The Impact of Investment

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Executive Summary

This report provides an overview of the impact of direct investment on developing countries, before conducting an analysis of the current state of investment in South Africa with an outline of South Africa's plan to attract and manage investment.

Methods of analysis include a brief literature review on the impact of domestic and foreign direct investment (FDI) on developing countries; a trend analysis of South Africa's foreign owned assets, capital account as well as gross fixed capital formation; and an overview of state policy documents insofar as they relate to relevant investment objectives and targets.

It is often proposed that direct investment (both domestic and foreign) is a driver of economic growth, with the assumption that this will culminate in a net benefit to the state and citizens of a country.[1] An overview of the research for and against this proposition suggests the following:

- Direct capital investment financed from within a country is generally accepted to be more likely to result in greater benefits than foreign financed direct investment. There is no consensus however on the net impact of FDI on an economy.[2]
- Several business practices have emerged that limit the potential positive spillover effects of FDI in developing countries.[3] These practices raise doubts as to the proposed causal relationship between an increase in FDI, economic growth and positive spillover effects.[4]
- FDI inflows have been found to be neither a sufficient or necessary condition for economic growth. It is more likely that the quality rather than quantity of FDI is a key determinant in achieving economic growth with positive spillover effects.[5]

From the perspective of the state, the process of encouraging and managing FDI flows appears to be a delicate balancing act. The state may attempt to ensure that FDI ultimately benefits citizens through targeted regulation of FDI ventures while also ensuring that the conditions imposed on foreign investors are not so stringent so as to dissuade future investment. The focus of the recipient state may therefore be on developing, monitoring and evaluating appropriate policy instruments to ensure that FDI flows genuinely contribute towards its development objectives.

An analysis of the current state of investment in South Africa revealed the following:

- The long term relationship between FDI and economic growth in South Africa is positive.[6] However, since 1994, the relationship has been unclear as periods of relatively higher growth have not necessarily coincided with higher FDI inflows. FDI in South Africa, as a percentage of GDP, is relatively low compared to most of its peer countries.
- Since 1994, South Africa has experienced an increased reliance on foreign investment into local bonds and stocks (portfolio investment) to fund capital formation. From 1994 to 2012, portfolio investments by non-residents grew by a compounded average rate

[1] See http://www.bdlive.co.za/opinion/2013/04/10/sa-can-enhance-its-attraction-as-investment-destination, http://www.bdlive.co.za/opinion/2014/09/15/sas-past-prudence-will-drive-economic-renewal, http://www.iol.co.za/capeargus/cabinet-will-drive-2030-development-plan-1.1694686#.VBbY68KSwRo.

[2] See Streeten (1973), White (1978), Hirschman (1977).

[3] See Singh (2007).

[4] Research by Lipsey (2002) finds that there is no consistent relationship between the size of FDI inflows and economic growth.

[5] See Singh (2007).

[6] See Fedderke and Romm (2004).

of 17.5 per cent per year. As a result, by 2012, portfolio investment assets had increased to 44 per cent, whilst direct investment assets had decreased to 31 per cent reflecting the shifting preferences of foreign investors from direct investment to portfolio investment.[7]

- While gross fixed capital formation (GFCF) has generally increased with economic growth, the last five years have seen growth in GFCF despite poor economic performance. This is partially explained by an increase in government capital expenditure including investment in transport and electricity infrastructure.

As part of South Africa's plan to attract and manage investment, the Department of Trade and Industry (Dti), amongst others, gives effect to the investment focused recommendations in the NDP through the Industrial Policy Action Plan (IPAP) as well as through its own programmes.[8] The IPAP identifies industrial development milestones for 2014/15 which includes the continued establishment of SEZs.[9]

A challenge with investment policy, such as SEZs, is that it seeks to attract investments with increasingly generous incentives, while the net effect of those investments on the economy remains unclear. By managing foreign investment in South Africa, the state may be able to increase the likelihood of positive spillover effects.

[7] South African Reserve Bank (2014).
[8] Department of Trade and Industry (2014).
[9] Industrial Policy Action Plan 2014/15.

Introduction

Several countries including Japan, Taiwan and South Korea have achieved periods of high economic growth in the absence of significant foreign direct investment (FDI) inflows. In many cases, FDI inflows have been found to be a response to economic growth, rather than a driver. Why then do countries compete with one another to attract investment? Conventional economic theory suggests that it is as a result of the potential positive spillover effects of investment and its propensity to enrich the lives of citizens.

The National Development Plan (NDP) and other government policy documents subscribe to this notion as they explicitly identify a critical need to promote both domestic and foreign investment in South Africa.

The New Growth Path (NGP) is, at its core, about creating faster growth and employment through investment, amongst other drivers. The NGP is identified in the NDP as government's key programme to take the country onto a higher growth trajectory.[10]

In broad terms, this document attempts to explore the South African investment landscape.

Specifically, the document aims to provide the following:

1. An explanation of key investment concepts;
2. a brief overview of the literature on the impact of direct investment;
3. a summary of the current state of investment in South Africa; and
4. an outline of South Africa's plan to attract and manage investment.

What is investment?

