Policy Framework for Foreign Direct Investment Promotion in South Africa: Operations, Effectiveness and Sustainability

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ABSTRACT

Foreign direct investment promotion in South Africa has expanded considerably in the two decades from 1995 to 2015. The investment promotion system is quite decentralised, with much of the work being carried out by provincial governments, albeit with support from Trade and Investment South Africa (TISA), a division of the Department of Trade and Industry. This occasional paper draws on a series of interviews with representatives of South Africa’s provincial investment promotion agencies and information from their annual reports. It looks at how these agencies operate and perform, examining issues of competition and co-ordination. There is a strong argument to be made for TISA to provide greater strategic oversight over investment promotion in South Africa. Moreover, with new efforts to improve the quality of foreign investment flowing to South Africa, especially in the light of the Promotion and Protection of Investment Bill of 2013, much of the focus has been on investment regulation. However, there are a number of potential interventions on the investment promotion front that the government should also be considering as part of its subsequent steps to ensuring high-quality, sustainable investment.

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ABBREVIATIONS AND ACRONYMS

dti  Department of Trade and Industry
FDI  foreign direct investment
IPA  investment promotion agency
TISA Trade and Investment South Africa
INTRODUCTION

It is notable that despite its name, the first draft of South Africa's Promotion and Protection Investment Bill released in November 2013 contains no direct discussion of investment promotion. No reference is made in the document to the country's investment promotion agencies (IPAs) or their activities. This raises a few important questions: How well is investment promotion working in South Africa? Is investment promotion completely separate from investment regulation or are they two sides of the same coin? What other areas, in addition to regulation, need to receive attention, such as economic incentives and competition policy?

This paper builds on earlier South African Institute of International Affairs research on investment incentives in South Africa. However, here the focus will be on providing a preliminary assessment of the workings of the country's investment promotion infrastructure. It draws on a series of interviews conducted in November 2014 with representatives of provincial IPAs, supported by an assessment of their annual reports.

The value of investment promotion for an attractive investment climate

IPAs are tasked with attracting and facilitating foreign and domestic investment through a variety of means, including image building, investor facilitation and investor services, investment generation, and policy advocacy. However, it is always difficult to disentangle the influence of these activities on investment inflows from other factors related to the broader investment climate. As such, critics of investment promotion have questioned whether IPAs constitute good use of public resources.

Yet investment promotion is receiving increasing attention in policy circles. Recent econometric research shows that investment promotion agencies can have a substantial impact on foreign investment inflows. Controlling for possible selection bias, it has been shown that sectors targeted by investment promotion agencies receive twice as much foreign direct investment (FDI) in the post-targeting period relative to the pre-targeting period and non-targeted sectors. What is clear, though, is that it is necessary to consider promotion as a complement to rather than a substitute for policies that directly create an attractive climate for sustainable investment, through, inter alia, securing property rights, providing adequate infrastructure and ensuring the availability of skilled labour.

What is also important is that agencies concentrate not only on FDI quantity but also on quality, steering investment towards priority areas. Sustainable FDI can be defined as FDI projects that yield profits sufficient to maintain effective corporate engagement without harming vital host country interests while producing positive net benefits for the country's long-term development goals as evaluated on prioritized economic, environmental, social and governance indicators. South Africa's recent national policy frameworks, such as the 2013 Industrial Policy Action Plan, have emphasised the importance of employment creation, industrial development and environmental sustainability (in the light of a heavy reliance on fossil fuel energy). FDI policy in the country could be steered towards these objectives through, for example, a cautious application of economic incentives that are focused on addressing South Africa's pertinent structural weaknesses and that do not discriminate between foreign and domestic investors.
HISTORY, STRUCTURE AND ACTIVITIES OF INVESTMENT PROMOTION AGENCIES IN SOUTH AFRICA

History

After South Africa had emerged from isolation in 1994, the new national government realised the importance of FDI for achieving its employment and economic growth objectives. A national agency, Investment South Africa (which later became Trade and Investment South Africa, or TISA), was set up to co-ordinate the activities of provincial IPAs and manage IPA networks through foreign offices. While most provincial IPAs are now government-owned, some started off as statutory bodies, while others evolved from Section 21 (ie, non-profit) companies. There were also differences in their original mandates: some primarily acted as property holding companies while others focused primarily on domestic investment. Over the years, the activities of these IPAs have converged. There are still, however, vast differences in experience: a few agencies have existed for as long as 20 years, while others were formed in the last five to seven years.

