European Union Discussion Paper

South Africa's Investment Conference 2018

South Africa is the European Union's only Strategic Partner in Africa. The economic dimension of such relationship is fundamental as the EU is South Africa's first trading and investment partner, accounting for 25% of South Africa's trade and 75% of its foreign direct investments (FDI). Direct jobs dependent on this economic relationship are well in excess of 500 000 jobs.

The strength and strategic nature of the EU-SA economic relationship is that it encompasses virtually all economic sectors of the South African economy, thus contributing to economic diversification, export-orientation and inclusive growth. Car manufacturing, citrus and wine industries are just a few notable examples in this respect.

The recently ratified SADC EU Economic Partnership Agreement (EPA) creates a free trade area with SACU and Mozambique, multiplying opportunities for strengthening trade and investment relations with South Africa and the region. A committed and forward-looking EPA implementation is thus a promising way to ensure that EU investors maintain confidence in South Africa and the region's investment potential.

Data shows that FDI from the EU in South Africa has proven resilient despite the deteriorating investment climate of the past years, but remains insufficient to contribute to higher GDP growth. European investors stand ready to invest in strategic and labour-intensive sectors both through greenfield and brownfield investments, in support of South Africa's growth and transformation agenda, however, a more certain and attractive investment and business climate is needed.

The EU welcomes President Cyril Ramaphosa's strong commitment to building a new social compact around investment, accepting that without investment – foreign and domestic – the country cannot grow above 2%, as National Treasury has systematically warned. The target to attract a minimum of $100 billion in new investment over the next five years is an encouraging statement and the EU appreciates that investment-friendly language of the new leadership has been coupled with the concrete actions. The following specific actions are acknowledged in particular:

- Appointment of experienced and well-trusted officials to key Ministerial positions;
- Appointment of President's Economic Advisor and four Special Investment Envoys, who are trusted and respected by the local and international markets
- Appointment of credible boards at the key State-Owned Enterprises
- Signature of the 27 outstanding power purchase agreements under the Renewable Energy Power Producers Programme
- New Integrated Resource Plan
- Establishment of Invest SA One-Stop-Shops

While all these are very positive signs, European investors continue to exercise caution as these steps are insufficient to compensate for the deterioration of FDI protection and business environment that has occurred over recent years. At the moment, foreign investors continue to monitor macro-economic stability and overall policy certainty in the country. There is hope for a clearer language on investment-led growth, which would complement redistribution-led growth, including through public investment in infrastructure, education and skills development, as well as by improving the financial health of the State Owned Enterprises.

In anticipation of South Africa's Investment Conference planned for the 25-27 of October 2018 as well as the EU-SA Presidential Summit in November 2018, this discussion paper outlines key challenges that are of particular concern to European investors. **The paper also presents proposals to be discussed with South Africa on how these challenges could be improved and/or even overcome**.

Extensive consultations with the EU Member States as well as European business (EU Chamber, Bilateral Chambers, specific companies across different sectors) have identified three main constraints to potential FDI (and trade) that would benefit from the government's urgent attention:

1. **Black ownership requirements under the B-BBEE Codes of Good of Practice.**
2. **Localisation requirements in Public Procurement.**
3. **Delays in obtaining letters of authority from the National Regulator for Compulsory Specifications.**

There are other issues that mark the investment environment, especially as Bilateral Investment Treaties (BITs) with EU countries have been unilaterally terminated causing a worrisome dive in the level of protection enjoyed by investors. In the absence of BITs, uncertainty around property rights is of particular concern, which has been amplified by the Parliament-led consultations on constitutional changes to land ownership rights.

Policy certainty is also pending in relation to other policy initiatives, such as the Expropriation Bill (recently withdrawn from Parliament), Regulation of Land Holdings Bill, Copyright Bill, Competition Amendment Bill, Private Security Industry Regulation Bill and Mineral and Petroleum Resources Development Amendment Bill. The new Protection of Investment Act which has just entered into force deprives investors of important guarantees contained under pre-existing BITs. While South Africa's institutions remain robust and the policy debate is conducted within sound principles, the effects of pending proposals on prospective investors cannot be discounted.

Other pertinent issues that are having a negative impact on the investment environment include stringent visa restrictions on foreign management staff and their family members of overseas subsidiaries, requirements for short-stay visas for the citizens of eight EU Member States, corruption, serious and organised crime, rising electricity prices, port and rails costs, and challenges with the registration on the Central Supplier Database. Government's steps towards resolving these issues would further contribute to paving the way to a more investor-friendly business climate sought by President Cyril Ramaphosa.