An asset or item purchased today with the intention of it generating income or a return in the future is referred to as an investment.

In contrast, consumption usually entails the immediate use of an asset or item purchased without any expectation of it generating income or a return in the future.

It is important to distinguish between two related investment concepts commonly employed by the South African Reserve Bank (SARB) and other entities, namely 'investment flows' and gross fixed capital formation (GFCF).

Inflows of money into the South African economy, both from residents and non-residents, are commonly classified as either 'direct', 'portfolio' or 'other' investments based on the nature of ownership of the asset or item purchased.

'Direct investment' involves the purchasing and/or establishing of assets such that the investor is able to exercise control over future decisions. An example would be a foreign corporation establishing a new business in South Africa or a local business purchasing a controlling share in a local retailer. Direct investment can be classified as either domestic direct investment or foreign direct investment depending on the geographical source of finance.

'Portfolio investment' involves the purchasing of assets (usually shares or bonds), where the investor is typically interested in the potential financial return on the asset. In this instance, the investor is not interested in managing the underlying business in which the investment has been made. Portfolio investments are usually characterised by shorter investment horizons than direct investment.

[10] National Development Plan (pg. 92).

'Other investment' is a category used by the SARB to capture any other investments that do not fall into either the direct or portfolio investment categories. Typical forms of investment under this category include trade credits,[11] loans, currency and deposits made into financial institutions as well as other assets and liabilities.

In the National Development plan, investment targets are based on another related investment concept commonly employed by the SARB. GFCF measures the amount spent on additions to the fixed assets (property, machinery and equipment) of the economy, plus net changes in the level of inventories.[12]

To illustrate the difference between investment flows and GFCF, consider the following example:

A foreign corporation uses its own capital (raised through issuing debt or equity) to purchase a majority share in a South African business. The total amount used for the purchase would be classified as an inflow of funds (FDI) into South Africa. The local business may then use a portion of that money to pay off its own debt, and the balance to purchase a new machine to boost production. The funds used to purchase the new machine would be recorded as GFCF and not the total FDI inflow. The three categories of investment flows can therefore be understood to relate to financing as opposed to actual GFCF.

Direct investments can be further separated into green-field and brown-field. A green-field investment occurs when a company or government entity constructs new operational facilities in a country from the ground up as part of a new venture. A brown-field investment occurs when a company or government entity uses or develops existing facilities to launch a new project. This can often involve the investing entity forming a partnership with an existing local business, known as a joint-venture. Joint-ventures can also take the form of licensing and franchising where skills, technology and rights are transferred by the investing entity.

The national income identity explicitly reflects the relationship between investment, other variables and economic growth. Specifically, national income (growth) is the sum of consumption expenditure, investment, government expenditure and the trade balance.[13] Investment is defined in the identity as all fixed capital and inventory expenditure excluding residential property and is denoted by the letter 'I'. Holding other things constant, an investment in fixed capital and/or inventory increases GDP.

The impact of direct investment

Background

It is often proposed that direct investment (both domestic and foreign) is a driver of economic growth, with the assumption that this will culminate in a net benefit to the state and citizens of a country.[14] In this context, a net benefit to society occurs when a direct investment leads to

[11] For example, when a South African importer purchases foreign goods, the transaction is often financed through short-term credit obtained abroad. Likewise, South African exports to other countries may also be financed through credit granted to the foreign importer by South African financial institutions. Trade credits constitute a significant portion of other investment (source: South African Reserve Bank).

[12] GFCF does not include funds spent on land as it represents the turnover of existing fixed capital stock rather than an addition. The word "gross" refers to the fact that the measurement assumes that the stock of fixed capital in the economy is not depreciated over time.

[13] $GDP = C + I + G + (X - M)$.

[14] See http://www.bdlive.co.za/opinion/2013/04/10/sa-can-enhance-its-attraction-as-investment-destination, http://www.bdlive.co.za/opinion/2014/09/15/sas-past-prudence-will-drive-economic-renewal, http://www.iol.co.za/capeargus/cabinet-will-drive-2030-development-plan-1.1694686#.VBbY68KSwRo.

a net positive impact on economic variables such as, amongst others, growth, employment and skills levels. This is best illustrated by way of example:

An investment opportunity is identified in a developing country as a result of the discovery of new reserves of a valuable natural resource. A corporation expresses an interest in the opportunity and commits to developing a new business venture in the developing country. The venture is expected to result in job creation, skills and technology transfers, as well as additional revenue for the state through taxation. In addition to the direct impact of the investment, the new business is expected to have both an indirect and induced impact, as a portion of both the revenue generated by suppliers, and wages paid to employees, will be spent locally. This is referred to as the multiplier effect. The multiplier effect is expected to amplify the benefits of the investment to both the state and citizens of a developing country.

In exchange for their investment, the investing corporation would expect to earn a return equivalent to at least their cost of raising capital. In other words, they would expect to earn a return that is at least as good as what they could have earned by investing in a similarly risky project.[15]

Studies have shown however, that the causal relationship proposed by the above narrative is not so straightforward. This is particularly true when the impact of investment on growth and other indicators is interpreted at an aggregate level. This is because direct investment doesn't appear to have a uniform impact across all sectors of an economy. An analysis of the impact of disaggregated forms of investment may therefore prove more valuable.

