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South Africa's Investment Landscape: Mapping Economic Incentives

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African perspectives. Global insights.

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ABSTRACT

For an economy to attract productive, sustainable local and foreign investment, a stable investment climate along with a supportive investment policy framework is necessary. Government-owned or -mandated investment promotion agencies (IPAs) have an important role to play in marketing the country and its particular investment opportunities to potential investors. Furthermore, government can help remedy structural weaknesses in sectors or regions allocated for priority development through economic incentives programmes. Financial incentives such as grants and subsidies reduce the investor's initial capital outlay; while tax-relief incentives increase net income by lowering the tax bill.

This paper considers the effects of the global economic crisis on the South African government's recent economic policy developments, especially those aimed at job creation. In addition, it considers the work in progress on creating an investment policy framework to support sustainable investment. The investment setting is examined by presenting the views of provincial IPAs, as well as government office-bearers at provincial and national level. Finally, a catalogue of economic incentives is presented which constitutes the government's economic support measures to encourage domestic and foreign firms' to invest in specific regions or sectors.

ABOUT THE AUTHOR

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ABBREVIATIONS AND ACRONYMS

APDP	Automotive Production and Development Programme
AIS	Automotive Investment Scheme
ANC	African National Congress
BBBEE Act	Broad-based Black Economic Empowerment Act
BPS	Business Process Services
BRIC	Brazil, Russia, India, China
BRICS	Brazil, Russia, India, China, South Africa
CCA	customs controlled area
CCAE	customs controlled area enterprise
CFC	controlled foreign company
CIP	Critical Infrastructure Programme
CTCIP	Clothing and Textile Competitiveness Improvement Programme
DBSA	Development Bank of Southern Africa
the dti	Department of Trade and Industry
EIP	Enterprise Investment Programme
FIAS	Investment Climate Advisory Service
FDI	foreign direct investment
HEI	Higher Education Institutions
IDC	Industrial Development Corporation
IDZ	industrial development zone
IMF	International Monetary Fund
IPA	investment promotion agency
IPAP	Industrial Policy Action Plan
M&A	Mergers and acquisitions
MIDP	Motor Industry Development Programme
MNC	multinational corporation
NGP	New Growth Path
OECD	Organisation for Economic Cooperation and Development
PPD	Product Process Development
PPP	public-private partnerships
R&D	research and development
SADC	Southern African Development Community
SARS	South African Revenue Services
SEDA	Small Enterprise Development Agency
SETI	Science, Engineering and Technology Institute
SEZ	special economic zone
SME	Small to Medium Enterprises
SMEDP	Small and Medium Enterprises Development Project
SMME	Small, Medium and Micro Enterprises
SPII	Support Programme for Industrial Innovation
TEO	The Enterprise Organisation
THRIP	Technology and Human Resources Industry Programme
TIPA	Trade and Investment Promotion Agency
TISA	Trade and Investment South Africa

TLAB	Taxation Laws Amendment Bill
UNCTAD	UN Conference on Trade and Development
VAT	value added tax
VCC	Vale Columbia Centre
WAIPA	World Association of Investment Promotion Agencies

INTRODUCTION

A favourable investment climate fostering optimum economic growth rests on a stable investment regime within a national policy framework that supports productive, sustainable investment. This is true of any economy. Throughout the world government-mandated agencies woo investors, work to reduce or eliminate red tape, and facilitate investor-government relations. In addition, governments address systemic or structural weaknesses in sectors or regions deemed strategically important for development, usually by offering incentives to tip the commercial scales in favour of a particular location. Such measures may include financial incentives (eg grants and subsidies) to reduce the initial cost of capital, and tax-relief incentives designed to increase an enterprise's net income.

In the main, South Africa's economy has been characterised by low national savings, and investment financed largely through unpredictable portfolio flows rather than by longer-term foreign direct investment (FDI). Some long-standing political legacies such as widespread unemployment, high crime rates and generally low education and skills development, have proved difficult to shake off in the 18 years since the present African National Congress (ANC) government took office. Despite this, South Africa's December 2010 acceptance into the forum of the 'big four' emerging economies (Brazil, Russia, India and China: BRIC) – which consequently became BRICS – gave the country a role on the global stage. The South African government has been pursuing what it sees as its economic priority: measures to boost employment in general and job-creating projects in particular. The government supports its economic vision, expressed in the New Growth Path (NGP) released in December 2010, with two Industrial Policy Action Plans (IPAP 1 and 2). In addition, a relatively sophisticated investment promotion framework is in place, together with a nascent policy framework to manage the costs and benefits of cross-border mergers and acquisitions. Finally, the authorities have put in place a package of incentives to foster the development of small and local businesses, to promote employment and competitiveness, and encourage FDI.

Within that general context the first section of the paper presents a short review of South Africa's economy in the wake of the global crisis that began in 2007–2008. This section also considers the government's economic vision and industrial policies, as well as the 'Gateway' initiative aimed at establishing South Africa as an investment avenue into the rest of Africa. The second section examines issues fundamental to discussions on FDI and domestic investment: investment policy, investment promotion and investment incentives. Section three offers an overview of three major investment-focused areas introduced in section two, in a South African context. This concluding section also presents the results of a survey distributed to provincial investment promotion agencies (IPAs), as well as a catalogue of economic incentives aimed at developing specific groups, regions and sectors.

SOUTH AFRICA AND THE GLOBAL ECONOMIC RECESSION

The 2011 World Investment Report¹ from the UN Conference on Trade and Development (UNCTAD) charts a significant decline in FDI flows into South Africa, which fell from \$5.4 billion in 2009 to only \$1.6 billion in 2010. This represents a drop of more than 70% on 2010 and over 80% from the \$9 billion peak reached in 2008. The negative trend is

largely attributed to South Africa's high unit cost of labour when compared, for instance, with that of India and China.² South Africa was admitted to BRIC notwithstanding this inferior investment performance. Although none of the BRICS countries has proved immune to the current global economic crisis, in 2010 the other four countries were still ranked among the top 20 global FDI recipients: Brazil with receipts of \$48 billion; Russia with \$41 billion; India \$25 billion; and China \$106 billion.³

FDI to South Africa is expected to rebound in 2011, in particular due to the \$2.4 billion acquisition of 51% of South African-based retail chain Massmart by US-based Wal-Mart. That transaction was finally approved despite a degree of ambivalence towards foreign investment shown both by organised labour and the departments of Agriculture, Trade and Industry and Economic Development. Like all major mergers and acquisitions (M&A), however, the deal is subject to scrutiny by the South African competition authorities. (The government is imposing stringent conditions on foreign M&A deals, principally to protect against local job losses and to ensure that local suppliers' interests are not jeopardised.)

In addition to the Wal-Mart issue, the nationalisation debate has not been silenced by the recently publicised report by an independent panel of experts, commissioned by the ANC a year ago, concluding that nationalisation of mines should only be considered as a last resort. Although the government has stated that nationalisation is not on its agenda, they have asked their panel to provide more detail inter alia on the other 12 mining countries with experience of state intervention (Chile, Norway, Sweden, Finland, Zambia, Brazil, Venezuela, Namibia, Botswana, Malaysia, China and Australia). However, government has made clear its dedication to the 'maintenance of an open environment for foreign direct investment while addressing the specific public interest considerations emanating from cross border direct investments for the country'.⁴

In 2011 South Africa performed unremarkably on most global competitiveness indices (see Table 1). For example, on the World Bank's Doing Business scale it ranks 34th out of 137 economies; on the Inward FDI potential Index 74th out of 141; and on the World Economic Forum Global Competitiveness Index 54th out of 139. Pervasive poverty, high levels of crime and un- and under-employment are among the problems frequently cited by potential investors, especially since the global recession took hold.

Table 1: South Africa: competitiveness rankings

Corruption Perceptions Index	54 out of 178
Ease of Doing Business	34 out of 183
E-readiness	40 out of 70
Freedom of the Press	70 out of 196
Global Competitiveness Report	54 out of 139
Global Enabling Trade Report	72 out of 125
Global Manufacturing Competitiveness Index (GMCI)	22 out of 26
Global Services Location Index	45 out of 50
Index of Economic Freedom	72 out of 179

International Logistics Performance Index (LPI)	28 out of 155
Inward FDI Potential Index	74 out of 141
KOF Index of Globalisation	50 out of 186
Management Index (Political Leadership Towards Democracy and a Market Economy)	33 out of 128
Networked Readiness Index (NRI)	62 out of 133
Open Budget Index	1 out of 94
Status Index (Political and Economic Transformation)	31 out of 128
Tax Misery and Reform Index	51 out of 63

Source: GlobalEDGE, Michigan State University, <http://globaledge.msu.edu/countries/south-africa/rankings/>

South Africa's economic strategy

On the domestic front, the South African government concedes low success rates on employment creation between 1994 and 2008. Inequality ratios remain disappointingly high⁵ and the country's high greenhouse gas emissions reflect its increasing reliance on fossil fuels – which provide 90% primary energy and emit more than 400 million tons of carbon each year – for electricity generation, rather than renewable energy.⁶ Strategies are, however, in place to reverse these trends.

