MANGAUNG

City on the move

TOWARDS A COMPREHENSIVE INVESTMENT PROMOTION & INCENTIVES POLICY

MANGAUNG LOCAL MUNICIPALITY (MLM)

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FINAL COUNCIL ADOPTED VERSION

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1. Background

Incentives are informed by a broader development policy plan and a critical need to shift the sector economies onto a new growth trajectory. An incentive policy must seek to introduce new investment in new business and industrial activities in a city such as:

- Industrial development
- Inner city regeneration
- Informal economy
- Small business development

Incentive package must be balanced against the competitive advantage of the city region where fundamentals like labour costs, rates, services, and land cost, are in order.

1.1 International Experience

International experience reveals the following core issues on investment promotion and incentives:

- A country or city region with weak economic fundamentals must pony up with incentives; while other countries with services and resource based economies do not require incentives at all, because they market themselves as incentives per se e.g. Hong Kong
- A city region that exudes a warm relationship with future investors adds a big plus to the investment promotion campaign.
- Foreign Direct Investment is attracted by competitive economies, and before attracting investment, these economies should first possess a pool of local high value industries that will absorb foreign skills and technologies.
- There is a vast array of the so-called economic fundamentals, which are essential, important and desirable. The essential fundamentals must be prioritized, they have to do with the economy that churns out an educated and skilled labour force.
- Investment promotion has less to do with a city region than a country. National policies tend to overwhelm local policies in terms of subsidies and tax regimes e.g. there is more often talk about investing in Finland than Helsinki, Australia than Sydney, DRC than Lubumbashi

1.2. South African context

The Mangaung IDP identifies job creation as a priority. The Mangaung Economic Development Strategy further highlights job creation and creating an environment that is conducive to economic growth as an important strategic thrust. One of the programmes that will aid in taking these strategic thrusts forward is an incentives and investment promotion programme.

When compiling an Incentives and Investment Promotion policy the relevant legislation has to be considered.

1.2.1 Legislation

In South Africa, the Constitution (1996) clearly defines the respective competencies and roles of all three spheres of government. This investment promotion & incentives policy falls within the ambit of the local government. and therefore its competencies and responsibilities. The policy therefore focuses on those areas that Council can influence directly.

Furthermore, there are funding mechanisms and financial regulations that guide the intergovernmental relationships. The investment promotion & incentive policy also needs to comply with the principles of Municipal Finance Management Act (2003), as well as various other legislation that has direct impact on the function of local government, such as Municipal Systems Act (2000).

1.2.2. Other guiding frameworks

Other guiding frameworks that have an influence on the policy include:

a) The rules of the World Trade Organisation (WTO)

South Africa subscribes to rules and conducts of the WTO. The WTO has introduced a multilateral trading system aimed at removing restrictions to trade, i.e. removing import tariffs (free market access) and abolishment of export subsidies. For example, if the Council charges certain companies “less than cost price” for services rendered it will constitute a subsidy under the WTO agreement.

b) National and Provincial Policies and Strategies

It is imperative that the incentive policy is aligned with other government policies and strategies. Some of these include, inter alia, the Expanded Public Works Programme, National Skills Development Strategy, the Free State Provincial Growth and Development Strategy.

c) Department of Trade & Industry (DTI) incentives

The National Department of Trade and Industry, in co-operation with the Industrial Development Corporation, offers over 90 incentives, loans and rebates to attract investment and to support business development. These incentives include the following categories:

- Investment support
- Small business development
- Empowerment finance
- Increasing competitiveness
- Innovation and technology
- Export assistance
- Industrial development zones
- Urban development zones

d) Integrated Development Plans (IDPs)

The IDP is a key strategic document for municipalities. It serves as a guide for both the citizens and municipal officials. The IDP also clearly sets out the strategic objectives and strategies of the Council over a 5 year period. The need for an investment promotion & incentive policy as outlined in the Mangaung IDP is a further effort to achieve equitable socio-economic development within Mangaung.

2. Purpose of the policy

The aim of the Mangaung Investment promotion and incentive policy is to provide a framework for the uniform development of incentives in MLM that will assist to:

- Attract major national and international investors to MLM.
- Retain and boost existing investment in MLM.
- Support investment into projects identified in the IDP and the Mangaung EDS

3. Principles underlying the policy

3.1 Affordability

The introduction of an incentive should not create a cost to the municipality and the income forgone should not have a severe effect on the revenue stream of the municipality.

