20% of qualifying South African production expenditure with additions if post-production takes place in South Africa |

Source: South Africa: dti (Department of Trade and Industry), *A Guide to DTI Incentive Schemes 2012/13*. Pretoria: Government Printer, 2013

Figure 5: South African automotive exports

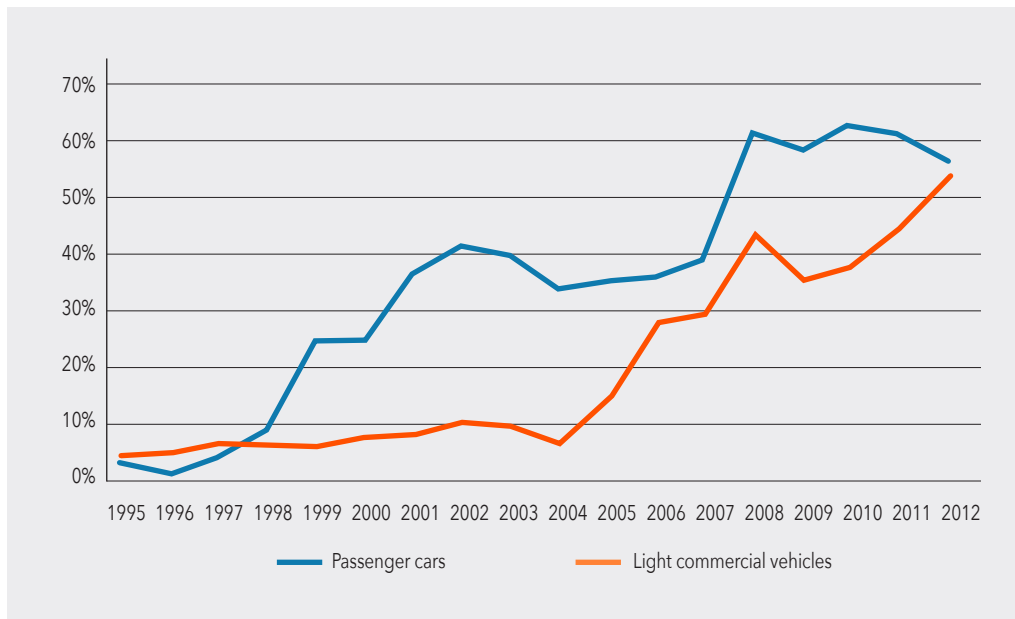


Source: UNCTAD/WTO, International Trade Centre, Trademap, www.trademap.org

An increase in exports has not, however, been directly translated into overall growth in the motor sector itself because of the effect of exports having replaced production for domestic sale. This is partly driven by the nature of the MIDP, which rewards motor companies for exporting by removing barriers to the sale of imported vehicles in the local market. It is also affected by a certain level of rationalisation of the industry and the direct reduction of tariff barriers over the lifetime of the MIDP. Figure 6 shows the shift in the proportion of automobiles produced for export.¹⁶

¹⁶ Barnes J & A Black, 'The Motor Industry Development Programme 1995–2012: What Have We Learned?', paper presented at International Conference on Manufacturing-led Growth for Employment and Equality, Johannesburg, May 2013.

Figure 6: Percentage of South African automotive production for export



Source: Barnes J & A Black, 'The Motor Industry Development Programme 1995–2012: What Have We Learned?', paper presented at the International Conference on Manufacturing-led Growth for Employment and Equality, Johannesburg, May 2013

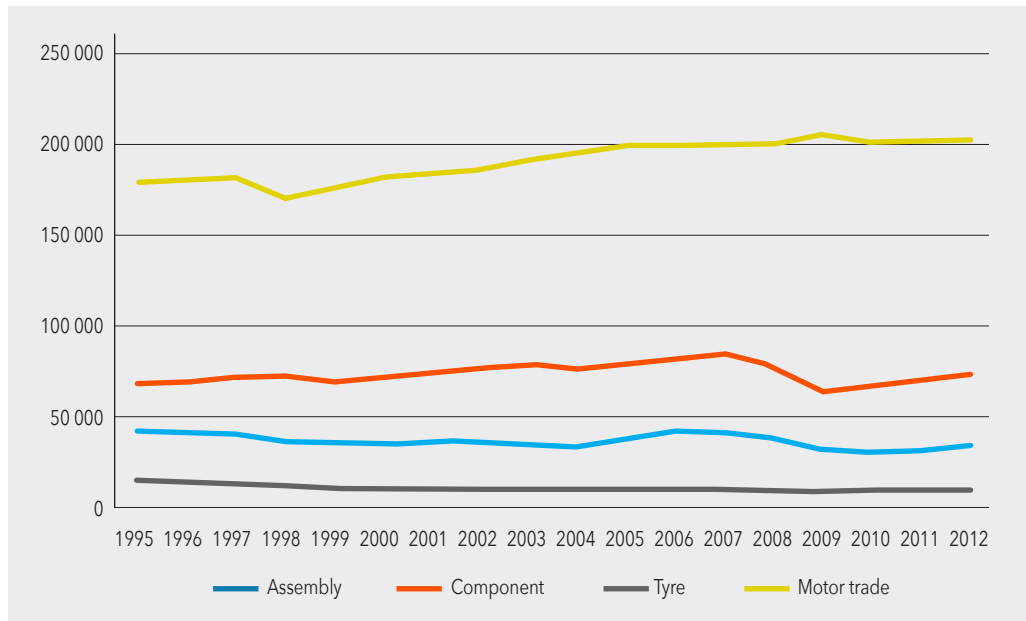
Partly as a result, job creation in the industry is lacklustre. Figure 7 shows the evolution of employment in select automotive production processes.¹⁷ At the industry's peak in 2007 the sector had added 34 800 jobs following on the implementation of the MIDP.¹⁸ Many of these posts, however, were lost in the downturn following the 2008 global financial crisis – reflecting the downside of the sector's shift to greater reliance on exports, hence foreign demand.

The MIDP is in the process of being phased out amid concerns that it is vulnerable to a challenge in the WTO, but it will be replaced by the similarly structured Automotive Production and Development Programme.

