
**“SOUTH AFRICA'S POLICY ON FOREIGN DIRECT
INVESTMENT: SOME POLICY RECOMMENDATIONS”**

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WORKING PAPER 2

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PREFACE

This project constitutes nothing more than a discussion document of all of those who read it. However, it also constitutes nothing less than a genesis to substantive policy formulation in respect of foreign direct investment ("FDI") in South Africa. This document has been written in a near vacuum of published material on the topic of FDI in South Africa. For this reason its contents manifest a blatant lack of "correct" order through which they are analysed and discussed. This should indicate that the discussion FDI in South Africa does not as yet possess form. Indeed, an underlying objective of this project is that it will ultimately lead to an informed debate on the issues which it introduces.

Two major themes run the length of this document. The first is FDI promotion and the second is "guidance" policy.

As far as can be ascertained, this is the first time in which the issues of FDI promotion have been analytically described in the South African context. It appears that the mechanics of investment promotion area not well understood at national level, although there has been an attempt by the current government to institutionalise some form of promotion agency. This document has endeavoured to show that FDI promotion constitutes a carefully structured programme (based on international experiences). However, what this project has made little effort to accomplish is the resolution of the issues which relate to the powers reserved to the provinces in respect of investment promotion. Obviously, this is a crucial area for national policy to consider, since it will determine whether or to what degree existing and future localised development corporations and similarly disposed institutions will be free to promote FDI.

The other area of policy to which this document has sought to make a contribution is that which relates to the relationship between the State itself and transnational corporations, supposedly the leading vehicle of FDI. Traditionally, investors towing large and important potential investments have negotiated special concessions directly with the responsible Minister concerned. This has meant that such negotiations – at the political level – have not necessarily lead to the maximization of benefits to the South African economy and society from important investments. For this reason, this document has recommended that the process of negotiation should instead be institutionalised in the proper context. This document has endeavoured to describe the institutional framework and substance of bargaining between the national government and transnational corporations.

1. THE PURPOSE AND NATURE OF THE PROJECT

The primary purpose of this project is to elucidate the law and policy of inward foreign direct investment ("FDI") in South Africa. Remarkably, although possibilities of renewed direct international investment in South Africa loom brightly on the horizon, very little local attention has been given thus far to the formulation of policy on the issue. For this reason, this project serves as an introduction to a South African policy on FDI.

In the final analysis, whether or not a national policy will necessarily lead to increased levels of FDI inflows is obviously an issue of great significance at this time. However, of arguably greater significance to the process of democratisation and national economic upliftment in South Africa is a policy which goes beyond the attraction of FDI to optimise the qualitative contribution which FDI can make to the South African economy. This project explores these considerations.

Although this project has attempted to address some of the more salient legal issues bearing upon FDI, no endeavour has been made to duplicate existing work on the laws of South Africa which relate to FDI.¹ It is obvious that every law which affects the economic rights of investors will have some bearing on the decision to invest. For this reason, the issues explored in this project have a primary and direct impact on the investment decision-making process, with special emphasis on their implications for the development of national policy.

While this project has not attempted to explore the possibilities which "law and economics" presents,² it is at this time in South Africa's development for lawyers and economists alike to realise that the "framework of laws provides the mechanism by which most economic policies must ultimately be implemented."³ If the framework of laws provides the mechanism for change, economics must provide the context and logic of change. In other words, laws must extend from an economic paradigm and legal policy must, by definition, serve an economic ideology. For this reason, the relationship between law and economics in this sense is a necessary one, and thus should attract more attention from policy-makers than it has in the past.

It should be pointed out at this stage that this project has not attempted to cover subject-matter which the author believes to constitute distinct and separate areas of examination. Principal among these are export processing zones, regional co-operation and integration, and mergers and take-overs. Although these three areas by no means exhaust the list of issues that requires further research and evaluation, they are of crucial significance for FDI policy-making. However, these studies shall be left for a later date.

1. A comprehensive overview of the laws relating to foreign investment has already been undertaken. See *Armstrong Foreign Investment in South Africa: The Legal Framework*, Commissioned by the United Nations Commission on Transnational Corporations in Conjunction with the ANC and COSATU, October, 1991.

2. See for instance, Botha "The Incorporation of the 'Economics of Law' into University Law Curricula" 3(3) 1992 *Stellenbosch Law Review* 319. I wish to thank Mr Derek Botha, Department of Accounting, University of Cape Town, for a helpful discussion on "law and economics," 22 September, 1993. Our mutual conclusion is that predictive models for assessing the economic welfare functions and optimalities of laws, while necessary, especially in macro-economic contexts, are too complex to be explored in the present endeavour. Therefore, this project serves at least the function of describing and defining the legal issues more exactly for such assessment if it should become a viable possibility in future.

3. *Ibid*, 324.

2. THE DEFINITION OF FDI

FDI can be defined as the establishment or purchase of a commercial enterprise in one country by residents of another country. A more particular definition is offered by the International Monetary Fund which defines FDI as

"investment which is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise." ⁴

The primary source for South African investment statistics is the South African Reserve Bank ("SARB"). For this reason, it is important to note that the SARB bases its calculations on a particular definition of foreign direct investment. The SARB defines any investment made by a foreigner ⁵ in a South African enterprise as a foreign direct investment, if it comprises:

- ownership of a branch or participation by foreigners in a partnership in South Africa;
- ownership of at least 25 per cent of the voting rights in an organisation in South Africa by one foreign resident or several affiliated foreign residents;
- ownership of at least 50 per cent of the voting rights in an organisation in South Africa by various residents of one foreign country; and
- ownership of less than 25 per cent of the voting rights in an organisation in South Africa, if the foreign residents are nevertheless able to exercise an effective say in the policies of the organisation, as, for example, in terms of royalty and management agreements. ⁶

This definition of FDI recognises that an effective say in an organisation by an investor is facilitated only if the investment constitutes equity control of the enterprise. ⁷ It is important to note that although the foregoing definition of FDI has currency in South Africa as far as the SARB is concerned, the same definition does not necessarily control in all contexts. ⁸

- ◆ For this reason, a national uniform definition of FDI should be formulated and adopted by government. This recommendation is based primarily on a concern that industrial development planning and statistical measurements and evaluation of FDI's role in the Southern African economy are or should be integrated activities. Uniformity in the administration of policy is an important consideration, especially when each government department has its own objectives and administrative function. The co-ordination of a single policy will therefore necessitate the adoption of a uniform set of definitions for the same terms.

⁴ IMF Balance of Payments Manual (4th ed. 1977) para. 408, 136.

⁵ The term "foreigner" means a domiciliary of any country outside the Southern African Common Monetary Area.

⁶ South African Reserve Bank Quarterly Bulletin March 1993 Supp., 3

⁷ See, Van der Merwe and Bester South Africa's Balance of Payments: Sources, Methods and Reliability SARB Occasional Paper No 3 (January 1991), 11.

⁸ The Board of Regional Industrial Development, for instance, uses a one-third equity ownership in a productive enterprise to earmark it "foreign-owned." Various interviews with Board members.

3. TRENDS IN FDI INFLOWS

Globally, FDI flows are concentrated in the Triad, comprising the United States, the European Economic Community and Japan.⁹ The Triad accounted for about 70 per cent of world inflows and 83 per cent of world outflows of FDI in 1989. The total cross-holdings of FDI stocks within the Triad amounted to about US\$572 billion during that period. It is expected that the trend toward concentration will increase.

Figure 3.1 illustrates the Triad and lists those economies "adopted" by members of the Triad in terms of the average annual investment flows to them.¹⁰ Although South Africa is not mentioned, Table 3.1 and Figures 3.2 and 3.3 confirm that the EEC is the primary source of foreign direct investment flows to South Africa. In 1991, the EEC was the source of approximately 73 per cent of the foreign direct investment stocks of South Africa.¹¹ Moreover, it appears that the EEC is the source of about 70 per cent of the total number of TNCs presently established in South Africa.¹²

In 1990, total world FDI inflows amounted to US\$184 billion. During this period, South Africa experienced a net increase of direct investment capital of approximately \$444 million, or 0,0024 per cent of the world total.¹³

What are the implications for South Africa? It is indeed very difficult to relate the trends of FDI inflows into South Africa with those of FDI outflows from the developed countries which constitute the major global sources of investment capital. There is little doubt that international economic sanctions against South Africa since the early 1970's have distorted this relationship, making it well nigh impossible to analyse the "natural" attractiveness of South Africa as an investment location. It would be unfair therefore to test the viability of South Africa's investment incentives (broadly defined) in respect of FDI inflows when it is clear that the rate of FDI flows is affected significantly by political factors.¹⁴ Although the official international sanctions regime may have been one specific political factor, the sanctions period itself was characterised by civil unrest and it is assumed here that the latter had a more direct impact on the rate of FDI inflows to South Africa.

Indeed, from a policy point of view it is important to note that as a rule FDI inflows are more sensitive to political than economic circumstances.¹⁵ In South Africa's case, therefore, the formulation of policy instruments to capture some of the potential benefits of global trends in FDI flows is an exercise with limited positive consequences. However, this is not to suggest that the exercise is a pointless one. The unstable political process underway in South Africa, punctuated as it is by civil insurrection, is expected to drive South Africa to a state of "normalisation" in respect of both its international economic relations and its domestic state of affairs.

⁹ See UN World Investment Report 1992.

¹⁰ UN World Investment Report 1992, 33.

¹¹ SARB Quarterly Bulletin (June, 1993).

¹² ECOSOC List of Transnational Corporations with Interests in South Africa (30 March, 1993). The total number of TNC's established in South Africa was approximately 500 as at the beginning of 1993. This calculation is based on equity holdings of not less than 10 per cent. The EEC countries represented in this list are Belgium, Austria, France, Germany, the United Kingdom, Italy, Luxembourg, the Netherlands, Portugal and Spain.

¹³ This percentage was calculated as follows: Change in S.A.'s foreign liabilities from 1989-1990 = R1331 million or \$446 million, using exchange rate of \$1 = R3.184,000/\$446 = 0.0024 per cent.

¹⁴ See Cooper *The Impact of Foreign Direct Investment on Post-War South African Economic Development*, PhD Thesis, UCT (1992) 236.

¹⁵ Cooper *The Impact of Foreign Direct Investment* 241.

- ◆ This means that the potential benefits of global flow patterns should nonetheless be assessed in order to evaluate whether or not South Africa is "losing" capital to other developing countries.

At least the South African authorities should be mindful of the fact that the African continent is losing capital to the East, South and South-East Asia, Latin American and Caribbean countries. However, inflows of FDI to developing countries grew by 7 per cent in 1990. ¹⁶ This recommendation has important implications for South Africa's regional and continental integration, since Africa's continued marginalisation as a target of international investment capital is a phenomenon that should be factored into the debate over FDI policy.

TABLE 3.1

**Relative geographic contribution of FDI to South Africa
(%) 1975-1991:**

Year	EEC	Non – EEC Europe	N & S America	Africa	Asia	Oceania
1975	64.4	7.2	24.4	1.9	1.2	0.9
1976	63.8	7.8	24.5	1.7	1.3	0.8
1977	63.0	8.2	24.0	2.6	1.2	0.7
1978	62.2	8.6	23.7	3.5	1.2	0.6
1979	62.7	9.5	23.6	2.6	0.8	0.8
1980	63.6	8.6	23.7	1.8	1.1	1.0
1981	62.6	8.3	25.5	1.5	1.0	1.1
1982	63.3	8.4	24.8	0.9	1.4	1.1
1983	64.4	8.4	23.0	1.7	1.2	1.2
1984	63.9	7.3	25.0	1.7	1.1	1.0
1985	65.4	7.4	23.5	1.7	1.0	0.9
1986	66.5	8.6	21.4	1.2	1.2	0.9
1987	66.4	9.7	20.7	1.5	1.1	0.7
1988	67.2	10.7	18.8	1.8	0.9	0.5
1989	72.6	12.0	13.1	0.5	1.2	0.6
1990	72.6	12.4	11.9	1.4	1.0	0.7
1991	73.0	12.5	11.2	1.6	1.0	0.7

¹⁶ UN World Investment Report (1992) 16

TRENDS IN FDI INFLOWS

Foreign-direct-investment cluster of Triad members, 1986-1989
(Economic in which one Triad member dominates average annual investment inflows)

Latin America

Argentina
Bolivia
Chile
Colombia
El Salvador

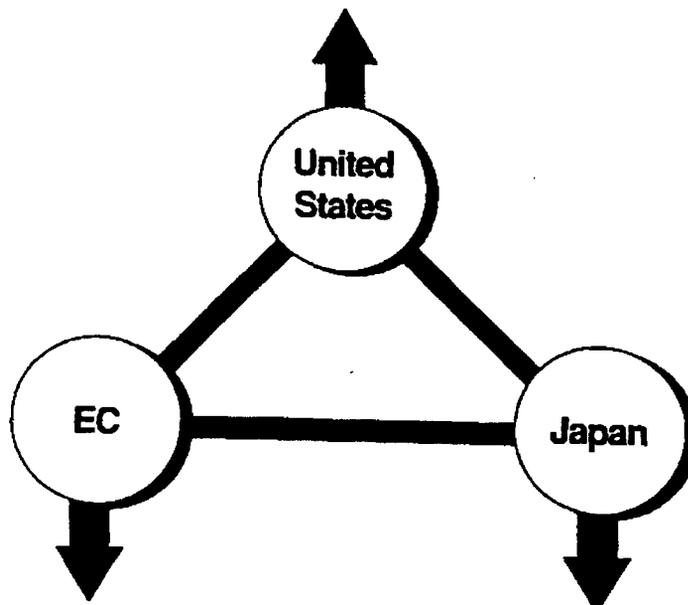
Guatemala
Mexico
Panama
Paraguay
Venezuela

Asia

Bangladesh
Pakistan
Phillippines

Other

Papua New Guinea
Sauda Arabia



<p>Other</p> <p>Czechoslovakia Hungary Poland USSR Yugoslavia</p>	<p>Latin America</p> <p>Brazil Asia India Sri Lanka Viet Nam</p> <p style="text-align: center;">Africa Ghana Morocco</p>	<p>Asia</p> <p>Republic of Korea Singapore Taiwan Province of China Thailand</p> <p>Other</p> <p>Fiji</p>
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FIGURE 3.2

Relative Geographic Contributions of FDI Stocks for SA (disaggregated) 1975-1991

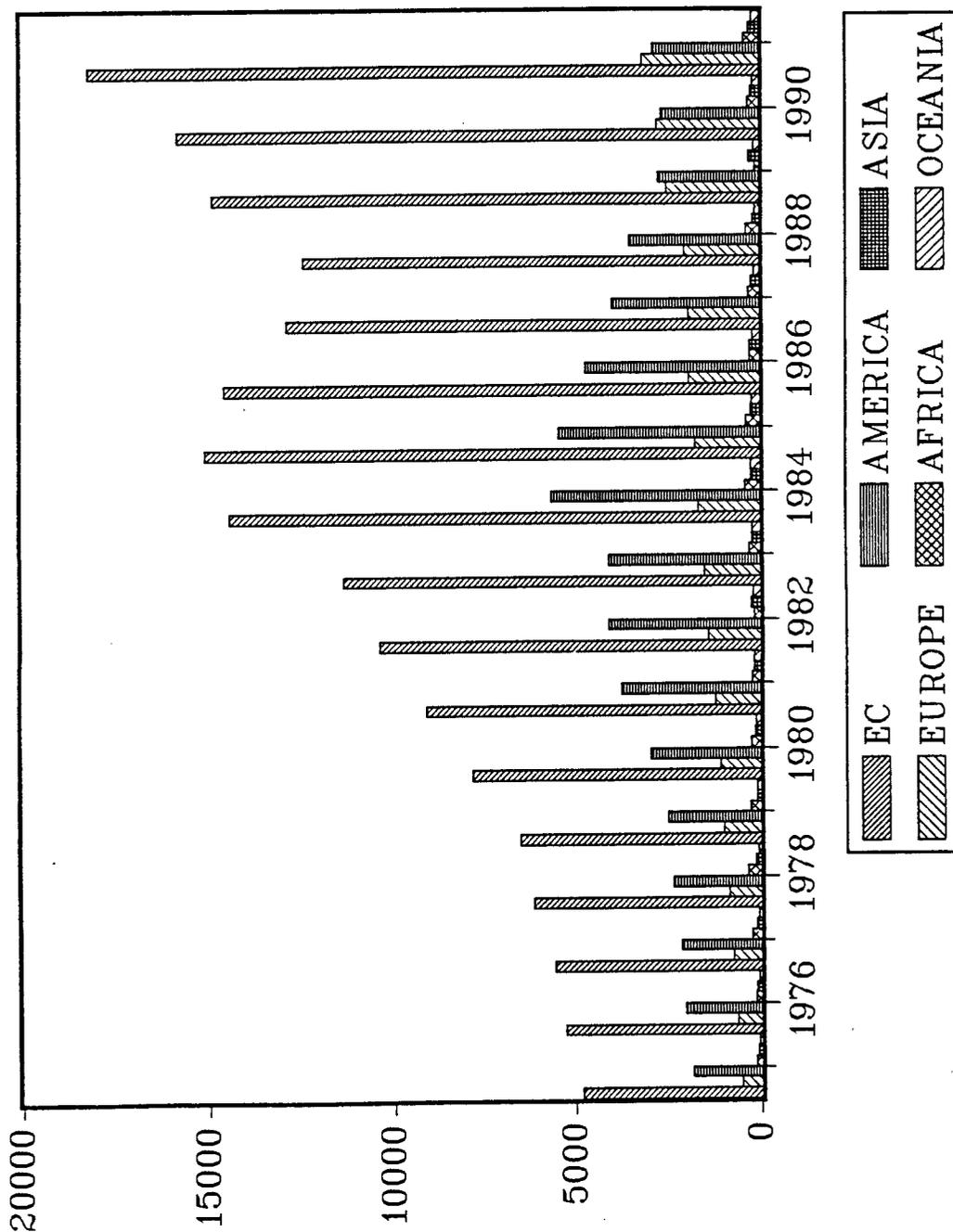
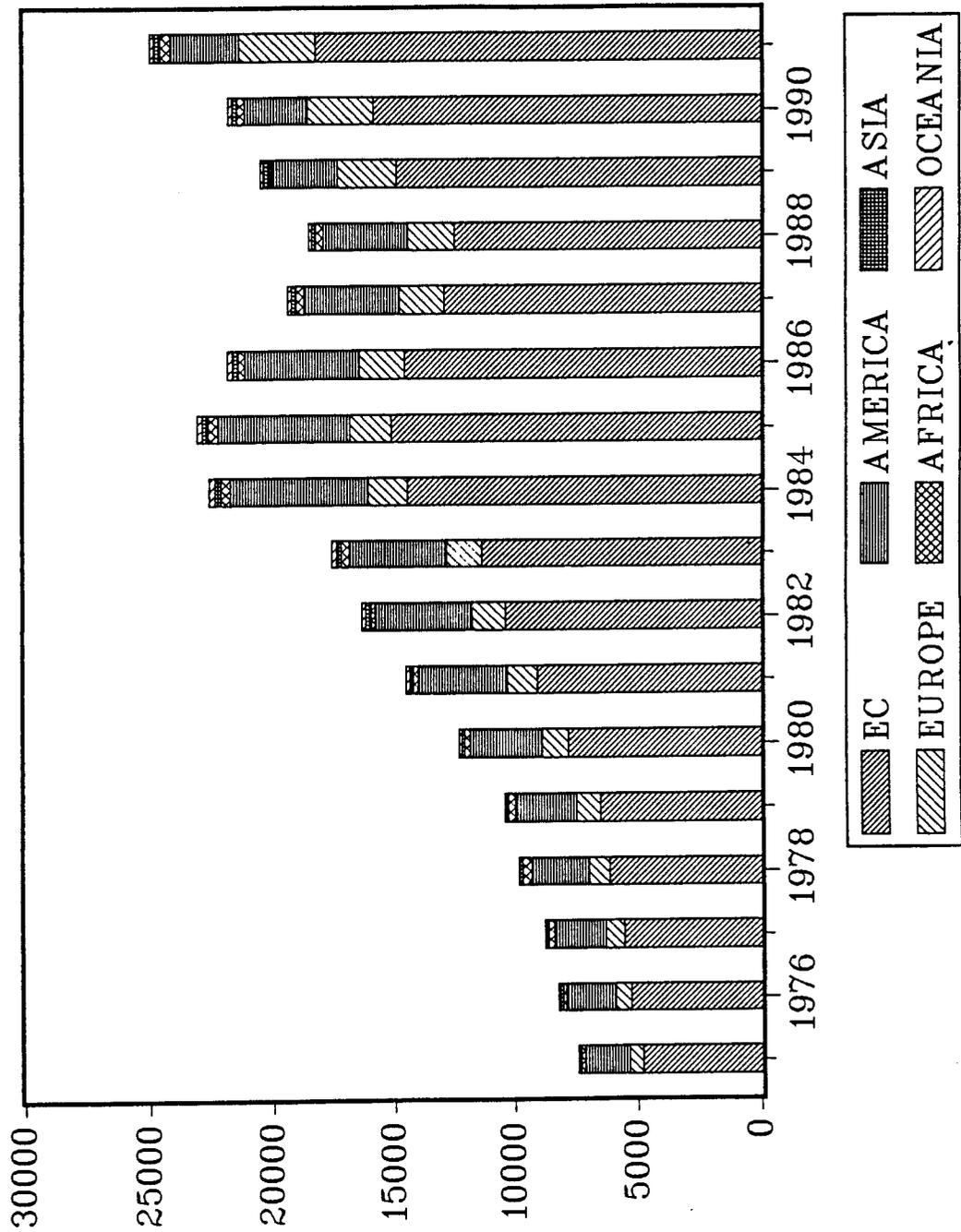


FIGURE 3.3

Relative Geographic Contributions of FDI Stocks for SA (aggregated) 1975-1991



4. THE POLITICAL DYNAMICS OF ECONOMIC POLICY FORMULATION IN SOUTH AFRICA

Although the administrative responsibility for implementing policy remains with the South African government, the National Economic Forum (NEF) is the current locus of economic policy reformulation in South Africa. Represented there are the interests of government, the formal business sector, and organised labour, represented by the Congress of South African Trade Unions ("COSATU"). The ANC has observer status at the NEF, and thus its current role in directly reshaping South Africa's economic future is somewhat limited. For this reason, the ANC's exclusion from formal participation in the NEF process, according to some, threatens the long-term stability of the process of economic policy formulation during this period of transition. ¹⁷

The continuity of economic policy, as the powers of government are shifted onto an incumbent government, is an issue of critical importance to investment planning in general. But more particular is the concern of foreign investors who must depend not merely on a stable economy, but on the long-term continuity of national economic policy. From a policy perspective, it is not enough merely to promise stability, continuity and viability of economic policy. A concerted effort must be made to articulate a view clearly so that market signals are projected without contradiction and confusion.

Government's negotiation and conclusion of agreements on a wide-ranging list of issues ¹⁸ with organised labour and the formal business sector, within a year of democratic elections, could, it is feared, be undone by a new government whose policies on the same issues diverge. However, a number of considerations militate against such fears.

Firstly, although the ANC is excluded from direct NEF negotiations, its economic agenda is in many respects compatible with that of the present government. Also Mr Derek Keys has established the Economic and Technical Committee "ETC") in which issues of national economic import are resolved through the active participation of the major political parties and organisations. According to Mr Keys, the ETC is the "government" representation at the NEF. ¹⁹ The ANC's chief position on the ETC appears to compensate for the fact that it sits as an observer at the NEF.

It seems therefore, that the ANC is the government's principle partner in economic policy formulation, and from this point of view, it seems highly unlikely that an ANC-led government after the expiration of the five years of a government of national unity will derogate significantly from its current course. The relationship between the ANC's Department of Economic Planning ("DEP") and the government's Ministry of Trade and Industry and Economic Co-ordination has already taken on a structured form. Of significance in this respect was the ANC's establishment of a second-tier of negotiations with South Africa's international creditors with the permission and patience of Mr Keys.

Secondly, there exists a strong and dynamic alliance between the ANC and COSATU. In many ways, COSATU is the ANC's representative negotiating partner at the NEF. For this reason, the ANC's position on economic affairs is represented at the NEF on two levels: through the ETC and through its relationship with COSATU. It is therefore difficult to imagine that the ANC, as gov-

¹⁷. See Ryan "ANC Exclusion Bodes Ill for Economic Policy" *Business Times*, July 11, 1993, 4.

¹⁸. Such issues include public works programmes, state procurement policies, collective bargaining and job security.

¹⁹. See Steyn "Keys Shows Why Skill is the Wrong Man for the Job" *Business Day*, 29 October, 1993, 10.²

ernment, would easily depart from the industrial development policies which it was partly responsible for formulating.

However, the ANC/COSATU alliance is in some respects fragile. Although the ANC requires the electoral support of COSATU's 1.2 million members, their respective visions remain at odds on the eventual role which labour will play under the new dispensation. The limitations which a future ANC-led government may place on the freedom of organised labour to pressure industry to increase wages, when the rate of productivity is declining or stagnating, is one area of concern. ²⁰ COSATU's concerns focus on the necessity to redress historical imbalances, with specific emphasis on affordable housing, health care, free and mandatory education and living wages for all, ²¹ despite severe economic constraints to growth.

These concerns suggest that labour's distrust is of government per se and of the politics of institutional restructuring, and not necessarily of the ANC in particular. The NEF presents COSATU with an opportunity to secure its role within the context of government policy. In this regard, the status of the NEF under a future dispensation remains in dispute. Obviously, COSATU has a vested interest in having the NEF become a policy-making statutory body, thus securing for organised labour a central decision-making role in economic policy formulation. The formal business sector appears to support COSATU's lobbying efforts, at least as far as NEF's future status is concerned. Government, on the other hand, wishes to retain its decision-making autonomy, with the NEF remaining as an economic advisory body. ²² It would appear that the ANC tacitly supports the present government on this issue, as the existence of dual policy-making bodies has obvious adverse administrative problems for government.

At any rate, it makes sense to view the domestic economic debate as a political debate. ²³ The fact that public policy is a creature of the political dynamic, through which elites formulate policies predicated on pragmatic self-interest, may explain COSATU's apprehensions. Therefore, whether and to what degree theoretical economic policy will find its way into administrative action depends on the outcome of the political debate. ²⁴ A great deal of effort has been expended by every party and political organisation with a vested interest in economic empowerment to fashion its own economic manifesto. And every endeavour has, in turn, been predicated on a general expectation (and hope) that the outcome of the economic debate will be in its own favour.

²⁰. See Robertson "Clash that is Bound to Happen" *The Argus*, September 14, 1993, 6.

²¹. See Jankowitz "ANC Agrees in Principle to Adopt COSATU's Reconstruction Programme" *Business Day*, September 13, 1993.

²². See, for instance, Ensor "Dispute over Economic Forum's Future Status" *Business Day* 22 October, 1993, 9.

²³. Professor Robert Schrire states in this regard that:
"the so-called 'economic debate' is, in fact, a political debate. Public policy is rarely, if ever, based exclusively upon technocratic expertise and theoretical knowledge. In all societies economic policy is formulated by political elites within a political context. Objectives such as getting re-elected, rewarding allies, and punishing opponents are often more important in shaping policy than 'neutral' economic objectives such as macroeconomic stability or economic efficiency."
 Schrire "The Economic Debate and the Politics of Unreason" October 1992 *South Africa International* 71 75.

²⁴. By "political debate" it is meant the process of defining the nature of the political leadership, its organisation, and its role (vis-a-vis the major institutional organisations of society, that is, business and labour) in the administration of affairs.

5. THE ROLE OF FDI IN THE SOUTH AFRICAN ECONOMY

The present government's Normative Economic Model ("NEM") of March 1993 ²⁵ states its primary objective as follows:

"What is envisaged is a process of structural adjustment in the developed market economy and the reconstruction of its less developed socio-economic framework, in particular the equitable access of all South Africans to all opportunities in the economy. The main product of this transformation is expected to be the generation of a growing, high quality income per capita, sustained by the beneficial participation of all South Africans." ²⁶

The "new paradigm" of South African economic functioning, as far as government sees it, must fulfill the roles of both economic growth and of social development. From a macro-economic policy perspective, there is a great degree of congruence between the ANC and the present government in this regard. But this is congruence at the level of vision, not necessarily at the level of approach, administration and implementation. Notwithstanding this area of possible divergence, a number of common considerations are central, especially as they relate to the role of foreign direct investment in a post-apartheid South Africa.

South Africa requires foreign investment to the extent that it can "contribute to the primary goals of economic policy: to create jobs, and to improve the quality of life of the population as a whole, especially the very poor." ²⁷ This suggests that the necessity for and role of foreign investment is harnessed to a policy of social, industrial and economic development. Generally speaking, however, the principle remains that foreign capital, whatever its form, is important as it can supplement domestic savings to finance domestic investment, as well as to cushion shocks to the current account when foreign reserve stocks are low. ²⁸ However, this is not to say that FDI has in fact supplemented domestic savings in South Africa. This is a point dealt with further below.

◆ From a policy perspective, one cannot overemphasize the fact that the role of FDI in South Africa's economy must be determined by factors endogenous to it. In other words, a South African FDI policy must be moulded on the contours of the South African economy and should not be based principally on trends which are observed and reflected in foreign experience. For this reason, it would be instructive to outline some of the broader aspects of the South African economy.

It is important to note, first of all, that South Africa's economy is driven by the private sector. The private sector's contribution to GDP has been in the order of a continuous 70 per cent. ²⁹ Economic growth in South Africa has not, however, followed a pattern of consistency, as annual

^{25.} Ministry of Finance *The Key Issues in the Normative Economic Model (March 1993)*[NEM]. The NEM was constructed jointly by the Central Economic Advisory Service, Special Advisor to the Minister of Finance, the South African Reserve Bank, several government departments, the Industrial Development Corporation and the Development Bank of Southern Africa. Although Minister Derek Keys refers to the NEM memorandum as "a macro-economic exercise for public discussion...[and not] a programme proposal from government," it has been suggested that it could be construed, rather, as a political document, embodying "the essence of free market liberalism, which could be the counter to the strong brew that may be forthcoming in the New South Africa." Osborn "The Normative Economic Model" August 1993 Nedbank Quarterly Guide to the Economy.

^{26.} NEM, 1.

^{27.} Hirsch "Inward Foreign Investment in a Post-Apartheid South Africa - Some Policy Considerations" July 1992 *South Africa International* 39. Mr Alan Hirsch is Deputy-Director of the Trade Policy Monitoring Project (of the Development Policy Research Unit) at the University of Cape Town. He holds the trade and investment advisory portfolio for the ANC's Department of Economic Planning, and he represents the ANC at the National Economic Forum. See also the Report of the National Economic Forum Long Term Working Group (LTWG) to the NEF Plenary, 5 July 1993, for a more specific enumeration of socio-economic objectives of a national development policy.

