In and Out the Bramble Bush: South Africa and the Global Investment Regime

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Investment is a key factor in contemporary economies, and a critical one in states requiring extensive economic development and poverty alleviation. International investment is affected by the same forces which operate in other areas of the global economy such as trade and finance. At the global level there is a dominant narrative in each area while there is both conformity with and deviation from this narrative at the nation state level.

The grand narrative of cross-border investment at the global level is as follows:

> Capital, as a scarce commodity in competitive environments, flows to investment situations in which it can secure the highest yields and promote economic efficiency. Returns on capital, such as royalties, profits and dividends, should be freely transferable, and investors, at their discretion should be able to withdraw investments and relocate them to situations in which higher returns are achievable. Where capital continuously transverses political boundaries, it should be subject to minimal legal restrictions, regardless of whether transference causes harm to the economy from which it is moved, and should not be subject to discriminatory treatment vis-à-vis domestic capital.

Nation-states should subscribe to the economic principles of the grand narrative in the utilitarian interests of the country as a whole and the corporations, consumers and employees within it. Economic efficiency, through the effective deployment of investment capital, leads ultimately to the advancement of human welfare.

While the grand narrative is not a fairy tale it is also not descriptive of reality; moreover it suffers from deficiencies as a prescriptive model in the complex circumstances of the contemporary, global economy.

This article considers aspects of South Africa's involvement in, and compliance with, the international investment regime and identifies areas in which it might make its own policy choices in this regard. It focuses on foreign direct investment (FDI), and not on portfolio and other non-FDI cross-border investment. It does not therefore address issues such as the proposed South African tax on volatile capital flows designed to stabilise the rand's vaulting value, as introduced in Brazil in similar economic circumstances.

The issues under discussion are approached from a predominantly legal-institutional perspective. While legal orders lay claim to higher normative allegiance, they often reflect economic imperatives and laws and concede (directly and indirectly) areas of autonomous market activity. This is also true for the political realm which, under the forces of globalisation, has become reflective of economic realities. What is within the authentic province of markets and what is within the domain of political and regulatory systems

is an enduring question not addressed here. Nonetheless, it is assumed that rule-based systems for cross-border investment, as for international trade, are preferable to unfettered political discretion or 'state-of-nature' market forces. As with other legal dimensions of the global economy the law in the investment field is both 'hard' and 'soft' in nature, the latter comprising guidelines, charters and customs which lack juridical enforceability.

South Africa's foreign direct investment: Catching the tide

South Africa has experienced ebbs and flows in its inward investment record, particularly in the 1990s and 2000s. Periods of heavy inward FDI have been followed by dramatic withdrawals of funds, as well as the outward flight of domestic capital. The reasons for the fluctuations are multi-faceted and by no means unique in developing and emerging economies, and in recent years, in the global economy as a whole. The following table shows South African investment figures over the last five years:

	FDI Flows (US $ millions)		FDI Stock (US $ millions)	
Period	Inward	Outward	Inward	Outward
2005	6644	930	69372	38505
2006	-527	1584	77033	44499
2007	5695	2996	110415	65878
2008	9006	-3134	68007	49788
2009	5696	1584	125085	64309

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In July 2010 the UN Conference on Trade and Development (UNCTAD) published its annual World Investment Report. The report combines statistical data, information on trends in global investment and some evaluation of policy developments in different contexts. In the previous month the Organisation for Economic Development (OECD) produced its annual report on international investment involving member states, and included non-member, South Africa, courtesy of its G-20 status.

In combination, the UNCTAD and OECD reports indicate that globally there has been a modest recovery in FDI flows after the drop-offs of previous years. While the recovery was not consistent across economies, a prominent feature has been the contribution of emerging countries in relation to both inward and outward FDI. This has implications for power relations in respect of future investment policy, as referred to below.