Basic structure and funding

Provincial IPAs in South Africa are generally not stand-alone entities but rather exist as units in provincial economic development agencies. Along with the promotion of foreign and domestic investment, most are also involved in export promotion (ie, assisting local companies with their export activities). There is much variation in the size of the teams that deal with foreign investment: reported team sizes ranged from five to 20 people. For the most part, agency staff were involved in a variety of activities, although the Gauteng Investment Centre made use of sector specialists and other agencies indicated that they were trying to move in this direction too. Some of the agencies reported being more primarily geared towards small, medium and micro-enterprise development, while others were more focused on foreign investment promotion.

TISA has a presence at the new Gauteng Investment Centre, which has been designed as a ‘one-stop shop’ providing a comprehensive range of business support services in one centralised location, including business and tax licensing, banking services and strategy consulting. However, this is not the case with other IPAs, which cannot grant business licences directly to investors. However, IPA representatives reported a high level of communication with TISA. IPAs also report contact with South African development banks to arrange funding for projects and with other government departments that grant licences for specific sectors. Directors of provincial development agencies meet on a quarterly basis and co-operation on investment promotion is reportedly always on the agenda.

Most of the funding for these IPAs comes from provincial governments. Sometimes major city governments contribute funding. It also seems that many of these agencies own land and property assets from which they derive some of their revenue. In the case of the Gauteng IPA, the investment unit has formed partnerships with a number of private sector actors, including the Industrial Development Corporation and the Development Bank of Southern Africa, several automobile companies and a consultancy company. According
to some IPA representatives, TISA views Gauteng’s one-stop shop as a prototype and may assist other provinces with setting up similar centres if the model is found to work well.

**Main activities**

All IPA representatives interviewed claimed that their agencies performed a wide range of general investment promotion functions. Given their location and relative economic development, some provinces receive much more interest from prospective investors than others. Agency representatives of provinces that have consistently attracted lower levels of investment admitted to being quite dependent on TISA for investor referrals. In contrast, the more successful provinces in terms of investment attraction received calls from investors who had come across their website or who had been advised by investors who were already established in the province.

Some representatives emphasised the importance of meetings arranged by TISA with newly appointed South African diplomats before they left for missions abroad. At these meetings they could make presentations about their province’s offerings and network with diplomats, in the hope that they might then be able to pass information on to companies based in other countries. All the IPAs sent investment missions abroad: either as part of collective ventures organised by TISA or on independent missions to investment events or company offices abroad. Some representatives spoke of the need to undertake more missions, but judging by the expenditure listed in some provincial development agency reports, other investment units seem to be scaling back substantially on these overseas missions. It was reported that TISA had recently tried to do more to regulate and co-ordinate the missions of provincial IPAs abroad.

Many representatives spoke about how their IPAs were trying to become more proactive in their investment promotion activities, with some having adopted proactive processes and policies. These included conducting surveys to assess investor satisfaction; implementing retention programmes aimed at encouraging established investors to reinvest or expand their activities; and organising discussions with prospective investors about new incentives that would suit their businesses.

**PERFORMANCE OF INVESTMENT PROMOTION AGENCIES AND EMERGING ISSUES**

**Professionalism and performance**

There seems to be a substantial difference in levels of professionalism among IPAs. Some agencies’ websites are very well presented and provide useful information for investors about key economic sectors and both provincial- and national-level investment incentives. The better websites also include a regularly updated investment news section, summary information on setting up a business in South Africa and sometimes a list of package investment opportunities. However, several other IPA websites have very poor layouts and contain limited and weakly presented information. Significant difficulties were encountered in getting into telephonic contact with certain IPAs in the process of...
conducting the survey for this paper. In a few instances the author was told that none of
the investment promotion staff had come into the office and that their whereabouts were
unknown.

In an assessment of the annual reports, reference to institutional mismanagement
emerged in some of the IPAs. As a result, some agencies had experienced a high turnover
of management staff and had run up deficits in recent years. In contrast, units within
certain agencies are clearly going the extra mile, evaluating their performance relative to
targets set at the beginning of the financial year and even volunteering for international
IPA evaluations. In certain annual reports, the IPAs concerned listed a series of successes
in terms of attracting foreign investors, making mention of numerous investment
deals signed and jobs created. Other IPAs apparently had not facilitated many foreign
investment deals in recent years, according to their annual reports. Of course, the global
financial crisis might have had a role to play here, but some representatives also spoke
about reduced provincial government funding for investment promotion activities, and a
shortage of potential recruits with the necessary skills and industry experience.