¹⁷ Barnes J & A Black, *op. cit.*

¹⁸ *Ibid.*

Figure 7: Employment by sub-sector in South African automotive production



Source: Barnes J & A Black, *op. cit.*

Isolating the specific impact of the MIDP on the growth of the automotive sector and the effect of investment incentives in general is difficult. This is partly due to the complexity of disentangling the ramifications of South Africa's transition from apartheid-era isolation, but it is also a result of the generally favourable global economic climate during the lifetime of the MIDP, which might have driven some of this growth regardless of the incentives under the scheme. Nevertheless, some broad conclusions can be drawn.

Firstly, the MIDP is widely considered a major success of South African industrial policy. The automotive industry has grown in scale and competitiveness, has created spillover benefits from related industries and has contributed to job creation. Although the MIDP is an example of the successful use of economic incentives, however, it is difficult to extend this lesson to other programmes, given that the MIDP is so much larger in scale than any other incentive. Perhaps one further programme on the scale of the MIDP is feasible, but anything beyond that would require a significant redistribution of resources from other parts of the budget.

Secondly, most academics are sceptical of the benefits of investment promotion incentives other than the MIDP. Some cite basic doubts about the capacity of such programmes cost-effectively to attract investment; others raise more specific concerns such as the lack of awareness of programmes, the high administrative costs involved in participating in incentive programmes and uncertainty on the continuity of programmes. The last issue is particularly important, because most incentives are time-limited to between five and 10 years. While

this provides a check against over-reliance on incentives it is often shorter than the planning horizon of potential investors.

Thirdly, some complain that the incentives on offer will have an effect only if accompanied by various structural changes, notably the implementation of strong investor protection but also including supporting measures such as lowering trade barriers, reducing the regulatory burden of programmes such as BEE, and improving infrastructure. Some of these points, such as the need for improvements in electrical supply and infrastructure, attract broad agreement but others are more contested.

The MIDP is a case in point. In most established framings of the global value chain (GVC) narrative the automotive sector would best be helped by lowering trade barriers to allow the smooth flow of components and improve competitiveness in GVCs. Yet the MIDP only works because of trade barriers – it incentivises exports through exemptions from import restrictions. On a broader scale the costs involved in policies such as BEE are often seen as unpalatable to investors; but policies of redress are widely recognised as essential not only in improving social justice but also to maintaining social stability and containing broader and more strident calls for redistribution of income. Undoubtedly investors want structural reform that lowers costs; but costs are lowest in efficient, stable economies and many of the costs foreign investors in South Africa face are designed to fund programmes designed to work towards this goal.

IDZs and SEZs

Regulations for the creation of SEZs were set out in the Special Economic Zones Bill of 2012, introduced in Parliament in 2014 and now being debated. SEZ policy builds on the more limited effort to create industrial development zones (IDZ), introduced during the transition from apartheid in the Manufacturing Development Act of 1993 (Act 187 of 1993). By international standards the IDZ incentives were limited. They included tax relief on customs duties, goods for storage, and certain productive inputs; attempts to simplify customs procedures; and limited incentives on the development of productive sites and infrastructure.

Four IDZs were opened, each targeting a strategic industrial hub. The Coega and East London IDZs serve the Eastern Cape's automotive manufacturing hub, with the East London IDZ sited directly adjacent to the Mercedes Benz assembly plant and almost entirely comprising original equipment automotive manufacturers.¹⁹ The IDZ at Richards Bay is

19 Chinguno C, 'An evaluation of South Africa's industrial development zones', in Bernstein A (ed.), *Special Economic Zones: Lessons for South Africa from International Evidence and Local Experience*. Johannesburg: Centre for Development and Enterprise, 2011.

based on the town's importance as a port for raw materials exports and aims to encourage their beneficiation; and the OR Tambo IDZ at Johannesburg's largest airport primarily targets the air transport industry.²⁰

IDZs in South Africa are widely considered to have been a failure. They stimulated around ZAR 11.8 billion (\$857 million) in investment but did so at the cost of ZAR 5.3 billion (\$385 million) to the national government.²¹ The combined total expenditure on IDZs by national and provincial governments is estimated at ZAR 9.3 billion (\$675 million) between financial years 2002 and 2013; it resulted in 5 137 direct jobs (33 000 if short-term construction work is included),²² putting the price of each direct job at ZAR 1.8 million (\$130,789.78) over the period, or ZAR 13 750 (\$999.13) a month.²³ The OR Tambo IDZ is yet to attract any investment and as of 2013, that at Richards Bay had only one large investor (Tata Steel), although agreements are in place with three additional firms.²⁴

Some good news from the IDZs is that their failure has largely been attributed to the limited nature of the policy. They offered few traditional SEZ incentives such as preferential corporate tax rates, specific investment incentives and discounted land costs, or the easing of labour or environmental regulation.²⁵ The IDZ policy may, however, have proved a useful testing ground in that it is a limited package that allows the government to better understand the nuances of running such zones. This experience might then inform policy on the more substantial SEZ rollout currently under way. Beyond incentives, numerous additional lessons have been flagged by the dti, such as the importance of introducing some flexibility into funding models and improving stakeholder co-ordination.²⁶

Under the 2012 bill the much-revised SEZ framework offers improved incentives. They include a preferential corporate tax rate of 15% (against the national average of 28%) as well as additional tax and customs incentives; tax relief for building expenditure; the offer of special employment incentives; and the creation of a 'one-stop shop' to provide easy access to the bureaucratic channels necessary to SEZ operations and exports.²⁷ According to the dti, the new policy sees the development of four distinct types of SEZ. These are²⁸

- Free port: duty-free area adjacent to a port of entry where imported goods may be unloaded for value-adding activities within the [SEZ] for storage, repackaging or processing, subject to customs import procedures;

20 *Ibid.*

21 Bernstein A (ed.), *op. cit.*

22 South Africa, dti, Policy on the Development of Special Economic Zones in South Africa. Pretoria: dti, 2012.

23 This figure is rounded for illustrative purposes only and assumes that IDZs have run from 2002 to 2013. Construction of IDZs does not align with financial years.

24 Chinguno C, *op. cit.*

25 *Ibid.*

26 dti, *op. cit.*

27 dti, 'Industrial development', http://www.thedti.gov.za/industrial_development/sez.jsp.

