Investment Project

South African Case Study

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1. Overview of the domestic investment framework in South Africa

1.1 Introduction

There has been a substantial paradigm shift globally among developing countries, in recent decades, from resisting or at least restricting foreign involvement in the domestic economy to actively encouraging it. This has led to countries actively competing for a share of global investment flows, especially foreign direct investment (FDI).

South Africa in particular has undergone major changes in this regard. Economic policies in the 1960s and 1970s were largely determined by the overriding goal of import substitution (through local industrial development) and economic self-reliance, brought about largely by political considerations and the country’s growing isolation from the international community.

Although FDI continued to flow into South Africa during South Africa’s political and economic isolation, owing to favourable domestic returns on investment, political circumstances locally and pressure from abroad (economic sanctions, trade boycotts, civil society campaigns etc.) lead to a massive outflow of capital, especially in the 1980s. Estimates place the number of trans-national companies (TNCs) that exited South Africa at 350 (Gelb, 2002).

The transition to democracy, together with the lifting of economic sanctions against South Africa in the early 1990s, brought about a gradual return of FDI into South Africa. However, despite investor-friendly policies of the ANC-led South African government, there is general consensus that South Africa is lagging behind in attracting FDI compared with a number of other emerging markets (Vickers 2003:7).

1.2 The current domestic legal framework for FDI

Little distinguishes the legal framework relating to FDI from the country’s domestic laws and regulations. Foreign investors require no government approval prior to setting up a local business presence, nor is there a minimum capital requirement. While foreign investors generally face no restrictions relating to exchange controls and the repatriation of profits, they do require approval from the South African Reserve Bank under the country’s exchange control regulations (Vickers, 2003:33). Similarly, the country’s bilateral investment treaties (BITs) stipulate that there should be no delay in the transfer of payments, and list the types of transfer payments / repatriations that are specifically covered by the agreements.

In most respects, therefore, foreign investors are subject to the same legal framework as domestic investors. Certain regulations, for example minimum capital requirements relating to financial institutions, generally apply equally to local and foreign investors alike. Likewise, South Africa’s commitments under the WTO Agreement on Trade-Related Investment Measures (TRIMS) specify that it does not impose specific performance or local content requirements on foreign investors. Important principles forming part of South Africa’s domestic legal framework for FDI also encompass the Most-Favoured Nation (MFN) and National Treatment (NT) principles. The MFN principle stipulates that (WTO member) countries do not discriminate amongst each other (although
additional reciprocal privileges may be granted under bilateral agreements), while NT stipulates that inward FDI should be granted the same privileges and obligations as local investment¹. As outlined later, some of South Africa’s bilateral investment treaties do, however, contain a derogation from this principle. This gives the South African government the right to elevate policies aimed at redressing economic empowerment imbalances with respect to previously disadvantages natural or legal persons above the normal NT principle, especially with regard to investment.

With respect to formal procedural requirements relating to FDI, investors are free to establish a local commercial presence through a variety of business entities, for instance private or public companies, close corporations (a form of company with restrictions yet with fewer administrative requirements to a private company), partnerships and trusts. There is no additional requirement stipulating that shareholders or directors must be official residents of the country, and the commercial presence (be it a joint-venture, fully owned subsidiary / “branch” or independent entity) may consist of any of the legal entities listed above. Where an entity with a commercial presence in South Africa is incorporated outside of the country it is regarded as an “external company”, and its South African-sourced profits are taxed at a flat rate above that normally applicable to a locally registered entity.

Broadly speaking, a commercial presence resulting from FDI is subject to domestic regulations in a number of spheres, with South Africa having developed a legal framework and guidelines in important areas such as capital controls, competition policy, labour policy, intellectual property, taxation, environment, privatisation and empowerment. See Appendix 1 for an overview of legislation in these areas.

1.3 South Africa’s judicial system and administrative requirements relating to FDI

Foreign-owned but locally incorporated enterprises have equal rights and obligations within South Africa’s judicial system. In terms of the South African Constitution, foreign-owned companies in South Africa would have jurisdiction to bring a case before a South African court provided that they can establish *locus standi*, as the right provided in terms of section 34 states that “everyone (and not every citizen) has the right to have any dispute…resolved in a fair public hearing before a court”. This would include both legal and natural persons.

Foreign investors, however, have the additional option of settling a dispute through international arbitration, provided that there is a Bilateral Investment Treaty (BIT) in existence between the parties and that it makes provision for such arbitration. South Africa’s BITs, until at least 2001, follow a similar pattern although some variances do exist (as will be explained later, South Africa’s BITs were until recently loosely modelled on the British model, following the conclusion of the country’s first BIT with the U.K. in 1994).

South Africa has an advanced legal system and its Constitution of 1996, drawn up following South Africa’s transition to a full democracy, is one of the most progressive in the world. It delineates the structure of the South African court system, creating a hierarchy of courts in terms of which the Constitutional Court is the highest court in the land.

¹ A more recent application of NT defines it as “treatment no less favourable to domestic persons / entities”
In hierarchical order the courts are:

1. The Constitutional Court
2. The Supreme Court of Appeal
3. The High Courts
4. The Magistrates Courts
5. Any other court

The Supreme Court of Appeal has jurisdiction within the whole of South Africa and is seated in Bloemfontein. The High Courts have divisions in each of the nine provinces in South Africa. South Africa is currently in the midst of restructuring its court system to rationalise the High Courts and their areas of jurisdiction. For purposes of specialised litigation, specialised courts have been established.

With regard to investment, the following specialised courts are of significance:

- **Labour Court and labour appeal court**
  Established in terms of the Labour Relations Act of 1995, the labour court has jurisdiction over the whole of South Africa in terms of labour disputes concerning, for example, strikes, retrenchments and discrimination.

- **Court for income tax appeals**
  The presiding judge and an experienced accountant and representative of the commercial community hear disputes regarding income tax issues.

- **Commercial court**
  Commercial courts were set up in South Africa to ensure the effective and efficient adjudication of commercial cases relating to, for example, companies, mining and minerals, banking and international trade. The presiding judges are experts in the field and play a more active part in the trial than is usual in South African courts.

South Africa’s Constitution is supreme law and international agreements cannot become part of domestic law unless incorporated through national legislation\(^2\). However, if there is general law which does not purport to incorporate any specific investment agreement or other international agreement but as a matter of principle makes non-discrimination a general legal principle and also makes this duplicable to foreign investors, then of course the

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\(^2\) The relevant provisions in the Constitution are Sections 231, 232, 233 and 239. Section 231 of the Constitution actually provides for five types of International Agreements. The most sensitive and important ones have to be approved by Parliament before they will enter into force. This applies to BITs (DTI, 2004). All International Agreements have to be negotiated and signed by the National Executive: meaning that the nine provinces cannot conclude international Treaties. Once negotiated and signed these very important International Agreements have to be approved by resolution in both Houses of Parliament and only after that will the consent to be bound be communicated through the Department of Foreign Affairs or another relevant State Department to the depository of the international agreement in question.

The other four types of international agreements are referred to as “Technical, Administrative or Executive Agreements or Agreements which do not require either ratification or accession”. They bind South Africa without approval by the National Assembly and the National Council of Provinces, but must be tabled in the two Houses of Parliament within a reasonable time. The latter is however not a requirement for validity in international law.
source is general domestic law and a specific reference to the Constitution is not required. The important point here is that the incorporation of international agreements into South African law requires national legislation. This can be done in law of general application or with respect to a particular international agreement.

South Africa’s BITs fall into the category of agreements requiring parliamentary approval prior to becoming enforceable.

1.4 Special provisions and exceptions relating to foreign investors

South Africa generally does not attach special provisions to FDI, since these would in all likelihood merely serve to reduce the country’s attractiveness as a destination for inflows of capital. Likewise, foreign investors have equal recourse under South Africa’s domestic laws as local investors have. Specific legislation relating to certain sectors, for example minimum capital requirements for financial institutions, generally apply equally to local and foreign investors alike and are intended less as a restriction rather than as a consumer- and banking system protective measure.

As indicated earlier, investors are free to establish a local commercial presence through a variety of business entities. There are no minimum capital requirements, local content provisions or major impediments that restrict the repatriation of capital to the source country. The NT principle, as outlined earlier, is a common feature of South Africa’s BITs and thus warrants the equitable treatment and non-discrimination of foreign investors. All performance requirements (mandatory or voluntary) would thus apply equally to local and foreign investors alike, and are as such not a specific feature of South Africa’s BITs. With respect to NT, there is an exception with respect to the Foreign Investment Grant (UNCTAD, 2003). This grant (to a maximum of R3mn) is aimed specifically at foreign investors, and covers associated costs of bringing productive assets relating to an investment into South Africa. The aim of this grant is to help facilitate the transfer of new technology to South Africa or of technology where domestic capabilities are limited. This facility has been reasonably successful with a number of companies successfully applying for it.