**Emerging issues**

A number of issues related to the decentralised structure of the investment promotion
system in South Africa arose in conversation with the IPA representatives. As mentioned
earlier, provincial IPAs are primarily funded by, and accountable to, provincial
governments. This inevitably leads to competition for foreign investors between IPAs,
which is no doubt healthy in some respects but also has its drawbacks.

Several IPA representatives were at pains to emphasise the co-operation and good
relations between provincial investment units, and claimed that IPAs referred investors
to other provinces when their businesses were better suited elsewhere. However, other
interviewees were less diplomatic on this topic and stated that competition was often
fierce, with several IPAs doing all they could to capture as much investment as possible.
Given that many IPAs set ambitious foreign investment targets, for example 3–5% annual
growth in the value of FDI projects even during a recession, this is not surprising.

High levels of competition are also not ideal when it comes to investment promotion
missions abroad. Often, each provincial IPA will send its own staff to events and meetings
overseas, which would seem an unnecessary waste of money except on the largest or most
important occasions. For potential foreign investors it is no doubt less interesting hearing
about the opportunities in one of nine provinces in South Africa than about opportunities
in South Africa as a whole.

Lastly, the decentralised IPA system may sometimes create extra hurdles for foreign
investors, who already have to navigate a complex system to get their businesses started.13
They need to apply for general business licences at the Department of Trade and Industry
(dti) and sectorial licences at the appropriate government department; obtain visas
for their foreign personnel at the Department of Home Affairs; complete business and
tax registration at the South African Chamber of Commerce; and complete additional
paperwork for land and utilities. Only at Gauteng’s one-stop shop can investors complete
most of these requirements in one place. At other IPAs, investors may only be able to
obtain advice. Furthermore, in deciding where best to invest in the country, investors
potentially need to comb through information about each of the nine provinces.
 Provincial IPAs and the Investment Promotion and Protection Bill of 2013

South Africa is currently undergoing a significant transition in its approach to foreign investment. In the past the foreign investment regime was relatively laissez-faire, but recently the government has shown interest in increasing its regulation of this sector. In 2013 the government announced that it was doing away with its bilateral investment treaties. As outlined in the draft Investment Promotion and Protection Bill, it instead wishes to adopt an overarching framework to govern foreign investment that, in its view, would be less biased against foreign investors and give the government more room to pursue South Africa’s economic and social goals. Key proposals in the previous iteration of the bill include local content requirements and an enabling clause for (direct or indirect) expropriation of foreign assets in cases where this would be in the ‘public interest’.

At the time of writing, the revised draft bill had not yet been introduced to Parliament. However, in terms of the constitution, if it is passed, provincial governments will most likely have no choice but to abide by it. South Africa is a quasi-federal state and provincial governments are wholly subordinate to national legislation. Still, it is unclear what part, if any, provincial IPAs might have to play in explaining the new regulations to potential investors.

Importantly, this move on the part of the South African government is not being carried out in isolation. It is emblematic of a recent global trend in which many governments around the world are becoming increasingly active in enacting FDI regulatory agreements that have more industrial policy space. In part, this is reflective of a new realism about the ever-increasing power of multinational organisations, and the economic and social costs of unregulated market forces in the wake of the financial crisis. There is talk of a new, ‘fourth generation’ of investment regulation in which IPAs focus on attracting ‘sustainable’ FDI with an emphasis on economic development, environmental sustainability, social development and good governance.

However, being a front runner among emerging economies when it comes to adopting new investment policy does carry its risks. Many commentators have pointed out that even just the perception that South Africa is adopting a more protectionist stance towards FDI could unsettle foreign investors, both prospective and established. Insofar as the government is concerned with making foreign investment more sustainable, it should be reflecting on the role of investment promotion in addition to that of investment regulation.

**THE WAY FORWARD FOR SOUTH AFRICA’S INVESTMENT PROMOTION**

Given the issues with South Africa’s investment promotion system, the government might consider the following recommendations to improve and better co-ordinate the system, and make it more sustainable.

