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### INVESTOR-STATE ARBITRATION AND SOUTH AFRICA'S BILATERAL INVESTMENT TREATY POLICY FRAMEWORK REVIEW

by

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*Africa-based Engagement with Changing Global Law*

**INVESTOR-STATE ARBITRATION AND SOUTH  
AFRICA'S BILATERAL INVESTMENT TREATY POLICY  
FRAMEWORK REVIEW**

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INVESTMENT TREATY POLICY FRAMEWORK REVIEW**

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## **INVESTOR-STATE ARBITRATION AND SOUTH AFRICA'S BILATERAL INVESTMENT TREATY POLICY FRAMEWORK REVIEW**

### **Introduction: The dti's BIT Policy Framework Review**

The dti's review of South Africa's bilateral investment treaty (BIT) policy framework should be warmly welcomed as should the opportunity to contribute to a discussion on the issue. As the Government's position paper makes clear, this review is long overdue. And the public workshop held on 20 August 2009 is likewise significant. Indeed, it is noteworthy that very few governments have engaged in this sort of public review of governmental policy regarding the treatment of inward investment. Given the implications of investment treaty policy for policy space, the government is to be applauded for instigating public discussion about these matters.

In this working paper, our principal recommendation focuses on dispute resolution, though the arguments we make here are relevant to many aspects of South Africa's BIT policy including standards of treatment, the relationship of foreign direct investment (FDI) to human rights and to sustainable development, and appellate review mechanisms.

In our view, this is an opportune moment for South Africa to do away with investor-state dispute resolution in its BIT model treaty (if any). This paper recommends that South Africa include only state-state dispute resolution mechanisms and omit dispute mechanisms to which investors have had direct access. To do so would be a proactive measure that moves "beyond damage control", removing blockages to exploring and advancing Southern agendas of development.<sup>1</sup>

The historical context to this recommendation may be instructive. It is accurate to note, as the position paper does, that most international investment agreements are based on a 50-year old model.<sup>2</sup> Nonetheless, the more specific practice of investor-state dispute mechanisms is of more recent provenance. Though the investor-state dispute model appeared in some post-1989 US and Canadian BITs, it was with the advent of the 1994 North American Free Trade Agreement that this model took off globally. Described as a "revolutionary" development, most every BIT since then entitles investors, in addition to state parties, to enforce the terms of an investment treaty directly before international arbitration tribunals. Global lift-off of investor-state dispute mechanisms coincidentally occurred at the same time that the transition to democracy took place in South Africa, which helps to explain the absence of any serious consideration of these disciplines after the fall of apartheid.

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<sup>1</sup> The dti, 'Bilateral Investment Treaty Policy Framework Review: Government Position Paper (June 2009)' 55. Such a recommendation goes beyond several more limited changes mooted in the position paper such as limiting the ability of indirect shareholders to assert claims under BITs and modifying the model investor-state arbitration process itself along the lines of enhanced transparency, an appellate process, and enacting a preference for domestic dispute settlement.

<sup>2</sup> Government Position Paper (June 2009) 11.



If investors are not winning all cases in these mechanisms, it has become increasingly clear that investors can use BIT entitlements to meddle significantly in the regulatory systems of host states, as one of us has argued at some length.<sup>3</sup> A significant number of states, in addition to South Africa, are at least in part for this reason reconsidering the terms of BITs in light of this experience. Ecuador and Bolivia have each removed natural resource disputes from the jurisdiction of the arbitration facility at the World Bank, the International Centre for the Settlement of Investment Disputes (ICSID). The United States, and in similar respects Canada, altered their 2004 model BITs so that foreign investors would receive rights, in circumstances of expropriation and nationalization, no greater than those available to U.S. citizens under their Bill of Rights. Although very few states have excluded investor-state disputes from their BITs, we are of the opinion that international investment law – which remains somewhat fluid – will develop in this direction.

In this respect, one can note most pertinently the 2004 United States-Australia Free Trade Agreement which also omitted provisions for investor-state dispute mechanisms.<sup>4</sup> According to a press release issued by the Australian Department of Foreign Affairs and Trade, investor-state dispute was eliminated because of “the Parties’ open economic environments,” their “shared legal traditions, and the confidence of investors in the fairness and integrity of their respective legal systems.” Though the United States has yet to evince this sort of confidence in later BITs with countries such as Chile, Jordan or regions such as Central America, the South African legal system should generate no less confidence in its fairness and integrity.<sup>5</sup>

In our view, there are at least five good reasons to take up our proposal and omit investor-state dispute mechanisms in a model South African BIT. First, the South African Constitution, in myriad ways, provides sufficient guarantees, and thereby mitigates risks, to foreign investors. Second, evolving South African treaty practice, as documented in the dti’s position paper, has appropriately been moving in the direction of reclaiming policy space – some of it constitutionally mandated – which has been lost to BIT practice. Third, though BITs are intended to be flexible in the use of treaty language and availability of exceptions, there simply is little assurance to those making

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<sup>3</sup> Generally, see David Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy’s Promise* (Cambridge: Cambridge University Press, 2008).

<sup>4</sup> For one view, see W Dodge ‘Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-United States Free Trade Agreement’ 39 VAND. J. TRANSNAT’L L. 1 (2006).

<sup>5</sup> The US is currently engaged in a review of the terms in its model BIT. See Federal Register Notice: Written Comments Concerning the Administration’s Review of the U.S. Model Bilateral Investment Treaty July 14, 2009 Federal Register (Volume 74, Number 133) (“The Department of State and the Office of the United States Trade Representative (USTR), [which co-lead] the U.S. bilateral investment treaty (BIT) program, are soliciting written comments and will hold a public meeting [29 July 2009] concerning the Administration’s review of the U.S. model BIT. The review is intended to ensure that the model BIT is consistent with the public interest and the overall U.S. economic agenda. The key question is whether the current model text, last updated in 2004, achieves these objectives or whether there are changes that should be made.” Comments received as part of this process are available online at [www.regulations.gov](http://www.regulations.gov) and are referenced under BIT Review: Written Comments Concerning the Administration’s Review of the U.S. Model Bilateral Investment Treaty, Docket ID: USTR-2009-0019.

and implementing policy that treaties will be interpreted in predictable ways. Fourth, the available empirical evidence suggests that little is gained, in terms of new inward foreign investment, by guaranteeing access to dispute mechanisms directly to investors. These first four considerations apply to the case of inward direct investment. The fifth reason speaks specifically to outward investment (as does our fourth) and this has to do with enhancing the development of legal institutions within host states that can benefit both nationals and foreign investors. The remainder of this working paper develops each of these arguments

### **Sufficiency of Constitutional Protections in South Africa**

**First**, the Constitution sufficiently mitigates risk faced by inward investment flows and foreign investors. South Africa's thus-far-concluded BITs do not distinguish, as the government position paper notes, between deprivation and expropriation, a distinction that is entrenched in the Constitution.<sup>6</sup> This is only one of several salient differences between South Africa's constitutional property clause and the BIT investment rules.<sup>7</sup> The scope of protected investment interests may well differ from the Constitution to a typical BIT. The BITs have had no explicit accommodation for land and water reform as exists in section 25. As opposed to the section 25 baseline of "just and equitable" – effectively the "appropriate" standard – the typical BIT standard of compensation in the event of expropriation or nationalization, as well as measures equivalent thereto, is modelled on the Hull standard of prompt, effective and immediately realizable compensation. The Constitutional Court property jurisprudence is still developing and is arguably more factor than rule driven.<sup>8</sup> Indeed, that jurisprudence is supplemented in significant and important ways by the protection given by the equality clause – which has been interpreted by the Constitutional Court in a fashion largely friendly to non-South Africans. Nonetheless, we can fairly conclude two points. First, the constraints concerning expropriation and nationalization in BITs are more onerous than those found in the text of the South African Constitution. Second, the South African property rights regime itself is substantially coherent and guarantees considerable protection of property interests. Finally, beyond the property rights regime strictly speaking, there are other significant constitutional mechanisms that operate to give assurance to foreign investors. These include the Chapter Nine protections afforded to the office of the Auditor-General and the Public Protector, institutions that directly assist in protecting rights and ensuring the rule of law. The protection given by the South African Constitution overall to foreign investment is considerable.

### **In Defence of South African Policy Space**

**Second**, constitutionally demanded and government guarded policy space arguably has been appropriated by BIT practice. As is noted, not only is compliance with Black Economic Empowerment (BEE) viewed as a significant risk factor shaping investment

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<sup>6</sup> Government Position Paper (June 2009) 41.

<sup>7</sup> This is developed in more detail in David Schneiderman, "Investment Rules and the New Constitutionalism" (2000) 25 *Law and Social Inquiry* 757 and Schneiderman, *Constitutionalizing Economic Globalization*, *supra* note 1 at pp. 137-147.

<sup>8</sup> See Theunis Roux "The 'Arbitrary Deprivation Vortex': Constitutional Property Law after FNB" in Stuart Woolman and Michael Bishop (eds) *Constitutional Conversations* (2008) 265.

decisions<sup>9</sup>, some foreign investors take the view that features of BEE are not in compliance with existing BIT commitments. South Africa was provoked to modify its BIT text to exclude from the scope of the rule of national treatment equality-promoting measures that are intended “to protect or advance persons . . . disadvantaged by unfair discrimination”.<sup>10</sup> Significantly, this equality-promoting exception does not extend to other BIT disciplines such as measures that might be considered equivalent to expropriation or nationalization. Elsewhere, one of us has written in detail about how well aspects of BEE stack up against the vaunted flexibilities of investment rules. We do not intend to repeat these arguments here.<sup>11</sup> It should be enough to assert that equality as entrenched in the SA Constitution ought to at least militate against giving foreign investors more enforcement rights than those enjoyed by South Africans, including historically disadvantaged South Africans.<sup>12</sup> Model BITs are only as developmentally friendly as states can anticipate they are required to be. BIT policy is reliant on *ex ante* predictions about how state policy will develop going forward. It thereby places an unfair burden on states that may choose to experiment with social and economic policy – particularly where the national constitution mandates the development of public policy – in ways that foreign investors may find disagreeable.

### Potential for Expansionary Interpretation of BITs

**Third**, even then, there can be little assurance that BITs will be interpreted by tribunals in a way that is constrained, respectful of state party intentions, and mindful of other commitments such as constitutional ones. As a recent UNCTAD document admits, it is “in the very nature of international [investment] agreements to constrain policy options at the national level.”<sup>13</sup> Given that this preference is embedded within most BIT models, it comes as little surprise that many international investment tribunals have interpreted BITs in ways that enhance the protections otherwise available to foreign investors. Sornarajah describes these as “expansionary attitudes taken by arbitrators who have accepted the expansionary litigation theories of lawyers who are seemingly taking the law in investment treaties beyond what the parties had originally intended.”<sup>14</sup> There is no better example of this than the expansionary interpretation of the opaque “fair and equitable treatment” requirement. This has been interpreted by a variety of tribunals to amount to requiring the payment of compensation in the case of regulatory changes that unreasonably upset investor expectations.<sup>15</sup> In a series of tribunal decisions arising out of the meltdown of the Argentinean peso in 2001, successive tribunals have interpreted the standard so as to render Argentina fiscally responsible for sunk costs and lost profits for

<sup>9</sup> Government Position Paper (June 2009) 20.

<sup>10</sup> Government Position Paper (June 2009) 38.

<sup>11</sup> David Schneiderman, “Promoting Equality, Black Economic Empowerment, and the Future of Investment Rules” (2009) 25 *South African Journal on Human Rights* \_\_ (under revision and consideration).

<sup>12</sup> For a discussion of the policy development towards giving foreign investors national treatment, see A Hirsch *Season of Hope* 53.

<sup>13</sup> U.N. Conf. on Trade & Dev., *Reserving Flexibility in ILAs: The Use Of Reservations* 6 (New York & Geneva: United Nations, 2006).

<sup>14</sup> M. Sornarajah, “A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration” in Karl P. Sauvant with Michael Chiswick-Patterson, eds., *Appeals Mechanism in International Investment Disputes* (Oxford: Oxford University Press, 2008) 39-77 at 40.

<sup>15</sup> See, for example, *Técnicas Medioambientales TECMED S.A. v. Mexico*, 2003. International Legal Materials (2004) 43: 133, para. 154.

regulatory changes made in the wake of a financial emergency that was likened to the economic depression of the 1930s (*CMS*, *LG&E*, *Enron*, *Sempra*, and *Continental Casualty*). In this same series of cases, there has been disagreement among the various tribunals about the degree to which Argentina can take advantage of US-Argentina BIT emergency clause, which would absolve Argentina for the duration of the emergency. Even then, Argentina remains responsible for damages suffered by investors once the emergency subsidies. Disagreement even has arisen in cases where two different arbitrators, participating in the first three awards (*CMS*, *LG&E*, and *Enron*), appear to have changed their minds without explanation. This is evidence that there is little that is stable and predictable about international investment law for non-investors. Indeed, inconsistency of decisions is an acknowledged feature of the investor-state arbitration system and one which has led to concerns regarding the legitimacy of this system.<sup>16</sup>

### Relative Role of BITs in Influencing Investment

**Fourth**, there is little threat to new inward investment by doing away with investor-state dispute resolution in a model BIT. UNCTAD early on, with little empirical back up, concluded that BITs are relatively insignificant in determining amounts of FDI. Other factors such as market size and growth, exchange rates and country risks appeared to be more important determinants of FDI.<sup>17</sup> This probably remains the case. In one of the few comprehensive studies completed to date, Neumayer and Spess find that there is a positive relationship between the signing of BITs and FDI flows.<sup>18</sup> Yackee, on the other hand, replicated Neumayer and Spess' model and found that the relationship of BITs to FDI flows is marginal and much smaller than they had suggested.<sup>19</sup> The scant empirical evidence, then, is ambivalent.<sup>20</sup> The available anecdotal evidence confirms this. According to a discussion thread amongst international investment lawyers posted in 2006 on 'transnational-dispute management,' most investment lawyers will admit that the existence of a BIT rarely is determinative of investment decisions. The case of Brazil

<sup>16</sup> See generally Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 *FORDHAM L. REV.* 1521, 1582–83 (2005) (expressing concerns about the legitimacy of resolution of investment treaty disputes generally) and Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford: Oxford University Press, 2007) (as international investment law concerns high public policy matters, an appellate system of judicial review is required).

