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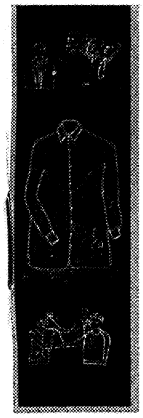
by

Cara North

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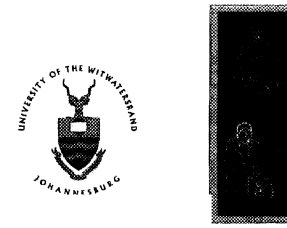


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An Examination of the Indirect Regulation of Foreign Direct Investment in South Africa

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

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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."[1] 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.[2] Today, FDI is internationally regulated by a plethora of multilayered and diverse treaty based legal frameworks.[3] 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.[4] 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.[5] As with other developing countries, FDI is suggested to be crucial to the development of the South African economy.[6] 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."[7] 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.[8]

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[1] Dr. Rafael Leal-Arcas, *International Trade and Investment Law* (to be published 2010) 176.
[2] 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.
[3] Dr. Rafael Leal-Arcas, above n, 1, 200.
[4] Ibid.
[5] See for example; *Ahguas del Tunari SA v Republic of Bolivia*, ICSID Case No ARB/02/3 See also; *Augas 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)
[6] See generally, Department of Trade and Industry, *Government Position Paper*: W*orkshop on Bilateral Investment Treaty Policy Framework Review* (2009).
[7] Ntwala Mwilima, 'Foreign Direct Investment in Africa' (2003) *Labour Resource and Research Institute* 33.
[8] See generally; Department of Trade and Industry, *Government Position Paper*: W*orkshop 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."[9] 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.[10] The three main methods of FDI are takeovers, mergers and acquisitions (M&A) and greenfields.[11] 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.[12]

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.[13] M&As have become the most popular mode of investment for foreign investors as they are favorable to

[9] Ntwala Mwilima, Above n, 7, 33.
[10] 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.
[11] 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.
[12] Ntwala Mwilima, Above n, 7, 31.
[13] Colin Kirkpatrick, David Parker and Yin-Fang Zhang, Above n 11, 143.

companies that want to "protect, consolidate and advance their position"[14] 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"[15] 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."[16] 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" [17] 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";[18]

[14] Ntwala Mwilima, Above n, 7, 31.
[15] Central Bank of Chile,'Greenfield FDI vs. Mergers and Acquisitions: Does the distinction matter?' (Working paper no, 173, Central Bank of Chile, 2002).
[16] Ntwala Mwilima, Above n, 7, 31.
[17] 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) 177.

[18] 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;[19]
- 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"[20] 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"[21] 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"[22] 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).[23] It is estimated that there are currently over 2500 BITs around the world, with more of these agreements being negotiated every day.[24] 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

[19] Ibid.
[20] Ntwala Mwilima, Above n, 7, 41.
[21] Ibid.
[22] Ntwala Mwilima, Above n, 7, 42.
[23] Department of Trade and Industry, *Government Position Paper*: W*orkshop on Bilateral Investment Treaty Policy Framework Review* (2009) 5.
[24] 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.[25] These treaties have been the focus of much debate recently with a number of countries moving towards more private direct forms of regulation.[26] Disputes arising out of these treaties will often be referred to the International Centre for the Settlement of Investment Disputes.[27]

2. *Codes of Conduct*

Further forms of regulation include codes of conduct which have been developed with a focus on bilateral and multilateral investments.[28] 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.[29] These codes of conduct are merely guidelines for countries entering into bilateral investment treaties and contain few specific binding commitments.[30] The draft code has also been used in some cases as an interpretative aid in investment disputes.[31]

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.'[32] 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."[33] ICSID contracting states are required to recognize and enforce ICSID decisions.[34]

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[25] Michael Pryles, Jeff Waincymer and Martin Davies, *International Trade Law: Commentary and Materials* (2nd ed, 2004) 1047.
[26] For example; Canada, America and Australia.
[27] 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.
[28] Dr. Rafael Leal-Arcas, above n, 1, 200.
[29] Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1047.
[30] Laurence Boulle, *The Law of Globalisation: An Introduction* (2009) 49.
[31] Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1047.
[32] Laurence Boulle, Above n 30, 49.
[33] Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1047.
[34] 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.[35] One problem identified is the level of transparency and accountability of the settlement of the investment dispute.[36] 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.[37] Consequently, several countries are now committed to negotiating "investment treaties which provide for mandatory transparency in all investor-state arbitrations."[38]

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.[39] 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.[40] South Africa continued to attract investment during the pre-sanctions era, although investment gradually slowed in the 1980's.[41] From the 1980's to the 1990's the global 'anti-apartheid based consumer boycott'[42] was largely imposed by transnational corporations operating in South Africa and had significant implications for the economy.[43] For example, "Barclays Bank's share of the student loan market,

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[35]See generally; Susan Franck, 'Empirically Evaluating Claims about Investment Treaty Arbitration', 80 North Carolina Law Review (2007) 1.