Nevertheless, BITs concluded with China, Iran, Russia, Ghana, Nigeria, the Czech Republic and Mauritius (being the more recent BITs) contain an important derogation from the usual NT principle, in that they provide for any laws enacted as envisaged by Article 9 of the SA Constitution (namely, with regard to black economic empowerment (BEE) or other advancement of previously disadvantaged natural or legal persons)

Black Economic Empowerment (BEE)

- It is an integrated and coherent socio-economic process.
- It is located within the context of the country’s national transformation program, namely the RDP.
- It is aimed at redressing the imbalances of the past by seeking to substantially and equitably transfer and confer the ownership, management and control of South Africa’s financial and economic resources to the majority of its citizens.
- It seeks to ensure broader and meaningful participation in the economy by black people to achieve sustainable development and prosperity.

Definition according to the Black Economic Empowerment Commission (2001)

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3 Black Economic Empowerment (BEE) has become an increasingly prominent feature in the South African economic landscape. Its aim is to address past imbalances relating to previous government policies through the special advancement of opportunities for persons (or legal entities) from previously disadvantaged ethnic groupings. A Black Economic Empowerment Commission (BeeCom) was set up and tasked with compiling a “clear and coherent vision for BEE in South Africa”. The idea of a BeeCom arose out of a resolution at the Black management Forum National Conference held in 1997. For example, with respect to government procurement the State utilises its position as buyer to promote the economic empowerment of previously disadvantaged groups, often at the expense of other groupings and entities both local and
to override the NT principle contained in a particular BIT\textsuperscript{4}. Interestingly, none of the BITs concluded with European countries contains such a provision. This may be due to the fact that South Africa’s BITs with European countries were the first to be concluded and are still strongly influenced by the EU investment treaty model.

However, a limited number of capital and local funding controls remain and apply directly to foreigners (and by extension FDI). These relate to the payment from South African sources of royalties, license fees and certain other remittances, and require approval from the SA Reserve Bank. Considering that capital controls (albeit vastly more relaxed than a decade ago) remain in place for South African residents, it could be speculated that these provisions would appear to be in place to prevent a circumvention of existing capital controls under the guise of royalty or license payments from SA residents and firms to outsiders.

A few years ago the South African government attempted to impose restrictions on ownership of firms operating in the security industry, citing strategic security concerns. It proposed that foreigners were not permitted to own and operate security firms in South Africa, notwithstanding the fact that at the time international firms such as \textit{Chubb} held dominant market positions within the country. Following vocal resistance to any such moves, the idea was abandoned shortly afterwards. Some limitations on foreign ownership in effect prevail in sectors such as mining and telecommunications. The recent Mineral and Petroleum Resources Development bill (2002) sets ambitious goals for black ownership, while in the broadcasting industry (following the Independent Broadcasting Authority Act of 1996) direct foreign ownership was limited to 20% of the total equity in an individual broadcaster (UNCTAD, 2003).

A further restriction relating to FDI however concerns \textit{local} borrowings. Business entities that are more than 75% foreign owned (i.e. by non-residents) are restricted in their local borrowings, although as local-resident participation increases so do the permissible local borrowings. Although there is no restriction on foreigners owning business entities incorporated in South Africa, foreign directors of local companies must indicate their nationality on company letterheads.

Indirect impediments to FDI arguably arise through for example immigration laws which specify the requirements and processes for obtaining work permits, Employment Equity requirements and BEE charters which have been adopted by various industries (e.g. the mining industry and liquid fuels industry). These may pose challenges to foreign investors especially with regard to the availability of skills.

\textsuperscript{4} In early 2004, a government tender for a large housing development project near Cape Town, South Africa, was awarded to a local empowerment consortium, despite two foreign (Irish) tenders being substantially more favourable from a financial perspective. Although one of the losing (Irish) bidders has filed an appeal, it would appear that in the absence of a BIT between Ireland and South Africa the investor would have little legal recourse, especially considering the government’s stated BEE developmental principles.
1.5 Investment promotion

South Africa has recognised the benefits of FDI inflows, not only from a currency perspective but also in terms of skills transfers, technology transfers and potential job creation. Investment promotion agencies exist both at the national and regional (provincial) level, and compete with one another for a share of FDI inflows. At the national level, Trade and Investment South Africa (TISA) is as its name suggest a trade and investment promotion agency with local and international representation (via most of South Africa’s diplomatic missions), and has been incorporated as an extension to the Trade and Industry Ministry.

TISA identifies investment opportunities and provides market intelligence to potential investors, especially in the priority growth sectors as identified by the government’s Integrated Manufacturing Strategy (IMS). These are automotive and transportation, agro-processing, chemicals, ICT, mining and metal-based industries, pharmaceuticals and biotechnology, cultural industries, textiles-clothing-leather-footwear, and tourism. Government facilitated FDI accounted for roughly 20% of FDI inflows in 2001 (Budget Speech by the Minister of Trade and Industry, 2002, cited by Vickers, 2003:38).

At the regional level, similar government-funded trade and investment promotion agencies exist, including WESGRO (Western Cape Investment and Trade Promotion Agency), ECDC (Eastern Cape Development Corporation), GEDA (Gauteng Development Agency) and so forth. These agencies provide a valuable service – including market intelligence, business advice and economic research – to potential foreign investors and local stakeholders alike.

Industrial Development Zones (IDZs) have also in recent years been a feature of the government’s strategy to attract foreign investment. IDZs are licensed to operators who run them while providing enterprise support measures and minimising bureaucratic red tape. In South Africa, no special provisions (for example with respect to labour or environmental regulations) apply to IDZs. They remain, however, different from Export Processing Zones (EPZs) found in some countries which usually dispense with some of the labour, environmental and customs requirements usually associated witha given country’s domestic legislation.

Despite its apparent advantages, investor response to IDZs has been relatively poor and has on the whole done little to create significant employment opportunities (of the investments that have been attracted to IDZs, many are highly capital-intensive mega projects). The Coega IDZ situated near Port Elizabeth in the country’s Eastern Cape Province, which is nearing completion, continues to struggle to attract long-term ‘anchor-tenants’. Uncertainty continues to surround the commissioning of a proposed US$ 2bn French-owned aluminium smelter, as the French company involved (Pechiney) was recently the subject of a (successful) hostile take-over bid by a Canadian rival firm (Alcan). Prior to its takeover, Pechiney had already spent € 45mn on developing plans for this proposed investment (SAPOA, 2004).

1.6 Role of development agencies and banks in FDI

Developmental agencies have an increasingly important role to play in the facilitation of FDI, both inward and outward from South Africa. Their mandate and assumed risk profile usually goes far beyond that of ordinary
financial institutions or merchant banks, and they occasionally play a leading role in the provision of finance as well as the underwriting of risk.

In South Africa, the Development Bank of South Africa (DBSA) and the Industrial Development Corporation (IDC) are two such institutions. Their financing horizon has increasingly shifted beyond South Africa’s borders and they play an important role in outward FDI from South Africa (for example investments in neighbouring Mozambique) and inward FDI (taking a 12.5% stake in the proposed French-owned aluminium smelter in the Coega IDZ). Eskom, the country’s state-owned electricity utility, would reportedly also take a 12.5% stake. The participation of domestic development finance institution in large FDI projects raises the issue of opportunity cost and the possible substitution of local for foreign investment.

As mentioned previously, a derogation from the common MFN principle (which underscores all South Africa’s BITs) relates to developmental assistance. More than half of South Africa’s BITs, namely those with Chile, China, Cuba, Denmark, Egypt, Germany, Greece, Italy, Korea, Mauritius, Mozambique, Netherlands, Sweden, Switzerland, Senegal, Spain and France, contain a provision stipulating that preferences granted by one country to development financial institutions, which operate with the sole purpose of providing development assistance through non-profit activities, need not be extended to investors or development finance institutions of the other country (IGD, 2000, cited by Vickers, 2003:34).

Foreign development agencies have also played a role in inward FDI, although in relation to overall FDI their contribution has been minimal. South Africa is party to the Multilateral Investment Guarantee Agency (MIGA), a World Bank institution, which has thus far issued three guarantees and has seven applications pending. The Overseas Private Investment Corporation (OPIC), a US government risk agency, has underwritten US$ 45mn worth of project financing over the past decade to U.S. companies investing in South Africa (Vickers, 2003: 34).
2. Bilateral and multilateral investment agreements

2.1 Outline of current bilateral and multilateral agreements

As of 2004, South Africa was party to 32 bilateral investment treaties (BITs), all of which were signed since the countries transition to a democratic dispensation in 1994. The first BIT was signed with the U.K. in September 1994, symbolising the start of the country’s reintegration into the world economy. It followed a strong downward trend in FDI in the 1980s, when South Africa was the subject of widespread economic and political sanctions.

The table below provides an overview of South Africa’s ‘formal’ investment partners by region. In addition to these treaties, South Africa has also signed various forms of investment cooperation agreements with Algeria, Canada, Cote d'Ivoire, Malaysia, Paraguay, Saudi Arabia, and the US. Other negotiated drafts (with Angola, for example) remain unsigned. A previous investment cooperation agreement (‘Agreement of Co-operation on the Promotion of Investments’) with Taiwan was annulled following South Africa’s establishment of formal relations with the People’s Republic of China in 1998.