^{28.} See Kahn *South Africa's Exchange Rate Policy: Lessons from the Past Economic Trends Research Group Working Paper No. 15 (1992)* 15.

^{29.} World Bank *South Africa: Economic Performance and Some Policy Implications February 1993*, 16. It should be noted that the present author is using a final draft of the World Bank study.

GDP growth patterns have been more influenced by internal and external shocks than by the normal business cycle.³⁰ The political environment of South Africa's economy seems to have had the greatest impact on growth, albeit the fact that such impact has itself not been consistent. While the effects of the Sharpeville riots in 1960 appears to have had little negative impact on GDP (with growth rising to 1965), GDP quickly declined after the Soweto uprising in 1976 and the debt-standstill of 1985.

Despite a slight recovery between 1986 and 1988, heightened political uncertainty and increasing social unrest have substantially contributed to the subsequent decline in economic growth.³¹ A serious contraction of national economic output since 1989 is reflected in the sudden decrease in real GDP per capita. This can easily be observed in Figure 5.1. Of great significance, both from an historical and policy perspective, is the fact that GDP growth has been intermittently stimulated by surges in gold-price values³² (as between 1974 and 1975 and between 1979 and 1980 and again in 1993), but demand-led growth in GDP has not been caused by factors associated with secondary production. This phenomenon underscores the central emphasis of an industrial (and investment) policy on higher added-value, export-led growth.

Another serious realisation is that South Africa's growth performance cannot be fully explained in terms merely of reduced investment.³³ The question as to "why high investment levels over much of the period, 1965-91, failed to generate a more satisfactory growth performance" calls for answers "clearly of vast practical importance as they should provide guidance as to how South Africa's growth performance may be improved in future."³⁴ In other words, the growth patterns of capital-stocks alone are not sufficient to explain fully the progressive decline of GDP, which peaked in 1967!

According to a recent World Bank study, two major reasons exist for South Africa's declining growth. The first reason is the fact that investment in the private sector is stimulated largely by public investment. Because this correlation has caused an allocation of capital into sectors with much lower-than-average output-capital ratios and higher-than average capital/labor ratios, levels of growth as well as employment have declined.³⁵

The second major reason for declining growth encompasses factors related to the labour market. Black wages have been steadily rising; the growth of employment and output has been slow; the skill endowments of the workforce have grown slowly and labour-productivity loss has grown due to the legalisation of unions and their subsequent striking patterns.³⁶

The decline in South Africa's economic growth has had an undeniably adverse impact on FDI flows to South Africa. Although the onset and persistence of international economic sanctions

³⁰. *World Bank South Africa: Economic Performance (1993)* 16.

³¹ *World Bank South Africa: Economic Performance (1993)* 16.

³². *World Bank South Africa: Economic Performance (1993)* 16.

³³ *World Bank South Africa: Economic Performance (1993)* 17. See also, for a critical appraisal of the relationship between rates of labour productivity and the underutilisation of capital in South Africa's manufacturing sector and the stagnation in growth, McCarthy "Structural Development of South African Manufacturing Industry - A Policy Perspective" 56(1) SAJE 1.

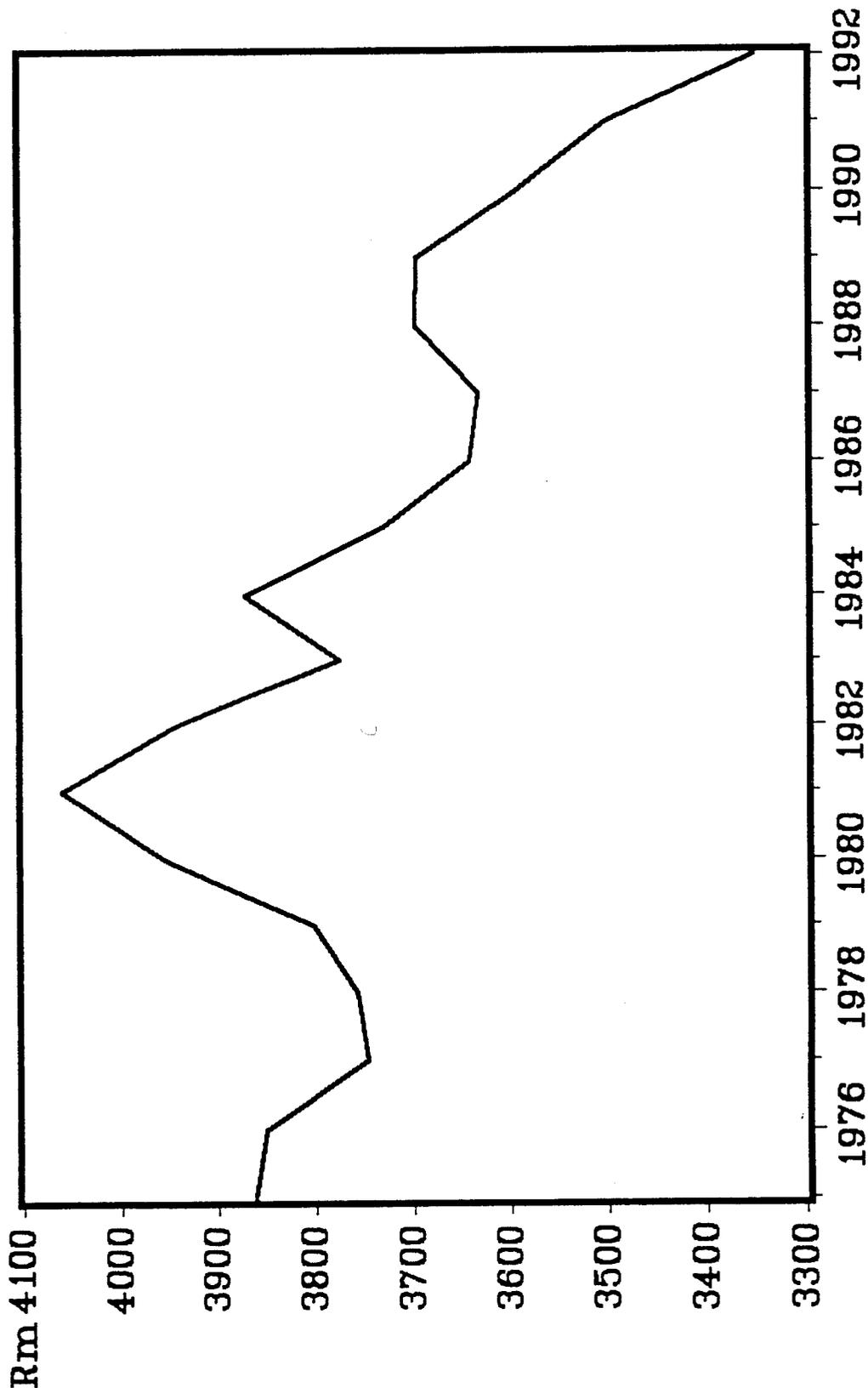
³⁴. *World Bank South Africa: Economic Performance (1993)* 35.

³⁵. This pattern has been accompanied by an overinvestment in the parastatal sector. *World Bank South Africa: Economic Performance (1993)* 39.

³⁶. *World Bank South Africa: Economic Performance (1993)* 43. This study indicates that "increased union activity, as measured by strikes per African employee, may have raised African real wages by as much as 15 percent between 1979, the year of legalization of African unions, and 1990. This effect is equivalent to an average annual real wage increase of 1.27 percent. The decline and eventual abolition of the apartheid system of influx controls also seems to have raised African real wages, and it is estimated that this led to an increase in the African real wage of 9.4 percent between 1975 and 1985 - an annual increase of about 9 percent." *Ibid*, at 46.

FIGURE 5.1

Real GDP per capita (1985 prices)



may have served as a convenient pretext for disinvestment from and for restrained new FDI to South Africa since the mid-1980's, waning economic growth of the South African economy and the increasing political and social instability of its investment milieu may well have been the primary reasons. Since 1985, the collapse in the international value of the rand, the government's declared seven month moratorium on foreign debt repayments, the persistence of high inflation, and increasing civil and industrial unrest added to South Africa's loss of appeal as an investment location.

In the case of the United States, perhaps the mandatory disclosure requirements of the Fair Labour Standards Act (which became effective on January 1, 1986) and the over-politicisation of continued investment in South Africa motivated (primarily) American companies to disengage from transparent commercial ties with South Africa. However, on the whole, it appears that sanctions had been a secondary cause for disinvestment. It has been observed in this regard that

"[t]he exodus of foreign companies from South Africa was not a simple response to the political costs of involvement with Pretoria. It was also the result of rational calculations of profit margins, though these were clearly influenced by adverse political events...While the anti-apartheid lobbyists claimed a political victory, in fact hard-headed economics and not morality had proved the stronger motive force." ³⁷

◆ However, it should be stressed that mere increases in levels of FDI should not be a primary policy focus.

It has been generally agreed that there has been an historical tension between foreign investment and economic growth in South Africa. If domestic savings drives economic growth through industrial development, then foreign investment per se cannot be said to have had a positive impact on growth. In other words, new capital inflows have had a consumption, rather than a trade stimulating effect on the South African economy. ³⁸

It also appears to be the case, based on the use of econometric modelling, that the growth elasticity of foreign capital is low. This means that capital inflows do not have a great propensity to cause large changes in average real economic growth per annum. ³⁹ This is explained by the fact that the marginal efficiency of capital is low, and therefore relatively small amounts of foreign capital inflows will not have a marked impact on industrial expansion, the reduction of the unemployment rate or similar factors directly bearing upon the rate of economic growth.

Also, increases in FDI do not necessarily mean increases in actual capital inflows. This point underlines the importance of defining the term "FDI flows." If the number of new company entries into the South African market, or joint ventures with 25 per cent foreign equity ownership/and or control are counted as direct investments, it may be misleading to believe that there has been a corresponding introduction of net foreign exchange equity amounts into the country.

³⁷. Holland *Disinvestment, Sanctions and the European Community's Code of Conduct in South Africa* 88(353) 1989 *African Affairs* 529 532.

³⁸. See Suckling "Foreign Investment and Domestic Savings in the Republic of South Africa 1957-1972" 43 (1975) *SAJE* 27.

³⁹. Cooper *The Impact of Foreign Direct Investment* 149.

- ◆ Whether or to what degree each FDI project positively adds to domestic savings is therefore an issue of crucial significance.

It appears that the majority of foreign-owned firms established in South Africa finance their investments from local sources, either through the raising of local debt finance or through the reinvestment of domestic earnings.⁴⁰ Therefore, the contribution which FDI has made to South Africa's foreign exchange reserves appears to have been less than one might have desired.

- ◆ The extent to which South African affiliates of foreign TNCs have added to South Africa's foreign debt burden (through international borrowing) is an area of importance to policy-makers. However, no figures are available to allow for analysis in this regard.
- ◆ In conclusion, it appears that the impact of FDI on the South African economy has been, as a general rule, relatively insignificant. The emphasis of policy on the quality of FDI rather than on its sheer magnitude is thus not misplaced. However, there is little doubt that the return of foreign multinationals could assist markedly with South Africa's commercial reintegration in overseas markets. This means that a co-ordinated marketing strategy should seek to bring withdrawn companies back, while a national pro-active FDI policy should endeavour to increase the efficiency of foreign capital in its positive impact on economic growth.

⁴⁰. Cooper *The Impact of Foreign Direct Investment* 151.

6. FDI AND INDUSTRIAL DEVELOPMENT

The decline in economic growth in South Africa reflects a serious deterioration in the gross domestic fixed investment/GDP ratio. See Table 6.1 and Figure 6.1.

TABLE 6.1

**Nominal gross domestic fixed investment ("GDFI"),
GDP and GDFI/GDP**

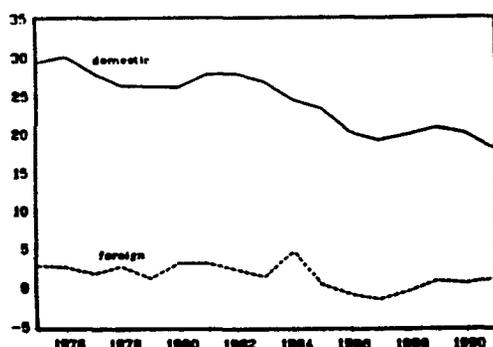
R billion

Year	GDFI	GDP	GDFI/GDP
1975	7846	26646	29.4
1976	9046	30020	30.1
1977	9312	33263	28.0
1978	10087	38247	26.4
1979	12015	45772	26.2
1980	16040	61328	26.2
1981	19738	71080	27.8
1982	22459	80531	27.9
1983	24498	91457	26.8
1984	26209	107221	24.4
1985	28715	123126	23.3
1986	28707	142135	20.2
1987	31497	164524	19.1
1988	39381	198063	19.9
1989	48575	233428	20.8
1990	52957	264203	20.0
1991	53668	297895	18.0
1992	52060	327068	15.9

Figure 6.1: Graph comparing the GDFI/GDP ratio to the foreign direct investment/GDP ratio.

FIGURE 6.1

**Graph comparing the GDFI/GDP ratio to
the foreign direct investment/GDP ratio**



The information contained in Table 6.1 shows that total fixed investment as a percentage of the gross domestic product has declined steadily during the last two decades. The sudden increase in investment between 1988 and 1990 is attributable, for the most part, to the Mossgas project which cost an estimated R11 billion. However, of crucial significance to the interpretation of this data is the degree to which fixed investment has contributed to the expansion of the productive capacity of South African industry, and on the other hand, the degree to which it has merely replaced worn-out machinery and equipment. ⁴¹ It does not appear that this issue has been resolved with any precision.

⁴¹ See Nedbank Quarterly Guide to the Economy November, 1993.

The Normative Economic Model, for instance, has recommended that the ratio of total fixed investment to GDP should grow from 15.9 per cent in 1992 to 23.1 per cent during the next five years as a necessary (but not sufficient) precondition for the stimulation of adequate growth of at least 4.5 per cent per annum. ⁴² The NEM also recommends that total private sector investment in relation to GDP must grow from 11.4 per cent to 15.3 per cent during this period, and that private manufacturing investment to GDP must grow from 3.5 per cent to 5.3 per cent. ⁴³

- ◆ However, it is crucial to view the quantitative aspects of economic growth in terms of qualitative development, especially in respect of FDI. Thus, increases in investment levels in manufacturing, for instance, must be accompanied by general improvements in the rate of manufacturing productivity and by appropriate business management strategies that adapt to changes in the relative cost of capital and labour use.

Of immense importance to South Africa's stability is the issue of unemployment, which has increased from 39 per cent in 1988 to 46 per cent in 1992 of the economically active population. ⁴⁴ In this respect, the expansion of South Africa's industrial base must occur in such a way as to absorb the 280,000 to 300,000 new entrants which come onto the labour market each year.

- ◆ However, increases in the level of investment will not necessarily lead to a proper balance between capital and labour in the process of industrial development, unless there is sufficient agreement between labour, business and government in the formulation and implementation of an appropriate industrial policy. In short, the role of investment in the South African economy must be carefully shaped in terms of a coherent and informed industrial policy.

While the foregoing comments are made in the context of investment generally, a range of issues arise with respect to FDI in particular. A primary issue in this regard is the relationship between industrial development and FDI.

It has been observed that policy intervention which systematically promotes both import substitution and export promotion simultaneously is unusual. ⁴⁵ This suggests that policy is normally implemented incrementally over time, and it is only at some point "when resources need to be mobilised into higher value-added activities that outward orientation occurs." ⁴⁶ This appears to be COSATU's conclusion in terms of South Africa's own experience, and it is a view that the ANC shares.

COSATU's rationale is that since manufacturing's direct contribution to employment creation will be in the high productivity/high wage job sectors, the expectation of industrial policy will not be that the manufacturing sector itself be responsible for significant job creation. Moreover, to accomplish the goals of industrial development, both the quantity and productivity of private manufacturing investment (from whichever source) will have to increase significantly.

^{42.} NEM, 10. A recent IMF report suggests, similarly, that South Africa's overall investment to GDP ratio must grow from the prevailing 19 per cent to 27 per cent in order to stimulate adequate growth. IMF *Economic Policies for a New South Africa 1992* 14. Although there appears to be disparity between the IMF and the NEM calculations, the principle that the investment/GDP ratio must grow by 6-7 per cent remains intact.

^{43.} NEM, 10.

^{44.} See, SARB *Annual Economic Report (1993)*.

^{45.} Greenaway and Nam "Industrialisation and Macroeconomic Performance in Developing Countries under Alternative Trade Strategies" 41 (1988) *Kyklos* 419-422.

^{46.} Greenaway and Nam (1988) *Kyklos* 422.

Therefore, it is contended that if economic growth is to result from industrial development, the increased value-added component of exports must be accompanied by a relative decrease in dependence of the economy on imported capital goods.⁴⁷ This logic implies that the domestic manufacturing sector can be stimulated into performance at the appropriate levels of productivity and competitiveness in terms of exported manufactures onto world markets through the implementation of an appropriate industrial policy.⁴⁸

* If this rationale becomes the preminent ethic of a national industrial development strategy, then industrial policy could drive the formulation of an FDI policy by supplying it with a focus.

* If economic growth is to be primarily export-led, the challenge facing policy makers is to identify the industrial sectors or sub-sectors most suitable for such purposes.⁴⁹

* Moreover, if the roles of export promotion and of import substitution in the process of South Africa's industrial development can be identified and appropriately described, an FDI policy could be developed which specifically augments them. The principle of augmentation is crucial in respect of FDI's role in economic development.

The linkage between FDI and economic development is not intuitive. To say that FDI has a role in economic development is only a first, yet necessary step toward policy building. However, only recently it has been observed that no conceptual theory has been designed which attempts to understand how FDI facilitates industrial and thus economic development.⁵⁰ The emergence of such theory facilitates the transformation of the static model of comparative advantage into a dynamic model of structural upgrading.

In other words, an economy's capacity for technological innovation and its factors of production change over time. The static Ricardian model of comparative advantage merely shows the reasons for, the direction of and the gains from trade. However, the "dynamic paradigm of FDI-facilitated development" [the "Ozawa model"], on the other hand, shows how FDI links trade to industrial growth.

The Ozawa model depicts the "magnified power of trade as an engine for growth." The amplification of trade's impact on economic growth occurs on the basis of three inter-related factors:

**strong outward orientation
(reduces market distortions and increases competition)**

**expanded basis for trade
(FDI augments comparative advantages)**

**upgrading of industrial composition towards
higher value added sectors by self-propelling
market forces set in motion**

(the creation of market-friendly environment reflected in government policy.)

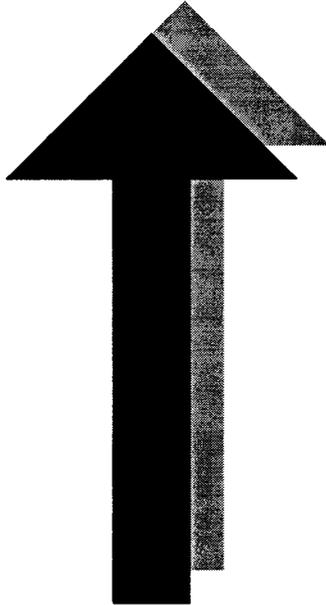
47. COSATU Industrial Strategy Project 14-15.

48. The substance of this policy is contained in MERG Making Democracy Work: A Framework for Macroeconomic Policy in South Africa (1993) 212.

49. See, for instance, Black Current Trends in South African Industrial Policy: Selective Intervention, Trade Orientation and Concessionary Industrial Finance (1992) ET Working Paper No 9, 10.

50. Ozawa "Foreign Direct Investment and Economic Development" 1(1) 1992 Transnational Corporations 27. The following discussion is based on this article.

The Ozawa model attempts to explicate the mechanism which drives an economy from a net FDI importer to a net FDI exporter, through a successive upgrading of its industrial and social structures. It is appropriate here to summarise the successive transformations which takes place according to this model.



Rising wages and increasing job creation causes rising national income; expansion of domestic markets, per capita income, and thus increased domestic savings. Change in factor endowments toward physical capital abundance; economy becomes source of FDI.

Disappearance of unemployment by continued labour-seeking FDI: upward pressure on local wages

FDI attraction in low-value added, labour - intensive manufacturing.

Outward Oriented market system: labour abundance, low income.

What is the relevance of the Ozawa model in South Africa's case? The South African economy is not in a state of homogenous development. Rather, South Africa is characterised by an internal hierarchy of economies. On the one hand, it could be characterised as a developing country with high population growth, low employment creation and a relatively low and declining per capita GDP. See Table 6.2. On the other hand, the manufacturing sector is the most important, commodity-producing sector in the South African economy.

As it was pointed out some time ago, industrialisation in South Africa has undergone a sectoral transformation from the predominance of consumer goods to capital and intermediate products or from light to heavy industry.⁵¹ Also, in the late 1960's and early 1970's it was discovered that a general policy of import substitution was no longer appropriate for industrial growth and that an export-oriented policy would instead ensure expansion. However, the maturation of South African industry has not been accompanied, at least since 1975, with a corresponding expansion of the South African economy and the enrichment of its population.

⁵¹. See McCarthy 1988 SAJE 10.

TABLE 6.2

Population, Employment Growth & Per Capita GDP Growth Rates(%) ⁵²

Country	(1980-1990)		(1980-1991)
	Employment	Population	Per Capita GDP
Japan	1.2	0.6	3.7
USA	1.7	1.0	1.4
France	0.6	0.5	-
UK	0.6	0.2	1.9
Sweden	0.6	0.2	-
Taiwan	2.4	1.3	6.3
Korea	2.	1.2	8.0
Botswana	9.3	4.8	5.6
Kenya	3.3	4.5	-
Chile	3.2	1.7	-
South Africa	0.7	2.6	-1.2

Net new investment in machinery and equipment as a percentage of the real capital stock in light industries declined by 4.4 per cent during the period 1985-1990, to take for example a recent time-frame. On the other hand, net new investment in machinery and equipment as a percentage of real capital stock in heavy industries declined by 6.3 per cent during the same period. These figures suggest that manufacturing as a whole experienced a net new investment decline of about 5 per cent, which means that the depreciation allowance for existing capital exceeded new investment by this amount.

Apparently, 1990 saw a net increase of capital investment of around 3 per cent. ⁵³ However, it is remarkable to note that real manufacturing output declined by just over 1 per cent from 1990 to 1991.

◆ This suggests that new investment does not necessarily translate into increased output, and in South Africa's case, the reasons for this are not well-understood.

With regard to employment, the manufacturing sector experienced growth of 3.75 per cent during the period 1985 to 1990. ⁵⁴ South Africa's total population increased by 11.5 per cent during the same period, and it is therefore worrying to note that the rate of employment in manufacturing should lag so far behind the general rate of population increase. However, this comes as no surprise when a decline of per capita GDP of over 4 per cent is registered for the 1985-1990 period.

The Ozawa model attempts to explain at least one causal link between export growth and increases in national welfare (that is, domestic savings) through the inflow of labour-seeking FDI. Although the model's scope is thus limited, its value lies in its analytical and explanatory utility. Its emphasis on the relationship between FDI and export-led growth is important for any coun-

⁵² Figures from NPI Productivity Focus (1993).

⁵³ NPI Productivity Focus, 12.

⁵⁴ The average annual employment growth rate in light manufacturing during the period 1970-1991 was about 1.5 per cent, while it was about 1.6 per cent for heavy industry during the same period. NPI Productivity Focus (1993) 39.

try striving to plot a national modus operandi based on the same criteria, that is, an industrial policy which focuses on export-led growth.

A recent study ⁵⁵ has shown that over 90 per cent of the foreign direct investment projects that have located in South Africa since the last quarter of 1989 have been directed to the capital-intensive sectors - with the electronics and the motor industry predominating. These results suggest that recent FDI inflows have been diverted primarily to capital intensive manufacturing. It should be noted, however, that while this study has quantified the number of net direct investment projects, it has quantified neither the value of those investments nor the number of employment opportunities created by each new investment. On the other hand, the pattern of FDI flows (proxied by the number of new project entries) is, generally speaking, a crudely reliable measurement of FDI penetration in South Africa's manufacturing sector.

TABLE 6.3

The Distribution of Foreign-Controlled Employment by Industry Group, 1978 and 1990

SIC	1978		1990	
	Employment	%	Employment	%
Food, beverages & tobacco	42,637	11.3	14,060	6.0
Textiles, clothing & leather	33,092	8.8	38,790	16.6
Wood and wood products	5,468	1.5	1,470	0.6
Paper and paper & products	16,298	4.3	3,450	1.5
Other manufacturing	1,595	0.4	300	0.1
LIGHT INDUSTRY	99,090	26.3	58,070	24.9
Chemicals, rubber and plastics	70,100	18.6	69,020	29.6
Non-metallic mineral	20,570	5.5	21,350	9.2
Basic metals	18,263	4.8	4,500	1.9
Fabricated metals, machinery & equipment	169,076	44.8	80,200	34.4
HEAVY INDUSTRY	278,009	73.7	175,070	75.1
GRAND TOTALS	377,099	100.0	233,140	100.0

Another set of data, perhaps the most comprehensive yet assimilated, shows that employment in existing foreign-controlled industrial firms is largely concentrated in heavy industry. ⁵⁶ Table 6.3 suggests that FDI in South Africa has not, as a general rule, at least since

⁵⁵ Garner *Determinants of Recent Direct Investment Flows to South Africa Preliminary Draft of Research Paper No.8, LSE (1993).*

⁵⁶ Cooper *The Impact of Foreign Direct Investment 106.* Cooper acquired the information for 1978 from Rogerson "Patterns of Indigenous and Foreign Control of South African Manufacturing" 10 (1982) *South African Geographer.*

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the 1970's, been labour seeking. It shows that between 74 and 75 per cent of all employment in foreign-controlled manufacturing firms was concentrated in heavy or capital-intensive industry in 1978 and 1990, respectively. From the relative concentration patterns of employment it is clear that in South Africa's case, employment in foreign-controlled industrial firms is concentrated in capital-intensive industry in the ratio 3:1 (heavy:light industry). What is remarkable about these statistics is the fact that they do not fit the concentration ratios for industrial employment as a whole.

However, Table 6.4 shows that the relative employment concentration ratios for industry in general have remained more or less constant since 1970. More specifically, the employment concentration for light industry has fluctuated between 47 and 48 per cent between 1970 and 1990, respectively. Correspondingly, the employment concentration for heavy industry has fluctuated between 50 and 52 per cent between 1970 and 1990, respectively. Although small discrepancies may exist in so far as different data sources are used for the 1990 figures, the general pattern is important. In short, the employment concentration ratios for light and heavy industries in South Africa are approximately equal.

TABLE 6.4

Employment by Industry Group, 1970, 1982 and 1990 ⁵⁷

SIC	1970	1982	1990
Food, beverage and tobacco			
Employment %	14.6	14.4	16.3
Textiles, clothing, leather and footwear			
Employment %	20.2	18.9	18.7
Wood and furniture			
Employment %	6.4	6.0	6.6
Paper and printing			
Employment %	5.7	5.2	6.3
TOTAL: LIGHT INDUSTRY			
EMPLOYMENT %	46.9X	44.5X	47.9
Rubber products			
Employment %	1.5	1.2	1.5
Chemicals			
Employment %	6.2	7.0	7.9
Non-metallic minerals			
Employment %	7.1	5.7	6.2
Metal products			
Employment %	17.9	18.2	17.6
Machinery (including electrical)			
Employment %	10.1	11.7	11.0
Transport equipment			
Employment %	7.0	8.0	7.7
TOTAL: HEAVY INDUSTRY			
EMPLOYMENT %	49.8	51.8	51.9

x Figures do not add up because "miscellaneous manufacturing" has not been included.

⁵⁷. Adapted from McCarthy 1988 SAJE 11. All 1990 figures were adapted from NPI Productivity Focus 1992 and 1993.

◆ In conclusion, FDI has not, as a general rule, and at least since 1978, been labour-seeking. Although South Africa can be characterised by labour abundance, FDI has been attracted largely to capital-intensive industries, such as chemicals, rubber, and machinery and equipment manufacturing. The particular causes for this phenomenon constitute an area of crucial significance in regards to policy which aims to steer FDI in one direction or the other. Although further research is required to explain more fully the reasons for this phenomenon as well as to explain the relative sectoral distribution of FDI capital in South African manufacturing, a number of comments are appropriate here.

If the basis for measurement is the light/heavy industry comparison, then it would be fair to conclude that FDI flows into South Africa's manufacturing sector have not been sensitive to the effective rate of tariff protection ("ERP"). Table 6.5 shows the ERP for those subsectors included in Table 6.3, illustrating the light/heavy industry comparison.

However, if Table 6.5's figures are further disaggregated, it would appear that in general, relatively high ERP for the textiles, leather and clothing sectors matches a relatively high employment concentration for foreign-controlled firms in those sub-sectors. In the same vein, the chemicals, rubber and plastics sectors, also with relatively high ERP, corresponds with a high employment concentration for foreign-controlled firms in those sectors. However, this pattern does not appear to hold true for the fabricated metals, machinery and equipment sectors with relatively low ERP but with a high relative employment concentrations. These results indicate that other factors must account for the strong sectoral bias which characterises FDI in South Africa.

TABLE 6.5

The Effective Rate of Protection for Selected Industrial Sub-sectors ⁵⁸		
	%	%
	1984/1985	1988/1990
LIGHT INDUSTRY	26	54
food, beverages and tobacco	24	68
textiles, leather and clothing	37	87
wood and wood products	20	37
paper and paper products	23	22
HEAVY INDUSTRY	24	45
chemicals, rubber and plastics	49	100
non-metallic minerals	13	34
fabricated metals machinery & equip	22	17

Perhaps one factor which may partly explain the reason for the sectoral concentration of

58. ERP figures have been adapted from Hirsch, A. *Trading up: Towards a Trade Policy for Industrial Growth in South Africa* (1993), Industrial Strategy Project, Development Policy Research Unit (UCT), Table 2.6, page 41.

employment in foreign-controlled manufacturing firms in South Africa is the sectoral pattern of FDI outflows from those countries which constitute South Africa's main sources of FDI.