The New Growth Path and Industrial Policy Action Plan

In his State of the Nation address in February 2011, President Jacob Zuma declared 2011 the 'year of job creation'. In relation to the NGP he outlined the government's plan to accelerate growth and employment, concentrating on certain key areas:

- expanding public investment in infrastructure;
- concentrating on labour-intensive value chains in agriculture and mining, as well as in manufacturing, construction and services;
- promoting innovation through low-carbon initiatives; and
- supporting rural development, including agriculture and regional integration.

The vision behind the NGP is, at least notionally, a response to many of the challenges facing the economy. No doubt, the devil will lie in the detail. The Industrial Policy Action Plan 2011–2012 to 2013–2014 (IPAP 2)⁷ is intricately linked to and viewed as a crucial component of the NGP, giving impetus to a 'new path of industrialisation'. High-value industrial and services sectors and those with strategic importance based on the NGP, have been under review; while key action programmes for specific sectors, as well as a 'skills for the economy' programme, have been revised and consolidated.

The Department of Economic Development was established in 2009. It is responsible for co-ordinating the government's response⁸ to the global economic crisis and for economic development planning, and works with other departments to ensure harmonised programmes that place work opportunities at the centre of the government's economic policies. Post-crisis policies and programmes are designed to ameliorate South Africa's recessionary hangover and reverse the slow-down in economic growth so as to build a strong and competitive economy.

The importance of private sector investment is highlighted in related policy documents. For example, the Medium Term Strategic Framework calls for large-scale private investment projects with high labour-absorptive capacity, as well as expansion of social and economic infrastructural programmes to promote environmental sustainability, growth and employment.

Gateway into Africa initiative

The National Treasury has also been making efforts to compete with tax-friendly African neighbours, especially Mauritius and, increasingly, Kenya and Nigeria. Mauritius, for example, has no exchange control regulations and offers a low tax rate pegged at 3% on Mauritian holding companies. To help meet such competition the government proposed its 'headquarter company' regime as part of the Gateway Initiative introduced by the Treasury in 2010. This scheme centres on three areas seen as significant tax-related obstacles to channelling investments into Africa. These are:

- controlled foreign company (CFC) rules. The proposed changes imply that CFC rules and their associated administrative burden would not apply to headquarter companies;
- secondary tax on companies (STC). Headquarter companies would not be subject to secondary tax or a proposed new dividend tax; hence profits could be expatriated without fear of tax leakage; and
- 'thin capitalisation' rules that reduce the ability of foreign investors to finance their operations with debt. Under the proposed changes, headquarter companies could be financed with debt without restriction, provided the debt is used to finance subsidiary companies.

Further review led to representations to the South African Revenue Service (SARS), which in August 2011 responded with additional recommendations that are to be put before parliament. These include the following stipulations.

- A headquarter company may use its operating currency (usually not rands) to report tax and will therefore avoid exposure to tax on currency fluctuations (the previous requirement was for companies to record transactions in rands for tax purposes).
- Possible amendments to exclude headquarter companies from exchange control regulations.
- Should a withholding tax on interest payments (expected in 2013) be introduced, it will not apply to interest paid by headquarter companies.
- Dispensation from 'thin capitalisation' rules has been confirmed, so long as deductions of interest expense are limited to the interest income earned from subsidiaries.

- A headquarter company will not be required to retain an interest margin on any back-to-back loan arrangements with its subsidiaries in respect of transfer pricing.
- Dividends received by a South African resident from a headquarter company will not be taxed.
- Disposals on certain interests in a headquarter company will be eligible for exemption from capital gains tax, on the same basis as if it were a foreign company.
- To the extent that intellectual property licensed to it is not used in South Africa, royalties paid out by a headquarter company should be free of withholding tax.⁹

It should be noted that some experts maintain that South Africa need not compete so aggressively against countries such as Mauritius. Given its reliable financial infrastructure and economic stability, the country need only improve slightly on its current tax and exchange control position to 'reinforce South Africa's position as the gateway of choice into the rest of Africa'.¹⁰ Khan¹¹ however believes that the gateway initiative (with necessary tax relief for foreigners) is crucial to South Africa's economic participation and competitiveness in BRICS. The relatively small size of its economy and market (at least compared with any of the other four BRICS countries) makes regional integration an imperative that the South African government must actively pursue. A series of actions towards economic integration is planned to complement a 2008 initiative toward a free trade area between the Common Market for Eastern and Southern Africa, the East African Community, and the Southern African Development Community (SADC). A customs union was planned for 2010 but postponed; although plans are still in place for a SADC monetary union for 2016 and a single currency in 2018. Such further integration into SADC would extend South Africa's market by about 200 million consumers.

It will be interesting to see whether by virtue of their location on international boundaries, the five provinces (KwaZulu-Natal; Limpopo; Mpumalanga; Northern Cape and North West) that border Mozambique, Zimbabwe, Botswana and Namibia respectively, eventually enjoy simplified customs procedures and related special economic zone (SEZ) incentives through the SEZ Bill and policy opened for public comment on January 16, 2012. Countries such as Thailand and China have had some success in establishing 'border economic zones' with related industrial estates, to expand economic co-operation, regional development and harmonised customs regulations with their neighbours.¹²

INVESTMENT POLICY, PROMOTION AND INCENTIVES

To implement their economic development strategy, most governments try to create an optimal investment policy framework, promote activities to support investment, and establish economic incentives to positively influence investor perceptions of costs and benefits related to business in a particular sector. South Africa does not have such a specific legal investment code, but the National Treasury recently issued as a discussion document a 'review framework for cross-border direct investment in South Africa'. The review is expected inter alia to feed into the process of supporting and informing M&As, and any restructuring of existing South African businesses prompted by foreign investment. More generally, the document sets out a policy framework that seeks to align FDI needs and criteria with the policies of all relevant government departments.

While economists continue to debate the merits and de-merits of foreign investment, there is enough evidence to support the view that benefits do in fact flow to FDI host countries. They include access to foreign capital, a degree of internationalisation (ie a stake in the global economy) and in the longer term, increased productivity and employment, relatively higher wages, and positive socio-economic systemic change.¹³ In addition, the arguments for technology and skills spillover from multinational corporations (MNCs) to local investors and suppliers through the latter's access to global enterprises are widely documented.¹⁴ Research by McKinsey Global Institute¹⁵ has revealed that unambiguous benefits have derived from FDI in manufacturing and services industries in Brazil, India, Mexico and China. In each case the ripple effect from FDI led to improved productivity, output and standards of living.

Alfaro and Chanda¹⁶ stress the importance of the host country's absorptive capacity through FDI spillovers. When local conditions, including financial markets, educational levels and human resource capital, are unfavourable, FDI has no significant effect. Given well-functioning financial institutions, however, domestic enterprises can enter the MNC supply chain. Evidence also suggests that domestic suppliers to MNCs do better than non-MNC suppliers.

Proksch¹⁷ underscores the need to put in place national competitiveness development strategies before FDI promotion begins. These competitive strategies are regarded as the foundation for FDI without which no country will be likely to develop in a global context. It follows that typically, FDI inflows will remain low in most sectors of a national economy that is without such a basis. Furthermore it could be contended that the main consideration for foreign companies seeking locations for investment is the nature of the subsidiary operation to be established: that is, whether or not it is intended to meet local market demand, or to produce for export to the home country or other markets.

INVESTMENT PROMOTION AND FACILITATION

In the past, inward investment promotion has usually included investor facilitation; national image-building; investor targeting and generation; and policy advocacy.¹⁸ In the late 1990s the 'one-stop-shop' became fairly widely adopted by IPAs, the idea being that the IPA would offer a range of services from advisory bureaus through to authorising licences and permits, and even lobbying other government units on behalf of investors. At present, many IPAs at the very least enjoy an investment- and a trade-promotion mandate.

