

**FOSTERING FOREIGN DIRECT INVESTMENT IN THE 'NEW' SOUTH
AFRICA IN THE CONTEXT OF A CHANGING WORLD TRADING SYSTEM:
CHALLENGES, OPPORTUNITIES, POLICIES**

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To my late dad
Butana Gabriel Gerard Moloji

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Le ka moso. Nangomso.

LIST OF ACRONYMS

ACM	Arab Common Market
ADDs	Anti-dumping duties
AEC	African Economic Community
AMU	Arab Maghreb Union
ANC	African National Congress
ANCOM	Andean Common Market
ANZCERTA	Australia-New Zealand Close Economic Relations Trade Agreement
APEC	Asia Pacific Economic Co-operation
ASEAN	Association of South-East Asian Nations
ASEAN-FTA	ASEAN Free Trade Agreement
BENELUX	Belgium, Netherlands, Luxembourg
BSEC	Black Sea Economic Co-operation Project
CACM	Central American Common Market
CBI	Cross Border Initiative
CEAO	Communaute Economique de l'Afrique de l'Ouest
CEFTA	Central European Free Trade Agreement
CEPGL	Communaute Economique des Pays des Grands Lacs
CM	Common Market
CODESA	Convention for a Democratic South Africa
COMESA	Community of Eastern and Southern African States
CU	Customs Union
CVDs	Countervailing duties
DMEs	Developed Market Economies
EAEC	East Asia Economic Caucus
EAI	Enterprise for the Americas Initiative
ECCAS	Economic Community for Central African States
ECO	Economic Cooperation Organisation
ECOWAS	Economic Community of West African States
EEA	European Economic Area
EFTA	European Free Trade Association
EMA	Export Marketing Assistance Scheme
EcU	Economic Union
EU	European Union
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investment
FTA	Free Trade Area
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GEIS	General Export Incentive Scheme

GNU	Government of National Unity (of the Republic of South Africa)
GSP	Generalised System of Preferences
IMF	International Monetary Fund
IOC	Indian Ocean Commission
IPP	Intellectual property protection
JVs	Joint ventures
LAFTA	Latin American Free Trade Association
LAIA	Latin American Integration Association
LDC	Least developed country
LPA	Lagos Plan of Action
MERCOSUR	(Southern Cone Common Market)
MFA	Multi-fibre Arrangement
MFN	Most Favoured Nation
MNC/E	Multinational corporation/enterprise
MRU	Manu River Union
NAFTA	North American Free Trade Agreement
NIE/C	Newly industrialising economy/country
NIEO	New International Economic Order
NTBs	Non-tariff barriers
OECD	Organisation for Economic Cooperation and Development
PRC	Peoples Republic of China
PTA	Preferential Trade Area
QRs	Quantitative restrictions
RDP	Reconstruction and Development Programme
R&D	Research and Development
RTAs	Regional Trading Arrangements
SAARC	South Asian Association for Regional Cooperation
SADC	Southern African Development Community
SADCC	Southern African Development and Co-ordinating Council
SSA	Sub-Saharan Africa
S&T	Science and Technology
TNCs	Transnational Corporations
TPRM	Trade Policy Review Mechanism
TRIMs	Trade-related Investment Measures
TRIPS	Trade-related Intellectual Property Rights
UAPTA	PTA Units of Account
UDEAC	Union Douaniere des Etats de l'Afrique Centrale
UK	United Kingdom of Great Britain
UN	United Nations Organisation
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations
UNECE	United Nations Economic Commission for Europe
UR	Uruguay Round of Multilateral Negotiations
US	United States (of America)
USSR	Union of Soviet Socialist Republics

VERs	Voluntary exports restraints
WAEMU	West African Economic and Monetary Union
WTO	World Trade Organisation

SUMMARY AND INTRODUCTION

The focus of this thesis is on foreign direct investment (FDI). This is an aspect of international trade that has recently become increasingly important, not only to developing and developed countries in general, but to South Africa in particular; notably so when this country was admitted back to the larger international community of nations after April 1994.

In the quest to address the many imbalances engendered by apartheid, South Africa's policy-makers maintain that FDI may play a critical role in helping achieve the goals and objectives of the government's Reconstruction and Development Programme (RDP). It is for this reason that the creation of a climate conducive to both local and foreign investment is expected to be one of the top priorities of the new government of national unity (GNU).

The important point stressed in this thesis is that, when devising policies and strategies aimed at increasing trade flows and attracting foreign investment into the 'new' South Africa, this country's policy-makers should, always, take into account the profound changes that the world trading system is currently undergoing. The current trends in world trade, FDI and regional integration are poised to influence the position of South Africa and the role it may play in the world economy of the 1990s and beyond. The writer of this thesis believes that the daunting challenge facing South Africa's policy-makers is to understand these patterns and changes, as well as forces behind them, as a basis for developing the ability to respond constructively and positively. This is important, because this country will be expected to play its respective role according to the existing rules of the prevailing world economic order.

In short, South Africa's policy-makers are faced with the task of devising some ingenious strategies and policies that may maximise the opportunities provided for South Africa by the new world trading environment. At the same time, those measures should also aim to minimise the potential negative effects arising from increased world-wide competition for

international markets, trade and investment funds. The point is also made however, that the effectiveness of such strategies and policies will depend in large part on South Africa's efforts and political will to adjust to the new opportunities and challenges of the international trading environment.

This thesis comprises four chapters. Chapter One discusses trends in world trade, FDI and regional integration in the 1990s and their possible implications for South Africa. Its aim is to provide the reader with a fuller appreciation of the international context within which South Africa's future trade and investment policies should be considered and implemented; because whatever approach South Africa adopts, it is imperative that it must be viable in the world trading environment of the 1990s. It will be shown for instance that, although the world trading environment of the 1990s is characterised by rapid 'globalisation' of world markets and proliferation of inward-looking regional trading arrangements (RTAs), this decade is experiencing, on the one hand, growing 'protectionism' and concentration of world trade and investment funds in the developed market economies and greater marginalisation of the developing and least developed (LDCs) countries on the other. It will be shown further that these phenomena have a negative impact on the ability of the latter countries to play a meaningful role in international trade and investment. Chapter One concludes by looking at the World Trade Organisation (WTO) and the impact it will have on international trade relations in the 1990s and beyond.

Chapter Two discusses the various determinants of FDI. In this chapter, it will be demonstrated that many analysts and governments hold the view that FDI is a 'good thing' as it is perceived to have a positive impact on other economic variables such as balance-of-payments, employment and capital creation, access to new markets and technological know-how. It will also be shown that in fact, many developing and transition countries are engaged in fierce competition for foreign investment, and that to this end, these countries have recently changed their respective foreign investment laws with the sole aim of creating a climate attractive to foreign investment in their respective economies.

The determinants of FDI in this chapter are discussed under the following headings, viz. government policies (e.g. ownership policies, taxation and subsidies, convertibility of foreign exchange and remittance of earnings, performance requirements, capital and price controls, etc.), locational determinants (e.g. host comparative advantage, host market size, etc.), structural determinants (e.g. economic 'openness', investment infrastructure, etc.), and economic determinants (e.g. international trade links, etc.). The impact of these various determinants will also be discussed as well as policy implications for South Africa.

Chapter Three discusses the current constraints and opportunities for the 'new' South Africa in the quest for increased foreign-direct-investment-flows. It will be argued that although South Africa has deep-seated structural problems (e.g. shortage of foreign capital and skills, lack of international competitiveness of its manufactured products, chronic unemployment, etc.), this country stands a good chance (given its developed infrastructure and a relatively dynamic manufacturing sector by African standards for instance) of being a possible destination for FDI and international trade flows.

The last Chapter (Four) discusses various policy implications for South Africa in its attempt to attract FDI into this country. It will be demonstrated that whatever approach South Africa adopts, will be impacted upon by various factors, *inter alia*, the prevailing world trading environment, growing protectionism in the developed market economies, its obligations under the WTO, its trade relations with other SACU and SADC countries, and so on. It is suggested that South Africa's current trade regime needs to be overhauled as it is not conducive to the development of competitive industrial capabilities *inter alia*, due to a strong anti-export bias that is inherent in its policies. It will also be argued that the state - like in other high-growth East Asian economies - has an important role to play in fostering the competitiveness of certain industries for instance, as a way of promoting the international competitiveness of South Africa's manufactured products.

The Conclusion summarises briefly the major issues covered in this thesis.

Before turning to Chapter One it is important to make the following point: the idea of FDI is broad, controversial and multi-faceted. The writer of this thesis does not claim to

provide a definitive account of how South Africa should deal with this complex phenomenon. On the contrary, this thesis should be treated merely as an attempt to provide a broad introductory overview from the South African perspective, of how this country could begin to address the issue of FDI with the aim of addressing its economic and trade problems, in the context of a changing world trading system of the 1990s.

CHAPTER ONE

TRENDS IN WORLD TRADE, FOREIGN DIRECT INVESTMENT AND REGIONAL INTEGRATION IN THE 1990s

1.1 Trends in world trade

1.1.1 Introductory remarks

Since the end of the Second World War international trade has grown at a faster rate than world output.¹ Although the world trading system experienced growth in international trade during this period, that trend has not been even all over the world. For instance, while on the one hand the developing countries'² share of world trade fell from 31 per cent in 1950 to 20.4 per cent in 1990, developed (market) economies³ on the other increased their share of world trade from 60.4 per cent in 1950 to approximately 70 per cent in 1990.⁴ In order for the reader to understand the current trends in world trade and to appreciate the international context within which the 'new' South Africa will be

¹ Peter J. Buckley and Michael Z. Brooke, *International Business Studies: An overview*, Blackwell Business, Blackwell Publishers, Oxford, 1992, p.79. See also Marc Williams, *International Economic Organisations and the Third World*, Harvester Wheatsleaf, London, 1994, p.15; Diana Tussie, *The Less Developed Countries and the World Trading System: A challenge to the GATT*, Studies in International Political Economy, St Martin's Press, New York, 1987, p. 39; Margaret R. Kelly and Bernhard Fritz-Krockow, 'Trade policies in industrial countries and their impact on Arab countries', in Said El-Naggar (ed.), *Foreign and Intratrade Policies of the Arab Countries*, IMF, Washington DC., 1992, p. 53; David Greenaway, 'Economic development and international trade: an introduction', in David Greenaway (ed.), *Economic Development and International Trade*, St Martin's Press, New York, 1988, p.1.

² The term 'developing countries' is usually discussed in terms of four geographical areas - Asia (including the Pacific Basin), Latin America (including the Caribbean), the Middle East and Africa [L.R. Klein, 'African economic development: situations and prospects', in D.J.J. Botha *et al* (eds.), *The South African Journal of Economics*, Vol. 61., December 1993, p. 229. See also Dominic Salvatore, *International Economics* (4th ed.), MacMillan Publishing Company, New York, 1993, p.317] This is that part of the world which is also referred to as 'South' or the 'Third World' whose economies are characterised in general by low (and sometimes extremely low) average real per capita income, many of the labour force in agriculture and other primary activities such as mineral extraction, a low life expectancy, high rates of illiteracy, low rates of growth in real per capita income.

³ The term 'developed countries' is usually used to refer to that part of the world which comprises mainly the Western Capitalist Countries (Canada, United States of America, the countries of the European Union) including, in the East, Japan, Australia and New Zealand. These countries are also referred to as the 'North' or the 'First World', whose economies are, in the main, technologically advanced.

⁴ Williams loc cit. See also Buckley and Brooke op cit 103. See also Mahmoud Sakbani, 'Comment' on Kelly and Fritz-Krockow op cit 87 *et seq.*

expected to conduct its trade policies, it is important to discuss these trends in developed market economies (DMEs) and developing countries separately. We start with DMEs.

1.1.2 *Developed market economies*

One of the defining characteristics of developed market economies (DMEs) is that they are marked by growing similarities in the broad pattern of their national economies.⁵ These economies, which currently generate more than 80 per cent of world trade as well as two thirds of world output, do not reflect the tendency towards specialisation and divergent economic structures.⁶ On the contrary, they reflect great structural convergence, not only in the distribution of output and employment between agriculture, industry and services, but also to the distribution of subsectors within industry.⁷ The structural convergence of these countries has led to a situation where cross-border trade between these countries is increasingly taking place along horizontal, intra-industry lines with countries simultaneously exporting and importing the same type of products, such as textiles for textiles or chemicals for chemicals.⁸ With intra-industry, world trade in manufactures has grown at a much faster rate than production.

Saunders [1975, p. 28]⁹ succinctly summarises the pattern of trade between developed countries when the learned writer suggests that trade between these countries

is determined only to a small extent by comparative advantage of the traditional kind. The *relative* labour costs, capital costs, etc. of manufacturing one description machine tool than another are rarely likely to be different between Britain and ...Germany. The pattern of two-way trade seems likely to be determined rather by such factors as the special technical advantages of individual producing firms, their marketing capacity, or the state of their order books, and by the particular preferences and requirements of individual customers [emphasis in the original].

The conclusion that can be drawn from this trend is that, trade in the developed industrial countries has been harmoniously coupled with an increasing fine degree of industrial

⁵ Tussie loc cit

⁶ Ibid.

⁷ Ibid.

⁸ Ibid. See also Robert Z. Lawrence, 'Trends in world trade and foreign direct investment', in Pauline H. Baker, Alex Boraine and Warren Krafchik (eds.), South Africa and the World Economy in the 1990s, David Phillip: Cape Town and Johannesburg, The Brookings Institution: Washington DC, in association with IDASA and The Aspen Institute, 1993, p. 4; Grazia Ietto-Gillies, International Production: Trends, Theories, Effects, Polity Press, Cambridge, UK, 1992, p. 23.

specialisation rather than with what Tussie¹⁰ refers to as “the threat of dislocation and ‘run away factories.’”

In his report to the United Nations Conference on Trade and Development (UNCTAD) VIII, the Secretary General of UNCTAD noted that at the root of many structural changes that are taking place in the world trading system today, technological progress - concentrated mainly in the DMEs - has been a major contributing factor.¹¹ In these countries, technology has led to increased product differentiation as well as to continual product innovation, which tends to be concentrated in larger firms that can cover the necessary capital outlays.¹² Trade in differentiated products necessarily means that DMEs compete in product style, quality or model, rather than simply price, leading to a sectorially balanced trade between these countries. This is manifested for instance by ‘the exchange of Fords for Austins and Renaults for VWs’.¹³ As can be seen, product differentiation and product innovation in DMEs have contributed to altering the nature of modern trade without necessarily affecting the geographical location of industrial plants.¹⁴

The increase in trade between developed countries has also been attributed to increase in trade by companies (Multinational Corporations (MNCs)) based in the DMEs.¹⁵ These companies have played a critical role in the ‘internationalisation of production’, by setting up new production plants and facilities in other developed countries as well as in countries outside of the DMEs.

In recent years, and in response to their slow growth and large unemployment, developed countries have increased the trade protection they provide to some of their large industries (such as textiles, steel, shipbuilding, consumer electronic products, TV sets, shoes and many other primary and agricultural products) against imports from developing

⁹ Quoted by Tussie op cit 41

¹⁰ Ibid.

¹¹ See Accelerating the Development Process: Challenges for National and International Policies in the 1990s, Report by the Secretary General of UNCTAD to UNCTAD VIII, United Nations, 1991, p. 5.

¹² Tussie op cit 43.

¹³ Ibid.

¹⁴ Ibid.

¹⁵ See Lawrence loc cit; Ietto-Gillies op cit 21.

countries.¹⁶ The growing protectionism in DMEs is against the very industries in which developing countries have gained or are gaining a comparative advantage. To ensure greater protection of their industrial sectors, DMEs adopted a variety of measures for this purpose, *inter alia*, tariff peaks, tariff escalation, voluntary export restraints (VERs), countervailing duties (CVDs) and antidumping duties (ADDs), and domestic subsidies.¹⁷ As far as agriculture is concerned, industrial countries support this sector (including fisheries and livestock) through various border and non-border measures.¹⁸ For instance, market price support schemes comprise about 80 per cent of the total support provided, and are supplemented by extensive border measures (quantitative restrictions (QRs), variable import levies, and import control by state trading entities) and domestic measures (intervention purchases and supply control measures).¹⁹

It is interesting to note that the various protection measures used by industrial countries, against developing country exports go against the traditional theory in international trade, of comparative advantage, as well as the grain of 'free trade' propagated by the DMEs in the General Agreement on Tariffs and Trade (GATT) and the World Trade Organisation (WTO).

1.1.3 Developing countries

One of the commonest characteristics of many a developing country, is that, unlike DMEs, they rely, in some cases almost exclusively, on one commodity for foreign exchange earnings²⁰ (e.g. Cuba on sugar, Zambia on copper). As a result, their exports are concentrated in primary commodities which have a low income elasticity of demand (in world markets), and are vulnerable to substitution from synthetic fibres and other materials, due to technological innovation in the industrial countries.²¹

¹⁶ Salvatore op cit 341. See also Kelly and Fritz-Krockow op cit 52; Williams op cit 17.

¹⁷ Kelly and Fritz-Krockow op cit 64.

¹⁸ Ibid.

¹⁹ Ibid.

²⁰ See *ibid.*, 60. See also Alfred W. Chanda, 'The Organisation for African Unity: an appraisal', in Zambian Law Journal, Vol. 21-24, 1989-92, p.24.

²¹ See Buckley and Brooke op cit 85. See also Williams op cit 16; Salvatore loc cit.