TABLE 6.6

Industrial Sectoral Distribution of Outward FDI Stocks of Germany, the United Kingdom and the United States (%) ⁵⁹

	Germany		UK		USA	
	1980	1990	1981	1987	1980	1990
Food, beverage & tobacco	3	3	31	27	14	14
Textiles, leather & clothing	3	3	5	-	3	2
Paper	2	3	6	11	6	9
Light industry	8	9	42	38	2	25
Chemicals & rubber	48	51	36	37	32	34
Non-metallic minerals	5	2			3	2
Metals, mech. machinery & equip (ex. motor ind.)	41	39	21	24	42	39
Heavy industry	94	92	57	61	77	75

Table 6.6 illustrates the relative industrial sectoral allocation of outward FDI stocks for three of South Africa's largest sources of FDI. Although the figures have been roughly adapted from secondary published data (and should therefore be treated with caution), they do constitute a pattern which is reflected very similarly in the industrial sectoral allocation of South Africa's inward FDI as measured by employment concentrations. The ratio of outward stocks in light industry to outward stocks in heavy industry for Germany, the UK and the US, for selected yearly intervals, is 1:3. This is the identical ratio for the sectoral allocation of employment in foreign-controlled firms in South Africa!

Obviously, one would not expect such a perfect fit if all the data for all capital-exporting countries were analysed and compared. However, if Table 6.6 represents a general trend, then it could be said that the sectoral allocation and penetration of FDI in South Africa's industrial sectors is linked to exogenous trends in international FDI outward flows.

- ◆ However, whether and to what degree factors endogenous to South Africa itself (such as political unrest, tax and other incentives, and infrastructure) have a modifying effect upon patterns of FDI flows is a key question. In fact, it is this issue which has for many years been central to national policy-making efforts in respect of FDI, and it is one which will require further attention in South Africa's endeavours in this regard.

⁵⁹ Adapted from UN World Investment Directory: Developed Countries (1992).

The Ozawa model promises rising wages and falling rates of unemployment as labour-seeking FDI inflows absorb surplus labour capacity. With regard to South Africa's propensity to attract labour-seeking FDI, the "quality" of labour could have an impact on FDI inflows that seek to exploit it. However, as a general rule, increased levels of investment in the upgrading of industry should (theoretically) result in a sufficient increase in employment only if the price of labour moves in line with capital. In other words, investment should (as a general trend) be driven toward capital-intensive industry, or mechanisation, rather than to the creation of employment-predominant light industry if labour is more expensive than capital. ⁶⁰

The "cost" of labour is an important issue in respect of its attraction for footloose capital. The cost of labour is a composite measurement which includes, amongst other things, both productivity and wage levels. Labour productivity in manufacturing has increased by 22 per cent during the period from 1980-1991 while per unit labour cost in manufacturing increased 1,121 per cent during the same period. ⁶¹

- ◆ Whether and to what degree these factors have affected the relative allocation of FDI in South African industry, in light of other factors which may have contributed to the sectoral bias, is a question of crucial policy significance.

For the aforesaid reasons, and no doubt others, the Ozawa model has rather limited relevance for a country like South Africa. However, because of the nature and diversity of South African industry, only specific sub-sectors which are characterised by relatively low wage levels (even when productivity rates are considered) have been attractive to FDI from certain countries and in specific industrial sub-sectors. In this regard, the textile and clothing industries are illustrative of labour-seeking FDI in South Africa.

Taiwan appears to be the largest foreign source of direct investment in the garment and textile industries in South Africa. This phenomenon is evidenced by information provided under the 1982 Regional Industrial Development Programme ("RIDP"), as analysed by the National Productivity Institute,⁶² as well as preliminary approval data collected under the 1991 RIDP.⁶³ Table 6.7 shows the relative concentration of FDI from Taiwan in the textile and clothing sub-sectors.

^{60.} NPI Productivity Focus 12.

^{61.} *Labour productivity growth in manufacturing (%)* *Growth in unit labour cost in manufacturing (%)*

<i>country</i>	<i>1980-1991</i>	<i>1980-1991</i>
USA	72.0	137.1
Japan	157.4	109.1
Taiwan	167.5	326.7
UK	91.9	526.7
Germany	54.5	145.7
South Africa	22.1	1,121

NPI Productivity Focus (1993) 24.

^{62.} I wish to thank Mr Jacob Graaff, Centre for Interfirm Comparison, NPI, for furnishing me with the following information, and Dr Johann Reinhardt, Board for Regional Industrial Development, for his authorisation in this respect.

^{63.} I wish to thank Dr Johann Reinhardt and Mr Koos Pretorius, Board for Regional and Industrial Development, for collating and providing me with this data.

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If the figures represented in Table 6.8 are grouped in terms of the USA/Europe and Asia, the trends are even more pronounced. This suggests that FDI coming from the so-called Asian "newly industrialised countries," and especially from Taiwan, is labour-seeking. On the other hand, FDI from developed countries, especially from European countries, has been attracted to the capital intensive industrial sectors in which product differentiation and technology-intensive-ness prevails.

The numbers shown in Figure 6.8 should be treated with caution. The 1982 RIDP figures represent the number of firms which were receiving incentives under that programme during the 1992/1993 financial year. However, they do not take into consideration the number of firms which were approved for incentives, and which actually invested but which were no longer receiving incentives during the 1992/1993 financial year. The 1991 RIDP figures, on the other hand, represent the number of projects approved for incentives (between August 1991 and November 1993), but they do not necessarily represent those projects that actually materialised. It should be added that the Board for Regional Industrial Development does not know to what degree approvals lead to actual investments. However, the general trends manifest in the figures are illustrative of investment concentrations.

TABLE 6.7

Relative Concentration of Direct Investments (Firms) in the Textile and Clothing Sub-Sectors, Under the 1982 RIDP and 1991 RIDP (%)

	Textile		Clothing	
	1982 RIDP	1991 RIDP	1982 RIDP	1991 RIDP
Belgium	6	6	-	-
Europe	-	4	-	-
France	10	1	-	-
Germany	6	4	-	-
Italy	3	6	-	-
UK	10	13	11	-
USA	3	-	-	-
Zimbabwe	3	-	-	-
	41	34	11	-
China	-	-	-	10
Hong Kong	3	-	-	20
Indonesia	-	-	-	10
Macau	-	-	-	20
* Taiwan	55	67	89	40
	58	67	89	100

On the basis of the 1982 RIDP data of the same sample, Table 6.8 shows the differences in wage rates between Asian countries and those of the United States and Europe. The disparity between wage levels is obvious, the Asian firms in the sample - Hong Kong (one firm) and Taiwan (seventeen firms) - having wage rates over 70 per cent lower than their European and American compatriots and 80 per cent below the industry average.

TABLE 6.8

Wage Differences Between Asian and European/American Firms in the Textile Industry as Measured Under the 1982 RIDP (1992/1993)

	(R)
Average Per Annum Wage	
Europe/United States (No. firms: 12)	14,006
Asia (No. firms: 18)	3,867
Domestic (No. firms: 109)	17,313
Industry Average ⁶⁴	18,834

The low wage rates apparent in Asian firms in the sample seem not only to be manifest in the textile industry, but represent a low-wage rate pattern in industry in general. The textile industry is exemplary because Asian, and specifically Taiwanese, firms are most concentrated in that particular industrial subsector. It is important to note that Taiwanese investment has taken place mostly in the border areas of the TBVC states. The reasons for this phenomenon are four-fold.

First, the prevailing wage rates in peripheral border regions with exceptionally high unemployment rates have been very low. Second, the incentives under the 1982 RIDP have been particularly high at the deconcentration points (largely in TBVC border areas). Third, the TBVC states have traditionally been recalcitrant to allow trade unions to operate freely within their borders, and Taiwanese industrialists continue to operate their firms with strong anti-union sentiments.

Lastly, an overriding explanation for labour-seeking FDI from Taiwan is its own national industrial development policy. Apparently, it is Taiwan's policy to export labour-intensive manufacturing facilities to low-wage developing areas internationally in order to penetrate foreign markets, to obtain raw materials and to capitalise on cheap labour. The Taiwanese government has established a tax rebate scheme with which to encourage such off-shore relocations. The basic idea behind this scheme is to encourage the moving offshore of low-technology, low productivity industries so as to make place for a more competitive and capital-intensive industrial base at home.⁶⁵

It should be pointed out here that the 1982 RIDP information used for wage rates should be treated with caution as the micro-economic data, as conveyed by the NPI, is distorted by the very nature of the decentralisation policy which underlies it.

◆ For this reason, the 1991 RIDP will have to be assessed and related to those trends which characterise industry generally in order to evaluate whether and to what degree the behavioural patterns of foreign firms receiving RIDP incentives compare to those trends manifest in domestic-owned firms. This sort of analysis, it is remarkable to note, has never been performed in South Africa.

⁶⁴. The 1992 wage is calculated by using a 14% multiplier (that is, ten-year average increase) on 1991 wage of R16,521. NPI Productivity Statistics (1992) 18.

⁶⁵. See Pickles and Woods "Taiwanese Investment in South Africa" 88(353) 1989 African Affairs 507.

7. THE RELATIONSHIP BETWEEN FDI AND TRADE

It has been recognised that South Africa's lacklustre export performance has been a primary contributing factor to slow economic growth.⁶⁶ Economic expansion means that an existing heavy dependence on imports of capital equipment will rapidly intensify, causing downward pressure on the capital account of the balance of payments. Also, a net outflow of capital has required that a surplus on the trade account be maintained in order to finance capital imports.⁶⁷ These factors have straightjacketed the expansion of South Africa's industrial base and economic growth in particular.⁶⁸

For these reasons, the central component of South Africa's emerging industrial development programme is the expansion of its industrial export sector. COSATU, for instance, accentuates both increased private manufacturing investment and an improved trade performance as inter-linked objectives of its industrial policy.⁶⁹

The NEM emphasizes the fact that an increase in export propensity will be required to finance the growth of imports of intermediate inputs and capital goods, "following the envisaged growth in domestic capital formation."⁷⁰ [emphasis added]. Moreover, the NEM attempts to describe the linkage between an increase in export propensity and FDI. It suggests that the stimulation of South Africa's manufacture export propensity will, in turn, attract foreign investment, and therefore unless economic growth is not led in this way, foreign capital will not be attracted.⁷¹

It appears therefore, that the relationship between FDI, economic growth and trade is, in terms of the NEM's approach, quite linear. In short, new FDI inflows, it maintains, will be stimulated by economic growth. It does not, however, answer the question whether and to what degree FDI itself could or should play a role in the process of social and industrial development in the stimulation of economic growth.

It appears that the NEM's approach was softened in the NEF's agreed statements on the need for inward foreign direct investment. One point of agreement recognises that

*"South African policy-makers should make special effort to attract the kind of FDI that will strengthen the country's growth potential and competitiveness in the long-term. Policies should not be unduly motivated by short term balance of payments considerations."*⁷²

Obviously, the NEF's Long Term Working Group goes one step further than does the government's normative economic model in explaining the relationship between FDI and improved competitiveness (as a proxy for export propensity). There is thus broad consensus that the role

66. COSATU Industrial Strategy Project 9.

67. See Hirsch 1992 S.A. International 40. It has also been observed that South Africa's capacity to import on the basis of export earnings has remained almost constant since the late 1970's. See also COSATU Industrial Strategy Project 9.

68. See Van Der Walt and De Wet "The Constraining Effects of Limited Foreign Capital Inflow on the Economic Growth of South Africa" 61(1) 1993 SALJ 3 13: "The constraining effect on real growth of the present continuous outflow of capital which necessitates a surplus on current account, is confirmed."

69. COSATU Industrial Strategy Project 14. Increased investment and improved trade performance are two components of a four-tiered strategy emphasizing also employment creation and the raising of productivity.

70. NEM 14.

71. NEM 14.

72. NEF Report 5 July, 1993.

of FDI in, and as a part of, the programme of industrial development and export-led growth is central.

As it has been recognised by an ANC economic advisor, the linkage between foreign investment and trade is two-fold.⁷³ First, in order for South African industry to produce more competitive manufactures, the funds and technology for achieving this objective will necessitate foreign investment. It is also suggested that the increased levels of trade stimulated by the operations of transnational corporations will, in turn, nourish the growth of industrial efficiency and competitiveness within its particular sector of operation. This linkage is more or less obvious.

However, a second, yet more subtle linkage exists. The existence of transnational corporations stimulate increased levels of international trade because, as it is generally recognised, a rapidly increasing proportion of world trade takes place within transnational corporations.⁷⁴ This phenomenon has important implications for policy. A number of comments in this regard are appropriate.

It is recognised that intra-firm trade consists of a growing degree of relatively capital intensive and research-intensive manufactures.⁷⁵ Also, it appears that as FDI has concentrated in members of the Triad, trade has increasingly become intra-industry and intra-company trade. Moreover, where this phenomenon is pronounced, the industries involved are characterised by differentiated products such as consumer durables, motor vehicles, pharmaceuticals etc.⁷⁶ Of particular importance, however, is the trade-creating effects of FDI. It has been noted in this regard that

“where exchange is in differentiated products, FDI does not necessarily displace existing trade but gives rise to new trade flows between national entities across countries. Thus, from the host country’s point of view, FDI in these types of industries tends to be trade-creating as it expands consumption possibilities and imports while, at the same time, it adds a factor-endowment basis for expanded exports. In this case, therefore, FDI and trade become complimentary activities...”⁷⁷

It would appear therefore that an emerging industrial development strategy which emphasizes the importance of the exportation of greater value-added manufactures concurs with the recognition that FDI and trade are positively linked.

- ◆ To the extent that foreign exchange levels are supplemented and pressure on the capital account of the balance of payments is relieved, increased levels of FDI in product-differentiated industries (which increases international trade) should be the focus of a FDI/trade policy.

73. Hirsch 1992 *South Africa International* 41.

74. Hirsch 1992 *South Africa International* 41.

75. In reference to US-based TNCs, see for example, Helleiner “Transnational Enterprises and the New Political Economy of U.S. Trade Policy” in Frieden & Lake (eds.) *International Political Economy* (2nd ed. 1991) 353 357.

76. UN *Foreign Investment and Trade Linkages in Developing Countries* (1993) 32.

77. UN *Foreign Investment and Trade Linkages* 32.

8. FORMULATING A SOUTH AFRICAN POLICY ON FDI?

Traditionally, South Africa's stance towards FDI has been very relaxed ⁷⁸. In fact, South Africa has not, during its post-War history, fashioned a policy specifically focussed on FDI. This can be attributed to a number of causes. Some of these include international sanctions against South Africa since the early 1970's and weak global competition for FDI until the 1980's. A further reason is that South Africa has depended on trade rather than on FDI for economic growth, ⁷⁹ and has left FDI to flow in at natural levels established by trade patterns, especially by the production and exportation of minerals and precious metals. Another cause - of an historical nature - may have been the strong influence of the British laissez-faire approach to FDI on South Africa's own policy attitudes in this regard. ⁸⁰

Because of South Africa's lack of a clear policy framework for FDI, no coherent profile of FDI in South Africa has been constructed. In other words, the nature and degree of FDI involvement in the South African economy is not understood in any precise way. Perhaps it is also true that because of an unwillingness to understand the role of FDI in the South African economy with precision, it has never been possible to fashion an informed policy on the subject.

- ◆ From a policy perspective, the impact of FDI on the South African economy must be assessed before FDI's involvement in the economy can be properly evaluated and an appropriate policy fashioned. ⁸¹
- ◆ In order to evaluate the role which FDI has played in the manufacturing sector, for instance, the following measurements would no doubt contribute significantly to a micro-economic profile of FDI which could serve as the empirical basis of policy:
 - The relative employment contribution of foreign-held enterprises to total employment in each sector;
 - Wage rates of foreign-held enterprises relative to domestic enterprises;
 - Value added of foreign-owned enterprises relative to total value added in a particular sector;
 - Exports of foreign-owned enterprises relative to domestic enterprises in a particular sector;
 - Exports of foreign-owned enterprise relative to total sectoral exports;
 - Foreign capital penetration on a sector-by-sector basis;
 - Relative productivity rates of foreign-owned enterprises to those of domestic enterprises.

⁷⁸ This sentence is taken from the opening line of an article written by Hood and Young, entitled "British Policy and Inward Direct Investment" 15(3) 1981 *Journal of World Trade Law* 231. This article is of great relevance to this project, since it deals with a fundamental policy approach toward inward private FDI. Its focus is not upon a comparative analysis of boom economies, stimulated by massive inflows of FDI and resulting in great export drives. Rather, its approach is pragmatic and structural in terms of existing British institutions and an assessment of the role of FDI in its economy.

⁷⁸ See for instance, Matthews "South Africa's External Economic Relations" 13(6) 1979 *Journal of World Trade Law* 495. Dr Matthews' article is typical in its historical context, since it gives little attention to FDI beyond stating that "South Africa has a thriving trade with [many] countries...and her strong economy based on rich mineral resources has attracted a substantial amount of foreign capital."

⁷⁹ Hood & Young (1981) *JWTL* 231.

⁸⁰ Hood & Young (1981) *JWTL* 231.

⁸¹ In this regard, a recent study has commented that:

"Within South Africa a consensus is emerging on the need to attract increased foreign direct investment into the country. However, there is less agreement on the level of appropriate incentives to attract such investment or regulations to ensure that the presence of foreign firms works to the country's benefit. Hitherto, this debate has had to take place largely in the absence of any solid analysis of the factors currently underlying direct investment flows to and from South Africa, or even the scale of such flows. No official statistics are available, and the most comprehensive alternative sources are not in a suitable form for the analysis which needs to be undertaken."

Gamer Determinants of Recent Direct Investment Flows to South Africa Preliminary Draft, forthcoming as Research Paper No.8 (1993) Centre for the Study of the South African Economy and International Finance, LSE, 1.

As far as can be established, no database source in South Africa can deliver the information required to make these measurements. However, only by being able to synthesize the data for these measurements can the historical impact of FDI in South African industry be assessed and an appropriate policy be formulated. The fact that South Africa currently receives FDI measuring less than 2 per cent of its GDP per annum ⁸² says very little about the value of FDI to South Africa's economy. The realisation that foreign investment "can help address" the shortfall of investment to GDP ⁸³ brings no-one any closer to concrete policy formulation than saying that South Africa requires more foreign investment.

- ◆ Without a sufficient evaluative infrastructure it is difficult to imagine how optimal policies can be formulated. For this reason, economic policy-makers should be willing to design and implement a data-collection project that can exhaust existing information sources and thereafter create a scheme to supplement, modify or formulate methods of (domestic and foreign) investment information disclosure. The recommendation here is that this information-disclosure scheme should be an independent evaluative programme, not necessarily tied to some other obligation on the part of investors. ⁸⁴
- ◆ It is nonetheless important to note, however, that existing information sources can contribute markedly to an FDI profile. But sufficient planning and resources are required to exploit these existing possibilities. An exploration of the modus operandi of such a scheme is, however, beyond the scope of this project.

⁸² See, for instance Frankel Max Pollak Vinderine Inc., Sanlam, Ernst & Young and the HSRC Platform for Investment 1992 112. This study views total FDI (ie private plus official) of 2 per cent of GDP, or R6 billion, per annum as a "realistic target."

⁸³ Hirsch (1992) *South Africa International* 40.

⁸⁴ The author is currently preparing a proposal for the undertaking of such a project.

9. PROMOTION OF FDI

It is now generally accepted that governments, especially those of developing countries, are in competition with one another for FDI. ⁸⁵ This competition has necessitated that governments desiring FDI must actively promote investment opportunities within their territories. In fact, promotion has been recognised as one of the most important influences on TNC investment location decisions. ⁸⁶ It is important to note that although "[t]his competition is not entirely new; what is new is its aggressiveness and intensity." ⁸⁷

◆ Therefore, as a matter of policy, it is to be conceded that it should not be left to the marketplace to dictate the optimal levels and quality of FDI inflow. Thus, the techniques which a country uses to attract, monitor and control FDI, and the official institutional structure through which such techniques are employed, are considerations of crucial significance to policy-makers and government administrators.

In the early 1980's two distinct components of a policy on FDI were already well recognised by the academic fraternity. ⁸⁸ These components were (1) the attraction of inward FDI and the maintenance of appropriate flows, and (2) the evaluation and control of FDI, which relates to the impact of FDI on the domestic economy. The first component raises institutional issues about the the organisation of inward FDI promotion, as well as issues relating to FDI incentives. The second component has a direct bearing upon the control and manipulation of FDI, through various policy instruments, in order to extract from it the net benefits to the domestic economy and its social environment.

9.1. FDI PROMOTION: IMAGE-BUILDING

The attraction of FDI through various marketing strategies is a primary function of a centralised investment promotion agency. The "control" of FDI, however, constitutes a separate administrative function and it is discussed in detail below. There is strong empirical support for a model of promotion which consists of two distinct phases: (1) image-building and, (2) investment generation. ⁸⁹ Investment promotion agencies normally use the initial image-building stage as a preparatory phase for a subsequently more tailored approach to targeted potential investors. The function of image building is to construct a desirable image of the country in the mind of the international investment community. This function serves the purpose of creating or modifying the image of the country's appeal as an investment location, in order to stimulate the investment decision-making process of potential investors.

Five image-building techniques have been identified to be widely utilised by official, central government, investment promotion agencies: ⁹⁰

□ Advertising in general financial media;

⁸⁵ Encarnacion and Wells "Sovereignty en Garde: Negotiating with Foreign Investors" 39(1) 1985 *International Organisation* 47.

⁸⁶ Guisinger "Do Performance Requirements and Investment Incentives Work?" 9 (1986) *World Economy* 79 85.

⁸⁷ Wells and Flint *Marketing a Country: Promotion as a Tool for Attracting Foreign Investment* (1992) 1. This monograph was published by the Multilateral Investment Guarantee Agency and the International Finance Corporation of the World Bank. It is the most definitive study in its field, and for this reason this project has relied heavily upon its findings.

⁸⁸ Hood & Yound (1981) *JWTL* 237.

⁸⁹ See Wells and Flint *Marketing a Country* 9-21.

⁹⁰ Wells and Flint *Marketing a Country* 9-10. The twelve image-building techniques listed are quoted directly from Wells and Flint without any changes.

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- Participating in investment exhibitions;
- Advertising in industry- or sector-specific media;
- Conducting general investment missions from source country to host country or from host country to source country; and
- Conducting general information seminars on investment opportunities.

South Africa's official investment promotion agency, the Industrial Development and Investment Centre ("IDIC") is a directorate within the Department of Trade and Industry. In light of the emergence of a newfound governmental emphases on industrial development, socio-economic growth, and political liberalisation, the Industry Branch of the DTI created the IDIC in November 1990.

TABLE 9 (i) I

Primary Image-Building Techniques Used by National FDI Promotion Agencies

Locality	Promotion agency	Image-building technique used
Britain	Invest in Britain Bureau	1,2,4,5
Canada	Investment Canada	1,3
Costa Rica	Costa Rican Investment Promotion Program	2,3,4
Indonesia	Investment Coordinating Board	4,5
Ireland	Industrial Development Authority	1,3
Jamaica	Jamaican National Investment Promotion	2,3,4,5
Malaysia	Malaysian Industrial Development Authority	2,4
Scotland	Locate in Scotland	1,2
Singapore	Economic Development Board	1
Thailand	Board of Investment	1
★ South Africa ⁹¹	Industrial Development and Investment Centre	1,2,5

The IDIC's investment-promotion approach emphasizes image-building as its priority, as Table 9(i).1 shows. Its 1992/1993 financial year budget was approximately R2,47 million, while its approved budget for the 1993/1994 financial year is on the order of R2.8 million. However, the 1992/1993 budget for advertising in general financial media was approximately R100,000, or 4 per cent of its total budget allocation. During the last financial year, three advertisements were placed in European financial publications ⁹², accounting for the entire advertising budget, but as far as the IDIC knows, no direct investment has materialised as a consequence. The adverse political press coverage that South Africa received abroad no doubt contributed to the poor response to the advertising effort.

⁹¹. Mr Gerhart Stander, IDIC, teleconference, 6 October, 1993.

⁹². Two advertisements were placed in the European edition of the Economist, in October/November 1992 and February/March 1993, respectively.

This result, however, concurs with the experience of overseas agencies which had no intention of generating investment through general advertising promotion, but rather which planned to create, modify or expand the appeal of their respective countries as ideal investment locations. ⁹³ However, even those agencies which purposely planned to generate investment directly through an image-building advertising strategy were disappointed. ⁹⁴ However, the overall effectiveness of image-building advertising campaigns varied according to their quality, intensity and focus.

For Ireland's IDA, for instance, advertising was intense and protracted, lasting through the 1980's. The IDA systematically assessed the effectiveness of its campaign and subcontracted out the evaluation work to an independent firm specialising in survey analysis. The results of Ireland's strategy - measured by the percentage of first recalls by corporate decision-makers of investment promotion advertisements of Western European countries - were staggering, measuring thirty-nine per cent in Ireland's favour! ⁹⁵

The effectiveness of such promotion stimulates the decision-making process in favour of a particular investment location, but does not itself lead directly to investment. This principle, borne out of international experience, should underscore South African policy in this regard.

During the 1993/1994 financial year, the IDIC planned and has already held five investment seminars at various international trade fairs and exhibitions. ⁹⁶ Because the IDIC's advertising campaign - as an ad hoc, unstructured and uncoordinated effort ⁹⁷ - was found to be ineffective in generating investment interest, the IDIC's emphasis has turned to the holding of investment seminars in various countries abroad. ⁹⁸ Over thirty investment seminars have so far been planned to take place during the 1993/1994 financial year, after the elections of April 1994 have been held and their results finalised. Apparently, the IDIC's seminar-holding plan is based on an industry-by-industry promotional strategy. ⁹⁹

9 (ii). STRATEGIES FOR FDI PROMOTION: INVESTMENT-GENERATION

- ◆ As a matter of policy, the transition from a general image-building strategy to the more specific investment generation stage has as its purpose the attraction of selected potential investors. A targeting strategy should be driven by a logic consistent with the host country's development goals.

⁹³. These agencies were Britain's IBB, Investment Canada, Ireland's IDA, Singapore's EDB, Locate in Scotland, and Malaysia's MIDA. Wells and Flint Marketing a Country 10.

⁹⁴. These agencies were Jamaica's JNIP, Costa Rica's CINDE, and Indonesia's BKPM. Wells and Flint Marketing a Country 10.

⁹⁵. Wells and Flint Marketing a Country 46-47.

⁹⁶. The list of seminars in the 1993/1994 financial year:

May 1993:	Milan
June 1993:	Taiwan
September 1993:	Singapore
October 1993:	Paris
March 1994:	Brussels

Gerhardt Stander, IDIC, teleconference, 6 October 1993.

⁹⁷. Gerhard Stander, IDIC, teleconference, 6 October, 1993.

⁹⁸. This change in emphasis follows overseas patterns, especially of those agencies (such as the JNIP, CINDE and BKPM) that had planned to generate investment directly through image-building advertising strategies.

⁹⁹. Gerhardt Stander, IDIC, teleconference, 18 October, 1993.

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Therefore, a policy of investment-generating promotion assumes that investment has importance for the country which it serves. The degree to which this policy distinguishes between different types of FDI and allows the agency involved to target sources of FDI investment that will be of specific advantage to the economy, or desirably for each industrial sector on its own merits, depends upon an overall government approach to foreign investment. In other words, investment promotion must be embedded in a national policy on FDI in general (and as an extension of an industrial development strategy in particular).

The level of detail with which a promotion agency must concern itself if it wishes to link its investment generating endeavours to a specific national industrial development strategy is high. In other words, the social welfare function of an investment-generating strategy is an issue of considerable importance. For instance, if the agency decides to target a category of potential investors, it should pay attention to the particular attributes of the class: for instance, the size, growth rate, export insensitivity of production, labour intensity of production, level of technology, value added of production or any other characteristic that will match the specific comparative and absolute advantages or requirements of the country being promoted. ¹⁰⁰

TABLE 9 (ii) I

Primary Investment-Generating Techniques Used By National FDI Promotion Agencies ¹⁰²		
Locality	Promotion agency	Image-building technique used
Britain	Investment in Britain	1,4
Canada	Investment Canada	4
Costa Rica	Costa Rican Investment Promotion Program	1,4
Ireland	Industrial Development Authority	4
Jamaica	Jamaica National Investment Program	1,3
Malaysia	Malaysian Industrial Development Authority	1
Scotland	Locate in Scotland	1,4
Singapore	Economic Development Board	4
Thailand	Board of Investment	2
★ South Africa	Industrial Development and Investment Centre	none
-- Western Cape	Wesgro	1,2,3,4

Four investment generating techniques have been identified to be widely utilised by official investment promotion agencies: ¹⁰¹

- Engaging in direct mail or telemarketing campaigns;
- Conducting industry- or sector-specific investment missions from source country to host country or vice versa;
- Conducting industry- or sector-specific information seminars; and

¹⁰⁰. Wells and Flint *Marketing a Country* 19.

¹⁰¹. Wells and Flint *Marketing a Country* 10.

¹⁰². This table has been modified slightly from Wells and Flint *Marketing a Country* 11, Table 2.

- Engaging in firm-specific research followed by "sales" presentations.

Over half of those agencies surveyed used direct mail and telemarketing campaigns, as well as firm-specific research followed by "sales" presentations as part of their investment-generating promotional strategies. According to existing survey evidence, the influence of a general mix of investment-generating promotion techniques on the investment decision-making process of foreign investors is significant. The table above summarises the data. ¹⁰³

Needless to say, the present six-man IDIC team and its current bureaucratic mandate make such focussed and intense operations impossible. First of all, the IDIC would have to equip itself with the appropriate expertise in order to indulge in micro-economic analysis, which would allow the sort of matching exercise called for. Secondly, the salaries on offer must be sufficient enough to attract the talent and skills necessary in this regard. Current salary levels are too low and for this reason, only six out of the twelve positions existing in the IDIC have been filled. ¹⁰⁴

It should be noted that regional investment promotional bodies have gone some distance in developing investment-generating strategies. For instance, Wesgro initiated its Western Cape Foreign Marketing Initiative in October, 1993.¹⁰⁵ It undertook three studies which examined import-substitution opportunities in the South African economy, trade opportunities between post-apartheid business in the Western Cape and Africa and South Africa's international competitiveness. Thereafter, Wesgro studied regional marketing strategies and techniques, developed audio-visual marketing materials, and chose Europe in particular for its marketing focus.

In following through with a tailored approach, Wesgro then carefully compiled lists of companies which it believed could benefit from investments in the Western Cape, and thereafter planned to solicit particular decision-makers in each such company, requesting opportunities for making investment marketing presentations. Evaluation assessments are planned for 1994, and therefore it is not possible to comment on the viability of Wesgro's scheme. It is remarkable that Wesgro's total budget for these activities is R2,5 million per annum - approximately the same budget as that of the IDIC!