[36] Luke Eric Peterson, 'Bilateral Investment Treaties – Implications for Sustainable development and for regulation' (2007) FED Conference Report 2.

[37] The OECD Investment Committee, 'Transparency and Third Party Participation in Investor-state Dispute Settlement Procedures' (Working Paper No 2005/1, OECD, 2005).

[38]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 is 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.

[39] Department of Trade and Industry, *Government Position Paper*: W*orkshop on Bilateral Investment Treaty Policy Framework Review* (2009) 5.

[40] CUTS Centre for Competition, Above n 40, 2.

[41] Department of Trade and Industry, Above n 39, 5.

[42] CUTS Centre for Competition, Above n 40, 2.

[43] Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1047.

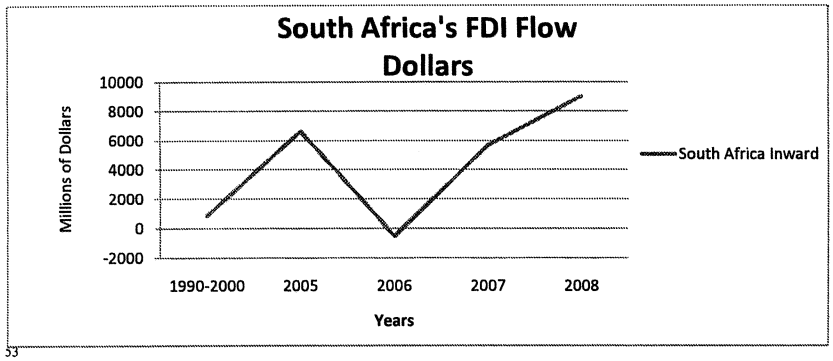
declined from 27 – 15% under pressure from socially and ethnically conscious clients."[44] As a result the, 1980's saw a significant decrease in capital "particularly following then President PW Botha's August 1985 Rubicon Speech."[45] Research indicates that roughly up to 350 companies pulled out of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

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.[47] Consequently, this period saw the introduction of BITs which globally increased in popularity and quintupled in number.[48] 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.[49] 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."[50]

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 %.[51] 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.[52]

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[44] CUTS Centre for Competition, Above n 40, 2.
[45] Ibid.
[46] CUTS Centre for Competition, Above n 40, 2.
[47] Department of Trade and Industry, Above n 39, 5.
[48] Luke Eric Peterson, Above n 36, 2.
[49] Department of Trade and Industry, Above n 39, 5.
[50] Ibid, 6.
[51] 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.
[52] 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



[53]

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.[54] It is reported that South Africa has an exceptionally low rate of Greenfield FDIs and that most FDI inflows in South Africa are "capital intensive and are directed at the already established sectors such as services and manufacturing."[55] 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. [56]

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.[57] South Africa has an extensive system of brokers, financial service specialists and merchant banks.[58] 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."[59] South Africa has easy access to the

[53] 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.
[54] Ntwala Mwilima, Above n, 7, 32.
[55] Ibid.
[56] Colin Kirkpatrick, David Parker and Yin-Fang Zhang, Above n 11, 143.
[57] 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.
[58] 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
[59] Ibid.

Southern African Development Community (SADC), which consists of 15 countries containing a total population of over 180 million.[60] 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"[61] 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.[62] Since the 1980's, the South African government has significantly relaxed regulations for foreign investors making it easier to gain access to local loans. [63] 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."[64]As a result, the only forms of regulation used today are the indirect FDI legislation, competition regulations and bilateral investment treaties.[65]

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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[60] 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
[61] Oludele Akinloye Akindoade, Franz Krige Siebrits and Elizabeth Niedermeier Roussot, Above n 57, 178.
[62] '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.[62]
[63] Ntwala Mwilima, Above n, 7, 35.
[64] Ntwala Mwilima, Above n, 7, 36.
[65] 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.[66] 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.[67]

In 2005, the South Africa government reviewed the *Exchange Control Amnesty and Amendment of Taxation Laws Act 2003* and the *Income Tax Act 1962*.[68] 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."[69] 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.[70] 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.[71]

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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[66] Ibid.
[67] 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.
[68] 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
[69] Ibid.
[70] 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
[71] 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."[72]

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."[73] 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 legislatives objectives.[74] 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.[75] South Africa has a relatively long history with the use of BITs the first of which was agreed to in 1994.[76] At present South Africa has 72 BITs operating and the government is currently considering further