3.2 Transparency and Uniformity

The granting of an investment incentive will be done according to a set of predetermined criteria and information on the actual granted incentive will be open for public knowledge.

3.3 Targeted sectors

The investment incentive will only be applicable in specific areas, i.e. areas identified for incentivised economic growth in the IDP.

3.4 Simplicity and continuity

The structure and administration of the investment incentive have to be easily understandable and should not require a complex administration so as to minimise staff and financial impacts. This will ensure quick turnaround times for applications (urgency and speed is essential to attract and retain investment).

3.5 Co-operative governance

The incentive is intentionally modest so as to avoid an incentive and relocation war with other investment locations in South Africa.

3.6 Continuous Review

The investment incentive policy will be regularly reviewed to ensure relevance and effectiveness.

4. Definitions

4.1. Definition of Investment

An investment can be defined as "the warehousing of capital or assets in the open market for a defined period with the intention of declaring a yield at the end of the defined period." (Gildenhuys, 1997).

In the complex world of risk, change, and different tax regimes, investment managers tend to rely more on the "satisficing behaviour" than the systematic evaluation of investment outcomes, when it comes to a decision to invest. The open market system comprises mainly the Western hemisphere countries and Asia where the amount of capital inflows in these economic hubs determines the size and profitability of investments made. The rate of these capital flows is used as an indicator of confidence to invest. It is therefore not surprising that the dominant markets are found in Europe, United States and Asia as compared to the developing economies, of which South Africa is one. This phenomenon explains the importance of direct foreign investment for any developing economy.

4.2 Definition of incentive

An incentive can be defined as:

- Stimulus
- Motivating influence
- Serving to incite to action
- Something that arouses to effort or action
- In economics, additional payment offered to workers to boost production

5. Determinants of Investment

Investors are interested to invest in a framework that respects **economic fundamentals**. The city or country that satisfies the considerations of profitability will influence the "satisficing behaviour" of the investor. Local government, such as MLM must ensure that the following economic fundamentals are in place or are being improved in order to position itself as a possible investment destination:

- Trade and investment regime
- Good infrastructure
- Clear property rights
- Political stability
- Mature financial system
- Macroeconomic stability
- Skilled workforce

City regions are competing for international investment in their areas. Some have travelled the extra mile to introduce incentives to lure investors. It is important that countries and cities must first ensure that they have competitive economies before deciding on introducing incentives (Bloemstrom, 2003). MLM's focus will be on putting the economic fundamentals in place.

6. Linkages between Investments and Incentives

The earliest use of incentives traces back to 1160, when wool weavers were offered tax incentives to locate in Biella, in the Piedmont area of northern Italy (Valodia *et al*, 2001). International experience shows that many city governments are making use of incentives as a carrot on the stick for investors (Pauw *et al*, 2001).

However, it should be noted that not all the investors would need incentives. Investors would have found that some city government meets the criteria of economic fundamentals, and they would naturally invest if they so wished. The effectiveness of incentives is often questioned as well as the lack of innovation and confidence of city governments in developing incentives (de Milo, 1997 cited in Valodia *et al*, 2001). Incentives need to be dealt with in a cautious manner since any tempering with the tax structure of a local authority will undermine sustainable development.

There is indeed a relationship between local incentives and national taxation system - local incentives increases a project's profitability – therefore increasing its taxable income – allowing for revenue transfer from local to the national sphere of government.

7. Types and effectiveness of Incentives

Though the effectiveness of investment incentives remains disputed – they remain a form of leverage in attracting business to proposed localities. The following incentives are cited as most common in country and city governments:

- Tax holidays
- Accelerated depreciation on fixed investment
- Investment allowances
- Import duty exemptions
- Duty drawback

Incentives do overlap and can further be classified into broad categories such as:

- Tax exemptions
- Subsidies and concessions
- Grants and financing
- Incentives through service provision

Tax reductions are the most widely offered incentive to attract investment in many regions. The local authority would normally apply tax rebates within the prescribed tax rebate framework of the National Treasury. Other incentives such as subsidies and grants would usually apply in cases where the local authority intends to revitalize specific sectors of the economy.

8. Use of incentives

The capital inflows that influence the economies are maximized through the improvisation of the existing industries towards high growth industries. The incentives injected into economic sectors will depend on which sectors have been prioritized for stimulation by the concerned city government. In the case of MLM, this is applicable since there is a need to diversify the local economy and grow the different economic sectors. For MLM, the following emerges from the EDS as important sectors for targeting:

- Industry development/manufacturing and secondary processing
- Tourism development
- Infrastructure development
- SMME Support
- Agriculture and value-adding

9. Benefits of investment incentives

There remains a strong debate on the positive and negative aspects of incentives.