TABLE 9 (ii) 2

The influence of Promotion on Investment Decisions by Market Orientation of Investment Decisions level of influence				
LEVEL OF INFLUENCE				
Market orientation of project	Significant influence	Some influence	No influence	Total
Domestic	0	1	7	8
Export	11	8	3	22
Total	11	9	10	30

¹⁰³. Wells and Flint *Marketing a Country* 51, Table 20.

¹⁰⁴. Dennis Fulton, Director IDIC, teleconference, 14 September, 1993; Gerhard Stander, IDIC, teleconference, 7 October, 1993.

¹⁰⁵. See Wesgro *The Promotion of Investment in the Western Cape: The Current Position and Proposals for Improvement Draft*, September, 1993.

Table 9(ii).2 shows that out of a total of thirty investment decisions tested, ¹⁰⁶ thirty-seven per cent of them were "significantly" influenced by the investment-generating techniques used by the agencies. These techniques had "some" influence over thirty per cent of them, while thirty-three per cent of the decisions were not at all influenced by promotion activity. What is remarkable is the relative marked response of export-oriented investment projects to investment-generating promotion. Sixty-three per cent of the projects surveyed that were positively responsive to investment generation techniques were export oriented.

The responsiveness of export-oriented projects to targeted promotional strategies appears to concur with the findings of researchers about the influence which tax and other incentives have on location decisions responsible for export-oriented investments. However, it was found that the personal contact, the professionalism, aggressiveness and persistence of the agencies involved had a profoundly positive effect on the investment decision-makers in the "significant influence" group. ¹⁰⁷

◆ In short, techniques involving direct contact with particular firms are effective in generating investment.

The IDIC has not adopted an investment-generating promotion strategy, nor has it attempted in any way to fashion a strategy which links regional industrial development policy to FDI-generation. Whatever the reasons for so general and unfocussed an effort, it reflects an overall South African policy of neutrality toward FDI.

◆ However, as international experience shows, well formulated and coordinated techniques are, for the most part, very effective in generating direct investment.

A range of investment-related services are also offered by agencies involved with investment promotion. These services consist, amongst others, of:

- the provision of investment counseling services;
- expediting the processing of applications and permits;
- the provision of post-investment services. ¹⁰⁸

While these services are frequently used, they are not of primary significance in the attraction of FDI. Rather, their role is to nurture pre-existing investor interest. The primary stated objectives of the IDIC are "to promote and facilitate investment in South Africa's industrial sector by preparing, collecting and disseminating relevant information and by providing a 'one-stop' service to prospective manufacturers." ¹⁰⁹ It is interesting to note, therefore that the IDIC's focus is the provision of information and service rather than investment promotion. The IDIC's services consist of the following:

- obtaining general economic information to facilitate industrial investment decisions;
- identifying and exploring new investment opportunities;
- the identification of foreign partners for joint venture operations;

^{106.} The data in the table was elicited from managers involved in investment decision-making in U.S. corporations, involving all ten promotion agencies examined in this chapter. Wells and Flint Marketing a Country 50-51.

^{107.} Wells and Flint Marketing a Country 51-52.

^{108.} Wells and Flint Marketing a Country 10.

^{109.} IDIC Services Offered to Prospective Industrialists information brief, 1993.

- ❑ the obtaining of capital and technology for industrial undertakings;
- ❑ the arrangement of itineraries for foreign investors visiting South Africa and South African entrepreneurs travelling abroad in search of capital technology; and
- ❑ the identification of local partners for foreign entrepreneurs interested in joint ventures.¹¹⁰

The IDIC also provides assistance in the expediting of services provided by other government departments on an ad hoc and informal basis. IDIC personnel will use their intra- and inter-government departmental contacts to resolve problems which investors may experience in gaining access to government personnel. However, the IDIC's mandate has not given it carte blanche to intervene in formal governmental processes in the other directorates of the Department of Trade and Industry or in the other departments of government. The IDIC also has no authority to intervene with the functions of local authorities, such as town and provincial councils.¹¹¹

9(III). FDI PROMOTION: SOME CONSTITUTIONAL CONSIDERATIONS

As far as policy planning is concerned, an important issue which arises in the context of South Africa's new Constitutional dispensation is whether a national FDI promotion policy is possible without causing any conflict with similar policies adopted by the provinces or local authorities. A number of comments in this regard are appropriate.

It is important to note that the Constitution provides for a two-tiered federal system: a national government¹¹² and nine distinct provinces,¹¹³ each with its own legislature.¹¹⁴ The Constitution also provides that the provinces have particular "legislative competence" which may be distinct to that reserved for the national Parliament.¹¹⁵

Section 126 of the Constitution provides in pertinent part that

"❑ A provincial legislature shall, subject to subsections (3) and (4), have concurrent competence with Parliament to make laws for the province with regard to all matters which fall within the functional areas specified in Schedule 6.

❑ The legislative competence referred to in subsection (1), shall include the competence to make laws which are reasonably necessary for or incidental to the effective exercise of such legislative competence.

❑ An Act of Parliament which deals with a matter referred to in subsection (1) or (2) shall prevail over a provincial law inconsistent therewith, only to the extent that-

(a) it deals with a matter that cannot be regulated effectively by provincial legislation;

(b) it deals with a matter that, to be performed effectively, requires to be regulated or co-ordinated by uniform norms or standards that apply generally throughout the Republic;

(d) it is necessary for the determination of national economic policies, the maintenance of

¹¹⁰. IDIC Services Offered.

¹¹¹. Dennis Fulton, Director of the IDIC, teleconference, 14 September, 1993; Gerhard Stander, IDIC, teleconference, 6 October, 1993.

¹¹². Constitution of the Republic of South Africa Bill, Chapter 4 on Parliament.

¹¹³. Constitution of the Republic of South Africa Bill, Chapter 9 on Provincial Government, s 124(1).

¹¹⁴. Constitution of the Republic of South Africa Bill, s 125.

¹¹⁵. Constitution of the Republic of South Africa Bill, s 126.

economic unity, the protection of the environment, the promotion of inter-provincial commerce, the protection of the common market in respect of the mobility of goods, services, capital or labour, or the maintenance of national security; or

(e) the provincial law materially prejudices the economic, health or security interests of another province or the country as a whole.

- *An Act of Parliament which deals with a matter referred to in subsection (3), only if it applies uniformly in all parts of the Republic.*
- *An Act of Parliament and a provincial law shall be construed as being consistent with each other, unless, and only to the extent that, they are, expressly or by necessary implication, inconsistent with each otheræ..."*

Schedule 6, on the *Legislative Competences of Provinces*, lists, inter alia, regional planning and development, tourism, trade and industrial promotion and urban and rural development as areas of regulation reserved to the provinces.

Parliament and the provincial legislatures have concurrent law-making authority in the areas of competence stipulated in Schedule 6, subject to the caveat that Parliamentary law shall prevail over provincial law which is inconsistent therewith. The supremacy of Parliamentary law in this respect is, however, limited to the extent to which certain norms of federal government are served, that is, by those policy concerns enumerated in section 126(3). A primary concern of federalism is the maintenance of national unity while preserving a degree of sovereignty to each province. This principle underlies section 126. A third tier of governance is left to local or municipal government, but local or municipal laws cannot, under any circumstances, be inconsistent with any Act of Parliament or with an applicable provincial law. ¹¹⁶

A hypothetical example in respect of regulation which aims to promote FDI is appropriate here. At issue is an ordinance enacted by the municipality of Bluesky, which establishes a not-for-profit corporation, Investnow. Investnow's mandate is "to promote economic development and employment for the benefit of all in Bluesky." A primary objective in furtherance of this mandate is to encourage and facilitate foreign direct investment in Bluesky. Bluesky is situated in the province of Makepeace. Makepeace has not legislated at all concerning FDI promotion, but has left it up to each municipality to devise its own scheme in this respect. Investnow, in accordance with Bluesky's enabling ordinance, establishes an advertising drive in the United States. Promotional advertisements are placed in financial magazines and newspapers in Los Angeles and New York, two cities it has purposely targeted. This drive is followed up by various investment promotion seminars in those cities. The slogan of this promotional campaign is "INVEST IN BLUESKY, THE HEART OF SOUTH AFRICA." Many municipalities in South Africa's nine provinces also establish promotion agencies similar to Investnow and wage campaigns just like Investnow's.

Parliament has, by way of legislation, delegated full discretionary authority to the Director-General of the Department of Trade and Industry to establish its own national investment promotion agency. Parliamentary legislation has not referred to investment promotion or to a promotion agency either in concept or in name. The Director-General then establishes the National Investment Promotion Agency (NIPA). NIPA's primary functions are to promote FDI into South

¹¹⁶. *Constitution of the Republic of South Africa Bill, s 175 on the Powers and Functions of Local Government.*

Africa, to administer a national FDI policy which targets specific kinds of investments, operates an investment database and analyses the impact of FDI on the South African economy. NIPA also administers an advertising campaign in many large cities in the United States, including Los Angeles and New York. Its promotional slogan is "INVEST IN SOUTH AFRICA, THE JEWEL OF AFRICA."

A few salient issues arise in the Constitutional context:

- ❑ For argument's sake, let us assume that the legislature of the province of Makepeace enacted a law which establishes Investnow and outlines its mandate, "to promote economic development and employment for the benefit of all who reside in Makepeace." The Director-General of the Department of Trade and Industry believes that FDI promotion "deals with a matter that, to be performed effectively, requires to be regulated or co-ordinated by uniform norms or standards that apply generally throughout the Republic." He believes that his Department should set the parameters of all regional and municipal investment promotion activities because an unco-ordinated splintering of endeavour in this respect may cause distortions to regional development and may foment competition between the provinces for capital investment. Could the Director-General attempt to have the Makepeace statute declared unconstitutional as applied?
- ❑ Because NIPA was established on the basis of Trade and Industry Departmental guidelines, themselves based on general Parliamentary enabling legislation, can the municipal legislation be said to be in conflict with the guidelines and therefore unconstitutional?
- ❑ Assume the answer to question (2) is "no" because it is found that municipal legislation cannot be in conflict with Parliamentary enabling legislation which vests in the Director-General wide discretion to establish "guidelines in respect of all functions of his Department." The Parliamentary Act does not refer to NIPA in any way whatsoever, and cannot be said to have anticipated its establishment. If Departmental "guidelines" are found not to fall within the category of Parliamentary legislation as contemplated in the Constitution, what implications does this finding have for concurrent commercial regulation on the part of the national government, the provinces and local authorities?
- ◆ Issues such as these are bound to arise in the framework of South Africa's new constitutional dispensation. Even if the constitutional rules governing concurrent competence do not provide mechanisms for preventing policy conflicts between the national government and provincial or local authorities, it would be advisable for policy to be co-ordinated on the basis of good faith between the provinces and the national government as soon as it is practical.
- ◆ Another solution to the problem of conflicts of the sort described above is to apply the rule that the powers of each government department be legislated finitely. For instance, a Parliamentary act establishes NIPA and defines its objectives and mandate, rather than delegating wide discretionary rule-making authority to the Director-General of the Department of Trade and Industry. However, if this policy were adopted, the entire field of central government's administration would be reversed. Although the implications of this change are beyond the scope of this project, it suffices to say that discretionary authority may serve to structure administrative operations with greater competence and skill than would a national Parliament. The delegation of discretionary authority to the head of a government department, especially with respect to trade and industry, may allow for less political pressure to bear on the decisions made. At the same time, however, such intra-departmental rules and guidelines can have the effect of sapping from the administrative process public accountability, predictability and transparency.

- ◆ In conclusion, an FDI promotion forum is advised. What should not be allowed to develop is tension between national and provincial competences, especially in areas such as trade and industrial promotion. An FDI promotion forum is advised because it would facilitate a good faith endeavour to promote regional development, cooperation and policy co-ordination and would lessen inter-provincial competition for footloose capital. This forum should obviously consist of representatives of each province and the national government. However, the actual structure the forum is not described here as it constitutes a very specific question of administrative organisation.

This chapter has as its sole objective the elucidation of a few of the salient issues which are arising or that will arise by virtue of South Africa's new interim Constitution.

10. GENERAL GOVERNANCE OF FDI

Between 1977 and 1985 no less than five codes of conduct - from the United States, the European Community, Canada and Australia - have been devised which specifically sought to govern TNCs operating in South Africa. ¹¹⁷ However, all of these codes were drafted, administered and monitored outside of South Africa. ¹¹⁸ In other words, these codes were driven by policies of the home countries of direct investment and activity in South Africa. With the exception of the United States, no country required its companies to ratify a code of conduct. ¹¹⁹

However, a survey orchestrated by the Washington DC-based Investment Responsibility Research Center concluded that

"[a]lmost all South Africans ...spoke[n] to endorse overwhelmingly the belief that any new code of conduct should have local South African input and control...that South Africa has the administrative base to oversee a corporate code of conduct [and] that local control and monitoring would ensure that the programme keep its flexibility as needs and priorities continue to change rapidly in South Africa." ¹²⁰

This conclusion concurs with the observations of others that these foreign codes of conduct may have become largely redundant. For instance, in reference to the *European Code of Conduct* one commentator has observed that the provisions of the Code relating to trade unions (for example, recommended wage levels, working conditions, and collective bargaining) have become interfering, paternalistic and obsolete. ¹²¹ It was therefore realised that the momentum for change generated by the foreign code movement needed to be internalized by South Africa and that the problems of its administration and implementation required growing domestic consideration.

In November, 1992, the ANC/COSATU Alliance presented the Platform of Guiding Principles for Foreign Investors ¹²² before a gathering at the Riverside Church in New York which sought to address the need for a purely South African statement on corporate conduct. The impetus of the ANC/COSATU Alliance for the adoption of a corporate code of conduct apparently grew out of a substantive critique of the existing "legislative process that governs investment" and "the process of foreign investment." ¹²³ Clearly, the single emphasis on the commercial viability of

¹¹⁷ These five codes are:

- (1) *The Statement of Principles Programme (previously the Sullivan Principles);*
- (2) *the U.S. State Department Fair Labour Standards;*
- (3) *the Canadian Code of Conduct;*
- (4) *the Australian Code of Conduct, and*
- (5) *the European Community Code.*

IRRC "An Overview of Codes of Conduct for Multilateral Companies in South Africa" in *Towards a Code of Investment* (1992) 62.

¹¹⁸ IRRC *An Overview of Codes* 62.

¹¹⁹ IRRC *Overview of Codes* 62.

¹²⁰ IRRC *Overview of Codes* 73.

¹²¹ Holland "Disinvestment, Sanctions and the European Community's Code of Conduct in South Africa" 88(353) 1989 *African Affairs* 529, 537. Dr Holland adds that "[t]o survive and to be of use, the Code needs to shed its paternalism, promote black empowerment and emphasize non-union activities."

¹²² *The Platform of Guiding Principles for Foreign Investors, ANC/COSATU position presented to the National Conference in Support of the African National Congress and Other Democratic Forces for a New South Africa, 12-15 November, 1992, Riverside Church, New York City. Published in ECOSOC (UN) List of Transnational Corporations with Interests in South Africa, Report of the Secretary-General, E/C.10/1993/13/add.1 (30 March 1993) 41.*

¹²³ *Platform of Guiding Principles for Foreign Investors, 1. Paragraph 1.1 reads: "The apartheid legislative process that governs investment at present is a major obstacle to growth and development. In this context the process of foreign investment needs to be assessed with care."*

investment by the present government will give way to a broader perspective which simultaneously emphasizes the social feasibility of investment. ¹²⁴ In the Introduction to the Alliance's *Platform of Guiding Principles for Foreign Investors* this phenomenon is clearly explained:

At present the basic ILO Conventions do not apply across South Africa. Discriminatory practices are widespread, and the lack of transparency in government is hiding corruption and inefficiency, and promoting political violence and destabilization. Measures to protect the environment are weak, weakly implemented or non-existent. Investment in such a context will, therefore, not automatically contribute to growth, development or the eradication of apartheid. ¹²⁵

In other words, the present government's legislative commitment to the growth and development of South Africa was viewed as inadequate. The adoption of a code of conduct was thus seen as a part of the transitional process which would lead toward the full integration of its principles into the future policies and laws of a democratic government. ¹²⁶ Two years ago the ANC/COSATU Alliance stated in this regard that:

***"Foreign investors would be expected to comply with domestic regulations regarding industrial relations, workers' health and safety, the environment, affirmative action, and the training and education of their employees. In the transitional period, where current regulations are inadequate, we will expect foreign and domestic firms to comply with suitable alternative standards. These standards might be drawn from international protocols in current use, or from successful national regulations of other countries, and will not be designated before potential investors and other parties have been consulted."* ¹²⁷**

In actual fact, however, the Platform of Guiding Principles was meant merely as a statement of general policy, not as a warning to potential investors that they will be forced to comply with draconian moral strictures. The fact that the Platform may have projected the wrong message abroad ¹²⁸ has caused both the ANC and organised labour to distance themselves from it. ¹²⁹

¹²⁴ Mr Trevor Manuel, Head of the Department of Economic Planning of the ANC, has stated that there is "no distinction between commercial and social investment." Johannesburg, 20 July, 1993. Mr Derek Keys, South African Minister of Trade and Industry and Economic Co-ordination, has, on the other hand stated that the "first fundamental is the economic growth imperative...Like all governments we would like to see income per capita growing by at least one per cent per annum..." Keys "The SA Government View on Foreign Trade and Investment" April 1992 *South Africa International* 169.

¹²⁵ Platform of Guiding Principles for Foreign Investors 1.2.

¹²⁶ The Platform of Guiding Principles states that "[i]t is our intention to have the above principles incorporated in the future policies and laws of a democratic government...[i]n the interim phase, we will campaign for these principles, and will support the further development of codes of conduct along with other democratic formations." para's 3.1 - 3.2.

¹²⁷ Draft ANC/Alliance Foreign Investment Discussion Document (October, 1991) 3, para. 12. The reference to the fact that the basic International Labour Organisation's (ILO's) Conventions do not apply across South Africa is a perception that international labour standards have no legal force in South Africa. South Africa is not a party to any international human rights convention, and nor is it a party to any of the ILO Conventions. Two years ago, this situation prompted COSATU to push for the incorporation of all the ILO Conventions into South African law. In fact, at that time, one of COSATU's principal affiliates, the Chemical Workers' Industrial Union (CWIU) had drafted its own Investment Code for Multinationals in Post-Apartheid S.A. which expressly adopted the ILO's nineteen Conventions and its twenty-three Recommendations without reservation. CWIU drafted its Investment Code for Multinationals in Post-Apartheid S.A. on 31 July, 1991. Specifically, COSATU called for three (apparently) alternative methods of incorporation:
 (1) Ratification of ILO conventions (about 155) (sic);
 2) incorporation of these into law/statute;
 (3) thorough review of domestic law to ensure that it conforms to international conventions.
 COSATU Meeting of Industrial Restructuring Committee: Draft Agenda (6 August, 1991) 3. The ILO framework referred to is the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, Including a List of International Labour Conventions and Recommendations Referred to in the Declaration, adopted by the Governing Body of the International Labour Office on 16 November, 1977. ILO Doc. No. GN 204/4/2, 18 November 1977.

¹²⁸ An American lobbyist involved in encouraging US firms to invest in South Africa has stated that "[a]lthough U.S. companies assume that South Africa will establish fair labor standards legislation, there is considerable concern that they might adopt a code of corporate conduct that would be a serious disincentive to investors choosing to locate there instead of other countries." J. Daniel O'Flaherty, Vice President of National Foreign Trade Council, Inc, Personal Correspondence, June 30, 1993.

¹²⁹ This position was related to me by a senior COSATU economic adviser, but for purposes of confidentiality his/her identity shall remain anonymous.

On the other hand, however, the South African Council of Churches (SACC) and its counterparts overseas have continued to emphasize the centrality of a corporate code of conduct which would empower black-owned businesses and ensure training and education programmes for black workers. ¹³⁰ The phrase "investment with justice" has become the basis for the theological critique. ¹³¹ In his opening address of the Broederstroom Consultation on 10 February, 1992, the Rev Dr Frank Chikane stated that the primary motivation of the Church "is to ensure that all economic activity relating to this country, both in its present and in the future, is conducted in a manner which does not jeopardise the livelihood of the majority of South Africans, who by design are black, poor and workers." ¹³² Moreover, in its initiative of 30 June, 1993, the South African Council of Churches pledged its belief in the need to "reverse" ¹³³ the economic distortions created by apartheid and to accomplish this objective by "reshap[ing domestic and foreign investment] in the image of an equitable democratic and life-enhancing society." ¹³⁴

The Church in South Africa views a code of conduct as a "tool of struggle" ¹³⁵ that will enable the ecumenical movement to continue to exert influence over the nature of international intercourse with South Africa while change continues to take place. The Church's emphasis on revision and reshaping of the South African economy reflects its continued traditional support of democratic political ideals.

Hitherto, no foreign corporation investing in South Africa has faced operating within the context of a code of conduct employed by the South African government. This observation concurs with the historical fact that the issue of corporate codes of conduct, especially those aimed at the behaviour of multinational enterprises established in developing countries, has been internationalised. Since the 1970's, an international and regional Code movement has concerned itself with the explication of the responsibilities of transnational corporations to their home and host countries. The fundamental premise of the Code movement has been

"that the protection of TNCs and foreign investors must be matched by decent conduct on their part...The formulation of codes of conduct also represents concerted international endeavors to provide mechanisms for resolving the perennial problem of reconciling the business imperatives and objectives of TNCs with the development or economic goals of host countries." ¹³⁶

^{130.} See Barber "US Churches Punt SA Investment Code" *Business Day*, 8 October, 1993, 4.

^{131.} *Towards a Code of Investment: A Report on the Conference on Ethics for South Africa's International Economic Relations, Held at the Alpha Training Centre Broederstroom Under the Joint Convenorship of the South African Council of Churches (SACC), South African Catholic Bishops' Conference (SACBC), Institute for Contextual Theology (ICT) and Kigiso Trust (April 1992)*, 1.

^{132.} SACC *Towards a Code of Investment* 5.

^{133.} At its meeting in Utrecht, the Netherlands, (12 June, 1993) the SACC stated: "The sobering reality is that the correction of these structural distortions [such as unequal distribution of income, a shrinking economy, unemployment, overconcentration of ownership and markets etc] will require years of cooperation between the new democratic government, its partners in civil society and the international community." The Church's recurrent emphasis on the need to correct and to reconstruct the South African economy is a feature of its general critique.

^{134.} SACC *Initiative Code of Conduct for Business Operating in South Africa* (30 June, 1993). This Initiative was subsequently adopted at the National Conference of the South African Council of Churches on 18 July, 1993, as its Code of Conduct after "a long process of consultation with trade unions, business and churches here and abroad." As of 29 July, 1993, the SACC was in the process of establishing mechanisms for the implementation and monitoring of the code. SACC letter (from Rev Dr John Lamola, Co-ordinator of the SACC Task Force on Economic Matters) to Mr Terry Crawford-Browne, 29 July, 1993.

^{135.} SACC *Towards a Code of Investment* 6.

^{136.} Asante "The Concept of the Good Corporate Citizen in International Business" 4(1) 1989 *ICSID Review* 1, 2-3.

An historical development in the relations between TNCs and host countries necessitated the development of international norms of conduct for TNCs. This development was the liberalisation of developing economies and their consequent policies to attract TNC investment in order to increase levels of foreign capital and technology flows. ¹³⁷ This process naturally led to an intensification of interaction between host governments and managements of TNCs, which left many states unable to regulate effectively the conduct of TNCs, especially in such areas as abusive transfer pricing, tax evasion, anti-trust, illicit payments, and environmental and consumer protection, without the assistance and the cooperation of the international community. ¹³⁸

More particularly, endeavours to devise codes of conduct and guidelines for multinational enterprises sought to address conflicts arising from competing interests. For instance, the competing interests between labour (represented by national trade unions) and the global management strategies of TNCs underlay the development of the OECD instruments during the period 1976 - 1979. ¹³⁹ The Andean Investment Code and the UNCTAD Transfer of Technology Code were preoccupied in addressing the potential conflict between foreign ownership rights through investment and the assertion of national sovereignty in the advancement of development objectives. Thus, the thrust of the Code movement has been to share the responsibility for regulating TNC behaviour between the appropriate governmental agencies of political and economic regions and international organisations.

^{137.} *Asante 1989 ICSID Review 2.*

^{138.} *Asante 1989 ICSID Review 2.*

^{139.} Horn "Codes of Conduct for MNEs and Transnational Lex Mercatoria: An International Process of Learning and Law Making" in Horn (ed) *Legal Problems of Codes of Conduct for Multinational Enterprises* (1980) 47.

11. A SOUTH AFRICAN "GUIDANCE" POLICY FOR FDI

The attempt to internationalise and thus to externalise regulation of the activities of TNCs was predicated on the observation that many developing countries had no internal capability to exercise such management. South Africa, unlike many developing countries, especially in Africa, has a well-established legal system.

One of the main feature of international corporate codes of conduct for multinational corporations is their emphasis on the rights of workers in those countries where these corporations invest. As suggested above, this emphasis has been particularly pronounced in respect of international operations in South Africa. However, South Africa's rapid socio-legal transformation, since the release of Nelson Mandela in 1990, has facilitated the emergence of a set of minimum standards for labour relations and for human rights in general. South Africa's new Constitution, in its Chapter on Fundamental Rights, creates a framework for labour relations, promising workers the right to fair labour standards, to form unions, and to organise and bargain collectively ¹⁴⁰. This constitutional framework builds upon a pre-existing regime of labour relations legislation which could be said to have been initiated by the Wiehahn Commission in 1979. ¹⁴¹ Thus, labour relations no longer constitutes an area of attention as it once did under the apartheid regime and thus, the focus of attention has moved from the basic conditions of employment to the development of commercial and human resource development policies.

Whatever form a substantive FDI policy takes, the central question remains to what degree a national government should intervene in the process of foreign investment in South Africa. South Africa has a well developed legal system capable of further development in particular commercial areas, such as competitions law, international trade, and mergers and takeovers regulation - all of which have important implications for foreign investment. These areas of regulation necessitate that social policy be served by highly technical and largely rigid legal instruments. The issue of an FDI policy, on the other hand, arises in the context of industrial development, and for various reasons related to industrial policy should not necessitate the same degree of regulation or government intervention.

- ◆ A policy which seeks to maximise the contribution which foreign investors can make to industrial development and thus to social welfare should not attempt to control, manage or interfere with the activities of those investors, beyond the administrative, criminal or civil application of law to all who operate commercially in the local market. In other words, an FDI policy should seek to drive investors into those sectors and subsectors which industrial policy targets for specific development. This should take place by implementing a well-coordinated national programme of investment incentives formulated with the sensitivity and particularity which an industrial strategy deems appropriate. The foregoing principles should constitute a general policy environment for all direct investment, irrespective of origin.

However, as discussed in detail below, an important departure from such an approach is the idea that a direct investment policy focus on foreign investment as a specific developmental resource.

¹⁴⁰. *Constitution of the Republic of South Africa Bill, Chapter 3, s 27.*

¹⁴¹. *Commission of Enquiry into Labour Legislation, appointed under GN 445 GG 5651 of 8 July, 1977. The Wiehahn Commission explained "fair" employment practice as "can be related to the right to work, to associate, to bargain collectively, to withhold labour, protection and to training or development." Report of the Commission of Enquiry into Labour Legislation Part 1 RP 47/1979 V para 4. 127.20. See Brassey, Cameron, Cheadle and Oliver *The New Labour Law* (4th impression 1990) 166.*

- ◆ This focus should give rise to a second-tier of direct investment policy which should have as its primary objective the guidance of qualifying foreign investments into optimal arrangements with the state.

The operative term here is "guidance" since it describes the process through which international investors and the state enter into contractual relationships based on the mutual accrual of benefits. One could thus characterise South Africa's FDI policy as a guidance policy, that is, one guided by each party's respective *commercial or social objectives*.

Another dimension of an FDI policy which may relate to guidance is FDI promotion. A national policy which links promotion to guidance in a four-tiered framework could be described as follows: **142**

- attracting FDI through a marketing mix of promotional **143** and pricing strategies; **144**
- screening FDI proposals in order to identify those that are appropriate and that deserve specific official support;
- monitoring FDI to ensure that it conforms to expectations; and
- intervening in FDI operations if they are believed to be made more favourable.

For reasons already discussed, a substantive policy on FDI has not been fashioned in South Africa, and therefore, there has been no attempt to assess FDI activity in the South African economy. Also, there is little recognition given by government to the notion that FDI has a particular role to play in industrial development. However, there is general tri-partite consensus at the NEF level that

"foreign direct investment contributes to economic development...through its effect on the quality of life of the population as a whole, and especially the very poor, [and that it] is crucially dependent on the domestic policy environment." **145**

But no consensus appears to exist beyond the level of general recognition. In strong contrast to government's contribution to the debate on economic development, is the ANC's policy focus on foreign investment as a specific potential developmental resource. Although the ANC is determined to apply the principle of national treatment to foreign and domestic investors alike, it has articulated a broad (but as yet undeveloped) policy of departure from this principle. The ANC has stated its view as follows:

"Departure from national treatment may include limitations on domestic borrowing or on foreign ownership in strategic areas such as land and national resources. Foreign investments that meet defined national growth and development objectives may enjoy specific contractual arrangements." **146**

142. Wells and Flint *Marketing a Country* 2.

143. *Promotional strategies would include the dissemination of information about the investment location, and the provision of investment services for the prospective investor.*

144. *Pricing strategies are incentive schemes coupled with costs to the particular investor, such as performance requirements.*

145. NEF Report 3-4.

146. ANC *Ready to Govern* 24. The ANC's control policy follows a principle already well-articulated in the international literature. For instance, Encarnacion & Wells 1985 *International Organization* 62:

"If a particular kind of foreign investment is extremely important to a country - that is, if the investment is politically 'salient' to the country's development goals - the country will tend to circumvent general decision-making structures and employ various special organizational arrangements."

That particular foreign investments will be identified for special treatment, as a matter of national policy, suggests that an ANC-led government will institutionalise some, yet a highly focussed, degree of selective intervention in the management of TNC activity. The general ideological underpinning of ANC policy rejects the notion that complete non-intervention will ensure that FDI is driven along the tracks laid by industrial policy and that it will contribute optimally to South Africa's economic welfare. The following discussion explores and develops the theme of an FDI guidance policy in South Africa.

- ◆ It was recognised overseas some years ago that TNC management, exercised through centralised domestic administrative efforts, must satisfy a number of conditions: **147**
- ◆ First, a country must have both the ability and determination to bargain effectively with TNCs. This means also that the effectiveness of the bargaining process depends, to an important degree, on the pre-identification of specific economic objectives.
- ◆ Second, there must exist a national economic plan which identifies the particular role of FDI in the country's economic (and thus industrial) development to direct negotiations with TNCs. If national economic development objectives are identified with specificity, the bargaining process should match those objectives with the investment projects most appropriate to the realisation of those objectives.
- ◆ Third, a national institutional mechanism should exist which would monitor the performance of the foreign enterprises in the host-economy in order to ensure that they adhere to the terms and conditions of operation set down through the bargaining process.