28 dti, *op. cit.*

- Free trade zone: duty-free area offering storage or distribution facilities for value-adding activities within the [SEZ] for subsequent export;
- Industrial development zone: purpose-built industrial estate that leverages domestic and foreign fixed direct investment in value-added and export-oriented manufacturing industries and services; and
- Sector development/specialised zones: centred on development of a specific sector or industry through the facilitation of industrial infrastructure, incentives and technical and business services, primarily for the export market.

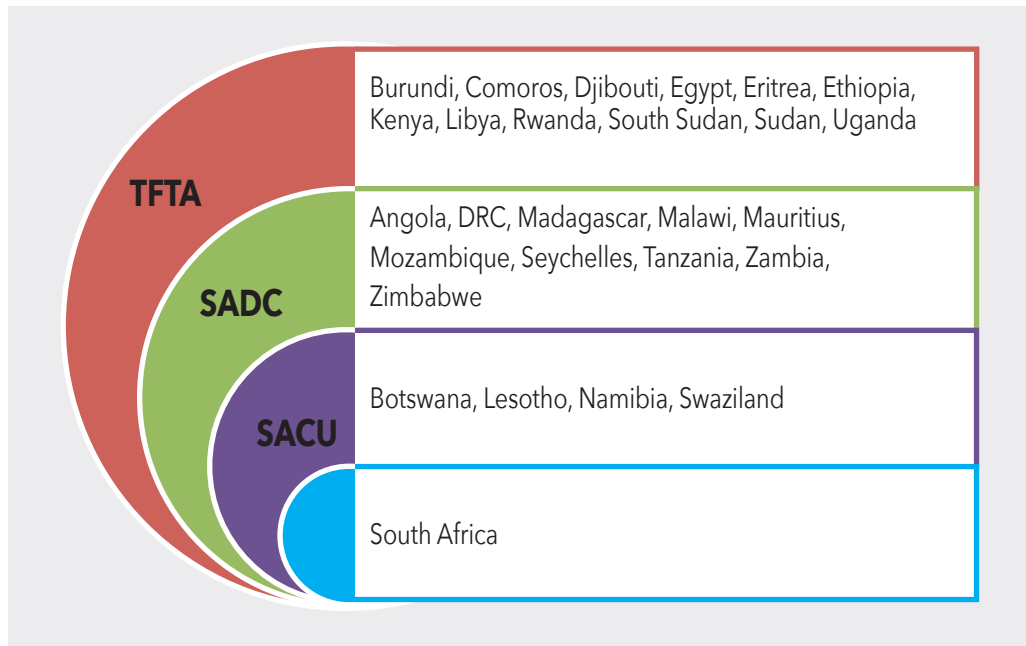
Five new zones are to be added to the existing four IDZs and a fifth under construction in Saldanha Bay. A special SEZ fund will be created to finance the development and operation of the zones, working with private investors to implement the projects. The SEZs will be overseen by a board of 15 that includes representatives of the dti, the Department of Public Enterprises, the National Treasury, South African Revenue Service, the Industrial Development Corporation, the power parastatal Eskom and the transport utility Transnet; as well as representatives of organised business, labour, civil society and other specialists in the field. Following the broader shift to investment for diversification, the main stated priority in the SEZ bill is the development of 'manufacturing sector and tradable services'.²⁹ Attracting FDI is third on the priority list.

REGIONAL IMPLICATIONS OF SOUTH AFRICAN INVESTMENT POLICY

South Africa considers itself part of a broader sub-Saharan Africa region and participates in forums such as the AU, the New Partnership for Africa's Development and the Tripartite Free Trade Area (TFTA) negotiations. However, the region in which South Africa is most influential is undoubtedly Southern Africa, including SADC and – even more importantly – the Southern African Customs Union (SACU), the country's customs link with neighbouring states. Figure 8 maps out the countries involved in these blocs. The present study focuses primarily on the SACU countries as the most integrated with South Africa and therefore most directly affected by spillovers from South African policy. SADC will be referenced mainly to give a broader regional picture.

²⁹ Republic of South Africa, Ministry of Trade & Industry, Special Economic Zones Bill. Pretoria: Government Printer, 2013.

Figure 8: South Africa and regional economic communities



Source: Author's compilation

Although very diverse, in economic terms the Southern African region broadly falls into two categories: 'emerging' and 'frontier' markets. Emerging markets are larger states with some nascent diversification, as witnessed by growing services and manufacturing sectors; in Africa they include the likes of Kenya, Nigeria and Botswana. Frontier economies are undiversified, often reliant on mining and agriculture activities and often with small domestic markets, which limits their capacity to develop economies of scale in domestic demand-driven sectors. They include countries such as Namibia, Swaziland and Mozambique. Some African states bridge the divide, notably Angola, which posts high growth rates but is virtually a single-commodity economy dependent entirely on oil.

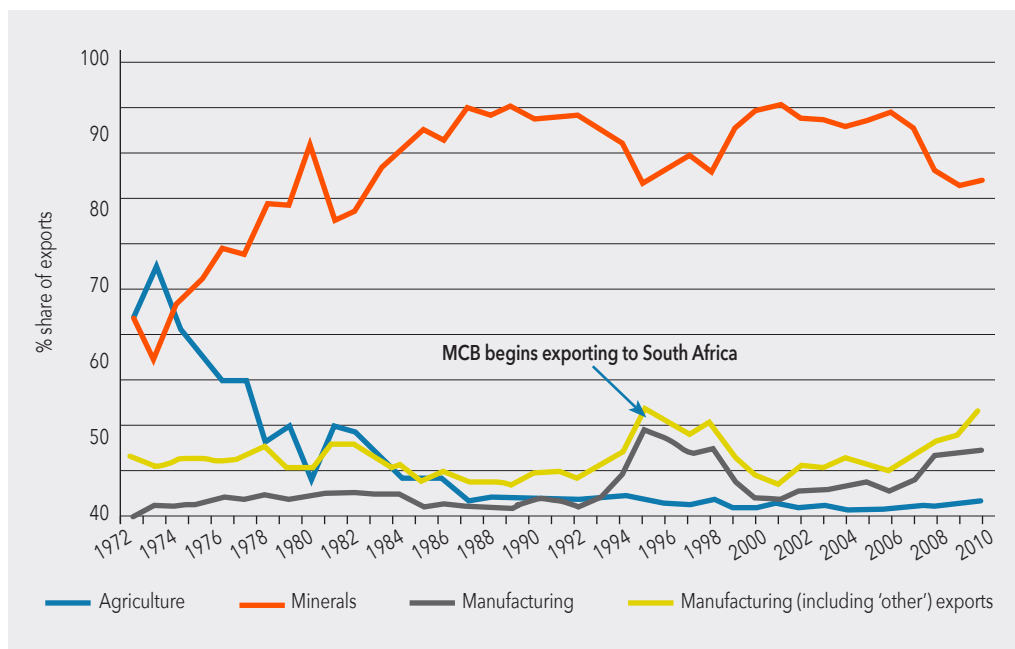
The distinction between the two types is important because the impact of FDI policy is often difficult to disentangle from the naturally unbalanced FDI flows that result from widely differing economic fundamentals between countries in the region. FDI is overwhelmingly driven by basic economic considerations: market-seeking investment looks to a large and growing consumer base, export-seeking investment seeks high productivity and commodity-seeking funds pursue resource availability. Policy plays only a supporting role in exacerbating or reducing these expected imbalances. Frontier economies in Southern Africa may see some investment diversion resulting from South African FDI policies but this is likely to be small. Most investment heading into these markets is seeking specific resources and is not subject to the sway of competitive policies. Emerging markets, however, may be in direct competition with South Africa and may therefore suffer a direct impact from the latter's domestic investment policy.

