The Impact of Policy framework on inflow FDI to South Africa: the tumbling of RDP and the lowness of GEAR

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Abstract: The impact of Growth, Employment and Redistribution (GEAR) as a macroeconomic strategy on South African economy has been questionable. Inasmuch as the policy has resulted in unprecedented fiscal discipline, monetary stability, and inflow portfolio investment since its passage in 1996, it has been criticised for job losses, increases in the crime rate and poor inflow foreign direct investments (FDI), not to mention continued social and economic divides in the country. The policy’s prevision to attract needed FDI to achieve the targeted economic growth rate expected to generate employment and to improve the local market capacity has been elusive. The GEAR’s antagonists contend that the policy has contributed to unsettling skittish foreign investors through crime increases thereby, contributing to South Africa’s inability to attract new FDI, while those that have not divested are sceptical about their future with the country.

Key words: Foreign direct investment, portfolio investment, low GEAR, RDP, ASGISA, South Africa’s socio-economic landscape.

Introduction

This article focuses on the impact of policy initiatives by the South African government on the attractiveness of the country to FDI inflows since 1994. In the process, it reviews the three basic measurable indicators of GEAR as a macroeconomic policy of the African National Congress (ANC)-led government.

The acceptance level of government policies in business circles is quite dissimilar to the societal acceptance as a whole. This may explain the reality of the ‘two-economies’ that characterises the country. While business views government policies as being favourable to investment, the general public on the other hand, are sceptical of the alleged trade-off between government’s social responsibility and its pursuit of global capital, which these policies facilitate. Meanwhile, capitalism has been widely criticised for being primarily interested in taking advantage of the less privileged people and their situations (Rich, 1994; Kapstein, 1999; Philips, 2000; Smith and Moran, 2000; Stiglitz, 2002; Wallach and Woodall, 2004).

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Although, the economic performance of South Africa has been impressive since 1994, this achievement has been marred by ugly incidences of violent protests, escalating aggravated crime and increasing unemployment in response to the perceived impact of these policies. The stable fiscal and monetary targets envisaged has materialised (until recently) but at the expense of FDI inflow into the country.

**Background information on RDP and GEAR**

**The RDP**

To resolve trade imbalances and related economic problems that characterised the apartheid regime, the Government of National Unity (GNU) adopted a Keynesian economic experiment (expanded public spending on social and infrastructural facilities), called the Reconstruction and Development Programme (RDP). The policy encapsulated ‘six cardinal points’ namely: “An integrated programme, based on the needs of people; that provides peace and security for all and builds the nation, links reconstruction and development and deepens democracy (RDP, section 1.3.8).

Prior to political emancipation in 1994, South Africa’s Government of National Unity (GNU) convened the Macroeconomic Research Group (MERG) to charter a way forward to achieving economic recovery from the quandary that characterised the apartheid regime. The Group was charged with the responsibility of designing an economic policy suitable to address the plethora of apartheid irregularities that had impacted negatively on the economy.

Using the recommendations of the Group as an arsenal, the GNU adopted the Reconstruction and Development Programme (RDP) as a macroeconomic strategy. The programme, at the time, seemed to have been sanctioned by the GNU constituencies as well as that of other stakeholders. Despite the conviction that this programme would serve as the ultimate ‘redistribution’ loadstar, the document failed to provide for some crucial policy directives, especially, the industrial strategy (Standing, Sender and Weeks, 1996; Michie and Padayachee, 1998), which contributed to its vulnerability.

The support generated by the RDP programme portrayed it to be an appropriate antidote to the legacies of apartheid. The programme was drafted to be a product of consultation and extensive debate, thereby spawning widespread support, as a ‘coherent and viable’ initiative.

There were many proposals, strategies and policy initiatives that combined to form the RDP policy framework. These are grouped into five major categories (RDP, section 1.1.4), namely:

- Meeting basic needs;
- Developing human resources;
- Building the economy;
- Democratising the state and society,
Implementing the RDP.

To meet the basic needs of the people which were identified by the government as job creation, land security, housing, water, electricity, telecommunications, transport, a clean and healthy environment, nutrition, healthcare, and social welfare (RDP, 1994:7); the government established ‘achievable’ programmes over a five-year period. These included land redistribution to the landless people, the building of over one million houses for the less privileged, provision of a clean environment for all, electrifying 2.5 million new homes, and the provision of accessible/affordable healthcare and telecommunications (RDP, sections 1.3.2-1.3.8).

These programmes were meant to address poverty and social deprivation prevalent mostly amongst the rural dwellers (at the time, an estimated 17 million people were surviving below the Minimum Living Level at that time and more than 11 million lived in rural areas), as a way of leveraging crime rate – a measure designed to achieve a sustainable investor-friendly environment.²

The shortfalls of the RDP emanated from Government’s inability to generate needed resources to finance the programme,³ coupled with its failure to establish an industrial policy. Also, the lack of compatibility between the political ideology of the ANC-led alliance, and the adopted economic orthodoxy – mainly trade liberalisation and privatisation (Hirsch, 1993; Nattrass, 1994), further incapacitated the policy. Fine (1995:21) was more critical of the proposed privatisation measure, as he observes

Whatever the motives or reasoning underlying the privatisation programmes were, they are seriously deficient in logic and ethos. This is because; privatisation does not offer the means of realising the RDP but rather, merely represents its erosion and redefinition. Privatisation was considered an antithesis-consolidation of, and continuity with, the economic powers and policies of the past regime” – the apartheid (my emphasis).

