

The Impact of Private Capital Flows on South Africa's Developmental State Agenda in the Post-Apartheid Era

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COMPULSORY DECLARATION

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Dedication

This dissertation is dedicated to my grandmother (Mamakhabane Mokoena) who has constantly kept me in her prayers. *Mme, Molimo utlwile thapelo ya hao!*

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Abstract

This dissertation explores the impact of private capital flows on South Africa's developmental state agenda in the post-apartheid era. South Africa is one country that has set, beforehand, the objective to become a developmental state. However, the role of private capital flows as a factor that can determine the success, or the failure of that objective is largely missing from the debate about constructing the developmental state in South Africa. By exploring the impact of private capital flows, the study seeks to inform the reader about the nature and composition of private capital flows in South Africa as well as investigate whether these flows hinder or accelerate South Africa's developmental state objective.

The study has utilized qualitative methods. It also made use of quantitative data as a secondary supplement to ensure a greater understanding of the research problem. In addition, the study has used the theory of financialization from Marxist Political Economy which posits that private capital flows are unproductive and merely interested in surplus accumulation without producing anything substantive in the long term.

The research findings indicate that financial liberalization as a step that was taken by the democratic government to attract private capital flows has not been beneficial for South Africa's long term development as it allows capital flight and illicit financial flows. While South Africa did manage to attract private capital flows after liberalizing its capital account, these flows have been made up mainly of portfolio investments that do not contribute significantly to the productive sectors. Instead, portfolio investments drive excessive household debt, consumption and financial speculation. Moreover, private capital flows reinforce a non-developmental agenda by exacerbating the problem of unemployment, inequality, and poverty which are key developmental goals that South Africa seek to overcome through the developmental state. More importantly, South Africa's reliance on private capital flows constrain its economic policy choices and this, in turn, hinders an emergence of a developmental state.

List of Abbreviation

ABSA - Amalgamated Banks of South Africa

ANC – African National Congress

AsgiSA - Accelerated and Shared Growth Initiative for South Africa

AU- African Union

BRICS – Brazil, Russia, India, China, South Africa

CIC- Chinese Investment Corporation

COSATU – Congress of South African Trade Unions

DPME - Department of Planning, Monitoring and Evaluation

FDI – Foreign Direct Investment

FPI – Foreign Portfolio Investment

GDP – Growth Domestic Product

GEAR – Growth, Employment and Redistribution

GM - Governed Market Theory

JSE – Johannesburg Stock Exchange

IMF – International Monetary Fund

MITI – Ministry of International Trade and Industry

NDP - National Development Plan

OECD- Organization for Economic Co-operation and Development

RDP- Reconstruction and Development Plan

SACP - South African Communist Party

SARB – South African Reserve Bank

StatsSA – Statistics South Africa

UK- United Kingdom

UNCTAD – United Nations Conference on Trade and Development

UNDP- United Nations Development Programme

US – United States

Chapter 1

Private Capital Flows and the Challenges of Development in a New Democracy

1.1 Brief Background

In 1994, the new democratic government inherited a battered economy that had been in decline for the past three decades. The country had just suffered a five-year recession and its GDP had been on the decline for the past 30 years (Tsikata, 1994:3). As the apartheid state declined in capacity from the 1980s, unemployment, inequality and poverty worsened for the marginalized people in the country (Lipton and Simkins, 1993:5). As a result, the new democratic government had a task to set the South African economy on the growth path that will induce inclusive development. The new ruling elite came with Reconstruction & Development Plan (RDP), a socio-economic policy framework that set out to transform the highly racialized economy and ensure inclusive development for the people of South Africa. From RDP as the first coherent policy framework under the new democratic government to latest policy framework – NDP, the triple challenges of unemployment, inequality, and poverty have been the hallmark of South Africa’s developmental agenda.¹ This developmental agenda has been largely framed around the country’s aspiration to be a developmental state. It is stated in the NDP that “in a society with deep social and economic divisions, neither social nor economic transformation is possible without a capable and developmental state” (NPC, 2012:407). The inspiration to build a developmental state in South Africa emanates from the East Asian developmental states that had achieved rapid growth, industrialization, and inclusive development in the 1970s (Chu, 2016:1). The African National Congress (ANC), and subsequently the South African government, embraced the idea of the developmental state due to structural-developmental challenges such as stagnant economic growth, poor-performing industries, unemployment, worsening inequality, and widespread poverty in the country (Qobo, 2007).

¹ While there other development objective that South Africa pursue, the study has limited the reference of developmental agenda to the triple challenge of unemployment, inequality and poverty.

To overcome these structural challenges, the ANC government decided that the state must play a central role in channeling domestic and international resources to productive sectors.² White and Wade (1988:1) define a developmental state as one whose notion of development is less spontaneous but rather “it is more subject to teleological determination with the state playing the role of historical *animateur*”. White and Wade’s definition of developmental states elucidates the role of the state as one that determines the developmental trajectory as opposed to market forces in a bid to positively transform society. In this regard, the state achieves its objective through a well-coordinated economic policy that does not displace the market but rather guides the market rationality in the long term for sustainability (Chu, 2016:1). The developmental state, as an economic model, presented an opportunity for the South African government to overcome the structural challenges in the country.

However, South Africa’s objective to become a developmental state is set in a global era whereby the global economy is underpinned by neoliberal ideology.³ It is an era whereby finance has been liberalized as many countries abolished capital controls⁴. Bello *et al* (2000:3) posit that prior to financial liberalization wave across the globe, capital flows were limited as they were tightly controlled.⁵ This was during the Bretton Woods era which began from 1945 to mid-1970s in which there was state-managed *modus-operandi* in the domestic and global economy (Bello *et al*, 2000:5). In the literature, this period is often referred to as a Keynesian economy or state-assisted capitalism. When the neoliberal ideology gained dominance in the 1980s, developing countries were encouraged to liberalize their capital accounts. There was a strong and consistent claim from the orthodox economists that liberalization of capital accounts and the acceptance of overall liberal international regime was good for developing countries because it promoted development (White and Wade, 1988:5). While other countries willingly liberalized their capital accounts and allowed the free movement of

² It is important to note that the ANC has been the ruling party since 1994 and thus has dominated South Africa’s economic policy direction.

³ Neoliberalism refers to a set of political beliefs which indicate that sole legitimate purpose of the state is to safeguard the individual freedom and property rights. In this context, the state ought to have minimal role in the economy and any intervention beyond its sole purpose would be classified as unacceptable (Thorsen and Lie, 2006:14).

⁴ Capital controls refer to taxes or any restrictions on the free movement of international capital (Neely, 1999:13)

⁵ According to World Bank (2019), capital flows refer to cross-border financial flows that are comprised of Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). Therefore, in this study, a reference to private capital flows includes both FDI and FPI.

capital, those who did not do it themselves were forced to do so by the international organizations such as the World Bank and the International Monetary Fund (IMF) through Structural Adjustment Programs (SAPs) (White and Wade, 1988:5). As a result of widespread financial liberalization, finance overtook trade and became the driver of the global economy. Currently, Reuters (2019) report that the volume of foreign exchange transactions that are traded per day amount to US\$ 5.1 trillion, thereby making it the biggest market in the world.

South Africa is one of the developing countries that adopted a neoliberal economic framework and proceeded to liberalize their financial account. In 1995, the new democratic government abolished the Financial Rand and dual exchange rate system which served as a mechanism to control capital flows (Liebenberg, 1995). The new democratically elected government made a case that the continuity of the capital controls was going to inhibit the new foreign investment (Liebenberg, 1995). This line of argument gives a glimpse of the extent to which the neoliberal ideas had penetrated the new ruling elites at the time. It is worth noting that the liberalization of capital first began during the RDP and then further liberalization happened under the Growth, Employment and Redistribution (GEAR), adopted in 1996 (Mosala and Bain, 2017). GEAR was the beacon of neoliberal ideology.⁶ There are two primary reasons for ANC's policy position and overall acceptance of neoliberalism. Firstly, when the ANC came to power, it wanted to be accepted by the international community. Secondly, the ANC government believed that private capital inflows will assist the country to build its infrastructure, create employment and bring economic prosperity (Kondlo, 2015).⁷ In other words, the ANC believed that the removal of capital controls would attract private capital inflows which would serve as a vehicle for inclusive development in South Africa. Indeed, after the liberalization of the capital account, there has been an influx of capital inflows into the country. South African Reserve Bank (SARB) quarterly reports indicate that total private capital inflows increased from US\$ 5.2 billion in 1994 to US\$280 billion in 2018 (SARB,2018). Whilst this is a significant amount of foreign investment, the orthodox economists' claim that private capital flows promote development is yet to be proven true by the empirical evidence in South Africa. The country still struggles with the problem of unemployment that is sitting at a staggering

⁶ GEAR's neoliberal stance will be fully discussed in subsequent chapters.

⁷ All capital flows referred to in the study pertains to private capital flows.

27.9 per cent using only the official definition, ballooning inequality, and widespread poverty (StatsSA; 2019).

1.2 Problem Statement

South African ruling elites built the economic foundations of the new democratic state on the neoliberal ideology. This was done with the primary aim of attracting private capital to assist with the state's developmental agenda. However, this has not resulted in overcoming the salient structural problems of the country such as unemployment, inequality and poverty. When the government recognized the failure of the unfettered market and neoliberalism, it sought to reintroduce a stronger role of the state through the developmental state model. However, the primary problem is that South Africa seeks to be a developmental state while private capital flows remain unregulated. So far in its plan to be a developmental state, the government has not devised mechanisms that will guide private capital flows.

Previous studies on developmental state have focused on the internal contradictions in the country that prevent the emergence of an effective developmental state including corruption and lack of capacity in the bureaucracy. However, exogenous factor such as private capital flows play a decisive role in the development of a country and therefore, can determine the success of a developmental state. Scholars have argued that private capital flows have effectively put an end to the East Asian development state during the financial crisis of 1997-1998(Pang, 2000). However, the role of private capital as the success determinant of South Africa's developmental state is conspicuously missing from the debate about constructing developmental state in the country.

1.3 Aims and Significance of the Study

The primary aim of the study is to understand the impact of private capital flows in the realization of South Africa's developmental agenda within the developmental state context. The study has two objectives and the first one is to understand the composition and nature of private capital in South Africa. The second objective is to understand whether private capital flows accelerate or hinder South Africa's developmental state agenda.

'Attracting foreign investment to promote growth and development' has become a daily mantra for South African officials and policymakers. However, South African

policymakers battle with the difficulty of balancing the international and domestic pressure to achieve sustainable growth while seeking to build the capacity to be a developmental state. This study seeks to add to the debate on the construction of the developmental state in the globalized and financialized era by focusing exclusively on private capital flows, its nature and the impact it has on development. South Africa has *a priori* set the objective to become a developmental state with the aim to emulate the rapid growth achieved by East Asian countries. However, time and context are different. By exploring the role of private capital, the study also seeks to inform the policymakers of the recent developments in global capital which they can use to design better policy mechanism to insulate the country from undesired developmental consequences.

1.4 Research Questions

The study seeks to answer the following question;

- What is the impact of private capital flows in the realization of South Africa's developmental state agenda in the post-apartheid era?

The study will also answer the following sub-questions;

- What is the nature and composition of private capital flows in South Africa in the post-apartheid era?
- Do private capital flows hinder or accelerate South Africa's developmental state agenda in the post-apartheid era?

1.5 Conceptual Framework

1.5.1 Private Capital Flows

Capital flows refer to cross-border financial flows that are recorded in other countries' financial accounts (IMF, 2014:3). The term private denotes that the financial flows emanate from non-government entities but rather from private institutions and individuals. Private capital flows are composed of Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). According to OECD (2008:16), FDI refers to cross border investments a direct investor makes to another country with the purpose of having a long-term relationship with a direct investment enterprise. The long-term relationship indicates that the direct investor will have a significant influence on the management of the direct investment enterprise. For a foreign investor to establish

this long-term relationship with the enterprise, the investor needs to own at least 10 per cent of the voting shares (OECD, 2008:17). OECD (2008:17) indicates that direct investment enterprises are essentially corporations that can be in the form of subsidiaries, associates or branches. The share ownership varies depending on the type of corporation. For instance, with the case of a subsidiary, the direct investor gets 50 per cent of the voting power; in the case of associates, the direct investor holds 10 per cent to 50 per cent of the voting shares; and in the case of a branch, the parent company owns 100 per cent of the voting share (OECD, 2008:17)

On the contrary, with FPI, the investor does not seek to influence the management of the enterprise.⁸ According to UNCTAD (1999:4), FPI includes "...investments by a resident entity in one country in the equity and debt securities of an enterprise resident in another country which seeks primarily capital gains and do not necessarily reflect a significant and lasting interest in the enterprise". Foreign portfolio investments include bonds, shares mutual funds, and financial derivatives (UNCTAD, 1994:4). Moreover, there is a mixture of local and international factors that are considered to be paramount in attracting private capital flows.

1.5.2 Determinants of Private Capital Flows

Other parts of the literature, particularly the econometrics scholarship, has focused on the determinants of private capital flows. This is one of the important aspects of the literature because it has policy implications. Policymakers focus on attracting foreign investment to supplement their domestic savings. In most cases, they would focus on factors that influence private capital inflows and aim to align their policies following those factors. Within the literature, six broad factors attract private capital inflow namely;

A. Macroeconomic performance

Economic growth is an important factor that attracts private capital flows. Iamsiraroj and Doucouliagos (2015) state that there is a positive correlation between economic growth and FDI inflows. Ahmed, Arezki and Funke (2005) indicate that a rapidly growing economy is more likely to generate high future returns. High

⁸ In this study, foreign portfolio investment will be referred to portfolio investments for easy reference.

returns attract most of the portfolio investments. Overall, high macroeconomic performance serves as a factor that attracts private capital flows.

B. Quality of institutions

Institutional quality is another important determinant of private capital inflow. Ahmed *et al* (2005) point out that those countries ranked high in terms of law and order, attract private capital flow. Álvarez (2015) posit that countries that possess high-quality public services attract more investment. Government effectiveness and regulatory quality is the most important driver of private capital flows. In addition, Álvarez (2015) points out that the role of quality institutions become more crucial during financial crises. This is because domestic investors tend to invest more when they live in a country that has a sound institutional framework. This can also make up for the declining capital inflows during the financial meltdown.

C. Investment environment

Three vital ingredients make an environment attractive to private capital flows, namely; the degree of openness in the economy, the exchange rate regime, and exchange control (Ahmed *et al*, 2005). It is important to note that investors generally prefer an economy that is open to trade. This is because direct investors are not only interested in serving the local market but also exporting goods (Ahmed *et al*, 2005). On the other hand, there is no clear relationship between the inflow of portfolio investment and trade openness.

In addition, exchange rate volatility has an adverse impact on the FDI inflow. According to Ahmed *et al* (2005), exchange rate volatility brings uncertainty of demand for goods from the exported-oriented firm. As a result, the profitability of FDI can reduce significantly. There is no clear correlation between exchange rate volatility and portfolio investment. In addition, Ahmed *et al* (2005) point out that capital account control restricts the inflow of private capital.

D. Infrastructure development

Good infrastructure is paramount in attracting private capital. Ahmed *et al* (2005) point out that good and reliable infrastructure boost productivity and attract FDI. It facilitates communication between the parent and subsidiary firms and makes the

information gathering process easier. Hence, countries that have good infrastructure tend to attract more FDI. This also forms part of the reason some African countries struggle in attracting FDI (Lawrence, 2002). For instance, Ogunjimi and Amune (2017) argue the low levels of FDI inflow in Nigeria are directly caused by low levels of savings and infrastructure development.

E. Finance development

Countries with a well-developed financial market are able to attract more private capital flows. It is often postulated that private capital flow can stimulate economic growth in the host country, however, this only works when there is a well-developed financial market. Agbloyor, Abor, Adjasi and Yawson (2014) argue that private capital flows have a negative impact on growth in the country that does not have a well-developed financial market. They argue that deep financial markets translate private capital flows into positive economic growth outcomes. In addition, Alfaro, Chanda, Kalemli-Ozcan and Sayek (2004) state that a well-developed financial market increases the sources of financing for companies and this creates an important link between local and foreign investment.

F. Global factors

Global developments such as interest rates and business cycle development influence the private capital flows. Ahmed *et al* (2005) point out that opportunity cost and international returns are factored in the decisions of foreign investors. US interest rates are taken as indicators of global development. In standard economic theory, interest rates are inextricably linked to a nation's currency. Therefore, US interest rates have an effect on the US dollar which is often taken as a benchmark for future economic growth.

1.6 Literature Review

There is a voluminous literature on private capital flows and developmental states. The literature is so dense on both these issues to the extent that the choice of literature inclusion becomes immensely difficult. Following the guidance of the research question, this literature review has been divided into two themes. Firstly, the literature review discusses private capital flows and their relationship with economic growth and development. Under this theme, two perspectives dominate the literature; one

perspective posit that private capital flows are unsustainable, and the other perspective posits private capital flow induce economic growth. Secondly, the literature review discusses the concept of the developmental state including the case of East Asia and South Africa's post-apartheid developmental agenda within the greater scheme of the country's developmental state discourse.

