



RECOMMENDATIONS

The promotion of industrialisation should be a combined effort, with the following interventions.

- Customs fraud is a key issue hindering South Africa's efforts to industrialise. To address this, it is imperative that policymakers consider introducing policies that will enable the inspection of imported goods before they leave the country of origin.
- Government should consider entering into voluntary export restraint agreements, similar to that signed with China in the mid-2000s, to cover strategic sectors identified by the Industrial Policy Action Plan (IPAP).
- There is also a need for companies and trade unions to ensure that workers benefit from the proceeds of investment. Employee share ownership schemes could be an ideal means of ensuring this. Research by Productivity SA has found a positive correlation between these schemes and productivity; and strengthening productive capacity is a key element in ensuring that South Africa becomes globally competitive. This initiative would be supported by unions, as they believe in worker control of the economy, and some have already entered into such schemes.

When is Foreign Direct Investment Beneficial to a Country and When Is It Not? The Case of South Africa

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EXECUTIVE SUMMARY

Although South African policymakers have introduced policies to encourage foreign direct investment (FDI), so far the results have not met expectations, particularly in relation to greenfield investment. Instances in which the country has managed to attract FDI have been in area mergers and acquisitions. However, even this type of FDI has declined in recent years, as shown by the United Nations Conference on Trade and Development 2011 World Investment Report. It is important that the country focus on strengthening its manufacturing capacity in order to create decent jobs, and not be too dejected when inward flows of FDI decrease. After all, FDI does not necessarily result in economic growth and may even be undesirable in certain sectors, such as retail. Increased FDI flows into South Africa should be an outcome of more investment by the public sector in economic infrastructure to facilitate further investment by the local private firms. This will increase confidence in the South African economy and can attract more FDI.

INTRODUCTION

South Africa is entering its 18th anniversary of freedom and democracy still facing serious challenges of unemployment, poverty and inequality. During the past 18 years, government has put in place various economic policies in an attempt to address these challenges, and has reviewed them from time to time. One of the objectives of economic policies is to attract FDI. FDI is generally regarded as being beneficial to the

recipient country in a number of ways, including the following.

- The transfer of management know-how and skills leading to the development of human capital.
- Access to markets not otherwise available to the country.
- The stimulation of competition in the domestic economy, thereby enhancing productivity and reducing inflationary pressures.
- The integration of the domestic economy with international supply chains – thereby offering improved benefits of reduced costs on both wage and non-wage goods.
- The improvement in economies of scale, and increased exports.²

The United Nations Conference on Trade and Development (UNCTAD) 2011 World Investment Report shows that FDI flows into South Africa decreased by more than 70% in 2010 when compared with 2009. The report also shows that the cross-border mergers and acquisitions decreased by 6.5% for the same period. Not surprisingly, this provoked an outcry from commentators and opposition political parties in parliament, who demanded answers from the ruling party. Seemingly, a decrease in FDI flows into South Africa is equated with the mismanagement of the economy by the ruling party and an indication that the economic policies in place are not attractive to FDI. However, it is questionable whether such a response is warranted, and whether the slump in FDI flows into the country should in fact be perceived as so negative. Although the benefits of FDI are well documented and appreciated, empirical evidence shows that not all types of FDI are beneficial and that FDI does not always lead to economic growth and thus to the creation of decent jobs that South Africa so desperately needs.

THE CHANGING FLOW PATTERN OF FDI STOCK: A CAUSE FOR CELEBRATION?

Historically, FDI has been concentrated in

developed countries; particularly the so-called triad countries of the United States, the European Union and Japan. For instance, in 2002 about 64% of the total FDI stock was in developed countries, whereas developing countries accounted for a mere 32.9%.³ This pattern is, however, changing rapidly, if the UNCTAD 2011 World Investment Report is anything to go by. The report shows that, for the first time in 2010, developing countries attracted more than half of the total inward flows of FDI, and half of the top 20 FDI recipients were developing countries. Countries in the same economic league as South Africa, such as Brazil, Russia, India, Saudi Arabia, Mexico, Chile and Indonesia, made it to the top 20 recipients. This changing pattern of inward flows of FDI stock will put a spotlight on developing countries and may even lead to a greater scramble in developing countries for the attraction of these investments.