The inadequacy of the programme manifested in the abandonment of interventions in support of rural development and social security issues, as the interest of capital becomes more central (Weeks, 1999). The strategy was savaged for the financial crises that hit South Africa in 1996, which resulted in capital flight and economic instability, necessitating a national call by the Mr Mandela (The President) on the “public and private sectors to develop and implement a national vision” (Nattrass, 1996:25).

This Presidential call generated spontaneous responses from various quarters of the economy namely the National Economic Development and Labour Council (NEDLAC), the South African Labour Movement (SALM), the International Labour Organisation (ILO) and the South African Foundation (SAF). SAF, a consortium of 50 top South African companies responded with a presentation of ‘Growth For All’, within a few weeks, followed by SALM’s ‘Social Equity and Job Creation.’ The ILO country review

² This assumption has been proven valid by recent statistics as more violent crimes are committed in the rural areas or in the urban areas by migrants from the rural areas.
³The government resolved to finance RDP through privatisation, a decision that did not augur well with some critics (Fine, 1995:17; Michie and Padayachee, 1998:624).
of South Africa supported the SALM’s proposition. The government blocked this development in June of the same year when the Finance Minister, Trevor Manuel, presented the Growth, Employment and Redistribution (GEAR) macroeconomic framework (Nattrass, 1996; Michie & Padayachee, 1998).

These policy proposals were not only diverse in origin but also in contents and acceptability. While the SAF’s blueprint advocated a free-market economy, SALM proposed legislative interventions to establish labour standards, collective bargaining, and a boost to the supply-side of the economy. GEAR on the other hand, threw its weight behind the Government’s orthodox macroeconomic policy, which stressed deficit reduction, and a tight monetary policy, combined with trade liberalisation (Weeks, 1999). The GEAR policy framework was devised as an instrument for building and restructuring the economy, by addressing the failings of the RDP.

The GEAR was designed as an integrated economic strategy capable of expiating challenges that subjugated the achievements of the RDP, like meeting basic needs, developing human resources, increasing participation in the democratic institutions of civil society and implementing the RDP in all its facets (GEAR, 1996). The ensuing empirical interrogation alludes to the paucity of some of the tenets of this policy.

This Neo-liberal approach – embedded in GEAR – appears to negate the provisions of the ANC’s earlier Keynesian paradigm that sought a leading and enabling role for Government in guiding the mixed economy through a process of reconstruction and development. The policy proposes a living wage, as a prerequisite for achieving the required level of economic growth and development, and a sustainable investment-friendly environment capable of attracting FDI (GEAR, 1996).

**The GEAR and FDI Inflow**

GEAR was adopted by the Government on the premise that the policy framework will create the needed enabling environment to facilitate FDI inflow into the country – a perceived sin qua non for economic growth and poverty alleviation; a putatively elusive strategic target to the policy initiative (Standing, Sender and Weeks, 1996; Weeks, 1999). To evaluate the impact of GEAR on FDI inflow, it is necessary to probe the veer of the policy’s measurable indicators namely, the reduction of the fiscal deficit relative to GDP, the reduction of inflation/interest rate adjustments, employment creation, poverty alleviation and wealth redistribution, and trade liberalisation – all of which are aimed at creating an investor-friendly environment.

To start with, the summary of GEAR as a policy framework, provides macroeconomic guidelines, some of which match the recommendations of the apartheid state, on the eve of the transition to democracy, as expressed in the Normative Economic Model (NEM), and endorsed by SAF; the WTO, and the International Financial Institutions (IFIs) - the International Monetary Fund (IMF) and the World Bank (WB) (Nattrass, 2001).
On an effrontery of spontaneous inflow of foreign capital, the policy projected that about 93 per cent of the total stimulus expected to achieve the targeted GDP growth (4.2 per cent between 1996 and 2000) would be generated by private investors (Weeks, 1999). By implication, the success of GEAR principally depends on the immediate success of Government to stimulate private (foreign) investment (Adelzadeh, 1996). As a result, the success of GEAR was contingent on volatile foreign capital inflows (Michie and Padayachree, 1998; Fine and Rustomjee, 1996; Gilroy, Gries and Naude, 2005). Amongst others, the policy canvassed the following measures that conform to the dictates of economic orthodoxy, which are observed to be inconsistent with a desire (inter alia) to alleviate poverty, enlarge the local market capacity, whilst creating an enabling environment capable of attracting FDI inflow (Nattrass, 2001; Gelb, 2006):

1. Concern for inflation/the use of interest rate

The policy is directed towards reducing inflation. The Reserve Bank Act 90 of 1989 provides that the primary goal of the Bank is “the protection of the domestic and external value of the Rand.” The enabling Act grants the Bank certain measures of independence in designing appropriate policies to fight inflation and to protect official foreign reserves. These combined functions ensure the maintenance of monetary stability. This it does by formulating and implementing effective fiscal and monetary stabilisation policies in the economy.