The level of skill and expertise required of the civil servants involved in guidance administration is high. The core activity of administering a guidance policy involves the bargaining of structured arrangements between the host-country government and the investing TNCs. The outcome of the bargaining process will be determined, for the most part, by the bargaining skill and expertise possessed by the negotiators. **148** For this reason guidance administration is a relatively rigorous governmental function, and therefore it would be safe to say that its institutional absence will pose fewer logistical problems than would its employment. Also, a guidance policy must be based on the common principle that the net gains flowing from guidance administration must exceed its national welfare costs.

As a matter of policy, two components constitute guidance administration: (1) an institutional structure; and (2) a substantive bargaining policy. These components are examined below.

11(i). GUIDANCE POLICY: INSTITUTIONAL STRUCTURE

A choice exists between the creation of centralised and diffused institutional structures. **149** A diffused structure entails the decentralisation and sharing of management authority between different government departments or ministries. Considerations of efficiency are important in this context because a high degree of consistent co-ordination is required between

147. *Sauvant and Lanier "Host-Country Councils: A Concept and Legal Aspects" in Horn (ed) Legal Problems of Codes of Conduct for Multinational Enterprises 1980 341 350.*

148. *Encarnacion & Wells "Sovereignty en Garde: Negotiating with Foreign Investors" 39(1) 1985 International Organization 47 48; UN Formulation and Implementation of Foreign Investment Policies 1992 71.*

149. *Encarnacion & Wells 1985 International Organization 56.*

governmental personnel responsible for different administrative functions. Therefore, inter-departmental linkages can reduce the effectiveness of the negotiating process by forcing it through unnecessary administrative hurdles. Indeed, it is well known that administrative delay, disorganisation and disorientation are characteristics viewed by investors as disincentives.

The establishment of a centralised structure means that a single government department will exist to which authority is delegated for the purposes of bargaining and concluding special arrangements with foreign investors. This means also that ministers and bureaucrats may have to surrender a degree of their existing authority to the new unit. There is obviously an existing political and bureaucratic devolution of power within government.

- ◆ For this reason, the political costs and benefits of restructuring must be carefully considered when a reconfiguration of authority will entail the disenfranchisement of certain well-entrenched power structures.¹⁵⁰

Again, it should be stressed that the current statements of the ANC which suggest the utilisation of a guidance policy for FDI also suggest that such policy is to be selective in the types of FDI to which it would apply. Therefore, such a policy will not necessarily apply to all investments. Accordingly, foreign investments *may* enjoy special treatment if they satisfy certain criteria and therefore a guidance policy will not be applied mandatorily at the level of entry.

This arrangement suggests that the screening process can take place only on the basis of the appropriate information supplied to the agency responsible for guidance administration. It is assumed here that a preliminary screening would be necessary to assess whether or not the particular investment is worthy of special treatment.

- ◆ At any rate, the submission of an investment proposal should be made mandatory for census purposes, irrespective of any other consideration. The centralisation of direct investment data collection and analysis is a crucial component of an economic development programme generally, and of an industrial strategy in particular. It should be noted that no institution exists in South Africa which fulfills this function. In short, an FDI management policy can be administered only upon a viable empirical basis.

The institutional body that will be responsible for guidance administration will not be an "approval" agency. Except for certain strategic industries or for sectors of economic activity reserved for South African nationals, the entry of FDI will be free, uninhibited and welcome. For those restricted economic areas, the acquisition of the necessary licenses will be required. This is, however, a separate issue to that of guidance administration, and for this reason a government authority which carries out this policy will not be an "approval" agency.

It suffices to say that entry restrictions do not appear in the current debate to hold any predominance over the notion that investment entry will be unimpeded. It should be pointed out that the greater the extent to which entry is conditioned on the acquisition of a license the greater degree of corruption or illegal rent-seeking on the part of the civil servants involved can be expected.

¹⁵⁰ Encarnacion & Wells 1985 *International Organization* 60-62; see also, Wint "Promoting Transnational Investment: Organizing to Service Approved Investors" 2(1) 1993 *Transnational Corporations* 71.

- ◆ From the standpoint of policy, this phenomenon alone is sufficient to recommend that as few areas as possible of economic activity should be conditioned on licensing.
- ◆ In South Africa's case, the Industrial Development and Investment Center ("IDIC") within the DTI is a viable choice of an existing institution for purposes of management administration.

As already discussed, the IDIC's current mandate is thin, and its scope of operation narrowly curtailed. However, notwithstanding its present constitution and ideological orientation, international experience seems to support the idea that investment promotion and the administration of an investment guidance policy are institutionally linked operations of government.

Singapore's Economic Development Board ("EDB"), for instance, administers an investment promotion portfolio and negotiates and concludes agreements with foreign investors outside of the regular ministerial structure.¹⁵¹ Another example is Thailand's Board of Investment ("BOI"), the central authority for administering Thailand's investment promotion program,¹⁵² which also regulates all investment projects which it identifies as being most profitable to the Thai economy.¹⁵³ In the case of Thailand, the BOI was originally created in 1954 to screen investment proposals and to negotiate with investors, and only in the early 1980's began also to promote investment. In contrast to the BOI, Canada's Investment Canada was created as an investment promotion agency to replace the previous Federal Investment Review Agency, which was established to screen investment.¹⁵⁴ This change in function was accompanied by slight changes in personnel.¹⁵⁵

- ◆ It appears therefore that investment promotion and investment guidance are linked administrative functions.

The ability to negotiate with informed, powerful and influential TNCs is a highly developed skill. Besides the fact that investment promotion and guidance may be linked administratively, individuals who have had intensive experience dealing with potential investors, and who have come to understand the character of the domestic economy are relatively well qualified for the job of investment guidance administration. However, whether a new governmental structure should be created and new recruits are to be employed and trained, or whether existing structures are to be modified, are considerations which face a prevailing government, but which are beyond the scope of this discussion.

11(ii). GUIDANCE POLICY: STRUCTURE AND SUBSTANCE OF BARGAINING

Once a government has chosen to institutionalise an investment guidance policy, it commits itself to a peculiar regime of official external economic relations. Direct, rules-based, government involvement in the dynamics of investment market-entry will, in South Africa's case, be a distinct and obvious departure from the status quo. There is no prevailing bargaining authority

¹⁵¹. Encarnacion & Wells 1985 *International Organization* 61.

¹⁵². The BOI also operates the Office of the Board of Investment which serves as an investment service center.

¹⁵³. See Ngo "Foreign Investment Promotion: Thailand is a Model for Economic Development in Vietnam" 16(1) 1992 *Hastings International & Comparative Law Review* 67-87.

¹⁵⁴. Wells & Flint *Marketing a Country* 25.

¹⁵⁵. Wells & Flint *Marketing a Country* 25.

in South Africa, and in this regard the example of the United States and Great Britain is followed. The absence of a bargaining framework, while allowing investors greater predictability in their decision-making, is unlikely to optimise the potential benefits for the host-country from each investment. ¹⁵⁶

- ◆ It should be made clear from the outset that investment guidance, if employed, should not be viewed as an all-or-nothing option. In other words, investment guidance should screen investment proposals for special treatment (as a departure from the national treatment principle), set terms and conditions for investment operation in the host-country and monitor adherence to those contractual requirements. However, such a policy would constitute targeted and managed intervention but should not be utilised as a substitute for an open-market entry regime.

The very idea of bargaining implies the swapping of concessions between the parties involved through a process of negotiation. Those investments not identified in terms of guidance policy would simply be governed by the laws of the land.

- ◆ First of all, as a matter of policy, a decision must be made as to the character of the bargaining framework.

Guidance administration may consist of a review process whereby an agency or board will invite all investment project proposals for screening. The screening process may lead to an objective identification of those projects believed to be of special interest to domestic economic development. ¹⁵⁷ The degree of rigidity inherent in the review mechanism will determine whether and to what extent inter-personal negotiation will take place. It has been recognised that the greater the rigidity and the degree to which the rules and conditions of market-entry are fixed, the greater the deterrent effect such a mechanism will have on incoming investment. ¹⁵⁸

- ◆ A balanced approach to guidance administration should be adopted. In line with existing recommendations, South Africa should define, clearly articulate and publicize the role that TNCs can play in its programme of social and industrial development. ¹⁵⁹

This approach will set the parameters of a bargaining structure. It would then be within the limits of such parameters that specific bilateral negotiations can take place. ¹⁶⁰ The particular terms and conditions of market entry and operation will be set through these negotiations.

However, the most crucial aspect of the negotiation-bargaining process is how the ownership-specific advantages of the TNC relative to other alternatives available to the host country combine with the location-specific advantages of the host country relative to the other alternatives available to the TNC to result in an optimal arrangement for all concerned. ¹⁶¹ In other words, the ownership-specific advantages of the TNC have a relative value to a host government, based

¹⁵⁶. Encarnation & Wells 1985 *International Organization* 56.

¹⁵⁷. The definition of "economic development" and the rules for application review may be promulgated from time to time as an administrative circular, or may be published in the Government Gazette. The degree of transparency and specificity inherent in the review procedure are distinct issues of policy.

¹⁵⁸. UN *The Determinants of Foreign Direct Investment* 62.

¹⁵⁹. UN *The Determinants of Foreign Direct Investment* 62.

¹⁶⁰. UN *The Determinants of Foreign Direct Investment* 62.

¹⁶¹. UN *Formulation and Implementation* 69.

on other available alternatives. This is true in the converse for the TNC for which the host country has an appeal relative to other alternative investment locations available to the TNC. This theoretical framework should generate the necessary differences between the respective expectations of the parties to enable them to work toward a satisfactory compromise.

Ownership-specific advantages are the profit-enhancing characteristics of a firm's operations. ¹⁶² These characteristics may be its level of research and development intensity ¹⁶³, its level of advertising intensity, ¹⁶⁴ its management expertise, ¹⁶⁵ and its trading expertise. ¹⁶⁶ These factors have potential spill-over value to a host-country's economy. Other factors such as the amount of foreign capital the firm intends to bring in as a net investment and the number of jobs which it proposes to create are also relevant. All of these firm- and project-specific characteristics, as they are perceived by the host country government to impact upon the domestic economy in the desired fashion, will determine the degree of bargaining power which the TNC will have in the negotiating process.

On the other hand, the location-specific advantages of the host country as they are perceived by the TNC will determine the extent of the government's bargaining power in the negotiation process. ¹⁶⁷ The location-specific advantages of the host country are those characteristics which enhance the attractiveness of the location as an investment site. Such advantages comprise, inter alia, the size of the host market in terms of level and rate of increase of GDP and per capita income, cost-effective labour and appropriate supply of skills in the labour force, cost-effective raw material supply, the value of tax and non-tax incentives, cost-effective infrastructure and industrial support, well-articulated plans for economic growth and prosperity, and political stability.

There exists a third consideration of some importance: performance requirements, and in particular, trade-related investment measures ("TRIMs"). ¹⁶⁸ Performance requirements

"are a special category of disincentives that direct an investor to buy from or sell to certain markets..[and, more specifically, TRIMs are] stipulated shares of production that must be exported and stipulated shares of inputs to be procured domestically - as well as such measures as restrictions on foreign ownership of equity and employment of local nationals." ¹⁶⁹

TRIMs constitute the overall category of policy tools which a host-government utilises to shape the undertakings of the investor. TRIMs could be used in the bargaining process to secure

^{162.} See UN The Determinants of Foreign Direct Investment 55-58.

^{163.} R&D intensity measures a firm's level of technological creativity and innovation, as measured, inter alia, by the percentage of a firm's profit that it spends on R&D-related activity. R&D intensity also includes the extent and nature of its ownership of intangible assets such as patents and trademarks.

^{164.} Advertising Intensity indicates the degree and competence with which a firm introduces new products or processes into the market or prolongs the life of existing products, and can be measured by the percentage of profit which a firm spends on advertising and marketing. Advertising intensity may also reveal the degree of a firm's commitment to stimulate demand for domestically produced goods in overseas markets.

^{165.} The degree to which a firm utilises management in terms of both quantity and quality may indicate the ability of the firm to organise its operations efficiently as well as its resourcefulness in training local management.

^{166.} A firm's trading expertise could well indicate its ability to secure overseas markets abroad for domestically produced manufactures, beyond considerations of advertising-intensity.

^{167.} See UN The Determinants of Foreign Direct Investment 58-59.

^{168.} For a discussion of TRIMs under the GATT, see Section below.

^{169.} Gulsinger 1986 World Economy 81. The term "TRIMs" will be used instead of "performance requirements."

various commitments from the investor, which amount to the terms and conditions of market entry and post-entry operation. TRIMs serve at least two important policy functions: ¹⁷⁰

First, while investment incentives are used to attract FDI into the host country, TRIMs can be used to guide the investment into the most appropriate geographic or sectoral location within the host market. It is left to an economic or industrial development strategy to identify the optimal market location options in respect of the ownership advantages of the TNC with which the host government bargains. TRIMs effectively lock into place the resulting "resource allocation" arrangement.

Such TRIMs may consist of a requirement to locate in a particular region in the Republic (identified for development); to export a certain percentage of output of a particular product to a particular market (identified for access for similar South African products); to use only locally developed technology for a particular manufacturing process (identified for licensing), etc.

Second, TRIMs can be used to secure commitments from the investor in fulfilment of the host-country's development goals. In other words, TRIMs can secure from the investor the necessary insurance that its entry into and operations in the host market will result in a net benefit to the host country's welfare.

Such TRIMs may consist of a commitment to source a certain percentage of value added or intermediate inputs from South African manufacturers (identified for purposes of industrial development); to hire a certain percentage of black employees (identified for purposes of affirmative action); to train local managers (identified in terms of a skill-transfer program); to export a certain percentage of added value (identified for balance-of-payments and industrial development purposes), etc.

Obviously, the investment will be made if the benefits to the investor outweighs its costs; the extent of gain will therefore be carefully weighed. Therefore, TRIMs may well be thought of as deductions from the net value of the location-specific advantages of the host-country if they constitute requirements that the investor was not initially planning on satisfying. For this reason, TRIMs could have the effect of corroding the appeal of the host-country as an investment location to the investor, and therefore a policy which incorporates the utilisation of TRIMs is generally a second-best policy. However, TRIMs are not meant to be adopted and utilised in vacuo. They are meant to shape a contractual arrangement which reflects the optimal division of benefits between the investor and the host country. It is the net incentive upon which the final investment location decision is made.

- ◆ The bargaining process will therefore have to be flexible and informed enough to combine all the factors and terms and conditions of market entry in such a way as to lock into place an optimal arrangement.

Optimality in this sense suggests that the resulting contractual arrangement will reflect a set of reciprocal obligations, the materialisation of which will conform to "national growth and development objectives." "National growth and development objectives" will have to be carefully evaluated in terms of an industrial and economic development programme. This means, in turn, that the role of FDI in each industrial sector will not necessarily be uniform and that each

¹⁷⁰ The following comments are based on the useful article, Greenaway "Trade Related Investment Measures and Developing Strategy" 45 (1992) *Kyklos* 139.

arrangement will have to be sensitive to the development profile of the specific sector penetrated by the project.

The UNCTC has recommended to the ANC that "major investments or investments designed to be responsive to the economic and social priorities of a democratic South Africa" should be classified as "special status" investments. ¹⁷¹ An envisaged Investment Code would offer such "special status" investments certain additional guarantees. ¹⁷² The UNCTC recommendations emphasize the application of the national treatment principle, but recommends that "[e]xceptions from national treatment may also be provided in respect of special advantages and investment incentives granted to previously disadvantaged groups; these will not be extended to foreign investors." ¹⁷³ Moreover, the UNCTC adds that "[t]he power to derogate from the principle of national treatment would be strictly limited to the categories and conditions in the code." ¹⁷⁴

The United Nations' recommendations appear to be in stark contrast to what the ANC has proposed thus far. It is beyond the scope of this project, however, to explore the implications of derogating from national treatment to favour previously disadvantaged domestic groups.

¹⁷¹. UNCTC *Policies Towards Foreign Investment for a Future Democratic Government of South Africa* (January, 1992) 26.

¹⁷². UNCTC *Policies Towards Foreign Investment* 26.

¹⁷³. UNCTC *Policies Towards Foreign Investment* 27.

¹⁷⁴. UNCTC *Policies Towards Foreign Investment* 26.

12. INCENTIVES FOR FDI

South Africa has a diversified investment incentive regime in place. Because South Africa does not have a coherent policy on FDI, the sensitivity of its current investment incentive schemes to foreign direct investment is minimal. In other words, FDI is not specifically targeted by an overall investment incentive policy. This observation reflects the fact that South Africa's investment incentives are based on a general neo-classical policy of neutrality toward FDI. ¹⁷⁵

Presently there are eight general categories of incentives available to investors. These are listed by the South African Industrial Development Information Center as: ¹⁷⁶

- Tax Incentives;
- Industry Financing Incentives;
- Regional Industrial Development Incentives;
- Financial Rand Incentives;
- Industrial Export Incentives;
- Import Tariff Protection and Tariff Relief;
- Development Programmes for Specific Industries, and
- General Incentives.

These eight categories are broad and encompass what some would classify as "trade" incentives. Nonetheless, the lumping together of industrial export incentives and import tariff protection and tariff relief measures into the category of industrial investment incentives reflects an integrated approach which the present government has taken towards investment incentives in general.

As discussed below, it is not believed that the availability of specific tax incentives have a significant impact upon the investment location decision. For this reason, the current tax regime in South Africa shall not be assessed. Also, industrial finance incentives offered by the Industrial Development Corporation will not be assessed because it is not at all understood at this stage whether and to what degree they have affected foreign investment location decisions. ¹⁷⁷

12(i). REGIONAL INDUSTRIAL DEVELOPMENT PROGRAMME

The RIDP was introduced on 1 May, 1991.¹⁷⁸ It encompasses three distinct industrial incentive schemes, namely (1) an establishment grant, (2) a profit/output incentive, and (3) a relocation incentive. The third incentive scheme is only applicable to foreign investors.

¹⁷⁵. Whether or not the various prevailing investment incentives are sufficiently coordinated in terms of a national industrial and macro-economic policy orientation is an important question, but goes beyond the parameters of this project.

¹⁷⁶. IDC Industrial Investment Incentives (1 June, 1993).

¹⁷⁷. Mr Hein Wiese, IDC, teleconference, 8 November, 1993.

¹⁷⁸. Department of Regional and Land Affairs Regional Industrial Development Programme Incentive Package Applicable from 1 May 1991 (29 March, 1993), 2.

□ Establishment Grant:

The establishment grant aims to encourage the establishment of new industrial undertakings or the expansion of existing ones. **179** The basis of the calculation of the grant is 10.5 per cent of total operational assets, subject to the maximum investment limitation of R15 million. **180** The establishment grant is to be paid over a maximum period of two years in quarterly installments, **181** subject to periodic monitoring.

In order for the applicant to qualify for the grant, it must satisfy three conditions: (1) The undertaking must hold a minimum of 25 per cent of the balance sheet value of total assets in the form of operational equity. **182** (2) The applicant must incorporate as a company or close corporation, **183** and (3) the undertaking must be a new secondary industry. **184** If the undertaking should sink below the required 25 per cent equity holding, it can continue to receive the grant if the Board for Regional Industrial Development is satisfied that the reasons for such a reduction are acceptable. Otherwise, the undertaking will immediately proceed to the next phase of the industrial incentive package, the profit/output incentive.

□ The Profit/ Output Incentive

The profit/output (P/O) incentive, which follows the two year establishment grant, is calculated accorded to the following formula: **187**

$$[20\% \times \text{profit before tax } \mathbf{188}] \times [1 + 200\%(\text{return on assets } \mathbf{189})]$$

179. IDIC Industrial Investment Incentives 6.

180. RIDP Incentive Package 2 para. 1.1. However, the value of operational assets is predetermined on the basis of the nature of the assets in question;

ASSET	% VALUATION
Owned land and buildings	= 100
Rented land and buildings	= 50
Manufacturing machinery & equipment	= 100
Commercial vehicles & office furniture	= 100
Stocks (maximum two month's turnover)	= 50
Trade Debtors (maximum three month's turnover)	= 50

See IDIC Industrial Investment Incentives 6.

181. RIDP Incentive Package 3 para. 1.3.

182. The minimum threshold must be indicated in the balance sheet supporting the application, and must be sustained in audited financial statements to be submitted at the end of each financial year for which the establishment grant was paid. RIDP Incentive Package 2 para. 1.2. In reality, however, the Board of Regional Industrial Development has recently decided to accept applications showing a minimum of 25 per cent equity ownership. Reasons for this change in attitude are not clear.

183 The RIDP guidelines state that non-incorporated entities such as sole proprietorships or partnerships will not be eligible for the incentives, while branches and/or divisions of incorporated undertakings may be eligible for the incentives, subject to certain conditions. RIDP Incentive Package 2.

184. Although the RIDP guidelines do not define "secondary" industry, they indicate that the applicant be engaged in manufacturing, processing or assembling. RIDP Incentive Package 2.

185 Acceptability would depend, inter alia, if the reasons for a reduction in equity involve excessive growth or start-up losses. RIDP Incentive Package 3 para. 1.2.

186. RIDP Incentive Package 3.

187. RIDP Incentive Package 4 para. 2.1.

188. Profits before tax are to be based on audited financial statements, prepared for shareholders/members in terms of the Companies Act/Close Corporation Act. However, profits before tax exclude non-operational income and RIDP incentive income. RIDP Incentive Package 4 para. 2.1.

189. The return on assets is calculated as follows: (profits before tax + interest on all borrowings)/ total assets. RIDP Incentive Package 4 para. 2.1.

The P/O incentive is paid annually over a maximum period of three years, subject to the constraint that it will not exceed the annual establishment grant as calculated at the end of the second financial year. ¹⁹⁰ All payments are to be made subject to reconciliation against audited annual financial statements in terms of Generally Accepted Auditing Standards. ¹⁹¹

□ The Relocation Incentive

The relocation is the only incentive not available to domestic undertakings wishing to establish or expand their operations. The Board, will, upon the consideration of each application on its merits, grant such foreign enterprises wishing to relocate to South Africa a maximum of R1 million, in addition to the other RIDP incentives. ¹⁹² However, the two qualifying factors are that the commercial enterprise must be relocated from abroad to South Africa, including the TBVC States, and that the plant and equipment relocated must represent a net direct investment. ¹⁹³ It should be noted that the amount of the relocation grant is calculated on the basis of the actual relocation costs to the investor and is therefore not a "free-based" incentive. ¹⁹⁴

□ General considerations:

In order to qualify for any of the RIDP incentives, the undertaking must enter into a standardised contract with the Board for Regional Industrial Development. ¹⁹⁵ The contract reserves the right in the Board, inter alia, to adjust its incentive payments against changes in the applicant's audited financial statements, ¹⁹⁶ to terminate the contract if all plant machinery and equipment relating to the project is not kept in productive use for the duration of the payments, ¹⁹⁷ to terminate the contract and to have a claim of refund over the prior incentive payments if a set of all financial statements and relevant records are not kept at the premises of the undertaking for at least three years, ¹⁹⁸ and to terminate the contract if the applicant has abandoned or suspended the activities of the undertaking. ¹⁹⁹

^{190.} If the establishment grant is forfeited because of a percentage reduction in equity in the first or second year, and is translated to the P/O incentive, the payment during that time will be limited to the "maximum theoretical establishment grant calculated for each of those years, based on the actual investment in operational assets in each year." RIDP Incentive Package 4 para. 2.2.

¹⁹¹ RIDP Incentive Package 5 para. 4.

^{192.} RIDP Incentive Package 5.

^{193.} That is, the plant and machinery must be free of any encumbrance. RIDP Incentive Package 7 para. 8.

^{194.} Mr Jacob Graaff, National Productivity Institute, teleconference, 26 August, 1993. The discretion of the Board of Regional Industrial Development is exercised on the basis of a selected engineer's evaluation of the capital to be relocated and shipping company freight and insurance quotations.

^{195.} A contractual offer follows approval by the Board for Regional Industrial Development of the application for the establishment grant and P/O incentive programme based upon information supplied by the applicant in the Application for Regional Industrial Development Incentives. It is then up to the applicant to accept the offer as submitted.

^{196.} BRID Anonymous Contract clauses 3.1 - 3.3.

^{197.} BRID Anonymous Contract clause 6.3.

^{198.} BRID Anonymous Contract clause 18.

^{199.} BRID Anonymous Contract clause 20.

All RIDP incentives are tax exempt. ²⁰⁰ However, the establishment/expansion and the P/O incentives are subject to a spatial application qualification. They are not available for projects in the PWV and the Durban core areas and are subject to a 60 per cent maximum in the first two years of operation in the Cape Peninsula and in the Durban/ Pinetown/ Pietermaritzburg area and larger Durban Functional Region (excluding the Durban core area) as well as in the deconcentration area surrounding the PWV region. ²⁰¹ The relocation grant is not subject to any such limitation.

The primary difference in the 1982 and the 1991 RIDPs is that the latter's aim is to neutralise the geographic bias of the former. ²⁰² Since the 1960's, the government has endeavoured to encourage the location of manufacturing industry to designated growth points outside the main metropolitan areas (particularly the PWV region), and since the 1970's to areas inside the home-lands, with tax and then with cash grants. ²⁰³

According to a recent economic assessment ²⁰⁴ the decentralisation scheme failed because it succeeded only in inducing the location of barely viable, low level job-creating, manufacturing concerns at the decentralisation poles created by the program. ²⁰⁵ If the initial motivation for the spatially biased RIDP was to create long-term, self-sustaining, efficient, manufacturing growth cores in the less developed regions of South Africa, it is argued that the programme attracted overwhelmingly smaller enterprises dependent on subsidies for their survival. ²⁰⁶ Also, it was found that the relative infrastructural disadvantages of the decentralisation areas ²⁰⁷ reduced their natural attraction for the better established enterprises for which short-term incentives are not of crucial importance.

Survey evidence has indicated that since the 1982 decentralisation policy revision, (that is, as of December 1989) more than 50 per cent of the firms at the growth points continued to be dependent on the subsidies for their profitability and survival. ²⁰⁸ The mechanics of this survey are not revealed. However, these conclusions are fundamentally contradicted by other evidence. ²⁰⁹ Rather, micro-economic analysis indicates that 71 per cent of the NPI's sample of approximately 2019 firms approved for RIDP incentives during the 1991-1992 financial year, performed above the break-even point, or in other words, were above-norm performers, *discounting the incentives they claimed.* ²¹⁰

²⁰⁰. RIDP Incentive Package 8 para. 10.

²⁰¹. RIDP Incentive Package 8 para. 11.

²⁰². Mr Koos Pretorius, Department of Regional and Land Affairs, teleconference, 17 August, 1993.

²⁰³. Addleson "Decentralisation Incentives, Industrialist's plans and the Location of Manufacturing Activity" 58(2) (1988) SAJE 173.

²⁰⁴. It should be noted that the policy paper behind the changes in the 1991 RIDP was commissioned by the Department of Regional and Land Affairs of the Development Bank of Southern Africa in 1989. The present author was unable to obtain a copy of the final report, but Addleson's article apparently reflects the views and major conclusions in the DBSA's report.

²⁰⁵. Addleson 1988 SAJE 174.

²⁰⁶. Addleson 1988 SAJE 174.

²⁰⁷. Such infrastructural disadvantages include the lack of skilled labour, poor social amenities and ancillary services and thus the difficulties of attracting skills to the region. Addleson 1988 SAJE 182.

²⁰⁸. Addleson 1988 SAJE 152.

²⁰⁹. Mr J. Graaff of the NPI believes that Addleson's survey evidence was based on too small and misrepresentational a sample, and furthermore that the interpretation is macro-economic in nature and is therefore distorted.

²¹⁰. Mr J. Graaff, NPI, Teleconference, 26 August, 1993. See NPI Progress Report on the Performance of Firms measured on the Productivity Monitoring System, February, 1993.

- ◆ It is appropriate here to emphasize that the debate over the success or failure of industrial incentives in general must be grounded in a uniform program of evaluation.

The National Productivity Institute analysed most of the firms receiving RIDP incentives under its Productivity Monitoring System ("PMS") in order to evaluate their productivity ²¹¹. This evaluation took place on the basis of the annual audited financial statements of each firm as well as on the basis of certain other information which the registered firms are obliged to submit.

The operating profit, sales, value added, total investment, employment creation, average salary, profit before tax, profit before tax and the incentive and the value of the incentives paid are calculated for each firm. Total calculations are then made for each region and industrial sector. This data is assessed for the purposes of the Productivity Performance Report which the NPI prepares for each firm. However, no evaluation is made in terms of a national or regional industrial strategy.

- ◆ Overall industrial development is the primary objective of the RIDP regime, and evaluation has taken place, it appears, for purposes of productivity improvement only. Therefore, an evaluation structure should be established which monitors not only the productivity of the concerns receiving such incentives, but also other micro-economic factors, such as export performance, human resource development, and technology transfer.
- ◆ Any firm wishing to receive such incentives should be mandated to disclose, on a quarterly or bi-annual basis, specific information required for analysis purposes. Any firm which does not satisfy this requirement should lose its entitlement to incentives.

Such data has not been called for in terms of the PMS. Therefore, no existing basis exists for assessing the 1982 RIDP in this regard. The Board of Industrial Development is planning to evaluate the 1991 RIDP internally rather than to contract out this task, but negotiations for a renewal of its contract with the NPI is underway. However, no matter the criteria or purposes of evaluation, the information necessary to evaluate the behaviour of firms for purposes other than productivity assessment is not being collected under the terms of the 1991 RIDP.

Therefore, it appears that the prevailing system of industrial incentives will not be vulnerable to evaluation in order to assess their impact on the trade performance, and the quality and quantity of the industrial investment of firms - both foreign and domestic. The data collected is simply not appropriate for such purposes.

The RIDP incentive program, which came into operation on May 1, 1991, will make payments for a maximum duration of five years. Those companies that begin to claim incentive grants, say, in December, 1993, will be eligible to receive P/O grants until the end of their financial year in 1997. However, by that time the entire policy framework for investment in general, and for regional industrial development in particular, may well have changed, rendering any current strategy obsolete. The RIDP is, after all, a regional industrial development scheme, and is therefore sensitive to variations in the industrial priorities of local planning authorities.

²¹¹. See NPI Progress Report. The NPI was contracted by the Department of Regional and Land Affairs to undertake the Productivity Monitoring System for the 1982 RIDP.