During the 80s and 90s, the world trading system experienced a marked decline for commodity prices.²² The decline affected mainly the poorest countries that had not diversified their structures of production. Williams²³ suggests that the two regions with the highest terms of trade²⁴ losses were Sub-Saharan Africa (SSA) and Latin America, which lost 13 and 15 per cent, respectively, of their purchasing power in real terms relative to the 1970s. Although some developing countries in Latin America and Asia (e.g. Brazil, Hong Kong, Korea, Mexico, Singapore, and Taiwan) are characterised by rapid growth in gross domestic product (GDP), in industrial production, and in manufactured exports, African developing countries, particularly SSA, have experienced very slow or negative growth in GDP, worsening terms of trade, deteriorating economic conditions, and lagging productivity.

During the 1980s, developing countries, especially those of Latin America had the huge international debt, which these countries are now finding very difficult to service, i.e. to repay. It is said that the debt arose as many developing countries borrowed heavily from private banks in developed countries to finance their growing capital needs and to pay for sharply higher oil bills during the 1970s.²⁵ In order to deal with the mounting 'debt crisis' of the 1980s, international financial institutions (the IMF and the World Bank) intervened in the economies of many indebted developing countries, and imposed various conditions through the 'structural adjustment programme'. It is argued by some economists that these programmes have played a role in hampering the development plans of developing countries.²⁶

For the developing countries as a group, the impact of falling commodity prices has been offset by an expansion in manufactured exports from the newly industrialising economies

²² Buckley and Brooke op cit 103.

²³ Loc cit.

²⁴ The 'terms of trade' of a nation are defined as the ratio of the price of its export commodity to the price of its import commodity, and that ratio is expressed in percentages. An improvement in a nation's terms of trade is usually regarded as beneficial to the nation in the sense that the prices that a nation receives for its exports rise relative to the price that it pays for imports. A deterioration in a nation's terms of trade means the opposite occurs.

²⁵ Salvatore op cit 339 - 40.

²⁶ See A.M. Mwanza (ed.), The Structural Adjustment Programme in Zambia: Lessons from Experience, Sapes Books, Harare, Zimbabwe, 1992, pp 32 *et seq.* for an exposition of how Zambia coped with the

(NIEs) of East and South Asia.²⁷ This increase in manufactured exports mainly benefited the NIEs, particularly the four 'Asian Tigers' of Hong Kong, South Korea, Singapore and Taiwan, which account for approximately 33 per cent of the developing countries' manufactured exports.²⁸ It is clear therefore, that the more developed of the developing countries were not caught in the trap of dependence on a limited number of primary commodities. The successful industrialisation strategies of the NIEs enabled them to diversify their production base and to increase, significantly, their exports of manufactured goods.²⁹

The expansion of developing country manufactured products has led to increased trade restrictions by the industrial countries. Powerful political forces (farmers and other businesspeople) have successfully persuaded governments in the developed industrial countries to enact protectionist measures against developing countries' exports as the latter group became more competitive. For instance, the Tariff and Trade Act of 1984 authorised the President of the United States to deny Generalised System of Preferences (GSP) privileges to the NICs that did not curb their own 'unfair trade practices' and 'restricted' U.S. exports.^{30 31}

Industrial countries have not only used their domestic measures to protect their industries; they have also relied on a number of international instruments. Perhaps, the classic example of an international instrument used by industrial countries for this purpose is the Multi-Fibre Arrangement (MFA). The MFA, first concluded in 1974 and subsequently renewed, extended and increased restrictions on developing countries' exports of textiles and clothing.³² Williams³³ cites the case of Bangladesh, and says that this country -which

structural adjustment programme and the impact it had on the Zambian economy.

²⁷ Williams loc cit. See also Salvatore op cit 341.

²⁸ Williams, *ibid.*

²⁹ *Ibid.*

³⁰ Salvatore op cit 341-42.

³¹ For a chilling account of how the U.S. 'punished' South Korea's 'unfair trade practices', see Walden Bello and Shea Cunningham, 'Trade warfare and regional integration in the Pacific: the USA, Japan and the Asian NICs', in Third World Quarterly, Vol. 15., September 1994, p.447 *et seq.*

³² Williams op cit 17.

³³ *Ibid.*

is one of the world's poorest countries- was subjected to restrictive MFA quotas when it developed an efficient textile industry in the 1980s.

The trade and trade-related policies of industrial countries affected developing countries in a number of ways. For instance, policies that restrict access to industrial countries' markets limited the ability of developing countries to produce and export on the basis of their comparative advantage.³⁴ It is on the basis of these and other observations that the present international trade system has been criticised as being unfair to developing countries.³⁵

In response to widespread poverty in most developing countries, and because of the widely held belief that the world economy worked in a way that was unfair to developing countries, the General Assembly of the United Nations (UN) (in June 1974) and the developing countries (through their mouthpiece, UNCTAD)³⁶ called for the creation of a so-called New International Economic Order (NIEO).³⁷ The developing countries' demands incorporated in an NIEO include (1) establishment of international commodity agreements for many commodities aimed at stabilising and increasing the export earnings of developing nations and financed primarily by developed nations, (2) preferential access in developed nations' markets to all the manufactured exports of developing nations, (3) removing trade barriers on agricultural products in developed nations, (4) increasing the transfer of technology to developing nations and regulating MNCs, (5) increasing the yearly flow of foreign aid to developing nations, and (6) allowing developing nations a greater role in international decision making.³⁸

Salvatore³⁹ records that, to date, most of these demands have remained unmet. The learned writer explains further that although developing nations do have a somewhat

³⁴ Kelly and Fritz-Krockow op cit 52.

³⁵ Salvatore op cit 42.

³⁶ UNCTAD started calling for most of the demands incorporated in an NIEO in Geneva in 1964, New Delhi in 1968, and Santiago in 1972, and were repeated in Nairobi in 1976, Manila in 1979, Belgrade in 1983, Geneva in 1987, Cartagena in 1992, (and Johannesburg (Midrand) in 1995?).

³⁷ See David B.H. Denoon, *Facing the New International Economic Order: A US Response*, NY, New York University Press, 1979 p.3 *et seq.*

³⁸ Salvatore loc cit.

³⁹ *Ibid.*, 343.

greater voice today than in the past in decision making in such international bodies as the UN, the World Bank, and the IMF, developing countries are far from controlling these crucial organisations, although they greatly outnumber developed nations.⁴⁰

1.1.4 Implications for South Africa

Padayachee⁴¹ maintains that South Africa is not a typical 'Third World' country. The learned writer points to the inherent and developed strengths of the South African economy that are impressive, despite their racially based provision and distribution as a case in point.⁴² According to Padayachee, these include its well-endowed natural resource base, especially in mineral and energy sources; its physical infrastructure (airports, harbours, railways, electricity, etc.); its sophisticated financial, banking, legal and communications network; and its lengthy and (until the mid-1980s) impeccable standing and repayment record with the IMF, World Bank and private bankers.⁴³ Despite these strengths, this country has many faces resembling a typical 'Third World' country: widespread poverty, high illiteracy and poor quality of education and training (among the African population), and rising unemployment - to mention but a few.

In the context of global trade, South Africa remains a small, open, mainly primary exporting country, which plays a marginal role in the global economy. Its share of world trade and world economic growth has been steadily reduced in the 1980s.⁴⁴ South Africa's role in world trade has been further reduced by decades of economic isolation, and the overall strength of the economy has been eroded by sanctions and apartheid economic mismanagement.⁴⁵

⁴⁰ Ibid, 345. For further reading on the position of the developing countries in the world economy of the 1990s, see Timothy M. Shaw, 'The South in the 'New World (Dis) Order': towards a political economy of Third World foreign policy in the 1990s', in *Third World Quarterly*, Vol. 15., 1994, p.17 *et seq.* See also Williams *op cit* chapters 2, 4, 5 and 6.

⁴¹ Vishnu Padayachee, 'Foreign capital and economic development in South Africa: recent trends and postapartheid prospects', in *World Development*, Vol. 23., February 1995, p.171.

⁴² Ibid.

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ Ibid.

Trends in world trade in the 1990s discussed above, will obviously affect South Africa's trade and investment prospects adversely, as they will those of other highly open developing countries.⁴⁶ For instance, South Africa's impressive minerals and metals base will be affected by a continued decline in demand for such products from Western industrialised countries,⁴⁷ and its minerals are likely to be quoted at a discount with the opening of supplies from the former Soviet Union.⁴⁸ South African agricultural products are not likely to receive any special treatment than that accorded to the rest of the developing countries. The same protectionist practices prevailing in industrial countries will be used against South Africa's agricultural exports. As a matter of fact, the main concern underlying the refusal of EU countries to admit South Africa as a full member of the Lome Convention, is based on the fear that, South Africa's otherwise 'strong' agricultural exports will have a negative impact on the incomes of many a farmer in the EU.⁴⁹

The manufactured exports of the NICs are already facing pervasive barriers to entry into markets of industrial countries. Even if South Africa, like the NICs, succeeds in diversifying its production base, protectionist policies of the developed countries will surely hamstring any efforts to get these exports into the markets of the 'North'.

Considering the prevailing trends in world trade, it would seem that the only solution (?) to the international trade problems of the developing countries (including South Africa), is to devise policies that will foster and expand trade amongst developing countries themselves; the so-called 'South-South' economic/trade dialogue. If this is the way developing countries should pursue, South Africa should seek to foster trade and other links with the African continent and other developing countries in Latin America and Asia. South Africa's trade and diplomatic relations with countries such as Libya, the

⁴⁶ Ibid.

⁴⁷ Ibid.

⁴⁸ This point is made by Sam Nolutshungu quoted by John Daniel, 'South Africa's role in the changing world and its impact on the region', in Minnie Venter (ed.), Prospects For Progress: Critical Choices for Southern Africa, Maskew Miller Longman, Cape Town, 1994, p.28.

⁴⁹ This concern has not only been raised by industrial countries. Some developing countries belonging to the Lome Convention have expressed concern that if South Africa is given full membership of Lome, its agricultural exports are likely to 'out-compete' theirs, with the result that South Africa will be unduly

Islamic Republic of Iran, and the Peoples' Republic of China (PRC), will invariably open 'a window of opportunity' for exports to these emerging markets, particularly the large market of China.

1.2 Trends in foreign direct investment

1.2.1 Introductory remarks

The United Nations Centre on Transnational Corporations (UNCTC) reports that since 1983 foreign-direct-investment-outflows have increased at an unprecedented rate of 29 per cent *per annum*, three times faster than that of the growth of exports and four times that of the growth in world output.⁵⁰ However, like world trade, the rapid increase in world FDI (since 1983) has been unequally distributed between developed and developing countries.⁵¹ For instance, by the end of the 1980s, the developed world accounted for 75 per cent of the world's foreign-direct-investment-flows, while the developing countries' share fell from 26 per cent to 21 per cent during the same period.⁵²

The reasons for this rapid increase in FDI in the world economy are many and diverse. We consider only a few. First, the 1991 UNCTC Report and other writers such as Calvo, Leiderman and Reinhart⁵³ attribute the rapid increase in world FDI to the changes in the world business cycle. According to Calvo *et al.*,⁵⁴ the early 1990s brought recessions in the US, Japan and many countries in Europe. This swing of the international business

benefited at the expense of the agricultural exports from other 'less fortunate' developing countries.

⁵⁰ World Investment Report: The Triad in Foreign Direct Investment, UN, NY, Sales No. E. 91. II. 12, 1991, p.3. (hereinafter 'The 1991 UNCTC Report'). See also Lawrence op cit 2 and 4. Vincent Cable, 'The new trade agenda: universal rules amid cultural diversity', in International Affairs, Vol. 72., April 1996, p.235. De Anne Julius, Foreign Direct Investment: The Neglected Twin of Trade, Occasional Paper 33, Group of Thirty, Washington DC, 1991, p.4 *et seq.* Kelly and Fritz-Krockow op cit 55.

⁵¹ Williams op cit 21.

⁵² *Ibid.* See also Heinz Bachmann and Ken Kwaku (eds.), MIGA Roundtable on Foreign Direct Investment Policies in Africa: Proceedings and Lessons, Policy and Advisory Services, Multilateral Investment Guarantee Agency, World Bank, Washington DC, 1994, p.13.

⁵³ Guillermo A. Calvo, Leonardo Leiderman, and Carmen M. Reinhart, 'Inflows of capital to developing countries in the 1990s', in Journal of Economic Perspectives, Vol. 10., Spring 1996. p.126 *et seq.* (hereinafter 'Calvo *et al.*').

⁵⁴ *Ibid.*, 127. See also the 1991 UNCTC Report op cit 4.

cycle, so argues Calvo *et al*, made profit opportunities in developing countries appear relatively more attractive, thus causing more capital inflows to the developing countries.⁵⁵

The 1991 UNCTC Report⁵⁶ on the other hand maintains that the economic spin-offs of the world economic recovery in the 1980s resulted in the improved economic performance of several developing countries, particularly those experiencing debt-servicing problems, as the economic recovery reversed some factors which had been inhibiting foreign investment in the first half of the 1980s, such as the ability of investors to repatriate profits.⁵⁷

Secondly, during the 1980s, the number of developed countries that became significant outward investors increased, and this process led to the erosion of the established positions of the US and the UK.⁵⁸ The most important of the new outward investors mentioned by the 1991 UNCTC Report is Japan. In addition, a number of East Asian NICs who, like Japan, faced current account surpluses, appreciating currencies and rising production costs at home and protectionist policies in their export markets, emerged as significant outward investors.

Thirdly, the world trading system in the 1990s, experienced a marked rise of the services sector.⁵⁹ According to Lawrence,⁶⁰ the rise of the services sector, coupled with a strong trend towards financial liberalisation, privatisation and deregulation (*inter alia*, on the movement of capital flows⁶¹) created investment opportunities in sectors such as banking,

⁵⁵ *Ibid.* For a discussion of how lower interest rates in the developed countries (particularly in the US during the early to mid 1990s) affected capital flows to developing countries, see *ibid.*, 126.

⁵⁶ *Loc cit.*

⁵⁷ This view is also shared by John T. Cuddington, Hong Liang and Shihua Lu, 'Uncertainty, trade and capital flows in Sub-Saharan Africa', in African Economic Research Consortium Plenary Sessions 1994-95, Journal of African Economies, Supplement to Volume 5., Part 1, Oxford University Press, 1996, p.200 who suggest that the so-called 'push factors' (e.g. financial liberalisation) and 'pull factors' (e.g. removal of capital controls and liberalisation of restrictions on FDI) were responsible for renewed capital flows to developing countries during the early 1990s.

⁵⁸ 1991 UNCTC Report *loc cit.*

⁵⁹ See the 1991 UNCTC Report *op cit* 5; Lawrence *op cit* 4-5; Cable *op cit* 228.; and Letto-Gillies *op cit* 25-26.

⁶⁰ *Loc cit.*

⁶¹ See 1991 UNCTC Report *loc cit.*

communications, utilities and transportation in which investment opportunities for foreigners were once relatively limited.⁶²

Fourthly, technological progress has been at the root of almost all structural changes taking place in the world trade system in the 1990s.⁶³ According to the Secretary General of UNCTAD,⁶⁴ the technological revolution of the 1990s, characterised in the main by advances in microelectronics, but also encompassing new materials, biotechnology and renewable energy, has had a profound impact on world economic activity and international economic relations. The Secretary General believes further that technological progress has given fresh impulse to economic integration, both global and regional, and to changes in pattern of production and exchange in many fields, including information and communications and, in varying degrees, transportation, manufacturing and agriculture.⁶⁵

The above mentioned trends and causes of rapid increase in world FDI, notably, the 'internationalisation' process of financial markets, the advances in computer and telecommunications technology, coupled with the trend towards abandonment of many financial regulations have led to what is now commonly referred to as the 'globalisation of the world economy and markets'.⁶⁶

We turn now to discuss trends in FDI in four of the world's major regions separately, namely, DMEs; Central and Eastern Europe and the former USSR; East, South and South East Asia; and developing countries (Africa and Latin America). It is important to do so for the reader to have a fuller appreciation of how FDI has fared in individual regions. It will be demonstrated that although a bird's view of trends in world FDI shows a rapid increase, various regions of the globe have had different and sometimes conflicting experiences regarding the expansion of world FDI.

⁶² See also the Report of the General Secretary of UNCTAD to UNCTAD VIII op cit 5 and 7.

⁶³ Ibid.

⁶⁴ Ibid.

⁶⁵ Ibid.

⁶⁶ For a caustic criticism of the 'globalisation process', see Manfred Bienefeld, 'The New World Order: echoes of a new imperialism', in *Third World Quarterly*, Vol. 15., 1994, p.35 *et seq.* who argues that the process of globalisation of world markets is far more harmful to the poorer and poorest nations of the world, than is normally perceived.

