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# South Africa Policy Brief

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# Investment

## PROMOTING INTERNATIONAL INVESTMENT FOR STRONGER GROWTH

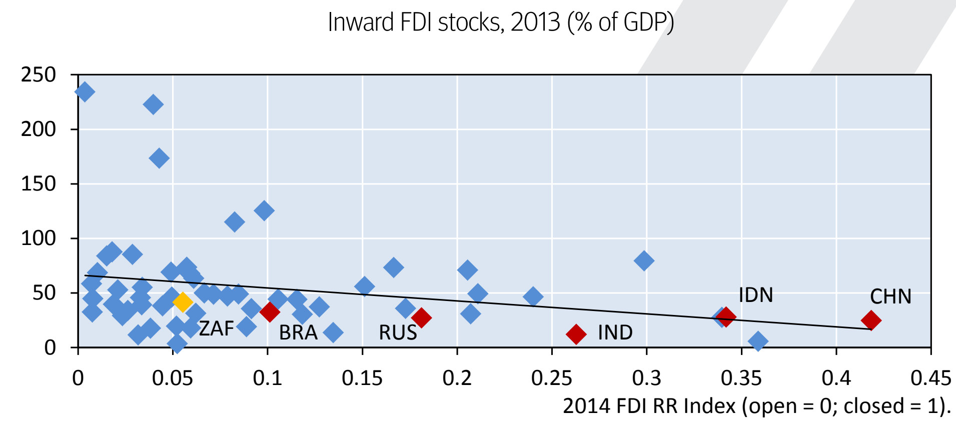
- At 40% of GDP in 2013, FDI stocks in South Africa are considerable, and in fact well above the levels in other developing countries.
- South Africa maintains a relatively open investment regime for FDI. Remaining restrictions are primarily driven by foreign equity limitations in air transport, media and business services.
- Such restrictions limit the degree of competition and their indirect effect is considerable since services directly and indirectly account for 37% of South Africa's exports.
- There is scope to further improve South Africa's investment climate. Investors cite concerns such as frequent policy changes, uncertainty of regulation, and corruption as limiting factors. In addition, recent electricity shortages are likely to be weighing on private investment.

### What's the issue?

FDI inflows to South Africa have increased substantially in recent years, from an annual average of USD 4bn before the crisis to USD 8bn in 2013. Subsidiaries of multinational enterprises are more prominent among big businesses than in other emerging economies such as India and China. International multinationals cite a sophisticated banking and financial system, good and reliable infrastructure and the availability of natural resources as key factors behind the country's attractiveness. South Africa's inclusion in the BRICS grouping also adds to its attraction for foreign investors, as does the fact that, according to *Doing Business*, it is relatively easy to do business in the country.

On the other hand, there is a large unexploited potential to raise FDI inflows (see Figure). The OECD's Product Market Regulation Indicator suggests that regulation is still relatively high. This includes for instance high levels of public ownership and government involvement in business operations (e.g. through price controls), complex rules for licences and permits, and obstacles for creating start-ups. Although limited to only a few service sectors, statutory restrictions such as ceilings on equity investment and screening and approval requirements – as measured by the FDI Regulatory Restrictiveness Index – as well as policy uncertainty surrounding property rights in the resources and agriculture sector

**South Africa's inward FDI stock is below the level suggested by its very open FDI regime**




*Source: OECD FDI Regulatory Restrictiveness Index database (http://www.oecd.org/investment/fdiindex.htm); OECD International Direct Investment Statistics; and IMF World Economic Outlook and Balance of Payments Statistics.*

may also be a burden to economy-wide productivity. In addition, factors that hamper South Africa's image amongst investors include issues such as crime, corruption, and electricity shortages.

### Why is this important for South Africa?

South Africa's sluggish growth rate (2½ per cent per year since 2010, versus 5.9% for upper middle income countries) is partly due to the dualism of its economy. Pockets of world-class efficiency, capable of participating in international production networks, such as the car industry, coexist with the poor dynamism of many sectors, including public services. Overall productivity of manufacturing firms is substantially affected by stringent product market regulations constraining competition and contestability in service sectors, and consequently raising service input costs for other economic sectors.

Multinational enterprises can generate further real income gains if they generate complementarities with local firms, diffuse more advanced technology and management practices, and spur positive externalities, for example raising productivity in other firms. At South Africa's current stage of development, achieving all these potential results would be crucial for inclusive growth. Improving the business environment would help South Africa to attract a greater proportion of its FDI inflows into manufacturing, as has been the case in China, Malaysia and Thailand.

South African multinationals operating abroad are another channel of integration into the global economy. In terms of outward FDI, stocks are indeed higher than in other emerging economies. An environment conducive to investment and innovation would also benefit South African firms and make it possible to upgrade and pursue appropriate internationalisation strategies. South Africa is already one of the largest investors in Africa. International expansion carries risks and responsible business conduct, as embodied in global standards and practices, would help to minimize them and maximise the returns.

### What should policy makers do?

- In network industries, complete the introduction of independent regulators and charge them with ensuring non-discriminatory third-party access.
- Accelerate privatisation, in particular in telecommunications, infrastructure and related services sectors.
- Significantly reduce red tape and other administrative burdens on business operations.
- Mainstream the use of regulatory impact assessments to new laws and rules, thus facilitating forward planning.
- Lift remaining foreign equity restrictions in air transport, media and business services.

### Further reading


OECD FDI Regulatory Restrictiveness Index. http://www.oecd.org/investment/fdiindex.htm

OECD (2014), *OECD Services Trade Restrictiveness Index (STRI): Policy Brief*, background report, Meeting of the Council at Ministerial Level. http://www.oecd.org/mcm/MCM-2014-STRI-Policy-Brief.pdf

OECD/WTO (2013), *Trade in Value Added (TIVA) Indicators – South Africa*. http://www.oecd.org/sti/ind/TiVA_SOUTHAFRICA_MAY_2013.pdf