Most of South Africa’s BITs are with European countries and European Union members in particular, the remainder having been concluded principally with African, certain Asian and Latin American countries. Only two of the African BITs are with co-members in the Southern African Development Community (SADC): Mauritius and Mozambique.

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<th>South Africa’s Bilateral Investment Treaties (BITs)</th>
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<tr>
<td><strong>Europe</strong></td>
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<td><strong>Africa</strong></td>
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<td><strong>Asia / Middle East</strong></td>
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<td><strong>Latin America</strong></td>
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*Source: SA Department of Foreign Affairs (2004)*

South Africa’s investment treaties were initially based predominantly on the European model. In fact, as a result of South Africa’s lack of an integrated investment framework the country largely adopted the British model during the negotiation of its first BIT. This model subsequently formed the basis of South Africa’s investment treaties, and was used as a basis for ensuing negotiations with partner countries. While most BITs were subsequently concluded bearing a strong resemblance with South Africa’s initial (British-based) model, it has since become evident that this model has numerous shortcomings and does not cater for the asymmetric needs of developed and developing countries (especially with regard to development objectives). Furthermore, a recent court case involving a foreign investor and the South African government (as one of the contracting parties to a BIT) highlighted the extent to which the government may have become liable to foreign investors beyond the
realms anticipated when negotiating the BIT, and beyond the rights normally attributable to a domestic investor (this matter is discussed in more detail later, although information on this case is difficult to obtain even from the relevant South African government departments).

The conclusion of BITs falls within the responsibility of South Africa’s Department of Foreign Affairs (DFA), although negotiations will normally take place under the auspices of the International Trade and Economics Division (ITED) of the Department of Trade and Industry (DTI). While the actual negotiation of BITs is undertaken by the DTI, the DFA ensures consistency and compatibility with the country’s other international obligations while the Department of Justice deals with the constitutional implications of a BIT. As outlined in the following section, South Africa’s BITS take on a relatively standardised format, with a number of principal characteristics. This means that in practice negotiation takes place on a much smaller scale than for instance during trade negotiations, and that the conclusion of BITs therefore frequently becomes more of a ceremonial byproduct of high-level political meetings and State visits between countries.

Within the multilateral framework, South Africa as a founding member of the WTO has made commitments under the TRIMS Agreement. TRIMS recognises that certain investment measures can have a distortionary effect on international trade, and spells out prohibited measures in GATT Articles III (concerning national treatment) and XI (concerning quantitative restrictions). For example, local content requirements whereby countries place certain local content restrictions on investors are not allowed, although TRIMS originally gave developed countries two years, developing countries five years and least developed country Member States seven years to comply. Work on TRIMS is however ongoing within the WTO framework, and was re-affirmed within the DOHA Agenda.

In its participation in multilateral negotiations South Africa has, however, sometimes found itself in a dilemma with regard to its status as a developed or developing country. In reality, South Africa’s unique economy features characteristics both of developing and developed countries: a case in point is the telecommunications sector, where vast discrepancies exist in terms of access, coverage, ownership. In this respect, large areas are substantially “third world”, while others are characterised by access to multiple mobile operators as well as fixed line access, and more recently, a rollout of wireless internet technology.

2.2 Basic features, commonalities and differences of investment agreements

South Africa’s BITs are fairly broad in scope, and cover a wide range of investment types. These include movable and immovable property, shares, bonds, and interest in companies, claims to money, assets or performance having economic value, intellectual property, and licenses or other rights to exploit a resource. However, the definitions provided in South Africa’s BITs are not as specific as in other investment treaties.

“The scope and content of BITs have become more standard over the years. Today, the main provisions deal with the scope and definition of foreign investment; admission and establishment; national treatment in the post-establishment phase; MFN treatment; fair and equitable treatment; guarantees and compensation in the event of expropriation; guarantees of free transfers of funds and repatriations of capital and profits, and dispute settlement provisions, both State-State and investor-State. But given the sheer number of BITs, the formulations of individual provisions remain varied, with differences in the language of the BITs signed some decades ago and those signed more recently.”

For example, in NAFTA there is less room for interpretation as to how debt securities would be treated in a claim, because certain classes of these (i.e. those of state enterprises) are excluded from the ambit of the treaty.

In the South African model, the scope seemingly extends to and affords protection to all types of investment\(^5\). Additionally, the model covers investments established both before and after the signing of the BIT. The BIT with Italy goes as far as according any profits the same status as the investment itself. By offering a wide scope of protection to potential investors, South Africa hopes to provide an attractive and secure investment framework that is conducive to attracting FDI.

Most of South Africa’s BITs follow a relatively similar format, and contain few derogations from the model structure. They contain definitions on ‘investment’, ‘investors’, ‘returns’ and ‘territory’, and clauses on the promotion and treatment of investments, compensation for losses, dispute settlement and transfers of investments and returns. As outlined earlier, the majority of South Africa’s BITs are based loosely on the British model, with whom South Africa concluded its first BIT in 1994. In respect of BITs negotiated prior to 2001, this model formed the basis of South Africa’s negotiating position and ‘offer’ to the partner country; since then a number of domestic developmental objectives (such as BEE) have started to become incorporated as an exception to the traditional NT principle (DTI, 2004).

### 2.3 Key features of South Africa’s BITs include:

#### Promotion and Treatment of Investments

Each party to the agreement is to afford investments from the other contracting party the necessary permits in connection with such investments, shall no discriminate against such investments and treat such investments “no less favourably” than domestic investments. (national treatment principle)\(^6\). However, the contracting parties are not obliged to afford each other special privileges that may result from any customs union, free trade area or the like that either country may be party to. A notable derogation from the non-discrimination and national treatment principle is contained in seven of South Africa’s BITs, namely China, the Czech Republic, Ghana, Iran, Mauritius, Nigeria and the Russian Federation (Vickers, 2003). This stipulates that countries may continue to use measures that ‘promote the achievement of equality in its territory, or (are) designed to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination in its territory’.

This is a clause of key importance especially in the South African context, the absence of which would make any policy measures designed to achieve economic empowerment of previously-disadvantaged groups in conflict with such investment promotion treaties.

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\(^5\) By way of an example, the South Africa-Germany treaty uses a very broad definition of investment, to include “movable and immovable property, shares of companies and other kinds of interest in companies, claims to money which has been used to create an economic value or claims to any performance having an economic value” (Mosoti, 2004)

\(^6\) By way of an example, The Agreement on Encouragement and Reciprocal Protection of Investments between the Republic of South Africa and the Kingdom of the Netherlands states in Article 3(2) that “each Contracting Party shall accord to such investments treatment which in any case shall be no less favourable than that it accords to investments of its own investors…” (Mosoti, 2004)
Compensation for Losses and Expropriation

The BITs contain specific clauses relating to restitution, indemnification, compensation or other settlement, stipulating that this be no less favourable to investors from the other contracting party as it is relating to its own investors. Expropriation of foreign investors’ property may only take place under exceptional circumstances where this is for public purposes, takes place in a non-discriminatory manner, is conducted in a transparent and legal process and against fair, prompt and market-related compensation.

Transfers of Investments and Returns

Each contracting party shall allow investors the free transfer of payments relating to their investments in a prompt manner at the most recent exchange rate applied to inward investments.

Resolution of Disputes between Contracting Parties

BITs afford dispute resolution an elevated status, as is illustrated by the relatively large number of clauses relating to this matter. They are outlined in more detail further below.

2.4 Dispute resolution

There have been a number of investment disputes involving African countries, for example between a Belgium investor and Burundi and a U.S. investor and the Democratic Republic of Congo (Mosoti, 2004). South Africa has also not been immune to a small number of foreign investor-State disputes.

South Africa’s BITs contain a number of clauses relating to dispute settlement, differing only slightly from one treaty to another. The underlying intention is for all disputes to be settled amicably, although where this is not possible, the agreements make provision for arbitration. Here the rights of the investor appear to be elevated above that of a contracting party to the agreement, as it is the investor who may chose the forum in which the dispute is to be settled. This provision is contained in a substantial number of BITs, notably with Argentina, Chile, Cuba, Czech Republic, Denmark, Egypt, Finland, Germany, Greece, Italy, Mauritius, the Netherlands, Nigeria, Spain, Senegal, Mozambique, Russia and the United Kingdom (Vickers, 2003:35).

This may be either by (a) the courts of the country in which the dispute occurs, (b) arbitration by the International Centre for the Settlement of Investment Disputes (ICSID) established by the Convention on the Settlement of Investment Disputes between States and Nationals of other States in 1965, or (c) an ad hoc arbitration tribunal, which unless otherwise agreed upon by the parties to the dispute, is to be established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL).

Disputes between countries party to the BIT concerning the interpretation of the agreement should be settled through diplomatic channels. In the event that such disputes can not be settled via these channels within six months, provision is made for it to be forwarded to an arbitration panel consisting of a representative from each country and chaired by an independent third country or International Court of Justice representative.
The in effect asymmetric rights provided for in the dispute settlement clauses have given rise to some concern that developing countries in particular are being exposed to potentially damaging arbitration and litigation brought about by external investors. According to some sources, South Africa’s vulnerability in this respect is one of the reasons for the country’s support of negotiating a set of investment rules in a multilateral forum such as the WTO (Vickers, 2003; IGD, 2000).