In the African region, the increase in inward FDI over the past year was greater than the global average. Most African FDI comes from developed countries. Of that emanating from developing countries, China was trumped as a source of FDI funds in 2009 by South Africa itself. This challenges some urban legends on the issue, though China's time profile discloses significant annual increases from a low historical base. While South Africa's outward FDI indicates a healthy involvement in the continental economy by over 1100 local companies, it creates some tension in relation to domestic economic needs and in terms of developing a coherent policy framework in this area.

South Africa performs moderately well with inward FDI in a competitive field, though considerably less well than the BRIC economies (Brazil, Russia, India and China). Among African countries it was the fourth largest recipient of FDI last year, after Angola, Nigeria and Egypt. However capital inflows for 2009 retracted from the previous year – from US$9.1 to US$5.6 billion – a significant drop in the context of the overall global recovery. The South African statistics are not sector-specific but it can be assumed that evidence of a general decline in manufacturing FDI, relative to that in the primary and services sectors, is also reflected locally. This is cause for concern, given government's commitment

to developing this sector of the domestic economy. Of additional concern is the fact that some competitors provide better treatment to transnational capital than to national capital for the purpose of attracting FDI through comparative advantage.

South Africa's general investment profile, both inward and outward, suggests strong engagement with the world economy. However, the recent OECD Report indicates that, on a spectrum of 50 economies, measuring the extent to which they are closed or open towards FDI, South Africa is approximately at mid-point on the range, finding itself between Switzerland and Latvia. At the same time well over half the inward FDI in South Africa is capital-intensive and related to mergers and acquisitions, and is not labour- intensive or necessarily supportive of economic growth. These realities suggest the need for constant refinement of legal and policy frameworks in the area of investment, insofar as this is compatible with the grand narrative.

Domestic Regulation of foreign direct investment: In the brambles

By and large South Africa's investment regime is compliant with global norms and the grand narrative on cross-border investment, particularly inward investment.

It is a predominantly liberal regime with relatively few restrictions on inward FDI. The most direct border obstacles are foreign exchange regulations which are modified periodically to serve broader economic purposes. Foreign investors involved in mergers with, or takeovers of, South African companies are subject to the same competition rules and policies as domestic corporations. This involves potential restrictions for prospective investors, given South Africa's sophisticated competition law regime, but the system operates on a non-discriminatory basis with the only difference being foreign investors have a ceiling on domestic loans granted to support their investment. Investors from abroad are necessarily subject to domestic law in areas such as employment, planning and environment, intellectual property and corporate governance. Again these measures are non-discriminatory in intention and effect, and South Africa generally satisfies the 'national treatment' norm of international economic law in this area.

In recent years both inward and outward investments have been further facilitated by relaxations in foreign exchange rules, in furtherance of liberalisation policies. There has been another recent liberalization of South African law relating to inward investment, namely in the taxation system. This is an attempt to recover comparative advantage over Mauritius in relation to headquartering of companies as a route into Africa. However, given South Africa's relatively reliable infrastructure, accessibility to African markets and other economic advantages, it has not been deemed necessary to take extreme measures on exchange control and taxation to re-establish South Africa's position as preferred gateway into Africa. For example corporate tax arbitrage between Ireland and South Africa has in the last five years led to extensive net outflows of capital to Ireland, but there is no suggestion of drastic reductions in corporate taxation to redress the imbalance.

Here, legislation empowers the Finance Minister to review investment proposals and enter into 'negotiations' with prospective investors. Ultimately the Minister has power to block investments on enumerated grounds. By comparison, and similar to with other capital-seeking countries, South Africa provides a welcome mat, and not a security check for prospective cross-border investors.