The most powerful instrument used by the Bank in this regard appears to centre on interest rates. The Bank raises interest rates to reduce the demand for loans, curb total domestic expenditure, and thus reduce the amount of money in circulation (Frank, 1996). The level of interest rate (either high or low) determines the growth potential of consumer spending and subsequently, economic productivity (De Vroey, 1984; Javier and Ignacio, 1997).

Over time, the Bank has been successful in achieving moderate inflationary rate (until recently). To this end, inflation should not temper Government spending (Weeks, 1999; Adelzadeh, 1996). Although inflation affects the poor the most and can lead to lower productivity, it is doubtful whether inflation hinders growth or if low levels of inflation are a prerequisite for growth, judging from the experience of many countries (MARG, 1993). Indeed, low or moderate inflation rates have a temporary negative impact on growth rates, leading to significant and permanent reductions in per capita income (Barro, 1995, 1996; De Gregorio, 1996). In the South African context, reducing moderate levels of inflation may exacerbate unemployment, thereby forestalling poverty alleviation.

Interest rates were raised consecutively for the tenth time on June 12th 2008, as a measure to cushion the cyclical effects of inflation on the economy. As a result of continued interest rates hikes, formal employment has continued to decline due to slow economic growth, occasioned (inter alia) by the high interest rates4. Specifically, the overall unemployment figure for the country was quoted at 41.8% in October 2007 (Business

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4 High interest rates reduce the disposable income of consumers through debt servicing/repayment mechanisms.
Anti-corruption, 2007). Unemployment continues to increase across racial lines in the country – the same source puts it at 5% among the white population, 20% among Indians and the coloured population, and more than 36.8% among the black population. It is evident that GEAR’s policy stance on inflation has resulted in more unemployment rather than creating jobs (Nattrass, 2001).

While many factors (like the global economic swings) might have contributed to the performance of the economy during these periods, there is a prima facie case that the GEAR policy package made a significant contribution to the collapse of employment growth in South Africa, and thereby exacerbated poverty (Wessel, 2007). This could be attributed to its emphasis on budget deficit reduction, the further reduction of inflation, and the resultant low local demand. The failure of the economy to generate adequate absorptive capacity needed to create an investor-friendly environment (Kebonang, 2006) occasioned by GEAR’s high interest rates, may have culminated in its inability to comparatively attract adequate FDI (greenfield) inflow required to generate the targeted economic growth stimulus (Magubane, 2002).

2. Poverty alleviation and wealth redistribution

Although the South African economy has continued to grow at an annual rate of about 5 per cent for the past three years (Wessel, 2007), the situation has changed faster than expected in 2008 when the economy is projected to record under 4 per cent growth (M&G, 2008). Despite the 5 per cent growth rate recorded in the previous three years, the real per capita GDP has been growing at an average annual rate of only 1.2 per cent, while the real wage rise was yet to catch up with the 1980 peak as at 2006 (Rodrik, 2007). This is an indication that attempts to redress poverty have not been successful. The proportion of the South African population living below US $1 a day has increased from 9.4 per cent in 1995 to 10.5 per cent in 2002 (Business Anti-Corruption, 2007).

On the issue of income/wealth redistribution, South Africa is one of the countries with the most skewed income distribution. Given a Gini index of 59.3 per cent, it is one of the most unequal societies in the world (Business Anti-Corruption, 2007). This explains why South Africa has ‘two-economies’ within a single country. About a third of the country earns less than R1, 500 per month, of which more than 50 per cent are female (Du Plessis, Jooste and Strydom, 2005). While the GNP per capita of South Africa is more than US $3,000, 30 per cent of the population lives in abject poverty (Wessel, 2007). This furthers the negative argument against the GEAR, as a macroeconomic policy (Weeks, 1999)

3. Trade liberalisation

GEAR identifies investments and exports promotion as the key drivers to the economy (GEAR, Appendix 4). This it intends to achieve through trade liberalisation. Although trade liberalisation began in 1983 (Nattrass, 1996), GEAR was adopted to serve as the

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5 The degree of income distribution among individual, mostly an approximate of income distribution among the 10% upper and bottom docile (named after the Italian statistician Cerrado Gini).
‘wrapping paper’ to re-package the existing macroeconomic policies in a way to achieve policy ‘credibility’ on the part of the government: to show government’s commitment towards creating a stable investor-friendly environment (Gelb, 2006).

However, the trade liberalisation that GEAR legitimatised appears to be self-defeating owing to the fact that it fails to facilitate a stable socio-political environment, capable of improving the purchasing power and living standards of the people – sin-qua-non for inflow (greenfield) FDI (Schimulow and Greyling, 1996; Michie and Padayachee 1998). More specifically, experience from the apartheid era confirms that promoting manufacturing exports without a corresponding increase in intermediate and capital goods would exert pressure on foreign reserves, thereby triggering capital account deficit (MERG, 1993; Van Seventer and Gibson, 1995). As a result, fiscal and monetary stability is traded-off on the altar of export promotion (Gilroy, Gries and Naude, 2005). This is the reality of the South African economy, today as the current account deficit amounted to R 16.9 billion (almost 8 per cent of GDP) in the first quarter of 2008 (SARB, 2008).