12(ii). TRANSFER OF TECHNOLOGY: INCENTIVES? POLICY?

The South African government has not made any of its incentive schemes sensitive to the transfer of technology from foreign investors, especially TNCs, into the domestic economy. Again, a policy of neutrality has been adopted which recognises with equal interest or disinterest the research and development activities of domestic- and foreign-held locally established companies alike. In other words, TNC's are not recognised as a source of technology distinct from domestic enterprises.

However, it is increasingly realised that the intellectual property rights of TNC's are subject to increasing international protection, causing new technologies to become more restricted to developing economies. ²¹² For this reason "we seem to be left with little choice but to attempt to entice those TNCs which develop technologies relevant to our growth strategy to invest in South Africa... [W]e should also encourage technically advanced TNCs to train South Africans to use new technologies, and to transfer those technologies in other ways. We should also attempt to encourage these firms to locate some of their research and development activities within South Africa." ²¹³

This conclusion has obvious implications for an export-oriented industrial development program, and as a matter of policy. Government has arrived at the realisation that manufacturers of technology-intensive products are finding it difficult to compete with existing manufactures in established markets. ²¹⁴ Many products manufactured in South Africa are subject to licensing agreements from foreign companies which restrict or preclude the exportation of those products, or which restrict the exploitation of the intellectual copyright of those products in other significant ways. ²¹⁵ For these reasons, government has emphasized that the stimulation of product innovation and product differentiation has a key role to play in ensuring the product market share of domestic industries in international markets. ²¹⁶

COSATU's Industrial Strategy Project "has found that a combination of relying upon private initiatives and the poverty of state policy has led to highly deficient technological capability." ²¹⁷ According to the Macro-economic Reserach Group, advisors to the ANC and to COSATU, South Africa's strong reliance on the acquisition of technology from abroad via license agreements manifests two important implications for policy: First, these licensing agreements are generally characterised by high levels of royalties. Second, there is little evidence that technology transfer in this respect is accompanied by training programmes to achieve affective assimilation. ²¹⁸

²¹². See "Trade Related Aspects of Intellectual Property Rights" in GATT News of the Uruguay Round of Multilateral Trade Negotiations The Draft Final Act of the Uruguay Round, Press Summary, 19 November, 1993, 21-25.

²¹³. Hirsch 1992 S.A. International 41.

²¹⁴. Speech by Dr Stef Naude, Director-General DTI, Blueprint for Posterity Conference, 8 October, 1992, 19.

²¹⁵. Approximately 80 per cent of the total value of South African industrial output is based on international licensing agreements. Moreover, about 54 per cent of this value is based on international licensing agreements which expressly restrict output for sale in the local market. However, with respect to value-added-intensive manufactures, about 59 per cent of such output is restricted on the basis of license agreements with foreign companies to the local market. Dr Gideon de Wet, Policy Studies Unit, CSIR, personal interview, 21 October, 1993; Lippert Die Bevordering van Technologiese Innovasie Deur Ontwikkelingsagente (1993) CSIR briefing paper.

²¹⁶. Naude Blueprint for Prosperity 19.

²¹⁷. MERG Making Democracy Work: A Framework for Macroeconomic Policy in South Africa (1993) 231.

²¹⁸. MERG Making Democracy Work 232.

The Department of Trade and Industry, which acts as advisor to the South African Reserve Bank in respect of exchange control approval for royalty payments in foreign currencies, makes recommendations as to acceptable royalty fees: 4% of the net ex-factory selling price for consumer goods and 6% for intermediate and final capital goods. ²¹⁹ Although, it also recommends that “[a]greements should not unduly restrict the export of licensed products,” ²²⁰ the DTI’s emphasis is thus on the cost of technology transfer. However, there is no mention of technology application or quality of transfer and diffusion of technology into the local economy. In short, there is nothing in the current government’s regulatory or policy scheme which attempts to induce the transfer of “know-why” into the domestic economy through “successful technology assimilation and learning.” ²²¹

According to the Directorate for Technology Promotion within the DTI, “technologies may either be developed locally or be imported.” ²²² This suggests that imported technology is understood to be acquired in an “unpackaged” form by domestic manufacturers. However, no recognition is accorded by government to the transnational corporation, in particular, as a source of technological innovation and technology assimilation. ²²³

It appears, in South Africa’s case, that the United Nations is correct in its observation that

“[w]hile technology regulation has been successful in improving the terms and conditions of foreign technology agreements, the promotional aspect of ensuring adequate inflows of needed technology has been given little attention in most developing countries.” ²²⁴

South Africa lacks a national policy on technology. ²²⁵ This reality has significant implications for the formulation of policy on foreign direct investment in general. The role of FDI in industrial development and its contribution to economic growth implies that the enhancement of industry’s technological capacity is a critical focus. The benefits of FDI consist in what is transferred from it into the domestic economy in terms of what the host market requires for its own development and expansion. In South Africa’s case, it is not known to what degree and how transfer of technology has taken place from existing foreign-owned firms in each industrial sector. Therefore it is not feasible at this time to conjecture whether international experience in this context is reflected in the South African case.

The focus of government on the local stimulation of technology innovation has culminated in the Support Program for Industrial Innovation (“SPII”) which is aimed at

²¹⁹ Directorate of Technology Promotion Form MP 337(b) General Information on Licence Agreements and Guidelines applied by the Department of Trade and Industry when Considering the Recommendation of Licence Agreements to the South African Reserve Bank 3.

²²⁰ DTI Form MP 337(b) 5.

²²¹ MERG Making Democracy Work 233.

²²² DTI Form MP 337(b) 1.

²²³ The United Nations Center for Transnational Corporations recognises that technology can be transferred via three distinct means: (1) the importation of products which incorporate technology; (2) licenses (when patents or trademarks are licensed); and (3) foreign direct investment by TNC’s. See UN Formulation and Implementation of Foreign Investment Policies 55.

²²⁴ UNCTC Formulation and Implementation 55.

²²⁵ I wish to thank Professor Rias Van Wyk, UCT Graduate School of Business, 14 October, 1993, for an enlightening discussion on the history of science and technology policy initiatives in South Africa. According to Professor Van Wyk, the lack of continuity in government ideological and institutional coordination since the Second World War, as well as its reliance on primary manufacturing and import substitution, has not made it possible for the emergence of a technology policy. This is especially true of a policy predicated on international sourcing strategies.

"promot[ing] local, technologically advanced and internationally competitive manufacturing industries through support for enhanced development of new innovative products and/or processes with commercial merit." ²²⁶

The SPII will grant fifty per cent of the actual direct cost incurred by a domestic firm in the development of a new product or process up to a maximum of R1 million. ²²⁷

It could be argued that the SPII encourages foreign-owned firms or affiliates of TNCs in South Africa to conduct a portion of their R&D activities in the local market. Perhaps relatively small R&D projects within a TNC will be sensitive to locate in a market that reimburses a significant portion of the cost. However, if such location decisions are taken on this basis, they will be incidental and not of great consequence to product and process innovation in each sector. Also, most TNC's have existing R&D centralisation policies which are relatively insensitive to incentives of host governments. ²²⁸

However, one of the SPII's primary objectives is to encourage the development of local products and processes in order to increase their export competitiveness. This suggests that the SPII, by design, has little or no bearing on FDI. This evidences that even the most liberal incentive scheme for R&D in South Africa totally ignores the augmentation of existing R&D capabilities with those ownership advantages existing within global companies.

It is fair to state that little to no effort has been expended, at national level, to define the limits of existing capacities in each industrial sector. It is remarkable that at least 80 per cent of total industrial output in South Africa is created on the basis of licensing agreements between local producers and companies based abroad. ²²⁹ This may indicate that existing capacities for product and process innovation, discounting licensing agreement-based technology, are rather limited.

- ◆ It is obvious that this area requires intensive further research in order to fashion a policy which will balance domestic capacities with those of TNCs at appropriate levels for increasing both the rate and quality of growth.

^{226.} IDC Support Program for Industrial Innovation: Application Manual, August 1993, 1. The SPII is administered by the IDC, but the DTI itself has responsibility of the approval process and is the source of incentive funds.

^{227.} SPII Application Manual 1-2.

^{228.} See Newfarmer "Multinationals and Marketplace Magic in the 1980s" in Frieden and Lake (eds) *International Political Economy* (1991) 192-201.

^{229.} Dr Gideon De Wet, CSIR, personal interview, 21 October, 1993.

12(III). AN FDI INCENTIVE POLICY

The Long Term Working Group of the National Economic Forum has already presented its views on investment incentives for a democratic South Africa. ²³⁰ The approach taken by the NEF, at least as it has been publically presented, can be divided into eight components, as follows:

- ❑ The national treatment principle must be followed in respect of tax rates for foreign and domestic enterprises;
- ❑ Instead of discriminatory tax rates applied to foreign enterprises, corporate tax rates must be reasonably low and stable;
- ❑ The national treatment principle must be followed in respect of labour legislation as it applies to foreign and domestic enterprises;
- ❑ During the transition period foreign investors must be provided with assurances on: security of investment, foreign exchange policy, and the minimisation of of bureaucratic obstacles to foreign investment;
- ❑ A diverse range of incentives must be "developed in terms of a coherent industrial restructuring programme;"
- ❑ The national treatment principle must be followed in making such incentives available to both foreign and domestic investors;
- ❑ Trade policy must be designed so as to obtain optimal access to foreign markets in order to attract export-oriented foreign and domestic investors; and
- ❑ Instead of sacrificing tax revenues that could be used for expenditures on social and economic infrastructure, government policy should be focussed on economic growth and political stability.

In its more detailed policy explanation on FDI, the NEF states that the

"principle of equal national treatment is considered fundamentally important...Special incentives applicable only to potential foreign investors should not be implemented." ²³¹

Furthermore, no special tax incentives should be introduced ²³² and no special exemption from domestic labour legislation should be offered. ²³³

This approach is predicated on two factors. First, it is recognised that such incentives "only influence TNC locational decisions when the different locations under consideration are roughly equal in terms of other criteria." ²³⁴ Secondly, special concessions may attract TNC, which do not have a significant commitment to the development aims of the host country. ²³⁵ The character of this approach is clearly defined, and its driving principles are easily discernable. The

²³⁰. Report of the National Economic Forum Long Term Working Group (LTWG) to the NEF Plenary, 5 July, 1993, at 4.

²³¹. NEF Addendum 1, "An Agreed Framework in Relation to Foreign Direct Investment" 6.

²³². *ibid.*, at 6-7.

²³³. NEF Addendum 1, 7.

²³⁴. NEF Addendum 1, 7.

²³⁵. NEF Addendum 1, 7.

national treatment principle remains intact, without derogation. In short, tax incentives should not be made available, and no exemption should be made to applicable labour legislation.

The application of the national treatment principle without exception appears to be predicated on the view that incentives which are designed merely to increase the quantity of FDI into South Africa will achieve little toward the realisation of South Africa's developmental objectives. ²³⁶ It is ventured here that the NEF Long Term Working Group's agreement is too rigid a position to support changes in the economic and policy environment of FDI. Also, its position assumes that all incentives are or will be administered without ensuring that the enterprises receiving such incentives will not be monitored and assessed in terms of their economic performance. It has been already suggested in this document that no incentive system should be implemented without the proper mechanisms in place which will monitor the performance of the companies receiving them and to ensure that the objectives for which the incentives were designed are satisfied.

The Long Term Working Group's position also assumes that incentives will be administered merely to increase the quantity of FDI flows to South Africa and will thus not affect the quality of such investment.

- ◆ In this respect, the policy recommendation made by the UNCTC is that "[i]ncreasing investment should not be the goal of an incentive system. Achieving the country's development goals should be." ²³⁷

However, this recommendation directs attention to the nature of the incentive scheme adopted. It does not imply that an incentive scheme which favours foreign investors should not be adopted. The Long Term Working Group is misled by believing that incentives which favour foreign investors will render such incentives useless or of reduced value in respect of the development goals of South Africa. On the contrary, the utility of fiscal incentives may depend on their application, the effect of which might be to favour technology-rich foreign-owned multinationals - as part of a strategy of firm-specific promotion.

- ◆ For the foregoing reasons, and despite the strong interests of business, the Long Term Working Group's position on incentives should be reconsidered and revised.

A few comments on the law of the national treatment principle are also in order. The principle of national treatment is derived from traditional international law. A sovereign State must accord equal treatment to aliens and nationals under domestic laws. This principle arose from the nineteenth century view that host States must display "fair and equitable" treatment in its conduct toward aliens. ²³⁸ This principle is known as the law of State responsibility. ²³⁹

The law of State responsibility constitutes a *minimum* standard of sovereign behaviour toward aliens and their property, and is directed to discriminatory State practice which harms alien economic interests. However, although the general principle of national treatment is entrenched in

²³⁶. NEF Addendum 1, 7-8; Alan Hirsch, *How to Attract Foreign Investment: MERG/COSATU Background paper for the National Economic Forum Long Term Working Group* (undated), at 8-9.

²³⁷. *UN Formulation and Implementation of Foreign Investment Policies* 53.

²³⁸. See Asante "International Law and Foreign Investment: A Reappraisal" 37(3) 1988 *International and Comparative Law Quarterly* 588 590.

²³⁹. Asante 1988 *ICLQ* 590.

international law, it is not applicable to cases where aliens or foreigners and their property are *favoured* by the host country.

There is no principle in either traditional international law or contemporary customary international law which prohibits States from treating foreign interests more favourably than domestic interests. Therefore, the national treatment principle applied to investment incentive policy is not governed by standards found in international law, but rather it is purely a creature of ideological preference. Favoursing foreigners by way of incentives may be interpreted as the disfavouring of nationals and therefore may provoke local vested interests to react against the prevailing government, perhaps with threats of non-support in the elections or in some other tacit way. This may be the actual reason for underplaying the notion of favouring foreign investors in current policy formulation. In the case of South Africa's NEF, the strength of business' representation ensured that the Long Term Working Group's Agreed Framework contain a rigid negation of incentives which favour foreign interests. ²⁴⁰

Surveys and other evidence indicate that FDI flows are weakly sensitive to tax and other incentives. ²⁴¹ The great variety of incentives offered by developing countries to attract FDI has been largely ineffective in achieving FDI flow target levels. ²⁴² However, these conclusions are not determinative since the role of incentives in the investment location decision-making process is usually tailored to satisfy a specific set of objectives. In this regard, it has been stated by one commentator that

"[t]he main reason for th[e] divergence between [investment level] targets and the results of incentive schemes is that the incentives provided by the developing countries are generally accompanied by a host of disincentives such as restrictions on ownership, size, location... mandatory provisions for purchases as well as exports, so that a likely positive effect of the incentives is cancelled out by a negative effect of the disincentives." ²⁴³

Another reason for the failure of investment incentives to attract FDI is the fact that incentives alone are not effective. ²⁴⁴ They constitute only one short-term locational advantage and should not thus be viewed as a substitute for developed infrastructure, efficient government or overly restrictive and repressive laws.

◆ In other words, investment incentives should be used only to augment existing locational advantages.

It has also been concluded that at the initial stages of the foreign investment decision, investment incentives, and especially tax incentives, are not at all considered by firms. ²⁴⁵ However, it is suggested that although total FDI flows are insignificantly affected by incentive schemes offered by developing countries, they may very well influence the relative distribution of the

^{240.} This observation was made by someone familiar with NEF negotiations. However, the individual concerned does not want to be named.

^{241.} UN The Determinants of Foreign Direct Investment 60.

^{242.} see Agarwal "Determinants of Foreign Direct Investment: A Survey" 116(4) 1980 Weltwirtschaftliches Archiv 738 762.

^{243.} Agarwal 1980 Weltwirtschaftliches Archiv 762.

^{244.} See, in relation to African investment incentives, "Foreign Investment: Africa's new Famine" 6(9) October 1993 Southern African Economist 3.

^{245.} Agarwal 1980 Weltwirtschaftliches Archiv 761, recalling the classic study undertaken by Aharoni The Foreign Investment Decision Process 1966.

flows among them. ²⁴⁶ This conclusion is supported by other evidence which indicates that although other determinants of FDI may be more significant to the investment decision-process, a company which has reached a point of deciding to invest in one of a small number of very similar countries will be influenced, at that margin, by incentives to invest in one particular location, all other criteria remaining equal. ²⁴⁷

246. Argawal 1980 Weltwirtschaftliches Archiv 762.

247. UN The Determinants of Foreign Direct Investment 60.

13. EXCHANGE CONTROL AND THE FINANCIAL RAND

The subject of exchange control and the remittance of investment-related funds to the investor's home country are important considerations to any foreign investor. ²⁴⁸ South Africa possesses an exchange control regime. Indeed, South Africa has an established tradition of exchange control dating back to 1939, which was introduced through the Emergency Finance Regulations. ²⁴⁹ These regulations sought to curb the excessive capital flight from South Africa when the United Kingdom was forced off the gold standard and the South African government refused to follow the same course. Naturally, people preferred to hold sterling until parity would be restored and profits followed. ²⁵⁰

Because of a sudden deterioration in the capital account of the balance of payments during 1961, after the Sharpeville riots, the South African Reserve Bank ("SARB") blocked the repatriation of the proceeds of non-resident owned securities,²⁵¹ in order to safeguard the level of its foreign reserves. As a result, a second exchange rate developed for the rand, its level determined by the supply of and demand for the blocked balances traded between non-residents, at prices set in terms of foreign currency. ²⁵² This second exchange rate later became known as the financial rand.

Because financial rand movements take place within a blocked market, external to the commercial rand market, a rise in investment confidence in South African assets has the effect of decreasing the amount of the discount. The pool of financial rand thus never leaves South Africa, and the sale and purchases within that pool have no direct effect on the capital account of South Africa's balance of payments. This is, after all, one of the major objectives in employing the dual exchange rate system. ²⁵³

The legislative basis for prevailing exchange control regulation is the Currency and Exchanges Act 9 of 1933, as amended (the "Currency Act"). However, the Currency Act reveals nothing of the substance of currency exchange governance. Rather, it vests in the "Governor-General" of the Union of South Africa, the power to

"make regulations in regard to any matter directly or indirectly relating to or affecting or having any bearing upon currency, banking or exchanges." ²⁵⁴

²⁴⁸. I wish to thank Professor Brian Kahn, Department of Economics, UCT, for his helpful comments and suggestions. The literature and thus informed debate on exchange control regulation in South Africa is relatively undeveloped. For this reason, much reliance is placed upon Kahn; *Capital Flight and Exchange Control in South Africa*; Research Paper No.4 (July, 1992) Centre for the Study of the South African Economy and International Finance, LSE.

²⁴⁹ Moss-Morris Mendelow Browde Inc *Exchange Control Service* (2nd issue, May, 1993) [Exchange Control Service], containing SARB Exchange Control Manual [Exchange Control Manual], 7-13.

²⁵⁰. Chaplin "The Basis of Exchange Control Blocked Rand, Commercial Rand and the Financial Rand" Nov. 1987 *De Rebus* 623.

²⁵¹. SARB Exchange Control Manual 7-13.

²⁵². SARB Exchange Control Manual 7-13.

²⁵³. The SARB has clearly expressed its policy approach to exchange control, stating that the primary purpose of exchange control is, *inter alia*, "to prevent the loss of foreign currency resources through the transfer abroad of real or financial capital assets held in South Africa" and to prevent an undue depreciation of the commercial rand and thereby to seriously increase the domestic rate of inflation and therefore to limit a further deterioration of the domestic economy. SARB Exchange Control Manual 7-25.

²⁵⁴. *Currency and Exchanges Act 9 of 1933, as amended, s 9(1)*.

The State President has the power to suspend the Act itself or any part of it or any other Act of Parliament which relates in any way to currency, banking or exchanges. ²⁵⁵ Also, any Act or law which comes into conflict with the Currency and Exchanges Act is deemed suspended to the degree to which it is in conflict. ²⁵⁶

Section 9 of the Currency Act is, therefore, merely enabling legislation, allowing the State President to make regulations. The current Exchange Control Regulations, were promulgated in 1961, in terms of s 9. ²⁵⁷ These regulations have since been amended, the amendments have themselves been subject to numerous amendments over the years and Orders and Rules have also been issued from time to time in terms of these regulations.

Whatever the character of exchange control regulation may be in South Africa, the foreign investor is mandated to understand it if he wishes to acquire an interest in South African assets. A primary exchange control issue which arises in the initial stages of the investment process is the classification of investment currency which the investor is able to export to South Africa. This is an important consideration because the prevailing foreign exchange system in South Africa is a dual one, each medium having its defined uses.

There exist no internal restrictions on the importation of foreign capital to South Africa. Indeed, as it is widely understood, South Africa's dual exchange-rate system is designed to advantage only foreign investors in South African assets. The effective advantage of the financial rand to foreign investors lies in the discount at which the financial rand trades relative to the rate of the commercial rand - the discount averaging about 30 per cent, ²⁵⁸ but appears to be declining. However, whether the discount has been *effective* in encouraging foreign direct investment into South Africa is "open to question." ²⁵⁹

As far as inward direct foreign investments are concerned, the financial rand may be used for acquiring unquoted securities and industrial and commercial property with Exchange Control approval. ²⁶⁰ The use of the financial rand is restricted in terms of Regulation 14A by the Treasury of the SARB, or anyone authorised by the Treasury. ²⁶¹ Accordingly, the financial rand is defined as "the local proceeds of South African assets owned by persons resident outside the Republic," or as funds designated as such by the Treasury or its authorised agent. ²⁶²

The SARB has placed certain restrictions on the utilisation of the financial rand. The financial rand will not be allowed, for example, for purposes of direct investment into a close corporation, trust or partnership, investment as loan capital, preference shares or debentures, feasibility

²⁵⁵. Currency and Exchanges Act 9 of 1933, as amended, s 9(3).

²⁵⁶. Currency and Exchanges Act 9 of 1933, as amended, s 9(3).

²⁵⁷. Government Gazette Extraordinary No 123, R111, 1 December, 1961.

²⁵⁸. See PLI Industrial Targeting Study for Regions A and E of South Africa Executive Summary, February, 1993. Prototype investment project evaluation studies conclude that when the financial rand's discount of 30 per cent is factored into investment flows, the profitability index/equity ratio increases dramatically, increasing South Africa's overall competitiveness in this regard across the industrial sector spectrum.

²⁵⁹. Itzikowitz "Exchange Control: The Financial Rand Regime" 107(11) SALJ 332, 334.

²⁶⁰. SARB Exchange Control Manual 7-81.

²⁶¹. See Regulation 14A(1) and (2), SARB Exchange Control Manual 2-24.

²⁶². SARB Exchange Control Manual 7-81.

studies and prospecting costs, farming property, residential properties, share-dealing companies, funding of working capital or current assets or funding of intangible assets. ²⁶³ Also, the industrial and commercial property investments allowed with the financial rand are subject to the condition that the properties be registered in the name of a South African "registered and incorporated" company. ²⁶⁴

The condition of registration and incorporation appears to mean, for instance, that an "external company," established in terms of the Companies Act, ²⁶⁵ is not entitled to acquire approved assets in the medium of the financial rand even though it is considered by the Companies Act to be a body corporate within the Republic of South Africa. It seems therefore that share certificates, evidencing the existence and nature of a concern and their entitled shareholders, allow the Treasury to evaluate and to control funds utilised in their acquisition while other forms of commercial enterprises do not facilitate this. ²⁶⁶

Investments into existing companies or into companies yet to be established through the financial rand require prior approval of the Exchange Control department of the SARB. ²⁶⁷ Certain restrictions apply to such financial rand approvals, specifically to new investments made by non-resident wholly-owned entities in South Africa. Four restrictions in this regard apply: ²⁶⁸

- ★ The ratio of share capital and share premium to the value of the company's fixed assets must be about one-to-one;
- ★ Exchange Control will not approve financial rand investments in company working capital;
- ★ Exchange control will consider an application for the introduction of loan funds through the commercial rand, and favourable consideration will be given to applications in which the ratio of loan capital to equity capital is about 1:3; and
- ★ In cases where shares in an existing company are been acquired, exchange control approval will be given to financial rand usage to the value of fixed capital assets, subject to the appropriate valuation certificate, but current assets and intangibles (for eg goodwill) can be funded only with the commercial rand.

The SARB is clear in its policy supporting the utilisation of the financial rand for direct foreign investments in fixed equity. It asserts that while loan finance is repayable at the expiration of a fixed period, equity investments, on the other hand, have indeterminate life-spans and thus the latter upon disinvestment via the financial rand will no disturb the balance of payments. ²⁶⁹

^{263.} SARB Exchange Control Manual 7-81.

^{264.} SARB Exchange Control Manual 7-81.

^{265.} For definition of "external company" see Companies Act 61 of 1973, s 1.

^{266.} Nedbank, International Division, Cape Town 1 September, 1993.

^{267.} SARB Exchange Control Manual 7-83. This provision applies to all foreign investments in non-quoted securities.

^{268.} SARB Exchange Control Manual 7-83.

^{269.} SARB Exchange Control Manual 7-84.

In light of South Africa's current developmental objectives, the SARB will give preference to investments through the financial rand if such investment will result in the expansion of manufacturing capacity, the promotion of exports, import replacement, labour-intensive industry, the development of strategic industries and the introduction of new or improved technology. ²⁷⁰

An issue which may arise after an investor has made the decision to invest in a company (either existing or to be formed) or to establish a branch operation in South Africa is whether the local company or branch company may borrow from a South African bank. The rules relating to domestic financial assistance to foreign investment enterprises are expressed in Exchange Control Regulations 3(1)(e) and 3(1)(f). ²⁷¹ They state:

"3(1) Subject to any exemption which may be granted by the Treasury or a person authorised to the Treasury, no person shall, without permission granted to the Treasury and in accordance with such conditions as the Treasury or such authorised person may impose: [emphasis added]

(e) grant any financial assistance to any person in the Republic, where as security for such financial assistance, the person granting the financial assistance in turn relies on any security, guarantee, undertaking or financial assistance, directly or indirectly furnished by:

(i) any person resident outside the Republic; or

(ii) an affected person;

(f) grant any financial assistance to any person in the Republic, where such person:

(i) is not resident in the Republic; or

(ii) is an affected person."

The term "affected person" is defined as:

"a body corporate, foundation, trust or partnership operating in the Republic, or an estate, in respect of which:

(i) 25 per cent or more of the capital, assets or earnings thereof may be utilised for payment to, or to the benefit in any manner of, any person who is not resident in the Republic; or

(ii) 25 per cent or more of the voting securities, voting power, power of control, capital, assets or earnings thereof, are directly or indirectly vested in, or controlled by or on behalf of, any person who is not resident in the Republic." ²⁷²

The Exchange Control Manual defines a "non-resident" as any person who is resident outside of the Common Monetary Area. ²⁷³ The phrase "financial assistance" means any financial concession, including, inter alia, money lending, credit facilities, discounting, factoring and hire purchase sales. ²⁷⁴

²⁷⁰. SARB Exchange Control Manual 7-84.

²⁷¹. Regulations 3(1)(e) and 3(1)(f) were amended by Government Notice No R357 GG 7415, 20 February, 1981.

²⁷². 1 GN R111 GG 123 of 1 December 1961, inserted by GN R357 GG 7415 of 20 February, 1981.

²⁷³. SARB Exchange Control Manual 7-76.

²⁷⁴. SARB Exchange Control Manual 7-76.

Regulations 3(1)(e) and 3(1)(f) apply to situations in which a non-resident controlled entity operating in South Africa receives a guarantee from the non-resident shareholder or affected person. Regulation 3(1)(e) also applies to situations where a domestically controlled entity receives a guarantee from a non-resident or affected person. **275**

After it is established to whom exchange control approval for local financial assistance applies, the following issue to arise is to what extent the non-resident or affected person can borrow locally. **276** The general rule is that any non-resident wholly-owned subsidiaries may borrow locally up to a maximum of 50 per cent of total shareholders' investment, or of its "effective capital" or "borrowing base." **277** The greater local equity participation in the venture, the more expansive is the venture's possible extent of local borrowing. This principle is incorporated in a formula which is used to calculate the maximum permitted "local financing ratio" as follows: **278**

$$\frac{50\% + (\% \text{ South African interest} \times 50\%)}{(\% \text{ Non-resident interest})}$$

Therefore, a local interest of 50 per cent or more in the entity will allow it to borrow locally up to 100 per cent of total shareholders' equity in the venture. However, any local entity defined as an "affected person" (that is, with 25 per cent or more of its control or capital vested in a non-resident) must still receive Exchange Control approval for any local borrowing it may wish to make.

The maximum local financing ratio can be extended with special approval and for a limited period if a company's operations would, with such extended borrowing facilities, increase employment, result in the development of export capacity, serve to reduce imports, be in the national interest or make further foreign investment possible. **279**

After a foreign investor has made his investment in South Africa, he may well decide to disinvest and remit the proceeds of the sale of his local interest, or merely to remit the dividend yield on his investment to an account outside of the Common Monetary Area. The two issues which then arise are whether, or to what degree, the disinvested or dividend proceeds can be remitted, and via which particular currency medium must such remittance take place.

The rule in regard to currency remittance is two-fold. First, the sale proceeds of non-resident owned South African assets which were acquired through the financial rand medium "are subject to the financial rand procedure." **280** This means that remittance of sale proceeds can take place only through the financial rand. Again, the use of the sale proceeds, mentioned above, for any purpose is subject to exchange control approval. **281** One of these uses could be remittance

275. SARB Exchange Control Manual 7-76.

276. It should be noted, for the sake of clarity, that local borrowing is one specie of "financial assistance" as defined supra, and there the following discussion does not touch upon the other variations of financial assistance noted above.

277. SARB Exchange Control Manual 7-82 defines the total shareholders' investment as (i) paid-up equity capital, (ii) preference shares, (iii) undistributed earned profits, (iv) shareholders' loans from abroad and (v) in certain circumstances shareholders' trade credit.

278. SARB Exchange Control Manual 7-76.

279. SARB Exchange Control Manual 7-78.

280. SARB Exchange Control Manual 7-82.

281. SARB Exchange Control Manual 7-82.

and therefore approval must be received for such activity. However, because the SARB has adopted an overriding policy of freedom of remittance, approval in this regard is automatic. However, Regulations 22A to 22D ²⁸² allow the Treasury, upon the advice of the Minister of Finance, to attach, block, forfeit and dispose of, and recover any money or goods which are believed to have been subject to exchange control contravention.