When it comes to assessing the impact of private capital flows on national economies, many scholars tend to look at the composition of private capital flows and distinguish between the FDI and FPI. Other scholars study the impact of FDI or portfolio investment separately, depending on the objectives of their studies. This is because FDI and portfolio investments have a different impact on the economy. Generally, FDI is more stable and long term in character. It is considered to be a catalyst for development because it brings innovation, technology and technical skills. In addition, FDI plays a crucial role in capital formation in the recipient country (OECD, 2002). Portfolio investments, on the other hand, are unsustainable and volatile. This is because the portfolio investments are short-term investments and subject to abrupt reversals. Portfolio investments have earned gloomy names in the literature such as speculative capital and hot money because of their destructive disposition (Strange, 1998 and Bello *et al*, 2000).

1.6.1 Private Capital Flows and Financial Crises

The association of global money and volatility can be traced back to the seminal work of the Political Economist, Susan Strange in both *Casino Capitalism* (1986) and *Mad Money* (1998). Strange provides a diagnosis of the evolution and explosive growth of financial markets that have deep political and social consequences. Strange (1998) explains that it is wildly foolish "... to let the financial markets run so far ahead, so far beyond the control of the state and international authorities. [Financial markets] have been erratically manic at one moment, unreasonably depressive at others". In this regard, Strange was illustrating the deep implication of free movement of capital as well as the foolishness of national governments to deregulate finance.

In addition, Bello *et al*; (2000) on the *Global Finance: New Thinking on Regulating Speculative Capital Markets*, bring to the fore and highlight the most destructive form of capital namely speculative capital. Bello *et al* (2000) highlight the financial crises in the developing world including the Mexican crisis of 1994-5, the Asian financial crisis

of 1997, the Russian Meltdown of 1998, and the collapse of Brazil's currency (*Real*) were all caused by speculative capital. Nasser Saber (1999) defines speculative capital as short-term portfolio investments that are nomadic and opportunistic. Speculative capital seeks to maximize its financial gain in a short period without contributing to the real sector. Therefore, this type of capital does not seek to be locked into a long-term investment (Saber, 1999). Interestingly, Al-Yousef (2000) analyzed speculative capital from the Islamic perspective and likens it to *gharar*. According to Al-Yousef (2002), *gharar* refers to the risk in which the outcome is uncertain. Therefore, *gharar* is prohibited in Islam because it is a form of gambling that takes place in trade rather than in ordinary games. Al-Yousef (2000) concludes that the high costs of speculative capital illustrate the infallibility of Islamic teaching and the fact that man needs guidance. Inadvertently, Al-Yousef was pointing out the importance of state regulation of capital flows. Strange, Bello *et al* (2002) and Al-Yousef (2000) have implicitly invoked Keynes' ideas when they called for the regulation of erratic financial markets, and the flow of speculative capital at the national and international level.⁹

The other parts of the literature use the country-specific case studies and illustrate the impact of unregulated inflows of portfolio investments. The impact is nuanced and varies because of the different policy mix that is used by countries. However, all scholars agree that there must be a form of regulation on the inflows and outflow of portfolio investments as they are disastrous for developing countries. For instance, Bulut, and Karluk (2016) used Turkey as a case study and showed that the abrupt reversal of hot money has caused the 2001 and 2008 Turkish crises. The significance of their study was to provide the Turkish policymakers with an opinion on the efficiency and usability of the hot money policy tools in managing the Turkish economy. Martin and Morrison (2008) used China as a case study and showed that speculative capital inflow has increased China's inflation. They point out that efforts to reduce the inflow of speculative capital may stifle China's economic growth, while the effort to reduce inflation through appreciation of the Renminbi would reduce China's attractiveness as a destination of FDI. Gaulard (2012) argues that Brazil has attracted high volumes of speculative capital inflows because of its high-interest rates and this has had a

⁹ John Maynard Keynes was a British Economist who strongly advocated for government intervention in order to reach full employment and moderate the booms and burst of the business cycle (Jahan, Mahmud, and Papageorgiou, 2013).

negative impact on the exportation of manufactured products. In the concluding remarks, Gaulard (2012) suggest that the outflow of speculative capital should be curbed through Tobin tax.¹⁰ In the case of South Africa, Mohamed (2010) reports that the country has experienced a surge in speculative capital flows from 2003 to 2008, leading to deindustrialization in the country. However, Mohamed (2010) did not divulge on policy recommendations to regulate speculative capital flows in South Africa.

1.6.2 Private Capital Flows and Economic Growth

FDI, on the other hand, has been linked with a positive impact on national economies. This is also in part due to its nature. Kinda (2009) explains that FDI provides more resources at the firm level and the economy at large. FDI has become a crucial developmental tool for developing countries to "catch up" with the industrialized countries which are mostly situated in the West.¹¹ FDI provides technological and skills transfers that are crucial in the development of the country. The literature confirms that there is a positive relationship between inflow of FDI and economic growth (UNCTAD, 1998; Fan & Dickie, 2000; Kinda, 2009; Tyson, Griffith-Jones & Velde, 2014; Chen, 2015). However, there are prerequisite domestic conditions that need to be in place before FDI can materialize and add to the development of the real sector. These factors include sound financial institutions and a coherent industrial policy (Banik & Bhaumik, 2006; Agbloyor, Abor, Adjasi, & Yawson, 2014).

There is a strand of scholarship that deny the developmental benefits of FDI and argue that the landscape of FDI has changed since the advent of financialization. Kalotay (2017) has observed that the financialization causes an increasing de-link of FDI from productive capacity building in host countries. Although the study has not been corroborated, Kalotay (2017) observations challenge the conventional wisdom that FDI adds to job creation; transfer technology and managerial skills.

In sum, previous research on private capital flows illustrates that portfolio investments have a negative impact on national economies as they are mainly speculative in nature. On the other hand, many studies except for that of Kalotay indicates that FDI

¹⁰ Tobin Tax refers to the proposal to tax global capital flows to finance development and combat market volatility. Tobin Tax was first proposed by the US economist, James Tobin in 1972 (Reisen, 2002:1).

¹¹ It is common among scholars to refer to the process of development in developing countries as catch up. It refers to the process in which developing countries make use of the technology forged by developed countries.

is relatively stable and act as a catalyst for development in developing countries. This is significant for this research as it gives an overview of the role of private capital flows on development. However, besides the pioneering work of Mohamed (2010) in the study of private capital flows in South Africa, there has not been extensive research done to assess the nature and composition of capital flows in South Africa as well as their role in South Africa's developmental agenda. Mohamed's assessment of capital flows in South Africa is limited in scope as it provides an analysis up to 2009. This omits a major shift in South Africa political economy landscape such as the quest to build a developmental state.

1.6.3 Developmental State

The concept of the developmental state is highly debated and contested in the literature. The East Asian countries economic development boom in the 1960s inspired much of the literature on the developmental state. Chalmers Johnson pioneered the study of developmental states in his seminal work, *MITI and the Japanese Miracle (1982)* (Onis, 1991 and Subira, 2011). Generally, the developmental state intervenes in the market to allocate resources in strategic industrial sectors for growth and development. Mkandawire (2001) defines the developmental state as a state that is ideologically driven by development and their primary mission is to ensure that there is economic development in the country. In this context, the state guides the market to long-term investment rationality. The primary purpose of a developmental state is to generate economic growth, promote equality, and drive social welfare policies (Graig, 2017). In essence, the developmental state is one that brings about a positive transformation in society. However, there are prerequisite features for a developmental state to emerge. In the analysis of East Asian developmental state, the following features were considered as defining (Evans, 1995; Johnson, 1999; Mkandawire, 2001; Fritz and Menocal, 2007; Graig, 2017); ¹²

- I. A small- scale elite bureaucracy that is comprised of the most talented individual within the system.

¹² It is important to note that the discourse developmental state is inextricably linked to the cases of East Asian economies. It is, therefore, difficult to talk about the developmental state in abstraction. This is because the key authors used historical comparative case studies to theorize about the developmental state this includes Johnson's case of Japan and MITI and subsequently Amsden's case of South Korea.

- II. A political system with an autonomous bureaucracy that will carry out its duties effectively. This bureaucracy must be shielded from private interests and political influence to effectively exercise its duties.
- III. There should be a pilot organization that will effectively control and implement the industrial policy. Ministry of International Trade and Industry (MITI) is a perfect example of the pilot organization.
- IV. The government must be committed to a developmental ideology.
- V. The state should have a vision and capable leadership.
- VI. There should be a high level of social cohesion and unity within the state.

In the developmental state model, the state neither follows the ideologically driven model of socialist state or the laissez-faire approach of free-market economics. Rather, it follows a rational plan which refers to resolute commitment to pursue sustainable economic growth that is supported by skilled and professional public service (Tapscott, Halvorsen, Rosario, 2018:10). In addition, industrial policy is considered to be central to the developmental state. This is evident in Robert Wade's (1990) formulation of the Governed Market theory of East Asian industrialization to rival the neoclassical account that credit free-market principles for the success of East Asian countries. Governed Market Theory (GM) explains that East Asian countries' rapid development was due to investment directed by the state in the key strategic sectors. It is a process in which the government set specific policies to guide resource allocation to produce different results that would otherwise not be produced under the free-market system (Onis, 1991).

However, the central debate around the developmental state is whether the model is *sui generis* to East Asia given the historical, cultural, geopolitical and economic context in which it has occurred. The uniqueness of East Asian development has been a central debate in literature given that many developing countries including South Africa seek to emulate it. The debate has also led to another debate about the construction of the democratic developmental state which Tapscott argues that it is a poorly theorized concept because it is used descriptively to demonstrate the attempt of the democratic state to gain greater control over the economy (Tapscott *et al*, 2018). The concept of a democratic developmental state is also used ambiguously to describe the

aspirations of states to achieve inclusive and equitable growth without any concrete action plan (Tapscott *et al*, 2018). According to Edigheji, (2005), "a democratic developmental state is one that not only embodies the principles of electoral democracy but also ensures citizens' participation in the development and governance processes". Inclusive participation is a cornerstone of the democratic developmental state. This is also argued by White (1988) who indicated that the true democratic developmental state is "the social basis and range of accountability of democratic politicians [that] goes beyond a narrow band of elites to embrace broader sections of society" (White, 1988:31)

1.6.4 South Africa's Developmental Agenda

It is important to note that the new government in South Africa did not begin with the clear intentions of becoming a developmental state in the first decade of democratic rule. However, the ultimate developmental goals they pursued under the neoliberal policy framework are similar to those that they intend to pursue under the developmental state context. These goals include the eradication of structural-developmental problems such as unemployment, inequality, and poverty. What is different in the development state context is that the South African government seeks to play a crucial role in strategically organizing resources to promote long-term and inclusive development. This is perhaps why scholars such as Thomson and Wissink (2018) have claimed that South Africa's policy discussion in the post-apartheid era, have reflected the ambitions of building a democratic developmental state.

Before the ascension of developmental state debates in policy circles and academia, scholars were preoccupied with the influence of neoliberalism on ANC economic positions. In this regard, some scholars have argued that the dominance of neoliberalism and its subsequent influence on ANC's economic policy choices have delayed South Africa from its true development potential (Bond, 2000 and Kondlo, 2015). Bonds encapsulates the argument against neoliberalism in South Africa in the post-apartheid era. Bond (2000:15) argues that;

"Democratic South Africa's inheritance included an economy that proved not only difficult to manage, but also to understand, particularly in relation to financial turbulence and global integration; yet post-apartheid policy-makers drew all the wrong lessons from 'international experience' and hence prepared to amplify rather than correct apartheid capitalism's main economic distortions".

Kondlo (2015) has argued that the ANC government were outsmarted at the negotiations table and were made to believe that liberalization of capital would serve as a vehicle for inclusive development in the post-apartheid context. Unfortunately, this has not been the case as the majority of black people still languish in poverty. In the very same economic negotiations, domestic and international capital positioned itself to squeeze out every benefit from the transition of apartheid to democracy (Kondlo, 2015). Mohamed (2010) reverberates the argument made by Kondlo and indicates that both the domestic and international capital were the biggest winners from the economic arrangement made in 1994. Mohamed (2010) indicates that due to the liberalization of capital, domestic capital was transferred to stock exchanges abroad to benefit from shareholder maximization movement that was happening across the globe. On the other hand, the inflow of private capital was mainly composed of portfolio investments that seek to maximize profit without making a substantive investment in the long term (Mohamed, 2010).

In addition, the influence of neoliberalism in the South Africa economic policy was also rejected by the ANC's tripartite alliance – COSATU and SACP. The alliance partners argued that GEAR, as the beacon of neoliberalism, would lead to job losses that can never be re-created and this will lead to the casualization of labor with workers placed on short term contracts (Twala and Kompfi, 2012). The move to GEAR was seen by the alliance partners as a deviation from ANC's core tenets with regards to economic management. Moreover, alliance partners' objections of GEAR was echoed by Duncan (2000) who argued that GEAR would lead to more inequality and the biggest winners from such an economic arrangement would be big corporates.

It is important to note that scholars on a different spectrum of the debate on South Africa's development agreed about what South Africa's developmental agenda entails which, in essence, includes overcoming unemployment, inequality and poverty. The disagreement was mainly on the development approach that needs to be taken to tackle the above mentioned developmental challenges. In this context, others were in favor of neoliberal approach while others looked for a different approach that would be suitable for South Africa's approach, *albeit*, it was less defined.

1.6.5 Developmental State Debate in South Africa

ANC internal discussion of constructing a developmental state in 2005 set in motion several critical debates about South Africa's developmental trajectory. However, many of the debates are centered on the internal contradictions that inhibit the country from realizing its objectives. Qobo (2007:34) argues that although South Africa has ambitions to be a developmental state and emulate East Asia, the policymakers are stuck between extending the role of the state and further liberalizing the market to attract foreign investment. Given the policy contradictions made by the ANC in the past, the ruling party seems indecisive on whether they should prioritize the market over the role of the state or vice versa (Qobo, 2007:34).

Other scholars have been pessimistic about the success of constructing the developmental state in South Africa. For instance, Kuye and Ajam (2018) and Ukwandu (2019) have argued that South Africa's objective of being a developmental state is mere rhetoric and cannot be grounded in South African reality. One pertinent issue that makes South Africa's developmental state objective an elusive dream is that its success rests on the possession of skilled and merit-based personnel in the administration. However, reality strongly indicates that South Africa's bureaucracy is riddled with ineffective and unskilled cadres and badly managed state-owned enterprises (Ukwandu, 2019). Furthermore, De Wee (2016) argues that one of the biggest weakness of South Africa that will serve as an obstacle to being a developmental state is corruption from civil servants. The problem of corruption erodes the legitimacy of the state within the public domain and subsequently fuels mistrust that the state cannot intervene in the most efficient manner. Another internal obstacle that inhibits the possibility of being a developmental state is the lack of social cohesion.¹³South African is deeply divided across racial lines and this prevents an emergence of social cohesive society which is a critical factor in sustainable development (Graig, 2017).

¹³ According to Club de Madrid (2009:20) social cohesion refers to "socially cohesive or 'shared' societies are stable, safe and just, and are based on the promotion and protection of all human rights, as well as on non-discrimination, tolerance, respect for diversity, equality of opportunity, solidarity, security and participation of all people, including disadvantaged and vulnerable groups and persons".

Although the attempt has been minimal, other scholars have attempted to explain exogenous factors that inhibit South Africa from being a developmental state. For instance, Mohamed (2010) argues that South African economic governance that is underpinned by neoliberal values impede the country's capacity to realize its objective of being a developmental state. This is because South Africa operates under the Anglo-Saxon governance and in this regard the economic policy is ceded to institutional investors. Graig (2017) makes a similar claim that South Africa is not an autonomous state as it has liberalized its economy. This has subjected the country to external shocks of commodity prices and international flow of capital.

1.6.6 Synthesis of the Literature

While there's a clear consensus on the role of private capital flows on national economies, there have been few attempts to investigate their role explicitly in South Africa, more specifically, in an era whereby South Africa aspires to become a developmental state. A thorough review of the literature shows that private capital flows have two components namely FDI and portfolio investment and these components have a different impact on the economy. The literature indicates that portfolio investments are volatile and they are subject to abrupt reversal. On the other hand, FDI is positively associated with growth although that is debatable as financialization has altered the very nature of FDI.