<sup>17</sup> UNCTAD, *Bilateral Investment Treaties in the Mid-1990s* (New York and London: United Nations, 1998) at 118; UNCTAD, *World Investment Report 1998: Trends and Determinants* (New York and London: United Nations, 1998) at 117; UNCTAD, *World Investment Report 1997: Transnational Corporations, Market Structure and Competition Policy* (New York and London: United Nations 1997) at 37.

<sup>18</sup> Eric Neumayer and Laura Spess. 2005. "Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?" *World Development* 33: 1567-85 at 1568,1585.

<sup>19</sup> Jason W Yackee, "Sacrificing Sovereignty: Bilateral Investment Treaties, International Arbitration, and the Quest for Capital" 2006 USC Center in Law, Economics and Organization Research Paper No. C06-15 at 31 online at [http://law.usc.edu/academics/assets/docs/C06\\_15\\_paper.pdf](http://law.usc.edu/academics/assets/docs/C06_15_paper.pdf)

<sup>20</sup> According to Susan Franck, while a BIT is a popular tactic, "there is mixed empirical evidence as to its actual

success in securing foreign investment". S Franck 'Integrating Investment Treaty Conflict and Dispute Systems Design' 92 *Minnesota Law Review* 161, 171 (2007); see also S Franck 'Foreign Direct Investment, Investment Treaty Arbitration, and the Rule of Law' 19 *PAC. MCGEORGE GLOBAL BUS. & DEV. L.J.* 337, 338 (2007) 348–53 (surveying the empirical literature, including studies by Hallward-Dreimer, Rose-Ackerman and Tobin, UNCTAD, Salacuse and Sullivan, Neumayer and Spess, and Swenson, on the topic of how investment treaties affect foreign investment).

lends credence to this view. Brazil is one of the largest magnets for inward FDI in Latin America, yet Brazil has not one BIT presently in force.<sup>21</sup> It likely is the case, then, that investors would not be frightened away from investing in South Africa if investor-dispute mechanisms were abolished and reliance placed on South Africa's national legal system.

#### **Host State Legal System Support Preferred over Investor-State Arbitration**

The **fifth** and final line of argument has a specific bearing on the question of whether doing away with investor-state dispute mechanisms will affect South African outward investment, particularly within the continent. We believe that greater emphasis should be placed on host state legal reform and, to the extent necessary, capacity-building within the system of the administration of justice, rather than on international investment arbitration. This is so for several reasons. First, as a simple matter of fairness and reciprocity, South Africa should not be desirous of limiting the policy space of other countries in the same way that South Africa is disadvantaged vis-à-vis powerful OECD states. Second, as a matter of institution-building, an emphasis on host-state legal reform and development in a model BIT could generate greater interest in changes at the domestic level that benefit citizens and investors alike. Daniels hypothesizes that generating legal enclaves for foreign investors "siphons off the investor voice from the enterprise of creating good and generalized rule of law institutions" in the host country.<sup>22</sup> Investors become not only less interested in host state legal developments, they demand contractual concessions from host states that are likely "to limit the state's capacity to respond to legitimate public policy concerns through the creation of credible, transparent and participatory regulatory institutions."<sup>23</sup> Tobin and Rose-Ackerman have similarly suggested that a world replete with BITs "reduces the interest of MNCs in property rights reform and enforcement in developing countries."<sup>24</sup> When foreign investors "bypass local law and lower their risk through BITs, developing country governments may have lost a major incentive to strengthen their domestic property rights regimes."<sup>25</sup>

This argument regarding greater domestic emphasis means both that more 'investment' should and would be made in the host state property and equality rights regime and that positive effects can be anticipated to occur more broadly throughout the host state national legal system. Abolishing the investor-state dispute mechanism and encouraging resort to national state legal systems (with state-state dispute mechanisms remaining available) could enhance existing legal institutions in unanticipated ways, even in legal

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<sup>21</sup> UNCTAD, *World Investment Report 2003: FDI Policies for Development: National and International Perspectives*. New York and Geneva: United Nations 2003) at 53. Fourteen BITs have been signed by Brazil and none are in force.

<sup>22</sup> Ronald J. Daniels, "Defecting on Development: Bilateral Investment Treaties and the Subversion of the Rule of Law in the Developing World" Faculty Workshop, Faculty of Law, University of Toronto (29 November 2004) at 4 online at <http://www.unisi.it/lawandeconomics/stile2004/daniels.pdf>.

<sup>23</sup> Daniels, *ibid.* at 31.

<sup>24</sup> Jennifer Tobin and Susan Rose-Ackerman, "Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties," Center for Law, Economics and Public Policy Research Paper No. 293 (2004), Yale Law School at 10, online at <http://ssrn.com>

<sup>25</sup> Tobin and Rose-Ackerman, *ibid.* at 34.

systems other than those of constitutional democracies. Consider an episode of Egyptian history. Desperate for new inward investment but preferring not to constitutionalize property rights, President Anwar Sadat used the then-new Egyptian Constitutional Court and revived administrative tribunals to attract such funds. This domestic legal reform then had the effect of generating a new forum for Egyptian politics and enhancing democracy. These judicial reforms, Tamir Moustafa argues, “provided institutional openings for political activists to challenge the executive in ways that fundamentally transformed patterns of interaction between the state and society.”<sup>26</sup> Constitutional litigation, institutionalized in order to provide credible support to the property rights of foreign investors, became a new weapon for civil society to challenge Egyptian authoritarianism. The emphasis on host state legal systems thus becomes a mechanism to prod institutional development to achieve justice and rights for all.

A greater emphasis on host state legal reform and development is, in our view, consistent with the strengthening of regional mechanisms for the protection of rights, including property rights.<sup>27</sup> The position paper notes five BITs concluded with SADC countries.<sup>28</sup> Thus, with respect to the SADC regional system, it may be important to note the recent Tribunal litigation, *In re Mike Campbell (Pvt) Ltd and others v The Republic of Zimbabwe*.<sup>29</sup> In this litigation, the Tribunal has issued three decisions on admissibility, the merits, and most recently on contempt and enforcement.<sup>30</sup> While the enforcement power is mediated through the political organs of SADC, this series of decisions gives at least some legal significance to the concept and status of SADC citizenship and pertinently operationalizes protection of investor expectations.

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<sup>26</sup> Tamir Moustafa, *The Struggle for Constitutional Power: Law, Politics, and Economic Development in Egypt* (Cambridge: Cambridge University Press, 2007) at 6.

<sup>27</sup> According to the Tribunal, the SADC Treaty must be interpreted to mean “that SADC as a collectivity and as individual member States are under a legal obligation to respect and protect human rights of SADC citizens.”

<sup>28</sup> Policy Paper p. 17.

<sup>29</sup> *Mike Campbell (Pvt) Ltd and Others v Republic of Zimbabwe* (2/2007) [2008] SADCT 2 (28 November 2008) (available at <http://www.saflii.org/sa/cases/SADCT/2008/2.html>). In an earlier 2007 judgment on admissibility, the Tribunal delivered itself of some far-reaching language in holding the complaint admissible despite the argument of the government of Zimbabwe and stating at page 3: “The interpretation and application of the SADC Treaty and the Protocol is therefore one of the bases of jurisdiction. For purposes of this application, the relevant provision of the Treaty which requires interpretation and application is Article 4, which in the relevant part provides: ‘SADC and Member States are required to act in accordance with the following principles – (c) human rights, democracy and the rule of law.’ This means that SADC as a collectivity and as individual member States are under a legal obligation to respect and protect human rights of SADC citizens. They also have to ensure that there is democracy and the rule of law within the region.” *Mike Campbell (PVT) Limited and Another v Republic of Zimbabwe* (2/07) [2007] SADCT 1 (13 December 2007) (available at <http://www.saflii.org/sa/cases/SADCT/2007/1.html>). The Tribunal judged the application admissible on the basis of its governing Protocol on Tribunal Article 15(1) which provides in broad terms “The Tribunal shall have jurisdiction over disputes between States, and between natural or legal persons and States.”

<sup>30</sup> *Campbell and Another v Republic of Zimbabwe* (SADC (T) 03/2009) [2009] SADCT 1 (5 June 2009) (available at <http://www.saflii.org/sa/cases/SADCT/2009/1.html>).

While accurate empirical information in this field is hard to come by, a final set of points may be suggested based on a recent study by Susan Franck.<sup>31</sup> She studied publicly available and finalized awards, finding 82 cases and 102 awards, and treating them as representative of the spectrum of resolved claims. While she calls for more research, three findings are of particular interest here. First, of the 107 investors involved: ‘... ninety-six were from “high income” countries, ten were from “upper middle income” countries and only one investor was from a “lower-middle income” country. None were from Africa. Second, in terms of cases against governments, her findings suggested that the highest risk was for countries of “middle income”, rather than either OECD countries or LDCs. South Africans take note. Two African Governments were respondents in her study; Burundi and the DRC. Finally, Franck notes a comment made to the effect that investment treaties “are reciprocal in theory but not in fact, for it is generally only the less developed country that bears the risk of being sued” and agrees that the data tends to support that view. In summary, perhaps the most significant conclusion to draw here is that the investor-state system seems to currently be of relatively little use or relevance in protecting South Africa’s outward investments in Africa.

#### **Conclusion: The Costs and Benefits of Principle**

In justifying our suggestion that the investor-state arbitration mechanism be omitted from the terms of any South African model BIT, we have raised a number of points of principle. To a great extent, these are of course arguments both of morality and of constitutional and international law. Nonetheless, the decisions facing South Africa as outlined in the position paper can also be likened to the decisions facing investors about where to place their capital. Here, the usual assumption is that the rational investor calculates the costs and the benefits, the risks and the potential rewards, does the sums, and makes the decision. Working within that paradigm, we would argue that, at least for the state side of the investor-state relationship outside of the developed world, the costs clearly outweigh whatever benefits there might be.

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<sup>31</sup> S Franck ‘Empirically Evaluating Claims About Investment Treaty Arbitration’ 86 North Carolina Law Review 1 (2007).



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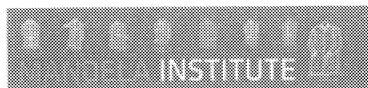
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by

**Cara North**

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# MANDELA INSTITUTE

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**AN EXAMINATION OF THE INDIRECT REGULATION OF FOREIGN DIRECT  
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**Cara North, Mandela Institute, University of the Witwatersrand**

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## AN EXAMINATION OF THE INDIRECT REGULATION OF FOREIGN DIRECT INVESTMENT IN SOUTH AFRICA

### I. INTRODUCTION

Few areas of law arouse as much debate as the law governing the regulation of foreign direct investment (FDI). This is mainly because FDI is viewed as a major stimulus for economic growth and can have serious implications for “national sovereignty and national interest.”<sup>1</sup> It has been suggested that well designed regulatory systems are the only way to ensure an economy can protect itself from the consequences of poorly implemented FDI.<sup>2</sup> Today, FDI is internationally regulated by a plethora of multilayered and diverse treaty based legal frameworks.<sup>3</sup> This is often seen as a by product of unsuccessful attempts to implement multilateral rules for investment such as the Multilateral Agreement on Investment 1998 and the Cancun WTO Ministerial Conference of 2003.<sup>4</sup> Consequently, South Africa and a number of other developing countries have experienced an array of difficulties with their foreign direct investors which have at times led to significant disputes.<sup>5</sup> As with other developing countries, FDI is suggested to be crucial to the development of the South African economy.<sup>6</sup> This is primarily because at present South Africa is trying to overcome “scarcities of resources such as capital, entrepreneurship, access to foreign markets, efficient managerial techniques, technological transfer and innovation and employment creation.”<sup>7</sup> As a result, the regulation of FDI in South Africa has become an extensively debated issue. Many commentators, including members of the South African government, have noted that the indirect regulation currently operating is insufficient and that the agreements that have been entered into are not assisting in the development of the economy.<sup>8</sup>

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<sup>1</sup> Dr. Rafael Leal-Arcas, *International Trade and Investment Law* (to be published 2010) 176.

<sup>2</sup> Colin Kirkpatrick, David Parker and Yin-Fang Zhang, ‘Foreign Direct Investment in Infrastructure in Developing Countries: Does Regulation Make a Difference?’ (2006) 15(1) *Transnational Corporations* 143.

<sup>3</sup> Dr. Rafael Leal-Arcas, above n, 1, 200.

<sup>4</sup> *Ibid.*

<sup>5</sup> See for example; *Aguas del Tunari SA v Republic of Bolivia*, ICSID Case No. ARB/02/3 See also; *Aguas Argentina, SA, Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v The Argentina Republic*, ICSID Case No. ARB/03/19. See also; *Piero Foresti, Laure de Carli and other vs. The Republic of South Africa* Case No ARB(AF)/07/1. See also; *Gabon v. Société Serete S.A.* (ICSID Case No. ARB/76/1)

<sup>6</sup> See generally, Department of Trade and Industry, *Government Position Paper: Workshop on Bilateral Investment Treaty Policy Framework Review* (2009).

<sup>7</sup> Ntwala Mwilima, ‘Foreign Direct Investment in Africa’ (2003) *Labour Resource and Research Institute* 33.

<sup>8</sup> See generally; Department of Trade and Industry, *Government Position Paper: Workshop on Bilateral Investment Treaty Policy Framework Review* (2009).

This paper will provide a review of the regulation of inward FDI in South Africa. In doing so, this paper will begin by defining FDI, describing the methods and factors that impact on its success and the problems that it can cause. The paper will discuss the history of FDI in South Africa, the statistical trends in the last 10 years, the way the Republic of South Africa regulates FDI, the problems that this can cause and some of the recommendations made to redress these concerns. Discussion will then focus on the regulation of FDI in Canada and Australia and will investigate the functions and powers provided to the regulatory bodies under the *Foreign Acquisitions and Takeovers Act* 1975 and the *Investment Canada Act* 1985. These countries have been chosen as they have both moved from more indirect to direct regulation of FDI due to the government's recognition of the communities concerns regarding the lack of regulation. Finally, this paper will conclude with a recommendation of a more direct form of regulation for FDI in South Africa.