In determining the impact of investment, it is important to firstly distinguish between the benefits derived from capital investment financed by domestic versus foreign investors.[16]

Capital investment financed from within a country is thought to result in greater benefits than foreign-financed investment. Several explanations have been proposed in support of this claim:

1. Domestic investors are less likely to repatriate profits and engage in transfer pricing and are therefore more likely to generate revenue for the state;
2. Domestic investors are more likely to invest in developing the entrepreneurial skills of locals;
3. Domestic investors are less likely to develop capital intensive technology that suits its objectives but not necessarily those of the state;
4. Domestic investors are more likely to reinvest profits in the domestic economy;
5. Domestic investors are more likely to develop forward and backward linkages within the economy.[17]

Point five, in particular, is thought to be a key differentiating factor. When an economic activity leads to the creation of another economic activity, it is understood to represent a 'linkage'. Development, in this context, can therefore be measured by the extent to which an economic activity creates linkages.[18] Findings suggest that, in general, domestically financed investment leads to more linkages than its foreign counterpart.[19]

[15] Referred to as a 'normal economic profit'.
[16] See Amin (1974, 1976), Barnet and Mueller (1974), Bornschier and Chase-Dunn (1985), Hymer (1979).
[17] See Streeten (1973), White (1978), Hirschman (1977).
[18] See Firebaugh (1992).
[19] See Amin (1974, 1976), Hirschman (1977).

While it is generally acknowledged that domestic investment is probably more likely to lead to a net positive impact on growth and other indicators, the net impact of FDI on an economy is more contentious. The rest of this section will therefore provide an overview of this debate with specific reference to developing countries.

Foreign direct investment

Several scholars have presented evidence to support the hypothesis that FDI has positive spillover effects for recipient countries.[20]

Some scholars have proposed that foreign investment increases competition in domestic markets which drives demand for domestically produced intermediate goods, leading to industry growth.[21] Their analysis showed that the degree to which linkages with local suppliers exist was a major determinant in the prevalence of positive spillover effects.

However, an empirical analysis using cross-country data for 47 countries for the period 1981-1999, found that the impact of FDI is unlikely to be uniform across an economy. The study established that FDI in different sectors yields different results and therefore it is not advisable to make generalisations about the impact of FDI. A key finding was that FDI flows into the primary sector tended to have a negative impact on growth, while flows into the secondary sector (which includes manufacturing) had a positive impact. The impact of FDI flows into the services sector showed no discernible trend.[22]

Clearly, it is too simplistic to classify FDI flows as either all good or all bad. A more useful approach is to assess who benefits from FDI and whether or not it contributes to the development of a developing country.[23]

The liberalisation of global capital flows has likely led to increased opportunities for capital growth from the perspective of the foreign investor, however, this has not necessarily translated into poverty reduction and development for the developing country.

Several business practices have emerged that limit the potential positive spillover effects of FDI in developing countries.[24] These practices raise doubts as to the proposed causal relationship between an increase in FDI and economic growth and other positive spillover effects.[25]

Firstly, Multi-national corporations (MNCs) have become increasingly adept at minimising taxable income through profit shifting (transfer pricing)[26] and base erosion. In so doing, they are able to shift their tax liability from a country like South Africa to a tax haven where rates are more favourable. The consequence for the state is a loss in tax revenue.[27]

MNCs are also more likely to repatriate earnings and recall loans to foreign subsidiaries in response to an economic slowdown in those countries.[28] This can place further pressure on

[20] See Markusen (1995), Caves (1996), Kokko (1994), Lipsey (2002).
[21] See Markusen and Venables (1999).
[22] See Alfaro (2003).
[23] See Singh (2007).
[24] See Singh (2007).

[25] Research by Lipsey (2002) finds that there is no consistent relationship between the size of FDI inflows and economic growth.

[26] According to UNCTAD's World Investment Report 1996, one-third of world trade is intra-firm trade.
[27] See Singh (2007).
[28] See Singh (2007).

exchange rates, foreign exchange reserves through the balance of payments, inflation, interest rates and the states capacity to employ counter-cyclical fiscal policy.

Many MNCs opt to import inputs[29] from and export outputs to foreign countries as opposed to developing linkages in the domestic economy. Inputs are imported on the basis of cost-minimisation or to achieve a desired standard of output. In such cases, the potential multiplier and hence positive spillover effects are reduced.

The idea that FDI creates employment has also been challenged. MNC's pursuing merger and acquisition (M&A) opportunities often favour capital intensive operations where predominantly highly skilled labour is employed. In such cases, a strong incentive exists for MNCs to import skilled labourers. The use of existing contractors and consultants is merely an extension of this strategy. Job creation may therefore not necessarily occur as intended, and in the case of M&As, the subsequent restructuring often leads to job losses.