The debate about the developmental state mainly focuses on whether the developmental state model is transferable to other countries including South Africa. Furthermore, the literature places a huge emphasis on the internal capacity required for countries seeking to be a developmental state. While this is an important aspect of the debate, it is also important to note that the developmental state is a means to an end and in the South African case, the end includes reducing unemployment, inequality and poverty. In this regard, it becomes imperative to understand that South Africa whether can deliver on its developmental state mandate in the presence of unregulated private capital flows in the country. Mohamed (2010) provides a nuanced analysis of private capital flows in South Africa, however, his analysis does not include South Africa's aspiration of being a developmental state. This study aims to fill in this gap in the literature by providing a thorough investigation of the role of private capital flows in post-apartheid South Africa's developmental agenda. Like any other debate

about development state in South Africa, the study looks at the possibility or lack thereof in constructing a developmental state in the country by focusing on the external factor –private capital flows. It is duly noted that South Africa has set the objective to be a developmental state, meaning it is a process that is yet to be achieved.

1.7 Research Design and Methodology

The study is predominately exploratory as it attempts to investigate the impact of private capital flows on South Africa's developmental state agenda in the post-apartheid era. Stephens (2001:3) defines exploratory research as "...a broad-ranging, purposive, systematic, prearranged undertaking designed to maximize the discovery of generalizations leading to description and understanding of an area of social or psychological life." While there are a plethora of studies on private capital flows and developmental state separately, there is hardly any literature that combines two subjects in an attempt to carve out a meaningful discourse about building a developmental state in financialized context. To fill in this gap, the study takes an investigative stance which is a characteristic of exploratory research (Neuman, 2014:38).

Due to the exploratory nature of the research, the study has predominantly used the qualitative approach. It makes use of data that is collected from academic literature such as books and academic journals as well as research from government publications and international institutions. In addition, the study has also used quantitative figures such as graphs, maps and statistical evidence to supplement the qualitative nature of the study. Maxell (2010:478) posit that the advantage of using quantitative data in the qualitative study is that it can help "... identify patterns that are not apparent simply from the unquantitized qualitative data". The quantitative data is sourced from secondary sources such as South African Reserve Bank (SARB), Statistic South Africa (StatsSA), and academic literature. The statistical evidence is used to describe the nature and character of private capital flows in South Africa in chapter three. Due to lack of expertise in extracting raw economic data and in the interpretation of primary statistics, the researcher has relied on secondary interpretation and explanation of statistical data. The researcher has also cross-checked the data to ensure reliability and validity. In some instance, the researcher has compiled the data from various statistical reports to present a coherent and surmised view.

1.8 Limitations and the Delimitations of the Study

This study has several limitations. Firstly, it has relied on data that has been collected and interpreted by other scholars. In this regard, the study cannot make a guarantee that some of the data is unbiased or absolutely correct. Secondly, this study is mainly situated in the discipline of International Political Economy, while some of the terms used are derived from finance and economics literature. In this regards, the researcher runs the risk of oversimplifying those terms. In terms of delimitations, the scope of the study is limited to the South African case and its development agenda in the post-apartheid era (1994 to 2018). It is duly noted that the period preceding democratic transition might enrich the study given that the apartheid regime had emphasized capital controls. However, for focused analysis, the study has limited its scope to the post-apartheid period.

1.9 Organization of the Study

Chapter One: This section introduces the study by providing context, research questions and the literature review.

Chapter Two: This section outlines the Marxism political economy as a theoretical framework, in particular, the theory of financialization. Theory of financialization from Marxist Political Economy provides a thorough argument about the proliferation of finance in the global economy as well as its social implication. South Africa is one of the countries that has been highly financialized in the post-apartheid context through market conforming policies. Thus, the theory of financialization becomes a suitable theoretical tool to guide the study.

Chapter Three: Influx of private capital inflows did not happen in a vacuum in South Africa, the government took deliberate steps to liberalize finance to attract private capital inflows. This move was premised on the belief that private capital inflows can induce long term and inclusive development in the country. Therefore, this chapter investigates the impact of private capital flows in South Africa from 1994 to 2018. This is done to answer the following questions; has financial liberalization attracted private flows as envisaged? What is the role of these inflows in South Africa economy and what are their development implications within the broader debate of becoming a developmental state. The aim is to provide the reader with a comprehensive understanding of decisions that led the ruling party to follow the international trend of

financial liberalizations as well as indicate whether private capital inflows helped in inducing long term and inclusive development that is aligned with developmental state objectives.

Chapter Four: Once a comprehensive understanding of the role of private capital flows been investigated and highlighted, chapter four carries on and discusses whether private capital flows accelerate South Africa's developmental state agenda as described in the NDP. In this section, the study elaborates more on South Africa's developmental state and its objective. Then it assesses whether private capital flows help to overcome the hallmarks of South Africa's developmental challenges such as unemployment, inequality and poverty that are sought to be achieved through a development state model. Seeing that South Africa seeks to become a development state, this discussion is of paramount importance.

Chapter Five: This section provides concluding remarks and it highlights the most important findings.

Chapter 2

Theoretical Framework: Unpacking the roots causes of a botched developmental agenda

“If capital is sent abroad, this is not done because it absolutely could not be applied at home, but because it can be employed at a higher rate of profit in a foreign country.”

Karl Marx (1894:255)

2.1 Introduction

In the above quote, Karl Marx captures the true nature of international capital flows. He brings to the fore the intention of exporting capital abroad which is premised on the maximization of profit rather than genuine development intentions. Marxism Political Economy thought serves as an important analytical framework to critically analyze the role of private capital and its relation to South Africa’s developmental agenda in the post-apartheid era. While it might have been the end goal for Marx and Engels to see the destruction of capitalism and ascendancy of a socialist society, the study merely relies on the Marxism’s frame of analysis to unpack the intricacies of private capital flows and their impact on South Africa’s developmental state agenda.

The purpose of this chapter is to discuss Marxism Political Economy in detail which will serve as an analytical framework to assess the role of private capital flows on South Africa’s developmental agenda in the post-apartheid era. This framework will highlight two Marxism perspectives that are applicable to the analysis of private capital flows. The first perspective is held by Neo- Marxists, which posits that the international structure of commerce and investment helps the developed countries to extract profit from less developed countries with one-sided economic arrangements (Szymanski, 1974). The second perspective is often used to analyze the latest development in capitalism namely financialization. The theory of financialization is deeply rooted within Marxist traditions which posit that finance has escaped the sphere of production and went into speculation because of epochal change in the capitalist system (Lapavitsas, 2013). This study will be anchored on the theory of financialization as a theoretical framework. This is suitable because South Africa’s economy became highly financialized in the post-apartheid era due to economic policies taken by the democratic government. Therefore, it becomes imperative to understand South Africa’s developmental changes through the critical lenses provided by the theory of financialization. The rest of the chapter is organized as follows. The first section provides a brief background on Marxism in its entirety. All strands of Marxism draw on

another, therefore, it is important to briefly describe Marxism in its entirety to ensure a greater understanding of Neo-Marxism and Financialization. The second section discuss Neo-Marxism because it is an alternative theory within Marxism thought that can describe the role and impact of private capital flows. However, due to its lack of dynamism, it becomes unsuitable to anchor the study. The third section discusses the theory of financialization as well as the financialization of the South African economy in the post-apartheid era.

2.2 The History and Origin of Marxist Theory

Marxism consists of emancipatory ideas that were first written by Karl Marx and Friedrich Engels during the Industrial Revolution in the 18th century. The ideas from Marx and Engels provide a theoretical foundation that nourishes the struggle of the working class to achieve a higher form of life by transforming society into socialism (Sewell and Woods, 2000). Marxism emerged as a political movement in 1848 within the enriched historical experience of the working class. According to O'Brien and Penna (1998:49), the core tents of Marxism were developed at the time when there was a transition from the agricultural economy that was underpinned by the feudal social relations to an industrial economy that is based on industrial capitalism. The emergence of the industrial economy brought many social upheavals as it introduced the wage-relations; induced migration of people from the countryside to the urban spaces to work in factories (O' Brien and Penna, 1998:49). Furthermore, it also increased commodity production and consumption. This transformation of the society resulted in widespread poverty of the working class and periodic economic crises that was nascent to industrial capitalism (O' Brien and Penna, 1998:50).

Marx and Engels philosophy and political ideas were greatly influenced by their social setting. When Marxism political movement emerged, different sects discussed the theoretical structures of Marx and Engels' ideas. This resulted in a variety of Marxism thought. Moreover, social conditions and intellectual climate in Europe in the mid-nineteenth century nourished Marx and Engels with ideas that they turned into a coherent theory of capitalism (O'Brien and Penna, 1998:50). Hence, Marxism encompasses historical, political, and economic strands and they draw on each other to create a critical theory of capitalism (O'Brien and Penna, 1998:50).

Aforementioned, Marxism is a broad theory that is made up of different strands. The first strand of Marxism is referred to as historical materialism which looks at the historical development of human society. Marx (1894) argued that societal history is shaped by material conditions rather than ideas. In other words, social change is not driven by human ideas but rather by changes in the modes of production. According to Marx (1894:2)

“In the social production of their existence, men enter into definite, necessary relations that are indispensable and independent of their will, relations of production which correspond to a definite stage of development of their material productive forces. The sum total of these relations of production constitutes the economic structure of society, the real basis, on which rises a legal and political superstructure, and to which correspond definite forms of social consciousness. The mode of production of material life conditions the social, political and intellectual life-process in general.”

In essence, historical materialism postulates that production is the basis of all human life, the mode of production underpins the societal development. The economic structure is given a special position as the determinant of societal progress. It determines the culture, religion, political, and legal aspects of society (O’Brien and Penna, 1998:56). Historical materialism illustrates that every major epoch development in human society was due to a specific mode of production. Marx and Engels identified four modes of production namely; primitive communism, slavery, feudalism, and capitalism (O’Brien and Penna, 1998:56).¹⁴

The second strand of Marxism is referred to as Economic Marxism which anchors the analytic framework of this study. With the Economic Marxism, Marx and Engels undertook the enormous task to explain the self-destructive nature of capitalism. Marx provided the most critical account of the operations of capitalism which can be mostly found in his magnum opus, *Capital*. According to Marx, capitalism is governed by three inevitable laws. The first law is the law of disproportionality which stipulates that in the capitalist society, there is a tendency to overproduce certain type of goods (Gilpin,

¹⁴ Primitive accumulation was made up of the social structure that was an extension of family and kinship, simple division of labour, and small properties. The slavery society was characterized by a class of citizens that owned slaves as part of their private property. Feudalism was a society in which land ownership was the division between two major classes (lords and vassals). The final stage is capitalism which is characterized by the private ownership of the means of production. The class division is between those that own the means of production and those that do not own them (O’Brien and Penna, 1998:51). Marx and Engels believed that capitalism will inherently destroy itself and thereby making a way for socialism.

1987:36). In this context, there is disproportionality between the capacity to overproduce and the capacity of the consumer to purchase the goods. As a result of this, there will be a constant period of depressions and economic fluctuations (Gilpin, 1987:36). The second law is the law of concentration which stipulates that capitalism's primary aim is to enrich the few at the expense of many. Therefore, as the wealth continues to be concentrated in the few bourgeoisies, there is a growing pool of unemployment and the impoverished proletariat, making the capitalist society ripe for social revolution (Gilpin, 1987:36). The last law is the law of falling rate of profit which stipulates that competition in the capitalist society forces capitalists to seek innovative ways to gain more profit (Gilpin, 1987:37). Consequently, they increase productivity through labour cutting and introduction of technology that will improve efficiency. In turn, the unemployment pool increases, and the profit declines. Meanwhile, capitalists lose the incentive to add to the productive sector that results in stagnation and mass unemployment. These unfavourable economic conditions will propel the workers to overthrow the capitalist system and replace it with the socialist system (Gilpin, 1987:36). From these laws, a crisis is endemic to capitalist society and hence it will self-destruct.

The last aspect of Marxism theory is referred to as Political Marxism. Political Marxists argue that a state is a tool used to manage the affairs of capitalist society and not the force of change. Therefore, the state should be overthrown (O'Brien and Penna, 1998: 51). According to Obo and Coker (2014:530), Political Marxists believe that 'liberal' or 'democratic' state is merely rhetoric, the state is an instrument of domination, exploitation and oppression of the proletariat. In the *Communist Manifesto*, Marx (1848) points out that "the executive of the modern state is but a committee for managing the common affairs of the whole bourgeoisie". Essentially, the state represents the interest of the bourgeoisie in the capitalist society. The Marxist concept of the state is contextualized within the framework of historical materialism. The state forms part of the superstructure that is determined by the economic base (Heywood, 2013:63). Therefore, it makes sense that the state represents nothing but capitalist interests because it is determined by the economic base in which capitalist interest reign supreme. In addition, O'Brien and Penna (1998:57) point out that capitalism forces the proletariat to be conscious of their collective power to seize the means of production. The exploitative nature propels the proletariat to recognize their collective

power to force historical change. It is important to note that each strand of Marxism draws on one another and constitute a critical theory of capitalism.

2.3 Neo-Marxism on Private Capital Flows

The neo-Marxist held a contradictory view about the role of private capital flows in development than the classic Marxists. Classical Marxists argued that private capital flows went from developed countries to 'poor' countries to realize higher profits abroad and in the same process it also helped with the industrialization of those countries. This point was made clear by classical Marxist, Rosa Luxemburg in *The Accumulation of Capital*. Luxemburg (1913:426) indicated that;

Realised surplus value, which cannot be capitalised and lies idle in England or Germany, is invested in railway construction, water works etc. in the Argentine, Australia, the Cape Colony or Mesopotamia... capital must purchase the element of production and thus become productive before it can operate”.

Luxemburg wanted to prove to Marx and Lenin that while it was true that capital went abroad largely due to the tendency of the falling profit and problem of surplus absorption. There was an industrialization benefit from the exportation of capital to less developed countries, *albeit*, surplus accumulation remains the central intention.

Neo- Marxists agree with Luxemburg and other classic Marxists about the direction of private capital flow from developed to developing countries but they fundamentally disagree with the fact the private capital flows help with the industrialization of less developed countries. Neo-Marxists hold the position that the net capital outflow from the less developed countries is much greater than the one that is ploughed back in these countries (Szymanski, 1974). This leads to the underdevelopment and entrenchment of the peripheral position of the less developed countries, thereby maintaining the binary position of the core and periphery. The Neo-Marxism argument on capital flows is formulated coherently in the seminal work of Paul Baran in *The Political Economy of Growth* (1957) and later by Andre Gunder Frank in *Capitalism and Underdevelopment in Latin America* (1967). Notably, these Marxist scholars are considered to be the pioneers of the dependency theory.

While Marx and his counterparts had come to the agreement that exporting capital bring about economic development, Baran was determined to prove that the underdevelopment of 'poor' countries was a direct result of the development of advanced capitalist countries. Baran (1957) argues that the existence of an advanced

capitalist society hinders the development of poor countries. This mainly because such development will be detrimental to the advanced capitalist countries interests. Baran investigates the significance of foreign investment, its impact on the current operations and its role in the underdevelopment of poor countries. In his conclusion, Baran (1957:184) indicates that:

“Thus while there have been vast differences among underdeveloped countries with regard to the amounts of profit plowed back in their economies or withdrawn by foreign investors, the underdeveloped world as a whole has continually shipped a large part of its economic surplus to more advanced countries on the account of interest and dividends”

Baran brought to the fore the imperialist and parasitic nature of foreign investment in less developed countries. Instead of being a progressive force that ignites economic development in underdeveloped countries, foreign investment serves as a regressive force that contributes to the underdevelopment of the poor countries (Szymanski, 1974:26). The surplus that is being produced in the periphery is siphoned off to the core, thereby making the countries in the core the rentier states.

In addition, Andre Gunder Frank advances Paul Baran’s thesis of underdevelopment and unambiguously point out that economic development and underdevelopment are two sides of the same coin. To Frank (1967:9) “... [Economic] development and underdevelopment are the same in that they are a product of single, but dialectically contradictory, economic structure and process of capitalism”. At the forefront of the plunder is private capital flows. Szymanski (1974:27) argues that the net capital flows have been the primary determinant in the widening gap between the core and periphery. Similar to the argument made by Baran, Frank (1967) use the Chilean case and argues that the surplus that is produced in poor countries is expropriated to the metropolis.

It is clear that integration into the capitalist world-system hinders the poor countries from economic development, thereby widening the gap between the core and the periphery. Private capital flows play an instrumental role in entrenching this inequality. As a result, Baran and Frank concluded that the underdeveloped countries should delink from the capitalist world society to have control over their economic surplus. In turn, they can reinvest that surplus into productive sectors, thereby inducing economic development. Baran and Frank realized that the attempt to induce economic

development exogenously is not effective due to imperialist and parasitic nature of foreign investment.