### 1.1 Defining FDI

FDI has been defined as any investment made which acquires a "lasting management interest (usually of at least 10% of voting stock) and acquires at least 10% of equity shares in an enterprise operating in a country other than the home country of the investor."<sup>9</sup> South Africa defines FDI as at least 10% of the voting rights or ownership of 25% or more of the total issued voting stock of the company.<sup>10</sup> The three main methods of FDI are takeovers, mergers and acquisitions (M&A) and greenfields.<sup>11</sup> The method of investment chosen will depend on a number of factors including whether the investment involves predominately new assets or transferred assets from local to foreign firms.<sup>12</sup>

International merges have been defined as the transfer of more then 10% ownership from a domestic business to foreign hands, while not creating any new product facilities.<sup>13</sup> M&As have become the most popular mode of investment for foreign investors as they are favorable to

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<sup>9</sup> Ntwala Mwilima, Above n, 7, 33.

<sup>10</sup> UNCTAD, *UNCTAD WID Country Profile: South Africa*, (2010), FDI Country Profiles <http://www.unctad.org/Templates/Page.asp?intItemID=3198&lang=1> at March 9, 2010.

<sup>11</sup> Colin Kirkpatrick, David Parker and Yin-Fang Zhang, "Foreign Direct Investment in Infrastructure in Developing Countries: Does Regulation Make a Difference?" (2006) 15(1) *Transnational Corporations* 143.

<sup>12</sup> Ntwala Mwilima, Above n, 7, 31.

<sup>13</sup> Colin Kirkpatrick, David Parker and Yin-Fang Zhang, Above n 11, 143.

companies that want to “protect, consolidate and advance their position”<sup>14</sup> and ultimately their level of competitiveness. However, research has determined that “for the host country, the benefits of M&A are lower and the risks of negative effects are greater”<sup>15</sup> when compared to other forms of investment. This is largely because M&A tends to bring “less resources into the economy, it can cause the denationalization of domestic firms and a loss of technological assets as well as an increased market concentration which has implications for competition within the host country.”<sup>16</sup> Therefore, it is suggested that while M&As will result in a profit for investing firms they tend to cause a loss for domestic industries.

***A. Factors that impact on the successfulness of FDI on a country and the potential problems it can cause***

The main factors that influence the success of FDI include the mode of entry used i.e. greenfield, M&A or takeover as illustrated above; the activities undertaken by the investor and whether these are new or existing activities in the host country; the “source of finance that is being used i.e. reinvested earnings, intra-company loans or equity capital from parent companies”<sup>17</sup> and; whether local physical and human resources are engaged.

If the FDI is ‘unsuccessful’ it can potentially hinder the development of the host country’s economy. Some of the consequences can include;

- An impact on domestic competition through the suppression of local entrepreneurship and a focus on foreign skills and knowledge including, “worldwide contracts, advertising skills, and a range of essential support services to drive out local competitors and hinder the emergence of small scale local businesses”;<sup>18</sup>

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<sup>14</sup> Ntwala Mwilima, Above n, 7, 31.

<sup>15</sup> Central Bank of Chile, ‘Greenfield FDI vs. Mergers and Acquisitions: Does the distinction matter?’ (Working paper no, 173, Central Bank of Chile, 2002).

<sup>16</sup> Ntwala Mwilima, Above n, 7, 31.

<sup>17</sup> Oludele Akinloye Akindoadé, Franz Krige Siebrits and Elizabeth Niedermeier Roussot, ‘Foreign Direct Investment in Africa’ in S. Ibi Ajayi (ed), *Foreign Direct Investment in Sub-Saharan Africa: Origins, Targets, Impact and Potential* (2006) 177.

<sup>18</sup> Ntwala Mwilima, Above n, 7, 41.

- An impact on the balance of payments: which may occur if the investor imports more than can be exported resulting in trade deficits;<sup>19</sup>
- Instability: a function of short notice of reinvestment outside the country of portfolio;
- Transfer pricing: “This refers to the pricing of intra-firm transactions which do not reflect the true value of products entering and leaving the country”<sup>20</sup> and can cause a depletion of national resources and;
- An impact on development: which can occur where the investor promotes the interests of a small number of “modern-sector workers against the interests of the rest of the population [by widening] wage and differentials”<sup>21</sup> causing an imbalance in the country.

Finally, as foreign direct investors are often able to “extract sizable economic and political concessions in the form of excessive protection, tax rebates, investment allowances and the cheap provisions of factory sites and services”<sup>22</sup> they can seriously impact the sustainability and development of any economy but particularly developing economies. Therefore, a key question for determination is how the FDI is being regulated to ensure it provides a social benefit to the country?

## ***B. International regulation of Foreign Direct Investment***

### *1. Bilateral Investment Treaties*

Today, the bulk of international regulation of FDI has risen and continues to rise through bilateral investment treaties (BITs).<sup>23</sup> It is estimated that there are currently over 2500 BITs around the world, with more of these agreements being negotiated every day.<sup>24</sup> The standard BITs deal with the treatment of foreign investors, their rights and obligations in relation to expropriation and nationalism, reparation of funds, the extent to which the investment is

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<sup>19</sup> Ibid.

<sup>20</sup> Ntwala Mwilima, Above n, 7, 41.

<sup>21</sup> Ibid.

<sup>22</sup> Ntwala Mwilima, Above n, 7, 42.

<sup>23</sup> Department of Trade and Industry, *Government Position Paper: Workshop on Bilateral Investment Treaty Policy Framework Review* (2009) 5.

<sup>24</sup> Laurence Boulle and John Klaaren, ‘Developing countries, BITS and ICSID Arbitration: Views from Africa’ (Paper presented at New Zealand Centre for International Economic Law Conference, Wellington, October 2009).

declared, the transfer of currencies and dispute resolution.<sup>25</sup> These treaties have been the focus of much debate recently with a number of countries moving towards more private direct forms of regulation.<sup>26</sup> Disputes arising out of these treaties will often be referred to the International Centre for the Settlement of Investment Disputes.<sup>27</sup>

## 2. *Codes of Conduct*

Further forms of regulation include codes of conduct which have been developed with a focus on bilateral and multilateral investments.<sup>28</sup> These codes of code include the 1976 OECD Guidelines for Multinational Enterprises, the United Nations Draft Code on Transitional Corporations and International Chamber of Commerce guidelines for investment.<sup>29</sup> These codes of conduct are merely guidelines for countries entering into bilateral investment treaties and contain few specific binding commitments.<sup>30</sup> The draft code has also been used in some cases as an interpretative aid in investment disputes.<sup>31</sup>

## 3. *International Center Settlement of Investment Disputes*

The International Center Settlement of Investment Disputes (ICSID) was established in 1966 under the Convention for the 'Settlement of Disputes between State and Nationals of Other States'.<sup>32</sup> ICSID is attached to the World Bank as an independent organization. The purpose of ICSID is to facilitate the "conciliation and arbitration of disputes between member countries and investors who are nationals of other member countries."<sup>33</sup> ICSID contracting states are required to recognize and enforce ICSID decisions.<sup>34</sup>

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<sup>25</sup> Michael Pryles, Jeff Waincymer and Martin Davies, *International Trade Law: Commentary and Materials* (2<sup>nd</sup> ed, 2004) 1047.

<sup>26</sup> For example; Canada, America and Australia.

<sup>27</sup> Colin Kirkpatrick, David Parker and Yin-Fang Zhang, 'Foreign Direct Investment in Infrastructure in Developing Countries: Does Regulation Make a Difference?' (2006) 15(1) *Transnational Corporations* 143.

<sup>28</sup> Dr. Rafael Leal-Arcas, above n, 1, 200.

<sup>29</sup> Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1047.

<sup>30</sup> Laurence Boulle, *The Law of Globalisation: An Introduction* (2009) 49.

<sup>31</sup> Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1047.

<sup>32</sup> Laurence Boulle, Above n 30, 49.

<sup>33</sup> Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1047.

<sup>34</sup> Boulle, Above n 30, 195. There are currently 155 signatory States to the ICSID Convention. Of these, 144 States have also deposited their instruments of ratification, acceptance or approval of the Convention and have become ICSID Contracting States.

There has been extensive debate by a number of countries as to whether this is an effective means of dispute resolution.<sup>35</sup> One problem identified is the level of transparency and accountability of the settlement of the investment dispute.<sup>36</sup> It has been argued that these private settlements have significant policy implications for local governments as they impact on the legislative, regulatory and taxation functions of the government.<sup>37</sup> Consequently, several countries are now committed to negotiating “investment treaties which provide for mandatory transparency in all investor-state arbitrations.”<sup>38</sup>

## II. SOUTH AFRICA

### A. FDI in South Africa Historically and Today

FDI has always played an important role in South Africa’s development. This was particularly so from the 1920’s to the 1970’s during the mining boom.<sup>39</sup> During this period it became apparent to the South African Government that foreign investment was playing a significant role in the South African economy albeit at the expense of black rights.<sup>40</sup> South Africa continued to attract investment during the pre-sanctions era, although investment gradually slowed in the 1980’s.<sup>41</sup> From the 1980’s to the 1990’s the global ‘anti-apartheid based consumer boycott’<sup>42</sup> was largely imposed by transnational corporations operating in South Africa and had significant implications for the economy.<sup>43</sup> For example, “Barclays Bank’s share of the student loan market,

<sup>35</sup> See generally; Susan Franck, ‘Empirically Evaluating Claims about Investment Treaty Arbitration’, 80 North Carolina Law Review (2007) 1.

<sup>36</sup> Luke Eric Peterson, ‘Bilateral Investment Treaties – Implications for Sustainable development and for regulation’ (2007) FED Conference Report 2.

<sup>37</sup> The OECD Investment Committee, ‘Transparency and Third Party Participation in Investor-state Dispute Settlement Procedures’ (Working Paper No 2005/1, OECD, 2005).

<sup>38</sup> Luke Eric Peterson, Above n 36, 2. For example, the 2003 Canadian Model FIPA and the 2004 U.S. Model BIT address transparency expressly and in detail. A similar trend can be observed in the ‘Dispute Settlement Understanding’ negotiations at the WTO where various transparency provisions have been advanced by State Parties. Finally, mandatory publication has in practice been illustrated on the International Trade Canada,; US Department of State, Mexico’s Ministry of the Economy websites and contains reference to awards, submissions and other relevant materials.

<sup>39</sup> Department of Trade and Industry, *Government Position Paper: Workshop on Bilateral Investment Treaty Policy Framework Review* (2009) 5.

<sup>40</sup> CUTS Centre for Competition, Above n 40, 2.

<sup>41</sup> Department of Trade and Industry, Above n 39, 5.

<sup>42</sup> CUTS Centre for Competition, Above n 40, 2.

<sup>43</sup> Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1047.



declined from 27 – 15% under pressure from socially and ethnically conscious clients.”<sup>44</sup> As a result the, 1980’s saw a significant decrease in capital “particularly following then President PW Botha’s August 1985 Rubicon Speech.”<sup>45</sup> Research indicates that roughly up to 350 companies pulled out of SA during that period.<sup>46</sup>

FDI gradually made its way back into the economy in the late 1990’s as sanctions were slowly lifted. Following the 1994 democratic election of the African National Congress the government immediately put into place investment friendly policies removing a number of the previous obstacles in place.<sup>47</sup> Consequently, this period saw the introduction of BITs which globally increased in popularity and quintupled in number.<sup>48</sup> It has been suggested that due to the apparent desperation of the South African government to make known that it was no longer a tumultuous country but rather a safe and viable place for investments there was a considerable lack of economic risk analysis undertaken.<sup>49</sup> As a result, South Africa’s approach to “inward and outward FDI has not been informed by a holistic policy perspective but rather a patchwork of general policy considerations.”<sup>50</sup>

Within the last 10 years, South Africa has shown unpredictable levels of investment. Between 2000 and 2005 there was a large increase of inward FDI in dollars of 677%, followed by a large decline in 2006 of 107.93 % and from 2006 to 2008 there was an increase of 1809.4 %.<sup>51</sup> While the most recent statistics for 2009 and 2010 have not yet been released it is predicted that 2009 may continue to see an increase but there will be a significant decrease in 2010 due to the delayed impact of the financial crisis.<sup>52</sup>

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<sup>44</sup> CUTS Centre for Competition, Above n 40, 2.

<sup>45</sup> Ibid.

<sup>46</sup> CUTS Centre for Competition, Above n 40, 2.

<sup>47</sup> Department of Trade and Industry, Above n 39, 5.

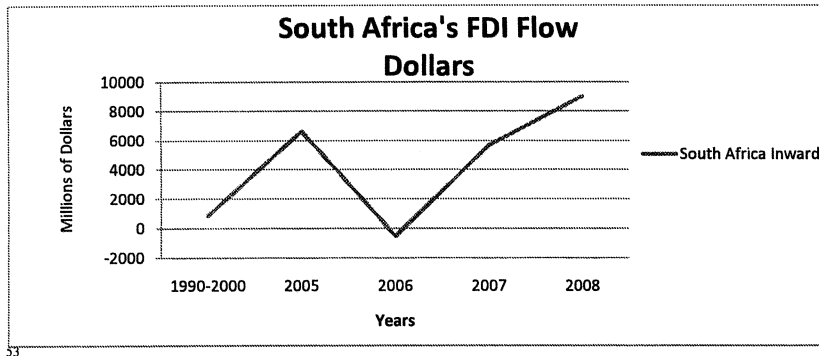
<sup>48</sup> Luke Eric Peterson, Above n 36, 2.

<sup>49</sup> Department of Trade and Industry, Above n 39, 5.

<sup>50</sup> Ibid, 6.

<sup>51</sup> UNCTAD, *UNCTAD World Investment Report 2009: Transnational Corporations, Agricultural Production and Development: Country Fact Sheet South Africa*, (2009), FDI Country Profiles <http://www.unctad.org/Templates/Page.asp?intItemID=3198&lang=1> at March 9, 2010.