9.1 Positive aspects

- Incentives do increase returns to investors, and tend to affect investor behaviour
- Incentives are effective where an investor must choose between two similarly competitive places for producing for export
- Incentives may be a useful public relations exercise for less known locations.
- Investment subsidies may be a stimulus for high growth outcome in developing economies because these economies are prone to market failures than their developed counterparts.

9.2 Negative aspects

- In the case of slow growth in the economy, the costs for incentive promotion outweigh the expected investment benefits
- A closer look will show that there are instances where incentives have effect on levels of output and employment.
- Incentive packages that are implemented without due consideration of their cost structure, negatively impact on revenue that would otherwise be collected.

For MLM to consider:

- The incentive must be effective at attracting new business and at retaining the existing one;
- It must address market failures that lead to sub-optimal investment levels;
- It must target a specific sector;
- It must be demonstrably cost effective and sustainable and not impact on revenue streams.

10. Framework for designing Incentives

There are two frameworks within which investment incentives could be offered to investors.

- **Rules-based**: in which a transparent policy with guidelines exists
- **Ad-hoc**: in which the city government gives a mandate to officials to lure in prospective and targeted investors. (Valodia *et al*, 2001)

For MLM to consider:

Exclusive use of these approaches is very problematic, the former allows the investors to take unfair advantage of the city government, while the latter is simply difficult to implement. In order to overcome complexities, the suggestion is to apply a mix of the two approaches while ensuring that:

- Incentives costs are reduced and revenue loss avoided.

- Tax holiday begins as early as possible
- Close monitoring of the returns is applied.

Different sectors would require different incentives, for example:

- New green field investment projects – introduce start-up costs reduction
- Expanding firms – tax related incentives
- Manufacturing firms – incentives related to depreciable assets

11. Factors to consider when designing incentives

Most investors are interested in the following information

- How to setting up a business in the city.
- Commercial property for sale.
- Other companies in same field of operation.
- Professional services available (accountant/ lawyer/ banker).
- Information about the city economy.
- Incentives available

For MLM to consider:

Information in this regard should be packaged, marketed and made easily accessible to prospective investors.

12. Policy Recommendations

The following with respect to incentives and investment is therefore recommended for adoption by the Council of Mangaung Local Municipality:

12.1. All incentives will be cognisant of the policy principles highlighted in section 2.

12.2. The Mangaung Economic Development Strategy be used as a tool for marketing investment into different sectors in the city.

12.3. The incentives introduced are complementary to the city's good standing on economic fundamentals.

12.4. A policy implementation framework be adopted that favours the application of incentives when attracting new business or retaining the existing one. The framework is to support the following procedure:

12.4.1 The design of incentives should be such that a combination of rules-based and Ad-hoc application of incentives is adopted.

12.4.2 The industry that supports the revitalization or growth of a specific sector should be prioritized and incentivised accordingly.

12.4.3 A potential investor should be guided with all the relevant and existing information regarding the setting up of business in the municipal area.

12.4.4. All incentives offered by MLM should be cognisant of those incentives offered by the National Department of Trade and Industry (DTI).

12.4.5 The following types of incentives may be applicable to new businesses in the city region through an agreement between MLM and the potential investor. The details will be contained in the Investment Promotion & Incentive Implementation Plan

- **Municipal Rates Reduction** –.
- **Land Concessions** –In accordance with the MLM Land Allocation Policy.
- **Urban Development Zone (UZ) Tax Incentive** – MLM will ensure that for buildings erected or renovated within the Urban Development Zone (UDZ), the concerned property owners are registered for rebate from the South African revenue Service (SARS) in accordance with National Treasury directives.
- **Capital Investment** – A capital investment may be considered to support business or industry to be established in prime nodes or corridors i.e. the CBD, N8 Corridor and Mangaung Activity Corridor. The potential investor must show commitment to investing an equal proportion to the capital grant availed by MLM.
- **Rates reduction**
- **Rates exemption**
- **Infrastructure Service Subsidy** for water, electricity and refuse removal:

12.5. The Directorate: Economic Development and Planning and the Finance Directorate be tasked to compile the implementation plan for this policy jointly manage the Investment Promotion and Incentives Programme.

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