1.2.2 *Developed market economies*

The rapid increase in FDI in the 1990s has, to a large extent, been accounted for by companies (MNCs)⁶⁷ based in DMEs.⁶⁸ Whilst the US was by far the largest foreign investor during the greater part of the 1970s and 1980s,⁶⁹ in recent years, that country emerged as the world's largest new absorber of direct investment.⁷⁰ Cheru⁷¹ maintains that Europe has replaced the US as the world's leading foreign investor. The European countries that have been leading role players in this regard include the UK, the Netherlands, France, Germany, and Austria. One of the prominent OECD countries that is currently an important player in international investment flows is Japan. According to Cheru,⁷² whilst by 1988, the EU (not including intra-EU foreign direct investment) was at parity with the US in terms of stock, Japan on the other hand was (and still is) investing more abroad than the US in terms of flows.⁷³

The DMEs are the main sources of FDI and foreign-direct-investment-outflows from these countries have been growing.⁷⁴ For instance, foreign-direct-investment-outflows from DMEs grew by 38 per cent annually after 1985, and reached \$187 billion in 1987.⁷⁵ According to the 1991 UNCTC Report,⁷⁶ the five major home countries (France, Federal Republic of Germany (before October 1990), Japan, UK and US) maintained their 70 per

⁶⁷ See V.N. Balasubramanyam, 'Foreign direct investment and technology transfer', in David Greenaway (ed.), *Current Issues in International Trade: Theory and Policy*, MacMillan Publishers Ltd, London, 1985, p.160 who suggests that a multinational corporation/enterprise is an enterprise that owns or controls production facilities in more than one country. At 160, the learned writer quotes Raymond Vernon who defines an MNE as '... a parent company that controls a large cluster of corporations of various nationalities'. Vernon (in the same quotation) observes that '[T]he corporations that make up each cluster appear to have access to a common pool of human and financial resources and seem responsive to elements of a common strategy'.

⁶⁸ See also Lawrence op cit 4; Ietto-Gillies op cit 21.

⁶⁹ Ietto-Gillies loc cit; See also Donald A. Ball and Wendell H. McCulloch Jr, *International Business: Introduction and Essentials (5th ed.)*, IRWIN, Boston, Massachusetts, 1993, p 44; Julius op cit 9.

⁷⁰ Fantu Cheru, 'Africa and the new world order: rethinking development planning in the age of globalisation', in Adebayo Adedeji (ed.), *South Africa: Within or Apart?*, African Centre for Development and Strategic Studies, SADRI Books, Cape Town, Zed Books, London and New Jersey, 1996, p.56.

⁷¹ Ibid.

⁷² Ibid.

⁷³ See also Ietto-Gillies loc cit.

⁷⁴ The 1991 UNCTC Report op cit 9. See also Williams loc cit. 21.

⁷⁵ The 1991 UNCTC Report loc cit.

⁷⁶ Ibid.

cent share of total outflows throughout the 1980s. Over the 1980 - 89 period, the UK, the US and Japan were the largest home countries for outflows during this period,⁷⁷ with the UK been the largest home country for the period overall, with annual outflows of \$17 billion (i.e. 20% of world outflows).⁷⁸ An interesting development came with Japan. The 1991 UNCTC Report⁷⁹ suggests that outflows from Japan have exceeded those from UK in 1989, with the result that Japan replaced the UK as the largest source country of investment flows, accounting for 23 % of total world-wide outflows in that year.

The DMEs are also, by far, the major recipients of FDI, and over the years their share has been increasing.⁸⁰ For instance, foreign-direct-investment-inflows to developed countries have grown at an average annual ratio of 46% since 1985, and reached a value of \$163 billion in 1989.⁸¹ Again, the share of developed countries in world-wide inflows increased to 81% in the 1985-89 period, up from 75% in the 1980-84 period.⁸² According to the Report,⁸³ the same five major countries (France, Germany, Japan, UK and US) - except for Japan - are also among the largest host countries, with an average share of 57% in world inflows during the 1980s.

As can be seen, the trends in FDI in DMEs follow the pattern and trends in world trade in these countries. Given the uneven distribution of world trade and FDI among the various groupings of countries, one consequence of this trend is that the most dynamic developments in the world economy are bypassing a large section of the world's community; notably, the majority of 'Third World' countries.

1.2.3 Central and Eastern Europe and the former USSR

The dramatic and unforeseen developments that took place in Central and Eastern European countries,⁸⁴ following the process of *perestroika* and *demokratizatsia* in the

⁷⁷ Ibid.

⁷⁸ Ibid.

⁷⁹ Ibid.

⁸⁰ Jetto-Gillies op cit 23. See also Williams loc cit.

⁸¹ The 1991 UNCTC Report loc cit.

⁸² Ibid.

⁸³ Ibid.

⁸⁴ These countries are normally referred to as 'the Second World' or 'countries in transition'.

former Soviet Union, let to the introduction of democratic forms of government in place of existing regimes, and encompassed the re-unification of Germany in 1990. The democratisation process was accompanied by far reaching institutional changes, rapid moves to market-based economic systems and further integration into the world economy.

These countries took immediate steps to realise their market reforms and rejuvenation of their economies that were characterised by, *inter alia*, stagnation, lack of capital and consumer goods. By the end of 1990, virtually all countries in central and eastern Europe had passed legislation encouraging FDI, and several countries had passed privatisation laws.⁸⁵ In the case of the former Soviet Union, in 1990, that country allowed foreign investors 100% ownership of foreign enterprises and guaranteed profit repatriation.⁸⁶ Still staying with the former Soviet Union, Boris Yeltsin (beginning in January 1992) initiated a series of bold reforms (affecting enterprises) amongst which the following were critical: '(1) price liberalisation; (2) devolution of authority over production and sales from ministries to enterprises; (3) legalisation of private property, including the privatisation of state enterprises; and (4) hardening of budget constraints, thereby introducing the possibility of bankruptcy'.⁸⁷

The above mentioned developments in eastern and central Europe and former USSR have made most of these countries quite attractive to foreign investors. Compared to other developing countries, these countries represent large domestic markets with relatively high purchasing power and consumer demand, as well as untapped business opportunities. In addition, they have a highly skilled labour force and plenty of natural resources, particularly in the former USSR.⁸⁸ It is therefore not surprising to note that there has been an increasing proliferation of joint ventures (JVs) between transnational

⁸⁵ See Melanie Lansbury, Nigel Pain and Katerina Smidkova, 'Foreign direct investment in central Europe since 1990: an econometric study', in National Institute Economic Review, National Institute of Economic and Social Research, Vol., 2., London, May 1996, p.107.

⁸⁶ The 1991 UNCTC Report op cit 14.

⁸⁷ Kathryn Hendly, 'The role of law in the Russian economic transition: coping with the unexpected in contractual relations', in Wisconsin International Law Journal, Vol.14., Summer 1996, p.632.

⁸⁸ The 1991 UNCTC Report loc cit.

corporations (TNCs) from DMEs and enterprises in eastern and central Europe.^{89 90} The Western TNCs view transnational JVs as a way of penetrating into eastern Europe and having access to its high skill, low-cost labour force.⁹¹ The eastern European countries on the other hand view JVs as a way of penetrating new markets and as a source of access to new technology, managerial and marketing skills, external financial resources as well as equity capital.⁹²

The number of registered JVs in Bulgaria, Czechoslovakia (before the break up), Hungary, Poland, Romania and the (former) USSR grew rapidly in 1990, reaching 13 120 by the beginning of 1991, compared to 3287 at the beginning of 1990, with Hungary surpassing the (former) USSR with number of registrations.⁹³ In Yugoslavia (before the break up), the number of registered JVs was about 3000 at the beginning of 1991.⁹⁴

⁸⁹ Chi-Chao and Eden S.H. Yu, 'Are wholly foreign owned enterprises better than JVs?', in Journal of International Economics, Vol. 40., 1996, p.225.

⁹⁰ Letto-Gillies op cit 31 explains the nature of JVs, what they entail, their advantages etc.. As the learned writer explains. 'The term JV refers to a partnership between two or more enterprises in a specific business 'venture'. The partnership may involve both equity and management participation and can be on the basis of equal or different shares for the partners. It can involve the setting up of new production facilities or the buying of existing ones. The advantages for individual companies over other forms of involvement are many and include the following:

- (1) lower risk, as the risk of a particular investment is spread among the participants;
- (2) the possibility of using complementary resources, skills and know-how on the part of participating enterprises;
- (3) the avoidance of competition in a particular market;
- (4) ease of penetration into a particular market or country. In some countries JVs with a domestic enterprise may be the only acceptable entrance route for a foreign TNC;
- (5) easier repatriation of profits for the TNC concerned;
- (6) the opening up of further possibilities for production and marketing in a new country;
- (7) flexibility with regard to the equity share, which can vary from case to case and can vary for the same venture through time according to the agreement between the participating companies: the new venture can be set up or closed down without excessive disturbance to the main corporate structure and organisation.'

⁹¹ See Bruce London and Robert J.S. Ross, 'The political sociology of foreign direct investment: global capitalism and capital mobility 1965-1980', in International Journal of Comparative Sociology, Vol. 36., December 1995, p.198 *et seq.*, where the learned writers argue that it is in fact the nature of capital to move out of the core-areas to non-core areas in search of low-cost labour. See also Dani Rodrik, 'Coordination failures and governments policy: a model with applications to East and Eastern Europe', in Journal of International Economics, Vol. 140., No. 1/2 February 1996, p.1 *et seq.* where the learned writer discusses some of the policy options open to countries such as those in Eastern Europe with skilled labour force in order to realise economic growth.

⁹² Letto-Gillies op cit 31 - 32. See also Ball and McCulloch op cit 63.

⁹³ The 1991 UNCTC Report loc cit.

⁹⁴ See Lansbury *et al* op cit 104 *et seq.*

According to the 1991 UNCTC Report,⁹⁵ foreign equity capital in JVs (in Eastern European countries), with domestic partners is concentrated in the manufacturing sector. In Poland and Hungary (the two main host countries), foreign capital in the manufacturing sector accounted for over 60% of the total foreign capital during the 1990s, while the remaining share was in the services sector, mostly in finance, trade, transport, storage and communications.

More than half of the total number of JVs and foreign equity participation in these countries originate from countries in western Europe, particularly the EU and Austria and to a lesser extent, the US. The 1991 UNCTC Report⁹⁶ maintains that these home countries are likely to remain the largest investors in the years to come, although several Japanese companies are reported as having indicated that they plan to invest considerable amounts in central and eastern European countries.

Although Eastern Europe has seen a plethora of JVs from 1990 onwards, only a few of these ventures have begun operations. In fact, it is reported⁹⁷ for example, that less than 10% of these ventures have actually begun operations in the former USSR. The rapid increase in the number of JVs in these countries, was based upon the assumption (on the part of western governments and some international institutions) that private FDI would play a key role in the transition process, and that this would obviate the need for official assistance on the scale of the Marshall Plan for example.⁹⁸ The net inflow of FDI into Eastern Europe has been much less than was expected - or hoped for - by both western and eastern governments.⁹⁹ For instance, in 1993, the total of net inflow of FDI into these countries is estimated to have been some \$ 3.5 billion, and that since 1990 the total inflow has been less than \$ 10 billion (for nine countries).¹⁰⁰ Most of the investment is concentrated in a few countries; the four 'advanced' transition economies have received

⁹⁵ Loc cit. See also Ietto-Gillies loc cit.

⁹⁶ Op cit 14 - 15.

⁹⁷ Ibid.

⁹⁸ United Nations Economic Commission for Europe, Economic Survey of Europe in 1993-1994, New York, 1994, p.5 (hereinafter 'The 1994 UNECE Report'). See also United Nations Economic Commission for Europe, Economic Survey of Europe in 1994 -1995, New York, 1995, p.14. (hereinafter 'The 1995 UNECE Report').

⁹⁹ The 1994 UNECE Report loc cit.

over 90% of the total since 1990, with most of it (80%) going to Hungary and the Czech Republic.

The poor performance of transition economies in attracting fixed investment is attributable to a number of factors, particularly the situation of uncertainty created by fundamental socio-economic and political changes that took place in those countries in the early 1990s. The rapid breakdown of the old command systems and their gradual replacement by the institutional framework of the market economy have created a situation of pervasive uncertainty in which the risks of investments are very high.¹⁰¹ The 1994 UNECE Report¹⁰² states that in many of the transition economies there is still a lack of clarity about property rights and their enforceability and, in general, the legal framework is still too weak to support a sustained expansion in private economic activity.¹⁰³ Whether the immediate removal of these stumbling blocks (in the way of FDI in transition economies) will have a positive impact is still a matter to be investigated.

1.2.4 East, South, and South East Asia

¹⁰⁰ Ibid.

¹⁰¹ See Erik C.F. Offerdal, 'Taxation of foreign direct investment', in Vito Tanzi, Fiscal Policies in Economies in Transition, IMF, Washington DC, 1992, p.233-34. See also Guy Pfeffermann, 'Facilitating foreign investments: some dos and don'ts', in Finance and Development, March 1992, p.46.

¹⁰² Op cit 4.

¹⁰³ Some of the factors mentioned by the 1994 UNECE Report pp.4 - 5, which have hampered fixed investment in transition economies include, high rates of inflation, political instability (Yugoslavia is a case in point), uncertainties over the macroeconomic outlook and the future level of demand, and other operational problems. The impact of the legal system on capital flows is also discussed by Andrei Shleifer, 'Establishing property rights', in Proceedings of the World Bank Annual Conference on Development Economics 1994, The International Bank for Reconstruction and Development, The World Bank, Washington DC, 1995, p.93 *et seq.* who suggests that (and here the learned writer refers to transition countries in central and eastern Europe) the establishment of secure property rights will go a long way in solving the problems of inefficient structures of control rights over assets (by bureaucratic or state machinery) and poor contract enforcement (through bribery). See also the comment of Michael J. Scown, 'Laying down the law', in Far Eastern Economic Review, Vol.5., October 1995, p.31 on the impact of Vietnamese laws on foreign-direct-investment-outflows in that country (Vietnam).

Foreign-direct-investment-flows to East, South and South-East Asia (hereinafter referred to as 'East Asia') have been increasing steadily since 1985.¹⁰⁴ In 1986 East Asia surpassed Latin America and the Caribbean for the first time as the largest host region for foreign-direct-investment-flows in the developing world.¹⁰⁵ Further, towards the end of the 80s, over half of all foreign-direct-investments-flows to developing countries went for East Asia.¹⁰⁶ A number of reasons explain the continuous increase of FDI in that part of the world; *inter alia*, these countries are quite attractive to foreign investors in the sense that their economies have been growing consistently since the 1980s, at the average rate of 6% *per annum*; intra-regional FDI became increasingly important for East Asia, particularly in the 1980s, when these countries emerged as important investors seeking new low-cost production locations in neighbouring countries in order to maintain their competitiveness in export markets;¹⁰⁷ the emergence of China as an important host country influenced many foreign investors to invest in that region with the hope of taking advantage of the 'largest market' in the world: China.¹⁰⁸

Thomas and Yan¹⁰⁹ suggest that the successes of East Asian countries are not only attributable to intra-regional trade and investment flows, but also to 'superior' public policy framework adopted by these countries. In fact, the governments of East Asia are known for their active intervention in their economies through various means. For

¹⁰⁴ See the 1991 UNCTC Report op cit 12.

¹⁰⁵ Ibid. See also Vinod Thomas and Yan Wang, 'Distortions, interventions, and productivity growth: Is East Asia different?', in Economic Development and Cultural Change, Vol. 44., January 1996, p.265 *et seq.*

¹⁰⁶ The 1991 UNCTC Report loc cit.

¹⁰⁷ Ibid.

¹⁰⁸ See Margaret M. Pearson, Joint Ventures in the People's Republic of China: The Control of Foreign Direct Investment under Socialism [Princeton, New Jersey, Princeton University Press, 1991] in Economic Development and Cultural Change, Vol. 44., October 1995, p.230 (Book Review) who maintains that China's seemingly contradictory policy - of maintaining a controlled socialist economy, in which private ownership of the means of industrial production remained severely limited, yet at the same time maintaining an open economy, in which market forces and foreign investment played a significant role - continued to attract foreign investors who wanted to have access to the huge China market, in the face of strict controls over foreign exchange by the Chinese government. See also Chi-Chur Chao and Eden S.H. Yu op cit 226. Peter Nolan, 'Large firms and industrial reform in former planned economies; The case of China', in Cambridge Journal of Economics, Vol. 20., January 1996, pp.1-29, where the learned writer argues that the economic reforms pursued by China, although not properly understood by the West, make perfect sense from an economic point of view.

¹⁰⁹ Op cit 266.

instance, countries like South Korea have stringent labour laws that restrict labour union activity, and in some cases outlaw it; a situation that may be attractive to foreign investors who may wish to invest in labour intensive production activities!¹¹⁰

Developing countries in Asia received an estimated \$ 66 billion in foreign-direct-investment-flows in 1991-93, roughly half of the total flow to developing countries.¹¹¹

East Asian countries that were destination for FDI during this period are Malaysia, Singapore, Thailand and Indonesia, with China being the largest recipient, accounting for more than 40% of the inflows to Asia.¹¹²

1.2.5 Developing countries (*Latin America and Africa*)

1.2.5.1 *Latin America*

¹¹⁰ Although stringent labour laws may have worked well in other East Asian countries, the current (January 1997) unrest in South Korea generated by the same stringent laws (outlawing union activity and giving the 'bosses' the right to 'fire' workers at will) is a manifestation of the fact that, in the long run, 'oppression of workers' is not in the long term interest of any country that wishes to attract FDI.

¹¹¹ Steven Dunaway *et al*, 'Private market financing for developing countries', in World Economic and Financial Surveys, IMF, Washington DC, March 1995, p.35. See also Vittorio Corbo and Leonardo Hernandez, 'Macroeconomic adjustment to capital flows: Lessons, from recent Latin American and East Asian experience, in Moshe Syrquin *et al* (eds.), The World Bank Research Observer, Vol. 11, February 1996: p.61.