<sup>52</sup> UNCTAD/PRESS/PR/2009/042 “Global FDI inflows continue to slide in 2009: significant recovery expected only in 2011” 17/09/09. Drawn from the World Investment Report 2009 [http://www.unctad.org/en/docs/wir2009\\_en.pdf](http://www.unctad.org/en/docs/wir2009_en.pdf)



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It is reported that today, the major form of inward FDI in South Africa is through M&A's, which makes up 60% of transactions.<sup>54</sup> It is reported that South Africa has an exceptionally low rate of Greenfield FDI's and that most FDI inflows in South Africa are "capital intensive and are directed at the already established sectors such as services and manufacturing."<sup>55</sup> As specified above this can result in fewer resources for the country as well as a depletion of technological assets and can have serious implications for the levels of competition within the country.<sup>56</sup>

Contrary to statistical evidence South Africa is seen by many as a sound investment destination for FDI. South Africa has relatively well developed business infrastructure for motor, rail and air transport by comparison to other African countries.<sup>57</sup> South Africa has an extensive system of brokers, financial service specialists and merchant banks.<sup>58</sup> Furthermore, it is a good trans-shipment point between the "emerging markets of Central and South America and the newly industrialized nations of South and Far East Asia."<sup>59</sup> South Africa has easy access to the

<sup>53</sup> UNCTAD, *UNCTAD World Investment Report 2009: Transnational Corporations, Agricultural Production and Development: Country Fact Sheet South Africa*, (2009), FDI Country Profiles <http://www.unctad.org/Templates/Page.asp?intItemID=3198&lang=1> at March 9, 2010.

<sup>54</sup> Ntwala Mwilima, Above n, 7, 32.

<sup>55</sup> Ibid.

<sup>56</sup> Colin Kirkpatrick, David Parker and Yin-Fang Zhang, Above n 11, 143.

<sup>57</sup> Oludele Akinloye Akindoade, Franz Krige Siebrits and Elizabeth Niedermeier Roussot, 'Foreign Direct Investment in Africa' in S. Ibi Ajayi (ed), *Foreign Direct Investment in Sub-Saharan Africa: Origins, Targets, Impact and Potential* (2006) 178.

<sup>58</sup> Caroline Maxwell, 'Foreign Investment in South Africa – An Overview' South Africa Information: Low Tax and Incentives Regime [http://www.lowtax.net/lowtax/html/offon/southafrica/sa\\_foreign.html](http://www.lowtax.net/lowtax/html/offon/southafrica/sa_foreign.html)

<sup>59</sup> Ibid.

Southern African Development Community (SADC), which consists of 15 countries containing a total population of over 180 million.<sup>60</sup> Finally, South Africa has one of the most developed sectors for specialized manufacturing areas such as gold, coal and mineral processing and areas including “tourism, agriculture and livestock development, construction, and the service industry”<sup>61</sup> have seen significant development over the last ten years.

### ***B. South Africa's FDI Regulations: An Indirect Regulatory Model***

The only legal framework for FDI in South Africa is through indirect regulation.<sup>62</sup> Since the 1980's, the South African government has significantly relaxed regulations for foreign investors making it easier to gain access to local loans.<sup>63</sup> This provides them with greater accessibility to land and mining concession ownership by supplying investors with ease of entry and; “by forming new kinds of partnerships with the private sector (public private partnerships) in areas which were previously the responsibility of the government e.g. water distribution.”<sup>64</sup> As a result, the only forms of regulation used today are the indirect FDI legislation, competition regulations and bilateral investment treaties.<sup>65</sup>

#### ***1. Indirect FDI Legislation***

The main pieces of legislation that control FDI in South Africa are the *Export Credit and Foreign Investments Re-insurance Act 2001* and the *Exchange Control Amnesty and Amendment*

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<sup>60</sup> Caroline Maxwell, 'Foreign Investment in South Africa – An Overview' South Africa Information: Low Tax and Incentives Regime [http://www.lowtax.net/lowtax/html/offon/southafrica/sa\\_foreign.html](http://www.lowtax.net/lowtax/html/offon/southafrica/sa_foreign.html)

<sup>61</sup> Oludele Akinloye Akindoade, Franz Krige Siebrits and Elizabeth Niedermeier Roussot, Above n 57, 178.

<sup>62</sup> 'Developing countries, BITS and ICSID Arbitration: Views from Africa' “As regards non-BIT and non-double tax treaties with investment implications there was little other activity on the African continent’ during the last couple of years.”<sup>62</sup>

<sup>63</sup> Ntwala Mwilima, Above n, 7, 35.

<sup>64</sup> Ntwala Mwilima, Above n, 7, 36.

<sup>65</sup> UNCTAD, *UNCTAD WID Country Profile: South Africa*, (2010), FDI Country Profiles <http://www.unctad.org/Templates/Page.asp?intItemID=3198&lang=1> at March 9, 2010.

of *Taxation Laws Act 2003*.<sup>66</sup> Other pieces of legislation such as the *Income Tax Act 1962*, the *Labor Relations Act 1995*, the *Financial Institution (Investment Funds) Act 2001*, *Competition Act 1998* and the *Companies Act 1972* can also play a significant role.<sup>67</sup>

In 2005, the South Africa government reviewed the *Exchange Control Amnesty and Amendment of Taxation Laws Act 2003* and the *Income Tax Act 1962*.<sup>68</sup> In doing so, the government substantially reduced its role in the economy. These laws were changed to “reduce import taxes and subsidies to local firms, eliminated the punitive non-resident shareholders tax, remove certain limits on hard currency repatriation, and reduce the secondary tax on corporate dividends.”<sup>69</sup> Accordingly, the only significant difference remaining between the treatment of local and foreign investors is in relation to their borrowing abilities. Current legislation specifies that the maximum a foreigner can borrow locally is half the net worth of the company in other words, no more than 50% of the company’s effective capital.<sup>70</sup> While the relaxation of legislative regulations may have been influential on the increase of FDI in South Africa, it is suggested that it has also impacted on the level of development.<sup>71</sup>

## **2. Competition Regulations**

Competition law in South Africa is regulated by the Competition Act, the Competition Tribunal and the Competition Commission. The main purpose of the *Competition Act 1998* is to achieve the following objective for South Africa;

- “To promote the efficiency, adaptability and development of the economy;
- To provide consumers with competitive prices and product choices;
- To promote employment and advance the social and economic welfare of South Africans;

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<sup>66</sup> Ibid.

<sup>67</sup> UNCTAD, *UNCTAD WID Country Profile: South Africa*, (2010), FDI Country Profiles <http://www.unctad.org/Templates/Page.asp?intItemID=3198&lang=1> at March 9, 2010.

<sup>68</sup> Caroline Maxwell, ‘Foreign Investment in South Africa – An Overview’ South Africa Information: Low Tax and Incentives Regime [http://www.lowtax.net/lowtax/html/offon/southafrica/sa\\_foreign.html](http://www.lowtax.net/lowtax/html/offon/southafrica/sa_foreign.html)

<sup>69</sup> Ibid.

<sup>70</sup> Caroline Maxwell, ‘Foreign Investment in South Africa – An Overview’ South Africa Information: Low Tax and Incentives Regime [http://www.lowtax.net/lowtax/html/offon/southafrica/sa\\_foreign.html](http://www.lowtax.net/lowtax/html/offon/southafrica/sa_foreign.html)

<sup>71</sup> Colin Kirkpatrick, David Parker and Yin-Fang Zhang, Above n 11, 143.

- To expand opportunities for South African participation in world markets and recognize the role of foreign competition in the Republic;
- To ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy;
- To promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.”<sup>72</sup>

These objectives are met through a detailed screening process which ensures that the competition commission is immediately notified of any M&A if “the proposed merger equals or exceeds R560 million (calculated by either combining the annual turnover of both firms or their assets), and the annual turnover or asset value of the transferred/target firm is at least R80 million.”<sup>73</sup> The proposal is then passed on to the competition tribunal who are provided with the opportunity to screen the M&A to ensure it meets legislative objectives.<sup>74</sup> This piece of legislation applies to both local and foreign investments. There is no separate process for FDI and there is nothing in the legislation that clearly specifies that investment agreements entered into would be subject to this Competition Act suggesting that it is more of a process for local investors. There is also no clear specification as to whether the competition tribunal would be privy to FDI negotiations or whether they would be able to have any input so as to ensure that the investment is in the interest of the country.

### 3. *Bilateral investment treaties*

The most common form of regulation is through bilateral investment treaties.<sup>75</sup> South Africa has a relatively long history with the use of BITs the first of which was agreed to in 1994.<sup>76</sup> At present South Africa has 72 BITs operating and the government is currently considering further

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<sup>72</sup> Competition Commission South Africa, *About us*, Competition Commission <http://www.compcom.co.za/about-us/> at March 7, 2010.

<sup>73</sup> Competition Commission South Africa, *Merger Thresholds*, Competition Commission <http://www.compcom.co.za/merger-thresholds/> at March 7, 2010.

<sup>74</sup> *Ibid.*

<sup>75</sup> Department of Trade and Industry, *Above n* 39, 5.

<sup>76</sup> *Ibid.*

agreements with Kenya, Nigeria, China, Singapore, South Korea and India.<sup>77</sup> The treaties which South Africa has become a party to over the last 16 years are predominately focused on investors rights rather than their obligations.<sup>78</sup> The main clauses focus on “protection against expropriation, the normal compensation guarantee and the ability to repatriate profits.”<sup>79</sup> There has been no clear reference to the preservation of equity, transformation equality, and empowerment which are all clearly stated in the South African constitution and were the main objectives of the new democratic government.<sup>80</sup>

Consequently, the Republic of South Africa is facing serious challenges from developed nations seeking to rely on the BITs that are contrary to South Africa’s local laws.<sup>81</sup> Recently the government has received a multitude of lawsuits brought by BIT parties regarding compliance with South Africa’s Black Economic Empowerment<sup>82</sup> policies.<sup>83</sup> This and other lawsuits have encouraged the government to recognise the need for change. Towards the end of 2009, the government held a workshop to discuss the issues surrounding bilateral investments.<sup>84</sup> At the conclusion of which, Mr. Enver Daniels, the Chief State Law Adviser stated:

“I want to argue that BITs undermine the initiatives to develop an economic order in which all countries will flourish through development and hold the global efforts to eliminate poverty and inequality.”<sup>85</sup>

One of the major concerns expressed by the South African government is that BITs significantly attract FDI and that the removal of these agreements will result in the depletion of FDI in the

<sup>77</sup> Eric Neumayer and Laura Spess, ‘Do bilateral investment treaties increase foreign direct investment to developing countries?’, (2005) 33(10) *World Development*, 1567.

<sup>78</sup> Department of Trade and Industry, Above n 39, 5.

<sup>79</sup> Laurence Boulle and John Klaaren, ‘Developing countries, BITS and ICSID Arbitration: Views from Africa’

(Paper presented at New Zealand Centre for International Economic Law Conference, Wellington, October 2009) 6.

<sup>80</sup> Ibid.

<sup>81</sup> Department of Trade and Industry, Above n 39, 5.

<sup>82</sup> These policies designed to remedy past discrimination and to provide preferential treatment to black employees, managers and business-owners, could run afoul of investment treaty strictures to provide “fair and equitable treatment” or “national treatment” to foreign investors.”

<sup>83</sup> See for example; *Piero Foresti, Laure de Carli and other vs. The Republic of South Africa* Case No ARB(AF)/07/1. Jason Brickhill, 2009 07 27 ‘South Africa’s Investment Treaties must meet its Human Rights obligations’ (2009) Legal Resource Centre <http://www.lrc.org.za/press-releases/> at March 9, 2010.

<sup>84</sup> Laurence Boulle and John Klaaren, Above n 79, 12.

<sup>85</sup> Ibid.

country.<sup>86</sup> This argument has some concerns. First, a number of countries around the world have made note of the implications these treaties can have for the development of their countries and therefore, have adopted new negotiating templates which are designed to strike a balance between foreign investor protection and the legitimate right of governments to regulate economic activity in the public interest.<sup>87</sup> Second, a number of studies have reported that there is no evidence to suggest that the signing of BITs increase the level of FDI inflow.<sup>88</sup> Third, as UNCTAD reported in 1998 “There are many examples of countries with large FDI inflows and few, if any, BITs”<sup>89</sup> a good example of this is Brazil which has never signed a single BIT agreement and is one of the most popular destination for FDI with FDI increasing 33058 million dollars over the last 8 years.<sup>90</sup>

Furthermore, while some recent BITs have included clauses specifying that FDIs will only be agreed to when they comply with the domestic law which governs the investment.<sup>91</sup> It has been suggested that this may in fact not be enough as it is evident that there is no specific legislation dealing with FDI. Rather it has become apparent that there is a “plethora of agreements in a variety of sectors involving more than one government department.”<sup>92</sup> Therefore, it is suggested that perhaps it is time for South Africa to review its indirect regulatory scheme and possibly look to other countries regulatory models for guidance.

### C. Recommendations

Due to the lengthy debates over the review of BITs there has been an array of recommendations. A primary suggestion has been the introduction of a new BIT model which contains a balance between the development of South Africa and the protection of foreign investor rights.<sup>93</sup> It is

<sup>86</sup> Department of Trade and Industry, Above n 39, 22.

<sup>87</sup> Both Canada and the United States have these negotiation templates.

<sup>88</sup> See for example; Eric Neumayer and Laura Spess, ‘Do bilateral investment treaties increase foreign direct investment to developing countries?’, (2005) 33(10) *World Development* 1567-1585. See also; C. Raghavan, ‘Bilateral Investment treaties play only a minor role in attracting FDI,’ (1997) 162 *Third World Economics*, 1-15.

<sup>89</sup> UNCTAD world Investment Report 1998 as seen in; Eric Neumayer and Laura Spess, ‘Do bilateral investment treaties increase foreign direct investment to developing countries?’, (2005) 33(10) *World Development*, 1570.

<sup>90</sup> UNCTAD, *UNCTAD World Investment Report 2009: Transnational Corporations, Agricultural Production and Development: Country Fact Sheet Brazil*, (2009), FDI Country Profiles

<http://www.unctad.org/Templates/Page.asp?intItemID=3198&lang=1> at March 9, 2010.

<sup>91</sup> Department of Trade and Industry, Above n 39, 7.

<sup>92</sup> Ibid.