For the rest, South Africa has no border barriers preventing market access by foreign investors. Other countries, by comparison, have state agencies screening prospective investments, with the capacity to impose conditionality requirements on those granted access. In Australia, the Foreign Investment Review Board can screen, veto or conditionally admit proposed investments, exercising its discretion in terms of security imperatives and safeguards for key economic sectors. The Board has a lengthy history, reflecting continuing local concern about foreign ownership of assets and corporations. The veto power is occasionally exercised in practice on national interest grounds. There is also provision for the supervision of conditionality requirements. In Canada there has also been a move from indirect, to more direct regulation of inward FDI out of similar concerns to those articulated in Australia. Here, legislation empowers the Finance Minister to review investment proposals and enter into 'negotiations' with prospective investors. Ultimately the Minister has power to block investments on enumerated grounds. By comparison, and similar to with other capital-seeking countries, South Africa provides a welcome mat, and not a security check for prospective cross-border investors.

With respect to outward FDI, the main restrictions for state enterprises or private corporations are again found in forex regulations, particularly those related to financial institutions. As indicated above they have not prevented South Africa from being the leading developing economy investor in Africa in 2009. They have also not precluded substantial investments in other parts of the world, from Portugal to New Zealand.

Review of Legal Framework: Outside the brambles

For the past year the South African government has been undertaking an extensive review of its policy framework on investment. The same reviews are occurring in other emerging and developing economies. However, in some respects South Africa's circumstances are different to those of other African and developing countries, creating a tension in its policy developments. In some years, it is a net exporter of capital. This provides pressure from local corporations whose self-interests motivate them to seek the legal protection for outward investments, which South Africa is reluctant to extend to investments from abroad. This asymmetry of interests is dealt with later in the article.

Where there are potential local challenges to the grand narrative, globalisation creates four options in relation to national policy choices:

- **The first relates to areas in which treaty commitments demand local compliance with global norms at the risk of international law sanctions or losing market share. This option concerns South Africa's obligations under the World Trade Organization (WTO) system where non-compliance of local measures with WTO rules can result in consequences, including retaliatory measures.**
- **The second concerns market pressures emanating from South Africa's main export destinations: China, the United Kingdom and the United States. Should these countries for example introduce climate change compliance measures relating to carbon emissions, market imperatives would require exporters to satisfy the external requirements. In either case the law or the market dictates that local policy and practice comply with global norms.**
- **The third relates to areas where neither treaty obligations nor market imperatives necessitate local arrangements conforming to the dominant narrative, and there is space to deviate from international economic law standards. Examples are the General Agreement on Trade in Services and the Art XX exceptions under the General Agreement on Tariffs and Trade in the WTO system. Various forms of 'soft' international economic law, such as OECD Guidelines for Multinational Enterprises and International Chamber of Commerce guidelines for investment, provide some (though not absolute) latitude at the domestic level. Moreover, states which enjoy comparative advantages through quasi-monopolies in key economic sectors might be less impervious than car exporters to normal market pressures. South Africa's control of nearly 90% of the world platinum reserves is a case in point.**
- **The fourth is reinforced by recent events in the global economy which invite emerging economies to exercise, or at least test, local policy options. The financial and economic crises have subverted hallowed doctrines of macro-economics and market-state boundaries through the practices of extensive deficit-funding, bail-outs of financial institutions, effective nationalisation of industries, increased financial regulation and local protectionist strategies of overt and covert varieties. These state interventions have countermanded long-dominant Washington-consensus and IMF policies, leaving uncertainties over future domestic and global frameworks in these areas. Reinforcing new ambiguities in economic policy are the changing politics of the global economy, as emerging countries not only flex their muscles in trade and investment across borders but also assume speaking roles in the G-20 group of countries.**

These circumstances invite consideration of which elements of investment policy and law inhabit the third category of international-domestic relations, and how South Africa might develop its investment framework to exploit any such latitude.

