National Treasury is releasing a discussion document entitled “A review framework for cross-border direct investment into South Africa”.

Many developing and developed countries have explicit measures that define the policy and/or regulatory framework for cross border direct investment into such countries and address the specific public interest considerations arising from cross border direct investment.

In some instances, more priority is given to industries or sectors considered to be of strategic importance to the economy and that are relevant to the future plans of that country. These policy measures take the form of explicit legislation and/or regulation that articulate the conditions within which FDI is expected to have net benefits for the country.

Currently, South Africa does not have a coherent policy framework for the regulation of cross-border direct investment in general or investment in particular sectors of the economy which may be regarded as strategic.

This policy gap means that responses within different departments on the position of Government on investments that affect national interests have lacked a formal coordinated framework and in many instances, there has been an over reliance on the application of exchange controls to assess the net benefits of cross-border investments.

In this context, the existing set of regulations that affect cross-border direct investment raises three major (and inter-related) concerns:

- The regulation of sensitive cross-border mergers and acquisitions is opaque and relies in part on exchange control rules on the structure of transactions rather than a clear statement of public interest objectives and process.
- Approvals for the re-domiciling or cross-border restructuring of South African companies have been considered on a case-by-case basis and the framework for assessing public interest has lacked transparency.
- Policy towards inward investments in strategic industries or companies is not well-defined, with a need for greater harmonisation with sectoral regulations affecting both domestic and foreign investors.

National Treasury has conducted a review and developed a discussion paper which proposes that a new policy framework and regulations targeted at the specific public interest issues raised by cross border direct investments into South Africa be developed.

The overall objectives of such a policy framework would align with the broader macro-economic objectives of Government including the maintenance of an open environment for foreign direct
investment while addressing the specific public interest considerations emanating from cross border
direct investments for the country.

This is important taking into account the need to support the growth of South African companies into
multinationals from a domestic base in a way that benefits the South African economy; attract new
capital into the country, while balancing the need to ensure that cross border investment into South
Africa is in the public interest.

In particular, the proposed policy framework has the following objectives:

- To encourage new inflows of foreign capital - with expected benefits for employment, growth and
  competition - while safeguarding public interests relating to strategic cross-border acquisitions
  and corporate restructuring

- To support consistency in policy on inward investment across government departments

- To support the growth of South African companies domestically and abroad with long-term
  benefits for the South African economy

- To provide policy certainty for investors through the transparency of decision-making

- To support the overall policy framework for the management of the macroeconomic benefits and
  risks arising from cross-border capital flows

The proposed policy framework will apply only to certain forms of cross-border acquisitions and
related restructurings of existing South African businesses. It is intended to provide a transparent
mechanism for assessing the balance of public interests in the case of these complex investments
and will not, in general, unduly restrict foreign ownership of South African firms.

Importantly, foreign investors seeking to establish new businesses in South Africa (greenfield FDI)
will not be subject to any new regulations under the envisaged policy framework.

It is envisaged that the development of a revised policy framework would have positive spin-offs for
the domestic economy by encouraging competition; providing a framework for consistency in policy
across government departments and certainty for investors; and reduced lobbying while ensuring
that South Africans benefit from the opportunities created by cross-border investment.

**Invitation for comments**

Comments on the discussion document are invited from all interested stakeholders. Written
comments should be sent to: financial.policy@treasury.gov.za or faxed to 012 315 5206 on or before
the 30 April 2011.

**Issued by: National Treasury**
23 February 2011
A review framework for cross-border direct investment in South Africa

Discussion Document

February 2011
A REVIEW FRAMEWORK FOR CROSS-BORDER DIRECT INVESTMENT IN SOUTH AFRICA

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A REVIEW FRAMEWORK FOR CROSS-BORDER DIRECT INVESTMENT IN SOUTH AFRICA

EXECUTIVE SUMMARY

INTRODUCTION

South Africa is committed to maintaining an open environment for investment. This is core to long-term, sustainable, economic growth. As a low-savings developing economy, with high domestic investment requirements, South Africa requires to attract foreign direct investment in order to support domestic investment financing requirements.

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

This paper discusses these issues and makes the case for a more coherent, harmonised and transparent framework to cover all foreign direct investment into South Africa. The proposals will necessitate the participation of a variety of different stakeholders within and outside government as well the investment community.

As part of the modernisation of the investment framework, the existing rules affecting complex cross-border acquisitions and corporate restructurings will be reviewed with the intention of replacing them with new regulations targeted at the specific public interest issues raised by these transactions. The review framework for cross-border direct investment will aim to maintain an open environment for inward FDI with the following objectives:

- To encourage new inflows of foreign capital - with expected benefits for employment, growth and competition - while safeguarding public interests relating to strategic cross-border acquisitions and corporate restructuring
- To support consistency in policy on inward investment across government departments
- To support the growth of South African companies domestically and abroad with long-term benefits for the South African economy
- To provide policy certainty for investors through the transparency of decision-making
- To support the overall policy framework for the management of the macroeconomic benefits and risks arising from cross-border capital flows

The proposed policy framework will apply only to certain forms of cross-border acquisitions and related restructurings of existing South African businesses. It is intended to provide a transparent mechanism...
for assessing the balance of public interests in the case of these complex investments and will not, in
general, unduly restrict foreign ownership of South African firms. Importantly, foreign investors seeking
to establish new businesses in South Africa (‘greenfield’ FDI) will not be subject to any new regulations
under this policy framework.

BACKGROUND: INTERNATIONAL PRACTICE IN THE REGULATION OF FDI

The regulation of inward investment is one of several policy and institutional variables likely to influence
the volume of FDI. Recent indicators of the restrictiveness of regulations on FDI compiled by the OECD
suggest that South Africa is a broadly middle-ranking country: it is 21st out of 48 countries in the 2010
OECD Index (from most to least restrictive). For South Africa, the main regulations captured in this
Index are operational restrictions on foreign-owned firms, together with some equity restrictions. In this
light, the development of the review framework would be sensitive to the administrative burden implied
by the range of existing regulations on foreign entry, ownership and operations.

There is a varied approach to the regulation of FDI – and, in particular, foreign ownership – across
developed and emerging economies. Many countries provide a generally open environment for FDI,
with a limited number of strategic industries where foreign entry is subject to specific conditions or
prohibitions. This approach is broadly consistent with the principle of free movement of capital and also
the non-discriminatory treatment of foreign investors as reflected in the OECD’s ‘National Treatment’
commitment. A more limited number of countries (both emerging and developed) continue to use
a general screening mechanism for FDI, accompanied by limits on foreign ownership in strategic
industries, although there has been a tendency towards relaxation of such regulations in recent years.
In these cases, general screening often applies to cross-border acquisitions, as opposed to new
‘greenfield’ businesses.

Regardless of the policy model, a number of strategic sectors emerge where regulations affecting
foreign entry or ownership are commonly found. Amongst the sectors subject to such regulations are:
agriculture and fisheries; broadcasting and print media; business services (e.g., accountancy, legal
services); defence and aerospace; energy; financial services; natural resources; nuclear energy and
materials; real estate; telecommunications and transport.

THE EXISTING POLICY FRAMEWORK FOR INWARD FDI IN SOUTH AFRICA

Existing regulations and implications for inward FDI

There are no general restrictions on inflows and outflows of foreign capital under exchange controls.
Since October 2009, local borrowing for the purpose of genuine FDI may also be undertaken without
restriction (previously it was limited to 300 percent of foreign capital). Foreign companies may also raise
capital in the local equity and bond markets (inward listings) with prior approval.

There are, however, a variety of sector based regulations including a review for competition issues and
other regulatory requirements, depending on the type of investment.

Inward investments that are structured and financed in more complex ways – typically acquisitions –
can require formal approval; here the rationale is the need to assess the balance of longer-term
benefits and risks for domestic companies and the economy more generally. Thus, cross-border
acquisitions of local entities financed wholly or in part by the exchange of shares in the foreign company
or mergers that create domestic shareholdings in a new merged foreign entity fall under exchange
control approval processes. Exchange controls also restrict loop structures that might otherwise provide
a vehicle for exchange control or tax avoidance. Related to these controls on the ‘externalisation’ of South African assets, the re-domiciling of South African companies is subject to approval from the Minister of Finance.

This approach means that large and complex cross-border investments may need to undergo review prior to authorisation, although there is no uniform framework under which proposed inward FDI transactions are assessed. The requirement for approval (and thus the role of the Minister of Finance) is closely related to the particular structure of the transaction, whereas the public interest issues raised by cross-border acquisitions may go beyond these criteria.

*Mergers/acquisitions under the Competition Act*

Mergers and acquisitions in South Africa are subject to screening and approval under the Competition Act (with the exception of the banking sector). There are no formal distinctions between foreign and domestic mergers under the Act. Mergers with a proposed value above a rand threshold require the approval (with or without conditions) of either the Competition Commission for intermediate-sized transactions or the Competition Tribunal for large mergers. In reviewing proposed mergers, the Competition Commission or Tribunal must first consider the impact on competition. If there are adverse implications for competition, then it must determine whether there are offsetting gains and whether the merger can be justified on public interest grounds.

*Sectoral regulation affecting foreign entry and ownership*

Strategic industries in South Africa are subject to sectoral regulations. Typically these regulations include licensing or similar requirements that involve some form of public interest review by the relevant Minister or delegated authority. Importantly, sectoral regulations generally apply to both domestic and foreign investors, although the sectoral framework, in principle, provides a potential mechanism for considering public interest issues arising from foreign ownership. Strategic industries subject to sectoral regulation include the financial sector (banking and insurance); mining sector, telecommunications and broadcasting, and transport, for example. The development of the review framework for cross-border direct investment would take into account relevant sectoral requirements to ensure a harmonised and consistent approach to approval mechanisms.

**THE RATIONALE FOR A REVIEW FRAMEWORK IN SOUTH AFRICA**

The public interest considerations arising from FDI cover a diverse range of economic and social issues regarding the ownership of firms and the private versus social returns to investment. Many of these issues apply equally to domestic and foreign investment, as reflected in the equal treatment of investors in various aspects of policy and the regulatory environment in South Africa. This includes, for example, the regulation of entry in the mining sector and in key services that support the economic infrastructure (e.g., financial services, communications, transport) and policies to support standards of corporate governance and operations, competition, and empowerment.