<sup>93</sup> Laurence Boulle and John Klaaren, Above n 79, 14.

suggested that this would need to be drafted with a particular focus on the “unique developmental needs and social transformation objectives”<sup>94</sup> of South Africa. Another suggestion has been to “develop a model investment chapter which would then be included in all future free trade agreements”<sup>95</sup> also with a clear development focus. Finally, it has been suggested that the “initiation of a new, developing country-driven multilateral investment protection policy”<sup>96</sup> might be an appropriate option. This would allow South Africa to initiate the coalition of major developing countries by devising a multilateral investment agreement which take into account the needs of all developing countries.<sup>97</sup> While these recommendations may meet some of the identified problems they could be relatively inflexible alternatives as they may not provide the government with the ability to determine, case by case what kind of development the country needs and target FDI accordingly. The South African government could use a more direct form of regulation containing a general focus on the ‘nation’s interest’ allowing the government the flexibility to determine what that means when prospective FDI is being considered. This more direct form of regulation with the country’s interest as the focal point has been adopted by a number of countries in different ways, in particular Australia and Canada.

### III. AUSTRALIA

#### A. *Regulations of Foreign Direct Investment in Australia: A Tribunal Model*

Prior to 1972, the Australian government had no FDI regulatory system in place. Their main focus was to create policies that would encourage Australian’s to own and participate in the management of companies that were foreign owned.<sup>98</sup> At that time, Australia placed no limit on “foreign ownership of Australian business property, except in a few particular industries, such as

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<sup>94</sup> Centre for Applied Legal Studies and the Legal Resource Centre, Submissions concerning the Bilateral Investment Policy Framework Review Government position paper (12 August 2009) As seen; in Laurence Boulle and John Klaaren, ‘Developing countries, BITS and ICSID Arbitration: Views from Africa’ (Paper presented at New Zealand Centre for International Economic Law Conference, Wellington, October 2009) 6.

<sup>95</sup> Ibid.

<sup>96</sup> Centre for Applied Legal Studies and the Legal Resource Centre, Submissions concerning the Bilateral Investment Policy Framework Review Government position paper (12 August 2009) As seen; in Laurence Boulle and John Klaaren, ‘Developing countries, BITS and ICSID Arbitration: Views from Africa’ (Paper presented at New Zealand Centre for International Economic Law Conference, Wellington, October 2009) 6.

<sup>97</sup> Ibid.

<sup>98</sup> Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1050.



banking, civil aviation and the media.”<sup>99</sup> In 1976 the Commonwealth Government decided to construct the Foreign Investment Review Board (the board).<sup>100</sup> The decision was partly made to demonstrate to the Australian public that the government recognised the communities concerns about foreign ownership of Australian assets.<sup>101</sup> The board’s general function was to advise the Treasurer on foreign investment policies.<sup>102</sup> The legislation which governs all facets of FID policy in Australia is the *Foreign Acquisitions and Takeovers Act 1975* (the Act).

### 1. *Processing of the claims*

Today, Australia has an extensive and established screening process for FDI which enforces the following procedures:

- When a proposal is submitted to the board they will determine what division of the Foreign Investment Policy Division of the Treasury will handle the initial work. This will depend on which industry sector the investment involves or in the case of commercial and residential FDI what the general location is likely to be.<sup>103</sup>
- The Executive will produce a report which the board will then consider and pass its view and recommendations to the Treasurer or Assistant Treasurer.<sup>104</sup>
- The Treasurer upon review of the recommendations has the power under the Act to prohibit a proposal which is determined contrary to the ‘national interest,’<sup>105</sup> or to impose conditions that are deemed necessary to ensure the national interest concerns are dealt with.<sup>106</sup> The national interest, which is the key underpinning of the whole Act, is not

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<sup>99</sup> Ibid.

<sup>100</sup> Australian Government: The Treasury, *Foreign Investment Policy in Australia - A Brief History and Recent Developments* (1999) Australian Government: The Treasury, <http://www.treasury.gov.au/home.asp?ContentID=521> at March 9, 2010.

<sup>101</sup> Ibid.

<sup>102</sup> Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1050.

<sup>103</sup> M.J. Phillips, *Foreign Investment Review Board Annual Report 2007-2008*, (2009).

<http://www.firb.gov.au/content/Publications/AnnualReports/2006-2007/Chapter1.asp> ,at 10 March 2010.

<sup>104</sup> Ibid.

<sup>105</sup> s 18, 19, 20, 21 and 21A *Foreign Acquisitions and Takeovers Act 1975*.

<sup>106</sup> s 25 *Foreign Acquisitions and Takeovers Act 1975*.

expressly defined. It remains deliberately ambiguous for the purpose of providing the Treasurer with the ability to determine its meaning in relation to any current national.<sup>107</sup>

## ***2. Managing and compliance activities***

The Act not only deals with screening issues but also contains a number of provisions which provide the Treasurer with the power to “enforce the intent of the government’s foreign investment policy.”<sup>108</sup> The powers include:

- “Unwind transactions that have gone ahead, without prior foreign investment approval having been obtained and where that purchase is inconsistent with policy;
- Prosecute persons and companies who fail to obtain prior approval;
- Prosecute persons and companies who fail to comply with an order to sell shares, assets or property and;
- Prosecute persons and companies who fail to comply with conditions attached to any approval given under the foreign investment legislation.”<sup>109</sup>

Other provisions include that it is an offence to provide the board or the executive with false or misleading information and to deliberately avoid particular provisions of the legislation.<sup>110</sup> It further includes provisions that empower the Treasurer to block proposals made by people who previously tried to evade the system.<sup>111</sup>

## **IV. CANADA**

### ***A. Regulations of Foreign Direct Investment in Canada: A Negotiation Model***

Since 1985, the basic legal framework for foreign investment in Canada has been provided by the *Investment Canada Act 1985* (the Act). The Act was introduced to combat the political

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<sup>107</sup> Michael Holden, *The Foreign Direct Investment Review Process in Canada and Other Countries* (2007) *Canada Library of Parliament* 5.

<sup>108</sup> M.J. Phillips, *Foreign Investment Review Board Annual Report 2007-2008*, (2009).

<sup>109</sup> <http://www.firb.gov.au/content/Publications/AnnualReports/2006-2007/Chapter1.asp> at 10 March 2010.

<sup>110</sup> Australian Foreign Investment Review Board, *Compliance Issues* (2009) Australian Foreign Investment Review Board [http://www.firb.gov.au/content/other\\_investment/compliance.asp](http://www.firb.gov.au/content/other_investment/compliance.asp) at March 9, 2010.

<sup>110</sup> Ibid.

<sup>111</sup> Ibid.

controversy focused on foreign ownership of Canadian businesses. Public opinion suggested that the government had not adequately assessed foreign investments to ensure they were in the countries interest.<sup>112</sup> This Act is currently the principal instrument used to regulate FDI in Canada.<sup>113</sup> The focal point of the legislation is to “encourage investment in Canada by non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such a benefit to Canada.”<sup>114</sup> In doing so, the legislation provides the Minister with the power to review or block FDI proposals if necessary.

### ***1. Processing of the claims***

This process is automatically triggered in circumstances where any proposed FDI is above the prescribed threshold.<sup>115</sup> This can vary depending on whether the investors are members of the WTO and the type of investment.<sup>116</sup> Regardless of this distinction the general process includes the following key steps;

- The Minister performs an initial review of the proposal and determines whether the proposal indicates any national security concerns.<sup>117</sup> If it is deemed that there are issues arising from the proposal it will be handed over to the Cabinet for a full review.<sup>118</sup>
- The maximum length the review will take is three to four months. Upon expiration of the review, “the Canadian regulators cannot challenge a reviewable foreign investment on national security grounds.”<sup>119</sup> However, under the legislation the government “retains the

<sup>112</sup> Report to the Honorable Richard Shebly, Foreign investment – law policies regulating foreign investment in 10 countries <http://www.gao.gov/new.items/d08320.pdf> 37.

<sup>113</sup> UNCTAD, *UNCTAD WID Country Profile: Canada*, (2010), FDI Country Profiles <http://www.unctad.org/Templates/Page.asp?intItemID=3198&lang=1> at March 9, 2010.

<sup>114</sup> Ibid.

<sup>115</sup> Michael Holden, Above n 107, 2.

<sup>116</sup> Ibid.

<sup>117</sup> Bill Newman, *Canadian Regulation of Inbound M&A and Other FDI Strongly Resembles CFIUS* (2009) USA Inbound Acquisitions and Investments: Commentary on Mergers, Acquisitions & Investments by Foreign Businesses <http://www.usainbounddeals.com/2009/10/articles/news-commentary/canadian-regulation-of-inbound-ma-and-other-fdi-strongly-resembles-cfius/> at March 9, 2010.

<sup>118</sup> Michael Holden, Above n 107, 2.

<sup>119</sup> Bill Newman, *Canadian Regulation of Inbound M&A and Other FDI Strongly Resembles CFIUS* (2009) USA Inbound Acquisitions and Investments: Commentary on Mergers, Acquisitions & Investments by Foreign Businesses <http://www.usainbounddeals.com/2009/10/articles/news-commentary/canadian-regulation-of-inbound-ma-and-other-fdi-strongly-resembles-cfius/> at March 9, 2010.

authority to initiate a review of non-reviewable transactions, including minority investments, at any time within 45 days after completion.”<sup>120</sup>

In reviewing the proposal the Minister considers whether the investment is in the ‘net benefit’ of the country or in other words whether it serves the nations interests.<sup>121</sup> As with the Australian legislation ‘net benefit’ and ‘national interest’ are deliberately not defined in the legislation to ensure flexibility in decision making.<sup>122</sup> However, in the Canadian Investment Act a number of pertinent factors are listed which require consideration. These are as follows:

- “the effect of the investment on the level of economic activity in Canada, employment, resource processing, utilisation of parts and services produced in Canada, and exports from Canada;
- The degree and significance of participation by Canadians in the business or the effect of the investment on the competition within any industry in Canada;
- The compatibility of the investment with national industrial, economic and cultural policies; and
- The contribution of the investment to Canada’s ability to compete in world markets.”<sup>123</sup>

Upon consideration of these factors the Minister will determine whether the proposal is satisfactory and in the interests of the country. Unlike the Australian Model, the Canadian Model allows the investment plan to be sent back to the prospective investor.<sup>124</sup> This provides them with the opportunity to amend the plan and work with the government on a continual basis to ensure that the investment is kept within the nations interests.<sup>125</sup> This is a much more subtle and collaborative screening process which ensures that prospective investors are aware of the process and that the government will expect them to take into consideration certain factors when

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<sup>120</sup> Ibid.

<sup>121</sup> Michael Holden, Above n 107, 3.

<sup>122</sup> Ibid.

<sup>123</sup> Bill Newman, *Canadian Regulation of Inbound M&A and Other FDI Strongly Resembles CFIUS* (2009) USA Inbound Acquisitions and Investments: Commentary on Mergers, Acquisitions & Investments by Foreign Businesses <http://www.usainbounddeals.com/2009/10/articles/news-commentary/canadian-regulation-of-inbound-ma-and-other-fdi-strongly-resembles-cfius/> at March 9, 2010.

<sup>124</sup> Report to the Honorable Richard Shebly, Foreign investment – law policies regulating foreign investment in 10 countries <http://www.gao.gov/new.items/d08320.pdf> 37.

<sup>125</sup> Ibid.

constructing proposals while preventing the negative publicity associated with the rejection of large scale prospective investments.

## **V. A DIRECT REGULATORY MODEL FOR FDI IN SOUTH AFRICA**

Given the significant implication FDI can have for the development of any given country a number of countries have moved away from the international regulatory model to a more direct regulatory process. Furthermore, a number of countries have recognised the need for a separate review process for local and foreign investment. This is largely because from a national accounting point of view, gross capital formation is financed from two sources: gross savings and foreign investment. These factors are particularly important for South Africa as the relatively low rate of investment in South Africa's history has been one of the most significant constraints on the growth potential of the economy. Research has indicated that one of the main problems with the current FDI regulatory model in South Africa is that it is not assisting the country in its development. In South Africa the government does not require approval for FDI and nor does it require that foreign investors are subject to the same laws as domestic investors.

It is therefore suggested that South Africa reviews their foreign investment policies and in doing so takes into consideration models such as that of Australia and Canada. It is proposed that what South Africa needs is a separate regulatory body that imposes a screening process on foreign investment. This body could contain the power to reject investment proposals, impose conditions upon investors or closely monitor the investment contracts entered into. This process should be conducted with the key objective of ensuring that the investments are in South Africa's best interests. For example, the regulatory body could require foreign countries to transfer technology, train local workers or source staff and resources locally wherever possible. Further they could, in cases where it is deemed necessary, ensure that foreign investors are unable to repatriate royalties.

It is not suggested that South Africa should wholly adopt either the Australia or the Canadian FDI regulation model. Rather, it is proposed that perhaps some of the legislative objectives and screening approaches could be adopted. For example, factors considered under the *Canadian*

*Investment Act 1985* could be a criterion which the South African regulatory body considers when assessing proposals. South Africa could also potentially adopt the negotiation model which ensures that there is no bad publicity associated with the rejection of proposals. Further, the South African government could also look to the local regulatory systems for domestic investor. South Africa is particularly strong in competition law and as discussed previously competition law in South Africa is regulated by the Competition Act, the Competition Tribunal and the Competition Commission all under the administration of the *Competition Act 1998*. The purpose and function of these recently reformed regulatory bodies meet the specific needs of South Africa's economic objectives. Therefore, it is suggested that this may be another appropriate administrative body to look to for guidance.

## VI. CONCLUSION:

In reviewing, the regulation of inward FDI in South Africa the paper began by defining FDI both globally and within South Africa and provided an explanation of the three main methods of FDI and their implications. Factors that impact on the success of FDI policy implementation were then followed by a discussion of the tumultuous history of FDI in South Africa and the unpredictable levels of investment over the last 10 years. South Africa's indirect model of FDI regulation consists of indirect legislative regulation, competition regulation, and bilateral investment treaties. It was acknowledged that changes need to be made as the current model lacks the critical economic development focus necessary to meet current government policy expectations. Other recommendations were considered including the formation of a new BIT model, a developed model investment chapter to be included in future trade agreements, and the introduction of a developing country-driven multilateral investment treaty. These recommendations however required a greater level of flexibility to ensure that the South African government has the capacity to review FDI proposals on a case by case basis ensuring a primary focus on the country's best interests and sustainable economic growth

The paper looked to the regulatory frameworks of Australia and Canada for guidance as these countries have previously moved from indirect FDI regulatory models to more direct approaches as a result of community dissatisfaction with previous screening processes. The purposes, processes and powers of the review bodies governed by the *Foreign Acquisitions and Takeovers*

*Act* 1975 and the *Investment Canada Act* 1985 were deemed relevant and highly instructional for the development of future South African investment policy. Finally it was recommended that South Africa should consider a direct FDI regulatory body that provides a screening process for foreign investment. It was suggested that in establishing this body guidance could be gained from the Australian and Canadian models as well as South Africa's local competition regulations.