This was highlighted recently in a case involving a Swiss investor, who sought to obtain restitution under South Africa’s BIT with Switzerland for certain losses suffered in South Africa. This case, where in any case damage was suffered prior to the conclusion of the BIT, has gone to arbitration but has not been concluded with little information is available in the public domain. Nevertheless, it would seem appropriate to further clarify the language and intent of the appropriate provisions contained in BITs to avoid situations in which for example domestic investors are left at a disadvantage to their foreign counterparts.

2.5 Experience under existing investment frameworks: types of investment and FDI flows

While there has been an increase in FDI inflows into South Africa in recent years, it is not clear how much of this has been driven by the country’s conclusion of BITs with partner countries. In fact, there seems to be no particular positive relationship between the conclusion of BITs between South Africa and its partners and changes in investment flows from that country. At the same time, it should be recognised that a number of large-scale FDI flows, usually relating to the privatisation of a state-owned asset, have distorted any trends that may have crystallised. What is clear however is the fact that South Africa has attracted fairly modest levels of FDI, especially when compared with other developing countries such as Argentina and Mexico.

Investment can take on various forms and consists of FDI and ‘portfolio investment’. Portfolio investment – often referred to as ‘hot money’ to its high mobility, is foreign investment in a country’s financial markets (equities, bonds). As these investments tend to be short term, and can easily move between countries, their benefits to a country are more indirect and less obvious. FDI on the other hand can consist of different types of investment, each being longer term in nature than typical portfolio investment flows and usually an investment in productive and / or tangible assets. The main types of FDI investments consist of:

*Greenfield investment*: whereby an investor creates a new asset or facility in the destination country (for example builds a factory a factor with or without joint venture (JV) partners;

*Brownfield investment*: whereby an investor acquires an existing asset (for example a factory) but replaces or replenishes its productive assets (such as plant and equipment);

*Cross-border Merger & Acquisition*: whereby an investor acquires a controlling equity stake in a local firm.

Greenfield investment generally represents the greatest degree of commitment from the investor and is usually the most sustainable and least mobile of all investment types. The recipient country typically benefits significantly from such investments, although the capital intensity and sector in which such investments take place further
determine the scope and benefits flowing from such investments. This is highlighted by the simple comparison between a ‘Greenfield’ investment in automotive components manufacture against that in the clothing manufacturing (CMT) sector. The latter, despite its ‘Greenfield’ status, remains highly mobile, a fact that is determined not only by the nature of the sector concerned but global dynamics in the textile-clothing value chain.

Various sources record FDI into South Africa (for example the SA Reserve Bank, UNCTAD, Business Map etc.), and variance between sources can be significant. This is largely due to the methodologies employed in calculating FDI, exchange rate fluctuations and the currency denomination of a transaction, and whether (if and how) so-called ‘abnormal’ transactions such as the once-off Anglo-American / De Beers deal in 2001\(^7\), or the transfer of various large firms’ headquarters to London, are included.

<table>
<thead>
<tr>
<th>Table x: FDI flows into South Africa (US$ mn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>---</td>
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<tr>
<td>FDI Inflows</td>
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<tr>
<td>FDI Outflows</td>
</tr>
<tr>
<td>FDI as a percentage of gross fixed capital formation</td>
</tr>
<tr>
<td>FDI Stocks (inward)</td>
</tr>
<tr>
<td>FDI Stocks (outward)</td>
</tr>
<tr>
<td>FDI stocks as a percentage of gross domestic product</td>
</tr>
<tr>
<td>Cross-border merger and acquisitions (Sales)</td>
</tr>
</tbody>
</table>


Note: * = 1990 figures, as no figures from 1991 to 1999 are available.

Definitions: FDI flows are recorded on a net basis (capital account credits less debits between direct investors and their foreign affiliates) in a particular year. On the other hand, Merger & Acquisition (M&A) data are expressed as the total transaction amount of particular deals, not as differences between gross acquisitions and divestment abroad by firms from a particular country.

As can be noted in the previous table, South Africa’s FDI inflows have been volatile in recent years, with anomalies such as the transactions mentioned above playing a substantial role. The 2003 UNCTAD Wold Investment Report, in its FDI ‘Performance Index’, found South Africa’s share of FDI inflows during 1999-2001 in proportion to its global share of GDP to be relatively low. South Africa was ranked in position 81 out of 140.

\(^7\) Anglo American – a mining conglomerate - was unbundled from De Beers and de-listed from the Johannesburg Stock Exchange in order to re-list in the U.K. Thus, an essentially South African stock of capital suddenly became reflected as a U.K. investment following this transaction.
countries measured. The country’s performance rating of 0.696 indicates that it was receiving less than 70% of what it ‘should’ receive in FDI inflows considering the size of the South African economy.

Much of South Africa’s FDI inflow since 1994 has been natural resource and market-seeking, whereas strategic or efficiency-seeking investments appear to have been low (Vickers 2003:18). Furthermore, South Africa has been the recipient of very little ‘Greenfield’ type investment, with most non-privatisation FDI driven by merger & acquisition activities (Business Map 2001, cited by UNCTAD 2003). Natural resource-seeking investments are attracted by South Africa’s relative wealth in natural resource stocks and related opportunities, while market-seeking investments target South Africa and the region (especially with respect to the country’s political and economic integration into the region) as new output markets. Market-seeking investment also looks beyond the region at markets where South Africa receives preferential market access, for example under the U.S.’ African Growth and Opportunity Act (AGOA). Strategic investments follow where the country is identified as a strategically important base from which to enter the domestic and foreign markets, or where backward integration into domestic supply networks (for instance low-cost steel or aluminium) make South Africa an attractive location. In cases of strategic (or efficiency-seeking) FDI, investors seek more than just “cheap” labour and access to natural resources, but a much wider range of competitively priced materials and other inputs.

On a sectoral basis, telecommunications and IT, and mining and quarrying, have attracted the bulk of FDI, followed by the automotive industry and the food, beverages and tobacco sectors. The largest source of FDI inflows since 1994 has been the U.S., although the U.K. was still by far the largest external holder of FDI capital stock by year end 2000 (this includes the pre-1994 era). The U.S.’ ‘led’ in this respect may be explained by the large-scale withdrawal of FDI during the 1980s, when U.S. firms in particular were under great political and civil society/market pressure to disinvest from South Africa. Altogether 256 U.S. companies are said to have left South Africa by 1991 (Business Map, 1999). Many have since returned following South Africa’s transition to a democratic dispensation in 1994.

Other than the U.K., the bulk of FDI capital stock in South Africa is held by the countries traditional (European) trade partners, although a notable addition is Malaysia (the source of substantial capital inflows over the past decade mainly in the telecommunications (Telkom) and energy and oil (Engen) sectors. Notable FDI deals in recent years include the following:

1996 / 1998: Petronas, the Malaysian-owned oil company purchases a 30% share in South Africa’s Engen, South Africa’s largest oil refiner, for R1,7bn. In 1998, it increased its holding in Engen to 100% with a R2,9bn offer, before selling a 20% equity holding in Engen to a local empowerment partner.


1998: An Italian airports management company (Aeroporti di Roma) acquires a 20% share in the Airports Company of South Africa for R819mn.
1999: *Swissair*, Switzerland’s national air carrier, acquires a 20% stake in South Africa’s government-owned national airline *SAA*, although following *Swissair’s* filing for bankruptcy protection it sold its stake in *SAA* back to the South African government for 30% of the original transaction resulting in a net benefit to South Africa of almost R 1bn.

2001: *Anglo-American*, which at that stage had already moved its listing to London, acquired diamond mining house *De Beers* through a share transaction. Since *Anglo-American* was officially a foreign company, this transaction appeared as an inflow of foreign capital, significantly affecting recorded FDI inflows in that year.

The following tables present an overview of FDI commitments in the post-1994 era based on a sectoral and source-country dis-aggregation.