Investment promotion, intended to inform or assist investors in making a commitment to invest, is a form of non-monetary investment incentive that is very difficult to quantify and monitor. IPAs operate in a blurred institutional environment with parallel jurisdictions and accountability to a large range of ministries at different levels of government. Not only do they themselves liaise with other government bodies but they also help investors navigate the bureaucratic waters involved in establishing a new project.

Much attention has focused on countries targeting sustainable FDI, with recent research from the New York-based Vale Columbia Centre (VCC), in association with the United Nations' World Association of Investment Promotion Agencies (WAIPA)¹⁹ examining the extent to which IPAs focus on attracting sustainable investment projects, the latter defined against four criteria:

- economic development (including linkages, training, and skills and technology transfer);
- environmental sustainability (centring on minimising environmental impact);
- social development (including employment standards and community development); and
- good governance (addressing issues of transparency and fairness in contracting).

The VCC-WAIPA survey also considered the role of incentives in supporting sustainable FDI. It concluded that of the four measures cited, IPAs generally placed most stress on investments and associated investment incentives aimed at promoting economic development. While this may be true in the current stage of the global economic cycle, it is at least plausible that the emphasis will shift towards the other three dimensions as the global economy recovers.

LOCATION DECISIONS

MNCs in search of new resources, cost-efficient processes and/or larger markets will seek opportunities in foreign locations. Table 2 provides an overview of motivational factors for specific types of FDI. Countries which have not addressed shortcomings in their macro-economic fundamentals, infrastructure and foreign investment policies will be at a disadvantage. Those offering political and economic stability, as well as transparent governance, will weigh favourably in the investment decision.

Table 2: Factors affecting four types of FDI

Type of FDI	Factors influencing locating decisions
Natural resource-seeking	Availability, cost and quality of resources, as well as processing and marketing; infrastructural development; availability of joint venture partners.
Market-seeking	Size, growth of domestic and regional markets, cost of labour, infrastructure quality, institutional competence, agglomeration economies and service support, macro-economic policies of host government.
Efficiency-seeking	Production costs, skilled and professional labour, industrial competitiveness quality of infrastructure and institutions, macro-economic policies, knowledge and innovation development, cluster specialisation (eg science and industrial parks).
Strategic asset-seeking	Availability of knowledge-related assets (eg technology and management expertise), markets and geographical dispersion of such assets, price and availability of synergistic assets to foreign firms, and access to different cultures, institutions and systems.

Source: Cleeve E, 'How Effective are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?' paper presented at the International Academy of African Business and Development (IAABD) 5th international conference, Atlanta, April 2004

INCENTIVES DEFINED

UNCTAD's 2004 Issue Paper on Incentives²⁰ outlines three major classes of incentives intended to encourage businesses to invest. They are:

- financial (eg grants and loans at beneficial rates);
- fiscal (eg tax holidays or reduced tax rates); and
- other, such as subsidised infrastructure or services, access to preferential markets, and regulatory allowances (eg exemptions from labour or environmental standards).

The World Bank's Investment Climate Unit recognises a slightly different taxonomy, acknowledging that there could be fiscal or non-fiscal elements within the two types of incentive. The incentives it identifies are:

- regulatory: for example by guaranteeing property rights; correcting for external economic factors; and preventing abuse by monopolies²¹, or by easing of or exemption from certain regulatory requirements; and
- financial: eg subsidies, grants or administrative assistance.

The two types are further refined as being either fiscal – tax-based – incentives (such as reduced corporate taxation and special tax-privileged zones); or non-fiscal incentives that may include subsidies and preferential loans; investor facilitation and after-care facilities, and increased engagement between government and business.

In much of the literature, incentives are seen as inducements by government to shift an investment decision towards a particular region, sector or project. This view is based on a supposition that investors have largely decided upon, or at least short-listed, a likely investment location without direct consideration of incentives on offer. Consequently, investment incentives tilt the balance at the margin of the investment decision. Criteria such as future demand; the political and economic stability of the host country; its financial, technological and physical infrastructure; and a stable and transparent legal and regulatory framework, are much more critical to the investment decision than are incentives per se.

Financial incentives such as grants and subsidies are important to the extent that they lower investment costs and therefore reduce initial project risk. Tax incentives are generally considered as those favourable tax-relief measures that reduce the tax burden and thereby lead to an increased net income for the beneficiary. On this definition a general cut in taxes or a universal depreciation allowance would not constitute a tax incentive. A tax incentive typically indicates that aggregate capital stock, or that in a region or sector, is seen as too low and that the tax system is itself an obstacle; or that other barriers exist that may be limited or eliminated by a change in the tax system.²²

The impact of incentives varies. It depends on the strategies and motivations of the investing firm and the market to which the investment is directed (for instance whether the investor has an established presence, or is a newcomer). In addition, the investor's country of origin and particular sector of operations play a part in determining the influence and impact of incentives.²³ Fiscal incentives are typically less effective for resource-seeking FDI or for investments intended to serve the domestic market. Incentives

offered to resource- or market-seeking investors may be wasted, since such investments would probably have occurred anyway. Efficiency-seeking FDI, on the other hand, or investment in technology industries or export-orientated investment projects, are much more susceptible to tax relief, not least because firms in those fields can move location with relative ease.²⁴

In a number of countries economic incentives, sometimes accompanied by overt protectionism, have helped develop high-performing global sectors. For example, a combination of low-cost labour and government incentives to promote FDI transformed China into a global manufacturing powerhouse. The Chilean grape industry benefits greatly from its government's research and development (R&D) incentive programme. In South Africa, the government's motor industry development programme has had a 'positive and significant'²⁵ effect on automotive and components manufacturing, including the catalytic converter sub-sector. Reports from South Africa's provinces also suggest that FDI in sectors such as agro-processing probably would not have occurred, or would have been less effective, in the absence of incentives such as the Small, Medium and Micro Enterprises (SMME) development programme.

STUDIES ON INVESTMENT CLIMATE AND TAX INCENTIVES

Research and econometric analyses by the World Bank, the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) all conclude that countries with an unappealing investment climate will not effectively address imbalances by offering fiscal incentives. Their studies found that tax incentives were far more effective in economies with a stronger investment climate.²⁶ Government incentives for attracting foreign and local investors have proliferated worldwide. There is continuing debate concerning the efficacy and cost of incentives, especially of tax incentives and particularly in economies that can ill-afford the added fiscal burden of reduced taxation revenues.²⁷

Barbour²⁸ advances a schedule of characteristics for an effective and efficient investment incentive scheme, advocating:

- a system to ensure that revenue loss is minimised;
- a cap on expenditure;
- a time limit on the duration of the incentive;
- that incentives be transparent;
- that incentives be uncomplicated; and
- that incentives have low administrative costs for both businesses and government

Investors may qualify automatically for incentives, or inducements could be provided on a discretionary basis. Barbour cautions that discretionary allocation allows for economic distortions such as, favour-seeking, corruption or procedural ineffectiveness. Wells et al note that 'incentives will generally neither make up for serious deficiencies in the investment environment nor generate the desired long-run strategies.'²⁹ Government may hope to counterbalance an unfriendly investment environment by means of incentives. While in particular cases targeted interventions (eg fiscal incentives, export processing

zones, or cluster support measures) may lead to higher investment, employment, and related spillovers, there is little supporting evidence that such initiatives are systemically successful.³⁰

SOUTH AFRICA'S INVESTMENT LANDSCAPE

Since 1994 South Africa's policy framework has tacitly acknowledged the need and desire for FDI, even though foreign-sourced M&As over a specific rand value may be referred to the competition authorities. Moreover, projects in strategic sectors must be carefully assessed in terms of private versus social returns on investment. The objectives governing many domestic and foreign investment approvals in those key sectors are that they do not represent a risk to the economy and that they are in the public interest. As mentioned above, in this respect there is a gap in the investment policy framework that government is attempting to address, initially through the National Treasury's discussion document on cross-border investment (see endnote 4).

By the standards of emerging markets generally, South Africa's investment promotion framework is stable and modern. The national investment promotion agency Trade and Investment South Africa (TISA) and the nine provincial agencies, as well as several municipal IPAs, are relatively well-resourced, and sectoral targeting strategies are in place. In addition, TISA and trade and investment promotion agencies (TIPAs) have been instrumental in the implementation and administration of the national investment incentives scheme.

Table 3 (see pages 16 and 17) outlines the promotional activities at those TIPAs that participated in the SAIIA survey and interviews.