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State, Corporation and Individual under Economic Globalisation**

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**Laurence Boulle**

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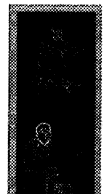
**MANDELA INSTITUTE**

# **Swaying to the Rhythms of the Global Beat**

**State, Corporation and Individual  
under Economic Globalisation**

**Laurence Boulle**

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**Swaying to the Rhythms of the Global Beat**  
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# **Swaying to the Rhythms of the Global Beat**

## **State, Corporation and Individual under Economic Globalisation**

### **1. Introduction**

The Mandela Institute in the School of Law was established to develop knowledge and skills for participation in the competitive global economy. Knowledge about the global political economy is part of a grand narrative but its subject is confusing, contradictory and restless. As regards the skills aspect a world-beating constitution and sophisticated legislation in South Africa require skills, techniques and building of capacity for government to implement policy -and ensure compliance by state and non-state actors. This is a less grand narrative of bureaucracy, administration and completing forms for licenses. The presentation deals with the grand narrative, though modestly, and you will not enjoy any building of your capacity. In fact after painting with a broad brush I shall take up an even broader one and continue painting, or at least brushing.

In so far as the presentation delves into matters of economics views are expressed with great diffidence and reservation by a lawyer, and one trained in a place other than Wits. In relation to economics I feel as a teacher said in my school Latin report which advised my parents that there were many gaps in their child's ignorance.

As explained in the marketing this presentation examines some features of globalization and its implications for the state, the corporation and citizen, and for their relationships with one another. It also boasted of pointing out 'key paradoxes' in the globalization project and how law and the legal process might be dealing with them. I have since discovered many paradoxes that have become tails wagging dogs. In other words the subject-matter is complex, uncertain and without neat conclusions.

#### **1.1 Globalization and Discourse**

A brief word is needed on language and terminology. Jeoffery Whian, in *How Mumbo Jumbo Conquered the World*, spoke about the deterioration of language and meaning under conditions of globalization. He had clearly attended one inaugural too many. However he noted that in politics, marketing and the media there has been a serious adulteration of language through spin, clichés and hyperbole.

Of course everyday language has changed in the wake of the global financial crisis (GFC). Please indicate how many of you still use the following expressions in the same sense did a few years ago – be honest now:

- As safe as houses
- You can bank on that
- It's too big to fail
- The luck of the Irish
- The markets will decide
- A Greek tragedy

The only winner is the last on Greek tragedy – if Sophocles were alive he would be focusing on the financial drama of sovereign debt instead of the psychological drama of Oedipus and Elektra.

So the language we use in discussing globalization frames a dominant view of reality and affects perceptions and behaviors. Discourse contributes to the reality we experience. Here are some examples of the framing effect in globalization talk.

First is the notion of free trade, a central concept in globalization speak. This is usually taken to mean the absence of government regulation in the movement of goods and services across national borders. The concept would have a different complexion if we meant by free trade voluntary, consensual and negotiated exchanges over goods and services and their prices.<sup>1</sup> True free trade would have these attributes at the level of private exchanges between corporations and institutionally in trade treaties. In reality much trade and commerce in economic history has been a result of notoriously oppressive treaties or coercive and exploitative encounters. It has been free in only one sense of the word.

Secondly we speak of trade as though it has one obvious meaning. But what really constitutes international trade? In reality more than 40%, and increasing, of what we call world trade takes place among the constituent parts of transnational corporations. When we talk about globalization increasing international trade we are dealing in part with increased trade within corporate structures which happen to flow across political boundaries. We speak about cross border trade but practice in part intra-corporation movements.

Thirdly are other phrases which have particular connotations in the globalization debate: protectionism is a word of great vulgarity in international economic law, whereas it could denote promotion of local employment, economic refugee has a more negative connotation than migrant labour, and so on. All discourse has value assumptions which narrow debate and sometimes new language is required to broaden the conversation. In short the language we use about trade, globalization, the corporation and so on has significant impacts on our attitudes towards and evaluation of these forces.

Finally there is paradox in the discourse used in measuring globalization. The system implies reductions in the significance of the nation state in a global market of goods and services, finance and shopping. However the measurement of globalization's successes and failures is predominantly made in terms of nation states and much less in terms of corporations, industries or employees. South Africa as a trading entity is evaluated in terms of cross-border flows of investment capital and goods, balance of trade figures and the like, and much less in terms of their domestic impacts within the country. In reality in early 2010 South Africa surpassed Brazil to top the global Gini-coefficient table which measures discrepancies of wealth within countries. This is as real, although less visible, a measure of globalization to what crosses the country's borders.

## 1.2 The law perspective

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<sup>1</sup> See Frank Garcia, 'Is Free Trade "Free"? Is it Even "Trade"? Oppression and Consent in Hemisphere Trade Agreements' (2007) 5 *Seattle Journal for Social Justice* 505.



My perspective is a legal and not an economic one, and sadly also not a musical one. It assumes the significance of law's normative ordering of social and economic systems in providing standards for the evaluation of institutions, processes and practices. All social discourse takes place in the shadow of law's norms and standards of legal rationality enjoying a privileged societal status. The jurist Joseph Raz says that legal systems are distinguished by their comprehensiveness – 'they claim authority to regulate any kind of behavior' – and they claim supremacy over other normative systems in society.<sup>2</sup> Law thus holds influence as a force for social change and if it takes up a particular position on an issue it can be expected to influence to some extent the shape of other forms of social discourse and resultant behavior, whether political or economic, social or cultural.

Law's rights emphasis makes it less utilitarian than economics or politics and is associated with rule-based governance and the Rule of Law. It is also concerned with the composition of governing authorities, the distribution of powers among them, their decision-making procedures, rights and duties of those subject to their rules, and rationality, reasons and accountability. All these have potential influence on the global economy.

However in reality law's practical province is a limited one. It not only concedes areas of activity to market behavior but is silent, inconsistent or impossible of implementation in many respects. It is concerned more with means, in the form of reasonable and rational procedures, and less with ends, on which it is inclined to defer to political and economic outcomes. Law in fact delegates to markets extensive areas of autonomous operation and itself sometimes mimics economic reasoning, without the mathematics. But the law-economics tension is ever present: some aspects of the World Trade Organization, such as the anti-dumping agreement, have a real legal foundation but are viewed with skepticism by economists.

In the current context the question to be addressed is the extent to which law brings its three R's, rights, remedies and rationality, into the discourse and practice of economic globalization and the state, the corporation and the citizen.

Now the present legal regulation of globalization is a complex spaghetti bowl of rules and principles emerging from many sources. At the global level law comes in two varieties: positive rules which provide specific directives on rights, duties and procedures, so-called 'hard law'; and principles which express more abstract and flexible values or required conduct and their consequences, so-called 'soft law'. Hard law has a juridical quality and can be enforced, while soft law is more in the nature of non-binding guidelines or codes of conduct. At the global level legal regulation is largely soft law – it has no teeth though it can gum you to death

### **1.3 The Globalisation Beat**

The globalization project is part of the grand narrative and provides the dominant beat for all things subject to it.

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<sup>2</sup> Joseph Raz, *Practical Reason and Norms* (OUP, 1999, 150)

Globalization means different things to different people and has legal, economic, social and cultural dimensions. Here the focus is on the economic dimensions of globalization, despite the Latin point, and not on the social or cultural aspects. Nor shall I be considering where or not globalization is a good thing. This is a faulty question, like asking if the wind is a good thing. For sailing a boat or developing a wind farm it is, for a game of tennis or a beach wedding it is not. Globalization, of course, has only tenuous connections with tennis or beach weddings.

Economically globalization is an extension of market economics in nation states to the international level. In the 'Washington consensus' sense it involves removing or reducing barriers to goods, services and capital flowing across political borders. It is a mixture of elements such as the lowering of tariffs on imported textiles, the removal of exchange controls on for foreign investors, the privatization of formerly state-run enterprises as being considered for SA ports, and reduction of state subsidies across the board, including tertiary education. There are of course big exceptions to the global musical score, such as the extensive agricultural subsidies in the United States and European Union. However it is too soon to introduce discordant notes into the globalization melody.

Neoclassical economics lays claim to a scientific basis as regards its theories and practices. It is about rationality and choice, the maximization of individual self-interest, and competition among market actors – all these make up a model, or did until recently, that maximizes efficiency, individual welfare and the common good. This model of economic thinking involves ethical minimalism, though moral hazard does find a place in economic texts. In fact mainstream economics is imperialistic in nature and asserts its policies in areas where culture, religion, ethical codes and politics formerly ruled. This is easier at the global level where culture and ethics are fragmented and inconsistent. However law's normative claims can conflict with economics' imperialistic ambitions.

Needless to say recent economic turbulence has challenged the dogmas preached by bishops and cardinals in the church of fundamentalist economics. Some have defended their doctrine but are not secure in the face of new articles of faith emanating from protestants and revivalists, apostates and various mad monks in the church of latter day economists.

Other traditions in economics assume models of human behavior based on the unhelpful premise that humans do not always pursue self-interest, they are prone to illogical reasoning and behavior, and that supply and demand are manipulated by powerful economic actors. Traditions such as behavioral economics challenge many basic principles of economic thinking, such as price elasticity of demand and comparative advantage.

We shall leave those debates for the more pressing question of who is responsible for the governance of economic globalization. There is no shortage of governance institutions as globalization has an extensive legal architecture. It is a complicated one designed, like the camel, by many proverbial committees, but without the efficiency of the Gautrain.

Nonetheless we have in the trade arena the World Trade Organization as a pre-eminent global institution and on the economic development side the World Bank and various UN organizations. The latest G-club, the G-20 group of nations, rose from obscurity to prominence during the crisis and anointed the Financial Stability Board and the International Monetary Fund as key institutions for future financial stability. These were the same bodies that failed in the financial stability stakes on the last occasion, but one does not want to be

negative. The FSB has connections with the World Bank for International Settlements and many other emerging international financial institutions, greatly increasing employment opportunities in exotic locations.

Nation states concede parts of their sovereignty to the international institutions for the sake of conformity and consistency, or because they have no choice. The institutions in turn make some concessions to national sovereignty, particularly in relation to developing country needs and during times of economic turbulence. The concessions can be highly contentious and there is suspicion that national economies will act in protectionist ways, in the vulgar sense of that word, where they can get away with it.

The international institutions promote two key economic and legal principles. The first prevents a country from providing benefits to another country with whom it has a treaty relationship and not to others in the same treaty system. South Africa cannot lower tariffs on sarongs imported from Thailand and fail to do so on those from Indonesia. This is the most-favoured nation (MFN) principle which prohibits a country discriminating among its trading partners. The second prevents a country from discriminating between locally produced goods and services and those imported or introduced from abroad. South Africa cannot impose more stringent environmental standards on Australian miners than it does on South African miners, even if the former are encroaching on Mapungubwe. This is the national treatment principle.

The two principles create substantive rights in international law. However critics of the world trading system argue that they privilege cross-border trade over domestic matters such as health, the environment and local culture. Where a country claims health and environmental exceptions they not only have to satisfy a necessity test, which is onerous in itself in requiring proper means to an end, but it also has to be applied and impact in a non-arbitrary and non-discriminatory manner. There are other principles in the global political economy such as transparency, proportionality and reciprocity, and separate and differential treatment for developing countries, but these will not be on this evening's exam.

While there are institutions and principles of governance in globalization, there is no government in the conventional sense of the term. There is also in the existing institutions a major democratic deficit. For example there are structural shortcomings in the composition of these bodies and their lack of electoral mandates. At a deeper level the democratic deficit is a product of difficulties in having citizen preferences reflected in their representatives' roles in international bodies. Rather it involves the distortion of popular sentiment as it is dissipated en route to the highest decision-making levels of foreign affairs.<sup>3</sup>

This then is the global beat, and the question arises as to its implications for the state, the corporation and the citizen. What discretions do they have to swing to a different rhythm?

## **2. The State under globalisation**

The globalization project has had significant implications for nation states, although as with most of contemporary life these are contradictory in nature. There are also competing notions of the modern state as between liberal democracies and social market democracies, as there are between market capitalism and state capitalism. However there are four consistent themes

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<sup>3</sup> See M Chinen and Lana Ellis, 'Matters of Preferecne: Tracing the Line Between Citizens, Democratic States and International Law' (2010) 19 *Transnational Law and Contemporary Problems* 419.

in relation to the state under globalization. They are reciprocity, subordination, reliance and resilience. They show that globalization is not really that different to raising a family. As Oliver Mtukudzu has expressed it [[Mtukudzu]]:

## **2.1 Reciprocity**

Traditional international law involved a surrender of jurisdiction by individual states to collective international institutions and laws in terms of a reciprocal social contract concept. This occurred mainly through international treaties and conventions in everything from customs and investment to refugees and cheese. For example South Africa is a member of the World Trade Organization and party to nearly 100 bilateral investment treaties and many other treaties in agriculture, aviation and maritime law. In each case there is mutual relinquishment of policy-making and enforcement powers to supra-national bodies.

The state, as opposed to the corporation or individual, has traditionally been the subject of international law, as well as the bearer of rights and obligations. The reciprocity aspect is found in the joint involvement of nations, nominally as equals, pursuing through consensus decision-making joint interests and policies. This is like five-day cricket between well-balanced teams where the lack of a result is less important than the spirit of the game. However this approach has been turned on its head by the development of economic globalization where the reciprocity and gentle surrender of sovereignty are replaced by a more forceful global order. This is T-20 cricket where there will be a result, quickly and effectively, then on to the next one.

## **2.2 Subordination**

The market system and globalization have limited the power of the state well beyond that of traditional international law and without the genteel implied consent of yesteryear. This is part of the imperialism of macro-economics. Both the non-discriminatory MFN and national treatment principles restrict domestic policy space in relation to trade preferences, local businesses practices and social policy.