While, Neo-Marxism has critical tools to analyze the role of capital in the development process, the recent development in capitalism has exposed the weakness of the theory. The central argument of the theory is that surplus is repatriated from the developing countries to developed countries thereby creating inequality between developing and developed countries. However, the Neo-Marxian theory is mono-causal and does not capture the full dynamic of private capital flows and their impact on development. For instance, the surplus that is siphoned out of developing countries does not necessarily make its way back to developed countries but rather it goes to tax havens. Damgaard, Elkjaer, and Johannesen (2018:51) report that approximately US\$ 12 trillion that is invested by multinational corporations globally has made its way to tax havens. Rerouting FDI to tax havens means that these corporations are avoiding tax and domestic regulations, and this has negative implications for the tax base of a country in which the multinational corporations have its origin. (Haldevang, 2018).

Moreover, the direction of capital flows is no longer unidirectional as more developing countries including South Africa are investing in other developing countries as well as developed countries. The World Bank (2017) reports that FDI outflow from developing countries has increased astronomically in the last two decades and by 2015 it accounted for the one-fifth of total FDI flows around the globe. Most of this investment came from Brazil, Russia, India, China and South Africa (BRICS) (World Bank, 2017). Lastly, South Africa is neither the core nor the periphery, rather it falls within the semi-periphery.¹⁵ In his conception of world-system theory, Immanuel Wallerstein classified South Africa as a country that falls under semi-periphery (Wallerstein, 1979:100). Babones (2015:49) used the national income to divide countries into three broad zones of core, semi-periphery and periphery and confirmed that South Africa falls within the semi-periphery zone. In this regard, the theoretical tools of Neo-Marxism become less applicable in the South African case.

¹⁵ Semi -periphery refers to a group of countries that are neither fall in the core or periphery because they have a mixture core and peripheral type of productions. While the core production is capital intensive technology with high paid labour and periphery has low capital intensity and low wages, the semi-periphery has an even mixture of both (Babones, 2005:31).

2.4 Theory of Financialization

The term financialization is relatively new in academia, there is still no consensus on the exact definition of the term and even less about its significance. Epstein (2005:3) defines financialization as "...the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies." Thomson and Dutta (2015:4) point out that financialization reveals the interconnectedness of the global political economy and illustrates the unprecedented influence of the financial sector and technology on society.

Marxists have claimed the ownership of the term financialization and they have described the phenomenon as a process that emerged as a result of an epochal change in capitalism. Foster (2008) postulates that "financialization can be defined as the long-run shift in the center of gravity of the capitalist economy from production to finance." It is indeed a fact that there are sequential events that led to finance being the dominant player in the global political economy.

The ascendancy of finance as a dominant player in the global political economy can be firmly placed in the events that took place in the late 1970s. Firstly, the Bretton Woods monetary system that pegged the US dollar to the price of gold at the fixed rate of \$35 an ounce had collapsed (Bello *et al*, 2000:3). This led to the free-floating exchange rate system that caused considerable instability in the exchange rate (Lapavitsas, 2013:792). This major change in the international monetary structure spurred the growth of the financial market across the globe. Secondly, the development of technology had an immense contribution to the growth and interconnectedness of financial markets (Bello *et al*, 2000:3). Thomas and Dutta (2005:6) report that computerized trading accounts for 70 per cent of the financial market activity in the US. This was coupled with high-frequency trading that can sell financial assets in the fraction of seconds. Lastly, the rise of neoliberal ideology as a hegemon in the global political economy played a huge role in the unprecedented expansion of finance capital across the globe. The trinity of liberalization, deregulation, and privatization became the driver of neoliberalism internationalization program (Bello *et al*, 2000:3). Furthermore, international private capital flows led the financialization in many developing countries (Lapavitsas, 2013:794). Many scholars strongly cautioned against the liberalization of the capital account. They have also warned that when finance is not linked to real production, crisis becomes inevitable.

Scholars have argued that financialization has undesirable consequences. As financial markets become more interconnected, there is an increase in movement of capital flows which cause vulnerabilities, particularly in developing countries due to widespread financial deregulation (Bello *et al*, 2003:5). Another undesirable consequence is that the increased presence of financial markets cause non-financial corporations to abandon their core assets and to hold financial assets to make more profit (Mohamed, 2010). Consequently, this reduces investment in the real sector. Financialization is also the root cause of the financial crises at the turn of the 21st century. It has been at the forefront of the Mexican crises of 1994-5, the Asian financial crises of 2007, the Russian Meltdown of 1998, the collapse of Brazil's currency (*Real*), and the global financial crises of 2008 (Bello *et al*, 2000). Additionally, as financialization emerged, the private capital flow increased at an unprecedented speed, causing vulnerabilities across the developing countries. UNDP (2007:86) report that since the late 1990s, there has been a large inflow of private capital in the less developed countries. It reports that countries such as Zambia have a private foreign investment that amounts to 75 per cent of their GDP by 2007. While many African countries including Cameroon, Tanzania, Uganda and Gambia have a private foreign investment that amounts to 30 per cent of their GDP (UNDP, 2011:86). Within the same report, UNDP (2011) highlights the problems associated with private capital flows such as volatility, inflationary pressure, real exchange-rate appreciation, the boom in the bank lending, and the deterioration of the current account. Although the report has gone to claim that FDI is relatively stable to portfolio investment, scholars such as have Kalotay (2017) have argued FDI has also become unstable in the face of financialization.

Lapavitsas argues that the theoretical foundations of financialization depart from the epochal change in capitalism since the 1970s (Lapavitsas, 2013:797). Financialization does not merely the escape of finance from real production into speculative activities in search of a higher profit. Rather, it is a presentation of 'financialized' interactions between financial enterprises, non- financial enterprises and households (Lapavitsas, 2013:798). Three tendencies should be considered in

the analysis of financialization. Firstly, monopoly capital has become financialized¹⁶. This is because large monopoly enterprise does no longer rely on banks for credit, they can just finance a large bulk of their operations in the open financial market. (Lapavistsas, 2013:798). Secondly, due to the emergence of financialization, banks have lost their primary role as financial intermediaries in the global economy. As a result, they have restructured themselves to make profits from trading, lending to individual households and handling their savings (Lapavistsas, 2013: 799). Thirdly, there has been financialization of household income across all social classes. According to Lapavistsas, this refers to increasing debt and holding of financial assets by the household. The financialization of the households has enormously increased inequality and the consumption of workers has been extremely privatized (Lapavistsas, 2013:800). The deviation of finance from real production to speculative activities is the outcome of these financialized social agents. These three tendencies should serve as a point of departure for the theoretical foundation of financialization. Equally important, these three tendencies in financialization have taken place within neoliberalism context whereby there was widespread liberalization of capital account and trade. Financialization emerged within the political context that fuelled its rapid expansion.

The theory of financialization is more suited to the study because it indicates the impact of excessive movement of capital. It indicates that the astronomical increase in private capital flows stems from the fact that finance does not longer supplement the real sector. Instead, the capital is flowing abruptly in search of higher profits without contributing to productive sectors. Thus, financialization as a theoretical tool reveals the true essence of private capital flows in the present era. Moreover, financialization is able to isolate the impact of financialization on social agents and thereby providing a nuanced analysis of private capital flow on development.

2.4.1 Financialization of South Africa's Economy

As aforementioned, financialization represents a structural change in the banks, non-financial enterprises and households as they interact with the growing presence of

¹⁶ Foster (2018) explains that monopoly capital is a term that used in Marxist political economy to denote the new form of capital that is embodied by big corporations. This new form of capital has displaced small family firms, thereby ending the free competitive state of capitalism (Foster, 2018).

financial markets. South Africa is one of the emerging countries in which financialization has taken deep roots in the post-apartheid era.¹⁷ As the new democratic government abolished the capital controls, there were inflows of capital into the country. This inflow of capital has astronomically increased the size and presence of South Africa's financial markets. StatsSA (2019) reports that in 1994, the financial sector contributed 16 per cent to the GDP and it was the third-largest contributor after manufacturing and public sector. In 2019, the financial sector became the leading sector in the economy, making up 19 per cent of the GDP. This can be attributed to financial liberalization and subsequent increase in private capital flows.

Moreover, at the dawn of democracy, many big South African corporations began to internationalize and move their primary listing to overseas' stock exchanges (Mohamed, 2009:19). This further integrated South Africa into the global economy and developed the country's financial market. The abolishment of capital controls and internationalization of South African companies facilitated the process of financialization. Financial liberalization has opened the South African economy to the preponderance of capital flows and erratic growth of the financial market. In this case, the theory of financialization indicates that this process is regressive for a developmental agenda. The excessive capital does not go into productive sectors and adds to the real sector but rather it is speculative in nature. In other words, it maximizes profit in the shortest period.

2.5 Conclusion

Neo-Marxism and the theory of financialization provide a substantive frame of analysis for the role of private capital flow in development. Although the framework will rely mainly on the theory of financialization, the Neo-Marxist provides a background on the older perspective on private capital flows. Neo-Marxist hold a view that private capital flows are the primary determinant of underdevelopment in poor countries. The surplus that is gained from foreign investment is taken back to developed countries instead of being re-invested. As a result, there is a widening gap between the rich and poor nations. The theory of financialization presents a consistent critique from Marxism on the latest development of capitalism. It postulates that finance became the dominant player due to the financialization of social agents such as non-financial corporations,

¹⁷ Although there was a strong presence of the financial market in the post-apartheid, there was capital controls in place to insulate the country from the volatility of global economy.

banks and household. As a result of this financialization, finance has wandered off from production to speculative activities. Financialization as an analytical tool is relevant for the study because it is more nuanced and provides an account for the structural transformation of social actors as they increasingly interact with finance. South Africa is among the emerging country that is deeply financialized in the post-apartheid era. Financial liberalization and internationalization of South Africa's mega corporations increased the private capital flows and growth of financial markets in the country.

Chapter 3

Sowing the Seeds of Underdevelopment: Financial Liberalization and Private Capital Flows in South Africa from 1994 – 2018

3.1 Introduction

The transition to democracy presented an opportune moment for South Africa to chart a new economic path for inclusive development. Instead of charting a non-conformist way, the new democratic government followed the orthodox neoliberal policy framework such as GEAR. GEAR served to reintegrate South Africa into the global economy (Gelb, 2007). As a macroeconomic framework, GEAR established a foundation that is antithetical to setting up a developmental state later. It emphasized the abolition of capital controls, thereby allowing free movement of capital, which have a catastrophic impact on the South African economy. The new democratic government adopted the neoliberal policy framework, more specifically, the liberalization of capital flows at the onset of democracy because it had envisaged that foreign investment would contribute to the productive investment in the country and therefore promote development (Bond, 2000).¹⁸ Indeed, there has been an influx of private capital inflows in the post-apartheid era. SARB (2018:34) reports that private capital inflows have increased from R5.2 billion in 1994 to a record high of R357 billion in 2017. However, South Africa remains the highest unequal country with 27.5 per cent unemployment rate in 2018 and with 35.1 million South African living in poverty (StatsSA, 2018). This raises the question of what happens to the private capital inflows in the economy.

The purpose of this chapter is to illustrate that financial liberalization and the subsequent influx of private capital flows are disastrous to the health of South African economy and therefore incompatible with developmental state and advancement of its developmental mandate. ANC's abandonment of socialist policies and acceptance of neoliberal principle as espoused in GEAR provided a fertile ground for private capital flow to dominate the country's developmental trajectory. This lead to an economic arrangement that is more interested in maximizing shareholder value as opposed to keeping the egalitarian disposition that was envisioned in the NDP.

¹⁸ In this study, productive investment refers to long term investment that engender value as opposed to short-term investment that focuses on maximizing returns and driving consumption.

The chapter is structured as follows. The first section provides an overview of the financial liberalization in post-apartheid South Africa. This includes the economic policies that were made in the formative period of democracy such as RDP and GEAR. These economic policies have been crucial in determining South Africa's economic trajectory and its relationship with the international economy. The second section discusses the immediate impact of financial liberalization such as capital flight and illicit financial flows. The government missed the first initial step in becoming a developmental by going with a *laissez-faire* approach that resulted in massive capital leaving the country instead of being reinvested in the country. The third section investigates the nature and composition of private capital inflows and how they are absorbed in the economy. This is done to elucidate the role of private capital flows and their impact on the economy. The third chapter investigates the nature and composition of private capital inflows and how they are absorbed in the economy. The fourth chapter highlights the developmental implication of private capital flows within the developmental state context

3.2 Financial Liberalization in the Post-Apartheid South Africa

Financial liberalization took place immediately after the transition into democracy through the abolishment of the Financial Rand. However, before delving into the process of liberalization in South Africa, it is important to explain the term financial liberalization as well as in the ANC's economic position at the dawn of democracy. This is paramount because financial liberalization as neoliberal internationalization program and the shift of ANC economic policy position provides a rich context that will facilitate a greater understanding of the process of financial liberalization.

There is a consensus among scholars that financial liberalization refers to the abolition of government-imposed mechanisms that regulate the financial markets (Masci, 2008 and Mar, 2018). Financial liberalization includes the elimination of capital controls, compulsory reserve requirement, and barriers to entry for foreign financial intermediaries (Masci, 2008). In this regard, a country's financial sector forms part of the international financial market and serves the interests of investors (Beder, 2009:4). The argument behind the financial liberalization is that it induces economic growth because it allows easy interaction between domestic and international firms. It is also argued that it improves efficiency and corporate governance of domestic financial markets (Mar, 2018:2). The World Bank (2017) indicates that financial liberalization is

different from financial repression which took place in developing countries in the 1970s. Financial repression which refers to extensive government interventions was a reflection of state-led development (Masci, 2018). On the contrary, financial liberalization is the process of removing the state intervention in the financial markets.

3.2.1 The Nexus between the Financial Liberalization and Neoliberalism

Financial liberalization forms part of neoliberal's agenda of internationalizing finance capital. Neoliberalism refers to a political theory whereby there is an existence of a strong state that does not interfere in the market. Harvey (2008:2) explains that neoliberalism proposes that "human well-being can be best advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free market and free trade". The state is only there to provide an institutional framework that will allow the market economy to thrive (Harvey, 2008:2). Neoliberalism is associated with the privatization, deregulation and liberalization. Neoliberal policies were first introduced in the 1980s by Margaret Thatcher in the United Kingdom (UK) and Ronald Reagan in the United States (US) (Fine, 2019: 80).

Financial liberalization emanates from the neoliberal thinking whereby state-intervention is said to produce inefficiency and distorts prices in the financial market. Thus, the state should be subordinate to market forces and private capital flows ought to be liberalized (Bello *et al*, 2000:4). Prabhat Patnaik (1999:16) indicates that;

"An economy exposed to the free flow of international finance capital, however, is obsessed with the need to appease international financiers, to retain their 'confidence': the thrust of policies in such an economy, therefore, even in principle, is not towards serving the interests of the people but towards serving the interests of the speculators..."

As neoliberalism became a hegemonic idea in the global economy, there was widespread financial liberalization in developing countries. Cross-border capital flows have increased so rapidly to the point whereby they have overtaken trade and become the driver of the global economy. In many African countries, financialization was introduced through the structural adjustment programs that were supported by the World Bank and the IMF (World Bank, 2019). South Africa forms part of African countries that voluntarily embraced neoliberal principles and subsequently allowed free movement of capital.

3.2.2 Changes in ANC's Economic Position: A Shift from Socialism to Neoliberalism

Before expanding on South Africa's liberalization of the capital account, it is important to elucidate more on the shift in the economic policy positions in the ANC as the ruling party which have been strongly influenced by changes in the international political economy such as the advent of neoliberalism. From the onset, the democratic government faced an enormous task of transforming the troubled and racial exclusive South African economy. To put into perspective, DMPE (2014:84) reports that

"In 1995, it was estimated that 28 percent of households and 48 percent of the population were living below the poverty line. Black women and youth, as well as black people living in the former "homeland" areas, were particularly likely to be poor and unemployed. There were also structural inequalities in the workplace. Under apartheid, a variety of measures effectively limited most skilled work to non-Africans, while entrenching hierarchical and oppressive management in many workplaces. Most black workers had virtually no prospect of promotion or reaching managerial levels, and would work in the same jobs for their entire lives, with no hope that their experience would be recognised or respected".

It was very clear to the incumbent party that they needed to transform the economy, to break the racialized economic institutions, and create new institutions that will reflect the values of all South Africans including the newly enfranchised groups (Ndletyana, 2015). Therefore, the main objectives of the democratic state was to create jobs, eliminate poverty, and reduce racial inequalities. Simultaneously, the government needed to maintain investment and ensure that there is continuous growth and sustainability (DPME, 2014:814). It was decided by ANC that South Africa would be best served as mixed economy whereby there will be a constructive relationship between the state, people, trade unions, private sector and the market (ANC, 1992). The notion of a mixed economy first appeared in the ANC document titled *Ready to Govern*, thereby solidifying the ANC's embrace of the neoliberal values. However, it should be noted that these were not initially ANC economic policy position. The party's ideologue was heavily influenced by the socialists' idea of the state.