1. Black ownership requirements under the B-BBEE Codes of Good of Practice

The EU acknowledges the importance of economic transformation in South Africa to redress historical injustices and for the future overall development and social stability in the country. With the EU being the largest source of FDI in South Africa, EU companies have been contributing to the country's economic transformation and have been consistently enhancing their B-BBEE profile in line with the existing legal provisions.

While compliance with the B-BBEE Codes of Good Practice is not compulsory for private companies, it is increasingly necessary to do business with government institutions and SOEs, as well as across the entire value chain of products and services consumed by these. It is also increasingly mandatory where a Government License is required. Compliance with the B-BBEE also influences overall foreign companies' reputation in the South African market.

The latest EU Business Survey 2016 however shows that uncertainty around the B-BBEE policies, notably as from 2013, is among the top three challenges for the European investors in the country. Indeed, certain aspects in relation to B-BBEE compliance do unnecessarily impede new FDI.

Contextualising the challenge

The amended Codes of Good Practice in 2013 resulted in downgraded ratings for many companies in view of stronger emphasis on black ownership requirements over other elements of the B-BBEE Codes, whether supply chain or skills development, as well as a total disregard for the amount of jobs created. This has compromised existing and prospective investors' ability to continue and/or expand their operations in South Africa. It has been particularly difficult for greenfield investors, for family-owned European companies as well as multinationals, who are often reluctant to dilute their control of assets. Subsequent proposals (both at the level of sector codes or the recent proposed amendment to the B-BBEE Codes of Good Practice gazetted on 29 March 2018) have kept insisting on growing ownership requirements.

EU acknowledges that foreign companies that have a global policy of non-dilution of their shareholding can qualify for the DTI-administered Equity Equivalent Investment Programme and gain ownership-related points. This programme, however, has significant limitations and low uptake levels (less than a dozen). Qualified companies have to make contributions equivalent to 25% of the value or 4% of the revenue of their South African operations annually, which is economically non-viable for many companies, especially new investors and SMEs. In addition, the process under the existing Equity Equivalent Investment Programme remains highly discretionary and outcomes are difficult to predict, notably for FDI investors.

EU welcomes a new proposal to include companies' efforts towards the implementation of the Youth Employment Service (YES) initiative within the amended B-BBEE Codes of Good Practice. The proposal however should go further to include the actual number of jobs created within the existing corporate structures and/or across the broader supply chain in the Scorecard. This is a missed opportunity in view of the government's overriding priority of job creation. Similarly, the contribution to black ownership along the value chain (through the establishment of franchises, seed funding, etc.) could receive stronger attention.

The current implementation of the public procurement policy and the discussion around the future design of South Africa's Preferential Procurement Policy Framework Act are creating further policy uncertainty detrimental to investors. During the B-BBEE Commission Annual Conference held in March 2018 the acting chief Procurement Officer announced that the current Act of 2017, which already has a strong focus on the B-BBEE status level of the bidder, would be repealed in its entirety and a new public procurement bill will be presented to enable procurement from black-owned enterprises only. In this context, it should be highlighted that when certain SOEs applied a requirement of the 51% black ownership in their tenders without the pre-approval from the DTI back in 2016 and 2017, a number of EU investments were put on hold or even downscaled.

EU proposals

EU supports continued economic transformation in South Africa through B-BBEE. The benefits of the B-BBEE, however, should be better understood through evidence-based analysis, which is presently missing (as also indicated in the recent World Bank report). The process should also be handled to ensure investments' long-term sustainability.

A study led by the Black Management Forum is currently being conducted on the role of the European Investors in transformation. Its results should be presented during the BMF Annual Conference in October 2018.