Moreover the market system effectively reduces the state's control over monetary policy as independent central banks and financial institutions, and not governments, determine the supply of credit and money. The economist Mankiw refers to the 'financial trilemma' (yes there is such a word, going back to 18<sup>th</sup> century discourse) which faces countries when dealing with apparently sovereign choices among three options, each having some inevitable problems. For example a country may wish to (i) open its economy to international flows of capital, (ii) use monetary policy to stabilize the economy, and (iii) maintain stability in the currency exchange rate.

However the trilemma is that once a country selects two of these options the logic of economic forces compels it to forgo the third. South Africa has selected the first two, being relatively open to international capital flows and having the Reserve Bank adjust interest rates to regulate monetary aspects of the economy. However it has difficulties with the value of the rand which is currently rising beyond its most appropriate value for domestic economic purposes and to which Minister Trevor Manuel referred at the NGC last week as a naughty schoolchild. At least I think the reference was to the currency.

China, by contrast, controls monetary policy and the value of its currency, but has to restrict the cross-border flow of capital because liberalized capital flows would jeopardize the other two. European countries such as Greece have foregone control of monetary policy in relation to the euro, again in favour of the other two options. Other trilemmas involve South African demands to increase meaningful employment, attract investment and make the labour market more flexible. Again not everyone can be a winner and the IMF reported last week, in its dry form discourse, 'Noting the sharp increase in unemployment resulting from the economic slowdown. Directors encouraged the authorities to reexamine labor market institutions, in particular with a view to reduce any policy distortions...' This is IMF mumbo... code for wage reductions, easier retrenchments and lower work conditions. The trilemmas involve difficult political choices for any government as is apparent in the Western Cape where 15000 textiles jobs are at imminent risk, partly a result of tariff reductions.

Globalization also imposes constraints on fiscal policy as countries outbid one another in lowering tax rates to attract foreign investment. A book on the subject [S] has found that if corporate tax rates continue to decline as they have over the last two decades companies will soon pay no tax at all. South Africa has experienced this pressure from Mauritius in recent years as the island state attempts to attract the headquartering of foreign investors intent on moving into African markets.

In short the big G hollows out not only the policy space formerly inhabited by domestic institutions but also reduces the nation state's levers of economic manipulation. Although causation is difficult to prove, there is a correlation between these realities and political trends in developed countries: low voter turnouts, the rise of independent and single-issue parties, converging tendencies in political ideology and destabilization of governments through hung parliaments. There is much less actual politics in many developed countries and elections are contested over who is the best economic manager, or has been involved in fewer scandals.

The low-point in state subordination is found in countries in the Americas, the Pacific and Africa which are referred to as 'failed' or 'failing' states. This means these state systems are simply unable to perform necessary activities in law enforcement, revenue collection or service provision. Even in developed economies national debt is having profound implications for the roles of the state in traditional government functions. These are all manifestations of the subordination of state systems under conditions of globalization.

### **2.3 Reliance**

For all its grand narrative pretensions, economic globalization relies intimately on the nation state. To push the metaphor a bit, many of its musical instruments are played by domestic musicians.

The reliance factor occurs for two reasons. First there are functions which in terms of current institutions cannot be dealt with at the global level; and secondly there is need for the state legal infrastructure to support the edifice of globalization. In practice many aspects of the globalization project are supported through the laws, procedures and courts of nation states, in particular competition law, securities regulation and corporate governance where there are no global institutions with enforceable powers to deal with these matters. Most of the post-crisis re-regulatory legal events have been a function of state and not international legal

actions. Social security, unemployment insurance and superannuation schemes can also only operate at state levels.

Even where there are global norms, as in intellectual property law, reliance is placed on states for monitoring, investigative and enforcement purposes. Here the state is more a vehicle for enforcing global norms than an autonomous actor, regardless of the formal nature of its treaty obligations. It plays another instrumental role in globalization in relation to citizenship and labour, referred to again later. The state is also important at the level of symbol interaction. It is, or is perceived to be, a source of democratic participation, which is absent at the global level. The state is the place where politics is played out, where rules of inclusion and exclusion are determined, where social policy is made when there is space for this in the margins of globalised norms. This engagement has a symbolic value which indirectly supports the globalization project. It is reinforced by the role of representative governments in legitimizing globalization, which again reinforces its survival and continuance.

## **2.4 Resilience**

The reliance factor contributes to the resilience of state systems and their continued significance under conditions of globalization. Here it is necessary, as there is no other place, to mention the emergence of new nation states in the global political economy. The BRICs countries, soon perhaps the BRICSA, have asserted a new collection of interests into the global political economy. Where responsive to their own economic constituencies these states have challenged and changed international policy agendas and might yet modify actual policy. While always susceptible to co-option by more powerful forces they have created some space to rethink aspects of trade policy, the nature of investment treaties and the role of the state in economic systems.

State resilience has forced changes in dominant patterns of economic globalization and its harmonizing tendencies. These include accommodating sovereign wealth funds and state-owned enterprises, coming to terms with the reality that global finance comes increasingly from emerging states, making space for Islamic banking and finance, as well as for FIFA, and accepting that authentic multilateralism requires concessions to developing states. Two economies currently in full throttle, manufacturing rich China and services rich Singapore, have extensive state involvement in most economic sectors. While these points should not be over-stated, Brazil, with state-owned Petrobras just achieving the largest share offering in financial history, and Russia, through its state champions, have similar features in their economic systems.

In short the globalization score sometimes allows the contemporary state to play its own tunes, and even embark on the occasional impromptu of its own.

## **3. THE Corporation under globalisation**

There are again four themes to the place of the corporation under conditions of economic globalization.

### 3.1 The corporation as beneficiary

From modest beginnings as the limited liability company, modern corporations bestride the global stage, full of sound and fury, signifying everything. Corporations generate wealth, provide employment and contribute taxation revenue. They also pursue profit, operate competitively and avoid responsibility where they can. We love their innovation, sponsorship and the consumer goods they produce, and deprecate their environmental, labour and call centre policies.

The transnational corporation has been a major beneficiary of many aspects of the globalization project. The reductions of cross-border legal barriers for movements of goods and services, as well as in finance and investment, have operated to the benefit of many transnationals. The restrictions of comparable liberties for individuals, referred to later, have also worked to their benefit. There are many illustrations of these tendencies.

One is found in the global supply chains which many large corporations operate. These might procure components in Ireland, assemble in Korea, market in India, customer care in the Philippines and head office in the Netherlands. Wherever there are no binding international laws the differences in local regulatory standards provide scope for transnational companies to choose from legal regimes which are most beneficial to their profitability. This is known as regulatory arbitrage and extends to incorporation itself. In the European Union German companies began incorporating in the United Kingdom to take advantage of lower capital requirements in that jurisdiction. Arbitrage also benefits transnationals in relation to tax obligations, conditions of employment, environmental standards and corporate governance requirements.

As indicated above the traditional unit of international law has been the nation state, but in some areas the corporation now sits at the table as an equal with global institutions in international activities. For example corporations now have places in formal institutions such as the Bank for International Settlements in Basel, Switzerland, and the World Intellectual Property Organisation in Geneva, Switzerland. This is quite apart from the corporate influence in non-official but powerful bodies such as the Davos forum in, err, Switzerland.

A local example of corporations assuming rights and remedies in terms of international law is in relation to investment disputes between foreign investors and host countries. Here Bilateral Investment Treaties (BITs) allow investing corporations to bring proceedings for compensation against host states. These are international law disputes in which corporations sue sovereign states. While this capability preceded the globalization project its practice has escalated extensively in recent years.

South Africa has experienced this unobliging irritant recently with a damages claim brought by Italian and Luxembourg investors against the state. Foresti, the foreign investor, alleged that state interventions in the form of the Mining and Petroleum Resources Development Act amounted to expropriation of their investments by imposing BEE policies in the mining sector. The BEE obligations were imposed on a non-discriminatory basis on all mining companies, domestic and foreign, and required them to transform 'old order' mining rights into 'new order' rights. This was subject to compliance with share divestitures, transformative employment policies and equity procurement commitments. After costs of about €5 000 000, or a lot more rand, on each side, for the attention of shareholders on one

and taxpayers on the other, the investors abandoned their claim. South Africa recovered about € 500 000 of its costs. This showed the potential leverage which corporations have against sovereign states, although the withdrawal of the claim spoiled the party and the arbitration did not get to adjudicate on the compatibility of BEE with South Africa's international obligations. This is a potentially momentous issue for the industry which awaits resolution.

In the World Trading Organisation, by contrast, only nation states as members of the organization can bring and defend claims relating to trade matters. It's difficult to give a South African example from the system because the country has never been involved in a trade dispute on the banks of Lake Geneva. So let's assume a fictitious dispute, involving South Africa's wine exports to China. China imposes higher tariffs on SA merlot than that from another WTO member, New Zealand.

However appearance and reality do not entirely coincide in this context. Where South Africa brings a complaint that China's laws or practices on wine imports are in breach of its treaty obligations, the nominal parties are the two states. In reality they are proxies for businesses or industries which lose or gain from the disputed measures, for example wine manufacturers in each country. In a famous WTO case involving bananas exported to Europe the complaint was brought by the United States which is not even a banana exporter. However it acted on behalf of its corporations operating in Central America which claimed to be affected by Europe's discriminatory import policies. This case was commenced in 1996 and an agreement was announced in June this year, requiring constant adjustments in the fruit's use-by dates.

The examples suggest that globalization increased the authority and power of transnational companies on the international economic stage. This is amplified by the ability of corporates to influence state policy, lobby politicians and fund political parties, and to control regulatory processes, referred to in the literature as regulatory capture. There are valuable prizes for large corporations in regulatory capture, at least in the short term, particularly if there is truth in the view that the Mobil corporation captured US regulatory policies in relation to deep-water off-shore drilling. The literature also provides examples of transnational corporations acting as private law-makers, for example in a case study on Wal-Mart activities in Germany. As this transnational company, currently the largest in the world, establishes in different countries it includes in its business model its own laws for employees, unions, suppliers and other entities, including mechanisms for the administration and enforcement of these rules. Until law according to Wal-Mart is challenged in domestic courts it is as effective as law emanating from parliamentary institutions.

Thus the combined corporate report card, unlike the Latin report, indicates that they are doing well – of the 100 largest economic entities in the world 45 are corporations and 55 nation states. The largest is the same Wal-Mart, about to become larger by swallowing Game and all its subsidiaries in Africa.

In the light of these factors the celebrated economist J K Galbraith in his last book, tellingly titled the *Politics of Innocent Fraud*, suggested that contemporary economic systems should not be referred to as the market system but as the corporate system. We could correspondingly refer to the nation-state as the market state. As shown later citizens and workers do not enjoy arbitrage, regulatory capture and law-making opportunities which avail some transnational corporations.



### **3.2 The corporation as casualty**

Globalization has not only put transnational corporations in the driving seat, it has also subjected them to the pot-holes and Jozi taxis of international competition. The competitive forces unleashed by globalization have impacted on the viability and autonomy of many companies. During normal times competitive forces make companies susceptible to hostile take-overs, loss of market share, regulatory intervention and protectionist tendencies by foreign states. During the global financial crisis banks, insurers, car manufacturers and other global operators went to the wall or were fundamentally reshaped through state intervention.

While regulatory arbitrage is a beneficial side of the coin, there is another burdensome side for even the best-governed company. Some of it is technical and legal: transnational corporations have to comply with different competition laws in countries in which they operate. Some of it shows how advantages are not all they seem to be: despite corporations being able to hold nation-states to account in investment arbitrations, in reality they succeed in fewer than 50% of these cases. Moreover the enhanced options for corporations generally entails inevitably that some will go to the wall, the consequence of competition made more intense through its global dimensions. Not everyone can be a winner, except in Bidinvest commercials. The Minister of Trade and Industry referred in 2010 to the need for the SA government to assist the prospects of local textile companies, delicately not using the protection word in his discourse. International harmonization of standards in banking, the environment or health can also disadvantage small corporate players for whom the standards are too burdensome and expensive.

### **3.3 The corporation as subject**

Reference has been made to some of the legal and economic rights accruing to corporations under globalization conditions. There is generally an asymmetry between contemporary corporations' rights and duties. Economic globalization is not without some obligations on transnational corporations in pursuit of various models of corporate social responsibility. These tend to be of the 'soft law' variety, such as the OECD's principles for multinational companies or the International Chamber of Commerce's guidelines on investment. In the absence of mechanisms of enforceability, transparency and accountability in relation to the obligations their effectiveness is dependent on self-regulation, consistent with market assumptions and the invisible hand, which in post-crisis conditions might better be called the amputated hand.

There are, however, limits to these 'good global citizen' projects. CSR has plenty of critics, particularly from developing countries. Some argue that it detracts from the true functions of corporations in economic systems. Others contend that it allows governments off the hook in terms of their social responsibilities. There are also arguments that it is more cosmetic than real. Some accountability was anticipated for US corporations under the Alien Torts Act for activities in Nigeria, the DRC and Ghana, but a judgment last week involving Chevron has undermined these expectations. Generally international criminal has had difficulties in subjecting corporations to criminal justice systems in the same way as it has citizens.

#### **4. The Citizen under globalization**

How is the citizen swinging to the global beat? The literature refers to us as now living in the 'risk society'. This means people are confronted with innumerable decisions and choices which did not face our counterparts a generation ago. Some of these are a result of globalization in goods and services. For those with the ching ching choices are available in relation to fashions and fads, and also in deeper structural issues relating to life-style. The market society presents choices in relation to financial products, pet foods, vacations and cosmetic surgery, and shortly in the genetic make-up of children. All choices bring responsibilities and risks for the individual.

Risk is accentuated by businesses forcing consumers to perform more of the functions previously provided for them. This started in supermarkets where fetching and carrying became customers' responsibility and followed in the fast food industry where table service and waste disposal were performed by customers. It now extends to online booking services, airline check-ins and innumerable other consumer activities. The shift of functions also involves the shift of risk to consumers and customers engaging in these services – errors, misunderstandings and faulty technology rebound on the consumer and not the service-provider. Even in the provision of state services we have become consumers in the market of services.

Individuals' relationships with the nation state are traditionally captured in the notion of citizenship. This denotes a package of legal, political and social rights and responsibilities. Citizenship is also about inclusion or exclusion from the body politic, the economic system and social belonging. It can have drastic consequences for those without it. Currently non-citizen Zimbabweans in South Africa are being required to apply for documentation or face deportation.