¹¹² Dunaway *et al* loc cit. See also Calvo *et al* op cit 123.; Mohsin S. Khan and Carmen M. Reinhart (eds.), Capital Flows in the APEC Region, Occasional Paper 122, IMF, Washington DC, March 1995, p.1. For a detailed discussion of capital flows to East Asian APEC region, see the following articles that are all in Mohsin S. Khan and Carmen M. Reinhart (eds.), Capital Flows in the APEC Region, Occasional Paper 122, IMF, Washington DC, March 1995:

- (a) Shogo Ishii and Steven Dunaway, 'Portfolio capital flows to the developing country members of APEC', p.3 *et seq*.
- (b) Mohsin S. Khan and Carmen M. Reinhart, 'Macroeconomics management in APEC economies: The response to capital flows', p.15 *et seq*;
- (c) David Folkerts-Landau *et al*, 'Effect of capital flows to the domestic financial sectors in APEC developing countries', p.31 *et seq*.

While net inflows of FDI to developing countries¹¹³ have been rising rapidly since the mid-1970s, this upward trend was marked by substantial fluctuations.¹¹⁴ Although many countries have experienced increases in foreign-direct-investment-flows, the latest upturn has been concentrated in only a few countries in Latin America. These countries - Brazil and Mexico¹¹⁵ - accounted for over 60% of all foreign-direct-investment-flows to developing countries between 1971 and 1981, while at the end of the 1980s, 63 per cent of the total stock of FDI in developing countries was held in five countries: Brazil, Mexico, (China and Malaysia in Asia) and Egypt (in Africa).¹¹⁶ Between 1990 and 1993, the bulk of foreign-direct-investment-flows went to two regions: Latin America and Asia.¹¹⁷

In Latin America, the total inflow of FDI doubled after 1990, and reached a figure of \$ 15 billion in 1992 before declining to the level around \$ 13 billion in 1993.¹¹⁸ Mexico and Argentina received approximately 75 per cent of the total foreign-direct-investment-inflows to Latin America during that period, with Chile, Venezuela, Brazil, and Colombia accounted for a large share of the remainder.¹¹⁹

Foreign-direct-investment-flows are not the only type of foreign capital that went to developing countries in the 1990s. There has also been an increase in foreign portfolio investment (FPI) as well.¹²⁰ According to Claessens,¹²¹ the increase in FPI is attributable to increased liberalisation of domestic financial markets, and to the opening up of markets to foreigners as capital controls and other barriers were removed in the developing countries. The increased flow of FPI to developing countries took the form of easily tradable securities - bonds, equities, and other negotiable instruments.¹²² Claessens maintains that from 1989 to 1993, total portfolio flows (bonds, certificates of deposit,

¹¹³ Including those developing countries in East Asia.

¹¹⁴ Steven Dunaway *et al* loc cit.

¹¹⁵ Including Indonesia in East Asia.

¹¹⁶ Steven Dunaway *et al* loc cit.

¹¹⁷ See Williams op cit 20.

¹¹⁸ *Ibid.*

¹¹⁹ *Ibid.*

¹²⁰ For an explanation of the differences between the two types of foreign capital, see chapter 2.

¹²¹ Stijn Claessens, 'The emergence of equity investment in developing countries: Overview', in Moshe Syrquin (ed.), *The World Bank Economic Review*, Vol. 9., January 1995, p.1.

commercial papers, and equity) increased more than sevenfold to a level of \$ 55.8 billion, and that these flows now account for about a third of overall net resource flow to developing countries.¹²³ Equity flows represented about a quarter of the total net external financing of Mexico in 1991 and 1992.¹²⁴

The reasons for increased equity flows¹²⁵ to developing countries in the 1990s are many and diverse. Ishii and Dunaway¹²⁶ suggest that the decline in global interest rates in the 1990s, and improved domestic policies¹²⁷ and better growth performance in the recipient developing countries, resulted in higher rates of return on equity. The learned writers suggest further that, with the process of globalisation of world markets, many developing countries (particularly in Latin America) and countries in transition removed barriers and restrictions on foreign ownership, liberalised capital account transactions, improved their accounting and information standards, and thus made it easier for foreigners to access their markets.^{128 129}

¹²² Ibid.

¹²³ Ibid. See also Masood Ahmed and Sudarshan Cooptu, 'Portfolio investment flows to developing countries', in Finance and Development, March 1993, p.9 *et seq.*

¹²⁴ Claessens, *ibid.*, 3.

¹²⁵ In the form of direct equity purchases by investors in the host stock markets, investment through country funds, direct foreign equity offerings, etc..

¹²⁶ *Op cit* 4.

¹²⁷ Calvo *et al* *op cit* 127 say that a number of Latin American countries began to adopt sound monetary and fiscal policies as well as market-orientated reforms that have included trade and capital market liberalisation. For example, Bolivia, Chile and Mexico implemented major disinflation stabilisation programs in the late 1980s, while Argentina, Brazil, Equador, and Peru have done so during the early 1990s. The learned writers maintain that an effective inflation stabilisation program can reduce macroeconomic risks and stimulate capital inflows. According to Calvo *et al*, the increase in capital flows to Latin American countries can also be attributed to the so-called 'contagion effect' (which presupposes that a large shift in capital flows to one or two large countries in a region may generate externalities for the smaller neighbouring countries). If this is indeed a possibility, then it could be concluded, so Calvo *et al* argue, that Mexico's and Chile's re-entry into international capital markets in 1990 had made foreign investors more familiar and more willing to invest in other emerging markets in Latin America.

¹²⁸ Claessens *op cit* 4.

¹²⁹ Claessens, *ibid.*, 14 suggests that '[E]quity portfolio flows can benefit developing countries by diversifying the sources of external finance, increase the risk-bearing by investors, reducing the cost of capital, improving incentives for managing the investment process, assisting in the development of domestic capital markets, and enhancing the mobilisation of domestic resources'.

For further reading on determinants and consequences of capital flows, see the following articles in Determinants and Systemic Consequences of International Capital flows, A Study by the Research Department of the IMF, Occasional Paper 77, IMF, Washington DC., March 1991:

(a) Morris Goldstein, Donald J. Mathieson and Timothy Lane, 'Determinants and systemic

1.2.5.2 Africa

While developing countries in Asia and Latin America have been experiencing a continuous rise of foreign capital flows since the late 1980s, Africa on the other hand experienced a decline in foreign-capital-flows during the same period.¹³⁰ For instance, Africa's share of world FDI fell from 6.7 per cent in 1975 to 1.9 per cent in 1989.¹³¹ It is reported¹³² that in 1987 Singapore alone attracted more direct investment than the entire African continent. In 1991 - 93 annual flows to Africa were largely unchanged, with almost all the funds going to (oil-rich) Nigeria and South Africa.¹³³

The two regions of Africa, Northern Africa (including Morocco, Algeria, Tunisia, Libya and Egypt) and Sub-Saharan Africa, show marked differences in their economic development. The former economies are not chronically depressed, while the latter group (with the possible exception of Nigeria and South Africa) is plagued by, *inter alia*, lack of a good industrial base and institutional organisations, shortage of financial capital, unfavourable debt positions, political instability (Rwanda, Burundi, and recently Zaire are cases in point), unfavourable terms of trade for primary products (except oil and precious metals), and pockets of inflation. Needless to say, this part of Africa has not been an attractive destination for foreign investment, with the result that there has in fact, been no significant growth of investment in this region.¹³⁴ Daniel¹³⁵ states that in 1993 Sub-Saharan Africa's share of world trade (and hence direct investment) was a mere 0.7% of which South Africa alone contributed 0.5%. Williams¹³⁶ on the other hand holds the view

consequences of international capital flows', p.1 *et seq.*;

(b) David Folkerts-Landau, 'Systemic financial risk in payment systems', p.46 *et seq.*;

(c) Lilian Rojas-Suares, 'Risk and capital flight in developing countries', p.83 *et seq.*

¹³⁰ Williams *op cit* 21. See also John Daniel, 'Southern Africa in a global context: forever in the slow lane?', in The South African Journal of International Affairs (incorporating International Affairs Bulletin), Vol. 4., Summer 1996, p.88.

¹³¹ Williams, *ibid.*

¹³² See Daniel, *fn 130 supra*.

¹³³ Steven Dunaway *et al op cit* 36.

¹³⁴ See Klein *op cit* 232 *et seq.* See also Bienefeld *op cit* 37.

¹³⁵ *Loc cit* *fn 130 supra*.

¹³⁶ *Loc cit*.

that this trend is likely to continue in the 1990s unless the stumbling blocks to FDI in these countries are removed.¹³⁷

1.3 Trends in regional integration

1.3.1 Introductory remarks

South Africa was introduced to a larger family of nations (following the first all-inclusive general election in April 1994) at the time when the world trading system was experiencing a proliferation of new regional trading arrangements (RTAs), and many existing ones were been given fresh impetus.¹³⁸ These RTAs came in a variety of packages, with varying degrees of internal liberalisation and alternative external commitments. The arrangements took diverse forms, *inter alia*, Free Trade Areas (FTAs),¹³⁹ Customs Unions (CUs),¹⁴⁰ Common Markets (CMs),¹⁴¹ and Economic Unions

¹³⁷ For a discussion of some of the obstacles to increased FDI to developing countries (in this case, the least developed ones) see Julius op cit 14 *et seq.*

¹³⁸ See Jaime de Melo and Arvind Panagariya, 'The new regionalism', in *Finance and Development*, Vol. 29., December 1992, p.37 *et seq.* See also B.D. Nomvete, 'Regional development and economic co-operation in Africa', in D.J.J. Botha *et al* (eds.), *The South African Journal of Economics*, Vol. 61., December 1993, pp.242-43. Gary P. Sampson, 'Compatibility of regional and multilateral trading arrangements: reforming the WTO process,' in *The American Economic Review*, Papers and Proceedings of the Hundredth and Eighth Annual Meeting of the American Economic Association, San Francisco, CA, January 5-7, May 1996, p.88 *et seq.* where he gives a birds-view account of the issues which RTAs deal with.

¹³⁹ In principle an FTA is an RTA where the member states remove all trade impediments among themselves but retain their freedom with regard to the determination of their policies *vis-à-vis* the outside world (the non-participants) (Ali M. El-Agraa, 'International economic integration', in David Greenaway (ed.), *Current Issues in International Trade: Theory and Policy*, MacMillan London, 1985, p.183). See also *World Economic and Financial Surveys*, International trade policies: The Uruguay Round and Beyond, Vol. II, Background Papers prepared by the team led by Naheed Kirmani, IMF, Washington DC, 1994, p.89 (hereinafter 'Kirmani *et al*'), where it is stated that in an FTA, rules of origin establish conditions under which an item qualifies for preferential access within the area. Kirmani *et al* maintain that some FTAs have recently included provisions to liberalise investment rules, service trade, government procurement, and have taken steps to achieve greater economic integration. Provisions for factor mobility are not included, except perhaps in the context of facilitating services trade. The learned writers further refer to article XXIV of GATT, which defines an FTA as an arrangement that seeks to eliminate duties and other restrictions on 'substantially all the trade' between members states, but point out that, in practice, however, FTAs typically include a number of sectoral

(EcUs).¹⁴² Other arrangements entail only an agreement on preferential trade, and economic co-operation.

The GNU under the leadership of the African National Congress (ANC), will no doubt pursue economic, political and diplomatic ties with other countries in Africa, the Americas, Asia, Europe, the Middle East and the Far East, which were not traditionally its trading partners (during the years of apartheid). The recent move by South Africa of cutting diplomatic relations with Taipei in favour of full diplomatic relations with Beijing is a case in point. The present South African government has shown keen interest in such ties by signing trade and other economic co-operation agreements with countries such as Cuba, Libya, Iran, Malaysia, Russia, Denmark, and Sweden.

It is very important therefore, for the new government (and other stakeholders as well) to understand fully the prevailing context and economic environment in which its old and new, and potential trading partners operate, in order to be able to formulate and implement appropriate policies that will take into account the prevailing trends in regional integration around the globe. In the circumstances, a global survey of recent trends in regionalism is appropriate, and to that, we now turn.¹⁴³

exceptions in which intraregional trade barriers remain in place (for example, in sensitive sectors such as agriculture, textiles and clothing).

¹⁴⁰ Customs Unions are in essence FTAs except that member states must conduct and pursue common external commercial relations; for instance, they must adopt common external tariffs on imports from non-participants. (El-Agraa loc cit). Kirmani *et al* loc cit refer to article XXIV of GATT which also requires that in a CU duties and other regulations of commerce applicable to non-members “shall not on the whole be higher or more restrictive than the general incidence of these prior to the formation of the union”.

¹⁴¹ Common Markets have all the attributes of a customs union, but in addition, include provisions to liberalise regional factor movements (Kirmani *et al* loc cit). In other words, in a common market, capital, labour and enterprise should move unhindered between the participating countries (El-Agraa loc cit).

¹⁴² Economic Unions have all the attributes of a common market, with the provision for the harmonisation of certain economic policies, particularly macroeconomic policies (monetary and fiscal) and regulatory policies. (Kirmani *et al* loc cit; El-Agraa loc cit). In an economic union, a central authority is introduced to exercise control over these matters so that existing member states effectively become regions of one nation (El-Agraa loc cit). There are other RTAs where member states have the creation of a political union as their ultimate objective. In a political union, the central authority needed in an economic union not only controls monetary and fiscal policies but is also responsible to a central parliament with the sovereignty of a nation’s parliament (El-Agraa loc cit).

¹⁴³ For the discussion that follows (i.e. discussion on trends in regional integration in various regions of the world), the writer of this thesis will rely extensively on the work of Kirmani *et al supra*, as they provide

1.3.2 Africa

Some of the earlier African RTAs include the South African Customs Union (SACU),¹⁴⁴ Union Douaniere des Etats de l'Afrique Centrale (UDEAC)¹⁴⁵ (established in 1966), Manu River Union (MRU)¹⁴⁶ (established in 1973), the Economic Community of West African State (ECOWAS)¹⁴⁷ (established in 1975), and Communauté Economique des Pays des Grands Lacs (CEPGL)¹⁴⁸ (established in 1976).¹⁴⁹ The Lagos Plan of Action (LPA) (comprising all countries in sub-Saharan Africa (excluding South Africa before 1994?) and the Southern African Development Community (SADC)¹⁵⁰ (formerly, the Southern African Development and Co-ordinating Council (SADCC) were both formed in 1980. In 1982 and 1984, the Preferential Trade Area (PTA), later to become the Community of Eastern and Southern African States (COMESA)¹⁵¹ and the Indian Ocean Commission (IOC)¹⁵² were formed, respectively.

In 1991, the African Economic Community (AEC) comprising fifty one African member states was formed. The Economic Community of Central African States (ECCAS),¹⁵³ the Cross Border Initiative (CBI),¹⁵⁴ and the West African Economic and Monetary Union (WAEMU)¹⁵⁵ were formed in 1992, 1993 and 1994 respectively.

While the AEC, the CBI, the MRU, the LPA and WAEMU on the one hand, are aiming at attaining an economic union in each of their respective groupings, COMESA, ECCAS, ECOWAS, UDEAC and SACU on the other hand, have a common market as each

an elaborate up-to-date summary of trends in regional integration around the globe.

¹⁴⁴ Botswana, Lesotho, Namibia, South Africa and Swaziland.

¹⁴⁵ Cameroon, Central African Republic, Chad, the Congo, Equatorial Guinea, Gabon.

¹⁴⁶ Guinea, Liberia, Sierra Leone.

¹⁴⁷ Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo.

¹⁴⁸ Burundi, Rwanda, Zaire.

¹⁴⁹ Kirmani *et al* op cit 108.

¹⁵⁰ Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Tanzania, Zambia, Zimbabwe. South Africa was formerly admitted as a member in 1994.

¹⁵¹ Angola, Burundi, Comoros, Djiboti, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Rwanda, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe.

¹⁵² Comoros, Madagascar, Mauritius, Seychelles.

¹⁵³ Burundi, Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon, Rwanda, Sao Tome and Principe, Zaire.

¹⁵⁴ Burundi, Comoros, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe, (members of COMESA, SADC, or IOC can participate).

¹⁵⁵ Benin, Burkina Faso, Cote d'Ivoire, Mali, Niger, Senegal, Togo.

grouping's respective goal. The SADC and the IOC are poised at promoting economic co-operation among their respective member states. The CEPGL and Communauté Economique de l'Afrique de l'Ouest (CEAO)¹⁵⁶ on the other hand are aiming at a free trade area and a customs union, respectively.¹⁵⁷

The main objectives of the AEC are, *inter alia*, the strengthening of existing arrangements, the formation of a pan-African FTA, a CU, and eventually a common market and monetary union. The CBI (as an economic union) aims at supporting integration objectives of COMESA, SADC and IOC, and the promotion of cross-border trade, investment and payments. The other objectives of CBI include the following: facilitating factor mobility, removing intraregional trade barriers as well as lowering external tariffs, liberalisation of administration and other controls relating to investment. The WAEMU - as an economic and monetary union - aims at harmonising tax systems and co-ordinating sectoral policies among its member states.¹⁵⁸

Those African states which have grouped themselves into common markets (or who are working towards establishing a common market) have the following as their stated objectives: sectoral co-operation in industrial, agricultural, and interstate transport and communications development, environment, natural resources, energy, and the development of economically depressed areas. Along with these, the common-market-African-countries aim to promote co-operation in monetary, financial and fiscal matters.¹⁵⁹ Some African countries have simply signed co-operation agreements in terms of which they will co-operate in economic, commercial, and industrial development matters.¹⁶⁰

The progress made by African economic groupings in the quest for their stated objectives shows a mixture of successes, uncertainties and at times, crippling failures.¹⁶¹ The

¹⁵⁶ Benin, Burkina Faso, Cote d'Ivoire, Mali, Mauritania, Niger, Senegal. CEAO was established in 1974 and abolished in 1994. The former member states now operate within the framework of WAEMU.