The Motor Company of Botswana

Botswana offers a useful case study on the possible diversion effects of South African investment policy. It is a small emerging economy, often hailed for its business-friendly operating environment, abundant natural resources and relatively high level of development (with good infrastructure and a per capita GDP higher than that of South Africa). Botswana's FDI is dominated by a traditional focus on mining and an emerging finance sector (the two together account for 80% of FDI stocks)³⁰ and like most countries in the region, its approach to investment is predicated on a desire to attract more diverse, value-added investment.

Figure 9 highlights the breakdown of Botswana's export basket, with a clear spike in exports in manufactured goods between 1990 and 2000.³¹ This was thanks to the short-lived Motor Company of Botswana (MCB), a franchised assembly plant for Hyundai motor vehicles destined for the South African market. The plant was funded by the Botswana Development Corporation and two private banks and employed around 600 people in the capital Gaborone. MCB seemed to encapsulate the ideal of the industrialisation dialogue dominant in the region: that of the developmental state guiding the creation of high-value added production for export.

Figure 9: Botswana exports by type



Source: Botswana Institute for Development Policy, 'Report on Export Diversification Policies for Export Success in Botswana'. Gaborone: Boccim (Botswana Confederation of Commerce Industry and Manpower), 2013

30 KPMG, 'Botswana risk profile', <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Botswana.pdf>.

31 Grynberg R, 'SACU Revenue Sharing Formula, Diversification and the Automobile Industry'. Gaborone: BIDPA (Botswana Institute for Development Policy Analysis) (forthcoming).

In 2000 MCB declared bankruptcy, having produced only 7 000 vehicles in the preceding two years (in the face of a break-even requirement of 15 000 units annually).³² A large part of this failure was due to mismanagement by MCB's unscrupulous owners (who would later be charged with fraud and other malfeasances) but a further significant aspect was the effect of South African policy on the operation. Thirteen years after the closure of MCB, Hyundai opened a plant in Benoni, near Johannesburg, which undertook the assembly of partial-knocked down kits, mirroring the work done in Gaborone. Unsurprisingly, the initiative sparked familiar accusations about South Africa's role as the economic bully of the region. Botswana's president at the time MCB closed down, Quett Masire, would later claim that the country's Hyundai plant was 'sabotaged by South Africa'.³³

Two features in particular of South African investment policy came in for criticism. The first was a protectionist bent that saw South Africa block imports from Botswana, its fellow SACU member. SACU rules of origin require goods to have 40% in local value added, a level difficult to reach for assembly plants predicated on assembling partial-knocked down kits. In the face of rules of origin complaints from Pretoria, the MCB plant faced tariffs of 54%³⁴ and reportedly accepted a voluntary quota of 1 000 vehicles a month into South Africa.³⁵ Given Botswana's small domestic market MCB's viability depended on tapping into the South African market, and these restrictions were devastating to its ability to do so.

The second problem arose from the large subsidies offered under the MIDP. The part played by the MIDP in the collapse of automobile manufacturing in Botswana might seem counter-intuitive, as the MIDP applies to Botswana as well; because it is based primarily on tariff rebates and SACU has a common external tariff, the five SACU countries all qualify for MIDP incentives. MCB was not producing for export outside SACU, however, and so failed to qualify for the highest incentives under the MIDP. Furthermore it found itself facing competition from efficient foreign producers that had circumvented import barriers by establishing factories in South Africa. The MIDP's unique structure makes it a complex case for understanding the regional effect of investment incentives but in essence, MCB exports found themselves in competition with subsidised rivals benefiting from the MIDP.

The case of MCB clearly highlights the dual role played by South Africa in the region. The company could not have existed without sales to the South African market, but this potential for attracting investment was offset by the distortions resulting from South African policy. The drive to create good quality jobs in the South African manufacturing sector gave rise to policies that undermined similar ambitions in Botswana.

³² Grynberg R, *op. cit.*

³³ Grynberg R, *op. cit.*

³⁴ Based on tariff rates for 1999 on product line 87032390.

³⁵ Grynberg R, *op. cit.*

South African policymakers do seem to appreciate the inherent inter-connectedness of regional growth. They know that South Africa cannot develop if its neighbours stagnate but long-term visions of regional development struggle to overcome the immediacy of simple short-term calculations such as moving the Hyundai plant from Gabarone to Benoni. Commitment to regional integration is often expressed in terms of grand development visions but in practice it runs up against the more hard-nosed implications of cases such as MCB. On that metric, South Africa's role in the region is less than clear.

South Africa as an investment driver

Of course, this single example does not capture the full picture of South Africa's role in the region. Leaving aside funds from tax havens,³⁶ South Africa is the single largest investor in the BLNS.³⁷ Figure 10 shows the dominant role South African FDI plays in SACU; although some of this investment is in natural resource extraction, particularly mining in Botswana and agriculture in Swaziland, the services sector is the most dynamic regional investor. The Standard Bank group is the principal financial services institution in the BLNS and South African firms are dominant in telecommunications and retail services. The high level of investment in customer-facing services firms is often cited as a factor in feeding an impression of regional dominance by a South African 'Big Brother'.