During the intense battle against the apartheid regime, the ANC policy position was influenced by socialism (Sampaio, 2014:78). This is evident in the Freedom Charter which stipulates that "the mineral wealth beneath the soil, the banks and the monopoly industry shall be transferred to the ownership of the people as a whole" (Freedom Charter, 1955). These socialist proclamations were further reiterated by Nelson Mandela in 1990 when he indicated that "the nationalisation of the mines, banks and monopoly industries is the policy of the ANC, and a change or modification of our views

in this regard is inconceivable"(Mandela, 1990). However, at the dawn of democracy, the ANC economic position changed and this can be attributed to the change in the international ideational structure.

South Africa's transition from apartheid to democracy coincided with the ascendancy of neoliberalism in the global economy and this had a profound impact not only on the economic development of South Africa but on the ANC economic policy decisions. As neoliberalism influence rose exponentially across the globe, the ANC economic policy choices became heavily constrained. Handley (2005:22) point out that the ANC abandoned its soft-left policies due to internal pressure from the business community and the international community's consensus on the neoliberal reforms. This was compounded by the fact that the Soviet Union as a sponsor of the liberation of the movement in South Africa and the vanguard of socialist ideas in the international community became weakened in Cold War and thus pushed the ANC into the negotiation table with the apartheid regime (Kondlo, 2015:5). This meant that the ANC could not turn South Africa into an interventionist state as this was frowned upon by the international and the local business community. Moreover, the ANC came to believe the orthodox idea that by opening up their capital account, they will attract foreign investment which will modernize and assist in the development of the South African economy (Bond, 2000).

3.2.3 The Abolition of Financial Rand in South Africa

Consequently, the newly democratically elected government began, soon after the democratic election, the process of financial liberalization and the creation of market conforming policies. The RDP was the first coherent economic policy framework from the ANC in government. RDP sought to reduce large social and economic inequalities that had been erected by the apartheid system. It placed an emphasis on the investment of the people, reduction of poverty by empowering people and long-term development (Roux, 2017:195). RDP has been subject to many interpretations and there is no consensus among scholars whether it was fundamentally socialist or neoliberal in nature. This is because there is an overlap of socialist and neoliberal values. For example, in the RDP, there is a decommodification of basic goods such as housing (O'Malley, 1994). Whilst, with regards to economic management, RDP has embraced orthodox economic ideas such as reducing government expenditure, endorsement of the Reserve Bank's independence and promoting international

competitiveness (O'Malley, 1994). While it might be subject to different interpretation, the embrace of orthodox ideas in RDP marks the penetration of neoliberalism in South Africa and within the ruling elite. Hadley (2005:224) report that RDP document went through six drafts and the final version which was released in September 1994 departed largely from the goals and ethos of the first draft (Hadley, 2005:224). The final version was a reflection of the victory of the market, marking the penetration of neoliberalism within the key ANC policymakers (Bond, 2000:98). This was reflected during the implementation of the program when the Minister of RDP, Jay Naidoo:

"... had other constituents now: 'the markets' as they were impersonally known. His mandate from the ANC leadership - to 'send out signals to the markets' - turned out to be a simple matter of running the newly drafted RDP White Paper past big capital's two leading organic intellectuals (Bobby Godsell of Anglo and Rudolf Gouws of Rand Merchant Bank) and getting good reviews from Jim Jones, Alan Fine and Greta Steyn [journalists] at Business Day. Only then did the cabinet get a look..." (Bond, 2000:98).

More importantly, under the RDP program, the South African government began to promote the country's international competitiveness (Sampaio, 2014:80). Gelb (2007:2) indicates that financial liberalization and re-integration of South Africa's capital markets were formulated, and some were legislated before the accession of the new government. In 1995, the Minister of Finance, Christo Liebenberg announced that the Government of National Unity has decided to abolish the financial rand and dual exchange rate system (Liebenberg, 1995:25).¹⁹Liebenberg indicated that the reason for this termination is because the financial rand system may discourage the new foreign investment in the future (Liebenberg, 1995: 25). The abolition of the financial rand, which served as a control mechanism of private capital flows, was an indicator of the influence of neoliberalism within the ANC. Gelb (2007:3) posit that;

"Alternative positions – particularly with respect to financial liberalization – were in some sense 'unthinkable', because the economy had just experienced several years of stagnation and stop-go growth cycles resulting exactly from a closed financial system and the absence of foreign capital inflows due to sanctions, disinvestment and so on. The need for capital inflows to support growth had been strongly argued by the ANC for years – could it now turn round and credibly propose growth policies without encouraging and enabling inflows?"

¹⁹ Financial Rand refers to exchange rate controls that were established in the 1960s which imposed controls on capital flows between Johannesburg and London (Barr and Kantor, 1983:13). The South African Reserve Bank formally adopted the Financial Rand in January 1979 as a policy to managing the floating exchange of the commercial Rand (Barr and Kantor, 1983:13).

Nonetheless, RDP was short-lived as an unsuccessful attempt to reconcile the Keynesian approach which was devised by the South African Macroeconomic Research Group (MERG) and the neoliberal framework that was favored by the business and the international community (Adelzadeh, 1996: 66). In practice, RDP reflected welfare capitalism whereby the capitalist system would continue uninterrupted and the government would simply carry out huge social programs as part of the transformation and redress.

In 1996, the government replaced the RDP with GEAR which provided the clearest commitment to neoliberalism. GEAR is a macroeconomic strategy that sought to make South Africa a globally competitive economy, broaden the employment, and redistribute opportunities in favor of the poor (GEAR, 1996:1). There are three broad policy themes covered by GEAR. Firstly, it sought to enforce macro-economic discipline by reducing the budget deficit, reducing government debt, and reducing government burden (GEAR, 1996). Secondly, it sought to increase international competitiveness by abolishing exchange rate controls, reducing tariffs, and to encourage foreign investment in the country (GEAR, 1996). In this regard, there would be free movement of capital and foreign investors can easily expand their portfolios by venturing into the South African market. Thirdly, it sought to free up markets by privatizing some of the state-owned enterprises (GEAR, 1996 and Roux, 2017). These were clear neoliberal tenets.

GEAR came as a response to the international capital market pressure instead of domestic needs (Hadley, 2005:224). It was a response to the currency depreciation that had a substantial impact on the country mainly because of financial rand and the dual exchange rate system that had been abolished in 1995 (Hadley, 2005:224). In 2001, Rob Davis (cited in Handley, 2005) confirmed that "the main impact in the [GEAR] was made by the global currency markets, and specifically, by the heavy shift against the Rand". Therefore, the policy was designed in part to send a positive message and surety to foreign investors that South Africa was committed to macroeconomic stability. This indicates that the abolition of financial rand was a premature move by the new ruling elite as introduced deep complexity in the economy. Handley (2005:226) indicates that the greatest highlight of the policy was that the government came to understand the important role of FDI. Guelke (1999:170) states that "the recognition that the confidence of the markets could only be maintained by a

commitment to financial orthodoxy and the belief that such confidence was vital to, subject to the country's ability to attract inward investment ... underpinned the government's economic policies". Hence, the policy stressed further liberalization of exchange rate controls.

However, GEAR was heavily criticized mainly by the left-leaning tripartite alliance in part because they were not consulted in the formulation of the policy (Qobo, 2007:38). COSATU proclaimed that "we have serious reservations over conservative fiscal policies that the document intends to implement" (Bond, 1996:79). It was also criticized because of the policy's neoliberal stance. On the other hand, the South African business community did not have input in the formulation of GEAR. However, they open-heartedly welcomed the policy because it sought to provide macroeconomic policy predictability which in turn creates a stable environment for investments and business decision making (Hadley, 2005:228).

In sum, South Africa began to liberalize its capital account during the formative years of democracy. The ascendancy of neoliberalism as a hegemonic idea in the international political economy had a substantial influence in economic policies of South Africa and this clearly illustrated in GEAR. The idea behind the financial deregulation was to attract foreign investment which the government believed would be *deus ex machina* for development (Carmody, 2002). However, the following subsection indicates that financial liberalizations sow the seeds of underdevelopment in South Africa.

3.3 Consequences of Financial Liberalizations: Capital Flight

Financial liberalization had severe consequences for South Africa's development agenda as there was a massive capital flight that could have been used as part of the development project to diversify the country's industrial base (Mohamed, 2010:161). The liberalization of capital flows meant the South African government had less control over large South African corporations (Mohammed, 2010:161). Due to the free movement of capital, South African corporations moved their primary listing from the Johannesburg Stock Exchange (JSE) to stock exchanges abroad (Mohamed, 2010:161). There are two reasons for this move. Firstly, there was a fear from white conglomerates of losing political control and the future of economic policy in the country. In essence, by moving their primary listing to the foreign stock exchange,

white-dominated corporations were moving their assets away from the new government (Mohamed, 2010:46 and Ashman *et al*, 2014: 33). Secondly, South Africa's transition to democracy coincided with prominent changes in the global economy. Mohamed (2010:44) states that in the 1990s, there was a rise of shareholder value movement and institutional investors as part of financialization. In this regard, corporations focused on the maximization of shareholder value and there was a frenzy of mergers and acquisitions. South African corporations took advantages of global changes and internationalized their operations and participated in the mergers and acquisitions (Ashman *et al*, 2014:34). This led to the concentration of their business to core sectors despite the attempt to unbundle and restructure their corporations as part of the transformation strategy (Mohamed, 2010:47).

The internationalization of South African corporations led to a massive capital flight that amounted to 10 per cent of GDP in 1998 (Mohamed, 2006:24). This is the capital that is yet to return to the country. Mohamed (2010:46) states the move of South African corporations to London Stock Exchange was supposed to allow them to raise capital to invest in South Africa. They have managed to raise capital, however, they have not invested it in South Africa (Mohamed, 2010:46). This impedes South Africa's development as it represents a huge misallocation of capital in the country. In addition, capital flight has severely affected the economy in the form of a loss in tax revenue, private investment and potential public investment (Mohamed, 2019:206). Nonetheless, the new democratic government did not interfere in these conglomerates because they did not want to lose credibility with other potential investors. This the first crucial step that the government had missed to create a developmental state. Scholars such as Kondlo (2015:2) have gone as far as to argue that capital account liberalization and acceptance of neoliberal policy framework in RDP has slipped South Africa into a 'semi-permanent state of paralysis'. This is because the state has been stripped off its ability to intervene in the interest of sustainable development in the country.

Moreover, the abolishment of capital controls has given rise to illicit financial flows. According to AU (2007:23), illicit financial flows refer to "money illegally earned, transferred or used". The removal of capital control means that the government has no mechanism to monitor the capital flows, thus giving rise to the illicit money flows (Reed and Fontana, 2011:23). It is important to note that illicit financial inflows form

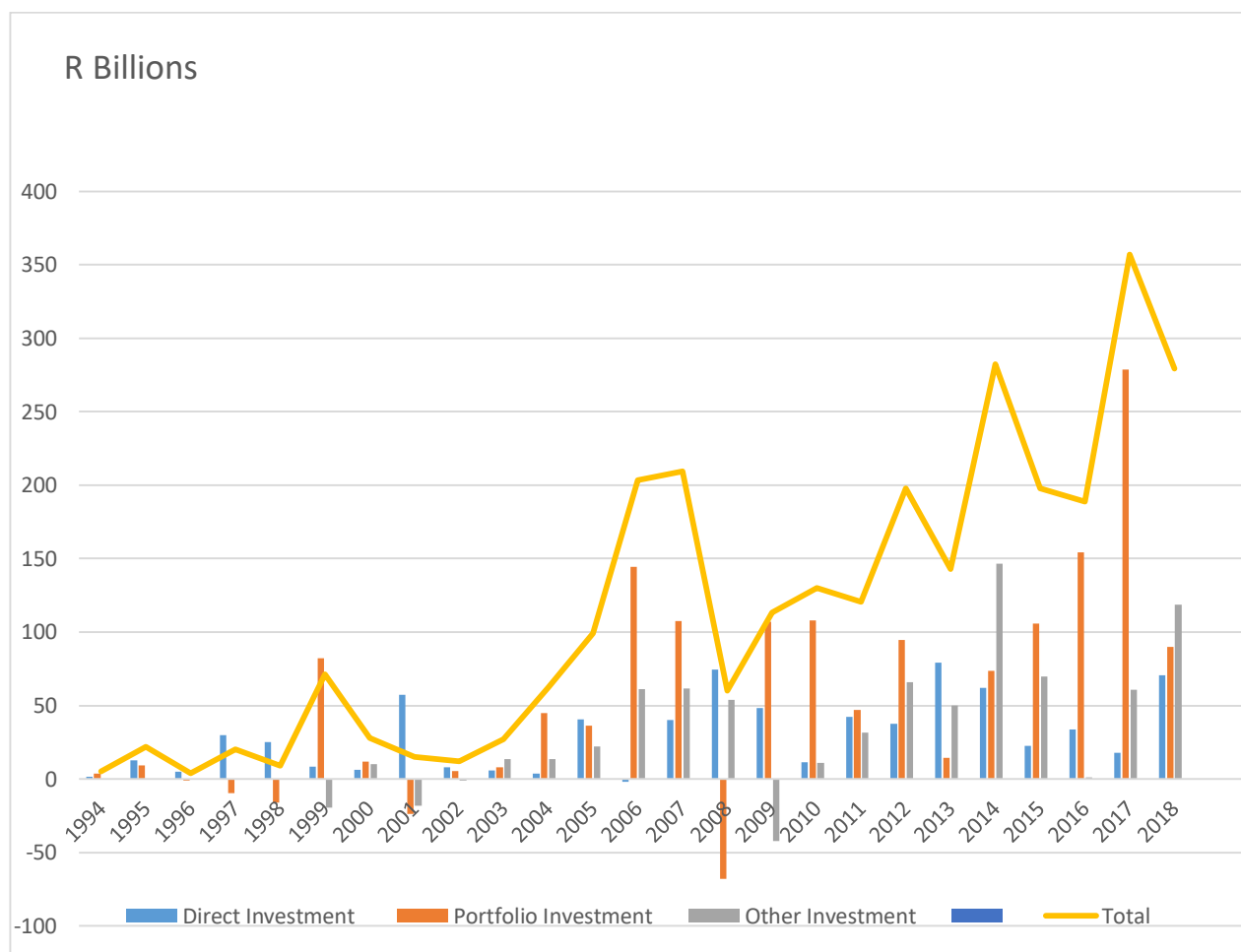
part of the capital flight and in some instances, the terms are used interchangeably. Kapoor (2003:3) report that South Africa has been losing an average of 9, 2 per cent of the GDP to illicit financial flows. This is capital that could have been reinvested in the productive sectors for sustainable economic development and growth. African Development Bank report indicates that “investment is one of the most important conduits through which capital flight affects human development. If capital flight was saved and invested in the domestic economy of the country of origin it would increase income per capita and help to reduce poverty”(African Development Bank, 2012:79). Thus, illicit financial flows rob a country of its true development potential.

3.4 The Role of Private Capital Flows and their Implications on Development

As aforementioned, during the formative period of democracy, the South African government liberalized capital flows. The process of liberalization of capital flows began in RDP and was later more emphasized in GEAR (Gelb, 2007:4). This was done to deepen the country's financial markets and promote FDI as a vehicle for development (Sampaio, 2014:87). In other words, South Africa came to depend on private capital inflows to assist with the country's developmental agenda. Indeed, the private capital inflows increased astronomically after the transition to democracy. Figure 1 illustrates the private capital flows in South Africa from 1994 to 2018. From figure 1, the total capital inflows increased from R5.2 billion in 1994 to R71.4 billion in 1999(SARB, 2000). This increase of private capital inflows in the abovementioned five-year period can be attributed to the large liquidity in the international financial markets at the time. South Africa was also perceived as a haven among investors in the wake of the Asian financial crisis (Sampaio, 2014:88). Moreover, after the democratic elections, South Africa became a premium investment destination in the Sub-Saharan region because it had the strongest economy with the wealthiest mineral sector and the most industrialized sectors (Mohamed, 2006:13).

However, these private capital inflows caused macroeconomic instability and were disruptive to the South African economy. From figure 1, private capital inflows began a decline in 2000 due to a sharp reversal of portfolio inflows as currency speculators and investors realized that the depreciation of the Rand was imminent (Mohamed, 2006:4).