¹⁵⁷ Kirmani *et al* op cit 107.

¹⁵⁸ *Ibid.*, 109.

¹⁵⁹ *Ibid.*

¹⁶⁰ *Ibid.*, 108.

¹⁶¹ See Nomvete op cit 247 *et seq.* who argues that the weakness of many African economies is the answer to the failure of these countries to attain their stated objectives. For a discussion of some of the reasons

economic groupings that have shown some measure of success are COMESA, SADC and SACU. For instance, COMESA member states introduced (in 1988) cheques denominated in UAPTA (PTA Units of Account) to facilitate intraregional transactions.¹⁶² Further, to ease intercountry flow of merchandise trade, COMESA, member states introduced the Road Customs Transit Declaration and replaced diverse documents previously required by member states from citizens of other member states travelling through the country of another member state. In 1987, the PTA Motor Vehicle Insurance Scheme was introduced to obviate the need to take out separate insurance in every COMESA country.

The SACU has relatively well integrated goods and labour markets. The SADC countries on the other hand, have made success in undertaking joint development projects in transport and communications, food and agriculture, and industrial rehabilitation. The Cahora Bassa (Mozambique) and the Lesotho Highlands Water Projects, as well as the Maputo Corridor are cases in point.

A great number of African economic groupings has not made visible progress in the direction of attaining their objectives. For instance, while the CEPGL has not fully implemented the application of preferential tariffs, and the ECCAS framework is still been discussed, the ECOWAS still has to design its common external tariff and to put into effect the Fund for Compensation and Development.¹⁶³ Further, although ECOWAS member states on the one hand signed a protocol on labour mobility (in 1979), and has still not been implemented, MRU member states on the other, although trade among themselves is tariff free and a common external tariff is in place, progress toward integration and intra-regional trade has been slowed by pervasive non-tariff barriers (NTBs).¹⁶⁴

why developing and LDCs in Africa have not achieved much in attaining their integration goals, see also Elianowy J. Kisanga, Industrial and Trade Cooperation in Eastern and Southern Africa, Avebury, England, 1991, p.28 *et seq.*

¹⁶² Kirmani *et al* op cit 107.

¹⁶³ *Ibid.*, 108.

¹⁶⁴ *Ibid.*

1.3.3 Asia

In Asia, new RTAs were formed in the 1990s in addition to the Association for South-East Asia Nations (ASEAN)¹⁶⁵ (established in 1967), the Australia - New Zealand Close Economic Relations Trade Agreement (ANZCERTA) (established in 1983) and the Asia Pacific Economic Co-operation (APEC)¹⁶⁶ (established in 1989). The three Asian economic groupings formed in the 1990s are, the ASEAN Free Trade Arrangement (ASEAN - FTA)¹⁶⁷ (in 1992), the East Asian Economic Caucus (EAEC)¹⁶⁸ (in 1990), and the South Asian Association for Regional Co-operation (SAARC).¹⁶⁹ The so-called Bangkok Agreement has been entered into by Bangladesh, India, Republic of Korea, Lao People's Democratic Republic, Papua New Guinea and Sri Lanka with the objective of promoting regional economic development through trade expansion.¹⁷⁰

Both ASEAN-FTA and ANZCERTA are aiming at establishing a free trade area in their respective regions, while the APEC, ASEAN and EAEC have economic co-operation among their respective member states as their stated objective.¹⁷¹ The ASEAN-FTA aims at promoting regional industrial co-operation, the elimination of quantitative restrictions (QRs) among member states, and the phasing down of tariffs to reach a zero to 5 per cent preferential tariff on manufactured goods by 2008.¹⁷²

The SAARC countries are primarily committed to step-by-step liberalisation of trade in such a manner that all member countries in the region share the benefits of trade expansion equitably.¹⁷³ Australia and New Zealand on the other hand aim to achieve the harmonisation of business laws and promote co-operation in the area of standards and

¹⁶⁵ Brunei, Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand.

¹⁶⁶ Australia, Brunei, Darussalam, Indonesia, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, Philippines, Republic of Korea, Singapore, Taiwan, Thailand, United States of America.

¹⁶⁷ Brunei, Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand.

¹⁶⁸ Brunei, China, Hong Kong, Indonesia, Japan, Republic of Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand.

¹⁶⁹ Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka.

¹⁷⁰ Kirmani *et al* op cit 110.

¹⁷¹ *Ibid.*

¹⁷² *Ibid.*, 109. See also Su Zhou, 'Trade connections and interest rate linkages among ASEAN, Japan and the USA: An empirical analysis', in Maurice Peston (ed.), *Applied Economics*, Vol. 28., Chapman & Hall, London, May 1996, p.617.

¹⁷³ Kirmani *et al* op cit 110.

customs procedures, and the elimination of dumping within the FTA. The ASEAN economic co-operation framework is aiming at the enhancement of regional trade, maintenance of the regions competitive position, and the promotion of beneficial exploitation of economies of scale.¹⁷⁴

Although some Asian economic groupings have made visible progress in the quest for their stated objectives, there are still slow movements and stumbling blocks in others. For instance, while Australia and New Zealand (in ANZCERTA) have, since 1990, had all intra-area trade in goods and services free of tariffs, QRs, antidumping measures, and production subsidies, ASEAN-FTA, APEC, ASEAN and SAARC member states were still discussing or completing their agreement. For example, during 1994 APEC member states were still doing preparatory work reviewing member states' customs procedures and investment regimes and prospects for mutual recognition of standards.¹⁷⁵

1.3.4 Europe

There are approximately seventeen different economic groupings in Europe today, ranging from FTAs to bilateral trade agreements. The collapse of Communism in the former Soviet Union and in Eastern and Central Europe, has resulted in the building of economic and political bridges between Eastern and Western Europe. There is now greater economic co-operation been fostered on both bilateral and multilateral levels between countries in Eastern and Western Europe.

The majority of present day European economic groupings were formed in the first half of 1990, while the rest were formed in the 1940s, 50s and 60s. The earliest European RTA, BENELUX,¹⁷⁶ was formed in 1948, followed by the European Community (now the European Union (EU)) in 1957.¹⁷⁷ The European Free Trade Association (EFTA)¹⁷⁸ and the EU-Turkey Association Agreement (EU member states and Turkey) were formed in 1960 and 1963, respectively.

¹⁷⁴ Ibid. See also Su Zhou loc cit.

¹⁷⁵ Kirmani *et al* op cit 109.

¹⁷⁶ Belgium, Netherlands, Luxembourg.

¹⁷⁷ Kirmani *et al* op cit 110.

The following European economic groupings aim to establish an FTA in each of their respective regions; they are, (a) the Baltic FTA (established in 1993);¹⁷⁹ the Bilateral Free Trade Agreements (established in 1992) between individual Baltic countries and Finland, Norway, Sweden, and Switzerland; the Central European Free Trade Agreement (CEFTA)¹⁸⁰ or the so-called Visegrad Agreement (of 1992); the European Economic Area (EEA)¹⁸¹ (established in 1994); EFTA; and EFTA-Turkey FTA (established in 1991). The bilateral association agreements between the EU and the former Eastern European states of Bulgaria, Czech Republic, Hungary, Poland, Romania, and the Slovak Republic provide also for the establishment of a free trade area between the EU and each of these countries. Likewise, the countries of the former Soviet Union¹⁸² and the Baltic States are also aiming at forming an FTA with the EU.¹⁸³

The Baltic FTA agreement went into force on 1 April 1994 and immediately thereafter the customs duties and QRs were abolished among the three countries.¹⁸⁴ In terms of that agreement, no new tariffs or NTBs are to be introduced among the three countries in future.¹⁸⁵ The Visegrad Agreement,¹⁸⁶ unlike the majority of other European RTAs (e.g. the Baltic FTA, the EEA, the EFTA, the EFTA-Turkey and the bilateral free trade agreements between individual Baltic countries and Finland, Norway, Sweden, and Switzerland), does not exclude agricultural goods completely, but makes provision for the liberalisation of trade in agriculture (including textiles and steel: the so-called “sensitive” goods) over a period of eight years (from 1993(?)), while liberalisation of trade in “normal” goods is expected to take place by no later than 1999 (?).¹⁸⁷ The EU Association Agreements provide for the liberalisation of trade in manufactured goods,

¹⁷⁸ Austria, Finland, Iceland, Liechtenstein, Norway, Sweden, Switzerland.

¹⁷⁹ Estonia, Latvia, Lithuania.

¹⁸⁰ The Czech Republic, Hungary, Poland, Slovak Republic.

¹⁸¹ EU, Austria, Finland, Iceland, Liechtenstein, Norway, Sweden.

¹⁸² Belarus, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Ukraine.

¹⁸³ Kirmani *et al* op cit 116.

¹⁸⁴ *Ibid.*, 110.

¹⁸⁵ *Ibid.*

¹⁸⁶ Was implemented as of March 1993.

¹⁸⁷ See Kirmani *et al* loc cit.

and includes provisions relating to competition law and commitment to negotiate liberalisation of trade in services.¹⁸⁸

Unlike their African counterparts, European RTAs appear to have made headway in attaining their objectives. For instance, all tariffs on manufactures and QRs have been eliminated by the EFTA member states, while by 1994 the same countries had abolished all customs duties on most imports from Turkey.¹⁸⁹ Turkey on the other hand, had, by 1993 reduced the tariff rate on EFTA imports by 70-80 per cent.¹⁹⁰

As far as the EU is concerned, by the end of 1993, the Internal Market Program had almost been completed. Although the EU has achieved free capital mobility and labour mobility is almost completely liberalised, some barriers still remain in areas such as energy, telecommunications and transportation.¹⁹¹ Like the EFTA member states, the EU Association agreements with individual countries of Eastern Europe have achieved the elimination of most tariffs and QRs on industrial goods after the coming into effect of the agreements.¹⁹² However, substantive restrictions still remain in steel, textiles and clothing, and coal, but these are to be phased out over a four-to-five-year period after the entry into force of the respective agreements.¹⁹³ The EU and the Baltic states have concluded negotiations in terms of which the former will liberalise imports of industrial goods and services from the latter. In terms of these negotiations, the same sensitive areas (e.g. agriculture) which receive special treatment under the so-called 'Europe Agreements' will be protected in the EU agreements with the Baltic States.

1.3.5 *The Middle East*

The Arab Common Market (ACM) is the earliest Middle East RTA set up by Arab countries¹⁹⁴ (in 1964) with the objective of establishing a customs union.¹⁹⁵ The three

¹⁸⁸ Ibid., 112.

¹⁸⁹ Ibid., 111.

¹⁹⁰ Ibid.

¹⁹¹ Ibid., 112. See also C. Fred Bergstein, 'Globalising free trade', in *Foreign Affairs*, May/June 1996, p.106.

¹⁹² Kirmani *et al*, *ibid*.

¹⁹³ Ibid.

¹⁹⁴ Egypt, Iraq, Jordan, Libya, Mauritania, Syria, Yemen.

Middle East RTAs formed in the 1980s are, the Co-operation Council for the Arab States of the Gulf (also referred to as the Gulf Co-operation Council (GCC)¹⁹⁶ (in 1981), the Economic Co-operation Organisation (ECO)¹⁹⁷ (in 1985), and the Arab Maghreb Union (AMU)¹⁹⁸ (in 1989) (formerly, Maghreb Customs Union). These RTAs aim to establish a common market, promote economic co-operation, and an economic union in their individual regions, respectively. The only Middle East RTA formed in the 1990s is the Black Sea Economic Co-operation Project (BSEC)¹⁹⁹ (in 1992) with the objective of fostering economic co-operation among member states.²⁰⁰

In its 1991 meeting, the AMU agreed to a four-stage economic integration process in terms of which deadline announced set the target of establishing an FTA by 1992, a customs union by the end of 1995, and a common market by the end of 2000.²⁰¹ The member states of BSEC aim at enhancing movements of goods, services, labour and capital, while member states of ECO are poised at promoting bilateral trade and investment, and economic co-operation.²⁰² The envisaged co-operation agreement among GCC states is designed to achieve “deep integration” by establishing free movement of goods, services, and factors of production.²⁰³

The GCC appears to be the only Middle East RTA that has achieved a lot in terms of progress to date. For instance, by the end of 1983 (i.e. two years after it was formed), the member states had virtually eliminated customs tariff and trade in services had been liberalised. Further, the free movement of factors of production has now been achieved.²⁰⁴ The other RTAs in the Middle East are, in the main, still in the planning and /or implementation stages. For instance, the ACM member states have still made no progress

¹⁹⁵ Kirmani *et al* op cit 113.

¹⁹⁶ Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates,.

¹⁹⁷ (Formerly, the Regional Cooperation Development). Islamic Republic of Iran, Pakistan, Turkey. And since 1992: Islamic State of Afghanistan, Azerbaijan, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan.

¹⁹⁸ Algeria, Libya, Mauritania, Morocco, Tunisia.

¹⁹⁹ Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russian Federation, Turkey, Ukraine.

²⁰⁰ Kirmani *et al* loc cit.

²⁰¹ *Ibid.*

²⁰² *Ibid.*

²⁰³ *Ibid.*, 114.

on the common external tariff, and although they had, by 1992, removed tariffs on manufactured goods - with a few exceptions though - considerable QRs still remain.²⁰⁵

The five central banks of the AMU signed an agreement in 1991 to help facilitate inter-bank payments, and has been implemented since April 1992.²⁰⁶ As far as the BSEC is concerned, working groups have been established covering areas such as organisational matters, exchange of statistical data and economic information, banking and finance, trade and industrial co-operation, transport and communications, agriculture and agro-industries, and free travel of business-people of the participating states.²⁰⁷ In 1992, the ECO member states established a very limited system of tariff preferences granting a 10% reduction on specific tariff lines.²⁰⁸ Some of the initiatives been considered by the ECO member states include the establishment of a regional trade and development bank and the formation of an ECO shipping company.²⁰⁹

1.3.6 The Americas

The Western Hemisphere (the Americas) has, by far, the largest number of RTAs. Although the majority of these RTAs are multilateral in nature, there are many that are conducted on bilateral basis. The earliest RTAs in this part of the world formed in the 1960s and revived in the 1990s are, the Latin American Free Trade Association (LAFTA) (now called, the Latin American Integration Association (LAIA),²¹⁰ the Central American Common Market (CACM),²¹¹ and the Andean Common Market (ANCOM) or the so-called Andean Pact.²¹²

The ANCOM member states aim to harmonise their respective social and economic policies and to undertake joint programmes. The bilateral agreement between Argentina

²⁰⁴ Ibid.

²⁰⁵ Ibid., 113.

²⁰⁶ Ibid.

²⁰⁷ Ibid.

²⁰⁸ Ibid.

²⁰⁹ Ibid.

²¹⁰ Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela.

²¹¹ Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua.

²¹² Bolivia, Colombia, Ecuador, Peru, Venezuela.

and Brazil provided for the establishment of a bilateral common market by 1994.²¹³ The majority of bilateral agreements between various Latin American countries (for instance between Chile and Colombia; Chile and Venezuela; Colombia and Venezuela; El Salvador and Guatemala; Mexico and Costa Rica) provide for the establishment of an FTA between respective contracting states. The member states of CACM, as well as those of the Chile-Venezuela bilateral agreement, have agreed to liberalise trade completely among and between their respective members. Both agreements, as well as the agreement among the 'Group of Three' countries²¹⁴ exclude agricultural products. The countries of the Caribbean Community (CARICOM)²¹⁵ entered into negotiations with Colombia to provide, during a transition period, a system of unilateral preferences for access of CARICOM products into Colombia, and for the former to later reciprocate.²¹⁶ The CARICOM member states (as a group) have also entered into an agreement with Venezuela that provides that during a period of five years (by 1998?), all duties on Venezuelan imports from CARICOM should be phased out.

The agreement provides further that after that period, negotiations should start on how to eliminate barriers on Venezuelan imports into CARICOM countries.²¹⁷ Negotiations were also taking place between Colombia on the one hand and a host of other Latin American countries²¹⁸ on the other, in terms of which Colombia is to grant unilateral tariff cuts to central American countries during a transition period, followed by reciprocity by the latter, and ultimately result in the formation of an FTA.

Colombia, Ecuador and Venezuela have agreed to eliminate tariffs and NTBs to bilateral trade and establish a simplified common external tariff.²¹⁹ The Enterprise for the Americas Initiative (EAI) aims to achieve a free trade zone for the entire western hemisphere, by reinforcing market-oriented reforms in Latin America through trade expansion, increasing investment, easing the debt burden, and strengthening

²¹³ Kirmani *et al* op cit 114.

²¹⁴ Columbia, Mexico, Venezuela.

²¹⁵ Comprising countries in the Caribbean.

²¹⁶ Kirmani *et al* loc cit.

²¹⁷ Ibid.

²¹⁸ Namely, Cost Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Venezuela.