Although exports promotion may lead to economic growth (Rugumamu, 2005), there is no strong evidence to support this assumption (De Gregorio, 1996). Evidence from developed countries confirms that higher percentage of production is geared towards domestic consumption (Roberts and Thoburn, 2004). More specifically, the USA and Japan’s share of exports of their total output was only eight and 10 per cent on average between 1960 and 1994 respectively; a record which South Africa surpassed as South Africa’s non-gold exports to GDP ratio was equal to 21 per cent over the same period6 (Adelzadeh, 1996:71).

One must admit, however, that GEAR has recorded an increase in foreign capital inflow to South Africa (until the recent financial swing). Political emancipation in South Africa generated supports from local and international bodies, which resulted in spontaneous inflow capital into the country. From table 1, except for the slight regression in 1995, investment (capital) inflow increased from 1994, reaching its peak in 1998. The gradient of investment regression between 1998 and 2002 was momentous. Although, this could not be totally secrernated from the global economic recess and Asian currency crises of the time, the level of uncertainty that characterised GEAR framework may not also be exonerated of this quandary.

Figure 1 shows the trend in investment inflow (mainly capital) to South Africa between 1994 and 2005.

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6 When the export of gold is included, the figure rises to more than 25 per cent of GDP
Figure 1: FDI\textsuperscript{7} into South Africa by year

\begin{figure}[h]
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\includegraphics[width=\textwidth]{fdi_chart.png}
\caption{FDI into South Africa by year}
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\textit{Source: Business Map, 26 March 2007}

Increase in capital inflow between 2003 and 2005 may be attributed to the favourableness of the GEAR to foreign capital, essentially the high interest rates that motivate portfolio investment. For example, in 2005, South Africa showed an improvement of 15.8 per cent in capital inflow over 2004. The inward stock sharply increased to USD $6.4 billion, representing about 21 per cent of the Southern Africa region’s total (UN, 2006). This sharp increase was due to a single M&A between Barclays Bank of England and South Africa’s ABSA, which amounted to about USD $5 billion. Similar stance followed when Industrial and Commercial Bank of China (ICBC), the world’s largest bank by market capitalisation, bought 20 per cent shares in South Africa’s Standard Bank Group Ltd, at an amount of USD $5.5 billion in 2007 (Nyamakanga, 2007).

Whilst ‘hot money’ is characterised by creating and furthering financial instability in the host country (Magubane, 2002; Stiglitz and Charlton, 2005), the most gruesome aspect of GEAR’s trade liberalisation appears to be import penetration. The hardest hit sectors were clothing (54 per cent), basic iron and steel (67 per cent) and paint (89 per cent) (Holden, 2001). Also, profitability of the manufacturing sector has been worsened as it has slumped averagely by 30 per cent over time because of import competition (Rodrik, 2007). Undoubtedly, this has led to the demise of some local firms in these sectors, and the corresponding job losses have been appalling (Holden, 2001). Employment has fallen in all the textile sub-sectors with spinning, weaving and finishing being the worst victims, where employment in 2001 was 45 per cent less than it was in 1996 (Roberts and Thoburn, 2004).

Aside the textile industry, the agriculture sector has also been hit by the Western waves of economic liberalisation. Statistics show that the contribution of agriculture to real economic growth has been decreasing over time (from 33 per cent in 1951, to less than 14 per cent in 1985, and to just 10 per cent in 1991 (MERG, 1993: 171-172). This figure

\textsuperscript{7} According to Business Map, FDI here includes portfolio investment.
further slumped to 0.2, -0.1, and 0.0 per cent in 2002, 2003, and 2004 respectively (Statistics SA, 2007). This may further buttress the argument against the appropriateness of GEAR’s trade liberalisation.

More specifically, the penetration of foreign MNEs is presumably the main cause of underdevelopment and exploitation of developing economies (Wilhelms and Witter, 1998; Seid, 2002; Aregbeshola and Palmer, 2007). MNEs maraud and exploit natural resources of developing nations without corresponding benefits for the host economies (UNCTAD, 1999; Kebonang, 2006). On a general note, liberalisation processes have spawned an ‘imperial policy’ of the conquest of capitalism over the rest of the world (Akindele, Gidado, and Olaopo, 2002). The benefits of trade liberalisation and economic openness advocated by the Washington consensus do not only benefit the West, but have entrenched their political and economic dominance as well. This is exemplified in Table 1, which illustrates exports statistics for North America, Europe and (South) Africa between 1948 and 2005.

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b- Figures are significantly affected by changes in the country composition of the region and major adjustment in trade conversion factors between 1983 and 1993.
c- Beginning with 1998, figures refer to South Africa only and no longer to the Southern African Customs Union.
e- Membership as of the year stated.

Note: Between 1973 and 1983 and between 1993 and 2003 export and import shares were significantly influenced by oil price developments.