Figure 1: Private Capital flows in South Africa from 1994 – 2018



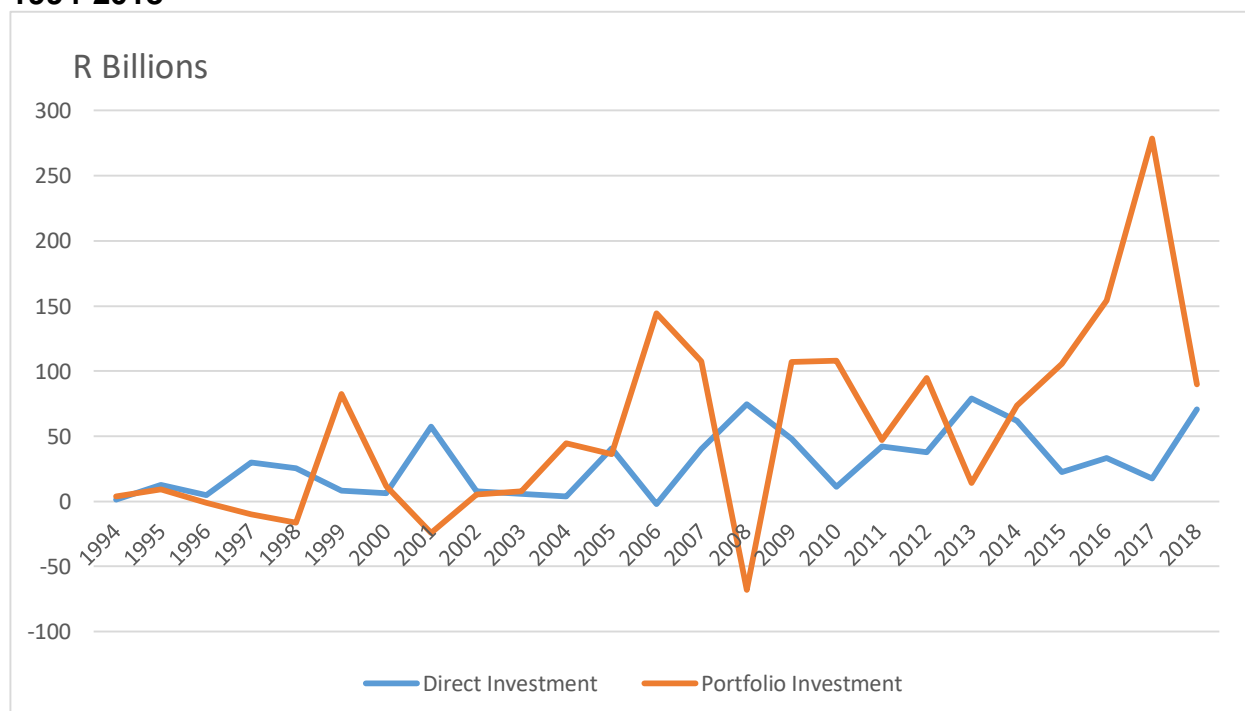
Source: Compiled by the author using SARB data.

Consequently, there was a massive flight of Rand based assets which led to more panic that resulted in the outflow of portfolio investment that amounted to R24 billion in 2001(SARB, 2002:34). This led to the sharp depreciation of the Rand as it lost 35 per cent of its value in the Rand to US dollar exchange rate (Mohamed, 2006:4). The consequence of Rand depreciation was a rise in inflation that warranted a response of the Reserve Bank with the interest rate hike of 4 per cent in 2002 (Mohamed, 2006:4).

Figure 1 further illustrates that there was a continuous increase in the total capital inflows until 2007. Thereafter, there was a sharp decline in the total capital inflows in 2008 due to the global financial crisis. In this regard, there was an outflow of R68 billion in portfolio investments whilst foreign direct investment remained stable in that period

(SARB, 2009). This was the biggest outflow since the 2001 currency depreciation and the consequences for the South African economy were severe. According to Rena and Msoni (2017:24), the sharp reversal of portfolio investment due to the 2008 financial crisis caused significant macroeconomic imbalances in the country. They report that the current account deficit increased from 1, 1 per cent of the GDP to 5.8 per cent of the GDP; inflation increased by 9,9 per cent; GDP fell to 1.8 per cent in the last quarter of 2008 and official unemployment increased to from 22.7 per cent in 2008 to 23.7 per cent in 2009 (Rena and Msoni, 2017:24). Moreover, the mining industry suffered the most from the global financial crisis as the commodity prices plummeted (Rena and Msoni, 2017:21). There was also significant job-shed and reduction in investment in the mining sector (Rena and Msoni, 2017:21). It is clear that the global financial crisis had a severe impact on real economic activity in South Africa and the impact was transmitted through private capital flows. Due to financial liberalization, capital goes out of the country at the sight of trouble thereby causing major macroeconomic imbalances including shedding jobs in the mining sectors. In this context, the state cannot promote long term development without a proper capital control mechanism to insulate the country from the volatility in the global economy.

Figure 2: The Foreign Direct Investment and Foreign Portfolio Investment from 1994-2018



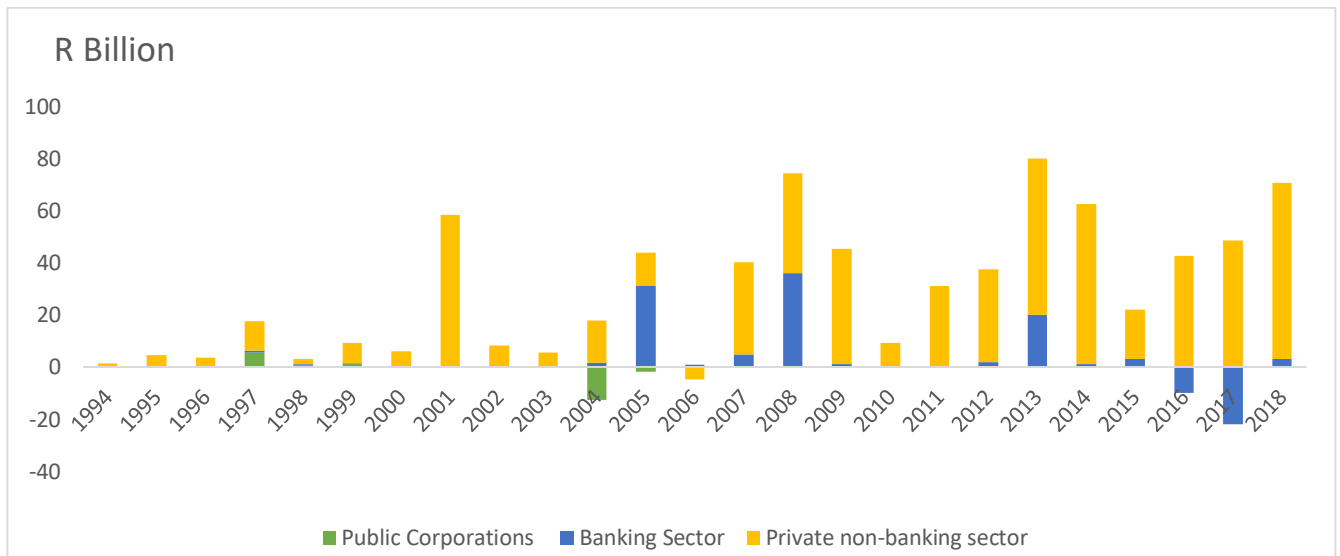
Source: Compiled by the author using SARB data.

In addition, South Africa liberalized the capital account because it wanted to attract FDI. However, the evidence illustrated in figure 2, which depicts the composition of capital inflows in South Africa from 1994 to 2018, indicates that this has not been the case. From the graph, there are more portfolio investments inflows than FDI inflows. As the literature has illustrated, portfolio investments are subject to sharp reversal, cause macroeconomic volatility and have no genuine interest in development. Furthermore, the Reserve Bank indicate that the majority of portfolio investments are short term (SARB, 2018). Mohamed (2010:50) argues that the surge of short-term capital flows fuel speculation that causes further instability and volatility in the exchange rates, interest rates, and inflations. More importantly, the portfolio investments do not contribute to the productive investment in the economy and therefore does not promote development in the country (Mohamed, 2010:51).

3.4.1 The Absorption of Private Capital Inflows in South Africa

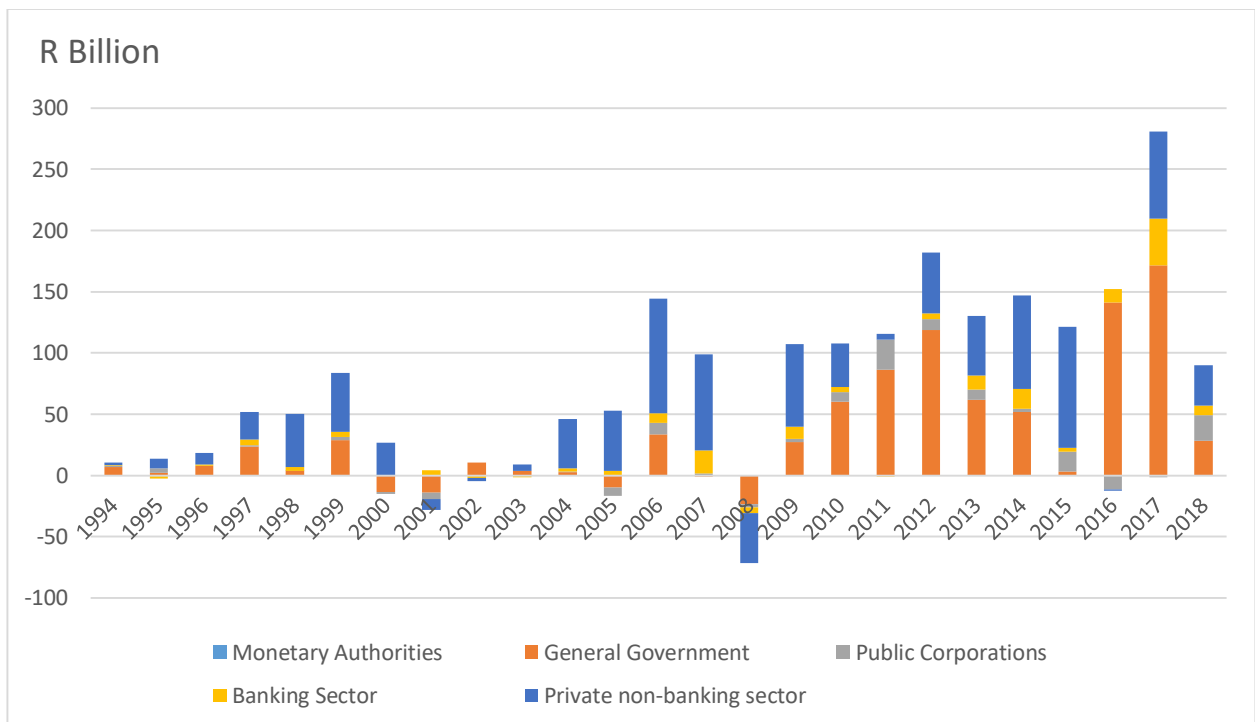
Private capital inflows have been mainly absorbed by the non-banking businesses in South Africa. Figure 3 and 4 illustrates the absorption of FDI and portfolio investment in the South African economy from 1994 to 2018. In both graphs, FDI and portfolio investment have been absorbed mainly by the private non-banking sector. Sampaio (2014: 90) point out the absorption of the capital inflows into private non-banking sector has been influenced by a major restructuring of the South African corporations and purchase of existing South African companies. For example, the increase in FDI in 2001 of approximately R58 billion is due to corporate restructuring of the De Beers mining company when there was a buyout of minority shareholders (SARB, 2000 and Sampaio, 2014:90). Moreover, the large inflows of in 2005(R13 billion) and in 2008(R38 billion) were driven by the acquisition of ABSA by the Barclays Bank and of Standard Bank the Chinese Investment Corporation (CIC) respectively (Sampaio, 2014:90). This indicates that the majority of FDI inflow has been limited to mergers and acquisitions of South African corporations. This means that there is not enough investment that flowing into productive sectors to promote industrialization.

Figure 3: Foreign Direct Investment by Sector from 1994 -2018



Source: Compiled using SARB data

Figure 4: Portfolio investment by sector from 1994 -2018



Source: Compiled using SARB data

Mohamed in (2006) and (2010) has argued that the inflow of capital does not add to the productive investment in the country. Instead, there has been positive growth of household consumption due to the increased availability of credit to the private sector and a decrease in real interest rates (Sampaio, 2010:91). The influx of portfolio

investment in the country has rapidly increased the domestic credit that has been extended to the private sector (Mohamed, 2010:47). The massive outflow of portfolio investment during the 2008 financial crisis decelerated the private sector credit extension from a record high of 30.2 per cent in 2007 to 17.1 per cent in 2008, thereby proving the correlation between portfolio investment and private sector credit (SARB, 2008:31). The increase in private sector credit has increased household consumption and indebtedness. Smith(2018) reports that " 77[per cent] of total South African household credit balances are now mortgage and instalment sales repayments, while 23.7[per cent] makes up the repayment of unsecured debt". This proves that capital inflow fuels household consumption and debt without adding to the productive sector which will fail to produce unsustainable future growth. IMF (2017) indicates that household debt is not sustainable for long term growth because consumers cut back on their spending to repay their loans. In additions, the global financial crisis in 2008 has illustrated that excessive household debt can dangerous (IMF, 2017). In the face of overwhelming evidence, it is fair to conclude that private capital inflows induce unstainable conditions and unfavorable environment for the promotion of long term and inclusive development. By extension, the development state will not be able to promote a developmental agenda with unregulated private capital flows.

3.4.2 Implications for South Africa's Developmental State Agenda

So far the private capital flows in South Africa has proved to have no genuine interest in the development of the country. This is consistent with the theory of financialization which indicates that finance under the auspices of neoliberalism has no interest in the real sectors. Instead, it has focused on maximizing profit without making a substantive investment in the real sector which is an engine for sustainable development. The developmental state agenda will likely not bear any fruits given there is a powerful external force such as private capital flows regressing the country in its developmental trajectory. For South Africa's developmental state to successfully promote the long term development, it must direct the all domestic and foreign investment into the productive sector. This is the cornerstone of developmental state – the ability to intervene to transform and promote development. Onis (1991:110) posit that the key to a successful developmental state is the ability for the state to provide a "directional thrust to the operation of the market mechanism". Yet, evidence indicates there is unregulated capital mobility in the country that is not interested in long- term

development. Against this overwhelming evidence, the government still went to set the objective of being a development state without addressing the role of private capital flows in the development of the country.

The evidence indicates that portfolio investments leave the country at the slightest sight of trouble thereby causing macroeconomic instability. Furthermore, the excessive portfolio investment over FDI has extended private sector credit which in turn has fuelled household debt, consumption and speculation in the financial market. None of the evidence indicates there is a positive flow of foreign investment into productive sectors. Instead, the private capital flows have expanded the financial markets in South Africa. The increasing levels of capital inflows have converted the financial system into the most dynamic sector in the South African (Sampaio, 2014: 91). StatsSA (2019) reports indicate that the financial sector has become the leading sector in South Africa with the contribution of 19.8 per cent in 2017. It has overtaken the manufacturing sector which has declined considerably in the post-apartheid era due to lack of investment among other things. The pertinent question remains that how can South Africa want to build a developmental state with unregulated private capital flows given its destructive dispositions as the evidence has suggested. There are two possible answers to this question. The first answer is one that has been raised in the literature that South Africa's objective to become a developmental state is mere rhetoric and realistic conditions do not allow the emergence of the developmental state that can effectively deal with structural problems. The second answer is that the role of private capital flows in South Africa's economy within the broader discourse on the developmental state has been inadequately addressed and thus officials have no adequate knowledge on the matter.

3.5 Conclusion

After the transition to democracy, the new South African government began to liberalize capital flows through the abolishment of Financial Rand and a dual exchange rate system. This financial liberalization was accompanied by the GEAR framework which was a strategy to ensure policy predictability to attract foreign investment. However, financial liberalization has caused more harm than good in the country. This is because there was a massive capital flight from the big South African corporations after the democratic elections. These corporations moved their primary listing abroad because they were attempting to maximize their shareholder value but also, they were

uncertain about the future of South Africa's economic policy. This is the capital that could have been reinvested in the country for development. Moreover, financial liberalization aided illicit financial flows as there is no virtual oversight on the movement of capital in South Africa. In addition, the capital inflows that the South African government had envisioned to modernize the economy and promote development has caused periodic instability in the country. Unregulated capital movement means that investors can pull out their investment anytime without incurring cost when there is a perception of risk. Indeed, investors pulled their investment significantly in 2001 and 2008, causing instability in the country. In addition, the data presented above indicate that the private capital flows that come into the country are mainly portfolio investment which volatile and unproductive in nature. Whilst, FDI which is considered to be more productive and stable has been mostly limited to mergers and acquisitions. These portfolio investments have been absorbed by the private sector which in turn has extended their credit. The extended credit has fuelled household consumption and speculation in the financial market and real estate. A continuance of the current regime and attitude towards private capital flows indicate that South Africa's developmental state agenda will unlikely to succeed in promoting development. A developmental state cannot succeed while capital flows are unregulated. This is private capital flows are destructive to the health of a nation's economy as illustrated above.

Chapter 4

Private Capital Flows and the Reinforcement of a Non-Developmental Agenda in Post-apartheid South Africa.