Finally, even in cases where a portion of the new labour force is sourced domestically, the degree to which technical skills are transferred can vary.[30] Two reasons are proposed for this. Firstly, that MNCs develop the skills required for their business and not necessarily those required by the host nation. Secondly, it is often the case that the majority of substantive research and development takes place in the country of the parent company.[31]

The extent to which skills and technology transfers do occur is again likely to depend on the linkages between businesses arising from foreign investments and the rest of the economy.[32] Vertical linkages (between the foreign firm and its suppliers and distributors) are thought to amplify the likelihood of a skills or technology transfer.[33]

Creating imbalances for developing countries

The practices described above, along with a renewed surge in FDI in recent years, have created several imbalances for recipient developing countries.

FDI used to establish or expand on an existing business in a developing country has tended to result in more capital leaving the country through remittances than is originally invested.[34] This can occur when the foreign-owned business repatriates profits through dividend payments, royalties and other fees or procures goods and services from foreign entities. The net outflow of capital often leads to current account deficits which are not wholly financed by foreign capital inflows.

Table 1 shows that profit remittance outflows exceeded FDI inflows from 1995-2003 for several African countries.

Table 1: FDI Inflows and Profit Remittance Outflows in Selected African Countries, 1995-2003

Country	FDI Inflows ($ million)	Profit Remittance Outflows ($ million)	Net Inflows ($ million)
Angola	10 761	7 169	3 592
Botswana	943	5 621	**-4 678**

[29] Such as raw materials, services or equipment.
[30] See Singh (2007)
[31] See Singh (2007).
[32] See Hirschman (1958).
[33] See Alfaro (2003).
[34] Remittance flows are defined as the sum of workers' remittances, compensation of employees, migrant transfers, dividend payments, royalties and other fees.

Cameroon	577	421	156
Congo, DRC	1 623	2 773	**-1 150**
Côte d'Ivoire	2 500	2 366	134
Gabon	-822	3 432	**-4 254**
Guinea	244	332	**-88**
Kenya	411	361	50
Mali	807	817	**-10**
Nigeria	10 784	12 387	**-1 603**
Senegal	712	541	171
Sudan	3 868	1 164	2 704
Tunisia	4 287	3 516	771
Zambia	1 158	362	796
Zimbabwe	910	837	73

Source: UNCTAD, Economic Development in Africa: Rethinking the Role of Foreign Direct Investment, New York, 2005.

When the balance of payments is in deficit (outflows > inflows) the state's foreign exchange reserves are run-down to balance the two accounts. Foreign exchange reserves are accumulated by a central bank through the purchasing of foreign currencies and assets. Substantial reductions in foreign exchange reserves leads to the state being more vulnerable to a negative shock to its foreign debt obligations.

Other factors worth considering are the environmental and social impacts of FDI, particularly in the case of resource rich countries in Africa and South America. The long-term liabilities for the host nations, created as a side-effect of such investments, are often not quantified and addressed.

There is also evidence to suggest that an increase in FDI substitutes, rather than complements, private investment.[35] This effect has been observed in Latin America, sub-Saharan Africa, Mexico and New Zealand.

Overview

It is therefore not a foregone conclusion that high FDI inflows are a sufficient or necessary condition for economic growth. Several countries (Japan, Taiwan and South Korea) have achieved periods of high economic growth in the absence of substantial FDI inflows. In many cases, FDI inflows have been found to be a response to economic growth rather than a driver.[36]

[35] See Ghosh (2004), Ffrench-Davis, Griffith-Jones (1995) and Chappel (1991).
[36] See Singh (2007).

It is more likely that the quality rather than quantity of FDI is a key determinant in achieving economic growth with positive spillover effects.

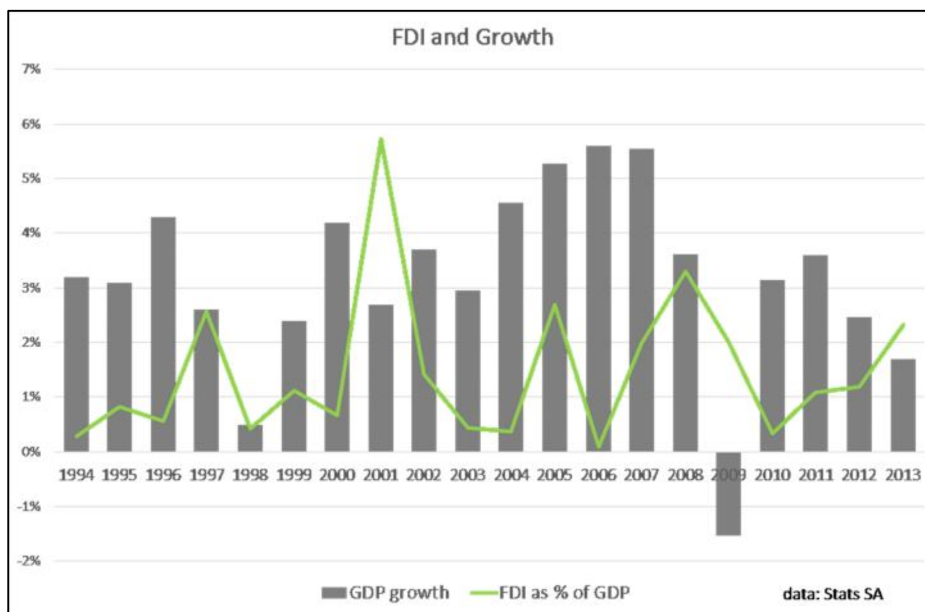
From the perspective of the state, the process of encouraging and managing FDI flows appears to be a delicate balancing act. The state may attempt to ensure that FDI ultimately benefits citizens through targeted regulation of FDI ventures while also ensuring that the conditions imposed on foreign investors are not so stringent so as to dissuade future investment. The focus of the recipient state may therefore be on developing, monitoring and evaluating appropriate policy instruments to ensure that FDI flows genuinely contribute towards its development objectives.