EU looks forward to a constructive engagement with the SA government on its transformation efforts and more specifically on the following proposals:

- Policy certainty can be achieved if clear timelines for revision of the B-BBEE Codes of Good Practice are established and overall policy direction is clarified. Current ability to shift goalposts through sudden policy changes is of great concern. Policy alignment across different sectors, through the Sector Codes, would likewise increasing effective implementation of the transformation policy.
- Temporarily relaxing black ownership requirements (reducing the percentage required) for greenfield foreign investors in the country, as well as further investments by FDI companies already established in the country should be considered. The scale of investment, the sector, job creation potential, etc., could be taken into account when determining the length of the leeway period.
- **Reduce the weighting for the ownership pillar, while introducing a job creation pillar**
- Revise scoring under the Codes to better consider black ownership created beyond Enterprise and Supplier Development section of the Codes.
- Revise the Equity Equivalent Investment Programme to make it simpler, more predictable and accessible for multinational investors and, in particular, for green-field investors. For multinationals, their score under the black ownership pillar could be linked to a certain level of achievement under other pillars of the Scorecard.
- Issue of a general clarification to the benefit of SME FDI investors, reassuring them as to their ability of effectively accessing market opportunities in the initial period of doing business in South Africa and progressive adherence to BEE legislation.

From the EU side, European companies would be prepared to strengthen their efforts in relation to skills development, technology transfer as well as job creation.

2. Localisation requirements in Public Procurement

EU takes note that the South African government sees local content requirements as representing an important tool towards inclusive and sustainable economic growth. Many EU investors have in fact contributed to localisation by setting up extensive operations in SA across different sectors.

Local content requirements, however, can hinder productivity and competitiveness. They may also foster non-transparent decisions and affect the ability of public authorities to get value for money in public contracts. This can be of particular concern when strategic projects are concerned and/or when the availability of the required skills is limited at the local level. It can also result in violation of bilateral and multilateral obligations and curtail a country's capacity to negotiate access to the public procurement markets of third countries. In addition, localisation requirements can lead to discrimination inside the country itself (e.g. if a company is disadvantaged because it has foreign shareholders, or uses foreign components, even though it is locally established).

The benefits of a more open public procurement system should not be discounted. It enables increased competition, which ensures 'better value for money' for the government and SOEs. Studies in the EU have shown that an open public procurement policy can save up to 30% of taxpayers' money. A second major benefit is that an open procurement system can be used as an instrument to fight corruption, which can increase costs by as much as 25% to 50%.

Contextualising the challenge

Similar to B-BBEE policy, localisation requirements in South Africa are becoming more far-reaching affecting a broader range of sectors aiming to achieve government's local procurement target of 75%.

Under the Preferential Procurement Policy Framework Act the government is able to designate certain products that organs of state and SOEs are obliged to procure from local suppliers at a prescribed level of local content. Currently 23 products have been designated with a minimum local content threshold ranging from 30% to 100% and more products are in the pipeline.

Localisation requirements are becoming more and more mutually reinforcing with the black ownership requirements in public procurement processes and beyond. It is evident in the B-BBEE Codes of Good Practice 2015 and in the foreseen provisions of the new Preferential Public Procurement Bill as highlighted above. This onerous combination is often further complicated by non-availability of the required expertise because of skills shortage and skills mismatch in the country. In addition, local content requirements are more costly to comply with in sectors missing longer-term strategies for their development, for example in the renewable energy sector. All of these aspects make foreign investors very cautious when making their investment decisions for South Africa.

EU companies have been also frustrated about the unlevelled playing field in certain sectors. There have been cases where European foreign investors have been complying with their local content commitments as part of their large-scale contracts with the SOEs, while other investors have managed to evade their commitments without any penalties imposed and import products designated for local content procurement from their base country.

South Africa's local content requirements result in limited access of the public sector projects to development finance provided by certain European Development Finance Institutions (DFIs). For example, guidelines of the European Investment Bank (EIB) – which are based on EU directive on procurement - do not allow funding projects that go above the 15% threshold for the local content.

European companies have also experienced some challenges within the framework of the National Industrial Participation Programme by being requested by the DTI to invest in local industry development programmes that are not necessarily linked to the direct line of business of the supplier thereby inhibiting skills and technology transfer processes.

EU investors are also concerned that private procurement in key economic sectors (e.g. mining) might become subject to local content requirements. These, if implemented, would have to be consistent with Articles III (national treatment) or XI (quantitative restrictions) of the GATT Agreement read with the Agreement on Trade Related Measures and article 39 of SADC EU EPA.

EU proposals

Local content requirements can play a role in industrial development and job creation. Localisation, however, can only be effective under certain conditions. Policy certainty, availability of infrastructure, skills development, non-distortive business incentives and potential market scale - all play a role.