Source: The World Trade Organisation. Accessed on 2007-07-16 (the table has been modified)

In 1948, world exports were put at USD $58 billion, of which North America (27.1 per cent) and Europe (31.4 per cent) accounted for more than 58 per cent of the world’s total, a trend that has changed dramatically over time. The European share of the world’s total
grew up until 2005, when it declined slightly. The trend for North America was not as impressive as that of Europe\(^8\), while African export has since been very disappointing.

Africa’s figure fell from 7.3 per cent of the world’s total in 1948 to 2.4 per cent in 2003, before increasing to 2.9 per cent in 2005\(^9\). The South African situation was not immune to these shortfalls. The country’s exports fell from 2.0 per cent in 1948 to 0.7 per cent in 1993, and stabilised at 0.5 per cent between 2003 and 2005. The recent balance of payment deficit on the national current account is a clear indication that GEAR has missed out on its export promotion targets\(^10\).

**Conceptual overview of FDI**

The need for trade and trade-related activities has a historical basis. Trade and the cross-border movement of resources are as old as creation itself (Ball and McCulloch, 1988). In most cases, international trade has contributed to the shaping of international borders (Czinkota, Muffett and Ronkainen, 1994; Hill, 2009).

Consequently, recent efforts by individuals and nation states, to participate in trade, may have been influenced by the trade practices of many centuries ago. In the early days of trade, it was discovered that people’s participation in any kind of trade (national and international) was an unquestioned necessity as it augmented (and still augments) economic growth and development (Ball and McCulloch, 1988), a situation that is more relevant now, than ever.

Opportunities provided by trade through the exchange of goods and services, which includes the availability of a variety of merchandise and services, contribute to increased per capita GDP, for participating countries (Ouattara, May 1997; Correa and Kumar, 2003; Akinkugbe, 2005). This invariably improves both the living standards and the quality of lives of the affected people (Köhler, 2003).

To benefit more through trade, economies were encouraged to liberalise and embrace foreign investments (Akindele, Gidado, and Olaopo, 2002). The unprecedented efforts geared towards trade liberalisation and openness of economies to international competition has resulted in increasing both the stock and the flow of FDI in recent time (UN, 2007).

A good understanding of this paper requires defining what FDI is. To start with, The International Monetary Fund (IMF, 1993:86) defines a direct investment as “the category of international investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy.” The Fund

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\(^8\) This may not be too surprising because most of American MNCs operate and produce abroad (UNCTAD, 2007).

\(^9\) This may be attributed to the rapid rise in global demand for African mineral resources, essentially crude oil to power the sporadic Asian economic growth

\(^10\) A successful export promotion should generate a positive balance of payment (China has one of the highest foreign reserves today, due to its successful export promotion strategy)
regards the resident entity as the direct investor, while the enterprise is the direct investment enterprise (emphasis mine).

According to the Organisation for Economic Co-operation and Development (OECD, 1996:7), foreign direct investment (FDI) “reflects the objective of obtaining a lasting interest by a resident entity in one economy (“direct investor”) in an entity resident in an economy other than that of the investor (“direct investment enterprise”).” The organisation goes further to explain that the lasting interest signifies the existence of a long-term business relationship between the investor and the enterprise, and a controlling stake by the investor in the investment (emphasis mine).

Peng (2009) contrasts FDI with foreign portfolio investment (FPI), which is the investment by individuals, firms, or public bodies (like national and local authorities) in foreign financial equities. Also, Hill (2009) points out that the flow of FDI refers to the amount of FDI that takes place over a period of one year while the stock of FDI refers to the total accumulated value (usually expressed in monetary terms e.g. US dollars) of foreign-owned assets at a given time. He further states that FDI inflow refers to the flow of FDI into a country while FDI outflow refers to the flow of FDI out of a country.

**The growth of FDI**

Close observation of both the flow and stock of FDI during the 1980s and recent times reveal dramatic increase and growth. Over the period, the growth of FDI has far surpassed the growth of exports (Rivera-Batiz and Oliva, 2003). FDI inflows grew at an annual average rate of 13.4 per cent during the 1980s and 20.2 per cent during the 1990s as compared to the annual merchandise export growth of 5.4 and 7.1 per cent respectively (Johnson and Turner, 2004).

More specifically, the global value of FDI rose from USD $105 billion in 1967 to an estimated USD $1.5 trillion in 2007 (UNCTAD, 2008), furthering the argument in support of trade liberalisation and market economies (ibid). While the bulk of these FDI benefitted the advanced economies, the developing economies have also benefitted substantially (ECA, 2008). In 2007, FDI was quoted at USD $800.7 billion for developed nations - an improvement of 47.7% growth, while the same report shows US $367.7 billion for the developing nations - an increase of 10.0 % growth (UNCTAD, 2008). Inflow FDI to Africa amounted to USD $36 billion over the period, primarily occasioned by a continuing boom in global commodity markets and, mergers and acquisitions (M&As) that took place in this sector (ibid).