A further motivation for intervention in foreign investment occurs when the mode of entry (i.e. greenfield versus acquisition) is perceived to create potential risks for the host economy. While many of the expected benefits of FDI do not depend on the mode of entry, the acquisition of domestic enterprises often creates apprehension over potential negative effects in the host economy. These concerns include the perceived risks for employment, production, exports and R&D at the firm level; as well as issues of corporate governance, competition, security of the tax base, and the identity and control of ‘national champions’.
For many aspects of public interest, there are existing regulations or policies in place to address specific objectives, either at the sectoral level or more broadly across the economy. The proposed review framework would not replicate or replace these alternative regulatory processes. Instead, the policy framework would have a complementary role by targeting specific public interest issues that arise in the case of complex cross-border acquisitions and corporate restructurings, for instance:

- balancing the benefits and risks of cross-border direct investments as part of the framework for the management of macroeconomic risk
- facilitating the growth of South African companies in both domestic and international markets in order to deliver broader economic benefits
- supporting the stability of the financial system and well-functioning domestic financial markets and institutions
- protecting the tax base

**POLICY CONSIDERATIONS: DEVELOPING THE REVIEW FRAMEWORK**

The existing set of regulations that affect cross-border direct investment raises three major (and inter-related) concerns:

- The regulation of sensitive cross-border mergers and acquisitions is opaque: there is no clear statement of public interest objectives and process.
- Approvals for the re-domiciling or cross-border restructuring of South African companies have been considered on a case-by-case basis and the framework for assessing public interest has lacked transparency.
- Policy towards inward investments in strategic companies is not well-defined, with a need for greater harmonisation with sectoral regulations affecting both domestic and foreign investors.

An important aspect of the review framework would be an overarching statement of regulatory principles that will apply to cross-border direct investment, aimed at enhancing certainty for foreign investors and domestic companies while also providing transparent mechanisms for intervention to protect public interest where warranted. In line with the existing policy of Government, the broader approach to FDI would be based on the principle that most forms of FDI are expected to have net economic benefits for South Africa and that, across most sectors of the economy, a non-discrimination approach to regulation can apply, meaning that foreign investors are not systematically disadvantaged relative to domestic investors.

*Replacing exchange control regulations with a targeted review framework*

The proposed framework is intended to replace the existing exchange control regulations that affect complex cross-border acquisitions and corporate restructurings. The main policy option to be considered is the introduction of a more transparent public interest review process, targeted at forms of cross-border direct investment that create specific risks for South Africa, while maintaining the generally open environment for most forms of inward FDI.
Transactions subject to the review process

The review process would be limited to large cross-border acquisitions and re-domiciling of existing South African enterprises or assets. Genuine greenfield FDI would not require review and approval but would instead be subject to the same regulations that domestic investors face.

A key decision will be whether the review process should apply consistently to all large cross-border acquisitions or alternatively whether the public interest objectives of policy can adequately be captured by a review process more finely targeted at particular structures of mergers or acquisitions.

Thresholds for the review process

Major public interest concerns are typically associated with large transactions. As such, reasonably high rand thresholds for formal review would apply in order to ensure that the process is appropriately targeted, although smaller transactions would be subject to a simple notification process. Nominal rand thresholds would increase over time by an appropriate formula, in order to maintain real value.

Criteria for approval or rejection

The range of public interest issues arising from specific transactions cannot be perfectly foreseen but it would nevertheless be appropriate to outline the principles of public interest that would be examined in order to enhance the transparency of the process. One important aspect is that approval would be given unless the transaction is expected to be contrary to public interest. A clear statement of the types of conditions that may apply to cross-border acquisitions would be developed to further contribute to greater certainty for foreign firms by limiting scope for arbitrary decisions.

Harmonisation with related areas of policy and regulation

Coordination with related areas of regulation would aim to limit the administrative burden on foreign investors. Where sectoral regulations apply, the review framework would adopt a harmonised approach with relevant licensing and authorisation processes. Here the statement of policy would need to clarify the sequencing of review by relevant departments and the lead responsibility for final approval. The sequencing of the review process with associated approvals for mergers required under the Competition Act would also need to be defined.

Coordination with the Department of Trade and Industry would aim to ensure that the proposed review framework is consistent with existing international commitments and bilateral agreements on trade and investment.

Finally, an important area for coordination will be with tax policy in responding to the tax challenges raised by cross-border investment.

Institutional arrangements

The appropriate institutional structure for the review process will be examined. This will include the allocation of responsibilities for decision-making and implementation (including the Minister of Finance, National Treasury, and Financial Surveillance Department at SARB); the development of mechanisms to facilitate cooperation with government departments and agencies; mechanisms for stakeholder inputs; the human and financial resources necessary to implement an efficient review process; and the design of the application process to limit uncertainty and the administrative burden on investors.
A REVIEW FRAMEWORK FOR CROSS-BORDER DIRECT INVESTMENT IN SOUTH AFRICA

1. INTRODUCTION

One of the key features of capital account liberalisation in South Africa has been the priority given to eliminating exchange control restrictions on foreign investors. The approach of the new democratic government in the mid-1990s reflected the role that foreign capital would need to play in South Africa in supporting investment and growth, especially in the context of a persistently low domestic savings rate. The abolition of the financial rand mechanism in March 1995 marked the end of restrictions on capital flows by non-residents, including inward foreign direct investment (FDI). In contrast, the reform of controls on South African investors has followed a more phased and targeted approach that has prioritised macroeconomic stabilisation and financial sector development.

South Africa offers an open environment for inward FDI, in the sense that there are no screening and approval processes or formal ownership thresholds across much of the economy, although the B-BBEE scorecard is a relevant factor in decisions on the structure of ownership. There are no major areas of regulation where foreign investors receive unfavourable treatment relative to domestic investors as a matter of policy. The existing policy framework for inward FDI thus provides a substantial degree of certainty for foreign investors that they will not face undue or arbitrary discrimination.

One outstanding area of ambiguity, however, is that in cases where foreign investors seek to acquire existing businesses in South Africa, the structure of the proposed investment becomes a key consideration because approval processes under the exchange control system can apply in the case of complex transactions. For instance, approval for a cross-border merger would be required if South African residents become shareholders in a merged and foreign-resident entity; this would also be the case for acquisitions structured through the effective re-domiciling of South African firms. This process lacks a transparent framework and set of principles for assessing the broader economic benefits and costs of proposed cross-border investments and corporate restructurings. In this respect, transaction-based exchange control is an imperfect policy tool for supporting the intended net benefits of inward FDI, given its historical objective has been to limit outflows of capital from South Africa.

As part of the modernisation of the exchange control system, the existing set of rules that affect complex cross-border acquisitions and corporate restructurings will be replaced with a review framework targeted at the specific public interest issues raised by these transactions. The aim of reform is to increase certainty for foreign investors and domestic companies seeking to expand through international partnerships and to provide greater transparency in assessing cross-border mergers and acquisitions that, internationally, make up the largest fraction of FDI flows. The intention is to maintain the open environment for inward FDI across most of the economy while clarifying the policy principles that will guide any intervention in support of public interest objectives.

Importantly, the scope of proposed reforms seeks explicitly to avoid the introduction of significant new barriers to inward FDI, either directly in the form of additional restrictions on foreign entry or indirectly in the form of substantial administrative burdens. In this light, the review of policy in this area also provides an opportunity to strengthen coordination with related regulations that affect foreign entry, especially in sectors deemed to be ‘strategic’ from the perspective of growth and development.
objectives. Internationally, policies on FDI have received increasing attention as a number of countries have sought to protect national security or strategic interests in recent years.

The development of a review framework for cross-border direct investment thus has the following objectives:

- To encourage new inflows of foreign capital - with expected benefits for employment, growth and competition - while safeguarding public interests relating to strategic cross-border acquisitions and corporate restructuring
- To support consistency in policy on inward investment across government departments
- To support the growth of South African companies domestically and abroad with long-term benefits for the South African economy
- To provide policy certainty for foreign and domestic investors through the transparency of decision-making
- To support the overall policy framework for managing the macroeconomic benefits and risks arising from cross-border capital flows

The framework proposed in this paper will apply only to certain forms of cross-border acquisitions and related restructurings of existing South African businesses. It is intended to provide a transparent mechanism for assessing the balance of public interests in the case of these complex investments and will not, in general, unduly restrict foreign ownership of South African firms. Importantly, foreign investors seeking to establish new businesses in South Africa (greenfield FDI) will not be subject to any new and additional regulations under this policy framework.

This paper outlines proposals for a new review framework for cross-border direct investment in South Africa. Section 2 provides an overview of FDI in South Africa and section 3 discusses international practice in the regulation of FDI as background for policy development. Section 4 explores the existing policy framework on cross-border direct investment in South Africa, covering the scope of the current exchange control system and the implications of related policy areas including competition and sectoral regulations that typically apply to both domestic and foreign investors. Section 5 builds on this assessment to set out the rationale for policy intervention and the role of the proposed review framework. Section 6 identifies conclusions for developing a new framework in South Africa, including the appropriate targeting of any review process, institutional arrangements, and the importance of harmonisation with related policy areas.
Box 1: The role of cross-border investment in South Africa

Historically, an extensive regime of exchange controls was in place in South Africa aimed at restricting capital outflows in the context of the severe constraints on economic growth and limited access to international finance. From 1994, Government gave considerable emphasis to the normalisation of international trade and financial linkages and exchange control reform has been part of the strategy of economic policy and institutional development aimed at increasing investment and growth and addressing unemployment and poverty.

Reforms have given priority to the removal of barriers to inward investment, while strengthening the resilience of the economy to the volatility of foreign capital flows that is frequently observed in emerging economies. The approach has recognised that foreign capital can support higher levels of investment and growth than might otherwise be financed from local resources in the form of domestic savings. In parallel, controls on cross-border investments by South African residents have been removed in a gradual manner reflecting the need to maintain macroeconomic and financial stability and the supply of long-term capital for domestic investment.

One important element of reform has been measures to facilitate inward foreign direct investment. Such investment can yield additional economic benefits including the transfer of technology and skills to the host economy which in turn can promote productivity and growth, the generation of linkages with domestic firms supporting employment and growth in other parts of the economy, and the opening of new markets through cross-border trade. These benefits are not necessarily automatic but are likely to vary across economies, sectors and investments; there is a large literature exploring the determinants and impact of direct investment, highlighted in section 2. Against these potential benefits, in some circumstances there can also be risks for the host economy and, here, an important distinction is often drawn between two modes of entry into the economy. ‘Greenfield’ investment involves the establishment of a new business and is often the preferred form of entry from the perspective of the host economy because of its impact on production and employment. The acquisition of existing domestic businesses is an alternative form of foreign entry and, here, the benefits of foreign investment must be balanced against possible risks for local employment and production as the domestic firm is integrated into the foreign parent company, as well as broader economic concerns that may arise from a shift in ownership and control of successful local firms, discussed in section 5.