South Africa's public procurement system could be adjusted to allow for a more balanced approach, ensuring that public procurement remains transparent, provide value for money and that industrial incentives lead to sustainable operations. The following specific proposals could be considered:

- Localisation requirements should not be broad based but sector and context specific, taking into account the availability of skills within the sector and the potential for achieving market scale, all the while underpinned by strong government support to prioritize the development of the industry.
- Local content requirements should always be aligned to the supplier's line of business to enable effective skills and technology transfer. This is particularly important in the case of the National Industrial Procurement Programme (NIPP) where DTI has been expecting localisation investments in areas totally disconnected from the contractor's core business.
- Incentives should be designed and sustained for the long run. Current uncertainties around existing schemes (such as the Automotive Production Development Programme) should be resolved without affecting the sustainability of existing investments.
- In projects where financing from the European DFIs is involved, mandatory localisation requirement should be limited to 15% of the project costs.

3. Delays in obtaining letters of authority from the National Regulator for Compulsory Specifications

The EU acknowledges the role of the National Regulator for Compulsory Specifications (NRCS) in ensuring that products in the local market comply with mandatory standards as well as South Africa's commitment to limit the introduction of substandard goods.

Certification procedures to these standards should however be proportional to the risk at stake and efficient enough so as not to inhibit existing business operations as well as new investment. We believe that the NRCS has not been working effectively in this regard since the new regulations were adopted in 2015, in particular with regards to verification of energy efficiency and safety standards for electro-technical equipment.

Contextualising the challenge

In 2015, the SA government declared compulsory specifications for energy efficiency and the labelling of electrical and electronic apparatus, adding to the already wide safety compulsory specifications specific to each type of electro-technical product. The compulsory certifications, which can only be issued by NRCS, are burdensome and costly with limited capacity among local testing and certification agencies.

Average time to issue a LOA peaked at an average between 240 and 500 days in 2015/2016 for electro-technical goods. These critical delays have a negative effect on importers as well as on the local manufacturing industry that uses imported electro-technical products in their production lines or investment projects. As a result, consumers are offered outdated products, companies are faced with increased logistical costs which result in higher prices for consumers, and delays in receiving strategic inputs are affecting production lines and business projects. This loss of competitiveness is already leading, according to the local industry, to loss of revenue and jobs.

In September 2016, the NRCS presented a detailed set of targets and a performance plan in Parliament, which included DTI Ministers' instruction that LOAs be issued within 120 calendar days. According to EU companies operating in SA, the backlog continues to prevail in spite of short term measures implemented in 2017.

EU Proposals

EU welcomes the appointment of a permanent CEO at the end of March 2018. The situation however has been left unattended for a prolonged period of time making the situation untenable not only for foreign manufactures but also for the local industry and regional trade.

EU hopes that the new NRCS leadership implement quick actions to reduce the delays in obtaining the LOAs. To resolve the issue the EU stands ready to engage and cooperate with the NRCS in the following measures:

• **Process**: As already proposed by NRCS in 2015, implement a risk based approach (RBA) certification system supported by an adequate electronic platform aiming at bringing down the turnaround time. **The aim should be a maximum of 30 days (in line with international best practices)**.

• **Testing:** As already envisaged in 2015, SABS testing facilities need to become operational as soon as possible.

• **Equivalence:** Adherence to the IEC (International Electro-technical Commission) system of conformity assessment schemes for Electro-technical Equipment and Components - IEECC CB Scheme. This is an international system of mutual acceptance of test reports and certificates dealing with the safety of electrical and electronic products. This would enable the NRCS to fast track compliance for low risk electro-technical products from trusted partners as it would not need a conformity assessment as such from the regulator (the NRCS would immediately accept the CB Test Certificate and associated Test Report issued by the IEC).

CONCLUSION

The EU, notably through its representation in South Africa, its Member States and associated entities (such as the Chambers of Commerce and Industry) remains eager to engage on all the issues highlighted above, which we believe are equally beneficial to all investors.

The establishment of a regular EU-SA forum where investment related matters could be addressed, including participation by private sector representatives, would be welcome.

Specific to the EU, the resolution of pending differences in the implementation of the SADC EU EPA should be swiftly resolved, hopefully by the time the announced EU-SA Presidential Summit takes place. Without an effectively functioning EPA, the value of the EU-SA Strategic Partnership would otherwise be seriously undermined as a platform for inviting further trade and investment.