**Benefits of FDI**

The global regulatory frameworks have alleviated the hindrances that hitherto frustrated international flow of capital (FDI and FPI) (Narula and Lall, 2006). This has been achieved through the advent of regulatory institutions, established during the Second World War, to avoid a repeat of the global economic depression of the 1930s, and the fascist regime of Germany, that led to the Second World War (Kindleberger, 1989; Mishkin, 2006). This process has also been facilitated by the global economic institutions
like the WTO, the IMF and the World Bank (Salil, 1995). The impacts of the United Nations in this regard have also been significant.

Given that the openness of an economy enhances the international participation of domestic enterprises (Tomohara, 2004); FDI has contributed to improving the living standard of the people (Versi, 2003). The recent increase in the stocks and flow of FDI has been credited with creating unsurpassed prosperity across the globe (Köhler, 2003). In a nutshell, the process of international capital flow has contributed largely to the rapid rise in incomes in advance countries and a few of the developing countries (Peng, 2009). On a general note, while developed countries increase their economic prosperity through FDI, the developing nations see FDI as a means to catapult themselves out of poverty (Versi, 2003).

For the purpose of this research, the benefits derivable from FDI are viewed from the perspectives of the contributions made by multinational enterprises (MNEs) to the host economies. This is based on the premise that FDI by multinational enterprises yields a larger market and therefore, fosters growth (Ghauri and Buckley, 2002; Tomohara, 2004). Greenfield projects create new businesses in the host country, thereby inducing more direct positive effects on employment, and domestic value-added (Meyer, 2004; Narula and Lall, 2006). In developing world, more material beneficiation could be achieved, thereby increasing foreign earnings (Hill, 2009).

The extent to which the host economy benefits from the presence of MNEs largely depends on the amount of initial capital involved, foreign market conditions and the political economy of the host country, amongst others (Balaam and Vaseth, 2005; Abramovitz, 1989; Shafaeddin, 2005). If integrated into a strategic concept of productive capacity building and upgrading, the direct impact of FDI inflows on domestic income and investment creation has been substantial (Akinkugbe, 2005). It combines both tangible and intangible resources that contribute to economic development in the host economy (UNCTAD, 2006). As a result, FDI serves as an engine of economic growth in the host economy (Akinkugbe, 2005; Loots, 2006).

Amongst the main contribution of FDI (greenfield) to a host economy are the creation of employment opportunities, it is a vehicle for transferring technology, it provides superior skills and management techniques, it helps with the process of capital formation, it facilitates access of local enterprises to international markets, it uses local resources more efficiently and productively, it increases labour rights, it uses environmentally clean technology, it observes human and labour rights, and it creates many linkage-effects in the economy, both forward and backward (Bruno, Potterie and Lichtenberg, 2001; Loots, 2006).

In essence, the ability of any nation to generate growth through FDI depends on the organisational settings, quality of labour (skills), technological capability of the host nation firms and their competitiveness – the national absorptive capacities or social capabilities (Asheghian, 2004; Shafaeddin, 2005). This suggests that lack of/low natural
absorptive capabilities may jeopardise the potential economic gains derivable from FDI (Basu and Weil, 1998).

**South Africa and FDI**

The relevance of FDI to South African economy culminated in the policy adjustment of 1993. Prior to the political emancipation, South Africa adopted an explicit industrial policy epitomised by Import Substitution Industrialisation (ISI) from the mid 1920s up to the post World War II as a way to circumvent the negative effects of international sanctions meted out to the apartheid regime (Moritz, 1994; Nattrass and Terreblanche, 1990; Lewis, Reed and Teljeur, 2004).

The ISI strategy recorded initial success as the economy transformed from the production of consumer goods to that of capital and intermediate goods; more simply, a regression from light to heavy industry. Between 1925 and 1985, manufacturing grew from 36.4 per cent of GDP to 64.3 per cent (Moritz 1994). As a result of overcapitalisation that resulted from importation of machines and foreign capital (intermediates), there was a balance of trade deficit that amounted to some 25 per cent of GDP in 1925 (Moritz, 1994). It was little surprise that government adopted export promotion in 1990, supported with an incentive scheme (The General Export Incentive Scheme) to boost exports. This intervention mechanism also failed as a result of its contravention to the GATT rules (Nattrass and Terreblanche, 1990; Lewis, Reed and Teljeur, 2004).

**Research methodology**

This research postulates that the timing and management of GEAR as a macroeconomic policy were not only wrong, the policy itself is self-defeating. To arrive at tenable postulations, this article reflects both literature and empirical surveys. The empirical survey (discussed below) was deemed necessary to interrogate the effects of GEAR on FDI (greenfield)\(^{11}\) inflow and its retention in South Africa.

**Research design**

The focus of this research is to test the relationship between FDI inflows to South Africa and the effects of policy framework that regulates FDI in the country. A test of Exact significance level of the interaction between the dependent (FDI inflows) and the independent (policy framework) is applied to examine the extent to which the trend of FDI inflow is policy dependent.