²¹⁹ Kirmani *et al* op cit 115.

environmental policies.²²⁰ The 'Group of Three' (Colombia, Mexico, Venezuela) signed a treaty in June 1994 creating a free trade zone over a ten year period starting in January 1995. The treaty excludes agricultural goods, while the car sector will be liberalised over a thirteen-year period.²²¹

The member states of the Southern Cone Common Market (MERCOSUR)²²² are co-ordinating fiscal and exchange rate policy, with the objective of accelerating economic development. These countries are also gradually liberalising intraregional trade and 1995 was set as the final deadline for the elimination of tariffs and NTBs.²²³ The bilateral agreement between Mexico and Chile provides for the promotion of inward investment, the elimination of tariffs and NTBs by 1998, and the harmonisation of taxation and investment rules.²²⁴ Colombia, Ecuador and Venezuela signed an automobile trade agreement in 1993 (which came into effect in January 1994) which includes a unified automobile industrial policy through a common external tariff and common rules of origin.²²⁵ These countries have also entered into negotiations on the harmonisation of agricultural policy to stabilise prices and align them within the customs union.²²⁶

One of the most important RTAs in the western hemisphere is the North American Free Trade Agreement (NAFTA).²²⁷ This agreement covers goods and services, government procurement and intellectual property rights - except for Canadian agricultural and Mexican petroleum products that are partially excluded. NAFTA further provides for the liberalisation of investment flows and professional services.²²⁸ The USA has also entered into a bilateral free trade agreement with Israel with the objective of eliminating (by 1995) tariffs on all products traded between the two countries.²²⁹

²²⁰ Ibid. See also Bergstein *op cit* 107.

²²¹ Kirmani *et al* *loc cit*.

²²² Argentina, Brazil, Paraguay, Uruguay.

²²³ Kirmani *et al* *loc cit*.

²²⁴ Ibid., 116.

²²⁵ Ibid., 115.

²²⁶ Ibid.

²²⁷ Canada, Mexico, United States of America.

²²⁸ Kirmani *et al* *op cit* 116.

²²⁹ Ibid. For a fuller discussion on integration process in the Western Hemisphere (the Americas), see Gary Clyde Hufbauer and Jeffrey J. Schott (assisted by Diana Clark), Western Hemisphere Economic

1.3.7 *Reasons for regionalism*

Regional trading agreements are pursued for a variety of reasons, ranging from economic issues to political considerations. According to Braga,²³⁰ the growing network of interdependence among economies around the world has increased the interest in regionalism. The learned writer suggests that this process of globalisation of economic relations led economic agents to begin to pressure for some type of economic harmonisation and governments began to react through regional arrangements.²³¹

According to Kirmani *et al*,²³² the prospects of enhanced economic growth (stemming from the opportunity to exploit scale economies, regional specialisation and learning-by-doing, as well as attracting investment by expanding the regional market) is a motivation that is present in virtually every RTA . The learned writers suggest for instance, that the realisation of scale effects was a major consideration underlying the Internal Market Program in the EU, while in Africa, the most important reason for regional integration is possibly the belief that individual economies need to overcome the drawbacks of small size and limited physical and human capital, which constrain economic growth.²³³

Regional trading arrangements are perceived by some countries as enhancing the prospects for sustaining domestic policy reforms, including unilateral trade liberalisation, as well as fostering an environment conducive to the maintenance of macroeconomic

Integration, Institute for International Economics, Washington DC, July 1994, Chapter 6.

²³⁰ Carlos Alberto Primo Braga, 'Regional trade organisations: strengthening or weakening global trade', in The American Society of International Law: Proceedings of the 88th Annual Meeting, Washington DC, April 6-9, 1994, p.310.

²³¹ Ibid.

²³² Op cit 90.

²³³ Ibid. See also Carlo Perroni and John Whalley, 'How severe is global retaliation risk under increasing regionalism', in The American Economic Review, Vol. 86., Wisconsin, May 1996, p.57, who maintain that the fears (that strengthened regional blocs may lead to global trade conflict and result in more retaliatory power for each bloc, etc.) have in fact fuelled the recent growth in regional blocs, as smaller countries have rushed to join larger blocs to insure themselves against the risk of being squeezed out of vital foreign markets. There are however, writers on regional integration (such as Jagdish Bhagwati and Paul Krugman) who argue that contrary to popular belief, strengthening of regional trading arrangements will do more harm than good to the world trade system. See also Ronald J. Wonnacott, 'Free trade agreements: for better or worse?', in The American Economic Review, Papers and Proceedings of the 108th Annual Meeting of the American Economic Association, San Francisco, CA, (January 5-7), May 1996, p.62 where the learned author discusses what he refers to as the 'hub and spoke' structure which may develop with strengthening of RTAs.

stabilisation (in particular in developing countries and countries in transition).²³⁴ Kirmani *et al*²³⁵ suggest for instance that, the East European countries view their association agreements with the EU as very important in enhancing and cementing their economic reforms, while MERCOSUR is viewed by Argentina as complementing domestic deregulation, and in Paraguay, it has supported market-based policy reform and trade liberalisation. It has been suggested²³⁶ that NAFTA serves the key US foreign policy objective of enhancing the prosperity and stability (both economic and political) of its neighbour to the south.²³⁷

1.3.8 *The World Trade Organisation*

Agreement signed in April 1994 in Marrakesh, Morocco, establishing the World Trade Organisation (WTO) is one of the most important achievements of the Uruguay Round of Multilateral Trade Negotiations (UR).²³⁸ Taking into account its rationale, scope and objectives, as well as the impact it will have on various countries, this organisation is poised to radically change the way the world does business.

It is trite fact, that in the context of the world trading system of the 1990s, that is characterised by rapidly increasing international economic interdependence and liberalisation of trade relations, countries (including South Africa) can no longer effectively implement their national economic regulations (ranging from interest rates to banking measures, to fairness in the stock markets, even to labour standards) without taking into account the new rules-based regime brought about by the WTO. There are often international constraints and implications related to almost any national measure,

²³⁴ Kirmani *et al* op cit 91.

²³⁵ Ibid.

²³⁶ By Gary Clyde Hufbauer and Jeffrey J. Schott, NAFTA: An Assessment, Institute for International Economics, Washington DC, February 1993, p.4.

²³⁷ For a Further discussion on the reasons for regionalism, see Kirmani *et al* op cit 92 *et seq.*; Bergstein op cit 106 *et seq.*; Rashad Cassim, 'Rethinking Economic Integration in Southern Africa, in Trade Monitor, Vol. 10., September 1995, p.9 *et seq.*

²³⁸ The Uruguay Round, the eighth multilateral trade negotiations of the GATT commenced in September 1986 in Punta del Este, Uruguay, and ended in April 1994 in Marrakesh, Morocco. The Agreement establishing the WTO came into effect on 1 January 1995. See Tsedisio Matona, 'From GATT to the World Trade Organisation ; Opportunities and Constraints for South Africa', in Trade Monitor, Vol. 9, June 1995, p.16

even those of the largest economies.²³⁹ Consequently, in formulating trade and investment policies for instance, South Africa will be obliged to always take into account its obligations under the WTO, and to implement them in such a manner that they accord with the general principles and regulations of the WTO.²⁴⁰

The UR introduced 'new areas' to those that were discussed in the previous rounds of the GATT. These include, trade related intellectual property rights (TRIPS), and trade related investment measures (TRIMs).²⁴¹ The contracting member states of GATT also introduced the Trade Policy Review Mechanism (TPRM) during the UR negotiations.²⁴² The General Agreement in Trade in Services (GATS) establishes the unconditional most favoured nation (MFN) clause as a fundamental principle of agreement and provides for increased participation of developing countries in world trade in services.²⁴³ The TRIPS agreement on the other hand, involves an international upward harmonisation of standards of intellectual property protection (IPP) for all countries, irrespective of the level of their development.²⁴⁴ This agreement also includes the obligation to comply with the substantive provisions of the Stockholm Act of the Paris Convention.²⁴⁵ As far as TRIMs is concerned, it has the effect of liberalising investments by reducing requirements for the entry and operation of foreign firms in host countries.²⁴⁶

²³⁹ John J. Jackson, 'The World Trade Organisation and the 'Sovereignty Question'', in M. van Empel *et al* (eds.), Legal issues of European Integration, Kluwer Law International, The Hague, The Netherlands, 1996, p.186.

²⁴⁰ See Matona *op cit* 18.

²⁴¹ See Samuel M. Wangwe (ed.), Exporting Africa: Technology, Trade and Industrialisation in Sub-Saharan Africa, GNU/INTECH Studies in New Technology and Development, Published in association with the UNU Press, Routledge, London and New York, 1995, p.57. See also UNCTC/UNCTAD, The Impact of Trade Related Investment Measures on Trade and Development: Theory, Evidence and Policy Implications, UN, New York, 1991, Preface. Belinda Coote, The Trade Trap: Poverty and the Global Commodity Markets, An Oxfam Publication, 1992, p 110. David Hartridge, 'Implications of the Uruguay Round and the new GATT for South African trade policy', in Baker *et al* (eds.), South Africa and the World Economy in the 1990s, David Philip: Cape Town and Johannesburg, The Brookings Institutions, Washington DC, in Association with IDASA and The Aspen Institute, 1993, p.169 *et seq*.

²⁴² GATT, Trade Policy Review: South Africa, Vol. 1., GATT, Geneva, September 1993, Preface.

²⁴³ Wangwe *loc cit*.

²⁴⁴ *Ibid.*, 58.

²⁴⁵ *Ibid.*

²⁴⁶ *Ibid.*, 59.

The objectives of the TPRM are to contribute to improved adherence by all contracting parties to GATT/ WTO rules, disciplines and commitments, and hence to the smoother functioning of the multilateral trading system, by achieving greater transparency in, and understanding of the trade policies and practices of contracting parties.²⁴⁷ Under the TPRM, trade policies and practices of contracting parties and their impact on the functioning of the multilateral trading system are subject to periodic review.²⁴⁸

The WTO establishes the legal basis for the new multilateral trading system.²⁴⁹ Its primary function is to implement all the multilateral and plurilateral²⁵⁰ agreements and legal instruments negotiated in the UR.²⁵¹ According to Matona,²⁵² it will also provide an implementation forum for all future trade negotiations, administer the dispute-

²⁴⁷ GATT, Trade Policy Review: South Africa, Vol. 1 loc cit.

²⁴⁸ Ibid.

²⁴⁹ See Raed Safadi and Sam Laird, 'The Uruguay Round Agreements: Impact on developing countries', in Janet L. Craswell (ed.), World Development, Vol. 24., Pergamon, July 1996, p.1238. See also Matona op cit 16.

²⁵⁰ Plurilateral agreements include Agreement on Trade in Civil Aircraft, Agreement on Government Procurement, International Dairy Agreement, and Agreement Regarding Bovine Meat.

²⁵¹ See also Jesus Seade, 'Results of the Uruguay Round', in Said El-Naggar (ed.), The Uruguay Round and the Arab Countries, IMF, Washington DC, 1996, p.17.

²⁵² Loc cit.

settlement procedures and the TPRM, and co-operate with the IMF and the World Bank with a view to achieving greater coherence in global economic policy-making.^{253 254}

²⁵³ See Sheila Page and Michael Davenport, World Trade Reform: Do Developing Countries Gain or Lose?, ODI special Report, London, 1994, p.101.

²⁵⁴ Jackson loc cit remarks that there are however many issues still requiring attention by the WTO. The learned writer expresses scepticism about whether the new dispute settlement procedures (spelt out in Dispute Settlement Body (DSB)) will work effectively, and op cit 187 enquires about how new or emerging subjects which arise in the future (such as the problem of environment and trade rules) will be integrated into the WTO. Whether the WTO will be able to attain its stated objectives remains to be seen.

CHAPTER TWO

DETERMINANTS OF FOREIGN DIRECT INVESTMENT

2.1 Introductory remarks

International private capital flows or foreign investment may be divided into two main components: portfolio capital flows and foreign direct investment (FDI).¹ Portfolio investment refers to the acquisition of securities (stocks and bonds) by individuals or institutions issued by foreign institutions, solely for the purpose of obtaining a return on the funds invested, without any associated control over, or participation in their management.² Direct investment on the other hand involves direct participation in the management or the exercise of control over the decision making process of a domestic enterprise by foreigners.³ Balasubramanyam⁴ observes that, the ability to exercise control over operations of a domestic firm by foreigners, suggests that there is something more involved in FDI than mere flows of financial capital. The learned writer opines that this relates to 'the transference of technology and managerial skills from the investing entity to the investor entity'.⁵ It is this ability to transfer technology and managerial skills, so Balasubramanyam argues, that enables foreign firms to exercise control over operations of a domestic firm/enterprise.

During the 1960s and 1970s many developing countries (including some industrialised countries in the West such as Canada, and recently the US),⁶ which are host to numerous

¹ Donald A. Ball and Wendell H. McCulloch Jr., International Business: Introduction and Essentials, (5thed.), IRWIN, Boston, Mass, 1993, p.35. See also Peter J. Buckley and Michael Z. Brooke, International Business Studies: An Overview, Blackwell Business, Blackwell Publishers, Oxford, 1992, p.15. V.N. Balasubramanyam, 'Foreign Direct Investment and Technology Transfer', in David Greenaway (ed.), Current Issues in International Trade : Theory and Policy, MacMillan Publishers Ltd, London, 1985, p.160. C.M. Jenkins, 'Foreign capital flows and welfare in the receiving economy : A review of the theory', in Economics Learning Resources, Series No. 9., UCT School of Economics, Rondebosch, October 1986, p.2.

² Balasubramanyam, *ibid.* See also Ball and McCulloch Jr. *ibid.*

³ See also Jenkins *loc cit.*

⁴ *Loc cit.*

⁵ *Ibid.*

⁶ For an interesting account of the concerns and worries of the US about the impact of FDI on its economy, see Rachel McCulloch, 'Foreign direct investment in the United States', in Finance and Development,

MNCs, maintained a rather cautious, and sometimes outright hostile and negative position with respect to foreign investment.⁷ During that period, FDI was perceived, ideologically, as another manifestation of imperialism and neo-colonialism, as MNCs for example, ended up being too powerful and having a grip on the developing host economy. From an economic and financial point of view, foreign investment was perceived as having a potential possibility of crowding local borrowers out of capital markets, as foreigners attempted to raise as much investment funds as possible in the markets of the host country in order to finance their investments.⁸

In the 1980s there was a radical shift away from hostility towards foreign investment on the part of developing countries to a more accommodating and welcoming policy stance.⁹ Jansen¹⁰ suggests that this change in attitude on the part of developing countries was not due to new research findings on the impact of FDI, but to the pervasive economic problems facing the developing world (including the balance-of-payments problems, low levels of private investment, stagnant or declining economic growth, worsening terms of trade). In fact, as observed in chapter one, developing countries (as a group) experienced an increase in flows of FDI and portfolio foreign investment (PFI) in the 1990s.

It is held, almost axiomatically, that FDI is a 'good thing', especially for capital-starved developing countries. FDI is seen as having a positive impact on capital formation, job creation, competitiveness of the receiving economy, and overall economic performance. These views are also expressed by many a businessperson and politician in South Africa in their deliberations on how the problems of this country (e.g., unemployment, low domestic investment etc.) could be solved.

March 1993, pp.14-15. See also Steven A.Y. Lin, 'Causes of Japanese firms' direct investments in US manufacturing industries', in Maurice Peston (ed.), Applied Economics, Vol. 28, Routledge, September 1996, p.1143.

⁷ Balasubramanyam op cit 161. See also Karel Jansen, 'The macroeconomic effects of direct foreign investment : The case of Thailand', in World Development, Vol. 23, February 1995, p.193. Pan-Long Tsai, 'Foreign direct investment and income inequality : Further evidence', in World Development, Vol. 23, Pergamon, March 1995, p.469.

⁸ See Alan Hirsch, 'Inward foreign investment in a post-apartheid SA - Some policy considerations', in South Africa International, Vol. 23, July 1992, p.40, who maintains that in South Africa this problem is not likely to be of major concern, as this country has 'sophisticated capital markets'.

⁹ Jansen loc cit.

¹⁰ Ibid.

Before discussing policies and other factors affecting FDI, we will first look at some of the reasons put forward in support of the argument that developing and transition countries in particular need FDI to address many of their economic and structural problems. Secondly, we will briefly discuss some of the theories explaining the process of FDI. Thirdly, a brief discussion will follow on the recent policy changes initiated by various countries, and groups of countries in an attempt to foster FDI in their respective economies.

2.2 Need for inward FDI

Jansen¹¹ holds the view that borrowing from international banks and/or on international bond markets is partly to blame for the debt crises of the 1980s that ravaged many developing countries, particularly those in Latin America. In the circumstances, the learned writer suggests that in order to avoid that problem in the future, countries should try to attract non-debt creating private capital flows, i.e. FDI and PFI. The financial advantage, Jansen maintains, is that such capital flows need not be repaid and that the outflow of funds (remittances of profits) would fluctuate with the cycle of the economy, with the result that balance-of-payments crises due to financial obligations would thus be less likely.¹² There are many other possible advantages of FDI that have been suggested; some of them are discussed hereunder.

2.2.1 Investment Capital

The policy-makers and businesspeople in developing countries desirous of attracting FDI think that foreign investment will boost the overall rate of investment.¹³ When looking at South Africa, this 'expectation' should not be surprising. Hirsch¹⁴ points out that investment has been extremely low in South Africa during the period (1980-1990 ?) and

¹¹ Ibid.

¹² Ibid.

¹³ See Hirsch loc cit.

¹⁴ Ibid.

that gross fixed domestic investment has declined (during that period) in all sectors of the economy except for mining and the private service sector.

Jansen¹⁵ suggests three reasons why it could be expected that FDI would have a positive impact on the level of private investment. First, according to Jansen, since FDI is part of private investment, any increase in FDI will, by itself, contribute to an increase in private investment. In other words, as far as Jansen is concerned, an increase in FDI is therefore likely to be accompanied by an increase in local investment¹⁶ (provided of course the domestic investment climate is acceptable to both FDI and local private investment).¹⁷ Second, and related to the first point, Jansen maintains that new FDI projects may invite complementary local private investments that provide input to, or use outputs of, the foreign firm.¹⁸ Third, Jansen imagines that 'it is likely that private investment increase by more than the foreign-direct-investment-flows because foreign equity capital finances only part of the local investment project', while a substantial part thereof is usually financed from local financial markets, notably so if a project in question is a joint venture.^{19 20}

¹⁵ Op cit 196.