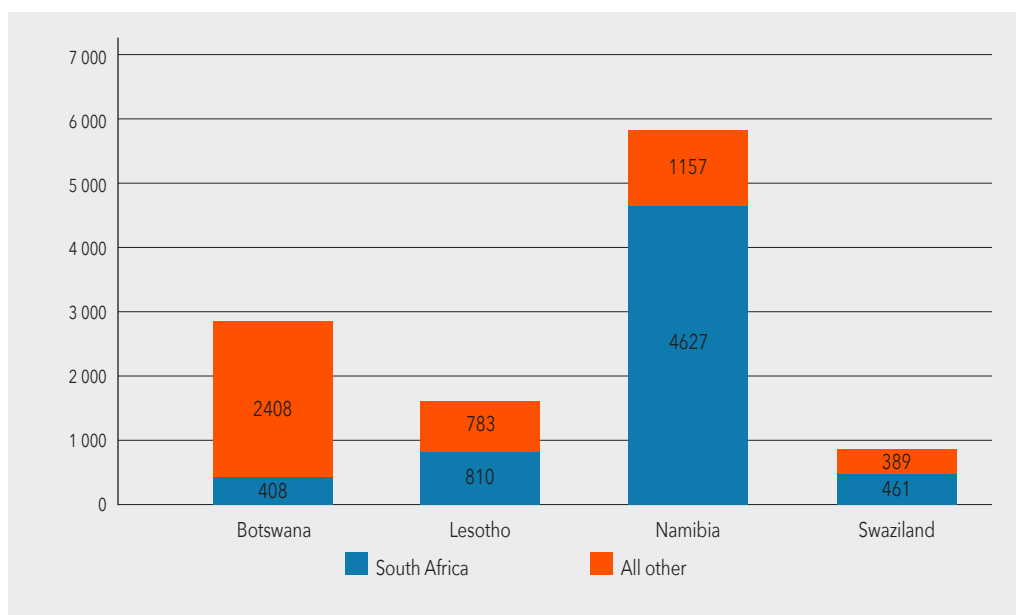
Although South Africa's investment in neighbouring countries is the most direct means by which the country drives regional investment, arguably the more important factor is the extent to which the presence of South Africa encourages outside investment in neighbouring countries. In this context South Africa can be thought of as playing a role in creating three investment 'gateways'.

First, the BLNS can be seen as a gateway to South Africa. This certainly was so for MCB, which was developed off the back of SACU preferential access to the South African market. SACU's tariffs are generally low, so it is unlikely that investors would be encouraged to set up shop merely for purposes of 'tariff hopping', except in a few protected industries such as automotive assembly. Nevertheless, the presence of the South African market may drive investment in neighbouring countries, for example by firms looking for lower-wage production centres. Investment for South African market-seeking should show up in the trade figures, but those numbers do not support the idea of a particularly important role for this type of investment. All BLNS countries run a large trade deficit with South Africa and none of them exports much by way of value-added goods.

³⁶ Luxembourg is technically the largest investor in Botswana: De Beers has its headquarters in the Grand Duchy.

³⁷ UNCTAD FDI/TNC Database, 'FDI flows in the host economy, by geographical origin'.

Figure 10: BLNS FDI stocks by country of origin (\$ million)

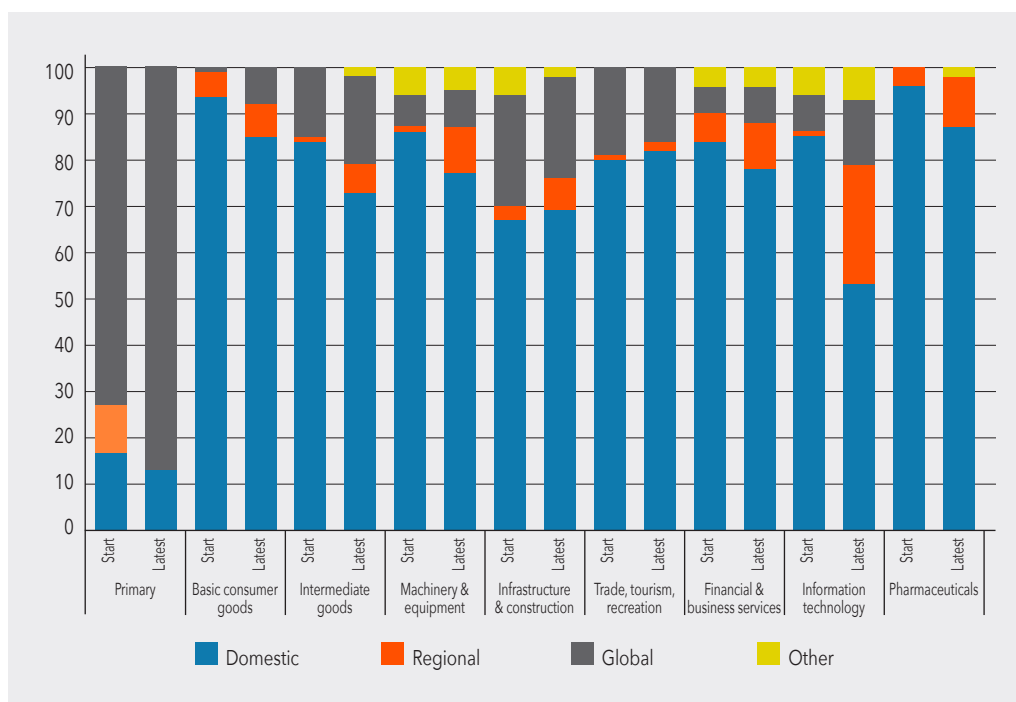


Source: UNCTAD FDI/TNC database, 'FDI flows in the host economy, by geographical origin', <http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Country-Fact-Sheets.aspx>

Second, South Africa can be understood as a gateway to the BLNS. South Africa has traditionally promoted an assumed role as a gateway to Africa, offering a base of operations characterised by strong skills and infrastructure from which to base investment projects in less well-developed parts of the continent. This framing of South Africa as a gateway to the continent is not entirely accurate but it certainly does appear to apply more narrowly as a gateway to Southern Africa.