Economists are still grappling with the effects of these positive spillovers on economic growth and resultant job creation in the host country. Some economists even contend that the benefits of FDI are not the same across the economic sectors in the host country. For instance, Alfaro⁴ contends that although there may be a positive correlation between economic growth and FDI in the manufacturing sector, the same cannot be said about the primary and services sectors. Fortanier⁵ found that the general effect of FDI on growth is negative, with the extent of the negative impact differing with each country. The Department of Trade and Industry's document on bilateral investment treaties (BITs) also laments the fact that investment rules in BITs prevent developing countries' governments from requiring foreign companies to transfer technology, train local workers, or source inputs locally. This negates the generally accepted theory on the benefits of FDI.

The focus of the retail juggernaut, Walmart, on developing country retail markets has also put a spotlight on the positive and negative aspects of FDI in the wholesale and retail sectors of developing countries. The advantages of FDI in the retail sector are said to be lower prices for the consumers and the linking of South African manufacturers with Walmart's international markets. However, the reality is that such an

investment will have devastating effects on the economy, as manufacturers in the country will be displaced due to massive imports by Walmart. Moreover, big retailers like Walmart have the ability to displace small economic players through predatory pricing.

It is interesting to note that South Africa's concerns about Walmart's effect on the country's economy are shared by stakeholders in India.⁶ Indians contend that the high numbers of small retailers in its economy are a consequence of a general lack of opportunities, and retailing is the easiest business to enter with low capital and infrastructure needs. Retailing basically provides a social security net for those who want to work but cannot find employment. In South Africa, there is a need to give IPAP a chance to create sufficient manufacturing capacity before the country can welcome a role for giant retailers such as Walmart. Walmart's offer of ZAR 100 million at the Competition Tribunal to assist in the development of local suppliers over a period of three years is a tacit acknowledgment on its part that the manufacturing capacity should be its first area of focus. As the manufacturing sector produces goods for the retail sector, its growth is critical for the growth of the retail sector itself.

WHAT SHOULD BE THE WAY FORWARD?

Although UNCTAD showed a slump in FDI flows into South Africa in 2010 compared with 2009, the economy grew relatively faster in 2010 than in 2009. The real output in the economy increased by 2.8% in 2010 in contrast to a decrease of 1.7% in 2009. The unemployment rate in the fourth quarter of 2010 was 24%, a decrease of 2.1% when compared with the fourth quarter of 2009.

Despite South Africa's attempts to do everything possible to attract FDI, the least it has managed to acquire has been portfolio investment. Major foreign investments have not been greenfield investments, but mergers and acquisitions. Incidentally, the only time when FDI flows have been significant was during the privatisation of state-owned enterprises. There is therefore a need for a different approach to

attracting FDI. This is particularly important in the context of an ongoing economic crisis in the major industrialised countries of Europe.

It is important for policymakers to focus their energies on drafting and implementing policy measures that promote industrialisation. Government should invest more in building infrastructure of the highest standard; including roads, rail to transport goods to other parts of Africa, and world-class ports of entry. Increased FDI flows into South Africa should be an outcome of more investment by the public sector in economic infrastructure to facilitate more investment by the local private firms. This will increase confidence in the South African economy and thereby attract more FDI.

ENDNOTES

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- 2 Hawkins P & K Lockwood, 'A Strategy for attracting foreign direct investment', paper presented at the Economic Society of South Africa's Biennial Conference, 13 September 2001, Glenburn Lodge.
- 3 Rugman AM, 'Globalisation and regional international production', in Ravenhill J (ed.), *Global Political Economy*. Oxford: Oxford University, 2005, pp. 263–290.
- 4 Alfaro L, *FDI and Growth: Does Sector Matter?* Boston: Harvard Business School, 2003.
- 5 Fortanier F, 'FDI and host country economic growth: Does the investor's country of origin play a role?', *Transnational Corporations*, 16, 2, August 2007, pp. 41–76.
- 6 Guruswamy M *et al.*, 'FDI in India's retail sector: More bad than good?', Centre for Policy Alternatives, http://www.indiafdiwatch.org/fileadmin/India_site/10-FDI-Retail-more-bad.pdf.

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