New BITs: The urge to surge

Unlike the rule-based system for cross-border trade, foreign investment has no multilateral system of rules despite attempts to develop such in the mid-1990s and early 2000s. Investment is minimally affected by the WTO system, deriving what legal architecture it has from international agreements such as Bilateral Investment Treaties (BITs) and investment provisions in regional trade agreements. There are several thousand BIT treaties, with exponential increases in recent years, comprising a confusing and sometimes conflicting regulatory scheme and reducing Rule of Law predictability in the area. Ironically, the addition of each new investment treaty diminishes the comparative advantage provided by existing agreements as countries outbid one another to attract scarce investment capital; they also expose states to proceedings initiated by investors under the treaties.

South Africa has been an active player in the world of BITs, with over 110 investment agreements currently in existence, most emanating from a BIT explosion in the mid-1990s. These include many with developing countries, including India, China, Kenya and Zimbabwe. The standard BIT template promotes six principal objectives:

1. **The encouragement of reciprocal investment by entities of each State in the other;**
2. **An 'umbrella' provision providing fair and adequate legal protection in each State for foreign investment from the other contracting State;**
3. **Specific protection against expropriation of investments, or actions tantamount to expropriation, which diminish the value of investments;**
4. **Provision for repatriation of profits, royalties and dividends to the investor's home state;**
5. **Provision for prompt, effective and adequate compensation in the event there is expropriation of investment property;**
6. **Establishment of a dispute resolution system for conflicts between foreign investors and host countries, including identification of service-providing institutions.**

The global BITs regime is currently experiencing pressures for change as new forces emerge in the global political economy. Historically, agreements were effectively constructed by developed countries – the principal sources of investment funds – and imposed on capital-seeking countries, mainly in the developing world. Over time more BITs were ratified among developing countries themselves, and African states were prominent in this regard. However these treaties perpetuated the conventional template and recently there have been serious critiques of the old pattern. This is partly a function of mixed evidence on the significance of BITs as determinants of investment decisions, and a surprising degree of ignorance about the agreements in investor communities. At best it can be said that BIT agreements are only one of many considerations motivating investor decisions. Brazil's economy has succeeded in attracting considerable foreign investment despite the country not having ratified a single investment treaty to date. There has also been disaffection with BITs in South America and European states such as Norway. Here reference is made to three areas in which countries disaffected with the old BIT regime are contemplating changes in the standard template:

- Stated purposes of the agreements: As with other treaties, BITs contain 'objects and purpose' clauses, regularly referred to in International Centre for Settlement of Investment Disputes (ICSID) arbitrations as sources of interpretation. In these clauses most BITS refer to encouragement of reciprocal investments between the states concerned and the protection of investments once made. Other purposes of cross-border investments are seldom included in 'objects and purpose' clauses, such as economic development, promotion of human rights, sustainable development or other social objectives. Here emerging and developing economies are committed to having

BITs identify economic development needs in particular, as well as other national interests in the objects clauses. This would provide an interpretive source for arbitrators when evaluating claims by investors and could challenge the dominant narrative of international investment.

- Balancing rights and duties: Standard BITs create rights for investors but little in the way of reciprocal rights for host countries, or correlative obligations for investors. Here there is a shopping list of rights and duties for enhancing local economic development: joint ventures, technology transfers, training in knowledge capital, procurement from local suppliers, sourcing of staff locally, and some capital retention in host countries. Transfers of technology, for example, are sometimes described as key advantages of FDI since merged companies are able to maintain existing staff or import professionals where needed, whereas technology transfer can confer real benefits on developing countries and lessen their dependence. There could also be alternative conceptions of expropriation and the measurement of financial damages, which are currently drawn from American jurisprudence and provide for 'prompt, equitable and adequate' compensation. This generally leads to monetary awards in excess of those entertained in legal systems such as South Africa's. Here, the Constitution merely provides for 'just and equitable compensation', not only in its quantum but also in the manner and timing of its payment. Moreover the 'equitability' and the 'justness' are subject to the balance between public interest and interests of those whose properties were expropriated. BIT jurisprudence in this area appears to conflict with South Africa's constitution, a factor in the country's refusal over many years to ratify the ICSID Convention.
- Transformation and empowerment policies designed to redress past inequalities and bring the formerly disadvantaged into the mainstream economy: This is simultaneously a significant policy space demanded by government and an area of concern to investors. Broad-based black economic empowerment (BEE) policies are constitutionally permitted and are reflected in many statutes, regulations and industry charters. They conflict with standard investment treaty policies and frustrate foreign investors, despite not being applied on a discriminatory basis. As discussed below, BEE in the mining sector has been legally challenged by investors. However, new political space, and commonalities with other emerging economies, provide circumstances to promote South African policy in this regard as a variation on the dominant narrative.