There is a clear tendency for market-seeking foreign firms that have established a presence in South Africa to expand into the subregion. Figure 11 shows the destination for goods produced by firms in various economic sectors at the start of their investment and later on. All sectors, with the exception of primary goods, show a clear tendency to expand further into the region once established in South Africa. While not a linear trend, firms that targeted the domestic market on entry were more likely to extend their operations into the region than those that targeted the export market on entry; this is perhaps an indication that expansion into the Southern African region tends to be favoured by market-seeking firms looking to extend their reach. This trend is also seen in company size: smaller foreign firms are more likely to expand into the wider region than are large multinationals, which favour global markets. On balance this data, although not painting a full picture of South Africa's role, seems to indicate that the country is a gateway to the Southern African consumer market but not necessarily to the Southern African industrial space.

Figure 11: Shifting market orientation of investment in South Africa, by sector



Source: Gelb S & A Black, 'Foreign direct investment in South Africa', in *Investment Strategies in Emerging Markets*. Cheltenham: Elgar Publishing, 2004

Third, South African can be considered as a gateway for the BLNS to the rest of the world. The rise of the GVC introduces new dynamics to regions with wide disparities in economic development. Whereas previously, constrained by barriers such as weak infrastructure, least developed countries would struggle to enter global markets, they can now make use of infrastructure in neighbouring countries through the development of regional value chains (RVCs). In the case of Southern Africa, the productivity advantages of South Africa's more developed economy meld with the natural advantages of the BLNS to drive their exports. Although most countries in sub-Saharan Africa are stuck at the low end of these value chains, the chains nevertheless offer the scope to enter into sectors that would otherwise be prohibitively difficult to reach.

The motor industry again offers a useful case study. While still a very recent trend, South Africa is increasingly importing automotive components from neighbouring states. This is most noticeable in the case of Botswana, from which South Africa buys wiring harnesses and batteries. Other products, such as materials from Botswana and Namibia's large leather goods industries, may also find their way into South African-built cars. At the moment it is difficult to gauge how deep this level of integration is, but there is clear potential to develop RVCs across the Southern African region, which can be particularly beneficial to smaller

states such as Lesotho or Namibia, which might struggle to enter global markets directly but can do so through the South African productive hub.

Although there are obvious channels through which neighbouring countries could benefit from the close proximity of the larger South African economy, the impact on investment is not clear. Market-seeking investment that targets the South African market is likely to establish itself in South Africa. RVC development does carry potential to grow neighbouring markets but the national value chain within South Africa is still under-developed. Large sub-national regional discrepancies offer similar advantages (ie, lower wages or natural resources) to regional states. South Africa's role as a service provider certainly improves the investment climate in the region but it does not substantially affect the competitive balance of productivity-sensitive investment between South Africa and its neighbouring states. On the whole, South Africa can play a major role in driving development in the region, but it is not clear whether or not this catalytic effect is large enough to create substantial social change.

Risks arising from South African policy

The risks associated with the relative scale of the South African economy and the potential associated distortions arising from its policy are difficult to measure. Beyond idiosyncratic cases such as MCB, evidence is scarce because the complaint is based on the counterfactual proposition 'if it were not for South Africa, our investment would be much higher'. Nevertheless, the perception in the region is certainly that the presence of South Africa could complicate efforts to attract high-quality investment. This perception, tied to broader concerns regarding South Africa's regional hegemony, can stymie regional co-operation efforts in the field of investment policy.

Given the evidence thus far, it seems safe to say that market-seeking investment is not significantly open to distortion from investment policy, for two reasons. First, the South African market seems the obvious main attraction, with regional markets either secondary or considered as part of a single SACU market. Second, market-seeking investment does not seem to make much use of investment incentives; and most incentive programmes are aimed at value-added production and focus on export promotion.

Although there is little data on what motivates inward FDI flows to SACU, surveys show that roughly 80% of sales for foreign firms operating in South Africa are focused on the domestic market. South Africa accounts for 93% of SACU FDI stocks, hence this picture probably can be extended to the region as a whole.³⁸ This explains only the proportion of sales and is not scaled to the size of the company; many larger firms are more globally focused and from this information cannot be understood as market-seeking.

Added to this uncompetitive market-seeking investment is resource-seeking investment. FDI flows into Africa have usually centred on resource extraction, a motivation still prominent in SACU and even more so in the broader SADC region. Luxembourg, which in this context can be understood as a proxy for De Beers, accounts for 68% of total FDI stock in Botswana, driven by the country's large diamond deposits.³⁹ Angola and Mozambique have each experienced FDI booms over the past decade but almost all of this have been directed to oil and gas extraction.

On balance, therefore, it appears that FDI inflows that might be subject to distortion from South African policy – that is, efficiency-seeking investments – are only a very small proportion of the whole. Although a lack of data again makes it difficult to understand the scale of this competitive investment, it might be that at present it represents only a small fraction of total FDI. This should mollify numerically inclined economists, but it does not reduce the political appeal of the high value-added, job-creating investment that is contained within this portion of total FDI. Against the backdrop of political systems that favour this kind of investment, the scarcity of inflows on offer might be of even greater concern, particularly because many of the uncompetitive flows are believed to have weak social benefits. Diamond mining in Botswana, for example, accounts for 40% of GDP⁴⁰ but creates only 4% of employment.⁴¹

Before considering incentives, some core competitive indicators, including the effects of investor protection, must be considered. Figure 12 shows the rankings of SADC countries in the World Bank's Doing Business Report, with SACU states highlighted in blue. For several countries the advantages of a more business-friendly environment are attenuated by problems specific to them. For example, logistics costs are restrictive for landlocked countries such as Botswana and Zambia, currency volatility hampers Malawi and Zimbabwe and political uncertainty clouds prospects for the likes of the Democratic Republic of the Congo and Swaziland.

These structural efficiency disparities, combined with the dominance of immobile investment, mean that only a small pool of investment is influenced by policy. To understand the competitive effect of this policy, Table 3 compares investment incentives across SACU members. It is purely indicative – based largely on marketing by investment promotion bodies – and may exclude other incentives; it definitely excludes those available under SEZ policies.

38 Gelb S & A Black, *op. cit.*

39 UNCTAD, FDI/TNC database, Botswana Table 1, FDI flows in the host economy, by geographical origin, <http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Country-Fact-Sheets.aspx>

40 KPMG, 'Monitoring African Sovereign Risk: Botswana Snapshot, 2013 Quarter 1'. Gaborone: KPMG, 2013, https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2013%20African%20Country%20Reports/KPMG_Botswana%202013Q1.pdf.