GOVERNMENT MANAGEMENT OF INCENTIVES PROGRAMMES

The South African government and its agencies offer various investment incentives, targeted at specific sectors or types of business activities (see below for extensive list).³¹ In addition to regulatory interventions (for example the right to freely establish; acquire; and dispose of commercial interests) and market structure or tariff norms, the government provides financial and fiscal incentives to investment. In some instances, financial incentives also have a tax-relief, or fiscal, component.

The Enterprise Organisation (TEO) is a unit of the Department of Trade and Industry (dti) responsible for the development of competitive enterprises through provision of effective and accessible incentives in support of national priorities (for instance those encompassed by the NGP and IPAP). TEO is authorised to 'amend rules for firms in distress [and to] administer the dti incentive programmes through making administrative requirements more user friendly'.³² The dti outlines the economic foundation³³ of its incentives scheme as:

- broadening participation;
- competitiveness;
- services;

Table 3: Survey responses from provincial and one city TIPAs(s)

	Gauteng (City of Johannesburg)	KwaZulu-Natal	Limpopo	Mpumalanga	Northern Cape	North West	Western Cape
Sectors for recent investment projects	<ul style="list-style-type: none"> • Property development • Tourism • Food and Beverages • Retail development • Financial services • Agri-business 	<ul style="list-style-type: none"> • Airports and port infrastructure • Urban and sport infrastructure • Hotel development • Retail property development • IDZ infrastructure • Road infrastructure 	<ul style="list-style-type: none"> • Quarrying • Mining (platinum) • Coal mining • Retail development • Water infrastructure (dams) 	<ul style="list-style-type: none"> • Food processing • Mining (gold) • Agri-processing 	<ul style="list-style-type: none"> • Engineering/construction • Renewable energy (solar) • Mining/beneficiation (diamond hub) 	<ul style="list-style-type: none"> • Hospitality • Retail • Mining (platinum) • Mining (iron-ore) • Quarrying • Automotive components • Agri-business • Agriculture • Road infrastructure 	<ul style="list-style-type: none"> • Construction • Renewable energy • Manufacturing • BPO • ICT • Agri-business • Real estate
Recent incentives used by investors	<ul style="list-style-type: none"> • Section 12i • Competitiveness improvement • Critical infrastructure 	<ul style="list-style-type: none"> • Incentives in the category: SMME Development • Financial Assistance • Manufacturing Investment Programme; • Tourism Support Programme • Critical Infrastructure Programme 	<ul style="list-style-type: none"> • Cooperative Incentive Scheme • Black Business Supplier Development • Manufacturing • Critical Infrastructure Programme 	<ul style="list-style-type: none"> • Enterprise Investment Programme • Critical Infrastructure • Export Marketing & Investment Assistance 	<ul style="list-style-type: none"> • Cooperative Incentive Scheme • Critical Infrastructure Programme 	<ul style="list-style-type: none"> • Tax incentives • Industrial Development • Financial Assistance • SMME Development 	<ul style="list-style-type: none"> • Manufacturing Investment Programme • Export Marketing & Investment Assistance • Film & Television Incentive • R&D Tax Incentive • BPS Incentive
Were investors aware of the incentives prior to investment?	No	Yes	Some investors were aware, others not	No	No	Many investors were not aware of them, but a fair proportion were aware	About half were aware of them, and half were not
Have investors had difficulty understanding for what incentives they qualify?	No	No	Occasional difficulty differentiating incentives, so the province offers seminar	Lack of prior knowledge has resulted in some difficulties	Since the appointment of dti representative to administer incentives, no reported difficulties	Some investors reported the application process somewhat cumbersome	Investors have some difficulty interpreting 'language' of the incentive

	Gauteng (City of Johannesburg)	KwaZulu-Natal	Limpopo	Mpumalanga	Northern Cape	North West	Western Cape
Have you been able to modify the incentive in any way?	No	No	Not the national incentives. At municipal level, non-financial incentives can be varied	Not the national incentives	No	No, this remains the area of influence of dti	No
Domestic to Foreign % ratio of investors using incentives?	Estimated 60:40	Estimated 9:5:5	Estimated 45:55	Estimated 80:20	Estimated 90:10	Estimated 40:10	Estimated 60:40
Has there been evaluation or performance monitoring of incentive scheme?	No evaluation	No	No evaluation	No evaluation	No evaluation	Aftercare service for investors – whether or not they utilise incentives	No evaluation
What is the extent of your investment promotion activities?	<ul style="list-style-type: none"> Advertising Outreach missions 	<ul style="list-style-type: none"> Advertising Product road shows Investor conferences Outreach missions 	<ul style="list-style-type: none"> Advertising Investor conferences Outreach missions District Summits Stakeholder engagements Provincial events 	<ul style="list-style-type: none"> Advertising in foreign journals DTI-led outreach missions Investor conferences 	<ul style="list-style-type: none"> Outward missions with TISA Articles placed with Trade and Invest SA 	<ul style="list-style-type: none"> Project road shows One-on-one workshops with TEO at dti 	<ul style="list-style-type: none"> Investor conferences, trade fairs and trade missions dti outreach missions/project road shows Media releases, investor declarations, bell ringing for successful declarations

Note: Eastern Cape and Free State were invited, but did not respond

- manufacturing; and
- infrastructure.

TEO co-ordinates nationally, provincially and locally with government departments; with the Small Enterprise Development Agency (SEDA) and various business support agencies; and with development finance institutions such as the Industrial Development Corporation (IDC) and the Development Bank of Southern Africa (DBSA), as well as with provincial TIPAs. This multi-level approach presents challenges to the department, in the light of which efforts are being made to forge strong working relationships.

A number of incentives are managed by other government agencies. Usually, if another agency has a comparative advantage in administering a specific programme, it is then given responsibility for it. For instance the IDC, a reputable development funding institution, is well-placed to manage the Support Programme for Industrial Innovation (SPII) described below. Final administration, however, remains with the dti. The 11 incentives managed and administered by TEO within the dti are shown in Table 4.

Table 4: Overview of dti-managed incentives

Critical Infrastructure Programme	Launched in August 2000, it has supported 42 investment projects worth ZAR ³⁴ 88.4 billion in investment. Grants of ZAR 1,147,054,564 have been issued, creating 47 219 permanent jobs.
Enterprise Investment Programme	a) Combined: Manufacturing Investment Programme (MIP) and Foreign Investment Grant (FIG): 2008 to March 2011, 846 projects approved, with ZAR 2,292,008,317 of funds committed at total cost to fiscus of ZAR 198,380,873, creating 2 851 direct jobs; projected to create 23 996 direct jobs. b) Tourism Support Programme: Between 2008 and March 2011, 401 projects approved: ZAR 869,369,283 in investment commitments costing the fiscus ZAR 64,039,658; 283 direct jobs created.
Automotive Investment Scheme	July 2009–March 2011, 36 projects approved and ZAR 2,155,688,982 investment commitments at total cost to fiscus of ZAR 249,252,065; 15 014 direct jobs created.
a) Business Process Outsourcing and Offshoring Incentive b) Business Process Service Incentive	a) December 2006–March 2011, 18 projects approved worth ZAR 362,788,365 in commitments and total cost to fiscus of ZAR 260,743,329; 7 275 direct jobs supported. b) January 2011–March 2011, 10 projects approved with ZAR 157,760,000 funds committed; 3 944 projected direct jobs.
12-i Tax Allowance	Four projects recommended by adjudication committee since 31 March 2011, total investment ZAR 4.1 billion, with investment allowance of ZAR 1.3 billion and training allowance of ZAR 13.3 million; 370 direct jobs created.
Film and Television Incentive	Approval granted to 169 films with ZAR 704,165,844 funds committed at total cost to fiscus of ZAR 377,620,856.

Cooperative Incentive Scheme	From 2005 to March 2011, 455 projects approved worth ZAR 100,509,964 in commitments and total cost to fiscus of ZAR 92,523,000. Study commissioned in June 2011 aims to determine why most co-operatives so far assisted by CIS to date are still performing poorly. Recommendations for the co-operatives include marketing, technical assistance, mentoring and administrative assistance.
Export Marketing and Investment Scheme	August 1997–31 March 2011, 7 295 projects approved with ZAR 452,947,886 funds committed, at total cost to fiscus of ZAR 350,866,370; 10 545 jobs supported.
Black Business Supplier Development Programme	From 2002 to March 2011, 10 761 projects approved of ZAR 458,189,045 in investment commitment and total cost to fiscus of ZAR 303,889,103.
Industrial Development Zones	Since first operator permit issued in 2007, total investment of ZAR 5,749,650,000 with total cost to fiscus of ZAR 4,830,842,000; 41 229 projected direct jobs (construction and investor combined).
Capital Projects Feasibility Programme	Twenty-two feasibility projects approved, of which three are bankable; a total commitment of ZAR 67,272,343 at total cost to fiscus of ZAR 32,219,901 in agro-processing, mining and infrastructure.