In economies with mature domestic corporate sectors – such as South Africa – acquisitions typically represent a substantial share of inward investment. At the same time, domestic firms may seek new investment opportunities abroad as a source of growth in profitability, offering potential benefits for the home economy in the form of new export markets and improved international competitiveness. The Government has supported outward investment by South African firms through gradual reforms aimed at increasing the scope of outward direct investment and the use of domestic capital in financing international expansion.

More complex cross-border investments arise as foreign investors seek to acquire South African firms and, in turn, these local firms seek new opportunities for growth in foreign markets, building on combined domestic and international capabilities. Mergers, acquisitions, and cross-holdings between foreign and domestic firms (and their shareholders) provide a vehicle for achieving these objectives but also raise questions about the balance of long-term benefits and risks for South Africa.

The policy framework outlined in this paper is intended to provide a transparent mechanism for assessing the benefits and risks associated with these complex cross-border investments, especially in the case of investments involving domestic firms that are deemed to have a strategic role in supporting investment and growth in South Africa. Three aspects of reform are emphasised in this paper:

- The proposed policy framework will support a more transparent assessment of public interest issues arising from complex cross-border investments and will not unduly restrict foreign ownership of South African firms.
- Many of the public interest issues arising from foreign investment are incorporated in other aspects of regulation of private investment (domestic and foreign), at a sectoral level or more broadly across the economy. The policy framework will therefore target the specific risks arising from cross-border investment.
- Foreign investors seeking to establish new businesses in South Africa (‘greenfield’ FDI) will not be subject to new and additional regulations under the proposed policy framework.

1 Direct investment is characterised by a substantial degree of influence or control over the local enterprise by the foreign investor – the standard international benchmark for defining direct investment is ownership of 10 percent or more, either individually or with affiliated entities. It is distinct from portfolio equity investment and other forms of foreign financing that do not provide a significant role for the investor in the management of the firm.
2. FOREIGN DIRECT INVESTMENT IN SOUTH AFRICA

2.1 The volume of FDI in South Africa

Capital inflows in the form of FDI in South Africa have tended to be lower than in countries with comparable levels of income. Table 1 shows the pattern of flows between 2005 and 2009 compared to the group of upper middle-income economies. Over the five years, the average annual net inflow of FDI as a percentage of GDP was 2.0 percent in South Africa but 3.0 percent for upper middle-income economies; for the five years between 2000 and 2004, the average for South Africa was 1.8 percent and 2.8 percent for the upper middle-income group. Preliminary estimates for 2010 compiled by UNCTAD suggest that net inflows to South Africa were much lower than in 2009, despite evidence of increased flows to developing countries as a whole (UNCTAD, 2011). The table also shows inflows to the major emerging economies - Brazil, China, India and Russia; relative to GDP, China and Russia have received more FDI than South Africa over the past five years, while Brazil and India have recorded similar levels. Australia and Chile are also shown as two resource-based economies; in particular, Chile has maintained very high levels of inward FDI over time.

Table 1: Foreign direct investment, percent of GDP

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>STOCK 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>South Africa</strong></td>
<td>2.6</td>
<td>-0.1</td>
<td>2.0</td>
<td>3.5</td>
<td>2.0</td>
<td>43.7</td>
</tr>
<tr>
<td>Upper middle income</td>
<td>2.7</td>
<td>2.9</td>
<td>3.6</td>
<td>3.6</td>
<td>2.3</td>
<td>28.2</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.7</td>
<td>1.7</td>
<td>2.5</td>
<td>2.7</td>
<td>1.7</td>
<td>26.2</td>
</tr>
<tr>
<td>China</td>
<td>3.5</td>
<td>2.9</td>
<td>3.9</td>
<td>3.3</td>
<td>1.6</td>
<td>10.1</td>
</tr>
<tr>
<td>India</td>
<td>0.9</td>
<td>2.1</td>
<td>2.0</td>
<td>3.4</td>
<td>2.6</td>
<td>13.3</td>
</tr>
<tr>
<td>Russia</td>
<td>1.7</td>
<td>3.0</td>
<td>4.2</td>
<td>4.5</td>
<td>3.0</td>
<td>20.3</td>
</tr>
<tr>
<td>Australia</td>
<td>-5.1</td>
<td>3.5</td>
<td>4.8</td>
<td>4.5</td>
<td>...</td>
<td>34.1</td>
</tr>
<tr>
<td>Chile</td>
<td>5.9</td>
<td>5.0</td>
<td>7.6</td>
<td>8.9</td>
<td>7.8</td>
<td>75.0</td>
</tr>
</tbody>
</table>


Note: South Africa is an upper middle-income economy; Brazil, Chile and Russia are upper middle-income; China and India are lower middle-income; Australia is high-income.
1. Own calculation using the stock data in US dollars reported by UNCTAD for each upper middle income economy, weighted by US$ GDP as reported by the World Bank.

It does not automatically follow that comparatively low levels of net inflows are indicative of severe barriers to foreign investment in South Africa, however. While some studies use cross-country empirical evidence on the determinants of FDI to identify areas for improvement in the investment environment (see below), there are also specific characteristics of foreign ownership in South Africa to consider.

First, South Africa has attracted high volumes of foreign portfolio investment, especially in the form of reasonably long-term equity inflows (Leape and Thomas, 2009, draw a distinction between short-term and volatile foreign investment in the South African bond market with more stable net inflows into South African equities over time). The value of South African equity securities held by foreign portfolio investors increased from 8 percent of GDP in 1995 to 31 percent in 2009. Internationally comparable data from the IMF’s Coordinated Portfolio Investment Survey suggests that the stock of foreign portfolio equity holdings in South Africa is higher relative to GDP than for upper middle-income economies as a whole, reflecting the size and development of the local equity market and the maturity of the domestic corporate sector.
Portfolio investment has thus provided an alternative mode of foreign entry into South Africa compared to the more traditional inflows of FDI observed in many other developing economies. Portfolio investment generally represents a lesser commitment to the economy than direct investment – for instance, there are no fixed costs involved in starting up an enterprise or taking on the long-term development of an existing enterprise – and the motivations of investors typically differ. Nevertheless, longer-term portfolio investors will be concerned with the prospects for growth and stability in the South African economy, as well as the protection of their investments. The sustained increase in inward investment of this form is one indication that South Africa provides a sound legal and economic environment for foreign investors, a key feature of overall openness to inward investment.

Second, the accumulated stock of inward foreign direct investment is far from low by international standards, indicating that, despite low levels of annual flows, foreign ownership in the economy is widespread. UNCTAD estimates that the stock of FDI in South Africa amounted to 44 percent of GDP at the end of 2009. There is considerable variation across countries (as is evident in Table 1 – compare China and India with Chile), however the ratio for South Africa is above the estimated ratio for the group of upper middle-income economies of 28 percent. Moreover, the sectoral composition of FDI is reasonably diverse, reflecting investments across manufacturing, mining, and financial and business services (Table 2).

An important factor to note here is that the internationalisation of some of the largest South African multinationals in the late-1990s has added significantly to the value of non-resident ownership of South African enterprises as reflected in the stock of FDI. The re-domiciling of Anglo American, Billiton, Old Mutual and South African Breweries in the UK in the late-1990s resulted in the existing South African operations of these firms being re-classified as foreign-owned in South Africa’s international investment position (i.e., FDI liabilities of South Africa). These companies remain important multinational investors in the South African economy, in terms of their ownership of existing operations and subsequent investments in the country.

Table 2: Sectoral composition of the stock of FDI liabilities, end-2009

<table>
<thead>
<tr>
<th>Sector</th>
<th>% of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining and quarrying</td>
<td>33.4%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>27.9%</td>
</tr>
<tr>
<td>Finance insurance real estate business services</td>
<td>27.1%</td>
</tr>
<tr>
<td>Transport storage communication</td>
<td>7.5%</td>
</tr>
<tr>
<td>Wholesale and retail trade</td>
<td>3.6%</td>
</tr>
<tr>
<td>Other</td>
<td>0.4%</td>
</tr>
</tbody>
</table>

Source: *Quarterly Bulletin*, December 2010, South African Reserve Bank

2.2 The effect of regulation on FDI

The regulatory environment for FDI is one of several factors likely to influence the locational decisions of foreign investors. There is a large literature examining the determinants of FDI and there are considerable methodological challenges in measuring the impact of policy variables. Some studies have approached this question through examining the motivations of multinational companies, giving rise to important distinctions in the type of FDI received (for example Shatz and Venables, 2000; Dunning, 1993). ‘Horizontal’ FDI is associated with the location of production to serve local markets, while ‘vertical’ FDI describes the location of individual parts of the production process in the most cost-
A review framework for cross-border direct investment in South Africa
National Treasury – Republic of South Africa

The effective environment, reflecting the globalisation of trade and investment. FDI can, of course, also be motivated by gaining access to the natural resources of the host economy.

Another extensive strand of the literature has used cross-country empirical techniques to highlight a range of key influences on the amount of FDI received, including geographical factors, the macroeconomic and institutional environment, the quality of infrastructure and labour markets, the openness of the economy, and ‘agglomeration’ or clustering effects. Ahmed et al. (2007) and Arvanitis (2005), for example, provide recent cross-country analyses and conclusions for South Africa.

Furthermore, there is not necessarily consensus on the linkages between FDI and growth or welfare. Here, some studies suggest that the effects are conditional on particular aspects of the investment environment: for instance, the effects of human capital are shown in Borensztein et al. (1998); the regulatory environment is explored in Busse and Groizard (2006); local financial sector development is considered in Alfaro et al. (2006). Calderón et al. (2004) examines the linkages with growth for greenfield investment versus mergers and acquisitions.

The findings from the literature imply that the effect of specific regulations on FDI cannot be considered in isolation from the wider economic and institutional environment. Moreover cross-country evidence on the impact of regulations on foreign entry appears to be scarce, not least because of difficulties in constructing comparable measures of regulations across countries and over time.