¹⁶ Ibid.

¹⁷ However, see Vishnu Padayachee, 'Foreign capital and economic development in South Africa : Recent trends and postapartheid prospects', in World Development, Vol. 23, February 1995, p.164 where the learned writer quotes Bell (1990 : p.22) as having observed that 'in developing countries foreign direct investment has generally been a consequence, rather than a cause of rapid industrialisation'. In other words, according to Bell (quoted by V. Padayachee), FDI comes about as a result of first, domestic investment/industrialisation. This view is also expressed by Gustav Ranis, 'Another look at the East Asian miracle', in Yale University Economic Growth Centre, Paper No. 505, Yale University Press, Connecticut, 1995 where the learned writer discusses the economic success of East Asian countries.

¹⁸ Jansen loc cit.

¹⁹ Ibid.

²⁰ The ability of foreign investors to raise funds in the financial markets of a host country is one of the major reasons for discomfort on the part of domestic investors, as such practices may lead to the crowding out of domestic investment (see Hirsch loc cit and Jansen Ibid.). Jansen ibid makes the point further that, 'crowding out may also occur on commodity and factor markets,.....when foreign investors claim scarce resources (such as import licences, skilled manpower, credit facilities, etc.) or when foreign investors foreclose investment opportunities for local investors'. It is for these reasons that Hirsch loc cit warns that the 'investment funds argument' for foreign investment needs to be presented more carefully that it usually is.

2.2.2 *Balance of payments*²¹

Many analysts suggest that lack of foreign exchange is one of the key factors constraining the growth of many less developed countries (LDCs).²² It is for this reason that FDI is perceived as a critical ingredient for providing much-needed foreign exchange.²³

According to Hirsch,²⁴ when South Africa begins to grow again, it will face enormous pressure on its foreign payments balance. It is important for this country therefore to ensure that whatever trade regime it puts in place does not worsen its balance-of-payments position.

The balance-of-payments effect on the host country by inward FDI consists of a once-for-all positive effect on the capital inflow.²⁵ However, according to Buckley and Brooke,²⁶ this positive effect is usually (?) followed by an ongoing impact made up of outflows to service the resource inflow. The outflows will be in the form of (a) dividends and interest in respect of the capital imported, (b) royalties in respect of technological imports, (c) fees for management and other skills, and (d) payments for imported inputs and services.²⁷ The learned writers point out further²⁸ that there are also indirect effects on the balance of payments occasioned by inward FDI. These concern the impact on exports and on import substitution as well as the effect on host-country economic aggregates such as income and demand.²⁹

²¹ Balance of payments here refers to accounting balance of payments (as opposed to the market balance of payments). The former is a record of all the financial transactions in goods, services and capital assets which have taken place between a country's residents and the residents of other countries within an arbitrary accounting period, normally one year. The latter concept of balance of payments refers to the balance of supply and demand for a country's currency in the foreign exchange market at a given rate of exchange. See A.P. Thirlwall, Balance-of-payments Theory and the United Kingdom Experience. (2nd ed.), The MacMillan Press Ltd, London, 1982, p.1.

²² See Buckley and Brooke, op cit p247.

²³ Hirsch loc cit.

²⁴ Ibid.

²⁵ Buckley and Brooke loc cit.

²⁶ Ibid.

²⁷ Ibid.

²⁸ Ibid.

²⁹ Ibid.

As can be seen, balance-of-payments problems can act as a serious constraint on a country's ability to attain other macroeconomic goals.³⁰ For instance, as the economy expands towards its capacity level (as a result of inflow of investment funds and capital?), bottlenecks in particular sectors of the economy may raise the aggregate level of imports in excess of the capacity to export, making necessary contraction of the economy, and thus constraining, for example, the achievement of faster, investment led growth.³¹

2.2.3 Access to (new) technology

The developing countries have adopted a more welcoming policy towards foreign investment, because these countries view FDI as a positive way of having access to new technology that is so desperately needed in the developing world.³² Hirsch³³ maintains that the prevalent structural problems in South Africa (e.g. international isolation during the days of apartheid, very poor educational system, economic sanctions, etc.) have contributed to a shortage of new technology in this country. In fact, Hirsch is of the view that 'we have fallen far behind our potential competitors as far as technological capacity is concerned'.³⁴ The success that many developing Asian countries have had with their mastery over new technology is a model to many a developing country that will want to take advantage of technological innovation (that accompanies FDI) in order to address some of their problems relating to poor productivity, lack of competitiveness etc.

Hirsch³⁵ however, makes an interesting observation that it may be difficult to attract MNCs (and hence new technology) based in developed countries, as these MNCs 'are trying harder than ever before to restrict access to those [new] technologies'. The learned writer points out that the moves to protect intellectual property rights within the Uruguay

³⁰ Thirlwall, loc cit.

³¹ Ibid. See also Trevor Bell, 'Should South Africa further liberalise its foreign trade', in Economic Trends Research Group, Working Paper No. 16., Development Policy Research Unit, UCT, Rondebosch, 1992, p.29.

³² See Jansen op cit 193. See also Erik C.F. Offerdal, 'Taxation of foreign direct investment', in Vito Tanzi (ed.), Fiscal Policies in Economies in Transition, IMF, Washington DC, 1992, p.232 where the learned writer makes the same point about Eastern European countries. Guy Pfeffermann, 'Facilitating foreign investments : Some dos and don'ts', in Finance and Development, March 1992, p.46.

³³ Op cit 41.

³⁴ Ibid.

Round of multilateral trade negotiations are a classic example, on the part of MNCs, of the desire to exploit the fruits of their research and development more effectively.³⁶ Be that as it may, foreign investment in South Africa is seen as a positive way of transferring technology and technological knowledge to the people of this country, who will, in turn, so it is believed, be skilled and become more effective and competitive.

2.2.4 Access to markets

One of the arguments put forward in support of the need for FDI, is that foreign investment may raise the productivity of investment and stimulate exports, and in this way enable the host country to have access to new markets.³⁷ Those economists who view export-led growth strategy as the most crucial for developing countries, would argue that FDI will play a crucial role in the expansion of exports, particularly the exports of higher value-added products. Growth in exports, so the argument would go, will increase trade (intra-firm and intra-industry trade), international competitiveness and improve the balance of payments.

The World Development Report 1989³⁸ on the other hand maintains that PFI will also play a crucial role in opening up a host country to new markets. For instance, according to the Report, PFI helps to increase demand for stocks on the stock markets which, in most developing countries, are still very small.³⁹ In this way, the Report concludes, PFI may stimulate the development of these markets.⁴⁰ In the context of South Africa, which has strong and sophisticated stock markets, it is envisaged that PFI may play a role in enhancing and expanding these markets.

³⁵ Ibid.

³⁶ Ibid.

³⁷ See The World Development Report 1991, World Bank, Washington DC., 1991, pp.94-95.

³⁸ World Development Report 1989, World Bank, Washington DC., 1989, pp.110-111.

³⁹ Ibid.

⁴⁰ Ibid.

2.2.5 *Competition on domestic markets*

The inflow of FDI is perceived as a positive way of increasing competition on domestic markets and thus increasing efficiency.⁴¹ It is trite that, the South African economy is, in the main, under the tight grip of very few firms / conglomerates which have become too powerful. Foreign investment should be welcomed, so the argument would go, so that the new inward firms can provide competition for domestic conglomerates.⁴²

2.2.6 *Employment creation*

The popular perception, even in South Africa, is that inward FDI will increase employment as more and more people who were previously unemployed are swallowed by the new MNCs coming into the country to invest. However, Buckley and Brooke⁴³ are of the view that this may in fact not be so. The learned writers observe that FDI, particularly in developing countries is not labour intensive but more capital- and skill-intensive, with the result that the unemployment problem is quite not solved.⁴⁴ The learned writers allege further that more capital- and skill-intensive FDI leads to a creation of labour-elites and is likely to create social tension and divisiveness.⁴⁵ Notwithstanding that, Buckley and Brooke⁴⁶ suggest that there may be positive employment-creating spin offs from inward FDI. The learned writers suggest that these effects will result from inward FDI by way of the incoming firms' purchase of inputs, services, construction demand and sub-contracting. According to the two writers, the multiplier effect of the firms' expenditure will stimulate activity and employment.⁴⁷

⁴¹ See Jansen loc cit.

⁴² See Hirsch loc cit.

⁴³ Op cit 245.

⁴⁴ Ibid.

⁴⁵ Ibid., 246.

⁴⁶ Ibid.

⁴⁷ For a detailed discussion of other advantages (and possible negative effects) of FDI on the developing host economy see Buckley and Brooke *ibid et seq.*

2.3 Some theories explaining the process of FDI

In order to explain the process of FDI, Balasubramanyam⁴⁸ suggests that it is important to consider, in the first place, why do firms prefer to export the package of capital, technology and managerial skill rather than exporting the products produced with the package; and also why do firms prefer to create production facilities abroad rather than export the capital or the knowledge, or both separately. According to Balasubramanyam, the answers to these questions will highlight the essential conditions necessary for FDI to take place.

First, analysts seem to agree that firms decide to transfer production abroad (in this case, from developed countries to developing countries) when, at a certain stage in the production process cost considerations are of great significance.⁴⁹ For instance, at the stage when costs are high (income and labour) and competitors emerge in the developed countries, firms decide to move production facilities to LDCs to take advantage of lower labour costs in the latter countries.⁵⁰ When production takes place abroad (in a host country), third markets as well as the home market may be serviced from LDCs.

Lansbury *et al*⁵¹ opine that wages in East European transition economies are amongst the lowest in Europe, and that this factor has been instrumental in the location decision on the part of those investors who moved production facilities to these countries. The view held by other analysts⁵² is that the export success of countries such as Hong Kong, Taiwan, South Korea, Singapore and Brazil in recent years, is largely attributable to a combination

⁴⁸ Loc cit.

⁴⁹ Balasubramanyam op cit 162. See also Melanie Lansbury, Nigel Pain and Katerina Smidkova, 'Foreign direct investment in central Europe since 1990 : An econometric study', in National Institute Economic Review, 2/96, May 1996, p.109. (hereinafter, 'Lansbury *et al*'). This view is held by those analysts who adhere to the so-called 'product-cycle hypothesis' explanation of FDI. According to this 'hypothesis', technological innovation occur in developed countries and production is transferred abroad as a result of, *inter alia*, rising labour costs and gaining of comparative advantage in these new technologies by developed countries. For a detailed discussion of this theory see Balasubramanyam *ibid* as well as Padayachee loc cit *et seq*.

⁵⁰ Balasubramanyam *ibid*.

⁵¹ Loc cit.

⁵² For instance, Balasubramanyam loc cit.

of technology and managerial skills supplied by foreign firms and their endowments of low-cost labour and materials.⁵³

Second, the explanation provided to why firms choose to invest abroad than to lease the technology they possess through licensing agreements, suggests that firms decide to undertake FDI in order to exploit the monopoly over rent-yielding advantages that they possess in foreign markets.⁵⁴ According to Balasubramanyam⁵⁵ and Offerdal,⁵⁶ these advantages range from access to patented and generally unavailable technology, team-specific managerial skills, plant economies of scale, preferential access to financing or to markets, to the possession of a brand name. The learned writers state further that, such advantages must outweigh the disadvantages firms face in operating in foreign markets. The disadvantages which must be outweighed by advantages include, ignorance of local customs and tastes, local legal and social institutions, increased costs of communications,⁵⁷ language barriers and the like.⁵⁸ The learned writers conclude that when this situation prevails (i.e. when advantages outweigh disadvantages) firms decide to invest abroad.

The third explanation of why firms undertake FDI, is based on the “theory” that, since markets for intermediate inputs and technology are imperfect in the sense that they are difficult to organise, pose serious problems of uncertainty, and that they often preclude pricing arrangements by which rent-yielding advantages can be fully exploited, firms resort to “backward and forward integration”, i.e. firms “internalise” their operations in

⁵³ See however, a contrary view expressed by Padayachee op cit 163 and John F. Devlin and Nonita T. Yap, ‘Sustainable development and the NICs : Cautionary rules for the South in the New World (Dis)order’, in Third World Quarterly, Vol. 15., 1994, p.49. *et seq.*, where the learned writers argue that the export success of the so-called Asian ‘tigers’ was not so much rooted in foreign technology and managerial skills as to profound and sound macroeconomic policies and domestic savings and investment as well as very strategic government intervention in these economies.

⁵⁴ Balasubramanyam op cit 163. See also Offerdal op cit 235.

⁵⁵ Ibid.

⁵⁶ Loc cit.

⁵⁷ Balasubramanyam loc cit.

⁵⁸ Offerdal loc cit.

order to overcome market imperfections.⁵⁹ The process of internalisation of markets across national boundaries, so Balasubramanyam⁶⁰ suggests, results in FDI.⁶¹

From the foregoing discussion, it can be concluded that there are basically three preconditions which must be fulfilled for FDI to take place. First, investing firms should possess ownership advantages.⁶² Second, locational considerations (such as tariffs, exchange rate etc.) should determine FDI rather than exporting the product. Further, the firm should be capable of overcoming the disadvantages of operating in a foreign location, and it should be profitable for the firm to combine its ownership advantages with factor endowments located in foreign countries.⁶³ Thirdly, internalisation must be much more beneficial to the firm than selling the advantages it possesses on the open market through licensing. It is important to note however, that any one of the above mentioned considerations may be necessary but not sufficient to give rise to FDI.

Writers such as Padayachee,⁶⁴ Lansbury *et al*,⁶⁵ Milner and Pentecost⁶⁶ and Lin,⁶⁷ maintain that there is a myriad of other factors which have a direct bearing on whether or not firms decide to undertake FDI. According to Padayachee,⁶⁸ all these factors combine

⁵⁹ Balasubramanyam op cit 165.

⁶⁰ Ibid. See also United Nations Centre on Transnational Corporations (UNCTC), The Determinants of Foreign Direct Investment : A Survey of the Evidence, UN, NY., 1992, p.3. (hereinafter 'The 1992 UNCTC Report').

⁶¹ For further reading on theories explaining the process of FDI, see Padayachee op cit 164 where the learned writer discusses the following theories : neo-classical approach, the *dependencia* school, the bargaining approach, and the structuralist approach. See also Pan-Long Tsai op cit 470 *et seq* for further discussion of contending theoretical perspectives on FDI. J. Saul Lizondo, 'Foreign direct investment', in Determinants and Systematic Consequences of International Capital Flows, Occasional Paper 77, IMF, Washington DC., March 1991, p.68 *et seq*.

⁶² For a discussion of how foreign firms in the US have used ownership and other advantages in enhancing their activities, see R McCulloch op cit 13 *et seq*. See also Dennis J Encarnation, Rivals Beyond Trade : America versus Japan in Global Competition, Cornell University Press, 1992, p. 31 where the learned writer portrays the importance of possessing full control of ownership advantages. For example, Encarnation is of the view that it is 'only with majority ownership [that] multinationals exercise sufficient managerial control to dictate their subsidiaries' decisions to import supplies from their parents'. UNCTC, Government Policies and Foreign Direct Investment, UNCTC Current Studies, N.Y., November 1991, p.8. (hereinafter 'The 1991 UNCTC FDI Report').

⁶³ See Balasubramanyam op cit 165. See also Offerdal loc cit. Lin loc cit *et seq*.

⁶⁴ Op cit 166.

⁶⁵ Op cit 106.

⁶⁶ Chris Milner and Eric Pentecost, 'Locational advantage and US foreign direct investment in UK manufacturing', in Maurice Peston (ed.), Applied Economics, Vol. 28, May 1996, p.606.

⁶⁷ Loc cit.

⁶⁸ Loc cit.

to make complex any analysis of the determinants of foreign capital flows (to developing countries). Padayachee points out further that the determinants of foreign capital flows (by geography or sectoral destination) also differ depending upon the precise form of capital that is being considered.⁶⁹

Padayachee⁷⁰ refers to Claessens (1993) who has identified four kinds of factors which affect the profitability of private financing (mainly FDI) to developing countries. These are:

- (1) real factors in the host country;
- (2) government policies;
- (3) real factors arising from the interactions between debtors and creditors; and
- (4) country risk factors.⁷¹

Some examples falling under (1) above include, *inter alia*, 'an outward-orientated economic strategy, the credibility of exchange rates, a convertible currency, repatriation requirements, the quality of fiscal policies, the transparency of the tax system, the interaction between private and public investments (e.g. possible crowding in/out of domestic investment), the state of the country's physical and financial infrastructure and system, the quality of its education system and human resource potential, the conditions of demand and trading arrangements in both local and regional markets, the buoyancy of the local business climate, and domestic content specifications'.⁷²

Under category (2) above, the following factors have been identified as factors affecting the profitability of FDI, *inter alia*, incentives, tax holidays, differentiated tax structures,⁷³ regulations in the form of authorisation procedures, requirements of employment levels

⁶⁹ Ibid.

⁷⁰ Ibid.

⁷¹ Ibid. See also Offerdal loc cit.