### Sectoral Distribution of FDI Commitments 1994 – 2001

<table>
<thead>
<tr>
<th>Sector</th>
<th>R mn</th>
<th>US$ mn</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telecommunications and IT</td>
<td>18,567</td>
<td>3,357</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>22,360</td>
<td>2,621</td>
</tr>
<tr>
<td>Motor and Components</td>
<td>15,230</td>
<td>2,457</td>
</tr>
<tr>
<td>Food, Beverages, Tobacco</td>
<td>13,090</td>
<td>2,431</td>
</tr>
<tr>
<td>Energy and Oil</td>
<td>9,295</td>
<td>1,935</td>
</tr>
<tr>
<td>Metal Products and Minerals Beneficiation</td>
<td>11,710</td>
<td>1,352</td>
</tr>
<tr>
<td>Other Manufacturing</td>
<td>4,374</td>
<td>1,149</td>
</tr>
<tr>
<td>Transport and Transport Equipment</td>
<td>5,621</td>
<td>946</td>
</tr>
<tr>
<td>Hotels, Leisure and Gaming</td>
<td>5,798</td>
<td>942</td>
</tr>
<tr>
<td>Chemicals, Plastics and Rubber</td>
<td>3,734</td>
<td>795</td>
</tr>
</tbody>
</table>


### Sources of FDI Stocks and Commitments

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>242,926</td>
<td>24,813</td>
<td>3,649</td>
</tr>
<tr>
<td>US</td>
<td>19,625</td>
<td>28,598</td>
<td>5,583</td>
</tr>
<tr>
<td>Germany</td>
<td>19,090</td>
<td>9,763</td>
<td>1,534</td>
</tr>
<tr>
<td>Netherlands</td>
<td>11,006</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Switzerland</td>
<td>10,263</td>
<td>7,207</td>
<td>1,211</td>
</tr>
<tr>
<td>Malaysia</td>
<td>6,816</td>
<td>12,504</td>
<td>2,406</td>
</tr>
<tr>
<td>France</td>
<td>2,531</td>
<td>2,971</td>
<td>531</td>
</tr>
<tr>
<td>Japan</td>
<td>1,533</td>
<td>5,178</td>
<td>870</td>
</tr>
<tr>
<td>Italy</td>
<td>1,517</td>
<td>3,861</td>
<td>607</td>
</tr>
<tr>
<td>Belgium</td>
<td>922</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Luxembourg</td>
<td>766</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>538</td>
<td>7,981</td>
<td>830</td>
</tr>
<tr>
<td>Taiwan</td>
<td>413</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Austria</td>
<td>260</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>242</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td></td>
<td>3,197</td>
<td>425</td>
</tr>
</tbody>
</table>

Source: The Business Map Foundation SA FDI database (2003), SA Reserve Bank [www.resbank.co.za](http://www.resbank.co.za)

Based on the available FDI data, it is clear that investment flows have been erratic and volatile over the past decade. However, this can be partly explained by the size of the South African economy against the substantial
magnitude of some of the investments that have taken place in recent years (see examples provided earlier). Other contributing factors include the gradual privatisation of state-owned assets in the post-Apartheid era which has in some instances been rather inconsistent and unpredictable.

Further, no clear trend emerges between FDI inflows and the conclusion of BITs between South Africa and partner countries. Based on the data, it is uncertain whether South Africa’s BITs has created any new FDI flows, or indeed whether they have protected or maintained prior flows. The latter in particular would require scrutiny of the reasons for FDI flows from the investment decision makers at the firm level, something which is beyond the scope of this paper. The largest source of FDI commitments since 1994 has been from the U.S., with whom South Africa does not have a BIT. The same applies to Malaysia and Australia. On the other hand, significant commitments have originated in the U.K. and Germany, countries with whom South Africa has an existing BIT. This lack of a positive relationship may indicate that investors rely less on the possible existence of a BIT but instead focus more on an economic climate conducive to investment, as well as on sound private and public sector institutions and regulatory framework.

From a data recording perspective, it must however be noted that FDI flows do not readily take into account secondary uses of FDI-related profits. For instance, FDI data only captures capital inflows and outflows as well as profit remittances, whereas profits re-invested locally by the investor in further productive assets are not directly connected to the initial FDI. In fact, such productive use would only be reflected in much larger withdrawals from the country later on, artificially reducing the net FDI balance.

Various other factors have been cited for South Africa’s relatively unsatisfactory FDI performance despite its increasingly permissive investment climate. These include a perceived lack of profitable opportunities (underscored by excess local productive capacity and the fact that South African companies are apparently sitting on immense and relatively unproductive cash reserves), exchange rate volatility (investors prefer currency stability over particular currency levels), negative perceptions about South Africa’s labour market and so forth. Some of these factors are outlined further down.

It is also notable that in recent years there has frequently been a FDI “deficit” recorded by South Africa, whereby FDI outflows have exceeded inflows in particular years. Based on available UNCTAD / Business Map data, this has occurred in 1995, 1996, 1998 and 1999. Much of this relates to new investment opportunities available to South African investors in the region and further afield under the new political dispensation, and South African firms have undertaken large investments particularly in the telecommunications (MTN, Vodacom), financial services (Standard Bank, First National Bank, ABSA), retail (Shoprite, Pep Stores, Woolworths), transportation (Traswerk, SAA), mining (Anglo-Gold, Harmony), beverages (SA Breweries) sectors, among others. Further contributing factors include the increasing realisation among South African investors that Africa holds vast investment opportunities despite the risks attached, and the evolvement of local exchange control regulations that now permit investments of up to R 2bn per project in Africa (up from R 0,75mn) and R 1bn per project elsewhere (up from R 0,5bn previously).
2.6 Drivers of FDI into South Africa

South Africa has over the past decade implemented various economic policies aimed in part at creating a climate conducive to FDI. Having emerged from an era of political and economic isolation, the country’s reintegration into the regional and world economy over the past decade has been rapid.

A relatively stable economic and political climate has been an important driver of FDI inflows into the country in recent years. South Africa has been re-appraised as a destination for investment by international ratings agencies, who now give this country an investment-grade rating. This is despite a number of economic shocks – often due to the country’s status as a small open economy – including for example periods of high currency instability (it is often said that investors require a stable currency more than a ‘strong’ currency). Also, mixed and sometimes inconsistent policy signals have at times confused foreign investors, for instance the (delayed) privatisation of the state-owned telecommunications enterprise, the licensing of additional network operators, BEE, suggestions to close certain sectors to outside investors (i.e. the security industry), and so forth.

FDI in South Africa has been largely from South Africa’s traditional trade partners, with whom long-established economic and political ties exist. These include mainly countries from Europe, who together hold much of the foreign stock of capital in South Africa. More recently, FDI has flowed in from ‘non-traditional’ countries too, especially the U.S., Malaysia, Australia and Hong Kong.

Recent FDI commitments (especially post-1994) seem to bear little relation to the country’s growth in BITs, with no clear pattern emerging. As stated elsewhere, this is partly due to the fact that a number of large transactions have distorted the picture, while at the same time an increasing emphasis has been placed on outward FDI (leading to net outflows of FDI capital in certain years).

But a further factor relates to the countries provincial trade and investment promotion agencies, which by their very nature operate on a fairly competitive basis in trying to market their respective provinces to potential investors. BITs play far less (if any) of a role compared with region-specific factors and opportunities that are used to market specific sectors. Likewise, incentives, investment support services and microeconomic factors play an important role, as does the broader institutional environment relating to competition and regulation, the judicial system, fiscal policies and so forth. Furthermore, it is the sector-specific legislation (for instance licensing requirements in the pharmaceutical, telecommunications and broadcasting industries) that determines the investment environment.

As reflected by UNCTAD’s investment ‘performance index’ (UNCTAD, 2003), South Africa has attracted less FDI than its global share of GDP would suggest. Further, this is despite its highly permissive investment environment, the widespread absence of capital controls on investment, favourable treatment of FDI (often more favourable than local investors receive) and investment incentives.

A recent study drew together a wide range of opinions by stakeholders, the media, investor surveys and commissioned research to put forward possible reasons for South Africa’s attracting less FDI than it should
These included policy issues (often not directly related to investment), uncertainty, various macroeconomic variables and even the size of South Africa’s (and the regional) consumer market, which at 190 million is seen as insufficiently large to attract FDI!

<table>
<thead>
<tr>
<th>Why is South Africa attracting less FDI than it should? Possible Reasons:</th>
</tr>
</thead>
<tbody>
<tr>
<td>✦ The size of SA’s consumer market and its purchasing power – as well as the SADC market of 190 million people – is seen as too small to attract FDI, particularly market-seeking FDI.</td>
</tr>
<tr>
<td>✦ SA’s low economic growth rate. The link between economic growth and FDI in SA is ambiguous. It is argued by many that FDI, once attracted, will stimulate economic growth, as opposed to the obverse where SA actually needs a significant amount of economic growth to attract FDI in the first place.</td>
</tr>
<tr>
<td>✦ The uncertainty and risk factors generally associated with investing in emerging markets also applies to SA. Politically volatile events in the region (particularly events in Zimbabwe from mid-2000) have led to concerns over property rights in SA, which the government has clearly committed to uphold and defend. The high price of oil, slackening commodity prices, and growing concerns of a global recession are also forcing fund managers to cut their exposure to emerging markets (indirect investment), and this can play an important Greenfield role for direct investors.</td>
</tr>
<tr>
<td>✦ Broad perceptions of SA, positive or negative (the latter usually sensationalised in the news media), can be a major determinant of FDI. Government is addressing this through various imaging, branding and marketing activities, aided by the work of the International Investment Council and the International Marketing Council.</td>
</tr>
<tr>
<td>✦ The high levels of crime in SA raise the costs of doing business (security, etc). However, while crime – which is being addressed by the government – is a red flag for investors, it has not deterred a dramatic upsurge in tourism to SA, which is one of the fastest growing markets worldwide. In the wake of the resurgence and threat of global terrorism, this perhaps reflects a reprioritisation of ‘security’, from crime to terrorism, with SA not being affected by the latter.</td>
</tr>
<tr>
<td>✦ A shortage of skilled labour for particular industrial sectors (e.g. ICT, financial services). SA’s complex immigration policy for skilled persons aggravates this dearth of skilled human capital, although new legislation has been introduced to facilitate employment of foreigners in SA.</td>
</tr>
<tr>
<td>✦ The high user cost of capital, compared to other countries. The interest rate for a start is a big problem; SA’s prime rate versus that of the developed world is a big factor, let alone the cost of equity premium). However, the long-term trend in interest rates is downward (depending on whether the Reserve Bank’s inflation target of 3-6% can be met).</td>
</tr>
</tbody>
</table>
The depreciation and volatility of the SA Rand (particularly in late 2001, although it has appreciated dramatically since the end of 2002 and start of 2003). This is said to be a disincentive to Greenfield FDI, as it leads to asset devaluations in home currency terms. Investors thus favour M&As and investment in services, rather than in fixed capital.