One recent international assessment (July 2010) is the new Investing Across Borders study of FDI regulations by the World Bank, covering 87 countries and providing indicators on limits on foreign equity ownership, procedures for starting a foreign business, access to industrial land, and the legal framework for commercial disputes (World Bank, 2010b). An alternative international measure of regulation of foreign entry is the OECD’s FDI Regulatory Restrictiveness Index (Kalinova, et al., 2010; OECD, 2007a), which provides a disaggregation of different types of entry restrictions. The current version of the Index provides a measure of restrictiveness combining the presence of: (i) foreign ownership (equity) restrictions; (ii) screening and approval requirements for foreign investment; (iii) rules relating to nationality of key personnel and (iv) other operational requirements that affect foreign-owned enterprises. It captures the presence of specific restrictions on FDI and does not necessarily reflect the broader regulatory and economic climate for investment. Nicoletti et al. (2003) use an earlier version of the restrictiveness index described in Golub (2003) in an assessment of the barriers to greater global integration, both trade and FDI. For OECD countries, their multivariate analysis and simulation of policy predicts that lower restrictions on foreign entry could encourage higher stocks of FDI. It does not automatically follow that the expected effect for developing countries would be the same or that any increase in FDI would have a positive impact on growth. Nevertheless, this provides a preliminary indication that the regulation of foreign ownership is one of several policy variables likely to influence the volume of FDI in South Africa.

The 2010 version of the OECD FDI Regulatory Restrictiveness Index (Kalinova et al., 2010) covers 48 countries and is calculated across 22 economic sectors. South Africa ranks 21st out of the 48 countries from most to least restrictive and has an Index score of 0.089 (1=closed; 0=open), lower than the average for the group of countries as a whole (0.117, compared to the median score of 0.075) and lower than the OECD sub-group average (0.095, with median score 0.065). The most restrictive regimes are in China and Iceland followed by Russia, Saudi Arabia and Indonesia, all with a score over 0.3. The most liberal regimes are found in the Netherlands, Luxembourg, Portugal and Romania, with scores below 0.01. Figure 1 illustrates the Index scores across selected economies. For South Africa, the main component of the Index score comes from operational restrictions on foreign-owned firms, with equity restrictions contributing a small share of the total score and no restrictions are captured.
under the screening and key personnel components. South Africa appears to perform reasonably well against this measure - especially compared to the 2006 version of the Index where differences in methodology implied that South Africa ranked as the seventh most restrictive out of 43 economies (OECD, 2007a). However, the emphasis on operational restrictions facing foreign investors suggests that the development of the new review framework must be sensitive to the administrative burden facing foreign investors through the range of existing regulations that affect foreign entry, ownership and operations.

![Figure 1: OECD FDI Regulatory Restrictiveness Index 2010: selected economies](source)


3. INTERNATIONAL PRACTICE IN THE REGULATION OF FDI

The OECD’s FDI Regulatory Restrictiveness Index (Figure 1) indicates that there is a varied approach to the regulation of FDI across developed and emerging economies. Many countries provide a generally open environment for FDI, with a limited number of strategic industries where foreign entry is subject to specific conditions or prohibitions, while some others have maintained wider screening mechanisms. Moreover in countries with extensive state ownership of key industries, the regulation of foreign investment interacts with implicit restrictions on entry that follow from the dominance of state-owned firms.

In the following discussion, we distinguish between ‘strategic sector’ approaches to regulation and countries that also have broader screening mechanisms, although the extent of diversity in regulatory frameworks implies that there is not necessarily a clear conceptual dividing line between these two models. In both broad policy models, a number of sectors emerge where regulations affecting foreign entry and ownership are often found. Table 3 at the end of this section provides a summary of common...
approaches across countries, in terms of the sectors that are typically subject to regulations that affect entry and ownership, the use of broader screening mechanisms, and national security review.

3.1 A ‘strategic sector’ approach

In this context, the ‘strategic sector’ model refers to countries where formal restrictions on foreign entry and ownership apply in a reasonably limited number of specific sectors. Underlying this approach is the principle that foreign investors should generally receive at least as favourable treatment as comparable domestic investors in most sectors of the economy (a non-discrimination principle). However, the approach recognises that foreign involvement in certain industries can raise particular questions about public interest and sovereignty of control over key infrastructure and services and, in some cases, natural resources, leading to exceptions in the application of consistent treatment of investors in the case of ‘strategic’ sectors.

For OECD member states, there are two relevant instruments that encourage a non-discriminatory approach to FDI. First, the OECD Code of Liberalisation of Capital Movements generally supports the removal of barriers to the free movement of capital and the right to establishment. Second, the National Treatment principle encourages a non-discriminatory approach to foreign-owned enterprises, defined as “... the commitment by a country to treat enterprises operating on its territory, but controlled by the nationals of another country, no less favourably than domestic enterprises in like situations”. This commitment is one element of the OECD Declaration on International Investment and Multinational Enterprises, adopted by the 32 OECD members and several other economies, including Argentina, Brazil, Egypt, Estonia, Israel, Latvia, Lithuania, Peru, and Romania (OECD, 2009a,b; 2008a).

Even within the OECD, there is diversity in the extent of exceptions reported by countries under the Code and National Treatment instruments that reflect existing regulations on inward FDI. For example, the screening and approval processes in Australia and Canada represent a departure from a non-discriminatory approach to foreign entry (discussed below), compared to the UK, Netherlands and Germany, for instance, where restrictions on FDI are limited. Nevertheless, according to information reported under the OECD Code of Liberalisation, the majority of OECD members appear to have adopted a limited sector specific approach to regulation of FDI, with few member countries reporting wider screening mechanisms.

Strategic sector models are also found amongst emerging and developing economies, although developmental objectives in these countries may imply wider scope for strategic status than in high-income OECD economies. Brazil and Chile are examples of emerging economies that appear relatively open to foreign investment with ownership or entry regulations applied to a limited number of strategic sectors; both countries have adopted a ‘national treatment’ approach to inward direct investment across the rest of the economy although foreign investment must be registered with the central bank (OECD, 2009a, Goldstein, 2004 and national official sources).

In Brazil, foreign investment is prohibited in nuclear energy and aerospace, health services, postal and telegraph services, and security services. Conditions and approval govern investment in rural land by foreigners and, for security reasons; the acquisition of property in border areas is subject to the approval of the National Security Council. Foreign investment in financial institutions and in mining is also subject to approval. Foreign ownership limits and restrictions apply in air and road transport, fisheries, broadcasting and print media, and telecommunications.

In Chile, there are regulations affecting foreign investment in air and road transport, shipping, fisheries and in broadcasting and print media. More generally, foreign investors can apply for approval of
investments over a certain size and the majority of FDI in Chile enters under this mechanism. This approval process provides a contract between the investor and State setting out various rights and responsibilities. There is very limited authority for the State to screen and reject applications; the role instead is to provide a transparent contractual framework for foreign capital to enter the country.

Somewhat in contrast, Russia has set out a more extensive list of strategic activities where foreign control is subject to approval, together with protected state-control of large firms in several sectors (OECD, 2008b). The framework encompasses regulations in hydro-meteorological and geophysical activities; geological surveys, subsoil prospecting and extraction; use of pathogens of infectious diseases; use of nuclear and radioactive materials; coding, cryptographic and information-receiving devices; weapons and military technologies; metals and alloys used in military goods; space technologies; aviation; TV and radio broadcasting and print; telecommunications; natural monopolies; fisheries; aircraft and shipbuilding; car manufacturing; banking; forestry; and nano-technology.

3.2 Broader screening mechanisms and ownership caps

A limited number of countries use a more general screening mechanism for FDI accompanied by limits on foreign ownership in ‘strategic’ industries, although there has been a tendency towards relaxation of such regulations in recent years. In these cases, general screening often applies to cross-border acquisitions (as opposed to new businesses) but these mechanisms potentially can capture a significant fraction of inward investment, given the important role of acquisitions in global FDI. China, India and Mexico are examples of middle-income economies that have used such an approach but to differing extents as a result of liberalisation over time.

Recent reforms of the investment framework in China included the introduction of new screening requirements for cross-border acquisitions that have potential implications for major industries, for national economic security, or for famous local trademarks and brands (OECD, 2008d). More generally, foreign investment is guided by a Catalogue setting out restrictions on foreign entry and limitations on foreign ownership; foreign investments fall under four categories: prohibited, restricted, encouraged and permitted.

In Mexico, acquisitions of shareholdings in local enterprises that exceed 49 percent ownership (direct and indirect) are subject to a review process, in addition to ownership limits across a range of strategic sectors and the reservation of a limited number of activities for the State or for Mexicans. The review process applies for acquisitions above a given threshold based on the total assets of the enterprise, set annually by the National Foreign Investment Commission; amounting to the equivalent of US$212 million in 2009 or around R1,552 million at the average 2010 exchange rate. (OECD, 2009b and national sources)

Historically, India has used broad screening mechanisms, with foreign ownership caps across much of the economy but has gradually been liberalising these processes since the early 1990s, shifting towards a strategic sector approach. At present approvals and limits on foreign ownership remain in several sectors that may be described as ‘strategic’, as well cases where production is reserved for micro and small enterprises. Rules for the calculation of ownership caps include FDI and foreign institutional investment and apply to layers of ownership of local enterprises depending on the extent of direct or indirect foreign control (DIPP, 2010; OECD, 2009d).

Screening mechanisms are not restricted to emerging economies, however: Australia, Canada and New Zealand use this approach in addition to sector-specific rules.
In Australia, foreign investment policy seeks to balance the economic benefits of FDI with domestic concerns regarding foreign ownership of Australian assets (see references for national official sources). Here, the *Foreign Acquisitions and Takeovers Act* (1975) enables Government to block proposals (or set conditions) for foreign investment that involve control of Australian corporations or interests in real estate if they are deemed ‘contrary to national interest’. Foreign acquisitions over a certain value and/or within particular sectors must be notified to the Government for screening and approval. The Australian Treasurer has responsibility for approvals, as well as for foreign investment policy more generally, and is advised by a Foreign Investment Review Board. Following reforms in September 2009, the number of thresholds for screening was reduced, with annual indexation. For acquisitions of substantial interests or control in Australian businesses, the threshold was A$219 million in 2009 (R1,472 million at the average 2010 exchange rate) for non-US investors and for US investments in certain sensitive sectors. For other US investments, the threshold was A$953 million (R6,406 million). The differential treatment of US investment followed from the free trade agreement between Australia and the US implemented in 2005. In the case of takeovers of offshore companies, these thresholds also apply to the value of Australian subsidiaries or assets. For acquisitions of developed non-residential commercial real estate, the threshold is A$5 million (R34 million) in the case of heritage-listed property and A$50 (R336 million) for non-heritage listed property but A$953 million for US investors. All other acquisitions of land, irrespective of value, including vacant non-residential land; residential real estate or shares in urban land corporations or trust estates are subject to approval. Prior approval is also required for foreign investment of 5 percent or more in the media sector and all FDI by foreign governments or agencies, irrespective of size. Additional sector-specific requirements and/or foreign ownership restrictions apply in banking, civil aviation and airports, shipping, and telecommunications, administered by the relevant Government department.