Source: dti presentation to Portfolio Committee on Trade and Industry, 19 October 2011

TEO has pointed to the need for a comprehensive set of incentives to address diverse economic objectives:

[I]n developing sound policy ... each policy instrument should have limited objectives which talk to the type of market/institutional failure that is being addressed or objective that is being promoted. Having only one incentive scheme with [for example,] the multiple objectives to promote job creation in the manufacturing sector, assist small companies to access export markets, and attract BPO providers to locate in South Africa would cause more confusion than having three [separate] schemes.³⁵

CATALOGUE OF INCENTIVES

Programmes under the SMME development financial assistance incentives, for the most part, concentrate on the aims of the Broad-Based Black Economic Empowerment Act 53 of 2003 (BBBEE Act). Other incentives or sub-programmes, however, also centre on entrepreneurs or small businesses from previously disadvantaged sectors of the population. One example is the Project Funding for Emerging Exporters, a sub-programme of the Sector-Specific Assistance Scheme (SSAS).

Through the BBBEE Act, the quest to address and correct non-participation in the economy by historically disadvantaged communities has become a critical government obligation. The Act is designed to transform the economy so that black (ie African, Indian

and Coloured) people, and women, youth, those with disabilities and people living in rural areas, are integrated into ownership, management and labour forces in enterprises and productive assets. Such assets include companies, co-operatives and other collective enterprises.

SMME development financial assistance incentives

Incentives geared towards increasing participation from SMMEs include the following programmes and sub-programmes.

- Black Business Supplier Development Programme
- Cooperative Incentive Scheme
- Enterprise Investment Programme, formerly the Small and Medium Enterprise Development Programme
- Isivande Women's Fund
- Small Enterprise Development Agency (SEDA) Technology Programme
- Support Programme for Industrial Innovation

Operational since 2002 but revised and re-launched in 2011, the Black Business Supplier Development Programme aims to improve core competencies, upgrade management capabilities and promote black business competitiveness in the mainstream business environment. The programme has a grant maximum of ZAR 1 million (ZAR 800,000 for tools, machinery and equipment and ZAR 200,000 for business development services) made available on a 65:35 and 50:50 cost-sharing basis between the dti and the beneficiary enterprise. From 2002 to March 2011, ZAR 458,189,045 has been committed to 10 761 businesses with a total cost to the fiscus of ZAR 303,889,103. Gauteng province received 5 849 out of the total 10 761 approvals.

The Cooperative Incentive Scheme permits maximum grants of ZAR 300,000 to co-operative enterprises that can make multiple applications provided the cumulative award does not exceed ZAR 300,000. According to the dti, from 2005 until May 2011, 455 co-operatives received grants totalling ZAR 100,509,964, costing the exchequer ZAR 92,523,000. Workshops run by the dti in the provinces have resulted in a higher volume of applications. The Eastern Cape showed a 20% increase, Limpopo 27%, Gauteng 16%, the Northern Cape and North West each 3%, KwaZulu-Natal 15%, the Western Cape 9%, and Free State 1%.

The Enterprise Investment Programme (EIP) consists of three sub-programmes.

- The Manufacturing Investment Programme, aimed at stimulating investment and employment in the manufacturing industry.
- The Tourism Support Programme, aimed at stimulating job creation and encouraging the geographical spread of tourism activities, as well as BBBEE implementation.
- The Foreign Investment Grant, which compensates qualifying foreign investors for costs incurred in transporting new machinery and equipment (except vehicles) to South Africa from abroad. Intended beneficiaries are solely foreign investors. Benefits include a cash grant (the lesser amount of 15% of the value of new machinery and equipment; or its actual relocation cost) to a maximum of ZAR 10 million.

The EIP is considered by the dti as the main incentive in the department's suite and is the largest by volumes of applications assessed. The EIP is also the first incentive package to be made available for online processing³⁶.

The Isivande Women's Fund was established by the dti Gender and Women Empowerment Unit in partnership with Old Mutual Masisizane Fund. The fund is targeted at 60% female-owned or -managed enterprises that have operated for two years or more. It offers a loan range of ZAR 30,000 to ZAR 2 million. Management of the fund is contracted out to the IDC.

The SEDA Technology Programme was set up in April 2006 in an attempt to consolidate small enterprise activities. Grants range up to ZAR 800,000 for tools, machinery and equipment; made on a 35:65 cost-sharing basis (with the dti carrying the smaller proportion); and to ZAR 200,000 for business development services on a 50:50 cost-sharing basis.

The Support Programme for Industrial Innovation (SPII) arose from a restructuring in April 1993 of the Innovation Support for Electronics, which was initially confined to the electronics industry, in order to spread its development efforts across all economic sectors. The origin of the SPII lies in this change. The SPII and its sub-programmes – the Product Process Development (PPD), the Matching Scheme and the Partnership Scheme – are aimed at promoting technological development and commercialisation in South Africa. The programme provides financial assistance for developing commercially viable, innovative products or processes and facilitating commercialisation of such technologies. SPII is housed in the development funds department within the IDC, and the administration team is led by a senior fund manager, responsible for the overall management of the SPII fund.

In the financial year to 31 March 2011, 20 projects totalling ZAR 22.8 million were approved, as against ZAR 100.9 million for 57 projects in the 2009–2010 financial year. Approximately 95% of project approvals were to companies with total assets of less than ZAR10 million in the PPD and Matching Schemes, up from 84% in the previous financial year. There were no Partnership Scheme approvals, nor any for women, and only one BEE approval under the PPD Scheme.

The PPD gained further acceptance, with 11 of the SPII's 20 project allotments (55%) in the funding period. The PPD scheme aims to encourage new product development in small enterprises. National BEE and gender objectives are supported insofar as firms can apply for grants over and above the 50% base level, up to 85% depending on the percentage of their ownership by black people, women or the disabled.

During the 2010–2011 financial year, eight approvals were allocated to electronics and software sectors, which jointly received 40% of the total, whereas in 2009–2010 the two sectors accounted for 52.6% of total approvals. Other important sub-sectors were plastics (15%) and medical and electro-machinery (10%).³⁷

Industrial development financial assistance incentives

Incentives for developing industrial programmes include:

- Income Tax and Training Allowance (Section 12i);
- Industrial Development Zones;

- Business Process Services (BPS);
- the Critical Infrastructure Programme;
- the Capital Projects Feasibility Programme;
- the Clothing and Textile Competitiveness Improvement Programme (CTCIP); and
- the Technology and Human Resources for Industry Programme (THRIP).

Based on Section 12i of the Income Tax Act (Act No. 58 of 1962), the Income Tax Allowance provides a tax and training incentive for manufacturing operations. Intended beneficiaries include investors in greenfield (ie new industrial) and brownfield (ie expansions or upgrades) projects. Allowances are provided up to ZAR 900 million in greenfield projects with preferred status,³⁸ ZAR 550 million in other greenfield projects; ZAR 550 million in brownfield projects with a preferred status; and ZAR 350 million for other brownfield projects. In addition the allowance scheme permits the deduction from taxable income of an additional training allowance of ZAR 36,000 for each employee, as well as a maximum total additional training allowance per project of ZAR 20 million in the case of a qualifying project, and ZAR 30 million for a preferred project.

Box 1: Industrial Development Zone (IDZ) incentive

The IDZ programme was introduced in the Manufacturing Development Act (No. 187 of 1993). IDZs are purpose-built industrial estates linked to an international air or sea port, aimed at attaining increased levels of FDI in the formal, developed economy. The scheme is intended to boost foreign and local investment. Typically, IDZs contain one or more Customs Controlled Area (CCA) for manufacturing and storage of goods to boost beneficiation, investment, economic growth and the development of skills and employment in the region concerned.

The South African Revenue Service offers the following tax incentives to enterprises in CCAs:

- relief from customs duties at time of importation;
- relief on goods for storage;
- relief on raw material for manufacture; and on
- machinery used in manufacturing.

Measures to simplify customs procedures, including those concerning:

- clearance of goods (importation, exportation and transit);
- applications for designation, licensing and registration;
- release of cargo;
- consideration of stage consignments if the requirements are met;
- consideration of release under embargo; and
- lesser amounts levied for security (licensing, registration and movement of bonded goods).