Perceptions that SA’s labour market as inflexible and over-regulated. The difficulty of laying off workers and uncertainty over employment equity legislation is said to be a disincentive to investment. There is, however, a whole lack of understanding of the new labour regime due to inadequate training; employers simply want a return to more convenient ‘hire-and-fire’ policies. This point as highlighted in a national firm survey (President’s Office: 2000) which indicated that it was not wage costs, but the ‘hassle factors’ such as hiring and firing procedures that prevented in vestment inflows (and also stifled domestic investment).

Hidden costs are a major disincentive to foreign investors. These include: transport costs and uncertainty of the arrival of goods; congestion and backlogs at ports; bureaucratic costs; and labour costs. The ports have not met the challenges posed by the increase in volumes and changes in composition of SA’s trade. Durban harbour is said to be a major problem; some companies are reputedly looking to export from Walvis Bay or Maputo (although the concessioning of the Durban container terminal might remedy this situation).

Predictability and uncertainty about the government’s BEE policies and equity targets, as witnessed with last year’s leak of the draft Mining Charter attached to the Minerals Act (which investors read as ‘expropriation’). The Charter proposed severe measures to ensure empowerment in the industry, including the placing of 30% of existing mining assets and 51% of new projects in previously disadvantaged people’s hands within 10 years. This led to capital flight and the sell-off of SA resource shares. However, although the Mining Charter is onerous, it is not obstructionist and has not deterred investors. There is also uncertainty about the requirement that foreign companies should have a BEE partner for government contracts and procurement. There is also regulatory uncertainty, particularly in the telecommunications, the electricity and the transport sectors for private participation.

Low levels of domestic investment (private, public and parastatal). Foreign investors are reluctant to invest in countries or regions where domestic investors do not. It has been argued that foreigners are delaying investing in SA because local firms are sitting on enormous cash reserves, estimated to be up to R300 bn (Business Report, 6 February 2003). The private sector is, however, said to be awaiting its cue from government raising its own spending on infrastructure and shifting the balance of state spending away from consumption. Private fixed investment has tended to move in the same pattern with public fixed investment.

A low return on investment relative to other countries in particular sectors (e.g. the globally competitive motor components industry).
Access to information on incentive schemes and packages. Although published information on DTI incentive schemes is readily available, it is reportedly difficult to get hold of the appropriate person who can explain the technicalities of the incentive scheme.

Source: Vickers (2003:21), based on inputs at IFD NRG meetings; IFD civil society questionnaires; various editorial comments in the popular and financial media; various investor surveys (e.g. Cassim, 2000; CDE, 2001 Gelb, 2001; Business Map, 2002, 2003; Jenkins and Thomas, 2002).
3. How does FDI relate to sustainable development objectives in South Africa?

3.1 Development spin-offs from FDI

In order for FDI to enter a country, it requires a set of conditions whereby the perceived risk associated with an investment is outweighed by the likely profitability of an investment opportunity. In South Africa, a country with known excess capacity and where firms together hold substantial cash reserves, any FDI would necessarily be of a strategic nature with respect to, for instance, seeking new markets, using South Africa as a strategic base for the expansion of exports, seeking competitively priced natural resources and other inputs, preferential access to third country markets and so forth.

As a result, FDI can have numerous developmental spin-offs. FDI opportunities necessarily present themselves as being attractive and potentially profitable – despite the local availability of capital – when local resources and opportunities are taken together with a third dimension, namely foreign skills and technology. Typically, FDI involves far more than the mere inflow of capital; investors in most cases take an active role in the local operations, introducing skilled personnel from the home country, introducing foreign technology not available locally and expanding trade linkages with the home country as well as third countries.

This results in the introduction or expansion of new skills and know-how in the host country, which in many cases are passed on to local personnel directly through training, or indirectly through observation and learning. South Africa faces a severe shortage of skilled and semi-skilled labour, and estimates of the shortage in managerial and technical sectors range between 350,000 and 500,000 (SAIRR, 2001:363). Despite this shortage, the country’s immigration laws continue to make it difficult to import expatriate skills from abroad.

A bi-product of FDI is usually also the introduction of new technology, as investors introduce proven technology from the source entity to the host country. An example of this relates to the proposed aluminium smelter to be situated in the Coega IDZ, where French-Canadian company Pechiney plans to introduce the latest AP50 smelting technology with its associated raw materials and energy efficiency, as well as its vast output capacity (Coega Development Corporation, 2003).

An example of FDI with wide-ranging positive spin-offs has been the South African automotive sector. Owing largely to a favourable operating climate, the sector has attracted large FDI inflows in recent years. The nature of value chain dynamics in this sector and involvement of mainly European holding companies has led to the integration through strong trade and technology linkages of the local sector into the global industry. At a time when the global automotive sector was shrinking by 3,9%, the South African automotive sector in fact grew by 13,9% (NAAMSA, 2002). While the sector is one of South Africa’s largest and sustains some 300,000 jobs, it has nevertheless shed a substantial number of jobs over the previous decade as domestic economic policies shifted away from import substitution and manufacturers were forced to become globally competitive.

The introduction through FDI of know-how and specialised skills, together with new technology, can help countries convert comparative advantage into international competitive advantage. Where FDI builds linkages
with domestic industries, the developmental benefits to the host country can be significant. In South Africa’s case, FDI can also promote the economic empowerment of previously disadvantaged sectors. Equity involvement by these sectors is often required especially in government tenders (for example, natural gas extraction rights) and the privatisation of state-owned assets. For example, Forest Oil, the U.S. oil and gas exploration company, was awarded prospecting rights to the vast Ibhubesi gas fields off South Africa’s West Coast on the back of a minority equity involvement by black-owned Mvelapanda Holdings. Besides being in line with the government’s empowerment principles and policies, such ventures can help transfer much-needed skills and technological know-how to South African stakeholders.

Notwithstanding the many positive development spin-offs associated with FDI, actual welfare benefits remain notoriously difficult to quantify. While this is less so in the case of direct employment creation, it is virtually impossible to accurately quantify in terms of intellectual capital, skills development and transfers of know-how, and backward linkages into the local economy.

3.2 Provisions for sustainable development

Sustainability is an important concept associated with FDI. Sustainable investment necessarily should have positive developmental spin-offs, including the transfer of skills and technology, and not rely excessively on investment or other incentives such as, for example, temporary market access opportunities provided by third countries (such as the U.S. with AGOA). As such, the drivers of FDI need to be rooted in sound business opportunities, economic stability and a predictable investment framework, rather than short-term opportunities brought about by special investment incentives.

The role of incentives in attracting FDI, and questions around the sustainability of such investments, recently came to the fore when Ramatex, a Malaysian-owned textile multinational, switched its planned Greenfield-type investment from South Africa to neighbouring Namibia. While South Africa offered a large tract of land and reduced wharfage charges, Namibia stepped in with a comprehensive incentive package that is reputed to have included subsidises water and electricity, a 99-year tax exemption on land-use as well as over R 100mn (approximately US$ 15mn) to prepare the site. In the same vein, it has been said that some Asian investors in the South African clothing industry, located in decentralised areas, are merely covering their production costs with the investment incentives in effect making up the profit.

South Africa’s FDI framework is largely non-prescriptive and liberal, with few provisions relating to foreign investors that do not apply equally to resident investors. In fact, South Africa's capital and profit repatriation regime applicable to FDI is far more liberal than the remaining capital controls that still apply to residents. Whereas government-funded investment promotion agencies, such as TISA, may try to nudge FDI into particular sectors (especially the priority sectors identified in the government’s Integrated Manufacturing Strategy), it is up to the investor to make any investment decisions themselves. This equally gives investors the liberty to pursue
short-term profits or strategic opportunities, as has been witnessed over the past few years in the clothing manufacturing sector in South Africa and its neighbours.8

The lack of sustainability provisions relating to FDI into South Africa probably has its roots in the desire to attract FDI without hindrance, and the realisation that capital and investors are “smart” and averse to excessive regulation (including that which has sustainability at its core). Furthermore, South Africa policymakers are acutely aware of the competitive environment globally for attracting FDI, and South Africa’s relatively poor performance thus far may mitigate against any desire to ‘regulate’ FDI.