In Canada, a review process applies to direct acquisitions of large Canadian businesses and in some cases also to indirect acquisitions of international companies with Canadian subsidiaries, administered by Industry Canada (or in certain sectors, the Department of Canadian Heritage). For investors from WTO member countries, the threshold (set annually and linked to GDP growth) for screening of direct acquisitions is C$312 million for 2009 (equivalent to around R2,217 million at the average 2010 exchange rate), while indirect acquisitions are not subject to review but must be notified. For investors from non-WTO countries, the thresholds are substantially lower: C$5 million (R35 million) for direct acquisitions and either C$5 million or C$50 million (R355 million) for indirect acquisitions depending on the share of Canadian assets in the transaction. Further regulations apply to investments in uranium production, transport, energy, fisheries, telecommunications, and activities relating to cultural heritage or national identity (Holden, 2007; OECD, 2009b). The aim of the review process is to ensure there are net benefits from FDI in Canada. While ‘net benefit’ is not strictly defined, the following aspects are considered: effects on economic activity, employment, competition, resource processing, utilisation of Canadian inputs, and exports; effects on productivity, efficiency, technology and innovation; participation by Canadians in the business; compatibility with industrial, economic and cultural policies; and contribution to international competitiveness (Holden, 2007).

In New Zealand, the approval process applies to acquisitions of 25 percent or more of New Zealand businesses exceeding NZ$100 million (equivalent to around R528 million at average 2010 exchange rates) (OECD, 2009a,b and national sources). Furthermore, all acquisitions of sensitive land or fisheries business require approval. The approval process is administered by an Overseas Investment Office. Investors must pass a ‘test’ taking into account ‘character, business acumen and level of financial commitment’ and investments that affect sensitive land must demonstrate a benefit for New Zealand (New Zealand, 2010). There are also restrictions on the share of foreign ownership of Air New Zealand and the Telecom Corporation of New Zealand. Regulations also apply to branches of foreign banks and insurance companies.
3.3 Conclusions from the international review

There is considerable diversity in the approach to regulation of FDI across countries, as reflected in the OECD FDI Regulatory Restrictiveness Index (Figure 1). The analysis above distinguishes between generally non-discriminatory approaches that incorporate explicit strategic sector regulations and broader mechanisms for the review of foreign entry and ownership. As noted above, however, the variety of international experience implies that the dividing line between these two models is not well-defined: policy frameworks are inevitably tailored to the specific economic and political environments of the country concerned.

Nevertheless, a number of sectors emerge where regulations affecting foreign entry or ownership are commonly found across countries, regardless of the policy model. Amongst the most common sectors subject to such regulations are:

- agriculture and fisheries
- broadcasting and print media
- business services, e.g., accountancy, legal services
- defence and aerospace
- energy
- financial services
- natural resource exploration and exploitation
- nuclear energy and materials
- real estate
- telecommunications
- transport, especially air and shipping

- FDI by foreign governments and state-owned enterprises or agencies is sometimes subject to regulation to limit the risks of non-commercial actions.

Table 3 provides examples of countries that report some form of regulation or restriction on foreign investment in each of these sectors, drawing on the reservations (exemptions) lodged under the OECD Code of Liberalisation of Capital Movements and National Treatment instrument, and on a variety of national sources. It should be noted, however, that the severity of restrictions is not considered here, for instance, whether authorisation for FDI is an exception or the norm or whether ownership caps are high or low or outright prohibitions. Furthermore, some restrictions may apply to both foreign and domestic entrants in strategic industries, as is the case in sectoral regulations for South Africa discussed in section 4.

There may also be some gaps in the coverage of information drawn from the OECD documentation: for instance, reservations under the Code do not typically include security considerations such that information provided on the United States does not cover the Committee on Foreign Investment in the US, which provides for the (voluntary) notification of proposed acquisitions of US businesses for national security review and has enabled the US to prevent certain transactions based on national security interests. We include this measure in Table 3 under national security screening. The implicit protection of sectors or specific companies through state ownership or other forms of control is also not fully reflected in the OECD Code.
### Table 3: Presence of regulations on foreign entry and/or ownership limits

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Countries where regulations are reported</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and fisheries</td>
<td>Brazil, Canada, Chile, China, Czech Republic, Denmark, France, Iceland, India, Ireland, Japan, Korea, Mexico, New Zealand, Norway, Poland, Russia, Sweden, US</td>
</tr>
<tr>
<td>Broadcasting and/or print media</td>
<td>Australia, Brazil, Chile, China, Canada, France, Germany, Greece, India, Italy, Korea, Mexico, Norway, Poland, Russia, Spain, Switzerland, Turkey, UK, US</td>
</tr>
<tr>
<td>Defence and/or aerospace</td>
<td>Australia, Austria, Brazil, Chile, Denmark, Finland, France, Germany, India, Korea, Russia, Spain</td>
</tr>
<tr>
<td>Energy</td>
<td>Austria, China, Iceland, Korea, Switzerland, US</td>
</tr>
<tr>
<td>Financial services</td>
<td>Australia, Brazil, Canada, China, Czech Republic, France, Germany, Greece, Hungary, Iceland, India, Ireland, Italy, Korea, Mexico, New Zealand, Norway, Poland, Portugal, Russia</td>
</tr>
<tr>
<td>Natural resources</td>
<td>Brazil, China, Greece, Iceland, India, Japan, Mexico, Norway, Russia, Spain, Switzerland, Turkey, US</td>
</tr>
<tr>
<td>Nuclear energy and materials</td>
<td>Australia, Brazil, Canada, Finland, India, Korea, Russia, Switzerland, US</td>
</tr>
<tr>
<td>Accountancy and/or legal services</td>
<td>Austria, Belgium, China, Denmark, Finland, France, Greece, Mexico, Norway, Spain, Sweden, Turkey</td>
</tr>
<tr>
<td>Real estate</td>
<td>Australia, Austria, Brazil, Chile, China, Denmark, Finland, Greece, Hungary, Iceland, India, Mexico, New Zealand, Norway, Poland, Switzerland, Turkey</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>Australia, Brazil, Canada, Chile, China, Iceland, India, Italy, Japan, Korea, Mexico, New Zealand, Russia, Sweden</td>
</tr>
<tr>
<td>Air transport and/or shipping</td>
<td>Australia, Austria, Belgium, Brazil, Canada, Chile, China, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, India, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Russia, Slovak Republic, Spain, Sweden, Switzerland, UK, US</td>
</tr>
<tr>
<td>FDI by state-owned entities</td>
<td>Australia, Iceland, Mexico, Spain, Turkey</td>
</tr>
<tr>
<td>General ‘screening and/or ownership cap’ mechanisms</td>
<td>Australia, Canada, China, Iceland, India (substantially reformed), Mexico, New Zealand</td>
</tr>
<tr>
<td>National security or public order screening measures</td>
<td>France, Japan, Korea, Mexico, US</td>
</tr>
</tbody>
</table>


Note: 1. The table provides examples of countries where regulations have been identified from various sources. It is not intended to be a complete assessment of international practice.  
2. As described in section 3.2
4. THE EXISTING POLICY FRAMEWORK FOR INWARD FDI IN SOUTH AFRICA

Against the background set out in sections 2 and 3, this section outlines the existing regulations that affect inward FDI in South Africa. The first part of this section examines the implications of exchange control for inward FDI. The discussion then highlights other regulations that imply an alternative approval process for particular types of inward investment, both at a general level under the Competition Act and at a sectoral level for key strategic industries. The discussion does not attempt to cover investment promotion activities or additional regulatory requirements on businesses, for instance registration and associated requirements under the Companies Act, residence and work permits required under immigration law, and compliance with tax and labour laws (see for example DTI, 2009). Broad-based black economic empowerment is a relevant consideration for the structure of ownership and operations in South Africa and is summarised in Box 2 at the end of this section.

4.1 Existing exchange control regulations and implications for inward FDI

There are generally no controls on inward investment and disinvestment by non-residents under exchange control legislation, i.e., on foreign capital inflows and outflows. The only requirement is for documentary evidence to show that transactions are conducted commercially at a fair price. Exchange controls continue to influence the channels for financing inward investment, however, and, in the case of complex cross-border acquisitions, the structure of large transactions can require approval from the Minister of Finance.

*The use of domestic capital in FDI*

Until recently, local borrowing by foreign-owned entities for the purposes of FDI was generally limited to 300 percent of the foreign capital invested in South Africa. This restriction applied in the case of foreign ownership of entities of 75 percent or more, although the formula implied that the greater the degree of local participation, the more liberal the borrowing limit. Wholly-owned local subsidiaries of foreign entities faced an equivalent limit of 300 percent of shareholder capital on local borrowing. Any local financing above the limit required specific approval from the Reserve Bank. The Minister of Finance announced the removal of the 3:1 ratio in October 2009 such that local financing may now be provided for the purpose of genuine FDI without restriction. Financial transactions and the acquisition of residential or commercial property in South Africa remain restricted to a 1:1 ratio.

Under the inward listing policy announced in 2004, foreign entities are also able to raise domestic capital through listing equity and debt instruments in local markets with the prior approval of the Reserve Bank. While South African private individuals, partnerships, close corporations, trusts, banks and non-financial companies can invest freely in locally-listed foreign securities, investment by institutional investors - representing the largest domestic shareholder base - is subject to prudential foreign asset limits. One of the objectives of the inward listing policy is to support inward FDI by broadening access to domestic capital.

*Complex cross-border acquisitions*

One important aspect of the removal of exchange controls on non-residents in the mid-1990s is that this applied to the free movement of foreign capital. In other words, since 1995, inward FDI financed by an inflow of foreign capital has not been subject to exchange control approval. Further liberalisation has subsequently enabled FDI to be supported by local capital as noted above. Inward investments that are structured and financed in more complex ways – typically acquisitions – can require formal approval; here the rationale is the need to assess the balance of longer-term benefits and risks for domestic
companies and the economy more generally. Thus, cross-border acquisitions of local entities financed wholly or in part by the exchange of shares in the foreign company or mergers that create domestic shareholdings in a new merged foreign entity fall under exchange control approval processes. Exchange controls also restrict forms of loop structures - i.e., offshore investments by South African residents intended to invest back into South Africa - that might otherwise provide a vehicle for exchange control or tax avoidance; where loop structures are deemed unavoidable for the transaction, then formal approval is required from the Minister of Finance.