Dispute Resolution Systems: Blowing in the Wind

Emerging countries have concerns about disputes being dealt with through private arbitration, where constitutional and legislative policies are less well comprehended than in domestic courts. The rational for adopting arbitration in standard BITs is that arbitrators, unlike domestic courts, are neutral and independent interveners and arbitral processes are relatively cheap and quick. However the system also has shortcomings. Arbitration in practice can be protracted and expensive, and the exclusive remedy of monetary compensation can lead to termination of what was envisaged as a long-term engagement. It also involves private commercial arbitrators adjudicating over sovereign states, a factor which has lead several countries to limit the use of arbitration in whole or in part. Furthermore complaints can be brought and prosecuted by corporations despite the fact that treaty obligations are accepted by nation states. Not only is there no parity between investor complainants and respondent states, but the arrangement undermines traditional principles of international law, which recognise only nation states. While there are other indications of the acknowledgement of corporations in international law, these usually comprise obligations of the 'corporate social responsibility-variety' and are essentially soft law in nature. BITs, by contrast, provide 'hard law' rights and remedies to non-state entities.

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Most BITs and other investment treaties make provision for the use of arbitration in terms of UNCITRAL, ICSID or ICC rules, while regional treaties often make use of dedicated tribunals for this prupose. Two recent case studies involving South Africa highlight issues in cross-border investment disputes:

The first relates to Zimbabwe land policies which resulted in expropriation of farms of South African investors. Here a protracted series of cases in Zimbabwean courts, South African courts (including the Constitutional Court on technical issues) and the SADC Tribunal have still not brought complete finality in the dispute. The application to the SADC Tribunal was based on human rights considerations and not on technical investment law issues, the Tribunal finding that Zimbabwean actions were discriminatory and unlawful in terms of the SADC convention. This decision was repudiated by both the government and courts of Zimbabwe and had no legal effect in the jurisdiction in which the investors were seeking their farms' return. The decision was ratified by South African courts but resulted in lengthy, and continuing, steps to execute on Zimbabwean government property in Cape Town. This will ensure some financial compensation for the investors but not the return of land.

The second case involves European investment in the domestic mining sector. It concerned BEE requirements, (affecting both domestic and foreign corporations), that mining companies divest shares at fair market prices to black South Africans and commit to other specified policy requirements. The investors contended that this amounted to expropriation without compensation, an argument refuted by government in terms of the provisions of the statutory scheme. The case was prosecuted through the ICSID arbitration system with the concurrence of South Africa. It had an unusual aspect in that civil society, interested in some right of participation in the proceedings, was able to secure the pleadings from the arbitral tribunal, though no other participation was entertained. After lengthy skirmishes, the investors withdrew from the case on the basis of separate deals finalized with government; the merits were never adjudicated and no public precedent was established. There was, however, a reasoned costs award in August 2010 which resulted in South Africa recovering some of the costs expended in the arbitration. Similar cases are currently underway.

Rights such as property protection and compensation for expropriation are constitutionally entrenched, as are guarantees of procedural fairness in judicial and administrative processes, and can serve investors' risk mitigation needs.

South Africa has other specific concerns about using arbitration for investment disputes.