The challenge in South Africa is thus to refine its investment framework to remain both attractive to investors while at the same time maximising the sustainability and developmental benefits flowing from inward investment. Vickers (2003:20) outlines a number of developmental purposes that should ideally be supported by FDI:

- Transfer of knowledge, technology and management skills
- Moving the economy away from primary exports towards higher levels of beneficiation, and supporting SA firms’ integration into global value chains
- Skills training and development
- Black economic empowerment (BEE) in terms of real ownership and participation in the economy
- Promotion of SMME development, whether through joint-ventures or subcontracting and outsourcing of non-core activities
- Lessening of monopoly power in South Africa by creating more competition and enforcement of current competition legislation
- Corporate social responsibility through a commitment to ethical investment, together with sound labour and environmental practices
- Fostering HIV/AIDS awareness and treatment

3.3 Negative impacts of FDI

FDI has long been associated not only with positive but also negative impacts. In many instances, employment opportunities stemming from a proposed investment have not materialized to the extent that was promised, and the value of the investment highly inflated. In other instances, investments have been staggered over such an extended timeframe that questions have arisen as to whether the cost of the investment to the authorities (in terms of incentives etc.) has been justified.

8 The US African Growth and Opportunity Act (AGOA) offers duty-free market access to certain African countries for among others clothing exports, together with very liberal origin rules (a mere single-stage transformation requirement). Although this window of opportunity is for the 4-year period to September 2004 only, it has induced an influx of (likely unsustainable) investment by East-Asian investors with the purpose of accessing the U.S. market during this window of opportunity. Clothing manufacturing investment is notoriously mobile as a result of its low set-up costs, low capital requirements and labour intensity. In addition, investors are known to have received significant investment incentives from the host countries involved.
Other factors have also contributed to certain negative impacts of investment, although many of these appear to be more pronounced in relation to South Africa’s outward as opposed to inward FDI. ‘Crowding out’ has been observed where local firms have entered new regional markets and have effectively driven away other FDI and displaced local economic activities. This appears to have been most prevalent in the retail sector, where South African chains such as Pep (clothing) and Shoprite (food) are now located in most cities in the region. For example in Maun, a small yet rapidly expanding frontier town serving mainly the tourism industry in north-western Botswana, more than 5 major South African retail chains have established a presence in the past few years, and their dominance has made it impossible for local players to play a meaningful role in the clothing, furniture or food sector. The situation is exacerbated by a lack of integration of these enterprises into the local economy, instead choosing to source most of their supplies from South Africa. This has lead to accusations across Africa of South African firms being the new economic ‘colonialists’, and calls for a regional investment policy.

Part of the success of foreign firms in new markets is that they are often more efficient than smaller local firms, offer superior goods and services, and have the resources to attract workers and finance away from host firms. In the process, these firms acquire control over local resources, in the process often reducing real competition.

Other negative impacts of FDI inflows have been noted where countries, in their eagerness to attract investment and related foreign exchange, may disregard environmental concerns and due diligence processes associated with investments particularly in environmentally sensitive areas. This raises questions about the sustainability of such investment, as its true costs (and associated impacts) are often far greater than the economic and developmental benefits flowing to the country. This was highlighted over the past 1-2 years by the proposed mining activity along ecologically-sensitive stretches of South Africa’s east coast, and the involvement of an Australian company.
4. Policy development

4.1 FDI policy in South Africa

South Africa has over the past decade embarked on a path of economic and social restructuring. Following the country’s transition to democracy, the government adopted the Growth, Employment and Redistribution (GEAR) strategy as its broad macroeconomic strategy. While GEAR was initially a five year plan aimed at broadening employment and socio-economic opportunities especially for the poor, and redistribution of income, GEAR remains government policy in the sense that the policy’s principles are very much those still implemented by the government today.

South Africa has placed an increasing emphasis on FDI, with calls for renewed investment particularly vocal since 1994. While export-led growth is a key strategy, attracting FDI was and is still seen as an important variable to achieve this goal. Nonetheless, the country’s FDI policy has to some extent been uncoordinated, with little evidence of a clear strategy especially with respect to BITs. This is sometimes attributed to factors including South Africa’s inexperience following the country’s relatively recent active participation in the global economy.

A number of BITs have been concluded, the first having been signed with the U.K. in 1994 shortly after the country’s first democratic elections. Symbolic of the country’s relative inexperience in this regard, this treaty was based almost solely on the British model. Since then, South Africa’s BITs have followed the same model at least until 2001, although some variance does occur between from country to country. The South African government has subsequently recognised that its British-based investment treaty model is not necessarily the most favourable from a developing country perspective, and is currently addressing this by revisiting its basic structure.

While South Africa actively encourages FDI, the government has sought to link investment with some of its development objectives, as outlined in the GEAR strategy. Income redistribution, using for example Black Economic Empowerment (BEE) as a vehicle, has become an important variable facing investors both locally and from abroad. As a result, the government has imposed certain limitations on some forms of FDI, which are largely sector-based. The most prominent sectors here are the broadcasting and the mining industries. A recent UNCTAD report (2003) listed the example where, upon the privatisation of South Africa’s broadcasting industry, the level of foreign ownership in an individual broadcaster was restricted to 20%. In the same vein, the Mineral and Petroleum Resources Development Bill of 2002 created opportunities in the mining sector specifically reserved for domestic investors from previously disadvantaged backgrounds. During 2001, for example, 61% (R2.5bn) of all deals involving black-owned companies took place in the mining sector, even before the government had fully articulated its intentions with regard to BEE in this sector (ibid).

South Africa’s government is committed to the continued privatisation of state-owned enterprises (SOEs), notwithstanding pressure from the ruling party’s political alliance partners and recent reports of a possible turnaround of this strategy (Business Day, 2004). Overall, the privatisation of SOEs appears to have been driven to a large extent by the desire to attract FDI, rather than by the need for improved service orientation, efficiency gains and competition. As a result, the privatisation process has encountered a number of setbacks, as is evident
for example in the telecommunications industry. Although global economic conditions in the telecommunications industry have in recent years made it challenging to privatisate the state-owned (albeit with some foreign equity participation) telecoms operator and award a license to a second fixed-line operator, the process has been shackled by bureaucracy and other issues and remains largely unresolved.

Domestically, the government’s economic strategy has to a significant extent been underscored by its Integrated Manufacturing Strategy (IMS), which was published in the late 1990s. This focuses on a number of specific target sectors, including the automotive industry, textiles and clothing etc., which have been tagged with having particular potential for growth and employment creation.

The country’s legislative environment concerning labour has come under some criticism from investors (both local and foreign), who perceive domestic labour laws to be excessively inflexible and to some extent ill-suited to a developing country such as South Africa. However, many of these serve particular developmental objectives – specifically skills development – and would thus seem to have substantial long-term benefits for the country as an investment destination (especially considering that low domestic skills levels are frequently cited as being a barrier to FDI). Regarding FDI, an important related issue concerns the country’s strict immigration laws, which make it difficult to ‘import’ much-needed skills from abroad even when associated with a specific FDI inflow. Moves are however currently underway to amend certain of the immigration laws to make them more investor friendly.

While South Africa recognises the National Treatment (NT) principle within its WTO obligations, the interpretation of NT has shifted slightly in recent years. Today, many developing countries interpret NT as providing for treatment of foreign nationals and entities “no less favourable” than local nationals and entities, while at the same time incorporating certain development objectives favouring specific stakeholder groups. For example, reserving a certain minority stake or preferences in the privatisation of a certain state-owned asset for BEE would be seen as a valid developmental objective to address past imbalances yet is not inconsistent with NT principles.

South Africa’s policy towards investment has in recent years also been shaped by the development of a comprehensive regulatory environment relating to competition. A Competition Commission and Tribunal have wide-reaching powers to enforce the country’s recently enacted Competition Act. Legislation to regulate uncompetitive industry structures and behaviour are an important requirement in creating an enabling environment for FDI, in that it provides investors (both foreign and local alike) with a more predictable and competitive business and investment environment. Regulations to counter uncompetitive business practices have played an important role in ensuring a more secure investment framework in the country.

More recently, the focus on FDI has shifted marginally to also include outward investment. Foreign investment by South African companies, especially in the region, is actively encouraged and has seen a substantial relaxation of exchange controls and capital restrictions for bona fide investment purposes. South Africa has in recent years
become possibly the largest investor in Southern Africa, especially in sectors including retail, mining, telecommunications and beverages.

4.2 Policy challenges and future policy considerations

South Africa’s policy framework faces important challenges as it attempts to marry an environment conducive to investment with the need to achieve important development objectives. In order to attain this overriding objective, a number of important issues and challenges must be recognised and dealt with. These include, *inter alia*,

- economic empowerment policies vs. the overregulation of FDI,
- the increasing mobility of FDI,
- the sustainability of investment incentives and the problem of incentive dependency and incentive competition,
- the tension between investment-related privileges for local and foreign investors,
- the coordination and coherence of government policy at the national and regional as well as at the inter-departmental level,
- adoption of a co-ordinated BIT policy and investment framework that considers South Africa’s unique needs and challenges,
- FDI policy commitments at the bilateral vs. the multilateral level.
- the problem of substitution (and opportunity cost) where local financial developmental institutions (e.g. the Industrial Development Corporation) co-finance FDI,

Each of these issues is important in the South African context, and needs to be recognised in the ongoing development of FDI policy in South Africa. One of the most pressing issues in South Africa is that of (black) economic empowerment of the previously disadvantaged sectors of the economy, although the government’s policy approach to this issue has been contentious. In recent years, various sectors of the economy have been targeted for the achievement of transformation, culminating in the development of sets of sector-specific empowerment guidelines and targets. These include the mining sector charter which was recently drawn up and the information and communication technologies (ICT) BEE charter, which is currently in the process of being concluded. Although BEE is recognised as an important development objective within the country, concerns have been raised by local and foreign investors alike that some of the policies being developed are causing distortions to South Africa’s investment climate while achieving little by way of true broad-based BEE. While BEE as a policy has found widespread acceptance, overregulation and excessive burdening of the environment for investment will not find favour among a highly competitive investment community.