This approach means that large and complex cross-border investments may need to undergo review prior to authorisation, although there is no uniform framework under which proposed inward FDI transactions are assessed. The requirement for approval (and thus the role of the Minister) is closely related to the particular structure of the transaction, whereas the public interest issues raised by cross-border acquisitions may go beyond these criteria. Reform in this area is one motivation for developing a new and transparent review framework for FDI.

**Re-domiciling of South African entities**

Related to the above controls on the ‘externalisation’ of South African assets, the re-domiciling of South African companies – and primary listing on international stock exchanges - is subject to approval from the Minister of Finance. Policy on re-domiciling is a further area that affects cross-border acquisitions: in this context, corporate restructurings and re-domicilings are considered as a special case of acquisition of South African entities by a new foreign holding company. A consistent approach to assessing complex acquisitions, loop structures and re-domicilings is one objective of the proposed review framework for cross-border direct investment.

Between 1997 and 2000, several large South African companies were given permission to establish primary stock exchange listings in London and to become registered companies in the UK: Billiton (now BHP Billiton) in 1997; Anglo American, Old Mutual; and South African Breweries (now SABMiller) in 1999; and Dimension Data in 2000. These five cases were considered individually by the Minister and in 2000 the conditions under which future applications would be assessed were clarified, including the following conditions:

- International expansion is integral for the company
- A significant proportion of revenue is derived outside South Africa, making the company, in effect, an international concern
- Monetary and balance of payments benefits to South Africa are expected and South Africa’s foreign reserves may not be negatively impacted by an outflow of dividends or other funds
- The corporate must commit to matching any dividends declared to the foreign holding company with dividends paid out to South African shareholders to preserve balance of payments neutrality
- A substantial advantage to offshore primary listing over alternative approaches to raising capital can be demonstrated
- South African operations and assets may not be encumbered and must remain in South Africa, except where exchange control approval for outflows to foreign shareholders is given.

Since 2000, there have been two further cases of re-domiciling approved by the Minister, both of which have been implemented through dual-listed company structures: Investec in 2002 and Mondi in 2007 (following the unbundling of Mondi from its parent, Anglo American). The dual-listed structure consists of a UK-based company holding the international operations of the Group and a South African based
company holding local (and African) operations. The re-domiciled UK (plc) companies have primary listings in London and secondary listings on the JSE, while the South African (Limited) companies have primary listings in Johannesburg. The UK and South African companies are linked by agreements such that shareholdings represent an equivalent economic interest in the Group as a whole. A similar model has been used in Australia, most notably for the merger between BHP Ltd and Billiton plc in 2001, where the combined BHP Billiton Group has retained an Australian identity.

4.2 Mergers/acquisitions under the Competition Act and Takeover Regulations

Mergers and acquisitions in South Africa are subject to screening and approval under the Competition Act (1998, as amended), with the key exception of the banking sector, as discussed below. There are no formal distinctions drawn between foreign and domestic mergers under the Act. The Act defines a merger as occurring when “one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm”. Further definitions are provided on the manner of acquisition and the interpretation of control.

Mergers/acquisitions with a proposed value above a rand threshold require the approval (with or without conditions) of either the Competition Commission for intermediate-sized transactions or the Competition Tribunal for large mergers. The thresholds are based on the combined value of the turnover or assets of both the acquiring firm and target firm, together with the turnover or asset value of the target firm. In reviewing proposed mergers, the Act sets out that the Competition Commission or Tribunal must first consider whether the merger is likely to substantially lessen or prevent competition. If there are adverse implications for competition, then it must determine whether there are offsetting technological, efficiency or other pro-competitive gains that would arise from the merger and whether the merger can be justified on public interest grounds. The Competition Act defines public interest considerations to include the effect that the merger would have on:

- a particular industrial sector or region
- employment
- the ability of small businesses, or firms controlled or owned by historically disadvantaged persons, to become competitive
- the ability of national industries to compete in international markets

The Act further sets out that the Minister of Trade and Industry may participate in merger proceedings before the Commission or the Tribunal in order to make representations on these public interest issues.

More generally, inward FDI is subject to the requirements of the Companies Act (2008) supporting corporate governance, and, in particular, mergers and acquisitions (domestic and foreign) must comply with takeover regulations, to be administered by the Takeover Regulation Panel (building on the previous Securities Regulation Panel). This process seeks to support the integrity of the market place and fair treatment of the shareholders of the targeted company; to ensure the provision of adequate information and time for shareholders to consider advice with respect to offers; and to prevent actions by the targeted company designed to impede, frustrate or defeat an offer.

4.3 Sectoral regulations affecting foreign entry and ownership

Sectors that are deemed to be ‘strategic’ in South Africa are subject to sectoral regulations. Typically these regulations include licensing or similar requirements that involve some form of public interest review (for instance, on consistency with national strategies on infrastructure and development) by the
relevant Minister or delegated authority. Importantly, sectoral regulations generally apply to both domestic and foreign investors, although the sectoral framework, in principle, provides a potential mechanism for considering public interest issues arising from foreign ownership.

In this section, regulations on entry and ownership in other selected industries are highlighted - this is not intended as a comprehensive assessment of sectoral regulations, rather as an illustration of types of licensing and approval processes. The development of the review framework for cross-border direct investment would need to take into account relevant sectoral requirements to ensure a harmonised and consistent approach and to avoid duplication of approval mechanisms.

Financial sector: banking

The Banks Act sets out requirements for registration and for shareholdings in banks or controlling companies, administered by the Registrar of Banks at the South African Reserve Bank (Bank Supervision Department). The requirements of the Act have implications for FDI in the banking sector, but, importantly, no formal distinction is made between domestic and foreign ownership, i.e., there is a non-discrimination approach to the approval of both banking licenses (greenfield FDI) and proposed mergers and acquisitions of domestic banks, although specific regulations apply in the case of applications to establish branches of foreign banks reflecting the need to ensure appropriate supervision. The Banks Act also provides for cooperation with respect to the supervision of individual banks between the Bank Supervision Department and international counterparts.

Any person who wishes to conduct the business of a bank must apply to the Registrar of Banks and the stated conditions for the authorisation of banking licenses include a broad requirement that the establishment of the proposed bank is in the public interest. Foreign banks seeking to establish branches (rather than legally-separate subsidiaries) in South Africa may need to provide information on the nature and extent of supervision of the foreign bank in its home country including in respect of the proposed branch in South Africa and any group of institutions of which the foreign bank forms part. The Act requires the Registrar to be satisfied that proper supervision will be exercised by the relevant authority in the country of domicile of the foreign bank. Several conditions apply to the establishment of branches of foreign banks in order to support financial soundness and management in South Africa. Proposed amendments to the Banks Act set out in 2010 seek to broaden requirements relating to the supervision of foreign banks to cases where foreign banks establish registered banks (subsidiaries) in South Africa. These proposals are still at a draft stage, subject to public consultation and Parliamentary process.

The Banks Act further requires the consent of the Minister of Finance for a merger between two banks (or full acquisition). The Minister is not compelled to consult the Competition Commission regarding mergers in the banking sector if the Minister decides it is in the public interest that the transaction be subject only to the jurisdiction of the Banks Act. The Banks Act prohibits any person (domestic or foreign) from holding more than 15 percent of the shares or voting rights in a bank (or its controlling company) without having obtained permission. For holdings between 15 percent and 49 percent, the Act empowers the Registrar to grant permission. For holdings above 49 percent, approval from the Minister of Finance is required. The Registrar or Minister must be satisfied that the proposed acquisition of shares will not be contrary to the interests of the general public, the bank, its depositors or the controlling company. Here, public interest is not explicitly defined.
Financial sector: insurance

The Long-Term Insurance and Short-Term Insurance Acts set out the requirements for registration and shareholdings in insurance companies, administered by the Registrar for Long-Term and Short-Term Insurance at the Financial Services Board. As in the case of the Banks Act, this legislation has implications for foreign entry in insurance but no formal distinction is made between domestic and foreign ownership for both new registrations and proposed acquisitions of domestic insurance companies, although there are limitations on the legal form of operations (subsidiary versus branch).

The Insurance Acts set out that a person who wishes to carry on insurance business is required to apply to the Registrar for registration as an insurer. Amongst the criteria for approval is a broad requirement that the application for registration is not contrary to the public interest or the interest of policyholders. As in the case of the Banks Act, public interest is not explicitly defined. The Insurance Acts also require that insurers operating in the domestic market have their head office in South Africa and also appoint a permanent resident as public officer. The implication of this requirement is that foreign insurance companies cannot establish branches in South Africa; instead foreign entry must be through subsidiaries with a head office in South Africa.

The Insurance Acts further impose limitations on the ownership and control of insurance business. The Acts state that no person shall, without the approval of the Registrar, acquire or hold shares or any other interest in an insurer which results in the control of the insurer. Acquisitions of shares that result in an aggregate shareholding of more than 25 percent of the issued shares must first have the approval of the Registrar, which can be subject to conditions determined by the Registrar. The Registrar may deny an acquisition if it is deemed contrary to public interest or to the interests of policyholders.

Mineral resources

Mineral and petroleum resources are the common heritage of all the people of South Africa and the State is the custodian for the benefit of all South Africans. The State, acting through the Minister of Mineral Resources, may grant or refuse permission or right to mine, retain, remove or trade in these resources. The Minerals and Petroleum Resources Development Act of 2002 requires an application for mining permits, mining rights and retention permits to be submitted to the Minister of Mineral Resources. The Act further sets out the duration of permits and criteria against which the Minister of Mineral Resources can grant or refuse various applications. Amongst the reasons for refusal would include the prevention of fair competition or the concentration of control of mineral resources. There appears to be no explicit differences between the treatment of foreign and domestic investors under the Act. Prospecting and mining rights or any interest in such rights or controlling interest in a company may not be transferred without the consent of the Minister of Mineral Resources. However, under the terms of the Act, this does not appear to apply in the case of a change of controlling interest in a listed company. The licensing process is currently under review.