Fiscal incentives on goods when:

- goods are imported for storage;
- raw material is imported for manufacture;
- machinery is imported for use in the manufacturing process;
- any material is imported for use in construction of CCA infrastructure;

- goods are exported from the CCA to a foreign country; and
- any services are rendered to a Customs Controlled Area Enterprise (CCAЕ), or in the CCA.

Subsidised infrastructure.

- No import duties to be payable on goods imported for use in the construction and maintenance of the infrastructure of a CCA in an IDZ (rebate item 498.02).
- No Value-Added Tax (VAT) shall be payable on goods imported for use in the construction and maintenance of the infrastructure of a CCA.
- No VAT is payable on land supplied to a CCAЕ in the CCA for sale, letting or any other agreement.
- No VAT is payable on electricity or water supplied to the IDZ operator or a CCA enterprise in the CCA.

In terms of the Customs and Excise Act³⁹ the following activities are allowed in a CCA:

- production or manufacture of any goods (other than goods liable to any excise duty, fuel levy or environmental levy), produced or manufactured in accordance with the provisions of section 75, the item of the relevant Schedule and section 21A and these rules;
- production or manufacture of any goods liable to excise duty, fuel levy or environmental levy, removed to and used in a licensed customs and excise manufacturing warehouse in accordance with the provisions of the Act; and
- storage of imported goods for export in the same condition as imported, or to undergo operations necessary for their preservation, or to improve the packaging or marketable quantity or quality or to prepare them for shipment (such as break bulk, grouping of packages, sorting and grading or re-packing) before exportation.

The Taxation Laws Amendment Bill (19 of 2011) proposes further deductions for IDZ projects. The bill states that in the case of greenfield projects, manufacturers in an IDZ should be able to claim a 100% deduction of the cost of manufacturing assets (the allowed deduction in non-IDZ investments is 55%). For brownfield IDZ projects the proposed deduction is 75% of manufacturing assets (outside IDZs the deduction is 35%).

South Africa has four IDZs.

- Coega in Port Elizabeth; designated in 2001 and issued with an operator permit in 2007.
- East London; designated in 2002 and issued with an operator permit in 2007.
- Richards Bay; designated in 2002 and issued with an operator permit in 2009.
- OR Tambo International Airport, Johannesburg; designated in 2002 and issued with operator permit in 2010.

IPAP 2 identified the desirability of an additional IDZ at Saldanha Bay, which was declared a designated IDZ on 24 October 2011.

*Black Business Quarterly Online*⁴⁰ recently examined the success of IDZs from the perspective of various academics and industry leaders. One pertinent observation relates to a requirement for regulation of the environment, among other things, to be balanced against the need for greater freedom for private enterprises in free trade zones. State involvement is not regarded as deficient because Coega alone has already received about ZAR 8 billion in state investment. This figure includes ZAR 3.1 billion for the port, ZAR 2 billion

for infrastructure in the IDZ, ZAR 2.1 billion to upgrade power infrastructure, and a ZAR 500 million facilities upgrade investment from the South African government's rail company Spoornet.

According to dti statistics on IDZs,⁴¹ the total value of the investment is ZAR 15,749,650,000 and the total cost to the fiscus, ZAR 4,830,842,000. The number of direct projected jobs (including those in construction) is 41 229 and the average cost per job, ZAR 117,171.

In line with IPAP 2 and the NGP, the dti has recognised the need to regionally diversify manufacturing industries from traditional industrial hubs to new economic regions. The IDZ scheme will be expanded into a Special Economic Zones (SEZ) programme that will comprise IDZs and other types of specialised zone.

If effectively managed, IDZs can be useful in promoting a regionally diverse manufacturing industry and fostering regional coherence and integration. To that end that the following measures are now being addressed:

- developing a governance model for industrial zones;
- promoting stakeholder co-ordination (including ports, railways, electricity supply, customs, and permits);
- re-visiting existing funding and business models; and
- developing strategies to attract more investors to the SEZ (IDZs and others).

BPS is a sector identified by IPAP 2 as key to investment and job creation. Formerly the Business Process Outsourcing and Off-shoring incentive programme, it was transformed into the current BPS and began operations in July 2007. Between then and March 2010 it resulted in the creation of more than 6 000 new jobs and attracted about ZAR 300 million in investment.

As part of its continuing efforts to tap into the multi-billion dollar global Business Process Outsourcing (BPO) industry and gain a competitive edge over its rivals in the industry, the dti undertook a review of the BPS incentive programme. South Africa's incentives were compared with those of established offshore locations in India and the Philippines, and with so-called Tier 2 competitors in Egypt, Malaysia and Kenya. That study resulted in a further revision of the BPS programme, starting 1 January 2011 and terminating on 31 March 2014. The revised programme will reduce the cost of BPO operations in South Africa by up to 20%, paying investors ZAR 112,000 for each full-time job created and maintained. The incentive includes a component called Monyetla (seSotho for 'opportunity'), designed to provide work-readiness training and placement for entry level agents in the BPS industry. A pilot programme in 2008 trained 1 117 young unemployed South Africans at a cost of ZAR 15,000 each, a sum which included a daily stipend. Of these, 77% were regarded as sufficiently competent to find permanent employment.⁴²

Incentives under the scheme will be paid over a three-year period in instalments of ZAR 40,000 (first year), ZAR 40,000 (second year) and ZAR 32,000 (final year). The programme will run for five years, of which any three may be used for incentives. Benefits include:

- a graduated bonus incentive to be paid over and above the current scheme for qualified companies, allowing for additional financial bonuses;
- a one-off bonus of 20% to be paid to operations providing between 400 and 800 offshore jobs; and
- a one-off bonus of 30% to be paid to operations providing more than 800 jobs.

The total allowance of ZAR 112,000 is almost twice that of the incentive previously paid and makes South Africa much more competitive than its Tier 2 rivals (Egypt, Mauritius and Morocco) as well as several Eastern European countries. The programme is open to local and foreign investors, registered as legal entities in South Africa, that create at least 10 offshore jobs each year.

The CIP provides a non-refundable cash grant of between 10% and 30% of the total development costs of qualifying infrastructure. It is made available to approved beneficiaries upon completion of the particular project. Infrastructure is deemed to be 'critical' if the infrastructure is necessary for an investment that could not go forward without the CIP contribution; or if it would be demonstrably of smaller scale or lower quality if established later than intended. Potential beneficiaries include public sector entities such as municipalities, private investors, public-private partnerships (PPP) and investors in strategic economic projects. Benefits consist of a maximum cash grant of 30% of the development cost of qualifying infrastructure.

The Capital Projects Feasibility Programme is a cost-sharing scheme. South African enterprises may receive in advance a portion of the cost of feasibility studies likely to lead to projects beyond the country's borders that increase South African exports and stimulate the market for South African capital goods and services. The programme will contribute a maximum of 50% of study costs for international projects outside Africa and 55% for projects within Africa.

The CTCIP is aimed at stimulating competition among clothing and textile manufacturers with a view to eventually competing internationally. Effective since April 2009, it provides investment support to local and foreign enterprises, offering a cost-sharing grant incentive of 75% of project cost for cluster projects, and 65% of project cost for single-company projects. Under a CTCIP sub-programme, the Production Incentive, applicants can use the full benefit as either an upgrade grant facility or an interest subsidy, or a combination of both. The programme is supervised by the IDC, which evaluates all business proposals.

Established in 1992, THRIP is a partnership programme funded by the dti and managed by the National Research Foundation. On a cost-sharing PPP basis, THRIP supports science, engineering and technology research collaborations that centre on the technological needs of participating firms, and encourage the personal development and mobility of research personnel and students among participating organisations. Companies invest jointly with THRIP in those research projects that are headed by personnel on the academic staff of South African Higher Education Institutions (HEIs). THRIP matches the industry's investment in the case of projects on which researchers and experts from Science, Engineering and Technology Institutions (SETIs) serve as project leaders, and students are trained. In addition, Transfer Of People ('Tiptop') schemes promote researcher and student mobility among industrial participants and the HEIs and SETIs involved in the projects.

Trade, Export Promotion and Investment Financial Assistance Incentives

The dti has designed the following incentives with their sub-programmes, to promote export development, market access and foreign direct investment:

- the Export Marketing and Investment Assistance programme;
- the Automotive Investment Scheme, already in force as part of the Automotive Production and Development Programme that will replace the Motor Industry Development Programme (MIDP) in 2013;
- the Film and Television Incentive; and
- the Sector-Specific Assistance Scheme.