South Africa has concluded a flurry of BITs over the past decade, the first of which was with the U.K. Owing to the fact that the country had until that stage little experience in such matters, it largely adopted the English investment treaty model. This has served as a basis throughout the 1990s, although it was subsequently deemed to be unsuitable to some of the needs and challenges facing a developing country such as South Africa. This was highlighted recently in a case involving a Swiss investor, as alluded to earlier. Nevertheless, South Africa’s BIT “model” is currently being overhauled to more closely reflect domestic needs and developmental priorities, while recognising the constitution of an investment framework that is sufficiently attractive in helping to attract FDI.
At the same time, pertinent issues further relate to the interface between an investment framework at the national and the multilateral level. While bilateral treaties can be customised to reflect the investment needs and aspirations of the negotiating parties, this nonetheless exposes the “weaker” party to the agreement to the usual power asymmetry and resultant dynamics. The multilateral level holds some promise due to its transparency, predictability and wide-reaching application among countries when concluded within the WTO framework. Also, provisions relating to the special needs of developing and least developed countries may find greater emphasis. Although South Africa at the last WTO Ministerial in Cancun sought to link any negotiation on investment to negotiations on agricultural subsidies, investment at the multilateral framework is a challenge that will nonetheless need to be dealt with in a co-ordinated manner in due course. While an investment framework agreed to at the multilateral level would imply a wide-reaching commitment on investment issues, it is likely to reduce the vulnerability associated with the negotiation of BITs at the bilateral level.

Since BITs have wide-reaching application within the domestic economy, the challenge remains to co-ordinate investment policy and incentives at the provincial and national level. At the national level, the process of concluding BITs involves various government departments, including the Department of Trade and Industry (which negotiates the BIT), the Department of Justice (which looks at the constitutional implications) and the Department of Foreign Affairs (which ensures the consistency and compatibility with the country’s other international obligations). This requires high levels of policy co-ordination and interdepartmental transparency, something that in the South African context remains a challenge.

A further challenge relates to that of investment finance. South Africa’s BITs contain clauses with reference to development finance institutions, whereby certain advantages or preferences given to local investors with regard to investment finance do not have to be made available to the same extent to foreign investors. Notwithstanding, the availability and provision of development finance to foreign investors raises questions on investment substitution and opportunity cost. Specific challenges relate to instances where a country’s development finance institutions provide finance to foreign investors, thereby decreasing the pool of resources available to local investors.

The presence of investment incentives and apparent investment competition was highlighted recently when a large Malaysian textile mill substituted its proposed South African location for that of neighbouring Namibia. At stake were substantial investment incentives (subsidised services, tax holidays etc.), where Namibia offered a better “package” of incentives than South Africa. In many cases investors are known to receive incentives (in some form or another) at the local, provincial and national level, which raises questions relating to their sustainability. Anecdotal evidence suggest that various investments both in South Africa and within the region are wholly dependent on similar incentives, which raises questions relating to the sustainability, economic benefit and indeed true cost to the country associated with such investments. The challenge for South Africa’s investment policy framework is to ensure a consistent and co-ordinated approach to attracting FDI.
References

Bilateral Investment Treaties:

• Agreement between the Government of the Republic of South Africa and the Great Socialist People’s Libyan Arab Jamahiriya for the Promotion and Reciprocal Protection of Investments
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• Agreement between the Government of the Republic of South Africa and the Government of the United Kingdom of Great Britain and Northern Ireland for the Promotion and Protection of Investments (and Protocol to the Agreement)
• Agreement between the Government of the Republic of South Africa and the Swiss Federal Council on the Promotion and Reciprocal Protection of Investments
• Agreement on encouragement and reciprocal protection of investments between the Republic of South Africa and The Kingdom of the Netherlands
• Iran-South Africa Bilateral Investment Treaty
• Treaty between the Republic of South Africa and the Federal Republic of Germany concerning the Reciprocal Encouragement and Protection of Investment

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## Appendix 1: South Africa's regulatory framework

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<th>General Policy</th>
<th>Restrictions / Issues</th>
<th>Principal Legislation</th>
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| **Capital controls** | SA does not impose restrictions on repatriation of capital investments; profits; transfer of dividends by non-residents; transfer of interest payments. Exchange controls on SA companies and private individuals have been gradually relaxed since 1996. | Royalties, licence fees and certain other remittances to non-residents require the approval of the Reserve Bank; Local borrowings of companies that are at least 75% owned or controlled by non-residents are subject to restrictions, but these decrease as resident participation increases. | - Import and Export Control Act 45 of 1963  
- etc. |
| **Competition** | The Competition Act of 1998 created regulatory and judicial bodies in the form of the Competition Commission, Competition Tribunal, and Competition Appeal Court. Importantly for investors, the policy and regulations aim to create a predictable business environment. | The Commission assesses the impact of mergers and acquisitions on competition and the taking of appropriate action. It considers: the sectoral / regional impact; impact on employment and BEE initiatives; and the ability of SA firms to compete internationally. It is mandated to exempt anti-competitive practices in, e.g. the promotion of exports. | Competition Act 89 of 1998 |
| **Labour and Empowerment** | The Labour Relations Act provides for inter alia general employee rights; a collective bargaining framework and creates the Commission for Conciliation, Mediation and Arbitration (CCMA). | In terms of SA’s Employment Equity Act, employers are expected to undertake employment equity programmes that set targets for the proportions of under-represented groups at different employment levels and the method of achieving these targets. These requirements will presumably also apply to foreign investors establishing businesses in South Africa unless specifically excluded in an Agreement. | - Labour Relations Act 66 of 1995  
- Basic Conditions of Employment Act 75 of 1997  
- Skills Development Act 97 of 1998  
- Skills Development Levies Act 9 of 1999  
- Employment Equity Act 55 of 1998  
- Occupational Health and Safety Act 95 of 1993  
- Unemployment Insurance Act of 2001  
- Compensation for Occupational Injuries and Diseases Act 130 of 1993 |
| **Intellectual Property** | South Africa has a comprehensive system of intellectual property law governing patents, industrial designs, copyright and trademarks and is also a signatory to most international conventions governing IP. | SA’s IP legislation is wide-ranging and progressive and goes beyond the minimum requirements laid out in the WTO TRIPS Agreement. | - Merchandise Marks Act (Act 17) 1941  
- Performers' Protection Act (Act 11) 1967  
- Patents Act (Act 57) 1978  
- Copyright Act (Act 98) 1978  
- Trade Marks Act (Act 194) 1993  
- Designs Act (Act 195) 1993  
- Counterfeit Goods Act (Act 37) 1997  
- Intellectual Property Laws Amendment Act (Act 38) 1997  
- Copyright Amendment Act (Act 9) 2002 |
| **Tax** | - Corporate Tax of 30%  
- Secondary Tax on Companies of 12.5%  
- External companies taxed on flat rate of 35% on SA | Exports are zero-rated and no VAT is paid on imported capital goods. Special exemptions exist for foreign owned companies. | - Companies Act of 1963  
- Income Tax Act of 1962  
- Value Added Tax Act of 1991  
- South African Revenue |
| Source Profits | Services Act of 1977  
- Close Corporations Act of 1984 |
|----------------|--------------------------|
| Environment    | Environment Conservation Act of 1989  
- Hazardous Substances Act of 1973  
- National Environmental Management Act of 1998  
| Privatisation  | Telecommunications Act of 1996 and the Telecommunications Amendment Act 64 of 2001  
- South African Maritime Safety Authority Act 5 of 1998;  
- South African Civil Aviation Authority Act 40 of 1998  
- National Roads Act 54 of 1971; and  
- National Land Transport Transition Act 22 of 2000 |

The South African Constitution made protection of the environment a priority in section 24. Regulation of the environment is the concurrent responsibility of national and provincial spheres of government, whose role it is to set the requirements and standards for impact management and ensure that these are met. It has recently been made compulsory for a number of planned developments to undergo environmental impact assessments. Investors in SA’s industrial Development Zones are not granted any labour and environmental regulation concessions.

SA is engaging in a programme of restructuring its state-owned enterprises. In preparation for private sector involvement, it has established various sectoral regulatory bodies: Independent Communications Authority and the National Electricity Regulator, while the Competition Board was upgraded to the Competition Commission. Regulatory uncertainty exists amongst potential investors on specific issues in the following sectors: telecommunications; electricity; transport; and minerals and energy.