The Act further sets out the basis for the Mining Charter which provides for mining companies to subscribe to broad based socio-economic empowerment principles, with the objective of enabling historically disadvantaged South Africans to benefit from the exploitation of mineral resources. The Minister of Mineral Resources may also facilitate assistance to historically disadvantaged persons to conduct prospecting or mining operations, subject to any conditions that the Minister may determine.

The Diamonds and Precious Metals Regulator administers matters relating to the acquisition, possession, smelting, refining, fabrication, use and disposal of precious metals and to the purchase, sale, beneficiation, import and export of diamonds. The Regulator deals with applications for various
licenses and permits relating to the use, beneficiation and trade in precious metals and diamonds. Various conditions apply to the issuing of authorisations under the Precious Metals Act 2005 and consultation with the National Treasury or National Commissioner of Police Services can be required. Similarly the Diamonds Act 1986, amended in 2005, sets out the functions of the Regulator and conditions for authorisations in the case of the diamond industry. In issuing the licenses and permits, the Regulator takes into account compliance with the Mining Charter for broad-based socio-economic empowerment, as noted above.

Telecommunications, broadcasting and other electronic communications

The Minister of Communications and Independent Communications Authority of South Africa (ICASA) have responsibility for issuing licenses and setting terms and conditions of licences in telecommunications, broadcasting and other electronic communications under the terms of the Electronic Communications Act (2005).

Applicants for licenses must either be South African citizens or registered with principal place of business in South Africa; this appears to imply that foreign investors would hold licences through locally registered companies. In issuing licenses, ICASA must ensure that the overall electronic communication and broadcasting services are provided by a diverse range of communities in South Africa and must promote empowerment of historically disadvantaged groups in accordance with the ICT Sector Charter.

Licenses may not be assigned, ceded or transferred without the prior permission of ICASA and limits can be set on the ownership of an individual licence in order to promote ownership and control of electronic communications services by historically disadvantaged groups or to promote competition in the ICT sector. A limit on ownership or control of an individual broadcasting licence can also be set in order to promote diversity of views and opinions.

The earlier Telecommunications Act (1996) set out licensing requirements for public switched (fixed line) telecommunication services; mobile cellular telecommunication services and long-distance and international telecommunications. Under this Act, two public switched telecommunications licenses were provided for. Historically, the sole licence holder has been Telkom; the second license was awarded to Neotel – partially foreign-owned – in 2006.

Transport sector

Transnet: Transnet is a wholly state-owned entity representing the largest part of the freight logistics network in South Africa, delivering goods within the country and for export, through port terminals, freight rail and rail engineering, and pipelines. The dominant role of state-owned Transnet in this sector has implications for both domestic and foreign entry. Transnet also incorporates the National Ports Authority, responsible for the regulation of operations at South Africa’s ports. The Authority controls the licensing of activities carried out in the ports and at offshore cargo-handling facilities. The Authority may grant or refuse applications for port operations subject to the requirements of the National Ports Act. Licenses may not be transferred without the prior consent of the Authority. Port operations may also be authorised by an agreement with the Authority within given conditions and duration.

Road transport: The National Transport Act of 2009 requires a licence or permit to operate a road-based public transport service. Licences are issued by the National Public Transport Regulator, the provincial regulatory entity or the municipality depending on where the relevant operating license function has been assigned. Policy and regulations are developed at both national and provincial levels.
Box 2: Broad-Based Black Economic Empowerment

Government policy on Broad-Based Black Economic Empowerment (B-BBEE) has the following objectives:

- Empower more black people to own and manage enterprises; black ownership is regarded as 51 percent ownership by black people with substantial management control by black people.
- Achieve substantial change in the racial composition of ownership, management and skilled occupations
- Promote access to finance for black economic empowerment
- Enable access to economic activities, land infrastructure, ownership and skills for rural and local communities
- Promote human resource development of black people
- Increase ownership and management by communities, workers, cooperatives and other collective enterprises and access to economic activities, infrastructure and skills
- Increase ownership and management by black women and access to economic activities, infrastructure and training
- Ensure black-owned enterprises benefit from preferential government procurement policies
- Assist the development of operational and financial capacity of BEE enterprises

Codes of Good Practice provide the framework for assessing B-BBEE across all sectors, together with the development of specific Sector Charters that set out targets within industries. The first phase has encouraged companies and public entities to implement B-BBEE initiatives, through issuing licences and concessions, asset sales, and preferential procurement. The second phase has introduced seven components of the B-BBEE scorecard, with weightings:

- Ownership: 20 points
- Management control: 10 points
- Employment equity: 15 points
- Skills development: 15 points
- Preferential procurement: 20 points
- Enterprise development: 15 points
- Socio-economic development: 5 points

Government and official entities will take BEE status into account in determining qualification criteria for licences and concessions, developing preferential procurement, and in setting criteria for the sale of state-owned enterprises or for public-private partnerships.

For foreign companies seeking to invest in regulated sectors where licences or approvals are required or where companies seek to do business with government, B-BBEE status becomes a relevant factor in establishing operations, influencing decisions on ownership structures and the extent of social responsibility initiatives. B-BBEE does not strictly require all foreign companies to share ownership and control with empowerment partners – for foreign multinationals that operate exclusively through wholly-owned subsidiaries, greater emphasis can be placed on alternative forms of empowerment under an approved ‘equity equivalent’ investment programme.

Source: Information on the B-BBEE framework from Investor Handbook 2009, Department of Trade and Industry

Marine: Under the Ship Registration Act of 1998, the Registrar of Ships has the power to grant and revoke ship registration certificates. Only ships wholly-owned by South African residents and nationals are entitled for registration in South Africa, reflecting a common international barrier to foreign ownership. The Registrar may refuse to register a ship where there is risk of safety and pollution from the ship; or safety, health and welfare of people employed on the ship is at risk or where it is in the interest of South Africa or international merchant shipping to deny registration.
Domestic aviation: The Air Licensing Act of 1990 (as amended) requires any person wishing to be registered as an air service operator to submit an application to the Air Service Licensing Council. The same applies where an existing operator wishes to amend the controlling shareholders of the company or the terms upon which the licence was issued. An application is granted if the applicant satisfies the Council that: the air service will be operated in a safe and reliable manner; the applicant is a natural person or a South African resident or is incorporated in South Africa with a minimum of voting rights held by South African residents (75 percent stated in the Act); and that the applicant will be actively and effectively in control of the air service; and that the aircraft which will be used in operating the air service is a South African aircraft. Exemptions from these provisions can be directed by the Minister. The conditions applied to domestic aviation have thus included a limit on direct foreign ownership of licenses.

5. THE RATIONALE FOR A REVIEW FRAMEWORK FOR CROSS-BORDER DIRECT INVESTMENT IN SOUTH AFRICA

Cross-border direct investment is widely viewed as beneficial for South Africa because of the expected impact on employment, productivity and growth, including the transfer of skills and technology from multinational parent to the host economy, spillovers through the creation of linkages with domestic firms, and prospects for stronger integration with international markets. Internationally, these potential gains form the basis for policy intervention to encourage FDI, reflected in targeted investment incentives (both sectoral and locational) and associated investment promotion activities.

A policy stance of encouraging inward investment does not necessarily imply an assumption that all FDI is equally beneficial, however. In particular, foreign investment in areas of the economy that are deemed to be ‘strategic’ can raise particular concerns for policy makers and stakeholders, reflected in regulations aimed at protecting public interest in the host country that may also apply to domestic private investment. Here, there are various possible criteria for assessing the ‘strategic’ status of industries or investments.

This section clarifies the potential role of a modernised policy framework in responding to the public interest considerations arising from cross-border direct investment. The starting point is to consider the motivations for the regulation of private investment more generally - both domestic and foreign - and the form in which these regulations are applied in South Africa. Commonly-cited concerns around cross-border acquisitions are then highlighted, although the expected benefits of FDI are not necessarily linked to the mode of entry into the economy. The section concludes by discussing the specific role for the proposed review framework.

5.1 Regulation of private investment

In common with international practice, a range of economic policies or regulatory interventions are in place in South Africa to respond to divergences between the private and social returns to investment. Motivations for intervention include:

- To provide for control over natural resource endowments and a sharing of the gains from the development of mineral wealth between private investors and the host country, e.g., through licensing, royalties and the tax framework. In South Africa, specific regulations apply to investment in the mining sector, as discussed above.
- To maintain investment in key services at the socially optimal level, for instance, in the energy, communications and transport infrastructure that supports economic growth. This motivation might
also include the extension of services to support developmental objectives, such as the provision of
financial services to the under-banked. For South Africa, investment in key service industries are
regulated under specific sectoral legislation, as illustrated above for financial services, mining,
telecommunications and transport.

- To limit the scope for regulatory arbitrage by requiring that firms in the host economy meet the
relevant standards for governance and operations, including specific sectoral requirements. In
South Africa, this includes a general role for regulation of companies administered by the Minister
and Department for Trade and Industry (e.g., under the Companies Act) as well as a specific role
for regulation in strategic industries (e.g., environmental standards in the mining sector). For the
financial sector, effective regulation has a crucial role in maintaining the robustness of the financial
system and is a key area of policy for the Minister of Finance and National Treasury.

- To support competition in the economy, including providing a competitive playing field between
domestic and foreign-owned firms. In South Africa, the Competition Commission and Competition
Tribunal are key agencies implementing the provisions of the Competition Act (noted above).

- For South Africa in particular, to promote social cohesion and growth through policies supporting
empowerment objectives, as set out in the B-BBEE framework discussed in Box 2.

- To protect the tax base through limiting scope for corporate structures aimed at tax evasion or the
externalisation of assets. This area of regulation falls under the Minister of Finance and National
Treasury, with important roles for the South African Revenue Service and the Financial
Surveillance Department of the Reserve Bank.

- To support stability of the financial system and the development and integrity of domestic financial
markets. Policy falls under the Minister of Finance and National Treasury with regulations
implemented by the South African Reserve Bank and Financial Services Board. Other agencies
also play a role in supporting integrity of financial markets, such as the Financial Intelligence
Centre.

- To support the domestic economy through encouraging the growth and development of domestic
and international markets for local firms. This broad motivation implies a role for close cooperation
across government to ensure the consistency of the economic policy framework in South Africa.
The Minister of Finance and National Treasury have a key role in managing the macroeconomic
risks arising from cross-border capital flows.

Regulations can also be motivated by national security considerations, including the control of defence
industries and related technologies, and in some countries this also extends to the ownership of
sensitive land and infrastructure.