Investment in South Africa

Foreign direct investment in South Africa

South Africa has experienced a steady growth in FDI since the advent of democracy. Figure 1 shows that FDI, as a percentage of GDP, grew from 0.3 per cent in 1994, peaking at 5.8 per cent in 2001 with an average of 1.5 per cent between 1994 and 2012.

Figure 1: FDI and growth, 1994-2013



Source: South African Reserve Bank, 2014.

Research examining the impact of FDI on growth in South Africa from 1956 to 2003, found the growth impact of FDI to be positive.[37] However, since 1994, the relationship has been unclear as periods of relatively higher growth have not necessarily coincided with higher FDI inflows. Economic growth between 2001 and 2008 was recorded at a compounded average rate of 3.9 per cent, which is the fastest sustained period of growth since 1994. During this period, FDI was particularly volatile, growing at an average of 8 per cent, compared to the preceding period (1994-2000) where growth averaged 33 per cent.

[37] See Fedderke and Romm (2004).

Table 2 shows that FDI in South Africa, as a percentage of GDP, has averaged 1.5 per cent since 1994. This is relatively low compared to its peer countries,[38] exceeding only India and Turkey, both of which are characterised by high levels of domestic investment.

Table 2: SA FDI compared to peer countries

Foreign Direct Investment as percentage of GDP			
	1994 - 2013	1994 - 2008	2009-2013
South Africa	1,5%	1,7%	1,4%
Argentina	2,6%	2,7%	2,0%
Brazil	2,5%	2,3%	2,5%
Chile	6,7%	6,7%	8,0%
China	3,9%	4,1%	3,3%
Indonesia	1,7%	1,7%	1,9%
India	1,3%	1,9%	1,8%
Mexico	2,7%	2,8%	2,1%
Russia	1,9%	3,4%	2,1%
Turkey	1,3%	2,5%	1,6%
			data: OECD

Source: The Organisation for Economic Co-operation and Development, 2014.

FDI into South Africa has not recovered since the financial crisis of 2009. Between 1994 and 2008, FDI as a percentage of GDP averaged 2.1 per cent, whereas since the crisis it has averaged only 1.4 per cent. South Africa's peers have, however, managed to partially recover. This suggests that other factors may be affecting the decisions of foreign investors.

FDI in South Africa has been concentrated in three key sectors. As of December 2012, 85 per cent of foreign owned assets in South Africa were the result of investments in mining and quarrying (31 per cent), manufacturing (18 per cent), and financial services (36 per cent). FDI in South Africa is dominated by investors from Europe (78 per cent)[39] and the USA (7 per cent), while China and the rest of Africa account for 3 per cent each.[40]

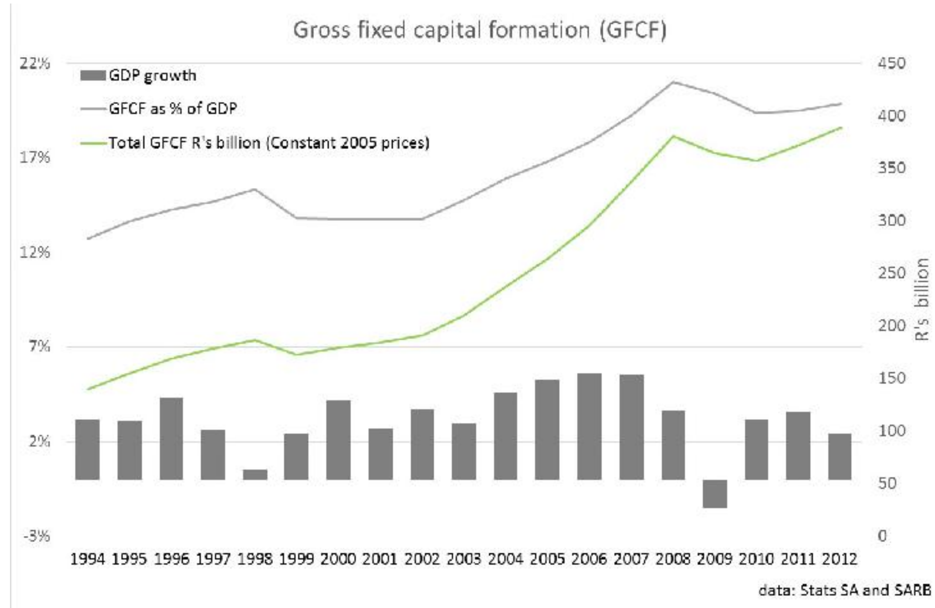
Since the development of South Africa's financial markets and liberalisation of exchange controls, portfolio investment has provided foreign investors with an alternate channel to invest in the South African economy. From 1994 to 2012, portfolio investments by non-residents grew by a compounded average rate of 17.5 per cent per year. In 1994 foreign portfolio investment comprised only 7 per cent of total foreign assets, compared to direct investment assets of 71 per cent. By 2012, portfolio investment assets had increased to 44 per cent, whilst direct investment assets had decreased to 31 per cent. This reflects the shifting preferences of foreign investors from direct investment to portfolio investment. The geographical composition of foreign owned assets stemming from portfolio investments is dominated by Europe (58 per cent) and the USA (38 per cent).[41]