4.1 Introduction

When the South African policymakers realized that neoliberal policies failed to overcome the structural challenges and the private capital flows did not promote development, they sought to introduce a stronger role for the state through the developmental state model. The concept of the developmental state is deeply rooted within a heterodox intellectual tradition which challenges the idea that market conforming policies lead to rapid growth and development (Haggard, 2018:2). Chapter three indicated private capital flows expand non-productive sectors and this problematic as the country needs investment into productive sectors such as manufacturing. The argument provided in chapter three mirrors that of a theory of financialization which indicate that capital flows have escaped their primary role of being a supplement to real production to largely being speculative.

This chapter continues the discussion and illustrates that the private capital flows derail South Africa's quest to being a developmental state and reinforces a non-developmental state agenda in the post-apartheid era. This is done by exacerbating structural challenges that South Africa seeks to achieve through the developmental state model. The rest of the chapter is organized as follows; the first section discusses South Africa's conception of the developmental state including the objectives it seeks to achieve. Thereafter, the second section indicates that private capital flows reinforce a non-developmental state agenda as they obliterate the same objectives that the country is seeking to overcome through the developmental state model. The third section discusses reasons that private capital flows and the exchange rate regime continues uninterrupted even in the context where the government seeks to build the capacity for the developmental state. Given that there is overwhelming evidence that private capital flows without clear state guidance do not accelerate South African developmental objectives, it comes imperative to understand the reluctance of the state to impose capital control.

4.2 South Africa's Developmental State

South Africa has committed to becoming a developmental state to overcome its developmental challenges such as unemployment, inequality and poverty (NDP, 2012). Generally, developmental states refer to “one whose ideological underpinning is ‘developmentalist’ in that it conceives its ‘mission’ as that of ensuring economic development, usually interpreted to mean high rates of accumulation and industrialization”(Mkandawire,2001:290). In this regard, they guide domestic and foreign investment into the productive sectors to induce industrialization. In addition, these states play a role in the positive transformation of society. For example, the East Asian development states’ goal was to drive rapid growth while simultaneously expanding opportunities for greater participation in the modern economy. This was done through expansion of public services such as health care, agriculture and education (Fritz and Menocal, 2017:532). This illustrates that the primary purpose of the developmental state is to drive sustainable and inclusive development.

South Africa also views the developmental state as a *deus ex machine* for its structural problems. Edigheji (2010:2) report that the concept of the developmental state first appeared in the ANC at the National General Council in 2005 when the party committed itself to construct a developmental state that will intervene in the economy for development. The idea of the developmental state was articulated coherently in the ANC document titled *2007 Strategy and Tactics* document (cited in Gumede, 2017:147). The document stipulates that the ANC aims to;

... build a developmental state shaped by the history and socio-economic dynamics of the South African society. Such a state will guide national economic development and mobilize domestic and foreign capital and other social partners to achieve this goal. It will have attributes that include: having the capacity to intervene in the economy in the interest of higher rates of growth and sustainable development; effecting sustainable programmes that address challenges of unemployment, poverty and underdevelopment with requisite emphasis on vulnerable groups; and mobilizing the people as a whole, especially the poor, to act as their own liberators through participatory and representative democracy.

The ANC policymakers understood that to have inclusive growth, the state must play a key role in allocating resources. Otherwise, if the market was to be left to its own devices without any meaningful intervention then the structural inequalities would remain unchanged. Mkandawire (2001:290) posit that developmental states possess

the ability to promote sustainable development and structural change in the productive system of the domestic economy as well as its relationship with the international economy. Overall, the success of East Asian developmental states presented the South African ruling elite the opportunity to experiment with this heterodox approach to overcome its ailing developmental challenges.

4.3 The move towards a Developmental State

The South African government devised macroeconomic policies in which the state would play a crucial role such as AsgiSA and NDP. These policies indicated a strong commitment to becoming a developmental state model. The failure of GEAR ushered a new era in South Africa economic reform whereby there was a loss in momentum for financial liberalization and industrial policy debates re-emerged (Qobo, 2007:30).²⁰ In fact, in 2005 the ANC began to debate about turning South Africa into a developmental state (Edigheji, 2010). Consequently, the government in consultation with business, trade unions, civil society and international experts, drafted an economic plan called Accelerated and Shared Growth Initiative for South Africa (AsgiSA) (Roux, 2017). It became the earlier attempt to have the state play a substantial role in the economy. One of the key issues that had occupied and dominated the policy discussions in the ANC was the phenomenon called the dual economy. Mbeki (2004:3) articulated that South Africa is characterized by the existence of two economies. The first economy is modern, wealthy and it is integrated with the global economy. Whilst, the second economy is underdeveloped; contributes very little to the wealth of the country and it has a large population, and it is disconnected from the global economy (Mbeki, 2004:3). The existence of a dual economy meant that the new democratic government had not managed to significantly change the conditions of previously disenfranchised black people and the structure of the economy is still largely resembled that of apartheid.²¹ This is with exception from few elites that had been co-opted into white-dominated corporations through Black Economic Empowerment (BEE). In other words, it meant that GEAR, as a

²⁰ It is important note that GEAR is fundamentally a neoliberal macroeconomic policy that placed a greater emphasis on cutting government spending, relaxation of capital controls, tariff reductions and labour market flexibility (GEAR, 1996). However, it failed to reach its target and more importantly to overcome structural challenges in the country.

²¹ The white minority still held more wealth and the income inequality between races continued to widen.

fundamental neoliberal macroeconomic policy, had failed to overcome salient structural problems in the country.

To tackle the challenge of dualism, President Mbeki proclaimed that government would seek to emulate the EU's 'Structural Funds' in which a portion of the EU's budget is directed to less prosperous regions and social groups within the EU (Mbeki, 2004:3). This model is based on the notion that the market is unreliable in delivering development in less prosperous areas (Mbeki, 2004:3). Mbeki's administration then instituted a range of programs in which the state would play an active role in synthesizing the first and the second economy. Instead of calling it a developmental state, Mbeki referred to it as a democratic state. Qobo (2007:14) speculates that Mbeki completely omitted the concept of the development state from policy discussions because he was aware of the uncomfortable relationship between the developmental states that were associated with authoritarianism and the democratic aspiration of post-apartheid South Africa.²²

AsgiSA sought to ensure the economic rate of 4.5 per cent between 2004 and 2009; and growth of 6 per cent between 2010 and 2014. It also sought to halve unemployment and poverty by 2014 (Roux, 2017:198). In addition, AsgiSA sought to implement sectorial investment strategies, infrastructure programs; skills development plan, and bridge the divide between the first and the second economy (Roux, 2017:199). The important shift in AsgiSA was to relocate the importance of the state in ensuring equitable and inclusive growth. Hence, the main thrust of the policy was 'shared growth' as the government sought to cross the divide between the first and second economy. There was an introduction of state-driven programs to deal with unemployment and skills shortages *inter alia* Expanded Public Works Programme (EPWP) and Joint Initiative on Priority Skills Acquisition (JIPSA). The introduction of AsgiSA served as an indication that the government has shifted its focus from international capital markets (which was the case with GEAR) to domestic realities. Qobo (2007:1) reports that this shift was indicated by the replacement of Alec Erwin who was at the forefront of international trade policy with Mandisi Mpahlwa who had previously been the deputy Finance Minister. AsgiSA was replaced with New Growth

²² It is important to note that most of the East Asian countries which inspired the literature on developmental states were authoritarian (Ohno, 2013:48).

Path (NGP) when President Thabo Mbeki left the office and was later built upon to formulate a much more coherent economic framework – NDP.

The NDP was released by the National Planning Commission (NPC) in 2011 and it was subsequently adopted as national policy framework by Cabinet in 2012. It is a long-term policy framework that aims to eliminate poverty and reduce inequality by 2030 (NDP, 2012:11). NDP was the government's clearest attempt to building a developmental state. In the NDP's foreword, Trevor Manuel (2012: 1) states that "the approach of the plan revolves around citizens being active in the development, a capable and developmental state able to intervene to correct our historical inequities, and strong leadership throughout society working together to solve our problems". It aimed to replicate the characteristics of the previous East Asian developmental states by having a single ministerial economic planning unit in government; producing more technical orientated human capital; initiating and leading the dialogue between the public and the private sector on economic development; and creating a policy cohesion between governments' related economic policies (Gumede, 2017:153). In addition, the NDP was an attempt to build the technical aspect of the development states similar to Singapore and Japan. Gumede (2017:153) posits that one of the most important technical attributes of the NDP is the NPC which will serve as a nucleus that plans the aspects of the economic development. It remains to be seen how effective the NPC will be in coordinating the economic development process.

However, both AsgiSA and NDP have not articulated ways in which the state will guide private capital flows in the developmental state context. This means that the same relaxed exchange rate regime continues in the developmental state era. This reflects the fundamental challenge between the state and the market in economic policymaking. It is plausible that the government strategically avoids setting a clear institutional mechanism because it does not want to antagonize the markets in which it has become reliant to finance its budget deficit. The South African government believes that capital controls inhibit foreign investment and thus they would rather keep the capital account open (Liebenberg, 1995). Government still hopes that it attracts more FDI as opposed to portfolio investment. So far the hope without accompanied capital regulation has not worked well for South Africa. The next section illustrates that private capital flows reinforce non-developmental state agenda by exacerbating poor

quality growth, unemployment, inequality and poverty – the primary objectives of South Africa’s developmental state.

4.4 Private Capital flows and South Africa’s Developmental State Agenda

4.4.1 South Africa’s Economic Growth Rate and Private Capital Flows

Private capital flows have affected the quality of South Africa economic growth. Figure 5 illustrates South Africa's GDP in the post-apartheid era. From the graph, South Africa experienced the lowest growth in 1998, 2009 and 2016. The first two lowest growth periods were caused by external shocks which were transmitted through capital flows. In 1998, the East Asian financial crisis slowed down global economic growth and harmed the South African economy (DPME, 2014:86). The 2008 financial crisis led to a global recession which also slowed down South Africa's growth rate (DPME, 2014:86). However, the low economic growth in 2016 was sparked by internal issues such as political instability and low productivity in the mining and manufacturing sectors (StatsSA, 2016). This indicates that private capital flows have prompted period economic instabilities in the country. As aforementioned, this period economic instabilities have caused harm to the economy as they translated into job losses and reduced investment, particularly in the mining sector (Rena and Msoni, 2017:21).

Moreover, figure 5 indicates that South Africa has experienced the highest economic growth rate from 2004 to 2007. Mohamed (2010:42) argues that the quality of economic growth from 2004 to 2007 is questionable. This is because it was spurred by short term portfolio investments (Mohamed, 2010:42). By nature, short term portfolio investments do not add to the productive sector but rather, they drive speculation, macroeconomic instability, household debt and consumption, as illustrated in chapter three.

Figure 5 South Africa's GDP (per cent), 1994-2018



Source: Compiled using StatsSA reports

Moreover, the influx of short-term portfolio investment had a negative impact on the current account balance. The rapid growth of GDP was accompanied by a negative balance on the current account that grew from -3.5 per cent of GDP in 2004 to -7.3 per cent of GDP in 2007 (Mohamed, 2010:42). Economic growth is a precursor for development, however, the preponderance of short-term portfolio investment has produced an inferior economic growth which does not promote development. As a result, this type of economic growth does not aid South Africa's developmental state agenda.²³ The following subsection investigates the role of private capital flows on unemployment, poverty and inequality. Given that the primary motive behind the construction of the developmental state in South Africa is to overcome these challenges.

4.4.2 The Triple Challenge of Unemployment, Inequality, and Poverty

A. Unemployment and Private capital flows

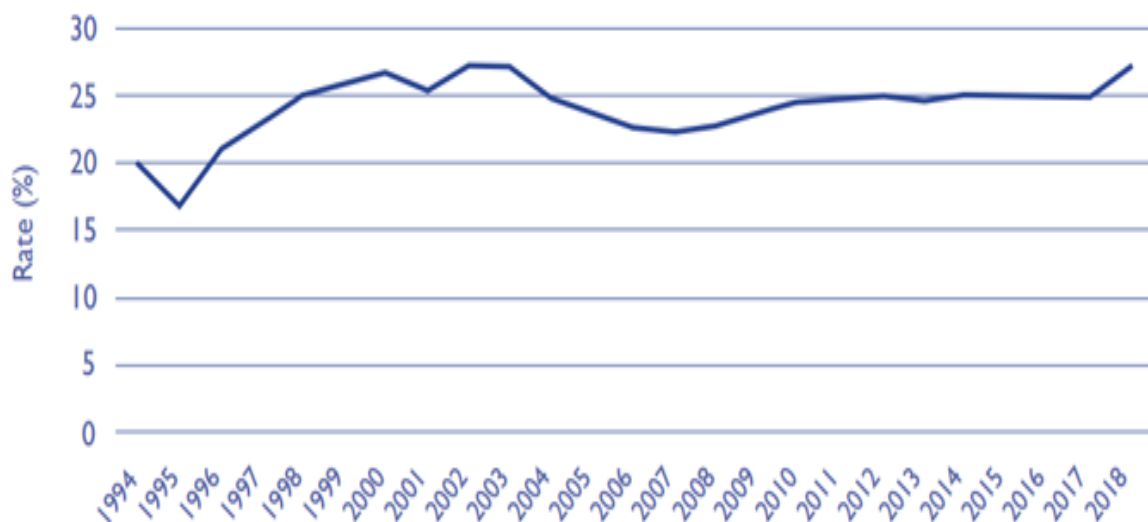
Private capital flows have exacerbated the salient developmental challenges that South Africa government intends to solve through the developmental state model. South Africa's unemployment rate is among the highest in the world, with an unemployment rate of 27.5 per cent in 2018 (StatsSA, 2018). In fact, it is reported that South Africa is ranked 6th in terms of the unemployment rate in the world (Businesstech, 2015). This has been a persistent issue in the democratic dispensation for South Africa. It is highly problematic given that the end of apartheid in 1994 filled

²³ One of the primary purpose of developmental state is to allocate resources efficiently to productive sectors. Economic growth is in sectors that are non-productive implies investment is not driving industrialization as part of developmental state strategy.

many South Africans with the hope that the new democratic era would usher in a structural change that would induce inclusive economic development.

Scholars indicate that unemployment in South Africa is a structural problem. Mlantsheni and Leibbrandt (2014:23) state that part of the reason of such high unemployment in the country is due to a mismatch between skills possessed by the majority of the labour force and the skills that are demanded by the employers. The structure of the South African economy has evolved due to changes in technology and production (Ferreira and Rossouw, 2016: 807). The manufacturing sector has also evolved to be more capital intensive than labour-intensive. As a result, there is a demand for high skilled labour meanwhile the country is well-endowed with low skilled to semi-skilled labour (Black *et al*, 2017:30). This structural problem has prevented the country from using its massive labour reservoir to its advantage.

Figure 6 South Africa's unemployment rate (per cent), 1994-2018



Source: businesstech (2018)

The problem of unemployment is further exacerbated by strict labour regulations. Hiring has become risky for employers as there are inflexible regulations on hiring and firing (Ferreira and Rossouw, 2016:810). In addition, employers complain about the entrance level wages which are high and do not necessarily reflect the productivity (Mlantsheni and Leibbrandt, 2014:23).

Capital flows have entrenched the problem of unemployment in the country. The influx of capital inflows has been absorbed by private-sector corporations. Consequently, there has been growth and expansion of the tertiary sectors while important secondary and primary sectors such as manufacturing and agriculture have declined considerably (Mohamed, 2010: 39). As pointed out in chapter three, the financial sector, which is part of the tertiary sector, has increased and is now the biggest contributor to the GDP due to the influx of capital inflows. Financialisation in South Africa has led to the de-industrialization because South African non-financial corporations have let go of their core assets to hold financial assets Mohamed (2010:49). This shift aims to make a profit in the financial market and maximize shareholder value. This is compounded by the fact that the large composition of capital inflow is portfolio capital whose main aim is to maximize profit without adding to the productive sector. Thus, there is no productive investment flowing to the manufacturing sector. The absence of capital control and productive investment undermine the manufacturing sector which is supposed to be the engine for employment growth in South Africa (Isaacs, 2016:96).

In addition, South Africa needs a manufacturing-led developmental state as opposed to service-led developmental state given its unique unemployment problems.²⁴ Behuria and Goodfellow (2018:600) point out that any country that seeks to specialize in service sectors such finance, insurance, and real estate with low levels of human development will result in a mismatch between skills demanded and supplied. In South Africa, the service sectors jobs require high skilled labors whilst the country is inundated with semi-skilled to low skilled labour. However, it is important to note the service sector does create jobs for low and semi-skilled labour but not at the same magnitude as a well-capacitated manufacturing sector. Moreover, employment that is generated in the service sector for the low and semi-skilled labour which includes cleaners and security guards has increased outsourcing and informalization (Mohamed, 2010:41). This has resulted in the decline of union density from 36 per cent in 1997 to 24 per cent in 2013 (Isaacs, 2016:94). Given the South Africa historical background, the employment of low skilled through insourcing and temporary contracts can be considered to be of inferior quality in comparison to the permanent

²⁴ Service-led development state is a concept that is used by Behuria and Goodfellow to describe a process whereby the state seeks to transform the economy through the service sector as opposed to the traditional approaches of manufacturing (Behuria and Goodfellow, 2018:583).

employment in the manufacturing sector. In fact, it exacerbates the inequality in the country.