- First, a sophisticated Constitution provides a sound legal framework for foreign investors to prosecute claims within the country. Rights such as property protection and compensation for expropriation are constitutionally entrenched, as are guarantees of procedural fairness in judicial and administrative processes, and can serve investors' risk mitigation needs. Moreover, standards and procedures in the Constitution are nuanced to reflect domestic political and economic realities and are more sensitive to policy space retention, necessary for governments in a post-apartheid society.
- Secondly, there are concerns about the directions future tribunal interpretations of BITS might take in the absence of formal systems of precedent, review and appeal. There are limited checks and balances to constrain tribunals from interpreting BIT provisions favourably to investors, and to the detriment of economic interests in the host country. This issue is fuelled by perceptions of negative outcomes for host countries from past arbitrations (regardless of overall patterns of outcomes) and the reality that developing countries are respondents in the majority of ICSID or UNCITRAL arbitrations. The perception is reinforced by an absence of empirical evidence on the causal connection between the existence of BITs and the attraction of inward investment.
- Finally, South Africa is a member of regional organisations, including the Southern African Development Community (SADC). SADC has a tribunal based in Namibia, which could develop jurisprudence in relation to host-investor disputes with human rights implications, and do so in light of local realities. As shown above, it has already been used in one case involving South African agricultural investors in Zimbabwe.

> While institutions such as these have their own shortcomings such as expertise in investment law and the enforceability of outcomes, they do provide 'local' alternatives to remote ICSID processes.

There are inevitably counter-arguments on these issues but changes in BITs arrangements, particularly in transitional societies, should be sensitive to local political and economic realities. South Africa's most recent investment treaty, with Zimbabwe, incorporates accustomed arbitration provisions involving ICSID, UNCITRAL or the ICC, arguably because of South African corporations' concerns about Rule of Law protections in that country, the converse of South Africa's argument relating to its own institutions.

In the current South African climate of policy deliberation on investment treaties generally, and their dispute resolution provisions in particular, it is appropriate to examine other options for the future. UNCTAD has recently published a paper on alternatives to arbitration in investor-state disputes. This paper promotes dispute prevention through the establishment of mechanisms for information sharing among states. For disputes themselves, it advocates a number of options, including mediation. This has the advantage of flexibility and the ability to focus on long term resolutions, and can operate on a without-prejudice basis in the event disputes do not settle. Mediation has the disadvantage of not being enforceable across state boundaries and poses difficulties for states in relation to settlement authority. However, investment arbitrations are largely self-enforcing, with no state not having complied (until the end of 2009) with an award, and this convention could extend to mediated settlements.

Investment for Development

Historically, developing and emerging economies could acquiesce or withhold assent from global economic policies; now they are also involved in changing prevailing norms, or at least modifying global agendas. The political space resulting from the global economic crises can be used to compete for new policies and legal frameworks for investment law. While innovations would not be without political obstacles, there has already been success in increasing transparency in investment-state arbitration cases.

South Africa's challenge is to balance three factors:

- An encouraging legal and economic climate for investment,
- incentives for FDI which will lead to economic development, and
- retention of policy space for transformation and environmental initiatives.

Moreover the quality of investment is as significant as the quantity. Unsuccessful FDI can be detrimental to host countries, impacting on domestic competition, affecting balance of payments, reducing revenue through transfer pricing and favouring small groups of modern-sector workers at the expense of those in labour-intensive industries. Complicating the picture is the fact that South Africa is needy in terms of FDI, but is in some years a net exporter of capital. This reality challenges the reciprocity principle in that the risk mitigation frameworks, which South African outward investors seek elsewhere, are precisely those that government is questioning in relation to inward investment. Nonetheless, coherent policy is needed for both inward and outward FDI.

As a member of the G-20 group of countries, South Africa can assume increasing significance as a 'representative' voice on international economic issues, including investment matters. Both change and continuity characterise the environment in which it operates. While the grand narrative precludes discrimination against foreign investors, it does not preclude the development of subsidiary narratives with new characters and alternative plots and themes.