**Population and sampling**

The population groups that receive attention in this study are divided into two categories namely, foreign investors and policy makers. The researcher adopted a random sampling method to ensure that every member in the population sample has an equal probability of

\(^{11}\) Greenfield investment is chosen based on its comparative advantage over M&A (UNCTAD, 2007)
representation. No sector/industry was excluded from this survey. In all, 68 research questionnaires were distributed among the targeted population, out of which a total of 30 were returned completed after a series of reminders and persuasion.

Data analysis

In analysing the data collected, significance is established if the probability associated with the test of the statistics is less than 0.05 (5% level of significance), or less than 0.01 (1% level of significance) or less than 0.001 (0.1% level of significance). This is indicated as ‘Pr > chi-sq’ in the analysis.

The frequency tables used for the preliminary analysis generally indicate that the most favoured type of FDI to South Africa is the greenfield type. This supports the assertion that greenfield FDI benefits the host countries more, essentially because it creates jobs, improves host economy’s foreign earnings, improves the quality and standard of living of the people, and contributes to the productivity and growth of local enterprises through spillover effects/externalities (Dunning, 1988; Blomstrom and Sjoholm, 1998; Elmawazini, Saadi and Ngouhouo, 2005; Kebonang, 2006). To this effect, the test of hypotheses is based on inflow greenfield FDI.

Research hypotheses

This research tests the perception of both the policy makers and foreign direct investors in South Africa on the role played by selected macroeconomic initiatives to attract FDI.

Hypothesis 1: Investment related policy frameworks (mainly the macroeconomic policies) do not improve the attractiveness of South Africa to inflow FDI.
Table 2: Favourability of selected measurable indicators of GEAR to inflow FDI

<table>
<thead>
<tr>
<th>Table of necessary policy reform</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reform l</td>
</tr>
<tr>
<td>Frequency Percent Row Percent</td>
</tr>
<tr>
<td>Empowerment Charters</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>High interest rates</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Labour policies</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Income redistribution</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Total</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

From table 2, respondents generally feel that the Empowerment Charter should be reviewed. 20 out of the 26 respondents feel strongly about the need for government to reform the policy if the government is committed to attracting inflow greenfield FDI. A stronger sentiment (24 out of 25) is expressed on the issue of interest rates, which has been criticised to be one of the global highest up until 2009. Labour policies were tamed with some lighter acceptance, but still with more negative popularity. The same could be said of income redistribution in the country as contained in table 2.

Statistics for Table of necessary reform

Table 3: Chi square test

<table>
<thead>
<tr>
<th>Pearson Chi-Squared Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chi-Square</td>
</tr>
<tr>
<td>DF</td>
</tr>
<tr>
<td>Asymptotic Pr &gt; ChiSq</td>
</tr>
</tbody>
</table>

The FREQUENCY Procedure
Table 4: Estimate for Exact test

<table>
<thead>
<tr>
<th>Monte Carlo Estimate for the Exact Test</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Pr &gt;= Chi Sq</td>
<td>0.6460</td>
</tr>
<tr>
<td>99% Lower Conf Limit</td>
<td>0.6337</td>
</tr>
<tr>
<td>99% Upper Conf Limit</td>
<td>0.6583</td>
</tr>
<tr>
<td>Number of Samples</td>
<td>10000</td>
</tr>
<tr>
<td>Initial Seed</td>
<td>1943940033</td>
</tr>
</tbody>
</table>

From table 4, the probability associated with the Pearson’s Exact test for the policies interrogated is greater than 0.05 – it is indicated as 0.6460 (it is given as ‘Pr <= Chi Sq’ in the analysis results, where chi-square = 3.8849 and where the probability associated with the statistic is 0.6460) thus indicating non-significance.

Significance in this instance would have indicated that investors and policy makers did not respond in a similar way to all the options – that they ‘preferred’ some policy-options to others (as contained in table 2). This could not be established in this instance - indicating that respondents’ general perception of policy reforms was positive (20 respondents out of 26 as indicated in table 2). By implication, this confirms that all the listed policies need to be reformed to make South Africa more attractive for inflow greenfield FDI. As a result, the research hypothesis is rejected.

**Hypothesis 2:** Investment related policies are not the only variables that hinder the attractiveness of South Africa to inflow FDI.

The research goes further to probe the impact of ‘other’ issues/forces on the attractiveness of South Africa to inflow greenfield FDI. Some measurable indicators of possible hindrances to inflow FDI were examined. The result is presented in tables 5 to 7:
Table 5: Obstacles to inflow FDI to South Africa