41 Zizhou F, 'Linkages Between Trade and Industrial Policies in Botswana', Industrial Policy Thematic Working Group. Pretoria: TIPS, 2009.

Table 2: Ranking of SADC countries, World Bank Doing Business Report, 2015

| Economy | Ease of doing business ranking |
|----------------------------------|---------------------------------------|
| Mauritius | 28 |
| South Africa | 43 |
| Botswana | 74 |
| Seychelles | 85 |
| Namibia | 88 |
| Swaziland | 110 |
| Zambia | 111 |
| Mozambique | 127 |
| Lesotho | 128 |
| Tanzania | 131 |
| Madagascar | 163 |
| Malawi | 164 |
| Zimbabwe | 171 |
| Angola | 181 |
| Democratic Republic of the Congo | 184 |

Source: World Bank, 'Doing Business Report', 2015, <http://www.doingbusiness.org/>

Two factors immediately become apparent. The first is that most incentives in the BLNS are more aggressive than those in South Africa, particularly in SEZs. Whereas South Africa tends to moderate costs through tax relief and investment support, the BLNS offer full tax breaks in many cases and the removal of almost all restrictions on movement of capital and profits. These more substantial incentives are possibly the result of higher costs associated with lower levels of development and the consequent need to set incentives higher to compensate. They could also result from competitive pressure from South African incentives, although this seems unlikely, particularly in the case of SEZs, given that the policies of many countries in the region predate South Africa's. The second observation is that most incentives offered by the BLNS are much less narrowly targeted; although there is a general effort to support manufacturing (broadly defined), most incentives set out to capture whatever investment they can, a situation that offers quite significant opportunities to target gaps in the South African incentive web.

Table 3: Investment incentives in the BLNS

| | Botswana | Lesotho |
|-------------------------------|--|---|
| Preferential tax rates | 15% tax rate (rather than 22%) for manufacturing firms, International Financial Services Centre accredited firms, and innovation hub firms | 10% corporate tax on manufacturing profit generated from exporting manufactured goods outside SACU; a maximum manufacturing corporate tax rate of 10% on profits for intra-SACU trade |
| Tax holidays | 0% tax holiday for five to 10 years | |
| Capital controls | No foreign exchange controls | No withholding or advanced corporation tax on dividends distributed by manufacturing firms; easy repatriation of manufacturing profits |
| Training incentives | Discretionary tax breaks and training grants by the Development Approval Order through the Ministry of Finance and Development Planning | Training costs allowable at 125% for tax purposes |
| VAT and duty | | VAT rate of 14% (ensuring harmonisation with South Africa) |
| Capital investment | | |

Sources: Botswana Investment & Trade Centre, <http://www.bitc.co.bw/incentives-investors>; Lesotho National Development Corporation 'Incentives', <http://www.lndc.org.ls/incentives/>; Namibian Embassy US 'Investment incentives', <http://www.namibianembassyusa.org/page/investment-incentives>; Namibian Ministry of Industrialization, Trade & SME Development. 'Incentives', <http://www.mti.gov.na/incentives.html>; Investors Guide to Swaziland, http://www.africanbondmarkets.org/fileadmin/Countries/Swaziland/Swaziland_Investment_Promotion_Authority/Swaziland_investment_guide_2011.pdf

| Namibia | Swaziland |
|--|--|
| 80% tax allowance on income derived from exporting manufacturing goods | |
| 18% tax rate for 10 years | 10% corporate tax rate for 10 years for companies in qualifying industries (including manufacturing, mining, agri-business, tourism, and international finance services) |
| Non-resident shareholder's tax of 10%, and tax-exempt dividends to Namibian companies and resident shareholders | Liberalised repatriations of capital and profits |
| Additional deduction from taxable income of 25–75%; industrial studies available at 50% of cost | 150% rebate for approved human resources training |
| Import or purchase of manufacturing machinery and equipment is exempt from VAT | Exemption from duty for capital goods imported and used in the production of final products, and raw materials used in exports beyond SACU |
| Factory building written off at 30% in first year and balance at 8% for 10 years; allowance for land-based transportation by road or rail of 25% | 50% allowance in the first year and 10% annual allowance for plant and machinery used in manufacturing; 40% first year and 4% annual for buildings used to house manufacturing; further allowances on hotel construction, employee housing and farming |

REGIONAL CO-ORDINATION OF INVESTMENT POLICY

The regional investment landscape may be defined by three factors. The first is uncompetitive investment: the great majority of investment into sub-Saharan Africa is not interchangeable with that into other locations around the world. Market-seeking and resource-seeking investment dominates, with a minority of investment flows driven by the region's export competitiveness and potential. The second factor is unbalanced fundamentals: economic parameters ranging from market size to productive efficiency are uneven across the region and most pronounced in the case of South Africa. The disparity between South Africa and its SACU and SADC neighbours means that flows of market- and efficiency-seeking investment are likely to be so unbalanced as to exacerbate regional inequalities. Third, there is an imbalance in policy capacity: the scale of South Africa's investment incentives limits the ability of neighbouring governments to use their policy structures to attract investment. Initiatives may work in niche industries or when set in co-ordination with South African policy but otherwise they risk being out-spent by South Africa's incentives. All three factors must be borne in mind when crafting regional investment policy.

Regional economic communities in general struggle to co-operate on investment policy, which is sensitive to the regulatory and fiscal priorities of individual countries. Southern Africa is no exception. Nevertheless, two SADC initiatives are broadly aiming to promote convergence on investment-related issues. The first, the SADC Model Bilateral Investment Treaty (Model BIT), aims to create a regional standard for the drafting of 'next-generation' BITs. It is not a prescribed model but is available to any country in the region. Drafted in co-operation with the Winnipeg-based International Institute for Sustainable Development and released in 2012, Model BIT aims to be a next generation treaty and includes provisions targeted at alleviating common concerns associated with investment agreements. For example, Model BIT narrows the scope for using the Organization for Economic Cooperation and Development's Fair and Equitable Treatment standard, a favourite prop of claimants in international arbitration proceedings thanks to its broad scope for interpretation that employs governance standards rather than investor rights as the basis on which to assess claims.⁴² The scope for private business claimants is further limited by the absence of investor-state dispute settlement rights, which are replaced by recourse to state-state dispute settlement. The Model BIT also provides for host states to impose regulatory measures in the pursuit of development and places obligations on investors regarding environmental safeguards, human rights and various social conditions. More traditional provisions such as restrictions on direct expropriation are included but give states broader powers, notably in the definition

⁴² Woolfrey S, 'The SADC Model Bilateral Investment Treaty Template: Towards a New Standard of Investor Protection in Southern Africa', Trade Brief No. D14TB03/2014. Stellenbosch: Tralac (Trade Law Centre), 2014.

of compensation against a 'fair and adequate' standard rather than a 'fair market value' standard.