[38] This report defines a peer country as one that is at a relatively similar stage of development to South Africa.
[39] The United Kingdom (UK) accounts for 11 per cent of FDI in South Africa.
[40] South African Reserve Bank (2014).
[41] The United Kingdom (UK) accounts for 30 per cent of foreign-owned portfolio assets in South Africa.

Gross fixed capital formation in South Africa

Figure 2 shows that GFCF has increased steadily since 1994. Expressed as a percentage of GDP, GFCF has averaged 16 per cent since 1994, growing from 12.9 per cent in 1994 to 20 per cent in 2013. In constant prices, GFCF has grown by over 190 per cent since 1994.

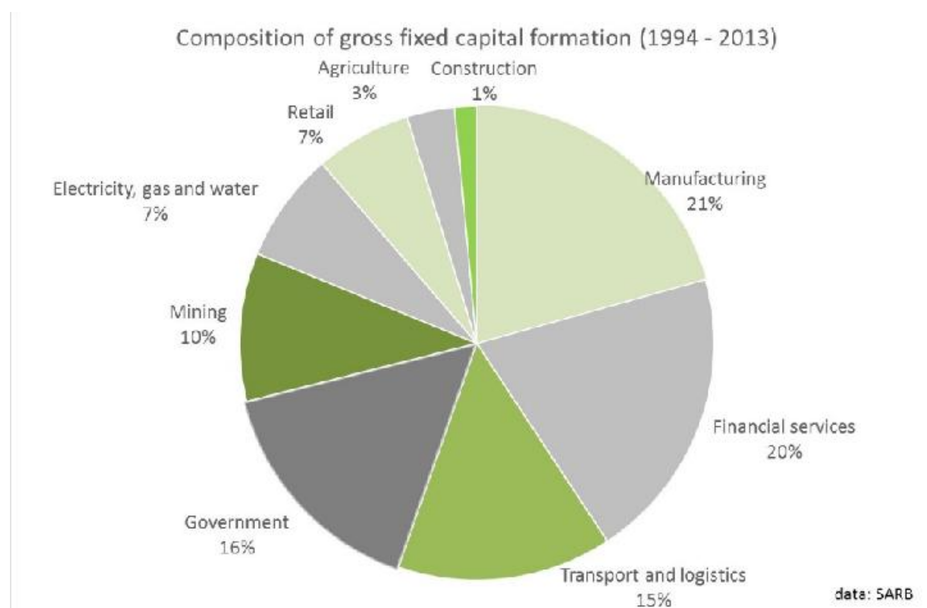
Figure 2: Gross fixed capital formation, 1994-2012



Source: South African Reserve Bank and Statistics South Africa, 2014.

While GFCF has generally increased with economic growth, the last five years have seen continued growth in GFCF despite relatively poorer economic performance. This is partially explained by an increase in government capital expenditure including investment in transport and electricity infrastructure.

Figure 3: Composition of gross fixed capital formation, 1994-2013

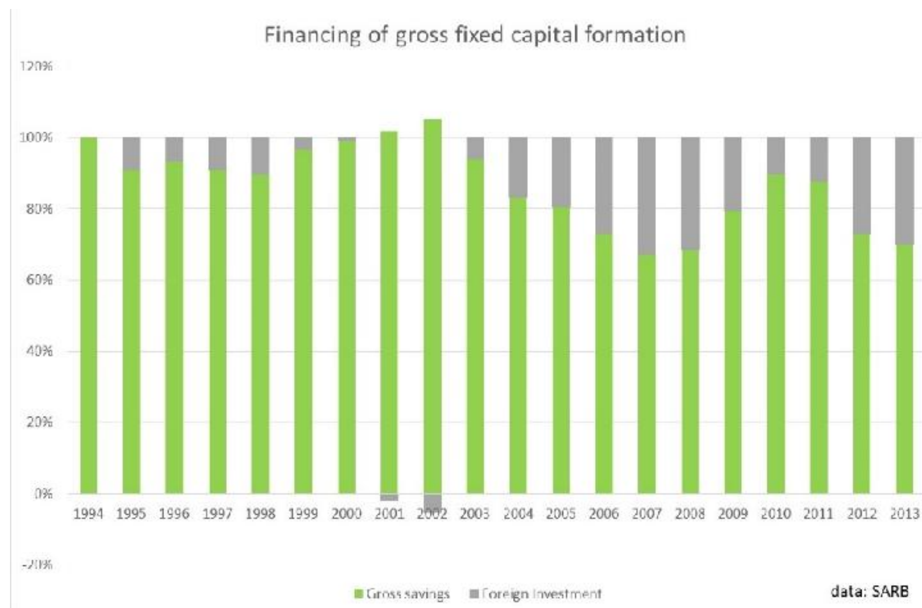


Source: South African Reserve Bank, 2014.