The Export Marketing and Investment Assistance scheme partially compensates exporters for activities aimed at developing export markets for South African products and services, and attracting new FDI. The programme is directed at local manufacturers and exporters; export houses representing three or more SMMEs, or HDI enterprises; South African commission agents representing at least three SMMEs or HDI-owned businesses; and South African export councils, industry associations and joint action groups representing at least five South African entities. Benefits include help with exhibition participation, including rental costs of exhibition space, construction of stands, translation and interpreter fees, Internet connection, telephone installation, and registration fees up to a maximum of ZAR 45,000. In addition, primary market research costs and costs incurred bringing new FDI into South Africa through personal contact with potential investors in foreign countries, will be compensated. Finally, costs involved in capacity-building and skills transfer may also qualify for assistance.

Box 2: Incentives supporting the South African automotive industry

The manufacturing and retail automotive industry contributes about 6% to South Africa's Gross Domestic Product and automotive exports make up almost 12% of total exports. The MIDP was started in 1995 to restructure the South African automotive industry away from import-substitution towards export-orientated production. Prior to 1995 the local content stipulation of 60% of the vehicle value contributed to a production structure of relatively low volumes and consequent high manufacturing cost.

The MIDP abolished local content requirements and introduced a phasing-down of tariffs on imports of light motor vehicles and automotive components (in the process, incidentally, going beyond South Africa's obligations to the World Trade Organisation). The programme was aimed at increasing production volumes through specialisation in vehicles and components.⁴³ In 2002 the Ministry of Trade and Industry extended the programme to the end of 2012. Import duties and duty rebates will continue to decline until the programme ends.

Under the MIDP a total of more than ZAR32 billion has been invested since 2000; and at least ZAR4 billion more is to be invested during 2011. An estimated 90 000 people are directly employed in automotive manufacture (in which at least 20 000 jobs have been lost

since the 2008 recession). In addition, about 200 000 are employed in the retail chain and the after-market.

In 2013 the Automotive Production and Development Programme (APDP) will replace the MIDP and will remain in place until 2020. The new incentive programme sees a shift in emphasis from exporting to more intensive production. The key objectives of the APDP include:

- increasing automotive vehicle production to 1.2 million vehicles a year by 2020, with a related expansion of the components industry;
- providing appropriate support for these targets;
- expanding value-added production, investment, employment and net government revenue directly and through the multiplier effect;
- achieving better balance between domestic and export markets to meet growing domestic demand; and
- contributing to the balance of payments.

The four main components of the APDP are:

- import tariffs of 25% will be introduced from 2012 for completely built-up vehicles and 20% for components used in vehicle assembly;
- a local assembly allowance for manufacturers producing more than 50 000 vehicles a year to import 20% of their components duty-free, reducing to 18% over three years;
- a tradeable duty credit of 55% for production on the value-added element of components, measured from the selling price minus raw material costs. This will reduce to 50% over five years and an additional 5% will be made available for vulnerable sub-sectors; and
- an allowance in the form of a grant to the value of 20% of the project over three years, to support investment in new plant and machinery.

The Automotive Investment Scheme (AIS) is a cash grant incorporated into the APDP (although in force since 2010) that sets the framework for the medium- and long-term development of the industry. The AIS offers a grant of 20% of an investment subject to certain performance criteria, including growth in volumes and employment, new technology and localisation; with an additional incentive of 10% tied to development performance. The Ministry of Trade and Industry estimates that the AIS has led to planned investments of ZAR13 billion by motor assemblers and component suppliers, supporting 24 000 jobs.

The Eastern Cape automobile industry, home to the automotive 'big four' manufacturers, contributes about 40% of South Africa's motor sales, 60% of automotive exports and approximately 30% of the province's employment. Volkswagen South Africa has a factory in Uitenhage; Ford and General Motors have plants in Port Elizabeth; and Daimler Chrysler is based in East London. Port Elizabeth has South Africa's largest concentration of automobile manufacture and component suppliers. The IDC, having identified motor manufacture as a sector in which South Africa holds a strong competitive advantage, has a 45% stake in Umicore Autocat South Africa, a materials technology specialist with a factory in Port Elizabeth. Parent Umicore Group of Belgium holds the remaining 55%.

Government offers the Film and Television Incentive to promote the film production industry. The incentive comprises two sub-programmes, the Foreign Film and Television Production incentive to attract foreign-based film-makers to shoot on location in South Africa, and the South African Film and Television Production and Co-production Incentive to assist South African film companies in the production of local content. Benefits under the programme amount to 15% and 35% of the Qualifying South African Production Expenditure capped at ZAR 20 million. By 2011, 169 films had been approved and ZAR 704,165,844 in funds committed, with a total cost to the fiscus of ZAR 377,620,856.

The Sector Specific Assistance Scheme (SSAS) is designed to help fund non-profit organisations in sectors and sub-sectors of industry prioritised by the dti, through two sub-programmes: Generic Funding, for the establishment of an export council; and Project funding for Emerging Exporters to aid in exhibition participation and outreach missions for export entrepreneurs. The organisation's purpose or the aims of its proposed project must conform to the export strategy of TISA, with among other things a 35% local content requirement for potential exports.

Fiscal incentives

In 2006 the Investment Climate Advisory Service (FIAS) of the World Bank was commissioned by the National Treasury, in conjunction with SARS, to conduct a tax burden study on five of South Africa's key economic sectors: manufacturing, agriculture, mining, finance, and tourism. The study aimed to provide the government with an analysis of its tax and incentive schemes through marginal effective tax rate (METR)⁴⁴ calculations; and with an assessment of the country's international competitiveness.

The study concluded that the South African tax system 'did not contain an overabundance of targeted incentive schemes'. It does not offer tax holidays, for example, and there are few targeted investment allowances and tax credits. South Africa was found to be broadly competitive with other SADC countries examined and with peer economies globally. It was felt, however, that there was room for a reduction in the tax burden. FIAS recommended the revision of both the Small and Medium Development Project (SMEDP) and the Strategic Investment Programme. These programmes were subsequently replaced; SMEDP by the EIP (see p22), and the Strategic Investment Programme by the Income Tax Allowance (Section 12i of the Act).

Fiscal incentives⁴⁵ available for investors include:

- preferential corporate tax rates for small business. SMEs with a turnover for the year of assessment not exceeding ZAR14 million are eligible for tax deductions of up to 10% for incomes between ZAR 59,751 and ZAR 300,000; up to ZAR 24,025 for incomes over ZAR 300,001 and an additional 28% for amounts over ZAR 300,000;
- R&D incentives. Tax deductions may be increased to 150% for expenditure incurred on or after 2 November 2006 in the discovery of 'novel, practical and non-obvious information' in devising, developing or creating any invention, design or computer programme or any knowledge essential to the use of the invention, design or computer programme;
- a special depreciation allowance. Such allowances are made for building and refurbishment of plant and machinery, hotel equipment, agricultural and manufacturing

- buildings and renewable energy installations. They vary between 5% a year for refurbishment to 50% a year for renewable energy. The allowance period is three years;
- an Urban Development Zone Tax Incentive. A taxpayer will qualify for the allowance only in respect of the erection, expansion or addition to a building or the purchase of a building from a developer, for the sole purposes of that person's trade, on or before 31 March 2014. The use of the building will determine the period of the allowance (four years for improvement to low-cost residential units, five years for improvement to existing buildings or their purchase from a developer, seven years for the erection, extension or addition to low-cost residential units and 11 years for the erection, extension, addition or purchase of such buildings);
 - an Infrastructural Development Incentive. A tax deduction of 10% of annual cost is granted in respect of any new or unused affected assets owned by the taxpayer on pipelines used to transport natural oil, and 5% of the cost of all other affected assets;
 - PPP allowance. Qualifying government grants utilised by the taxpayer to effect improvements to state-owned property are exempt from tax. The allowances are for 25 years; or the period of the lease, whichever is shorter;
 - rolling stock depreciation. Rolling stock is defined as railway locomotives, carriages and other vehicles. A deduction is permitted of 20% a year of the cost incurred in respect of rolling stock brought into use on or after 1 January 2008;
 - environmental expenditure deductions. Environmental treatment and recycling assets ancillary to a manufacturing process qualify for relief of 40% for the first year and 20% for the second to fourth years. There is a further 5% allowance on the annual cost of waste disposal assets;
 - commercial buildings depreciation. A 5% annual depreciation allowance is permitted on new or unused buildings (and improvements) used wholly or mainly in the production of income, where the building is owned by the taxpayer;
 - carbon-reducing charges. Companies which receive primary certified emission reductions (CERs) revenue from clean development mechanism (CDM) projects are tax exempt in respect of disposals on or after 11 February 2009;
 - energy expenditure allowances. To provide relief for the depreciation of energy-efficient equipment, an additional allowance of up to 15% is provided, subject to conditions (the effective date of the measure has not yet been announced);
 - oil and gas income tax incentives. Tax incentives are offered to oil and gas companies involved in exploration and production, and incidental business activities, inside South Africa. Prior to 2007 the incentive applied only to exploration and production;
 - underwater telecommunication cable allowances. To provide relief for the depreciation of underwater cables for voice and data communications off the African coast, a depreciation write-off of 5% over 20 years is available; finally
 - film rebate subsidies. Tax rebates for portions of the cost involved in producing a South African film are extended to investor-owners without triggering additional tax.