Second, the non-resident may desire to remit only the dividends which he receives from his South African investment. In this case, Exchange Control will only approve the remittance of "recent profits" through the commercial rand medium. However, "[i]n no circumstances will Exchange Control allow the transfer of dividends to be financed by the payment received from the South African purchaser." ²⁸³ Clearly then, the rule against the remittance of sale proceeds through the commercial rand is well-entrenched. Although the term "dividends" is not defined by the Exchange Control Manual, or in the Regulations, Orders and Rules, it is well established in the commercial laws of both England and South Africa that dividends may not be paid out of capital, but rather that they be paid out of profits only. ²⁸⁴

13(I). EXCHANGE CONTROL: A CRITIQUE

From the point of view of policy, two questions are becoming increasingly important to answer.

First, does South Africa's current exchange control regime achieve the objective of "avoid[ing] undue pressure on the country's gold and foreign exchange reserves and an undue depreciation of the exchange rate of the rand," as the SARB has asserted? ²⁸⁵ Second, does the financial rand act, in the final analysis, to increase levels of foreign direct investment in South Africa?

- ◆ The mere complexity and intransparency of exchange control regulation has probably scared off a significant number of small to medium sized foreign investors wishing to retain flexible and free control over their equity throughout the investment process. ²⁸⁶ The development and nature of exchange control has prompted one prominent lawyer to remark that exchange control regulation in South Africa,

"is a body of law which is often most difficult and time consuming to extract and find. It invites the criticism that it violates the requirement of natural justice which legislation is supposed to satisfy - that laws should be known before they are enforced, which in turn, presupposes that the laws are readily accessible and discernable." ²⁸⁷

²⁸². Exchange Control Regulations GN R1111 GG 123 of 1 December 1961, as amended by GN 957 GG 10730 of 4 May, 1987.

²⁸³. SARB Exchange Control Manual 7-79/80.

²⁸⁴. See Pretorius et al *Hahlo's South African Company Law Through the Cases* (5th ed) 1991 566; see for instance, *Cohen v Segal* 1970 (3) SA 702 (W) ("a dividend cannot be declared which has the effect of diverting a portion of the corpus of the company to the shareholders. A dividend may thus, generally speaking, only be declared out of profits, and a resolution which declares a dividend to be paid out of the capital of the company is ultra vires the company." at 706, quoted in Pretorius et al, *supra*.)

²⁸⁵. SARB Exchange Control Manual 7-24.

²⁸⁶. Mr Kevin Lings, Nedbank Economic Unit, telephonic interview, 6 September, 1993.

²⁸⁷. Mr A. Tugendhaft, preface, *Moss-Morris Mendelow Browde Inc Exchange Control Service*. From a moralistic point of view, another writer has stated that exchange control regulations in South Africa: "are laws which profoundly affect basic human freedom, namely the right of the citizen to deal with that which is his own. Yet they are laws of which lawyers know little. Because [exchange control regulations are amended by circulars issued from time to time to authorised dealers by the SARB] and the fact that members of the public do not have direct access to the Reserve Bank, the regulations remain a dark mystery to most people outside the banking sector." Chaplin 1987 *De Rebus* 623.

Also, the time lag of exchange control approval presently averages about three months. ²⁸⁸ This delay factor substantially slows down the investment process because approval is mandated at each major phase of financial rand utilisation.

- ◆ A major policy consideration upon which exchange control in South Africa is predicated is its supplementary role in stabilising the capital account of the balance of payments. It is suggested that exchange control is a necessary artificial instrument because not all capital movements can be effectively influenced or controlled by market-related measures. ²⁸⁹ Thus, the rationale of exchange control as an instrument of policy in this context is explained by the vulnerability of the capital account of the balance of payments to depletionary shocks caused by sudden decreases in investment confidence in the South African economy. Exchange control, therefore, has as one of its primary aims the reduction in demand for foreign exchange.

Notwithstanding exchange control, it is well settled that South Africa's net gold and foreign reserves have declined from R1,042 billion in 1986 to R2,272 billion in 1992. ²⁹⁰ Gross gold and other foreign reserves have increased from R5,725 billion in 1986 to R11,205 billion in 1992. ²⁹¹ In spite of exchange controls, total capital flight over the period 1970-1985 appears to have exceeded US\$30 billion! ²⁹² However, even in light of these statistics, it is not economically possible to quantify the degree to which exchange control regulation has either encouraged or discouraged net capital outflows in general and inward foreign direct investment in particular. ²⁹³

The phenomenon of capital flight is central to exchange control policy. Capital flight could be defined as "an insurance against risk of future taxation or expropriation." ²⁹⁴ The net outflow of capital adversely impacts upon foreign exchange reserve levels because foreign currencies finance a great deal of capital outflow. This means that capital flight also imposes serious constraints on economic growth because economic growth depends, in turn, upon the availability of capital or "savings." And in order to bring about political instability, sufficient economic growth must be sustained. ²⁹⁵ There is obviously an inverse relationship between capital flight, economic growth and political stability - the latter two phenomena constituting the conditions necessary for attracting net inflows of FDI. Exchange control is supposed, therefore, to stimulate FDI in the long term.

The availability of sufficient foreign reserves for the servicing of external debt and the availability of savings for purposes of economic growth in general are considerations that exchange control policy endeavours to address. However, these factors should not be thought about in *vacuo*, that is, out of the context of South Africa's overall economic reality. In other words, it would be

²⁸⁸. Mr Kevin Lings, Nedbank Economic Unit, telephonic interview, 6 September, 1993.

²⁸⁹. SARB Exchange Control Regulations 7-26.

²⁹⁰. SARB Quarterly Bulletin 188 June 1993, S-85.

²⁹¹. SARB Quarterly Bulletin June 1993, S-85.

²⁹². About US\$20 billion seems to have left South Africa over the period 1970-1985 through misinvoicing in trade with its major trading partners. Kahn Capital Flight 7.

²⁹³. As far as the ANC is concerned, the financial rand (a primary exchange control instrumentality) has not had a positive historical impact on South African foreign exchange reserve levels. See Steyn & Barber "ANC Joins FW in Call to Kill Finrand" Business Day 27 September, 1993, 1.

²⁹⁴. Kahn Capital Flight 12.

²⁹⁵. Kahn Capital Flight 15.

foolish to argue that the viability of exchange control rests merely on concerns of a purely macro-economic character.

To the extent that the existence of exchange control raises the cost of illegal capital outflows, exchange control may be effective in stemming leakages or delaying leakages which are bound to occur. ²⁹⁶ The issue therefore remains to what degree capital outflow would have exceeded past levels had there been no exchange control mechanism. Conjecture in this regard brings one no closer to an optimal policy.

The fact that the remittance of sale proceeds must take place via the financial rand erodes its appeal as an investment medium. The reason this is so is that the value of the financial rand is influenced directly by the level of investment confidence which the political environment in South Africa generates. ²⁹⁷ In other words, because of the extremely limited degree of SARB intervention in the financial rand market, the supply and demand functions of investment have a direct impact on the value of the financial rand vis-a-vis other currency denominations.

Therefore, the timing of investment and disinvestment is crucial. For instance, if political events in South Africa were to reduce investment confidence, the margin of discount of the financial rand relative to the commercial rand will grow. This means that the gains from exiting the market via the financial rand are reduced or neutralised because the investor is able to exit with the investment corpus only via the financial rand. This means that a fall in investment confidence - a fair reason for wanting to disinvest - will act as a break on an independent market-related commercial decision. On the other hand however, FDI is viewed as inherently long-term and therefore although the remittance of capital is vulnerable to fluctuating exchange rates, short-term profit remittance through the commercial rand is of greater significance. ²⁹⁸

In light of the existence of market barriers to capital remittance, the issue of transfer pricing is no doubt current in South Africa. ²⁹⁹ It has been contended that misinvoicing of trade has been the primary avenue for exchange control evasion in South Africa. Although the underinvoicing of exports far exceeds the overinvoicing of exports in South Africa, there appears to be a steadily increasing trend since 1982 of positive import overinvoicing. ³⁰⁰ International experience suggests that overpricing of intra-firm exports to affiliates in certain countries and in particular sectors amounts to significant outflows of capital, especially when capital repatriation is inhibited. ³⁰¹

- ◆ Further research should reveal the nature and extent of transfer-pricing practices among domestic affiliates of TNCs.

Obviously, South Africa's relatively high tax rate as well as its exchange control restrictions on capital remittance (i.e. via the financial rand) will have an impact on transfer pricing strategies. However, it suffices to say that administrative mechanisms other than exchange control should

²⁹⁶. Kahn Capital Flight 18.

²⁹⁷ Mr Edward Osborn, Chief Economist, Nedbank Ltd, telephonic conference, 6 September, 1993.

²⁹⁸. Kahn Capital Flight 19.

²⁹⁹. See Kahn Capital Flight 9.

³⁰⁰. Kahn Capital Flight 8 (Table 2).

³⁰¹. See for instance, Plasschaert *Transfer Pricing and Multinational Corporations: An Overview of Concepts, Mechanisms and Regulations* (1980) 63; Newfarmer in *International Political Economy* (1991) 202-203: The Greek government, for instance has found that foreign subsidiaries on average paid 20% above world market prices on metallurgical imports and 25,7% for chemical imports.

be employed to inhibit capital flight. Exchange control appears merely to delay the outflow of capital but does not prevent its exit in the final analysis. Low domestic investor confidence as well as the internal financial policies of TNC's both pressure the outflow of capital through the pores of exchange control regulation.

In terms of general policy, the remittance of investment earnings, corporate dividends, and proceeds from the sale of an investment in the host country are factors usually construed as entry signals of one sort or another. Whether or not funds can be freely removed from the host country will, in the first place, signal whether the host country is experiencing balance of payments problems. One writer, for instance, has commented that "[t]he higher per capita income, and the lower the balance of payments deficit, the more foreign direct investment is attracted." ³⁰² This suggests that the mere existence of exchange control limitations on the free movement of capital will, at least in theory, act as a disincentive to investment.

- ◆ Therefore, any regulation which restricts or intervenes with the remittance of funds from the host country ³⁰³ will signal to the foreign investor that the particular host government has chosen to redress a deficit in its balance of payments at his expense, or has transferred onto him the burden of remedying the ills besetting the local economy. Such restrictions may also reflect that a positive outflow of capital from the host country has been caused by a general lack of confidence in the political and economic health of the host economy. In this regard, it has been generally concluded from a policy point of view that

"[a]s a distinctive gesture, both valuable in practical terms and as an amelioration of a specific form of environmental uncertainty of notable concern to transnational corporations, developing countries could undertake to give priority to limiting foreign exchange controls applicable to their activity." ³⁰⁴

³⁰² Schneider & Frey "Economic and Political Determinants of Foreign Direct Investment" 13(2) 1985 *World Development* 161 173.

³⁰³ Again, it should be noted that in South Africa capital remittance is not restricted per se but is subject to a fluctuating exchange rate. This makes capital transfers vulnerable to devaluation, loading investment capital with expectations of greater returns in the form of dividends.

³⁰⁴ UN *The Determinants of Foreign Direct Investment* 61; See also Faber "Governance of The Foreign Direct Investor" 24(1) 1993 *IDS Bulletin* 51.

14. THE PROTECTION OF FDI: EXPROPRIATION AND COMPENSATION LAW IN SOUTH AFRICA

The phenomenon of expropriation in South Africa has not, at least since the Second World War, had a bearing on foreign interests. However, the expropriation or nationalisation of private interests under a future dispensation in South Africa is a consideration of relatively recent vintage, born from and nourished by recent pronouncements of trade unions and incumbent political leaders alike. Whether or to what degree the expropriation or nationalisation of private property rights - as a distinctive instrument of economic and social policy - has been displaced by more friendly alternatives is an issue not explored here. The reason for not examining this issue here is that from a legal point of view it is of little importance. Rather the legal focus in this context is on the right and nature of redress which the divested party has claim to. In this respect, it has noted that:

"[i]f nationalization is pursued in South Africa by a democratic government operating under a Bill of Rights constraints, a key issue for adjudication will be the determination of an acceptable measure and mode of compensation for any interferences with vested property rights." ³⁰⁵

South Africa does have in place legislation and a well-developed case law which governs expropriation and the subject of compensation, albeit with a rather narrow focus. Since 1965, the South African parliament has passed two successive expropriations Acts. The first one, the Expropriation Act 55 of 1965 was amended on three occasions, and the second one, which replaced it - the Expropriation Act 63 of 1975 now in force - has been amended fifteen times! ³⁰⁶ This should serve as some indication that South Africa's legislature has been rather preoccupied in recent history with the subject of expropriation. ³⁰⁷

The scope of the current Act is narrow. Section 2(1) states that:

"the Minister may, subject to an obligation to pay compensation, expropriate any property for public purposes or take the right to use temporarily any property for public purposes."

The Minister referred to is the "minister responsible for the administration of works and land affairs" and generally includes the executive committee of a Provincial Government. ³⁰⁸ The term "any property" means immovable as well as movable property, ³⁰⁹ that is, it includes both real and personal property rights.

³⁰⁵ Murphy "Compensation for Nationalization in International Law" 110(1) 1993 SALJ 79.

³⁰⁶ Jacobs *The Law of Expropriation in South Africa* 1992, ix; *Statutes of the Republic of South Africa Expropriation Act No. 63 of 1975, as amended.*

³⁰⁷ It should be stressed that South Africa's historical administrative preoccupation with expropriation has centered on the expropriation of immovable property in the context of a "separate development" policy. In other words, expropriation in South Africa has affected local interests rather than those of foreigners. See, for instance, the Black (Urban Areas) Consolidation Act 25 of 1945, Community Development Act 3 of 1966, and the Housing Act 4 of 1966, all repealed by the Abolition of Racially Based Land Measures Act 108 of 1991. However, there is no indication that South Africa has purposefully used either its police powers of eminent domain or its authority of national sovereignty to expropriate or nationalise foreign-owned assets within its territory.

³⁰⁸ Expropriation Act 63 of 1975, as amended, s 1.

³⁰⁹ Expropriation Act 63 of 1975, as amended, s 1.

The issue arises immediately whether any other agency of government may expropriate property besides the Minister and executive committee referred to, without the payment of compensation on the basis described in the Act. The Act mandates that if the Minister responsible for the administration of works and land affairs or the executive committee of a provincial council does the expropriating, compensation ³¹⁰ must be paid to the entity divested of his property, in accordance with the minimum standards of compensation set out in the Expropriation Act.

However, this means that if a local authority, some other governmental authority or parliament itself were to be the expropriating authority, ³¹¹ and if the statute or ordinance expressly denies the divested party compensation, or sets compensation at some inadequate maximum, no right to compensation or to a higher quantum will prevail. However, there appears to be a strong, but by no means settled, presumption in South Africa's municipal law that where the issue of compensation is not expressly dealt with by the expropriation statute or ordinance, the common law will impute to the divested party the right to compensation. ³¹²

With regard to the time of payment of compensation, the Act states explicitly that the Minister has full discretion whether to pay the compensation amount offered prior to, at the time of or at any time after its determination. ³¹³ In effect, the Minister referred to determines the time of payment, and the divested party is not therefore accorded the right of "prompt" compensation. Also, no time-frame for compensation appears to be suggested by the common law.

From the point of view of the foreign investor, the Expropriation Act is comforting as it represents one category of situations in which the government is bound to compensate the divested party on the basis of a relatively liberal standard. In the case of immovable property, the standard is in effect the "market value" plus the solatium described in s 12 (2) of the Act. ³¹⁴ In the case of a right, ³¹⁵ "actual financial loss" is the standard. In effect, these standards amount to traditional contract damages. The common principle inherent in damages for contract breach or rescission, is that the aggrieved party deserves to be placed in the position he would have been in if the contract had been honoured. ³¹⁶

³¹⁰ See Expropriation Act 63 of 1975, as amended, S 12(1), for details of the basis for computing the amount of compensation.

³¹¹ It should be noted that "expropriation powers have always been conferred by statute...and any attempt to expropriate without statutory authority would be void..." Baxter Administrative Law 399 n76. See Joyce and McGregor Ltd v Cape Provincial Administration 1946 AD 658, 671; Belleluin (PTY) Ltd v Cape Town Municipality 1978 (1) SA 346 (C).

³¹² See Baxter Administrative Law 636-637; In re John Freeman v Colonial Secretary of Natal (1889) 10 NLR 71, 73; Belluco (PTY) Ltd v Belville Municipality 1970 (4) SA 589 (A). cf Cape Town Municipality v Abdulla 1976 (2) SA 370 (C), at 376A, which states that "there is... no all-embracing principle that, in the event of an enabling provision being silent as to the payment of compensation, a municipal council is obliged to pay compensation to any person whose rights are curtailed by reason of the exercise by the council of statutory authority lawfully conferred upon it."

³¹³ Expropriation Act 63 of 1975, as amended, s 11(1) states in pertinent part: "If the Minister deems it expedient, he may, prior to the determination of the amount of compensation...and on or at any time after the date of expropriation...pay the amount offered the owner concerned..."

³¹⁴ The language of s 12(1)(a)(i) has prompted South African courts to use three methods of calculation: (1) the comparative or market data approach (which bases the quantum on the going market value of lands under like circumstances); (2) income investment or economic approach (which bases the quantum on the capitalisation of a property's actual or potential net rental income); and (3) land residual technique (which bases the quantum on a calculation of projected net gain from the use of a property). See various chapters for extensive analysis and caselaw, Jacobs The Law of Expropriation in South Africa.

³¹⁵ The term "right" is not defined in the Expropriation Act. One would suppose that right includes any right of economic value.

³¹⁶ See Kahn, Lewis & Visser General Principles of Contract: Agency & Representation (2nd ed. 1988) 766-839.

It is crucial, however, for a discussion on the issue of expropriation, and the right to and quantum of damages in South Africa to take place from now on in the context of the Chapter on Fundamental Rights, contained in the new interim Constitution of the Republic of South Africa Act,³¹⁷ ratified on 22 December, 1993, by a parliamentary vote of 237 votes to 45. ³¹⁸ Section 28 on "Property" reads:

"□ Every person shall have the right to acquire and hold rights in property and, to the extent that the nature of the rights permits, to dispose of such rights.

□ No deprivation of any rights in property shall be permitted otherwise than in accordance with a law.

□ Where any rights in property are expropriated pursuant to a law referred to in subsection (2), such expropriation shall be permissible for public purposes only and shall be subject to the payment of agreed compensation or, failing agreement, to the payment of such compensation and within such period as may be determined by a court of law as just and equitable, taking into account all relevant factors, including, in the case of the determination of compensation, the use to which property is being put, the history of its acquisition, its market value, the value of the investments in it by those affected and the interests of those affected." ³¹⁹

It will be up to the Constitutional Court ³²⁰ to give these provisions on property more tangible shape as it is confronted with issues justiciable in terms of its jurisdiction. A number of comments are nonetheless appropriate in respect of these provisions and their meaning.

Section 28 (2) requires that all expropriations be pursuant to law. Section 28 (3) mandates that all expropriations of rights in property be for a "public purpose," and that the standard of compensation and its timing be "just and equitable." Obviously, the phrase "just and equitable" could be explained in a myriad of different ways, depending on the ideological disposition of those sitting on the Constitutional Court. Therefore, it is a pointless exercise trying to guess how this standard is going to be construed and applied in terms of substantive law.

Whatever orthodox methods the Court will utilise to interpret the provisions of the new Constitution, it will be bound to interpret Chapter 3 on Fundamental Rights on the basis of four distinct principles. ³²¹ First, the Court must, in its interpretation, promote "the values which underlie an open and democratic society based on freedom and equality." ³²² Second, the Court will in its interpretation "have regard to public international law applicable to the protection of rights entrenched" in the Chapter on Fundamental Rights. ³²³ Third, any provision which on its face "exceeds the limits imposed" by the Chapter on Fundamental Rights must be interpreted narrowly if such interpretation is reasonable and prevents such construction from

³¹⁷. At the time of this writing, the Government Printer had not yet released the Constitution of the Republic of South Africa Act.

³¹⁸. Noble "For South Africa, 'A New Beginning': Parliament Puts End to Apartheid, Paving Way for Black Majority Rule" *International Herald Tribune*, 23 December, 1993, 1.

³¹⁹. *Constitution of the Republic of South Africa Bill No. 212 of 1993, Chapter 3 on Fundamental Rights*, s 28.

³²⁰. *The Constitutional Court is to be established in terms of Chapter 7 of the Constitution of the Republic of South Africa Act*, s 98.

³²¹. *Constitution of the Republic of South Africa Bill, Chapter 3*, s 35.

³²² *Constitution of the Republic of South Africa*, s 35(1).

³²³. *Constitution of the Republic of South Africa Bill*, s 35(1).

exceeding those limits.³²⁴ Fourth, interpretation is to be guided by the spirit, purport and objectives of the Chapter on Fundamental Rights.³²⁵

Of particular note in respect of the substantive meaning of "just and equitable," is the mandate that the Court shall have "regard to public international law applicable to the protection of rights entrenched" in the Chapter on Fundamental Rights. The identification of the second principle of interpretation as of special note is not meant to suggest that the other three principles are less important. However, in regard to rights in property, public international law is a source of substantive rules on the particular issue of compensation. Thus, the Constitutional Court will be bound to international law as a source not only of interpretative guidance but of substantive law. The question arises as to what public international law says of expropriation and compensation.

14(i) EXPROPRIATION AND COMPENSATION IN INTERNATIONAL LAW

From the perspective of the foreign investor, the possibility of expropriation by the host government is a crucial consideration in the investment decision-process. That a State may expropriate or nationalise foreign property located within its borders, however, is a well recognised and accepted right of national sovereignty in international law,³²⁶ and therefore invites little further deliberation. However, the issue of considerable importance, as suggested above, is the minimum standard or quantum of compensation which a State is required to pay the party whose rights in property are expropriated.

In *modern* international law, the doctrine of acquired rights allows the host state to expropriate or nationalise foreign property, subject to the mandate that the taking be for a public purpose, non-discriminatory in application, carried out with due process of law and accompanied by prompt, adequate and effective compensation.³²⁷ This standard is known as the Hull formula. The term "prompt" has been construed to mean that compensation is to be immediate.³²⁸ The term "adequate" has been explained as "the value of the undertaking at the moment of disposition, plus interest to the day of [payment]."³²⁹ The requirement that compensation must be "effective" is understood to mean that the divested party must be able to make full, unrestricted and beneficial economic use of it.³³⁰

³²⁴ Constitution of the Republic of South Africa Bill, s 35(2).

³²⁵ Constitution of the Republic of South Africa Bill, s 35(3).

³²⁶ See Charter of Economic Rights and Duties of States 1974, G.A. Resolution 3281 (XXIX), 14 I.L.M. 251 (1975), Article 2(c) which states that each State has the right
 "[t]o nationalize, expropriate or transfer ownership of foreign property in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent."
 Quoted in *Harris Cases and Materials on International Law* (4th Ed) 1991 526. See also *Amoco International Finance Corp. v. Iran* 15 Iran - U.S.C.T.R. 189 para. 114.

³²⁷ *Asante* 1988 *International and Comparative Law Quarterly* 595-596. In a note to the Mexican Ambassador on August 22, 1938, in response to the Mexican expropriation of land belonging to American citizens, the US Secretary of State, Cordell Hull stated:
 "...under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate, and effective payment."
 Quoted in *Steiner and Vagts Transnational Legal Problems* (2nd ed. 1976) 421. The Hull formula has been reiterated in more subsequent cases, for instance the *BP Case*, 53 I.L.R. 297 (1974).

³²⁸ *Anglo-Iranian Oil Co. Case* (1952) I.C.J. Rep. 105-106.

³²⁹ *Anglo-Iranian Oil Co. Case*, 106. see also the *Chorzow Factory Case*, P.C.I.J. Reports, Series A, No.17 (1928).

³³⁰ *Anglo-Iranian Case*, 542.

According to some commentators, the Hull formula is not widely accepted internationally and appears to lie at one extreme of the ideological scale, espoused by the major capital-exporting countries.³³¹ Article 2 (2)(c) of the 1974 *Charter of Economic Rights and Duties of States*,³³² for instance, with its "appropriate compensation" yardstick comes closest to representing the traditional developing country standard. Appropriate compensation has been interpreted mostly in relation to expropriated natural resource concessions, to mean compensation based on the "legitimate expectations" of the parties.³³³ The actual standard of compensation was thus said to amount to the value of the expropriated enterprise as a going concern (i.e. the expectation of profits for the duration of the expropriated concession contract), an evaluation of the non-fixed assets, and the depreciated replacement value of the fixed assets of the enterprise.³³⁴

One study which examined thirty compensation settlements between 1953 and 1976 came to the conclusion that there was no settled formula or standard by which the "correct" quantum of compensation is measured in light of State practice, that is, beyond the obligation to pay compensation in good faith.³³⁵ Although the "prompt, adequate and effective" as well as the "appropriate compensation" standards were often asserted by investors and the host countries, respectively, during settlement negotiations, the end results have been invariably different.³³⁶

It has been recognised that on many occasions compensation settlement negotiations between States and the divested parties have defied judicial considerations and rigid standards, and have instead involved considerations such as the resumption of diplomatic or trading relations.³³⁷ In short, in the absence of a treaty or international agreement between the host country and the investor or his state of domicile, the standard of compensation as well as the method of calculation remains a fluid creature of negotiation, each case on its own merits. Therefore, because State practice differs so widely on the issue of compensation, it has been difficult to identify with any certainty the customary international law standard on the issue.

³³¹ *Murphy 1993 SALJ 82-83*:

"A review of the literature indicates that no simple formula exists which can express the complexities of state practice...little support can be found for the Hull formula's acceptance in state practice or in authoritative writings."

Asante 1988 I.C.L.Q. 597:

"[T]he [Hull] formula has been strongly resisted by developing States and 'has not made its way into multilateral agreements or declarations or been universally utilised by international tribunals.'"

³³² *Charter of Economic Rights and Duties of States, G.A. Resolution 3281 (XXIX), 14 (1975) I.L.M 251*. The voting pattern which brought the Charter into existence is itself interesting. Of particular note is the separate vote which was taken on Article 2(2)(c): The majority in favour was 104 to 16, with six abstentions. The states against Article 2(2)(c) included Belgium, Denmark, the Federal Republic of Germany, Luxembourg, the UK and the United States. These countries fall into the category of developed countries, and therefore their rejection of the "appropriate compensation" standard is historically significant. See *Harris Cases and Materials on International Law 526 n. 54*.

³³³ See *Aminoil Case (Kuwait v. American Independent Oil Co) 21 (1982) I.L.M 976, para 148*.

³³⁴ *Aminoil Case, para. 178*. Harris adds that the *Aminoil case* "is a notable example of the increasing use of tribunals of the 'appropriate compensation' formula in [UN General Assembly] Resolution 1803 as the standard of compensation required by international law." It should be noted that the UN Resolution referred to is the Resolution on Permanent Sovereignty over Natural Resources of 1962, G.A. Resolution 1803 (XVII), G.A.O.R., 17th Session, Supp. No. 15. This Resolution was adopted by 87 votes to 2, with 12 abstentions. South Africa and France were the two countries which voted against it. This resolution applies only to State concessions which are granted for the purposes of exploiting natural resources. *Harris Cases and Materials 525 n.1*.

³³⁵ Bring "Impact of Developing States on International Customary Law Concerning Protection of Foreign Property" (1980) *Scandinavian Studies in Law 99*, in *Asante I.C.L.Q. 605*.

³³⁶ *Asante (1988) I.C.L.Q. 606*.

³³⁷ See, for instance, the *Sedco Case 10 Iran-US C.T.R. 180 184-185 (1986)*.

However, state practice relating to expropriation and standards of compensation seems to be overshadowed by the proliferation of bilateral investment treaties between developing countries and capital-exporting countries, as well as national legislation, often incorporating some variation or another of the traditional Hull formula. These treaties and national laws, rather than State practice ascertained in the actual resolutions in compensation cases, may have contributed significantly to a customary international law standard on the issue of compensation.

It appears that subsequent to the close of the cold war a uniform standard of compensation has emerged, or at least appears to be in a state of rapid solidification. A number of examples - specifically relating to developing countries - are appropriate. ³³⁸

The Treaty Concerning the Reciprocal Encouragement and Protection of Investment between Argentina and the United States: ³³⁹

"□ Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation") except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law."

Tanzania has recently enacted legislation governing investment ³⁴⁰ which includes language on expropriation and compensation:

"□ Where an enterprise is compulsorily acquired, full and fair compensation as provided under [the Tanzanian Constitution] shall be payable.

□ Any compensation payable under the provision of this section shall be made promptly and shall be transferable."

The Charter adopted by the Preferential Trade Area for Eastern and Southern African States governing multinational industrial enterprises ³⁴¹ incorporates language as follows:

"1. Where an MIE, or any Branch or Subsidiary thereof, is nationalized, expropriated or is made subject to other forms of State intervention having effects similar to nationalization or expropriation, the State shall pay compensation in accordance with generally accepted rules of International Law."

The Constitutional Court will therefore have to interpret the words "just and equitable" in line with those others offered by public international law, such as "adequate," "full and fair," "effective," "prompt" and "transferable." There is a burgeoning literature on this subject, as well as published caselaw and arbitral decisions, which capture the ways in which these laws are applied. In other words, rights in property possessed by nationals of South Africa and foreigners alike are protected against arbitrary expropriations and can reasonably expect compensation in keeping with international trends.

³³⁸. I wish to thank Professor Derry Devine, University of Cape Town, Faculty of Law, for his useful comments on the issue of compensation standards in international law, and for his reference to the examples cited in the text. 25 October, 1993. In light of the uniformity which has emerged in the last three years in regard to a compensation standard, Professor Devine holds that customary international law is now clear on the issue.

³³⁹. Treaty Concerning the Reciprocal Encouragement and Protection of Investment, 14 November 1991. Art. IV. 31 (1992) ILM 124, 131.

³⁴⁰. National Investment (Promotion and Protection) Act 1990 (29 June 1990). Section 28. 30 (1991) ILM 894, 905.

³⁴¹. Charter on a Regime of Multinational Industrial Enterprises (MIEs) in the Preferential Trade Area for Eastern and Southern African States 23 November 1990. Art. 16. 30 (1991) ILM 696, 715.

14(ii). INVESTMENT PROTECTION IN SOUTH AFRICA: SOME COMMENTS

South Africa's internal political and economic problems have been externalised to the extent that as market risk signals they have become effective investment barriers. In practice such signals have given rise to fears that investments will be nationalised or in some way dominated by governmental intervention, thus exposing the invested equity to unfavourable risks of loss or to a diminution of value.

The "political instability" factor as a deterrent of foreign investment is statistically significant. Studies have consistently shown that political instability or the threat of political destabilisation (as a proxy for risk of loss to rights in property) has significantly reduced FDI capital flows to host countries, especially to developing host countries. ³⁴² What is of note for the purposes of this study is the indication that investment guarantees against political risks have a compensatory role to play in correcting the negative impact which perceived political instability and assessed political risk may have on incoming FDI flows.