B. Inequality and Capital flows

According to the World Bank (2019), South Africa remains the country with the highest inequality in the world. South Africa's Gini Coefficient has increased from 59, 3 in 1993 to 63.4 in 2011, a 7 per cent increase in 18 years (CDE, 2017:5). Currently, South Africa Gini-Coefficient is 63.95 which is expected to increase further because of the high unemployment rate (CDE, 2017:5). World Bank (2019) reports in 2015, the richest 10 per cent of the population held 71 per cent of the net wealth in South Africa while the bottom 60 per cent held only 7 per cent of the net wealth. Moreover, income inequality persists largely because of the apartheid legacy that excluded people from meaningful economic opportunities. Indeed, the inequality in South Africa is strongly correlated with race. In 2014, the income ratio of a white person was 7.5 times that of the African person (CDE, 2017:7). Webster (2019) notes that income inequality is not only high across race but across gender and spatial as well.

Beyond the engineered inequality by the apartheid system, private capital flows have also exacerbated the problem of inequality in South Africa. The manufacturing sector has resorted to downsizing and retrenching its employees because capital inflows have shifted away from productive investment to being nomadic and speculative. In this case, large corporations tend to restructure and downsize and this results in relegating other jobs to low wage locales (Isaacs, 2018:85). The shareholder movement has also altered income distribution patterns as they have come to get a bigger piece of the profits (Isaacs, 2018:85). Moreover, financial liberalization and financialization have increased household's access to financial markets and various financial products. Consequently, the rich and urban-based households can hold financial assets and accrue income from those products. This, in essence, deepens the income inequality between the rich and the poor (Azis and Shin, 2015:85).

C. Poverty and Private capital flows

Table 1 Poverty headcounts in 2006, 2009 and 2011

Poverty headcounts	2006	2009	2011
Percentage of the population that is poor	57,2%	56,8%	45,5%
Number of poor persons (millions)	27,1	27,8	23,0
Percentage of the population living in extreme poverty	26,6%	32,4%	20,2%
Number of extremely poor persons (millions)	12,6	15,8	10,2

Source: StatsSA (2014)

Overall lack of investment in labour-intensive and productive sector slows down the much-needed progress to lift people out of poverty. Dlodla (2019) reports that South Africa manufacturing sector has shed 15 000 jobs in the second quarter of June, thereby adding to the high unemployment rate. In turn, fewer people are unable to feed their families due to unemployment. Table 2 depicts poverty headcount in 2006, 2009 and 2011, there is a decline in the poverty level from 2005 to 2011 using the upper-bound poverty line. Indeed, in 2006, several people who were estimated to be roughly 27 million people and this number dropped to an estimate of 23 million people in 2011. The decline is due to various factors *inter alia* expansion of social safety nets, and access to basic services. Bhorat *et al* (2014:17) explain that the persistence of inequality and poverty is due to structural reasons including inequality in skills particularly educations; unemployment; inequalities in returns to skills; and low productivity and low labour income in the informal sector.

In sum, private capital flows derail South Africa's developmental state from achieving its developmental mandate. Private capital inflows have expanded the service sector as opposed to the manufacturing sector. This has resulted in the inability of the country to absorb its massive labour that is composed mainly of low skills and to semi-skilled individuals which cannot be absorbed by the service sectors as it demands highly skilled labour. Moreover, it has exacerbated income inequality by emphasizing shareholder value as well as providing greater access to rich households to financial markets to increase their income. Unemployment and inequality have slowed down the progress on poverty reduction in the country. Thus, the impact of private capital flows does not reinforce the objective of South Africa's developmental state.

4.5 The Resilience of Private Capital Flows in South Africa

South Africa has come to depend on the international financial markets to supplement its budget deficit. Abedian (2016:22) points out that South Africa's national savings amount to 15 per cent of the GDP which translates to 1.5 per cent GDP growth or less. If South Africa seeks to have a sustainable growth rate of 3 per cent and above, it needs to have a national investment rate that is above 30 per cent. Since national savings are about 15 per cent, the government borrows money from in the international market to make up for the shortfall (Abedian, 2016:22). This dependence on foreign capital has led the government to continue with market conforming policies. If the government follows non-conformist policies they stand a chance to be downgraded by the credit rating agencies. A downgrade has become an indictment for not following neoliberal policies, thus making it harder for the government to access capital from international markets. Furthermore, capital flows are at the center of the modern global economy and both corporation and governments have become reliant on external financing. Any measure taken to regulate the capital flows might have an adverse impact on the corporations and government access to external finance. Brazil is one of the developing countries that has imposed a series of capital controls between 2008 and 2013 and this has had an adverse impact on the small non-exporting firms that have become reliant on the external finance (Alfaro, 2017: 206).

4.6 Conclusion

South Africa is one of the countries that has taken deliberate steps to become a developmental state. When the fundamentally neoliberal economic policy like GEAR failed to promote economic growth, transform the economy and induce inclusive development, the South African government wanted to experiment with a heterodox approach to development. The structural problems which some were an inheritance from the apartheid past continued to linger and the policymakers understood that some problems can be solved by a *laissez-faire* approach. Hence, the government decided to become a developmental state to overcome the triple challenge of unemployment, inequality and poverty. The government began to introduce a state-led economic policy such as AsgiSA and it later came up with NDP which was the clearest commitment to becoming a developmental state. However, there is still no clear ways that the government will deal with capital flows. As a result, private capital flows have

failed to advance the objectives that the South African developmental state intends to achieve. Private capital flows have expanded the service sector meanwhile a South African need a thriving manufacturing sector to overcome its chronic unemployment problem. Moreover, private capital flows have exacerbated income inequality and slowed down the progress on poverty reduction. Private capital flows continue to be unregulated despite their regressive impact on development because the government has become too reliant on external financing that it sources from international markets. In addition, private capital flows are the heart of the modern global economy and if capital control were introduced the small firms that depend on external financing would suffer.

Chapter 5

Conclusion; Private Capital Flows inhibits South Africa from Realizing its Developmental State Aspirations

5.1 Introduction

The South African government faced an enormous task of transforming the highly racialized economy in the post-apartheid era. Prominent developmental challenges such as unemployment, inequality and poverty required that the new government take decisive steps in a bid to ensure inclusive participation of all South Africans in the economy. At the formative period of democracy, the government followed the conventional neoliberal approach to advance its developmental agenda. This was more prominent in GEAR which was introduced two years later after the first democratic elections. When the GEAR failed to advance South Africa's developmental agenda, the government sought to replicate the East Asian development state model, *albeit* with tweaks to suit the South African context. The government wanted to construct the South African developmental state because it needed to overcome the developmental challenges that it has grappled with since the dawn of democracy.

The developmental state model provides a unique opportunity for developing countries to promote long-term and sustainable development and also 'catch up' with highly industrialized countries through a state-directed approach. However, South Africa's objective is set in an era whereby finance has become an engine of the global economy under the auspices of neoliberalism. It is an era whereby there is strong support for the free movement of capital by the international community. Free movement of private capital as an integral part of neoliberalism and developmental state model from afar seem to be mutually exclusive approaches to development. Thus, this study set to explore the impact of private capital flows in the realization of South Africa's developmental state agenda in the post-apartheid era. This study had two secondary objectives which were to find out the nature and composition of private capital in South Africa as well as investigate whether they hinder or accelerate the realization of South Africa's developmental agenda within the developmental state context.

The debate around the developmental state has drawn attention from many scholars. However, much of the literature has focused on internal capabilities and the nature of the political system that is required in constructing a developmental state, particularly in the South African case. While internal capabilities are important features, another critical question that has been left inadequately answered is whether South Africa's developmental state can succeed in the face of unregulated private capital flows.

The literature on private capital flows mainly focuses on the impact on economic growth. It indicates that portfolio investments are associated with volatility and speculation while there is no conclusive evidence that FDIs still contribute positively to growth since the advent of financialization in the 1990s. There is hardly any literature that focuses on South Africa's developmental state agenda in the post-apartheid era and ways in which this agenda is derailed or advanced by private capital flows. This study aimed to fill this gap. In the search for answers, the study has utilized the qualitative methods supplemented by quantitative figures and the guidance of the theory of financialization.

5.2 Theoretical Considerations

This study has adopted the theory of financialization from the Marxist Political Economy because it provides a critical examination of private capital flows. South Africa's developmental agenda relies heavily on foreign investment because the country has low domestic savings. In this regard, the private capital flows need to be carefully examined to understand their nature, composition and their overall impact on the economy. Financialization proved to be the best theory to anchor the study. It posits that private capital flows are unproductive as they are interested in surplus accumulation without producing anything substantive in the long term. This is because finance has escaped the sphere of production due to the structural transformation of capitalist economies. The structural transformation took place in three aspects. Firstly, non-financial corporations have bypassed banks and directly financed their operations from the open financial markets. In this case, these corporations have let go of their core assets to hold financial assets. Secondly, banks have become involved in the financial markets to increase their profit as their primary role of intermediation vanished with changes in global finance. Thirdly, the individual household also got involved in the open financial market to increase their income. In essence, the theory

of financialization explains the proliferation of finance in the global economy and the social implication thereof.

On the other hand, Neo-Marxism as an alternative theory to explain private capital flows fails to capture the full dynamism of capitalist accumulation machinery. Neo-Marxism still insists that the private capital flows are still unidirectional, flowing from developed to developing countries. In this context, private capital goes to developing countries with the sole purpose of extracting as much surplus as possible thereby causing further underdevelopment in the poor countries. While Neo-Marxism is still important in understanding underdevelopment, the global economy has evolved over time and some countries have moved from peripheral to semi-periphery status while others have moved to the core. In other words, developing countries such as South Africa have also become exporters of finance capital to both developing and developed countries. In addition, the surplus that has been accrued from developing countries no longer make their way back to the developed countries but rather to tax havens. This evolution in the global economy problematizes the Neo-Marxist's central thesis that the development of industrialized countries is directly related to the underdevelopment of poor countries.

5.3 Key Research Findings

5.3.1 Financial liberalization has not been beneficial for South Africa's Long-term Development

After the transition to democracy, the new South African government liberalized the country's capital account by abolishing the Financial Rand. The government had envisaged that liberalization of capital account will attract foreign capital which in turn should play a critical role in transforming the South African society and promoting development. To accompany financial liberalization, the South African government created market confirming macroeconomic policy frameworks such as GEAR which served to attract more private capital flows. This firmly rooted the principles of neoliberalism in the country. Indeed, South Africa did manage to attract a massive amount of foreign capital. However, empirical evidence suggests that financial liberalization had an adverse impact on long-term development that out-weighed its benefits.

The results in chapter three indicate that due to the abolition of capital controls, South African corporations moved their primary listings abroad and internationalized their operations. There are various reasons for this move, *inter alia*, lack of trust in the new government and the newfound ability to maximize shareholder value. This resulted in massive capital flight that could have been invested in the productive sectors to promote growth and development. Moreover, the abolition of capital controls meant a lack of monitoring of private capital flows. Consequently, illicit financial flows rose exponentially in the country, hindering the country from its true development potential. Simultaneously, financial liberalization enabled preponderance of private capital flows which have also failed to live to their expectation that they would be a vehicle for development.

In sum, financial liberalizations mean that South Africa cannot intervene in the market to curb capital flight and illicit financial flows and repurpose this capital into productive sectors. The ability to guide investment into the productive sector is the hallmark of the development state and if South Africa does not reverse the process of financial liberalization. It cannot realize its developmental state aspiration.

5.3.2 Private Capital Flows have an adverse impact on the South African Economy

Chapter three has firmly established the nature of private capital flows in South Africa. Private capital flows in South Africa are disruptive to the economy as they cause periodic macroeconomic instability. This is because investors pull out their investment at the sight of any trouble, causing macroeconomic instability. This is evident in the 2001 currency crisis and 2008 global financial crisis whereby South African economy suffered currency depreciation, inflation, current account deficit, sluggish economic growth and increase in the unemployment rate.

The chapter has also illustrated that there is more portfolio investment than FDI that is flowing into the country. The greater inflow of portfolio investment is undesirable for a country that seeks sustainable development given the nature of portfolio investment as described in the literature review. On the other hand, FDI inflows in the country are also mainly limited to South Africa's corporate restructuring such as mergers and acquisitions. This has limited its contribution to long-term development in the country. In addition, portfolio investments have extended private sector credit which has

resulted in an increase of household debt, consumption and speculation in the financial markets. In essence, South Africa has been inundated with portfolio investments that do not make a positive contribution to long-term development.

Private capital flows that the South African government had envisaged would promote development in the post-apartheid have done the exact opposite. As White and Wade (1988) have eloquently explained that a developmental state is one that determines the developmental trajectory in the country. However, in the case of South Africa, private capital flows to determine the development trajectory. Due to the fact that they are unregulated and unguided, these flows go into sectors that cannot promote sustainable development. Therefore, in the face of unregulated capital, South Africa's developmental agenda that is framed within the developmental state context will unlikely succeed. South Africa cannot emerge as a successful developmental state that can promote development when there is an external force such as private capital flows that is regressive to development.

5.3.3 Private Capital flows Reinforce a Non- developmental Agenda in South Africa

Chapter four has established that the primary motivation for the quest of being a developmental state is that the South African government sought to overcome the triple challenges of unemployment, inequality and poverty. It has illustrated that private capital flows derail this quest to become a developmental state by reinforcing a non-developmental agenda. In this regard, private capital flows affect developmental goals that South Africa seeks to advance through the developmental state. Chapter four argues that the influx of short term capital flows induces economic growth that does not translate into sustainable development. This is because short term capital flows are solely interested in maximizing profit and they have no real interest in development.

In addition, private capital flows have exacerbated the problem of unemployment in South Africa. Due to the influx of private capital flows and financialization, financial and business services has become the biggest sector in the economy. This comes at the expense of the manufacturing sector which has seen the biggest decline in the post-apartheid era. As a result of this structural transformation, the country cannot absorb the massive labour that is composed mainly of low-skilled and semi-skilled. In

areas where the financial sector can create jobs for the low -skilled and semi-skilled labour, this employment is not considered to be good quality because of outsourcing and informalization.

Private capital flows also increases inequality in the country because manufacturing firms have resorted to downsizing due to lack of investment. This has been compounded by the fact that big non- financial corporations have gained the ability to make a profit in the open financial market and this allows them to let go of core and productive assets. As a result, some jobs have been relegated to low wages and there is less social mobility. In addition, the shareholder movement and the ability for the rich and urban-based household to hold financial assets has altered income distribution. This, in turn, has exacerbated the income inequality in the country. Consequently, poverty reduction has been slowed down due to high unemployment and inequality. In this regards, private capital flows obliterate the very same objective that South Africa seeks to advance through the developmental state model.

5.3.4 Reliance on Private Capital Flows Inhibits Emergence of Developmental State

South Africa has become heavily reliant on private capital flows because it is a country with low savings. As a result, it has to access other people's savings to supplement its budget deficit. Similarly, South African corporations also rely on private capital to expand their businesses. This constrains the country on its economic policy choices as foreign investors prefer an economy that is both open to trade and free movement of capital. Due to this heavy dependence on private capital flows, the South African government cannot simply opt for a policy that is non- market conforming as this will result in a massive outflow of capital and it will be difficult to attract more investment in the country. Therefore, the state is ripped off its policy sovereignty and it cannot intervene meaningfully in the economy. This prevents the emergence of a developmental state that can intervene meaningfully in the economy. As mentioned in chapter one, the *raison d'être* of developmental states is the ability to intervene in the economy and repurpose the market rational toward long term development. However, this ability to intervene in the economy is taken away because the government has limited control over its economic policy.

5.4 Consideration for Future Research

This study has presented an in-depth understanding of the role of private capital flows in the realization of South Africa's developmental state agenda in the post-apartheid. However, it does not claim to provide a full account of the phenomenon. Some questions are left unanswered. For instance, while private capital flows provide a glimpse of the role of financial markets in the developmental state objective of South Africa, it does not provide a full picture. Therefore, the role of financial markets needs to be further explored to determine their influence on the success of developmental states. This becomes more imperative for the countries that seek to become a developmental state in the globalized and financialized era. In addition, East Asian developmental states had relied on manufacturing industries to promote development. However, production has evolved to become capital intensive and other countries do not have a comparative advantage in certain industries that can become key to their industrialization trajectory. Therefore, an investigation can be conducted to check whether the financial and business sector can repurpose effectively to become the key driver of sustainable growth and development as opposed to traditional manufacturing that used by East Asian development state to induce rapid growth and development.

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