Compared to FDI, GFCF is spread more evenly across different sectors. Figure 3 shows that, since 1994, capital outlays in the manufacturing, mining, and transport and logistics sectors have comprised over half of total GFCF.

The financing of GFCF is presented in figure 4. Since 2003, South Africa has experienced an increased reliance on foreign investment to fund capital formation. Expenditure on fixed capital must be financed from domestic and/or foreign savings. The increase in foreign financed capital formation is, therefore, likely to be partially explained by a relatively lower national gross savings rate as a percentage of GDP.[42]

Figure 4: Composition of gross fixed capital formation, 1994-2013



Source: South African Reserve Bank, 2014.

South Africa's plan to attract investment

The NDP provides a common framework for activities across all sectors and sections of South African society. The need to promote both domestic and foreign investment in South Africa as a pivotal driver of economic growth is explicitly recognised in the NDP and other government planning documents. The plan identifies the need to remove the most pressing constraints on growth, investment and job creation, including energy generation and distribution as well as urban planning.

At the time of the development of the NDP, public infrastructure spending had reached historically low levels. The low levels of infrastructure spending was predominantly the consequence of under-expenditure in infrastructure including on roads, rail, ports, electricity, water, sanitation, public transport and housing. According to the NDP targets, total GFCF as a percentage of GDP should reach approximately 30 per cent by 2030 to realise a sustained impact on growth and household services. Public sector GFCF would be expected to reach 10 per cent of GDP by the same date.

So as to monitor the progress in GFCF, an interim target for total GFCF of between 20 and 25 per cent of GDP has been set for 2014.

[42] Since the beginning of 2003, gross national savings as a percentage of GDP has decreased from 17.5 per cent to 13.2 per cent at present.

It has been proposed that capital investment, including bulk infrastructure, is most effectively driven when both the public and private sectors make contributions.[43] In the wake of the 2009 recession, government has shifted the composition of expenditure towards investment. The private sector has, however, been reluctant to invest buoyant levels of retained earnings in productive capacity.

Currently the private sector in South Africa accounts for 80 per cent of production and employment. The 2014 – 2019 Medium Term Strategic Framework (MTSF) therefore suggests that more rapid private sector investment is critical for higher levels of growth. The Presidential Business Working Group will lead engagements with business to unlock private sector initiative, build investor confidence, promote trust and seek long-term commitments.

The Department of Trade and Industry (Dti), amongst others, has the responsibility for building an equitable global trading system that facilitates development by strengthening trade and investment.[44] The Department further stimulates and facilitates the development of competitive enterprises which supports direct investment flows.

The Department gives effect to the investment focused recommendations in the NDP through the Industrial Policy Action Plan (IPAP) as well as through its own programmes. In recognition of the role the Dti plays in promoting investment, the department's budget allocation has grown annually at an average rate of 17.7 per cent between 2010/11 and 2013/14.

The bulk of the department's expenditure occurs within the *Incentive Development and Administration* programme, which makes up 57.4 per cent of the department's total budget over the medium term. The expenditure is channeled towards incentive schemes such as the manufacturing development incentive, which contributes to the development of manufacturing industries, and the special economic zones (SEZ) investment incentive.[45]

The SEZ investment incentive scheme encourages investment in South Africa through a range of incentives including a tax incentive which offers a blanket corporate tax rate of 15 per cent on corporate profits. New legislation on SEZs will enable the graduation of Industrial Development Zones (IDZs) into SEZs. The Bill is presently before Parliament.

Examples of IDZs and large infrastructure projects currently underway are:

- The **Coega industrial development zone** was designated in 2001. The zone currently has 20 operational investors contributing a total value of R1.13 billion; and has created about 40 900 direct and indirect jobs. Another 17 investors, with an investment value of R9 billion, have been signed up but are not yet operational on site. In 2012/13 alone, the zone attracted 8 new investors pledging a total of R1.7 billion.
- The **East London industrial development zone** was designated in 2001. The zone has to-date secured 31 investors to the value of R4 billion; 21 of these, worth R1.08 billion, are operational on site. The zone has so far created over 7 500 direct and indirect jobs. In 2012/13, the East London industrial development zone attracted 5 new investors contributing a total of R284 million.
- The **Richards Bay industrial development zone** was designated in 2002 but due to delays related to land, environmental and other issues, only started developing infrastructure in 2010/11. To-date, the industrial development zone has attracted 1 investor pledging R800

[43] http://www.bdlive.co.za/national/2014/03/19/capital-spending-on-infrastructure-too-slow-to-spur-growth.
[44] Department of Trade and Industry (2014).
[45] *Ibid.*

million (later expanded to R980 million) who is operational on site. The investment has created approximately 180 jobs.