Table of hindrances to FDI inflows

<table>
<thead>
<tr>
<th>Frequency Cell Chi-Square Percent Row Pct</th>
<th>FDI 1</th>
<th>Obstacles to inflow FDI to SA</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>negative</td>
<td>positive</td>
<td>positive ++</td>
</tr>
<tr>
<td><strong>Political instability</strong></td>
<td>3</td>
<td>13</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>0.0137</td>
<td>0.3711</td>
<td>0.4375</td>
</tr>
<tr>
<td></td>
<td>2.80</td>
<td>12.15</td>
<td>8.41</td>
</tr>
<tr>
<td></td>
<td>12.00</td>
<td>52.00</td>
<td>36.00</td>
</tr>
<tr>
<td><strong>Skilled labour shortage</strong></td>
<td>4</td>
<td>10</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td>0.4031</td>
<td>0.1767</td>
<td>0.0097</td>
</tr>
<tr>
<td></td>
<td>3.74</td>
<td>9.35</td>
<td>11.21</td>
</tr>
<tr>
<td></td>
<td>15.38</td>
<td>38.46</td>
<td>46.15</td>
</tr>
<tr>
<td><strong>Small market size</strong></td>
<td>5</td>
<td>16</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>1.4896</td>
<td>1.8363</td>
<td>3.807</td>
</tr>
<tr>
<td></td>
<td>4.67</td>
<td>14.95</td>
<td>4.67</td>
</tr>
<tr>
<td></td>
<td>19.23</td>
<td>61.54</td>
<td>19.23</td>
</tr>
<tr>
<td><strong>Crime</strong></td>
<td>0</td>
<td>8</td>
<td>22</td>
</tr>
<tr>
<td></td>
<td>3.3645</td>
<td>2.0343</td>
<td>5.4218</td>
</tr>
<tr>
<td></td>
<td>0.00</td>
<td>7.48</td>
<td>20.56</td>
</tr>
<tr>
<td></td>
<td>0.00</td>
<td>26.67</td>
<td>73.33</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>12</td>
<td>47</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td>11.21</td>
<td>43.93</td>
<td>44.86</td>
</tr>
</tbody>
</table>

Table 5 indicates that 88 per cent of the respondents regard political instability as a possible hindrance to inflow greenfield FDI to South Africa. Most of the respondents that were reticent to acknowledge the negative impact of political instability were largely policy makers. Lack of skilled labour was identified as one of the major hindrances to inflow greenfield FDI to South Africa by 85 per cent of the respondents, and a similar percentage (81 per cent) regards small market size as a possible hindrance. It is amazing to observe that all the respondents (both investors and policy makers) admit that crime is a strong deterrent to inflow greenfield FDI to South Africa.
From table 7, the probability associated with the Pearson’s Exact test for the factors/issues that hinder inflow FDI to South Africa, is less than 0.05. It is indicated as 0.0027 (it is indicated as ‘Pr <= Chi Sq’ in the analysis results, where chi-square = 19.3652 and where the probability associated with the statistic is 0.0027), thus indicating significance.

A critical evaluation of the values of the cell-chi-square in the two tables (for hypothesis one and hypothesis two respectively) indicates that the cell-chi-square values for each variable tested in tables 5-7 are higher than those in tables 2-4. This indicates that although policy reforms will improve South Africa’s attractiveness to FDI inflow, the impact of other variables (tested in tables 5-7) is more significant.

More specifically, the cell-chi-values 5.4218 for crime (with a frequency of 22 for the positive++ category) and 3.3645, also for crime in the cell-chi-square contribution (with a frequency of zero for the negative category) indicate that respondents viewed crime in a significantly different way to the other FDI issues. They generally regard crime as a very important variable that hinders the attractiveness of South Africa to inflow greenfield FDI.

To buttress this point, South Africa spends above global standard on the police, courts and prisons. Specifically, this amounted to three per cent of GDP in 2004, or an average of USD $130 per person on criminal justice, as compared to the world average of one per cent or USD $66 per person) (EIU, 2005). This is a clear indication that crime is indeed, a real problem in the country. The Global Competitiveness Report (2008-2009) ranks

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**Table 6: Chi square test**

<table>
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**The FREQUENCY Procedure**

**Table 7: Estimate for Exact test**

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<tr>
<td>DF</td>
</tr>
<tr>
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</tr>
</tbody>
</table>
South Africa 116th out of 131 countries on the business costs of crime and violence, and 92nd on the unreliability of police services to protect victims from crime.

Conclusion

The research on which this paper was based substantiates that crime, small market size, political instability, and skilled labour shortages in South Africa are major deterrents to inflow (greenfield) FDI into the country. From the preceding discourse, these are precipitated by the measurable indicators of GEAR’s macroeconomic policy; thereby strengthening the unpopularity of GEAR as a macroeconomic strategy.

The overwhelming asseveration is that decisive efforts are needed to improve socio-economic conditions in South Africa, as a measure of creating an investor-friendly environment needed to attract adequate, greenfield, FDI. It is suggested that an effort is required to ameliorate the negative impacts of GEAR as a policy framework. Although the Accelerated Growth Initiatives for South Africa (ASGISA) may help in some respects, an over-reliance on the credibility of this policy to woo investors may be risky.

On the whole, it is suggested that the Government and other stakeholders shift focus to the possible use of an alternative strategy as an intervention mechanism to improve the labour-intensive (manufacturing) export-base of the economy, as a way to reduce unemployment, thereby alleviating poverty. A well-guided wealth redistribution mechanism that is different from the current controversial Broad-Based Black Economic Empowerment (BBBEE) should be devised. It is observed that a well guided truly redistributive mechanism will pacify the tantrums, and create an enabling environment for inflow greenfield FDI. It should be understood that macroeconomic stability is a necessary, but not a sufficient condition for inflow investment or economic growth (Loots, 2006).
Reference list