The Model BIT is a powerful starting point to respond to evolving complaints against BITs, with no obligation for SADC states to use the new template. Despite this, there are limits on its capacity to drive regional investment policy. First, the main way in which the Model BIT mechanism can bring about change is through its use in negotiating future BIT agreements, which at the moment are not on the cards. In South Africa particularly, opinion has swung firmly against BITs and towards domestic regulation of foreign investment. The Model BIT may assuage some of the concerns underlying this trend but it cannot have a serious impact unless core opinions on the value of BITs shift considerably and states begin to sign new agreements. Second, the logic underlying the regionalisation of investment protection (rather than promotion) policies is not quite clear. While regulatory convergence in the region makes it easier for investors with a presence in one country to move to another, most regulatory barriers do not explicitly concern investment. The core barriers cover a range of industry-specific rules and some broader rules on labour, company registrations and so on. At present, regional co-ordination of investor regulation does not seem capable of creating a simple channel through which investment in one country can move to the wider region.

Other integration efforts, although not directly targeting investment, play a significant part in creating a regional investment market. For example, the SADC Financial Services Investment Protocol (FIP) adopted in 2007 is a broad-ranging effort to harmonise the financial services sector, ranging across payment and clearance systems, insurance and securities trading to central bank regulation and exchange control. FIP reflects the apogee of rapid internationalisation of finance with minimal regulation. It also pre-dates the Zuma administration and subsequent moves by the South African government to cancel BITs and build an investment regulatory regime that accrues power to government. Perhaps for this reason FIP Annex 1, concerning investment, offers extensive regional protection of the type available under old-style BITs. This includes the right to ISDS, broad demands for 'prompt, adequate and effective' compensation for expropriation and the inclusion of the controversial 'fair and equitable treatment' standard.

FIP is a case study in the limits of regional co-operation on issues such as investment. Although it may have been acceptable in 2007 when governments were in general agreement with its provisions, it is unlikely to survive the more recent tack in thinking on investment protection in the region, particularly in South Africa. Already questions have been raised about the legal applicability of the agreement (although in theory its commitments are binding on all SADC states) and it is widely expected that the protocol will be revised to reflect the

changing investment regime at national level. Regional agreements that are applied only when all concerned are happy with them are of extremely limited utility. The degree of certainty required by investors cannot be found in protocols that change with opinions.

Beyond SADC, some regional investment co-operation is evident in the sub-region of SACU and the macro-region of the TFTA. SACU has no formal investment co-operation; it is limited by the severity of the economic imbalance between South Africa and the BLNS and by the weak institutional capacity of an institution that is essentially just a trade agreement. SACU does, however, share access to South African initiatives that make use of tariffs as incentives for investment (notably the MIDP). Under the latest treaty other SACU states should have an equal say in setting tariff policy once they have established bodies that can govern this process, perhaps modelled on South Africa's International Trade Administration Commission (ITAC). Efforts to develop ITAC bodies in BLNS countries would create scope for greater engagement on how to use the common external tariff to promote investment across the region.

The TFTA is a more complex proposition. Investment is not one of its three pillars (respectively market access, infrastructure development and industrial development); and it is generally believed that the political will behind efforts to reach deep agreement on regulatory convergence of the kind sought in other mega-regional negotiations such as the TPP is weak at best. Nevertheless, the market access pillar does include negotiations on trade in services and mention has been made of cross-border investment's being a priority in the agreement. Investment promotion in the TFTA is seen more as linked to the core benefits of the deal itself – a large integrated consumer market from Cape to Cairo – rather than to specific provisions on investment governance or incentives.

CONCLUSION

Deepening co-operation on investment policy will be difficult. Internalising the benefits of regional integration in trade, even when there is very compelling logic behind building an integrated market, has been a fraught political process. That logic is much less clear in the case of investment policy. Why should politicians in South Africa support industrial development in Botswana rather than their own impoverished North West province? And why should the likes of Botswana re-direct scarce resources from domestic incentives towards regional initiatives that might dilute their impact? The immediate answer – creating shared wealth that reinforces growth across the region – is easy to arrive at in theory, but considerably more difficult to present convincingly to voters.

Nevertheless, the situation outlined in this paper – of a region in which economic inequalities can make investment policy an unbalanced zero-sum game – seems to call for active policy measures to ensure that South Africa’s investment initiatives spark regional agglomeration effects rather than national diversion. Policy in this regard will have to be cost-effective and easy to implement at the regional level and also must play to some shared benefits for all concerned. Possible initiatives could include:

Incentives along value chains: Inducements at various stages across value chains are mutually reinforcing. Incentives to promote export of cars would be even more attractive if the vehicles included components made more effective by incentives granted parts manufacturers further down the value chain. Support across value chains also allows governments to share the fiscal burden of incentives. Some level of co-ordination along a handful of value chains will reach into the imbalances in the region and allow smaller countries to share in the growth promoted by South Africa’s investment policy.

Developing a SEZ network: SEZs are ubiquitous across the region. They should tap into the tendency of investment in one SACU (or possibly SADC) member country to move to the wider region. Developing relationships between the management of different SEZs can encourage firms located in successful SEZs to consider investing in others in the region. Some level of harmonisation in the processing of entry into SEZs might also encourage such expansion. Successful SEZs should be seen as gateways to the SEZ network in the SADC region.

Developing tariff bodies in the BLNS: Using tariff walls and import rebate certificates is a controversial approach to investment promotion but one that is likely to remain popular in the region after the success of the MIDP. Regionalising the benefits of these initiatives would be much easier if the BLNS develop the institutional capacity to enact their rights under the SACU agreement to take part in the process of setting tariff policies, which would boost their influence in this important dimension of investment policy.