Local and municipal incentives

Unlike rules-based national incentives, certain local municipalities are permitted to offer a combination of incentives to potential investors, some on a discretionary basis. They are typically offered to companies on a case-by-case basis to induce employers to locate

or expand in the area provided they meet particular requirements and undertake specific obligations. As cautioned earlier, discretionary incentives are inherently less transparent and offer opportunities for rent-seeking or collusion.

Local and municipal incentives may include:

- discounts on service costs (water, electricity and rates);
- rebates on municipal building plan approval costs for approved investments;
- discounts on rates and services for new investments; and
- discounts on municipal land and building rentals.

SURVEY AND INTERVIEW RESEARCH

Some interesting perspectives emerged from interviews with government agencies and IPAs at the provinces. An interview form (see Appendix 1) served as the basis of questioning for face-to-face, email and telephone interviews. Participants generally had a few days to read the questionnaire, consult their colleagues, complete the form and conduct a telephone or personal consultation with the interviewer.

IPAs responsible for investor facilitation provided comments from the investor groups they served. A relatively large number of domestic and foreign investors were unaware of the South African investment incentive schemes. In many instances where investors were aware of the scheme they were unsure of which programmes their projects qualified for, or how to access them.

Many, especially foreign investors, relied on specialised consulting firms to assist them with the application process. IPA staff reported that in some instances they encouraged investors to use consulting firms when investors indicated that the process had become too onerous.

A member of staff at one IPA pointed out that it was much easier to add new incentives than to revise (and reduce) existing programmes, which could explain some investors' perceptions that there were too many programmes with similarly focused benefits. Nevertheless, the dti has taken pains to review and revise a number of major programmes over the years. It is global best practice to evaluate continually programmes on offer and to ensure that a single incentive programme is not in place for too long, because its effectiveness will decline over time.

Most agencies did not have a reporting system that could access historical information on investors using the incentives; whether or not they utilise incentives for the entire duration of the programme, or how many are repeat users. Many thought this information would be useful, as would the numbers and identities of investors who had unsuccessfully applied for incentives, and the reasons why the application was blocked or turned down. It was felt that IPAs could assist investors by ascertaining the reasons behind a failure to complete the application, and then addressing the problem.

With smaller investments, the incentive benefit is questionable relative to the perceived difficulty of form-filling, or the cost of employing a consultant. In the case of large equity investments, benefits usually far exceed costs and investors will typically complete the application process despite regarding it as cumbersome. In certain provinces TEO staff members deployed by the dti to assist the incentive application process are having a

positive effect on incentive application procedures and utilisation. In others, however, a relationship between IPA staff facilitating the investment and TEO staff has yet to be established.

The interviews and assessment of provincial marketing assets made it apparent that those incentives specific to the provinces received serious attention. In agriculture-rich provinces, for example, the cooperative scheme was well-known, as it has been deployed with some regularity. There were also reports from individuals in some of the provinces that dti workshops had been held for some of the schemes. They hoped that others would follow.

A recommendation flowing from the interviews is that a strategic marketing effort may be advisable to co-ordinate the marketing messages on the topic of incentives. The national incentives scheme provides a wide variety of potential benefits to domestic and foreign investors which, if presented appropriately, could prove a powerful additional development tool at national and provincial levels.

APPENDIX I: INTERVIEW QUESTIONS

Please list **significant** investments that have occurred in your province over the past five years and comment on their significance. ('**significant**' refers not only to investments with substantial equity investment but also those, for example, with job-creation potential; emphasising infrastructure development; supporting beneficiation industries; supporting green initiatives).

- a)
- b)
- c)
- d)
- e)
- f)
- g)
- h)
- i)

The Department of Trade and Industry (dti) and collaborating agencies offer various investment incentives (financial, fiscal and other preferential inducements) aimed at strategic sectors; small enterprise development; industrial development; and trade and FDI development. **Which incentives have been utilised by investors in the projects listed in Question 1 above?**

Small, Medium and Micro-sized Enterprises (SMME) Development Financial Assistance , incl. Black Business, Supplier Development, EIP, SEDA Technology Programme, Support Programme for Industrial Innovation	
Industrial Development Financial Assistance , incl. Tax and training allowance for manufacturing, Capital Projects Feasibility, Competitiveness Improvement, Business Process, Critical Infrastructure, Clothing and Textile Competitiveness Improvement, THRIP	

Trade, Export and Investment Financial Assistance Incentives , incl. Export Marketing and Investment Assistance, Foreign Investment Grant, Sector-specific Assistance Scheme, Automotive Investment Scheme, Film and Television Incentive	
Tax Incentives , incl. Preferential Corporate Rate for Small Business, R&D Tax Incentive, Special Depreciation Allowance, Capital Incentives Allowances, Infrastructural Development , PPP Allowances, Rolling Stock Depreciation, Environmental Expenditures Deductions, Carbon-Reducing Exemptions, Energy Expenditure Allowances, Oil and Gas Income Tax Incentives, Underwater Telecommunication Cable Allowances, Film Rebate Subsidies	

Which of the incentives listed in Question 2 (above) have been most popular, or most often applied by investors in your province?

- a)
- b)
- c)
- d)
- e)
- f)

National and provincial governments undertake a number of marketing or promotional activities to compete with other potential investment destinations. These activities include advertising, project road shows, investor conferences, outreach missions. **What types of activities has your unit/province conducted to assist in securing these investments?**

Advertising	
Project road shows	
Investor conferences	
Outreach missions	
Other	
Other	

Were investors aware of the incentives prior to the engagement in your province, or did your unit/agency conduct marketing and promotion activities to bring the incentives to investors' attention?

YES , investors were already aware of incentives	
NO , investors were not aware of the incentives prior to engagement	

In offering incentives to your investors, has your agency been able to modify them to fit the category of investment?

YES , we have been able to modify them	
NO , we have not been able to modify them	

Has your agency/unit or a national agency conducted any performance monitoring or evaluation activities relating to the investment projects where incentives have been applied?

YES , performance monitoring has been undertaken. Please provide detail:	
NO , performance monitoring has not been undertaken	

In your experience, have any investors reported difficulty in understanding for which incentives they qualify? If yes, please share some detail.

YES , investors have some difficulties in understanding for what incentives they qualify. Please provide detail:	
NO , investors have found no difficulties in understanding for what incentives they qualify	

Please provide information concerning the proportion of domestic investors and the proportion of foreign investors that have used incentives in your province? If no data, what are your estimates?

TYPE OF INVESTOR	PERCENTAGE	DATA/ESTIMATE
Domestic investors%	
Foreign investors%	

What is the relationship between your agency and the national authorities (eg dti, Treasury, TISA, IDC, and DBSA) in the administration of incentives?

dti	
TISA	
IDC	
DBSA	
Treasury	

What is your agency's assessment of the costs as related to the benefits (cost-benefit analysis) of the investment incentives scheme as applied in your province?

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Are there any conspicuous gaps in the suite of investment incentives you are able to offer investors?

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Can you point to any significant administrative barriers or delays in the implementation of incentives and/or the benefits being made available to investors?

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What do you find the most positive aspect of the South African investment incentives scheme?

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APPENDIX 2: INDIVIDUALS ASSISTING WITH INFORMATION FOR THIS PAPER

- Nigel Gwynne-Evans, Western Cape Department of Economic Development and Tourism
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- Tumelo Chipfupa, Department of Trade and Industry
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- Lucky Tetse, Industrial Development Corporation
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