One particular study ³⁴³ examined two successive periods of American FDI in developing country manufacturing industries, analysing the effect of political instability on those FDI flows. In the first period, when no investment guarantee existed, political instability affected FDI flows negatively. However, in the second period, when the investment guarantee was available, not only was there no negative correlation between political instability and FDI flows but the investment guarantee variable appeared to operate as a significant determinant of American FDI flows into those countries examined.

It is interesting to observe that in this study, the investment guarantee emanated from the investing country, through the American Investment Guaranty Program. The guarantee mechanism, as an incentive for FDI, seemed to operate not merely as a compensatory factor reducing perceived risk, but actually reduced the assessed political risks to the investors concerned. ³⁴⁴

No empirical study has been located which measures changes of FDI flows into host countries in response to investment guarantees - private insurance schemes, constitutional protections, or other such legal devices - offered by host governments. However, it is presumed here that foreign investors would be more inclined to invest in politically unstable countries if the institutional source of the prevailing investment guarantee was perceived to be willing and able to honour its guarantee commitments. Political instability is an inseparable dimension of the environment of the projected investment. For this reason, if the governmental source of the investment guarantee is itself beset with political weakness or with the desire to nationalise haphazardly, the viability of the guarantee is reduced to insignificance.

³⁴² It is interesting to note that while a government's ideological position does not have a statistically significant effect on inflows of foreign investment, political instability per se does have a negative impact on foreign investment inflows. Schneider & Frey 1985 *World Development* 173. One particular study which focussed on FDI flows to Africa recorded that in Nigeria net foreign capital flows fell 75% from 1964 (the year preceding the height of Nigeria's political troubles) to 1969 (just prior to the end of the Nigerian Civil War, which officially came to an end in 1970). Immediately thereafter, FDI flows climb to almost pre-1964 levels. Agodo "The Determinants of U.S. Private Manufacturing Investments in Africa" 9(1978) *Journal of International Business Studies* 95 103.

³⁴³ Rock Cross-Country Analysis of the Determinants of U.S. Direct Foreign Investment in Manufacturing in Less Developed Countries. Ph.D. Diss., University of Pittsburgh, 1973, unpublished. This study is described by Agarwal 1980 *Weltwirtschaftliches Archiv* 761.

³⁴⁴ Argawal 1980 *Weltwirtschaftliches Archiv* 761.

Therefore, it is reasonable to assert that the effectiveness of any unilateral effort on the part of the developing host country to reduce the risks associated with political instability is relatively low. This observation applies in particular to host countries which are themselves in a state of transition and which are as yet barren of a pragmatic historical record in this regard. Perhaps for this reason the United Nations Center for Transnational Corporations has suggested (in rather couched terms) that it is unnecessary, and perhaps undesirable

"for developing countries to attempt to present distinctive unilateral policies on political risk, beyond perhaps a normal embracing of bilateral investment protection treaties and comparable multilateral programmes." ³⁴⁵

With these policy considerations in mind, it is remarkable to note that up until very recently South Africa was not party to any investment insurance or protection treaty. However, on 4 November, 1993, the Council of Governors of the Multilateral Guarantee Agency (MIGA) ³⁴⁶ reclassified South Africa's status from developed to developing country and therefore approved South Africa for "Category 2" membership. This means that under Article 14 of the MIGA Convention, foreign investments in South Africa qualify for insurance guarantees. However, although South Africa signed the MIGA Convention on the 16 December, 1992, it has not yet been ratified. An Economic Technical Committee decision was taken in support of ratification and it is a matter of time before the technical aspects of ratification are resolved by the legal advisors to the Department of Foreign Affairs. ³⁴⁷

MIGA is a cooperative affiliate of the World Bank. MIGA's central objective is to "encourage the flow of investments for productive purposes among member countries..." ³⁴⁸ The primary focus of MIGA is the issuance of investment guarantees, including coinsurance and reinsurance, against non-commercial risks in regard to investments made by member countries in other member countries. ³⁴⁹ In this respect, only time will tell to what extent MIGA will contribute to increased investment flows to South Africa.

Although the United States is currently the source of about 11 per cent of South Africa's FDI stocks, insurance coverage by the United States Overseas Private Investment Corporation (OPIC) is an important symbol of South Africa's legitimacy and viability as an international investment location. OPIC's Investment Incentive Agreement was signed by the United States Commerce Secretary Ron Brown and South African Finance Minister Derek Keys in Cape Town on 30 November, 1993. The signing took place in the presence and with the full agreement of the ETC. In terms of Article 5 of the OPIC Agreement, as signed, South Africa has yet to notify the Government of the United States that all legal requirements for the entry into force of the Agreement have been fulfilled.

In light of South Africa's commercial reintegration into world affairs, currents within the Department of Finance and Foreign Affairs are strongly in favour of concluding bilateral as well as multilateral international agreements relating to investment promotion, protection and insurance. ³⁵⁰ It does not appear that the ANC's position differs.

³⁴⁵. UN *The Determinants of Foreign Direct Investment* 61.

³⁴⁶. *Convention Establishing the Multilateral Investment Guarantee Agency* 24 (1985) I.L.M. 1605. [MIGA Convention]

³⁴⁷. Johann van Tonder, *Directorate of International Relations, Department of Finance, personal communication, 7 December, 1993.*

³⁴⁸. MIGA Article 2.

³⁴⁹. MIGA Article 2(a)

³⁵⁰. Mr Johann van Tonder, *Department of Finance, teleconference, 19 October, 1993.*

15. FDI & THE GENERAL AGREEMENT ON TARIFFS AND TRADE

The General Agreement on Tariffs and Trade ("GATT") was initially and still continues to be concerned with primarily the international trade of goods and services. The GATT, therefore, has no definitive preoccupation with international investment. However, certain measures which a country administers in relation to investment ³⁵¹, may have an impact on the flow of goods and services between GATT contracting countries. The GATT has for this reason, during the Uruguay Round, cast its attention on those so-called "trade related investment measures" ("TRIMs") which have a negative or constricting effect on the international trade in goods. The GATT's primary concern, therefore, is the degree and nature of this effect. The Uruguay Round has, accordingly, produced an agreement ("TRIMs Agreement") annexed to the World Trade Organisation ("WTO") Agreement. ³⁵² The objective of the Agreement, as stated in its Preamble, is

"to promote the expansion and progressive liberalisation of world trade and to facilitate the movement of investment across international frontiers so as to increase the economic growth of all trading partners, and particularly developing country Members, while ensuring free competition." ³⁵³

The concern of the Agreement is with TRIMs which have the effect of distorting and restricting international trade flows in goods only. ³⁵⁴ Article 2 of the Agreement prohibits any contracting party to apply any TRIM inconsistently with Article III ³⁵⁵ or Article XI ³⁵⁶ of the GATT. Article 4 of the Agreement recognises the right of a developing contracting party to "deviate temporarily" from Article 2, to the extent and in accordance with the requirements of Article XVIII of the GATT. ³⁵⁷ The Agreement also allows developing countries up to five years, and developed countries up to two years, in which to eliminate all TRIMs which are not in conformity with the Agreement. ³⁵⁸

³⁵¹. The term "investment" applies primarily to investment in production.

³⁵². Draft Final Act Embodying the Results of the Uruguay Round of Multinational Trade Negotiations, Trade-Related Aspects of Investment Measures, MTN.TNC/W/FA, 20 December 1991. See final Agreement MTN/FA II-A1A-7.

³⁵³. TRIMs Agreement, preamble, second para.

³⁵⁴. TRIMs Agreement, Article 1.

³⁵⁵. GATT Article III, dealing with National Treatment on Internal Taxation and Regulation, reads in pertinent part:

"1. ...internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products...should not be applied to imported or domestic products so as to afford protection to domestic production."

4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use..."

Text of the General Agreement, GATT, Geneva July 1986.

³⁵⁶. GATT Article XI, dealing with the General Elimination of Quantitative Restrictions, states in pertinent part:

"1. No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party."

Text of the General Agreement, GATT, Geneva July 1986.

³⁵⁷. GATT Article XVIII, dealing with Governmental Assistance to Economic Development, states in pertinent part:

"1. ...the attainment of the objectives of this Agreement will be facilitated by the progressive development of their economies...
2. ...it may be necessary for those contracting parties,

³⁵⁸. TRIMs Agreement, Article 5, dealing with Notification and Transitional Arrangements.

Although the subject of TRIMs was de-emphasized in the course of Uruguay Round discussions,³⁵⁹ it appears that the TRIMs Agreement has remained an inherent component of the WTO which resulted from the Uruguay Round. However, although South Africa will be compelled to comply with GATT rules on TRIMS once it ratifies the WTO Agreement the South African government will have to act with vigilance lest its regulations conflict with GATT rules in this regard.

Currently, South Africa utilises two distinctive TRIMs. One is its local content programme and the other is a price preference system incorporated into government procurement. Because state procurement regulations do not apply to foreign companies, they must be incorporated in South Africa in order to bid against state tenders. For this reason, South Africa's price preference system could well be construed as a TRIM.

The local content programme applies in three industrial sectors, namely, the motor vehicle industry, the television receiving set and microwave manufacturing industries.³⁶⁰ Opting in to the local content programme is not mandatory. Rather, it is encouraged by applying an excise duty in inverse proportion to the level of local added value.³⁶¹

The current state procurement policy provides for certain preferences to domestic suppliers.³⁶² As a general rule, tenders are invited only from South African suppliers.³⁶³ The State Tender Board, which administers the General Conditions and Procedures for all purchases exceeding R3,000 in value, makes the final decision whether or not to make a particular tender award. The decisions of the Board in this respect are final and not subject to appeal, and furthermore, the Board is not obliged to give the reasons for its acceptance or rejection of a particular bid.³⁶⁴

A certain percentage is deducted from the bid price in proportion to the degree of local content of the goods involved. For instance, if local content is 5 per cent or less, the price preference awarded is 1 per cent, while local content of 80 per cent or more invites a maximum preference of 10 per cent.³⁶⁵ A further preference of 2.5 per cent is awarded for products that carry the South African Bureau of Standards' Standardization mark.³⁶⁶

Moreover, a preference may be given on an ad hoc basis in regard to locally produced products subject to little or no tariff protection, and where the imported product is marginally cheap-

³⁵⁹ Page GATT and Its Impact on Developing Countries, Paper Prepared for the Conference on South Africa's International Economic Relations in the 1990's, April 27-30, 1993, 19.

³⁶⁰ GATT Trade Policy Review Mechanism: Report by the Government of the Republic of South Africa, C/RM/G/37, 3 May, 1993, 15. The objective of the local content component of Phase VI of the motor vehicle industry's structural programme is the reduction of foreign exchange utilisation through import replacement and exportation. It would appear also that the local content policies of the television receiving set and microwave oven industries reflect the one behind Phase VI of the motor vehicle industry. However, it seems that industry expansion through import replacement is the driving principle in the former two industries.

³⁶¹ The general local content schema is summarised in GATT Trade Policy Review Mechanism: Republic of South Africa, Report by the Secretariat, C/RM/S/3/A, 3 May, 1993, 79. It should be noted that imported inputs to which 25 per cent value has been added domestically qualify as "local inputs." [TPRM Report by the Secretariat].

³⁶² TPRM Report of the Secretariat 78.

³⁶³ TPRM Report of the Secretariat 79.

³⁶⁴ TPRM Report of the Secretariat 79.

³⁶⁵ TPRM Report of the Secretariat 80.

³⁶⁶ TPRM Report of the Secretariat 79.

er than the one manufactured locally. However, the decision upon which such a preference is given may be referred by the State Tender Board to the Board of Tariffs and Trade to make. ³⁶⁷ Where both the domestic and the imported products are equally priced, even after the preference reduction, the Board gives preference to locally manufactured product. ³⁶⁸

Because the annual value of South African government supply contracts is approximately 3 per cent of GDP or R6 to R8 billion, the measures which it employs in the administration of those contracts are relatively important in terms of GATT discipline. However, since South Africa has only observer status to the MTN Agreement on Government Procurement, since 1984, it is not legally obligated to act in accordance with existing GATT rules relating to procurement.

However, because it is well understood by all parties concerned that South Africa will ratify the Final Act of the Uruguay Round which will incorporate the Agreement, its procurement policies and its local content programme may well run into conflict with GATT rules. It is appropriate here to illustrate how South Africa's local content programme, for instance, could come into conflict with the Agreement.

The ANNEX to the Agreement contains an illustrative list of TRIMs that are in conflict with it. Its list of TRIMs that are inconsistent with the national treatment principle contained in Article III(4) of GATT, includes

"those which are mandatory or enforceable under domestic law...or compliance with which is necessary to obtain an advantage, and which require:

(a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production" ³⁶⁹

South Africa's current local content programme grants excise duty advantages (or discounts) in inverse proportions to the "use by an enterprise of products of domestic origin." Therefore, the local content program as it operates in South Africa is a TRIM to which the Agreement clearly applies. For this reason, its implementation is, in principle, prohibited. If South Africa's status in the GATT community remains that of a "developed" country when the Final Act of the Uruguay Round (including the TRIMs Agreement) comes into force, a two year period will be allowed in which to eradicate the local content programme, and if South Africa becomes reclassified to the status of "developing" country, ³⁷⁰ five years will be allowed for removal.

It is important to emphasize that South Africa's application of its local content programme to industry is not mandatory. The industrialist has the option of "opting in" if the corresponding prescribed tariff advantages on inputs are desired. However, by "opting out," the particular firm may find itself disadvantaged and unable to compete in terms of price. Non-participants will not be eligible for cost-reduction incentives such as duty rebates, tariff concessions and export subsidies.

³⁶⁷. TPRM Report of the Secretariat 79.

³⁶⁸. State Tender Board, General Conditions and Procedures (ST36) para. 26. TPRM Report of the Secretariat 79, fn 29.

³⁶⁹. TRIMs Agreement, ANNEX 1(a).

³⁷⁰. South Africa may well receive recognition as a country "in transition" rather than as a "developing" country and therefore will be eligible for certain concessions which the Agreement has not attempted to deal with.

However, the national treatment principle implicit in South Africa's current and evolving policies toward foreign direct investment applies also in the administration of the local content programme. Clearly, such a programme applies specifically to the sourcing origin of intermediate inputs by certain industries, irrespective of whether or not the industry itself is owned by foreign interests.

In other words, TRIMs are "operating restrictions on investment."³⁷¹ If TRIMs, employed as a part of the industrial development strategy of a country, are perceived by the foreign investor to be disincentives to investment, a problem may arise for the host country with which the GATT remains unconcerned. The reason for GATT's non-involvement with such an issue is that there is no direct correlation between the administrative mechanism of the TRIM and the substance of Articles III and XI of the GATT. GATT's rules on TRIMs are narrowly circumscribed. This, of course, does not mean that the subjectmatter of TRIMs other than those specifically targeted by the Agreement do not continue to have relevance from the point of view of industrial development policy.

South Africa's prevailing TRIM regime appears to be in jeopardy. The reason for this is that the South African government is, or appears to be, strongly committed to phasing out its present regulations governing tariffs and trade, including its local content programme, which run afoul of GATT rules.³⁷² This means that the foregoing analysis of South Africa's current TRIMs in the context of the Agreement is more theoretically illustrative than it is of practical significance. However, the subject of TRIMs in South Africa will not remain a dead letter, especially since the Final Act of the Uruguay Round was successfully concluded. The reason for this is that the ANC has already intimated that it will adopt "performance requirements."

The ANC has stated that:

*"As part of the overall industrial policy, trade policy will aim at raising the level of productivity and improving the competitiveness of domestic and Southern African producers. In this context, we will take a differentiated approach towards trade barriers. In particular, tariffs may, in conjunction with performance requirements, enable domestic and regional producers to develop new branches of production."*³⁷³ [emphasis added]

Obviously, the meaning of the phrase "performance requirements" is not self-evident, and it is not certain what the specific meaning is of the phrase as it is used in the ANC Guidelines. As discussed above,³⁷⁴ TRIMs are a subset of performance requirements, and thus the GATT's relevance in this respect is marginal. Also, the word "requirements" may be misleading. Not all performance requirements are mandatory. As they are applied by a particular country or within a specific sector, they may be negotiable or voluntary.

³⁷¹. McCulloch "Investment Policies in the GATT" 13(1990) *The World Economy* 541 546.

³⁷². See for instance, *GATT Trade Policy Review Mechanism: Review of South Africa, Concluding Remarks by the Chairman of the Council*, 2 June, 1993.

³⁷³. *ANC Policy Guidelines* 23.

³⁷⁴. See text accompanying footnote 169, above.

The following is a non-exhaustive list of performance requirements and their possible economic effects: ³⁷⁵

- **Local equity requirements:**
 - restrict ownership of investments
- **Licensing requirements:**
 - require technology transfer
- **Remittance restrictions:**
 - restrict external financial transfers
- **Foreign exchange restrictions:**
 - restrict external financial transfers
- **Manufacturing limitations:**
 - restrict production
- **Transfer-of-technology requirements:**
 - require transfer of technology
- **Domestic sales requirements:**
 - displace imports
- **Manufacturing requirements:**
 - displace imports
- **Product-mandating requirements**
 - displace other exports
- **Trade-balancing requirements:**
 - displace other exports
- **Local content requirements:**
 - displace imports
- **Export requirements:**
 - displace other imports
- **Import-substitution requirements:**
 - displace imports

Evidently, the performance requirements numbered (vii) to (xiii) have a potential direct impact on trade and therefore fall under the purview of the Agreement. However, it would appear that the TRIMs Agreement would be violated if such requirements are inconsistent with Articles III and XI of the GATT. As a matter of policy, it is important to note that Article 3 of the TRIMs Agreement contains an escape clause which allows all exceptions under the GATT to apply. This means, in South Africa's case, that balance of payments problems, for instance, or the GATT's exceptions relating to infant industries and to economic development ³⁷⁶ could support a programme of continued implementation of such performance requirements. This is not to suggest, however, that policy should be based on the predetermined objective of contravening affirmative provisions of the GATT.

³⁷⁵ UN *The Impact of Trade Related Investment Measures on Trade and Development* (1991) 12.

³⁷⁶ See, for instance, GATT Article XVIII(C).

Another important consideration should be noted. Article 5 of the Agreement mandates that contracting parties must notify the GATT within ninety days after the entry into force of the Agreement of all TRIMs that are not in conformity with it. However, the Agreement adds in a footnote that “[i]nformation that would prejudice the legitimate commercial interests of particular enterprises need not be disclosed.” Even if the information in a particular case cannot reasonably be said to be harmful to the legitimate commercial interests of an enterprise, the issue arises whether the particular contractual arrangement between the State and the foreign investor need be revealed under the notification provisions of the Agreement. The answer depends upon the nature of South Africa’s policy on TRIMs. If the performance requirements to be used as part of a FDI guidance policy are going to be clearly pre-defined in public or official literature, then they must satisfy Article 6 of the Agreement which requires transparency, as well as Article 5 which requires notification.

However, if they are going to exist on an administrative menu, in the form of fluid policy alternatives, strictly for the purposes of negotiating contractual arrangements with foreign investors then the principle of transparency will, by definition not apply. There exists no legal requirement for the contents of state contracts to be published in the absence of a legislative mandate. This means that the privacy of the investor’s relationship with the State will be preserved. TRIMs applied in the latter sense will arguably not fall under the purview of the Agreement because they will be a component of a targeted or managed policy rather than a uniform dimension of national policy.

The issue as to which particular contracting party to the GATT is likely to proceed with discipline procedures against South Africa lest TRIMs are implemented which could be construed to violate the TRIMs Agreement is a significant one. The TRIMs Agreement has been finalised, and thus technically it is not difficult to pre-judge which specific performance requirements violate it. However, even with this in mind, the negotiating positions of the various countries in the Uruguay Round in regard to TRIMs are indicative as to which countries are more likely than others to take action against the use of TRIMs which they may construe as illegal.

During the Uruguay Round the United States and Japan shared similar positions. These two countries have emphasized that measures which have adverse trade effects are “inherently” distorting investment measures - that there is no distinction between the measures themselves and their effects.³⁷⁷ The fear that such TRIMs as adopted by developing countries could cause harm to its trade interests prompted the United States (among other developed countries) to push for the inclusion of the issue of trade-related investment performance requirements (in general) in the Uruguay Round.³⁷⁸

³⁷⁷. UN *The Impact of Trade-Related Investment Measures on Trade and Development* 83. See also the position of the United States in its action against Canada in respect of the latter’s Foreign Investment Review Act (“FIRA”) in 1982. It was found by the GATT settlement dispute panel that Canada’s allowance of certain FDI projects under FIRA, on the condition that the investors obligate themselves under contract with the State to purchase goods of Canadian origin or from Canadian suppliers, violated GATT Article III(4). See footnote 355, above. For the US-Canada dispute, see *GATT Basic Instruments and Selected Documents*, 30th Supplement (Geneva, March 1984) 141-142.

³⁷⁸. See Moran and Pearson “Tread Carefully in the Field of TRIP Measures” 11(1) 1988 *World Economy* 119.

The European Union, on the other hand, has not been negatively disposed towards any national investment measure directly, but maintains that GATT discipline should instead be concerned with the elimination of the distortive effects caused by TRIMs.³⁷⁹ This means that the United States (in particular, as far as its relevance to South Africa is concerned), based on its negotiating position in the Uruguay Round, is more sensitive to the use of TRIMs that would be South Africa's chief trading and investment partner, the EEC.

- ◆ This note may have implications for South Africa's national marketing campaign abroad in respect of its investment policies. In other words, it would be to South Africa's advantage to "ventilate" its investment programme in a transparent and well ordered manner, thus giving the overseas community, especially its fellow GATT contracting parties, sufficient time to reflect upon and to respond positively with any specific policy criticisms.

³⁷⁹ UN *The Impact of Trade-Related Investment Measures on Trade and Development* 84. According to the UN's assessment, the European Community does not maintain that technology transfer and

A COMPARISON OF THE CORPORATE CODES OF CONDUCT RELATING TO FOREIGN INVESTMENT IN SOUTH AFRICA WITH EXISTING SOUTH AFRICAN LAW:

KEY:

LSA : Laws and statutes of South Africa;

PGP ANC/COSATU's *Platform of Guiding Principles for Foreign Investors*, Nov. 13-15, 1992;

CC: *SACC's Code of Conduct for Business Operating in South Africa*, 18 July, 1993;

ECC: *European Communities' Code of Conduct for Companies Operating in South Africa*, October 1977;

ILO: *International Labour Organisation's Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy*, 16 November, 1977;

OECD: Annex to the Declaration of 21st June 1976 by the Governments of OECD Member Countries of International Investment and Multinational Enterprises.

WORKER'S RIGHTS:

PGP: para 2.1

Companies should uphold workers' rights including the recognition of representative unions and their rights to bargain collectively, to strike, to picket peacefully, and strike breakers will not be hired.

CC: para 3

Companies should recognise representative unions and uphold their employees' rights to organise openly, bargain collectively, picket peacefully and strike without intimidation or fear.

ILO: 380

para 41

Workers employed by multinational enterprises as well as those employed by national enterprises should, without distinction whatsoever, have the right to establish and, subject only to the rules of the organisation concerned, to join organisations of their own choosing without previous authorisation. They should also enjoy adequate protection against acts of anti-union discrimination in respect of their employment.

para 48

Workers employed by multinational enterprises should have the right, in accordance with national law and practice, to have representative organisations of their own choosing recognised for the purpose of collective bargaining.

^{380.} It should be noted that the ILO Tripartite Declaration contains two broad provisions dealing with freedom of association and the right to organise (para 41-47), and collective bargaining (para 48-55). However, only the introductory paragraph of each provision is quoted here, as the others are detailed elaborations of the same principles as applied to various other arrangements.

^{381.} Convention (No.98) concerning the Application of the Principles of the Right to Organise and to Bargain Collectively, 1948, Article 1(1), is referred to.

OECD:

EMPLOYMENT AND INDUSTRIAL RELATION

Enterprises should, within the framework of law, regulations and prevailing labour relations and employment practices, in each of the countries in which they operate,

1. respect the right of their employees, to be represented by trade unions and other bona fide organisations of employees, and engage in constructive negotiations, either individually or through employers' associations, with such employee organisations with a view to reaching agreements on employment conditions, which should include provisions for dealing with disputes arising over the interpretation of such agreements, and for ensuring mutually respected rights and responsibilities;
2. a) provide such facilities to representatives of the employees as may be necessary to assist in the development of effective collective agreements..

EQUALITY OF OPPORTUNITY:

PGP: para 2.3

Companies will eliminate all discrimination on the basis of race, religion, sex, political opinion or physical handicap and will implement affirmative action programs.

CC: para 1

Companies should insure that their operations are free from discrimination based on race, sex, religion, political opinion and physical handicap, and implement affirmative action programs designed to protect the equal rights and treatment of the historically disadvantaged.

ILO: para 21

All governments should pursue policies designed to promote equality of opportunity and treatment in employment, with a view to eliminating any discrimination based on race, colour, sex, religion, political opinion, national extraction or social origin. ³⁸²

para 22

Multinational enterprises should be guided by [the principle of equality of opportunity and treatment in employment] throughout their operations without prejudice to ...government policies designed to correct historical patterns of discrimination and thereby to extend equality of opportunity and treatment in employment. Multinational enterprises should accordingly make qualifications, skill and experience the basis for the recruitment, placement, training and advancement of their staff at all levels.

³⁸² Convention (No.111) and Recommendation (No.111) concerning Discrimination in Respect of Employment and Occupation; Convention (No.100) and Recommendation (No.90) concerning Equal Remuneration for Men and Women Workers for Work of Equal Value are referred to.

OECD:

EMPLOYMENT AND INDUSTRIAL RELATIONS

Enterprises should, within the framework of law, regulations and prevailing labour relations and employment practices, in each of the countries in which they operate,

7. implement their employment policies including hiring, discharge, pay, promotion and training without discrimination unless selectivity in respect of employee characteristics is in furtherance of established governmental policies which specifically promote greater equality of employment opportunity;

ENVIRONMENTAL PROTECTION:

PGP: para 2.4

Investment must incorporate environmentally sound and clean practices and technology.

CC: para 8

Companies should utilize environmentally sound practices and technologies, disclose how and in what amounts they dispose of their waste products, and seek to minimize hazardous waste.

ILO:

No provision

OECD:

GENERAL POLICIES

Enterprises should:

2. in particular, give due consideration to those countries' aims and priorities with regard to economic and social progress, including industrial and regional development, the protection of the environment

TRAINING AND EDUCATION:

PGP: para 2.5

Investment should enhance the productive capacities of South Africans, and should, in particular, institute training and adult education programs for workers in consultation with the trade union movement.

CC: para 2

Companies should develop and implement training and education programs to increase the productive capacities of their South African employees in consultation with the trade union movement.

ILO:

para 29

Governments, in co-operation with all the parties concerned, should develop national policies for vocational training and guidance, closely linked with employment. This is the framework

within which multinational enterprises should pursue their training policies.

para 30

In their operations, multinational enterprises should ensure that relevant training is provided for all levels of their employees in the host country, as appropriate, to meet the needs of the enterprise as well as the development policies of the country. Such training should, to the extent possible, develop generally useful skills and promote career opportunities. This responsibility should be carried out, where appropriate, in co-operation with the authorities of the country, employers' and workers' organisations and the competent local, national or international institutions.

OECD:

EMPLOYMENT AND INDUSTRIAL RELATIONS

Enterprises should, within the framework of law, regulations and prevailing labour relations and employment practices, in each of the countries in which they operate,

5. in their operations, to the greatest extent practicable, utilize, train and prepare for upgrading members of the local labour force in co-operation with representatives of their employees and, where appropriate, the relevant governmental authorities;

CONDITIONS OF WORK AND LIFE:

PGP: para 2.6

Conditions of work and life offered by companies shall compare favorably with the best conditions in the relevant sector domestically.

CC: para 4

Companies should maintain [a] safe and healthy work environment and strive to ensure that the working and living conditions they provide accord with relevant international conventions.

ILO:

para 33

Wages, benefits and conditions of work offered by multinational enterprises should be not less favourable to workers than those offered by comparable employers in the country concerned.

para 36

Governments should ensure that both multinational and national enterprises provide adequate safety and health standards for their employees. Those governments which have not yet ratified the ILO Conventions on Guarding of Machinery (no. 119), Ionising Radiation (no.115), Benzene (NO. 136) and Occupational Cancer (No. 139) are urged nevertheless to apply to the greatest extent possible the principles embodied in these Conventions and in their related recommendations (Nos. 118, 114, 144 and 147). The Codes of Practice and Guides in the current list of ILO publications on Occupational Safety and Health should be taken into account.

OECD:

No provision

SECURITY OF EMPLOYMENT:

PGP: para 2.7

Investment should contribute to the security of employment of South Africans.

CC: para 5

Companies should strive to maintain productive employment opportunities and create new jobs for South Africans.

ILO:

para 25

Multinational enterprises equally with national enterprises, through active manpower planning, should endeavour to provide stable employment for their employees and should observe freely negotiated obligations concerning employment stability and social security. In view of the flexibility which multinational enterprises may have, they should strive to assume a leading role in promoting security of employment, particularly in countries where the discontinuation of operations is likely to accentuate long-term unemployment.

OECD:

No provision

EMPOWER BLACK BUSINESS:

PGP: para 2.8

Companies should, where possible, adopt business practices which enhance the development of Black business in South Africa.

CC: para 9

Companies should strive to improve the development of black-owned South African businesses by purchasing from and sub-contracting to such firms.

ILO:

No provision. However, the ILO Declaration does state, generally, that: Multilateral enterprises should take fully into account established general policy objectives of the countries in which they operate [and that t]heir activities should be in harmony with the development priorities and social aims and structure of the country in which they operate... (para 10).

OECD:

No provision. However, the OECD Annex to the Declaration does state, generally, that: Enterprises should...take fully into account established general policy objectives of the Member countries in which they operate [and] favour close co-operation with the local community and business interests..

IMPLEMENTATION:

PGP: para 2.9

Mechanisms should be put in place to evaluate the implementation of the above principles, including the disclosure of relevant information by companies.

CC: para 10

Companies should cooperate with monitors established to implement these standards by disclosing relevant information in a timely fashion.

ILO:

No provision.

OECD:

GUIDELINES FOR MULTINATIONAL ENTERPRISES

6. The[se] guidelines... are recommendations jointly addressed by Member countries to multinational enterprises operating in their territories...which take into account the problems which can arise because of the international structure of these enterprises, lay down standards for the activities of these enterprises in the different Member countries. Observance of the guidelines

is voluntary and not legally enforceable. However, they should help to ensure that the operations of these enterprises are in harmony with national policies of the countries where they operate and to strengthen the basis of mutual confidence between enterprises and States.