- The **OR Tambo International Airport industrial development zone** was designated in 2002 and received a provisional operator permit in 2010. The first phase of construction, on 6.1 hectares of land leased from the Airports Company of South Africa, was scheduled to begin in 2013/14, but has yet to take place. The department is assisting the Gauteng provincial government in addressing the bottlenecks delaying the progress of the zone.
- The **Saldanha Bay industrial development zone** was designated in August 2013. The department will finance the initial infrastructure developments in this zone through the SEZs investment incentive. Infrastructure for which capital is required includes the water demand management programme, bulk sewerage, upgrading of the Saldanha waste water treatment system, public transport facilities, bulk water supply services, solid waste transfer systems, and internal engineering services inside the industrial development zone area. The Saldanha IDZ is committed to contributing 86 per cent to the region's gross geographic product and creating nearly 12,000 direct, indirect and induced jobs. It is expected to attract R9.3-billion in FDI over the next 25 years. The Saldanha IDZ - which is one of South Africa's 18 Strategic Integrated Projects - is strategically located to serve the large oil and gas sector on the West Coast of Africa and provide an opportunity for greatly expanded and enhanced manufacturing of componentry for the oil and gas industry. The Saldanha Bay IDZ licensing company has already signed six lease agreements with international and South African oil and gas companies.[46]

Other Dti programmes targeting the promotion of investment include:

- The **Critical Infrastructure Development programme** which is a cost sharing grant for projects designed to improve critical infrastructure in South Africa. The programme expects to provide financial support to 39 enterprises over the medium term, with an estimated project investment value of R19 billion.
- The **Trade and Investment South Africa programme**, although one of the smaller programmes, is responsible, amongst others, for promoting and attracting direct investment from targeted countries into targeted sectors of the South African economy. IPAP identifies a target of R135 billion by 2016/17 in this regard.[47]

In addition to existing initiatives, IPAP identifies industrial development milestones for 2014/15.[48]

The performance of a department is assessed based on their capacity to realise the objectives and targets outlined in their Annual Performance Plan (APP). There is therefore a stronger incentive for a department to work towards reaching a milestone if it is included in its APP. By including the shorter-term IPAP milestones in the APPs of relevant departments, the likelihood that the investment targets set-out in the NDP and medium term strategic framework (MTSF) will be achieved, is possibly enhanced.

However, based on the relevant departments latest APPs, the only IPAP 2014/15 milestone to have a performance indicator attached to it is the 'finalisation of the SEZ regulations and guidelines'.

At the time of writing, the SEZ regulations and guidelines had been approved and gazetted.

[46] Department of Trade and Industry (2014).
[47] Department of Trade and Industry (2014).
[48] Key milestones in relation to SEZs and industrial development are included in an appendix at the end of this document.

The absence of the remaining IPAP milestones and MTSF targets from future APPs is likely to compromise effective monitoring and reduce the prospect of implementation.

Conclusion

In conclusion, South Africa has formulated policy to attract both domestic and foreign investment. A challenge with investment policy, such as SEZs, is that it seeks to attract investments with increasingly generous incentives, while the net effect of those investments on the economy remains unclear.

While domestic investment has been found to be more likely to result in positive spillover effects, the net impact of FDI is contentious. The net impact of FDI on economic growth, tax revenue generation, job creation and skills and technology transfers has been the subject of much debate. There is also evidence suggesting that FDI inflows may lead to other economic imbalances.

By managing foreign investment in South Africa, the state may be able to increase the likelihood of positive spillover effects.

Appendix

Key milestones in relation to SEZs and industrial development include:

1. The establishment of Industrial Clusters through SEZs
    - 2014/15 Q1-Q4: Rollout of Saldanha Bay IDZ (SBIDZ): Infrastructure support provided within the IDZ
    - 2014/15 Q1-Q4 Establish SBIDZ Board
    - 2014/15 Q3: Sign MOU between the Dti and Indonesia to facilitate collaboration on the establishment of Oil and Gas industry at Saldanha Bay
    - 2014/15 Q1-Q4: Secure 8 Investments in Saldanha Bay IDZ within Oil & Gas and Marine Repair Cluster.
2. The implementation of SEZ Bill proposals
    - 2014/15 Q2: SEZ Regulations and Guidelines (in line with the promulgation of the SEZ Act)
    - 2014/15 Q2: Establishment of the SEZ Board (Once the SEZ Act has been promulgated)
    - 2014/15 Q1-Q3: Implementation Protocols entered into by the Minister (the Dti) and 4 government departments that are critical to the success of the SEZs
    - 2014/15 Q3: Testing of the SEZ One Stop Shop Model
    - 2014/15 – 15/16: Ongoing establishment of SEZs.
3. SEZs: planning and development
    - 2014/15 Q1: Pre-feasibility study reports for 8 proposed SEZs
    - 2014/15 Q4: 5 technical feasibility reports (from Q2).
4. The SEZ Capacity Building Programme
    - 2014/15 Q1: Planning and finalisation of logistical arrangements with the Chinese government on the training of South African officials on SEZ in China
    - 2014/15 Q2: Recruitment of 30 candidates, across the country, to be trained in China on SEZs planning, development and management
    - 2014/15 Q3: Training of 30 officials in China on the planning, development and management of SEZs.[49]

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[49] Industrial Policy Action Plan 2014/15.