While citizenship involves a relationship with the nation state, in international law natural persons have not traditionally been bearers of rights and responsibilities. This is despite international law's strong focus on human rights in the last half century. International conventions on different forms of rights are aimed predominantly at nation states which assume duties and obligations in terms of the various treaties. Rights and remedies only accrue to individuals when states incorporate treaty provisions into domestic law or where courts apply norms of customary international law in their judgments.

Economic globalization does not significantly modify these principles. It provides no supra-national citizenship, however much people who attended the World Cup might regard themselves as citizens of the world. There have been some exceptions to the pattern. The international law of the European Union allows individuals direct access to the European Court of Justice whose decisions are binding on member states. In the event of a cross-border investor being an individual and not a corporation they too could bring claims against host nation states. Global criminal justice applied through the International Criminal Court also adjudicates on the liability of individuals, including heads of state. In these respects natural persons have attained some degree of rights and responsibilities in the international domain.

However there is no emerging concept of citizenship at the global level, other than in terms of increased market choices flow across political boundaries in what is sometimes referred to economic democracy, or credit card democracy. In some respects economic globalization has

left citizens in a mid-20<sup>th</sup> century world while bringing goods, services and capital (GSC) into a 21<sup>st</sup> century environment. While globalization reduces the significance of political boundaries for the movements of GSC, for natural persons these kinds of liberalization have not ensued.

While globalization has involved the deterritorialisation of economic and political space it has in some cases reinforced the territorialisation of citizenship. Movements of people are still subject to political, legal and physical controls that have been removed in relation to the GSC factors. Where manufacturing industry relocates in terms of a transnational company's global supply chain, labour cannot follow in its wake. Mobile capital + immobile labour = corporate arbitrage. The globalization project while not explicitly based on restrictions on people movement benefits from it.

The European Union again has exceptions in allowing free movement, residence and employment of citizens of one member state in the jurisdiction of another. However while there is increased internal mobility it is currently more difficult for those outside Europe to gain entry, as you have experienced queuing for your schengen visa. The boundaries are not only legal but also physical: in recent years about 7500 kilometers of physical barriers, much with floodlighting, have been built to prevent movement of people across borders. This is one manifestation of tightening migration laws and policies in the last decade, which has become even more stringent recently in many OECD countries. From France to Australia the strident rhetoric of 'border control' has echoed coldly through political hallways. In South Africa, by contrast, migrants have experienced a relatively more open door, or at least open fences. However recently Tanzania, one of Africa's poorest countries, more deliberately conferred full citizenship rights on 160 000 Burundi nationals within its borders. This might be the spirit of Ubuntu. It deserves at least a shout of Ayoba.

For skilled professionals migration is less problematic and can amount to a vast subsidy by developing countries to the developed world. The brain drain is a particular problem in the health sector, with evidence of more Malawian doctors in Manchester than in Malawi. Although Africans migrate less than inhabitants of other continents, and do so mainly within Africa, the same cross-subsidisation operates within countries and regions of the continent. For these reasons SADC has been working on anti-brain drain protocols among members.

In this context law provides not only a normative order but also a positivist order that has real consequences. Legal labels such as 'illegal resident', 'alien', 'refugee' and 'asylum seeker' have significance, nationally and internationally, in relation to the movement, residence and rights of people. They denote insiders and outsiders and for the latter lead to criminalization, punishment and deportation, even for those making the same rational economic choices as corporations. The principles of most-favoured nation status and national treatment which apply to goods, services and investments do not generally avail individuals, unless they are excellent soccer players. While globalization is based on non-discrimination and inclusion in some respects, it discriminates decisively between insiders and outsiders in others.

There is some beneficial international regulation of movement, for example in relation to human trafficking, child labour and the rights of refugees. However breaches of these treaties do not afford much in the way of realizable rights and remedies for individuals. Moreover there is no international governance in this area, such as a WTO-like body with mandatory jurisdiction, and this aspect of the global political economy is predominantly within the sovereign domain of states.

In short the citizen as consumer has benefitted from globalization's expanded market choices. As holders of rights and remedies he and she have been swayed, but less rhythmically and more drunkenly, to the globalization beat.

#### **4.1 Practical law under Globalization – The Paradox of the Fishing Commons**

The story thus far is that globalization has fragmented international law and subordinated national law, benefitting some and disadvantaging others. At the same time it has aggregated many contemporary social challenges which can only be dealt with at an international level: carbon emissions, public health, species preservation and international crime. Fragmented law facing aggregated problems means that interaction among relevant legal regimes is a necessity or collective problems will remain unaddressed.

Let's see how this might operate in relation to the humble fish. Last year I saw a coelacanth for the first time at Wits but Google had nothing on the coelacanth and globalization so it has no further part in the presentation.

Market economics concedes the need for regulatory intervention in the provision or preservation of public goods. Public goods are those in which supply and demand forces do not operate because the goods are either available or they are not and it's not possible to particularise who is benefitting from or should pay for them. The theory of public goods concedes limitations in invisible hand theory, the notion that the markets auto-regulate without need for state intervention.

Societal security and public health are examples of public goods in that avian flu and foreign invasions affect all without consumers being able to pick and choose according to brand. They are appropriate for state intervention and individuals have an expectation of them as attributes of citizenship. Public goods are either directly provided by the state, as in relation to water and the army, or delegated to private enterprise for provision under close state regulation, such as prisons and toll roads. In an interconnected world there are more global public goods than even before, so if regulatory intervention is needed it will require the combined interaction of different legal regimes.

The oceans and marine biodiversity are an example of a public good. A documentary called *End of the Line*,<sup>4</sup> soon to be released in South Africa, contends that the abundance of large fish globally has declined by about 90 per cent. While the collapse of Atlantic cod stocks in the mid-1990s is well known, other species such as blue fin tuna and kingklip are in danger of extinction while stingrays and jellyfish are exploding in numbers, providing a different meaning to fish and chips discourse. In simple terms too many fishers are going after too few fish. As bumper stickers should say, 'Save a blue tuna, eat a vegetarian.'

This conundrum is sometimes referred to as the Tragedy of the Commons, a term first used by Garret Hardin in 1968. This was a parable about the logic of individual farmers having a self-interest in grazing an extra cow on the commons, until the commons was over-grazed to every farmer's detriment. Aristotle had much earlier noted that 'what is common to the greatest number has the least care bestowed upon it'. Common resources are disproportionately ruined by some individuals guided by human greed in pursuit of their

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<sup>4</sup> Based on a book by Charles Clover.

interests, and with no awareness of how harmful their acts are to the entire society.<sup>5</sup> The trick is that the entire collectivity finally shares the burden of negative consequences while individuals have reaped the benefit and left for Auckland.

Preserving fish stocks and marine diversity is a global problem and the question arises as to the appropriate political, economic and legal responses to it. Fishing intersects national, regional and international levels and involves trade, the environment and economic development. As usual there are different interests and views on the subject.

Market economists contend that one of the contributors to the problem is global fishing subsidies which amount to \$ 25 billion a year, constituting about 25% of the value of the fishing industry.<sup>6, 7, 8</sup> The subsidies allows fishers to fish further, deeper and longer than if they were not subsidised. Economists argue that this is an inefficient system as it involves the subsidization of externalities and over-capacity of fishing boats. The resultant over-fishing distorts supply-demand curves. The subsidies, the argument goes, involve net economic losses despite short-term benefits for some fishers, consumers and economies.

Environmentalists contend that problem requires extensive fishing prohibitions without which diversity and sustainability will not be possible. This needs to operate on a coordinated basis among national, regional and global authorities.

Emerging states argue for differentiation between developing and developed countries<sup>9</sup> and between local off-shore fishing which should be subsidized and commercial and industrial fishing on the high seas which should not be supported.

Fishers contend that this is a matter of subsistence, livelihood or business, depending on how big their boats are. How do these considerations come together in the development of a good policy? The answer is that under current globalization conditions they don't. In some respects there are too many agencies involved with too little activity.

Some of the bodies involved in fishing policy at the international level are the WTO, the World Wildlife Federation, an NGO called Friends of Fish and the UN Committee on Trade and Development. Numerous bodies are involved in fishing policy at the regional, bilateral and national levels. They range from commercial fishing groups demanding, and state governments supporting, fishing subsidies, to Jamie Oliver removing endangered fish species from his recipes.

The activities of these many bodies are inconsistent and uncoordinated. At the global level the WTO's interest is in the subsidy aspect and its potential breach of treaty obligations. Until the Doha Round subsidies were covered by the Subsidies and Countervailing Measures Agreement (SCM) which not lacks any sense of rhythm, but has been weak in terms of policy

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<sup>5</sup> What is a common resource? <http://www.wisegeek.com/what-is-a-common-resource.htm>

<sup>6</sup> Global Fisheries Research Finds Promise and Peril: While Industry Contributes \$240B Annually, Overfishing Takes Toll on People and Revenue. <http://www.sciencedaily.com/releases/2010/09/100914115246.htm>

<sup>7</sup> See the Beacon. Oceana holds WTO Forum on fishing subsidies. <http://na.oceana.org/en/blog/2010/09/oceana-hosts-wto-forum-on-fishing-subsidies>

<sup>8</sup> Historically the biggest OECD subsidizing countries were the US and Japan with respectively 30 and 28% of overall OECD transfers.<sup>8</sup> However not all government interventions account for actual subsidies, some being allocated to conservation. WTO Report 2010: trade in Natural Resources. p 123

<sup>9</sup> In terms of an accepted norm of separate and differential treatment,

for fisheries subsidies.<sup>10</sup> Members are continuing to negotiate, slowly, rules on fisheries subsidies and preservation as part of the continuing Doha Round.<sup>11</sup> Even as it approaches agreement on some prohibitions, developing countries attempt to secure complete exemptions from them. Many species too will have passed their use-by date by the time the negotiations are completed. Moreover the WTO has no expertise in either the economic or environmental factors in over fishing.

At the national level there is great variation in the regulatory policies and practices in fishing. It is at this level that the subsidy problem is maintained for political and short-term employment reasons. However even the best domestic regulation cannot address a global problem of species preservation.

As regards corporations they are rent-seeking bodies in this area, using influence and political favours to maintain and increase subsidies and operating without effective global supervision.

As for citizens as political actors they have very remote input into the matter. And for the citizen as consumer individual action seems insignificant, though collectivity has some potential. Last week the Southern African Sustainable Seaford Initiative (Sassi) released an updated pocket guide indicating which species are okay to eat. If you're at a fish dinner without the book you can SMS the name of the fish, or if you don't know its name, then the species of the fish, to Sassi for an instance response (079 499 8795).

In short fragmented law and the absence of global government is a major problem in responding to a predicament partly attributable to economic globalization.

## 5. Synthesis

The challenge in the final few minutes is to bring together the state and corporation, bananas and tuna, laws and economics, beach weddings and wind farms into a grand musical number.

In terms of the relationships among the state, corporation and citizen we have seen that the state has been subordinated by a proliferation of international institutions and the imperialism of economics, both of which have pushed back the borders of state power. However there are limits to this subordination because of globalisation's reliance on state systems, and the resilience of those systems themselves.

The corporation has new territories to roam under globalization but requires the state as a source of law enforcement in relation to property and contract rights, key factors in the market system. It also has an interest in limits to state power in relation to revenue collection, competition policy and various forms of regulation.

Citizenship finds expression at the national and not the global level, but its package of rights is diminished by the reductions in state power, and it is finding alternative expression through NGOs, single-issue movements and consumer activism. In frustration at the impotence of states citizens express what is called the politics of identity with ethnic, religious and linguistic affiliations becoming chosen bases for political mobilisation.

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<sup>10</sup> Kemi Lewis. Fisheries subsidies and the WTO: An EU perspective.

<sup>11</sup> WTO report 2010: Trade in Natural resources. P 15

Failed states, economic trilemmas and worrying Gini-coefficients are some of the consequences of the interaction of these forces. What are the more positive indicators?

The first is that despite its shortcomings the law and legal systems do have capacity to contribute process values in the future evolution of the global political economy. Legal procedures can require inclusiveness, information, rationality, transparency and accountability for decisions, regardless of the nature of outcomes. In this respect it can provide some discipline to the utilitarianism of market economics.

Secondly are the potential benefits of technology, about the only factor not mentioned so far in the lecture. In combination with state policy and market innovation the engineers, chemists and microbiologists have immense contributions to make in everything from sealed potholes to cleaner energy.

The third is the increased appreciation of discourse, the significance of the language we use in relation to matters of trade and investment. Glib editorials, political sound-bites and corporate public relations frame the world in partisan and self-serving ways which imply inevitable outcomes. A new world of discourse, we must insist, is dawning.

Finally the rebalancing of globalization dynamics through the rise of emerging economies, individually and collectively, must require rethinking of hallowed economic and governance issues. As a member the G-20 South Africa can contribute at least to the setting of new global agendas to meet contemporary challenges. In collaboration with other emerging economies it can move beyond agenda setting to important policy deliberations.

## **6. Tribute**

Finally I should like to pay tribute to my predecessor, Marylyn Christianson. By strange irony, I taught her at then University of Natal in Durban. Marylyn was so successful that the apprentice surpassed the master and she reached the position first. She did an outstanding job and extended significantly the certificate courses, the continuing professional development programmes, the conferences and public lectures. She also developed the partnership arrangement the MI is signing next month with the World Trade Institute in Berne, Switzerland. Given that she was a brief acting Director it is worth paying tribute to other navigators of the MI ship who have since assumed higher commands. Jonathan Klaaren is now Acting Head of School and supporter of the Institute and David Unterhalter plies forensic skills in Johannesburg and London and judicial skills in WTO's Appellate Body in Geneva. Appreciation goes to all three for their contributions to an Institute which attracts over 500 registrants a year to its certificate courses and continuing professional development programs. Hopefully some of these students will join the crew and contribute to the global beat.

And finally, on a personal note, many families are now globalised and in my case, with children in Europe, Africa and Australia and partner in Asia, I'm now looking to the Origins Centre to discover relations in Antarctica. However I'm delighted to have a son, brother and sister-in-law in one place at the same time, swinging, if only temporarily, to the Jozi beat.