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Investment barriers are problem No 1

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COMMENT

Foreign direct investment (FDI), which generally refers to an investment by a firm or an individual in a business in another country, is vital for economic growth. It provides capital, access to foreign technology, knowledge and managerial skills, and leads to other important inputs.

But neither FDI nor its benefits are automatic. Weak domestic conditions can hamper the ability of a country to profit from inward FDI. Without the necessary prerequisites, FDI can limit knowledge spillover, crowd out domestic investments and intensify market concentration. Moreover, anti-competitive behaviour by multinational corporations can lead to welfare losses, particularly if their interests are not aligned with a host country's developmental objectives.

South Africa's attractiveness to FDI is relatively high compared with other African countries because of high real returns on investment. Paradoxically, though, there has been relatively little interest in South Africa. The key question is:Why?

According to data from the South African Reserve Bank, FDI fell significantly from a record level of $8.3-billion in 2013 to $2.3-billion in 2016, a more than threefold reduction over three years, despite high returns.

A country's attractiveness to FDI is closely linked to macroeconomic factors such as openness and exports, exchange rates, inflation rates, budget deficits and political stability.

At company level, conditions such as market size, structure and growth, labour costs and labour cost drivers (including labour laws and trade unions), government policies, tariff and trade barriers, and the product life cycle all play a critical role in attracting FDI.

South Africa has many macro-assets attractive to investors, such as a vibrant democracy, a relatively diversified economy, abundant natural resources and a transparent legal system. Its economy is relatively open, but export market concentration is preventing strategic sectors of the economy from responding optimally to, for instance, the exchange rate depreciation.

As a result, the inward FDI does not promote sustainable growth because most of it is channelled mainly to the natural resources sector and to the acquisition of existing companies, and not enough of it goes to building new capacity.

The country also suffers from policy uncertainty, a high crime rate, a shortage of skills, increasing social unrest (as demonstrated by strikes and service delivery protests) and high levels of corruption. At a micro level, the labour market suffers from a number of rigidities, including wage levels relative to worker productivity. There are also high barriers to entry to many key product markets.

These structural barriers to investment warrant a coherent plan for attracting FDI. This must encompass skills development, competition policy, industrial relations and wage moderation in line with productivity growth, fighting crime and corruption, and stronger backward linkages.

This strategy should be prioritised before any initiatives, such as the presidency's plan to raise $100-billion in investment to boost the economy, are carried out. Resolving the structural barriers to investment will also ensure that financial risks are minimised and that there will be larger and more broadly based FDI inflows, going beyond the natural resource and capital-intensive sectors.

But, in the broader scheme of things, attempts to stimulate the economy should transcend FDI inflows and incorporate domestic investment, since enormous domestic resources are readily available for investment. According to the Reserve Bank, the official pension fund holdings of fixed-interest securities was R675.6-billion during the fourth quarter of 2017. Research by Johannesburg University also shows that the majority of the largest 50 firms listed on the JSE retained their profits, and their total reserves held amounted to R1.4-trillion by 2016.

There is clear evidence that there are domestic resources that can be tapped into to stimulate economic growth. South Africa needs to address structural impediments to FDI and devise incentives to domestic investment in order to kick-start the economy.

The National Development Plan targets investment of 30% of gross domestic product to accelerate growth to an average of 5.4%. Given the structural barriers to FDI and the absence of proper incentives to stimulate domestic investment in new capacity to limit further industrial concentration, this target is unlikely to be realised.

Sabelo Mtantato and Thando Ngozo are senior researchers at the Financial and Fiscal Commission. These are their own views

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