5.2 Regulation of cross-border acquisitions

An additional motivation for intervention in the case of foreign (rather than domestic) investment occurs
when the mode of entry is perceived to create potential risks for the host economy. This is reflected in
the screening mechanisms for foreign acquisitions in place in Australia and Canada, for example (as
discussed in section 3). While greenfield FDI is often seen as particularly desirable because it is
explicitly associated with investment in new production, a substantial fraction of global flows of FDI are
in the form of cross-border mergers and acquisitions.

It is important to acknowledge that many of the expected benefits of FDI do not depend on the mode of
entry, in particular both greenfield investment and acquisitions offer the possibility of productivity growth
through technology and skills transfers as well as supporting international integration. However, the
acquisition of domestic enterprises often creates apprehension over potential negative effects in the
host economy. Primarily, these concerns reflect perceived risks for employment, production, exports and R&D as the parent company integrates the local enterprise into its international operations. Issues associated with corporate governance, asset-stripping, competition and security of the tax base can also arise. Moreover, the more intangible threat to the identity and control of national champions in the global economy is a further reason why acquisitions are often seen to have greater economic and political implications than greenfield investment. Evidence from developed countries suggests that foreign acquisition can in principle have positive effects on domestic firms but the circumstances under which such transactions have net benefits for the host economy is a relevant issue for consideration in developing policy on FDI (discussed further in OECD, 2007b).

5.3 The role of the proposed review framework

The varied motivations outlined above imply that public interest considerations arising from FDI cover a diverse range of economic and social issues regarding the ownership of firms and the private versus social returns to investment. The concept of public interest varies across sectors: sensitive issues around the ultimate ownership of resources arise in mining but not to the same extent in manufacturing; similarly, investments in key services and infrastructure typically have broader implications for the economy than investment in other sectors. Moreover, many of these issues apply equally to domestic and foreign investment, as reflected in the equal treatment of investors in various aspects of the regulatory environment in South Africa.

It is evident that for many aspects of public interest, there are existing regulations or policies in place to address specific objectives, either at the sectoral level in the case of strategic industries or more broadly across the economy, for example, through competition policy or through empowerment policy.

The proposed framework is not intended to replicate or to replace these alternative regulatory processes. Instead, it will have a complementary role, replacing the existing opaque exchange control process that has applied to complex cross-border acquisitions and corporate restructurings.

The framework will target the specific public interest issues that are linked to the existing role of the Minister of Finance in the management of cross-border exposures and macroeconomic risk. Drawing on the discussion above, the broad objectives of the envisaged framework will thus include:

- balancing the benefits and risks of cross-border direct investments as part of the framework for the management of macroeconomic risk
- facilitating the growth of South African companies in both domestic and international markets in order to deliver broader economic benefits
- supporting the stability of the financial system and well-functioning domestic financial markets and institutions
- protecting the tax base

The development of the proposed framework is discussed in the final section of this paper.
6. POLICY CONSIDERATIONS: DEVELOPING THE REVIEW FRAMEWORK FOR CROSS-BORDER DIRECT INVESTMENT

South Africa offers an open environment for inward investment and Government seeks to encourage FDI to support its growth and development objectives. In this context, the existing set of regulations that affect cross-border direct investment raises three major (and inter-related) concerns:

- The regulation of sensitive cross-border mergers and acquisitions is opaque and relies in part on exchange control rules on the structure of transactions rather than a clear statement of public interest objectives and process.
- Approvals for the re-domiciling or cross-border restructuring of South African companies have been considered on a case-by-case basis and the framework for assessing public interest has lacked transparency.
- Policy towards inward investments in strategic industries or companies is not well-defined, with a need for greater harmonisation with sectoral regulations affecting both domestic and foreign investors.

An important aspect of the proposed review framework would be an overarching statement of regulatory principles that will apply to cross-border direct investment, aimed at enhancing certainty for foreign investors and domestic companies while also providing transparent mechanisms for intervention to protect public interest where warranted.

In line with the existing policy of Government, the broader approach to FDI is based on the principle that most forms of FDI are expected to have net economic benefits for South Africa and that, across most sectors of the economy, a non-discrimination approach to regulation should apply – an open environment in this context means that foreign investors are not systematically disadvantaged relative to domestic investors.

Replacing exchange control regulations with a targeted review framework

The proposed framework would replace the exchange control treatment of complex cross-border acquisitions, incorporating both traditional forms of acquisition and other forms of corporate restructuring that imply a shift in the ownership and control of domestic companies to a foreign domicile.

A key aim of reform is to improve the transparency of policy in order to provide greater certainty for foreign investors and domestic companies, while protecting public interest when necessary. It is not envisaged that reform in the short to medium term would involve the complete removal of all controls of cross-border investment – inward and outward – nor would this be considered particularly desirable given the macroeconomic risks faced by small emerging economies.

In this context, the main policy option to be considered is the introduction of a more transparent public interest review process. The main objective of implementing a review process is to target regulation at forms of cross-border direct investment that create specific risks for South Africa, while maintaining the generally open environment for most forms of inward FDI.

The design of a new review process will be carefully examined to ensure that it does not represent a major new administrative barrier to inward investment, with targeted regulations aimed at removing as many uncontroversial cross-border investments as possible from the review process. The following elements will thus be considered.
Transactions subject to the review process

The review process will be limited to large cross-border acquisitions and re-domiciling of existing South African enterprises or assets, also including loop structures. As noted above, the process will be aimed at transactions that create specific risks for South Africa.

A broad approach that states that all acquisitions above a threshold (see below) should be reviewed implies that some large transactions that may not previously have been subject to exchange control approval would now require approval. This would include acquisitions financed by some combination of foreign capital inflow and permitted local borrowing. A key decision will therefore be whether the review process should apply consistently to all large cross-border acquisitions or alternatively whether the public interest objectives of policy can adequately be captured by a review process more finely targeted at particular structures of mergers or acquisitions that create risks for South Africa. Here a simple notification requirement could apply to any acquisitions that do not require review in order to support monitoring and policy evaluation.

Genuine greenfield FDI would not require approval under the review process but would instead be subject to the same regulations that domestic investors face, as is current practice. The exclusion of greenfield investment is crucial to avoid introducing a significant new barrier to inward FDI. However, some rules may be necessary to prevent greenfield investment being used as a mechanism to circumvent the review process, for instance, where a small local presence through nominal greenfield investment could be used to pursue larger acquisitions.

Thresholds for the review process

Major public interest concerns are typically associated with large transactions, rather than the acquisition of smaller enterprises. There would therefore be reasonably high thresholds for formal review to ensure that the process is appropriately targeted, although smaller transactions could be subject to a simple notification process to support monitoring and policy evaluation. Nominal rand thresholds - which could vary depending on the structure of the transaction – would increase over time by an appropriate formula (as in Australia and Canada), in order to maintain real value and the focus on the transactions that are associated with greatest potential risks for the economy.

Criteria for approval or rejection

A transparent review process would need to set out the basis for approval or rejection. While the range of public interest issues arising from specific transactions cannot be perfectly foreseen, it is nevertheless appropriate to outline the principles of public interest that would be examined in order to enhance the transparency of the process and to limit the extent of discretion.

The proposed framework would be linked to specific public interest issues. As set out in section 5, this might include:

- balancing the benefits and risks of cross-border direct investments as part of the framework for the management of macroeconomic risk
- facilitating the growth of South African companies in both domestic and international markets in order to deliver broader economic benefits
- supporting the stability of the financial system and well-functioning domestic financial markets and institutions
• protecting the tax base

One important aspect to emphasise is that approval would be given unless the transaction is expected to be contrary to public interest; in other words, investors would not necessarily be required to demonstrate substantial net expected economic benefits for South Africa over and above what would be expected from equivalent domestic investment.

Approvals for acquisitions could be accompanied by conditions to protect public interest (as in the Australian screening process, for example). Here, a clear statement of the types of conditions that may apply to cross-border acquisitions would further contribute to greater certainty for foreign firms by limiting scope for arbitrary decisions. The aim would be to provide confidence for foreign investors that they will not be placed on a substantially unequal footing with domestic competitors.

**Harmonisation with related areas of policy and regulation**

The scope for coordination with related areas of regulation will be explored in order to limit the administrative burden on foreign investors.

For cross-border investment in strategic industries, where sectoral regulations already apply to both foreign and domestic investment, the framework will adopt a harmonised approach with relevant licensing and authorisations at a sectoral level. Here the statement of policy would need to clarify the sequencing of review and approval processes, including the lead responsibility for final approval of foreign entry or acquisition in each strategic industry.

The interaction and sequencing of the review process with associated approvals for mergers/acquisitions required under the Competition Act would also need to be clearly defined to avoid an unnecessary duplication of effort.

Coordination with the Department of Trade and Industry would aim to ensure that the proposed review framework is consistent with existing international commitments and bilateral agreements on trade and investment.

Another important area for coordination is with tax policy in responding to the tax challenges raised by cross-border investment. To the extent that inward investment contributes to production and growth in the economy then there should be benefits in the form of additional tax revenues to fund national development objectives. However, the possibility of tax avoidance strategies by foreign- and domestic-investors also implies risks for the domestic tax base and thus a complementary role for tax policy in delivering the intended net benefits of inward FDI. The proposed framework would provide a mechanism for assessing the tax implications of cross-border acquisitions and restructurings to ensure consistency with the objectives of tax policy.

**Institutional arrangements**

The appropriate institutional structure for the proposed review process will be examined, including:

• The allocation of responsibilities for decision-making and implementation between the Minister of Finance, the National Treasury and the Financial Surveillance Department of the South African Reserve Bank.
• The development of mechanisms to facilitate coordination with other government departments or agencies as required (for instance, for investments in strategic industries).
• The potential scope for a mechanism to allow for submissions from a broader range of stakeholders.

• The human and financial resources required within the National Treasury and/or the Financial Surveillance Department to implement an efficient review process, including analytical capacity for assessing public interest issues, monitoring ongoing compliance with any conditions placed on approvals, and the long-term evaluation of policy, and administrative capacity for managing applications and stakeholder inputs.

• The design of the application and notification process, which would include clear advice on the information to be provided by potential investors and time limits for review and official decisions. The aim is to limit the uncertainty and burden faced by potential foreign investors and domestic companies seeking to expand offshore.

7. NEXT STEPS

This discussion paper is being released for public consultation. Comments should be sent by email to financial.policy@treasury.gov.za or by fax to 012 315 5206 no later than 30 April 2011.
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