**More strategic oversight from TISA**

TISA should play a stronger role in investment promotion in South Africa, providing more strategic oversight, while continuing to give provincial IPAs room to innovate and carry
out their own strategies. The national agency needs to come up with a better framework to guide co-operation between provincial IPAs. A certain degree of pooling of resources and co-operation between actors would benefit South Africa and all its provinces. In particular, the national agency should consider developing and adopting the following:

- An efficient ‘funnel and referral system’ for inward foreign investment: This was recommended as necessary 15 years ago, but is still not in place today. While it may be the case that TISA does field some queries from foreign investors, there needs to be an official system to facilitate the functioning of this process.
- A single, well-designed website for all the provinces: This should list opportunities in all nine provinces and summarise information from the provincial websites. It should also endeavour to provide positive investment-related stories about South Africa to try to counter negative perceptions of the country.
- A more formal inter-provincial referral system: It is not enough just to expect provincial agencies to refer prospective investors to other provinces out of a sense of altruism. These referrals need to be recorded and monitored, and perhaps rewarded in some way.
- A national central hub with representatives of all provinces: This would make much more sense than trying to develop more provincial one-stop shops which are expensive to set up and only viable in provinces that receive considerable attention from foreign investors. Ideally, this would be placed at a central location such as OR Tambo International Airport. According to some respondents, TISA has been considering a national one-stop shop, but it should look to take action in this regard soon.

Rigorous evaluations of provincial IPAs

Provincial IPAs should be rigorously evaluated for the purpose of comparative benchmarking. A representative of one of the larger IPAs mentioned that they were volunteering for international evaluations but, at the moment, other agencies were just relying on self-evaluations. In addition, a major evaluation should be undertaken of investment incentive schemes implemented by TISA and the provincial IPAs to assess their impact. This has not been done for almost a decade.

A new sustainability focus for investment promotion

TISA should consider refining its incentive policies. Some of its current incentives are aimed at stimulating industrial development, building critical infrastructure and supporting black-owned businesses. However, in the absence of comprehensive evaluations, it is not clear how well these incentives are working. There are also many other incentives that the government could consider, including tax reductions for foreign companies conditional on the reinvestment of profits, cash grants tied to the number of employees employed or money spent on training costs, and subsidised factory space in key areas.

TISA could also facilitate engagements between foreign investors and local firms with which they could partner and that might be able to provide input. It could set up a ‘business linkage’ programme of the sort already in place in many countries, where it
would provide relevant information, promote local supplier firms, undertake matchmaking activities and come up with project proposals.

Lastly, if the South African government is serious about deepening the sustained local and economic benefits of FDI, it should advertise this fact. Information on the commitments could be provided on TISA’s website and those of the provincial IPAs. Sustainability-oriented incentives and special package investment deals should be actively promoted to foreign investors.

CONCLUSION

Several of South Africa’s provincial IPAs seem to be doing a sterling job in attracting and facilitating foreign investment. They are internationally competitive and use innovative investment promotion strategies. Still, the picture for the whole country is far from uniform. Moreover, even if all provincial IPAs were performing well there would still be a strong argument for greater co-ordination among agencies to ensure resources are not wasted and foreign investors receive the information and services they need in the most efficient way possible.

This paper has argued that South Africa’s national investment agency, TISA, should exercise more strategic oversight over the country’s investment promotion system. It should push forward with plans to set up a national one-stop shop for foreign investment and work on better national and inter-provincial referral systems for foreign investors.

Better co-ordination of provincial IPAs is also needed if the government is to adopt the sustainability focus referred to and advocated earlier in the paper for its investment promotion regime. Individual IPAs might be reluctant to implement such policies if they cannot be sure that other IPAs will follow suit, leaving them at a potential competitive disadvantage. Once again, there is a need for TISA to play a guiding role.

ENDNOTES

1 In keeping with the literature, this paper uses the term investment promotion agency. It should be noted, however, that investment promotion activities at provincial level in South Africa are often carried out by units or divisions of provincial economic development agencies rather than by stand-alone entities.
3 IPA representatives interviewed by the researcher for this paper are not mentioned by name. In order to encourage frank discussion, they were promised anonymity. Most of the interviewees were directors of provincial investment promotion units, but there were a few cases where other high-ranking officials in provincial development agencies were interviewed instead. The majority of interviews were conducted by telephone, except for one, which was conducted in person. Interviews were conducted with representatives of the following agencies: Free State Development Corporation (FSDC), Western Cape Destination Marketing, Investment and Trade Promotion Agency (WESGRO), Gauteng Investment Centre (GIC),
Northern Cape Economic Development Trade & Investment Promotion Agency (NCEDA), North West Development Corporation (NWDC), Trade & Investment KwaZulu-Natal (TIKZN) and Trade & Investment Limpopo (TIL).


7 Morisset J & K Andrews-Johnson, op. cit.


11 Ibid., p. 18.


13 It should be noted that in the past some of the larger multinational companies did not deal directly with provincial IPAs in South Africa but approached industry bodies or the South African Chamber of Commerce directly. However, multinationals with less bargaining power generally have had to go the provincial IPA route.


19 Wentworth L, op. cit., pp. 18–19.
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