[72] Competition Commission South Africa , *About us,* Competition Commission http://www.compcom.co.za/about-us/ at March 7, 2010.
[73] Competition Commission South Africa, *Merger Thresholds,* Competition Commission http://www.compcom.co.za/merger-thresholds/ at March 7, 2010.
[74] Ibid.
[75] Department of Trade and Industry, Above n 39, 5.
[76] Ibid.

agreements with Kenya, Nigeria, China, Singapore, South Korea and India.[77] The treaties which South Africa has become a party to over the last 16 years are predominately focused on investors rights rather then their obligations.[78] The main clauses focus on "protection against expropriation, the normal compensation guarantee and the ability to repatriate profits."[79] 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.[80]

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.[81] Recently the government has received a multitude of lawsuits brought by BIT parties regarding compliance with South Africa's Black Economic Empowerment[82] policies.[83] 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.[84] 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."[85]

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

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[77] Eric Neumayer and Laura Spess, 'Do bilateral investment treaties increase foreign direct investment to developing countries?, (2005) 33(10) *World Development*, 1567.
[78] Department of Trade and Industry, Above n 39, 5.
[79] 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.
[80] Ibid.
[81] Department of Trade and Industry, Above n 39, 5.
[82] 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."
[83] 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.
[84] Laurence Boulle and John Klaaren, Above n 79, 12.
[85] Ibid.

country.[86] 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.[87] 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.[88] Third, as UNCTAD reported in 1998 "There are many examples of countries with large FDI inflows and few, if any, BITs"[89] 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.[90]

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.[91] 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."[92] 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.[93] It is

[86] Department of Trade and Industry, Above n 39, 22.
[87] Both Canada and the United States have these negotiation templates.
[88] 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.
[89] 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.
[90] 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.
[91] Department of Trade and Industry, Above n 39, 7.
[92] Ibid.
[93] 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"[94] of South Africa. Another suggestion has been to "develop a model investment chapter which would then be included in all future free trade agreements"[95] also with a clear development focus. Finally, it has been suggested that the "initiation of a new, developing country-driven multilateral investment protection policy"[96] 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.[97] 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.[98] 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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[94] 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.

[95] Ibid.

[96] 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.

[97] Ibid.

[98] Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1050.

banking, civil aviation and the media."[99] In 1976 the Commonwealth Government decided to construct the Foreign Investment Review Board (the board).[100] The decision was partly made to demonstrate to the Australian public that the government recognised the communities concerns about foreign ownership of Australian assets.[101] The board's general function was to advise the Treasurer on foreign investment policies.[102] 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.[103]
- The Executive will produce a report which the board will then consider and pass its view and recommendations to the Treasurer or Assistant Treasurer.[104]
- 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,'[105] or to impose conditions that are deemed necessary to ensure the national interest concerns are dealt with.[106] The national interest, which is the key underpinning of the whole Act, is not

[99] Ibid.
[100] 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.
[101] Ibid.
[102] Michael Pryles, Jeff Waincymer and Martin Davies, Above n 25, 1050.
[103] 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.
[104] Ibid.
[105] s 18, 19, 20, 21 and 21A *Foreign Acquisitions and Takeovers Act 1975.*
[106] 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.[107]

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."[108] 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."[109]

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. [110] It further includes provisions that empower the Treasurer to block proposals made by people who previously tried to evade the system. [111]

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

[107] Michael Holden, The Foreign Direct Investment Review Process in Canada and Other Countries (2007) *Canada Library of Parliament* 5.
[108] 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.
[109] Australian Foreign Investment Review Board, *Compliance Issues* (2009) Australian Foreign Investment Review Board http://www.firb.gov.au/content/other_investment/compliance.asp at March 9, 2010.
[110] Ibid.
[111] 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.[112] This Act is currently the principal instrument used to regulate FDI in Canada.[113] 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."[114] 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.[115] This can vary depending on whether the investors are members of the WTO and the type of investment. [116] 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. [117] If it is deemed that there are issues arising from the proposal it will be handed over to the Cabinet for a full review. [118]
- 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."[119] However, under the legislation the government "retains the

[112] 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.
[113] 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.
[114] Ibid.
[115] Michael Holden, Above n 107, 2.
[116] Ibid.
[117] 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.
[118] Michael Holden, Above n 107, 2.
[119] 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."[120]

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.[121] As with the Australian legislation 'net benefit' and 'national interest' are deliberately not defined in the legislation to ensure flexibility in decision making.[122] 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."[123]

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.[124] 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.[125] 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

[120] Ibid.
[121] Michael Holden, Above n 107, 3.
[122] Ibid.
[123] 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.
[124] 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.
[125] 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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