⁷² Padayachee, *ibid.*

⁷³ Ibid.

and technology transfer, limits on ownership, limits on repatriation of profits,⁷⁴ and specific investment promotion strategies.⁷⁵

Examples of country risk factors having an impact on FDI include, *inter alia*, economic and political stability, unexpected changes in the legal or fiscal environment (e.g. expropriations, abrupt changes in the macroeconomic environment, such as spiralling inflation and exchange rate volatility).⁷⁶ Other factors which have been postulated as affecting FDI are, privatisation programs,⁷⁷ host comparative advantage,⁷⁸ levels of per capita income and real per capita growth rate,⁷⁹ the external debt burden,⁸⁰ and capital controls.⁸¹

2.4 International policy changes

In recent years, the world trading system has been dominated to a very large extent by issues and policies relating to FDI. This is not surprising because, according to Encarnation,⁸² FDI has recently 'driven global competition well beyond the narrower limits of international trade', and that FDI 'has moved national competition beyond simple bilateral rivalries to encompass multilateral contests among the far flung (but closely linked) subsidiaries of MNCs'. The area of FDI has thus been given increased attention by policy makers at both the international and the national levels.

At the international level, the Organisation for Economic Co-operation and Development (OECD)⁸³ and the WTO are currently perceived as the two most important forums for

⁷⁴ Offerdal loc cit.

⁷⁵ Pfefferman op cit 47.

⁷⁶ Offerdal loc cit.

⁷⁷ Lansbury *et al* loc cit. See also World Investment Report 1991 : The Triad in Foreign Direct Investment, UNCTC, N.Y., 1991, pp.23 and 26.

⁷⁸ Milner and Pentecost loc cit.

⁷⁹ Joshua Greene and Delano Villanueva, 'Determinants of private investment in LDCs', in Finance and Development, December 1990, p.40.

⁸⁰ *Ibid.* See also Michael T Hadjimichael *et al*, Sub-Saharan Africa : Growth, Savings, and Investment 1986-93, Occasional Paper 118, IMF, Washington DC., January 1995, p.44 *et seq.*

⁸¹ Determinants and Systemic Consequences of International Capital Flows, Occasional Paper 77, IMF, Washington DC., March 1991, p.22. See also S. Neal McKnight, 'Stepping stones to reform : The use of capital controls in economic liberalisation', in Virginia Law Review, Vol. 82, August 1996, p.864.

⁸² Op cit 5.

⁸³ Comprising mainly of developed market economies.

crafting and implementing multilateral policies relating to FDI.⁸⁴ Concerning the former, OECD countries took measures to harmonise the treatment of MNCs by host countries and to strengthen the OECD codes of liberalisation.⁸⁵ Further, the OECD added a chapter on MNCs and the environment to its Guidelines on Multinational Enterprises.⁸⁶ The Guidelines cover the following areas : general policies,⁸⁷ disclosure of information,⁸⁸ competition,⁸⁹ financing,⁹⁰ taxation,⁹¹ employment and industrial relations,⁹² and science and technology.⁹³

Concerning the WTO, the creation of a framework to govern international transactions in services, and rules governing the application of trade-related-investment-measures (TRIMs) by member states,⁹⁴ are two very important issues for the future of a multilateral approach to foreign direct investment issues.⁹⁵ However, as far as TRIMs are concerned, there seems to be no consensus on how they must be applied. According to the World Investment Report 1991,⁹⁶ differences of opinion concerning TRIMs centre on four basic issues : the coverage of a TRIMs agreement (whether it should be extended to measures applied to established firms or only to measures on new investments); the level of discipline to be imposed; the treatment of developing countries (whether they may be granted a special allowance to use TRIMs in the context of their socio-economic

⁸⁴ World Investment Report 1991 op cit 23.

⁸⁵ Ibid.

⁸⁶ See International Investment and Multinational Enterprises : The OECD Guidelines for Multinational Enterprises, OECD, Paris, 1986. The Guidelines were annexed to a Declaration on International Investment and Multinational Enterprises/MNCs/TNCs which was endorsed by the OECD member governments at the 1976 meeting of the OECD Council at ministerial level and which was accompanied by related Council Decisions on Guidelines for MNEs, on National Treatment (for firms under foreign control), and on International Investment Incentives and Disincentives. According to the OECD member states, the objective of the Guidelines is 'to encourage the positive contributions which multinational enterprises can make to economic and social progress and to minimise and resolve the difficulties to which their various operations may give rise' (p7).

⁸⁷ Ibid., 13.

⁸⁸ Ibid., 13-14.

⁸⁹ Ibid., 14.

⁹⁰ Ibid., 15.

⁹¹ Ibid.

⁹² Ibid., 15-16.

⁹³ Ibid., 16.

⁹⁴ Discussed in the Uruguay Round (UR) of Multilateral Negotiations.

⁹⁵ World Investment Report 1991 loc cit.

⁹⁶ Ibid., 25.

development goals); and the treatment of restrictive business practises in the context of restrictions of TRIMs.

2.5 National policy changes and recent policy developments

During the 1980s and early 1990s, a large number of countries changed their policies and regulations affecting MNCs and capital flows in general. The reasons for doing so were many, and varied from countries to countries.

As for developed market economies (DMEs), those changes were 'a component of policies aimed at improving the climate for business operation in general, and did not single out the activities of TNCs'.⁹⁷ For example, the process of privatisation of previously government-owned or government-regulated assets in some developed countries (e.g., UK and US) is viewed as a positive way of increasing efficiency and national competitiveness as foreign MNCs entered markets previously dominated by state enterprises.⁹⁸

In developing countries, policy changes were frequently part of explicit attempts to attract greater amounts of FDI and/or to influence the impact of such investment.⁹⁹ Some developing countries, by introducing these changes, hoped to provide some medium to long term solutions to their economic problems (of e.g., lack of capital, indebtedness). For example, some developing countries have reduced or removed their exchange controls, thus permitting wider currency convertibility and allowing greater repatriation of profits and dividends.¹⁰⁰

The countries of Central and Eastern Europe introduced sweeping changes in order to create a climate attractive to foreign MNCs, and thus opened ways for new capital flows into the region. As mentioned earlier (in chapter one), these countries formulated new

⁹⁷ Ibid.

⁹⁸ Ibid., 25-26.

⁹⁹ Ibid., 26.

¹⁰⁰ Ibid.

legal and regulatory regimes allowing substantial foreign participation, and in some cases 100 per cent ownership of foreign MNCs.¹⁰¹

2.6 Policies and factors affecting FDI

2.6.1 *Government Policy instruments*

2.6.1.1 *Ownership policies*

In our earlier discussion (of why do firms decide to move production abroad than to lease the technology they possess through licensing agreement), it was suggested that firms decide to undertake FDI in order to exploit the monopoly of advantages (e.g. access to patented technology, brand names, team specific managerial skills) they possess in foreign markets. As can be seen, in order to exploit these to their fullest advantage, foreign firms must be in a position to exercise substantial managerial control over their foreign subsidiaries. In other words, firms should possess ownership advantages which should outweigh any disadvantages (such as tariffs, exchange controls, local content requirements) which may be prevalent in the host country. In the circumstances, it is fairly axiomatic that any policies geared toward limiting or in any way interfering with the crucial ownership advantages of an investing firm are likely to be viewed as hostile to FDI, and consequently discourage these firms from undertaking it (FDI).¹⁰²

Conversely, policies that ensure that the ownership advantages of foreign firms are enhanced (e.g. through strict protection of patents and copyrights) will most likely be regarded as investor-friendly, and consequently encourage foreign firms to move production abroad.

¹⁰¹ See *ibid.*, 27.

¹⁰² For a discussion of the impact of Japan's restrictive foreign ownership policies on US exports/sales to Japan, see Encarnation *loc cit* where the learned writer explains how Japanese policies have constrained US exports to Japan and not the other way around. In that explanation, Encarnation shows why Japanese are able to sell more in the US, than Americans in Japan.

According to the 1991 UNCTC Report,¹⁰³ a number of countries (in both the developed and developing worlds) have systematically moved away from policies imposing (sectoral) limitations on foreign equity ownership, to policies that allow more and more control of foreign equity. For instance, the Report¹⁰⁴ refers to recent moves by Mexico to allow 100 per cent foreign ownership for enterprises with assets up to \$100 million as one recent example of many announcement of liberalised ownership policies.

The other countries which, according to the Report¹⁰⁵ have also liberalised their foreign ownership policies are Australia, India, Indonesia, Japan, Malaysia, New Zealand, Trinidad and Tobago, and Yugoslavia. In the light of the foregoing discussion, it should therefore be important for South African policy-makers to consider carefully the impact that their new trade and/or investment policies (if any) may have on foreign equity ownership, as it is clear that those policies may no doubt have a positive or negative impact on the foreigners' decision to move production to this country.

2.6.1.2 Taxation / Subsidies

According to the 1991 UNCTC FDI Report,¹⁰⁶ tax measures and subsidies remain the single most common policy instrument in the overall foreign investment regime, and governments seem to continue to announce changes in this category. It is widely believed that low or lower corporate income taxes, accelerated depreciation allowances, investment allowances, and granting of tax holidays, etc. are incentives which create a climate conducive to FDI. Conversely, an environment characterised by high corporate taxes and absence of tax holidays (to mention but two) is likely to be viewed by potential investors as unfriendly and risky.

The Report¹⁰⁷ records that during the period 1977-1987, twenty developed market economies, five NICs, and twenty-one developing countries appear to have changed often their respective tax/subsidy policies, in an attempt to entice MNCs to invest in their

¹⁰³ Loc cit.

¹⁰⁴ Ibid.

¹⁰⁵ Ibid.

¹⁰⁶ Op cit 9 and footnotes thereto.

respective economies. Cull¹⁰⁸ refers to Rudolf Gouws (of Rand Merchant Bank) who suggests that one of the many reasons why Zimbabwe attracted no new fixed investment in the 1990s is that country's relatively high corporate tax rate.

In the case of South Africa, it was suggested that the absence of tax holidays was one of the negatives cited by foreign firms operating in South Africa which made South Africa unattractive to FDI.¹⁰⁹ However, Padayachee¹¹⁰ points out that the literature suggests that special incentives (such as tax holidays and differentiated tax structures) that are aimed at influencing the allocation of FDI are less important than the general investment climate and policies affecting specific factors. According to Padayachee,¹¹¹ this is especially so when such incentives can be easily withdrawn.¹¹² Pfeffermann¹¹³ on the other extreme hand recommends that tax holidays be abandoned as a measure of attracting foreign investors. The learned writer is of the view that companies do expect a reasonable level of taxes, and that in fact, companies prefer a steady, reasonable tax rate that enables them to make long-term financial plans, rather than a tax holiday followed by high, uncertain

¹⁰⁷ Ibid.

¹⁰⁸ Patrick Cull, Economic Growth and Foreign Investment in South Africa, IDASA, Cape Town, 1992, p.36.

¹⁰⁹ Ibid. 38.

¹¹⁰ Loc cit.

¹¹¹ Ibid.

¹¹² Padayachee *ibid.*, hastens to add that '[T]his does not mean that government intervention of other kinds is not significant and positive determinant of private capital flows'. The learned writer cites the cases of South East Asia and says that many writers (e.g. Pfeffermann and Madarassy) have found that active government intervention undoubtedly played a major role in boosting private investment. For instance, Korea did this by increasing manufactured exports through incentives and penalties; extending subsidised credit from the state owned banking sector, restraining union activity [at their own peril - see recent (January-February 1997)labour unrest which has paralysed that economy]; setting in place sound macroeconomic policies, and making other targeted interventions. For a detailed and interesting reading on the East Asian economic success, and the role governments played in that 'economic miracle', see the following articles all in World Development, Vol. 22, April 1994 :

- (a) J.M. Page, 'The East Asian Miracle : An introduction', p.615 *et seq.*
- (b) A.H. Amsden, 'Why isn't the whole world experimenting with the East Asian model to develop?: Reviewing of The East Asian Miracle', p.627 *et seq.*
- (c) J. Kwon, 'The East Asian challenge to Neo-Classical Orthodoxy', p.635 *et seq.*
- (d) S. Lall, 'The East Asian Miracle : Does the bell toll for industrial strategy', p.645 *et seq.*
- (e) D.H. Perkins, 'There are at least three models of East Asian development', p.655 *et seq.*
- (f) T. Yanagihara, 'Anything new in the Miracle Report? Yes and No', p663 *et seq.* See also Ranis *loc cit.*

¹¹³ Op cit 47.

rates.¹¹⁴ Pfeffermann maintains further, that eliminating tax holidays will boost government revenues.^{115 116}

2.6.1.3 Convertibility of foreign exchange and remittance of earnings

Foreign investors may need to convert local currency into foreign exchange for a number of purposes, *inter alia*, for the import of capital goods, for recurrent inputs needed by the enterprise, for repayment of international loans, for the remittance of dividends, royalties, and other fees.

In order to be able to do all these, it is important for the foreign investor to have ready access to local currency which can easily and expeditiously be converted into foreign currency. As can be seen, the type of foreign exchange regime a country puts in place, will have an impact on FDI decisions. For instance, some countries have eased or eliminated limits on capital repatriation, and removed ceilings on the payment of dividends, royalties and other fees to foreign parties in order to attract FDI.¹¹⁷

The 1991 UNCTC FDI Report¹¹⁸ points out that, although a country (e.g. Brazil) may offer attractive incentives and have few other constraints, it may be unattractive to some investors as a result of a tight foreign exchange regime. Pfeffermann¹¹⁹ maintains that restrictions placed on foreign investors' access to foreign exchange, will deter foreign investors, particularly those who intend to sell products locally, which may be in short

¹¹⁴ Ibid.

¹¹⁵ Ibid.

¹¹⁶ Pfeffermann's suggestions herein are drawn from a body of The World Bank Group's Foreign Investment Advisory Service (FIAS). FIAS was created in 1986 by the International Finance Corporation (IFC) in response to a strong interest among governments for attracting FDI. Two years later, the Multilateral Investment Guarantee Agency (MIGA) was added as a joint venture partner in sponsoring FIAS. 'Today, FIAS works around the world, advising governments in over 40 countries on how to obtain increased flows of FDI. FIAS also offers help in building an attractive investment climate by counselling government on laws, policies, regulations, and procedures. It also assists in creating an effective institutional framework for government to interact with investors, including developing investment promotion strategies. FIAS helps governments to meet their long-term development needs by maximising the advantages of foreign investment for transferring capital, technology, and managerial expertise' (p.47). Whether FIAS will succeed in its recommendations for many poor developing countries is still a matter to be investigated.

¹¹⁷ See 1991 UNCTC FDI Report op cit 9.

¹¹⁸ Ibid.

¹¹⁹ Loc cit.

supply.¹²⁰ In order to create a climate conducive to FDI, Pfeffermann¹²¹ advises that unrestricted transfer abroad of dividends, royalties etc. should be permitted, as this is in fact the motive (profit making) for investment on the part of investors.

However, economists argue that (unrestricted) outflow of foreign exchange will have a negative impact on the host country's balance-of-payments.¹²² Buckley and Brooke¹²³ observe that, since lack of foreign exchange is a key factor constraining the growth of many LDCs, the balance-of-payments impact of repatriation of foreign exchange (by MNCs) is a source of concern and often of conflict. Thus exchange control regulations are frequently used in LDCs to prevent outflows; a phenomenon which, in turn, impacts negatively on much needed investment funds/capital.

In his attempts to lure foreign investors into this country, President Mandela has been promising potential foreign investors that they will be able to repatriate all their profits and other remittances (without restrictions?). Hirsch¹²⁴ has pointed out that when South Africa begins to grow again, it will face enormous pressures on its foreign payments balance. It is still to be seen therefore, whether the President's 'promises' can be reconciled with the 'danger' Hirsch foresees.

2.6.1.4 Sector-specific limitations and incentives

The 1991 UNCTC FDI Report¹²⁵ reports that virtually all countries that are significant recipients of FDI (mainly the OECD countries) have put a circle around some sectors of their economies from which FDI is restricted. For instance, in the OECD countries limitations on foreign ownership are placed on so-called "sensitive" industries such as

¹²⁰ This point is also emphasised by Roland Brown, Mike Faber and Max Sisulu, 'Policies toward inward foreign investment', in Raphael Kaplinsky (ed.), *IDS Bulletin*, Vol. 25., January 1994, p.47 (hereinafter, Brown *et al*).

¹²¹ Loc cit.

¹²² See Buckley and Brooke op cit 247.

¹²³ Ibid.

¹²⁴ Op cit 40.

¹²⁵ Op cit 12.

broadcasting, transportation, electronics, banking, insurance and other services.¹²⁶ In developing countries (e.g. Brazil), sectoral limitations are also common in industries such as petroleum, communications, transport etc.¹²⁷ The policies which deliberately bar foreign investors from entering these sectors and using their ownership advantages they possess in foreign markets in these industries, may create an environment that may be interpreted as hostile toward foreign investment.

In order to lure specific kinds of investments, the 1991 UNCTC FDI Report¹²⁸ recommends that a country may, (like India, Mexico, Singapore, and Venezuela) begin to offer sector-specific incentives. Pfeffermann¹²⁹ on the other hand suggests that, as a rule, unrestricted entry of foreign investment should be allowed. The least that governments can do, Pfeffermann¹³⁰ suggests, is to limit the number of sensitive industries (to industries related to national defence or highly protected industries). Further, the learned writer suggests that the types of investment activities that will garner incentives must be clearly defined and that these incentives must be granted automatically, thus minimising discretion or negotiation which may further lead to delays and corruption.¹³¹ Pfeffermann¹³² concludes by cautioning that foreign investors must not be favoured over local ones in granting incentives, as offering superior benefits to attract international capital is not only unfair to national entrepreneurs but will also encourage questionable JVs, in which foreign partners will be sought merely to qualify for incentives. In other words, government policy should be non-discriminatory to domestic and foreign firms alike, in line with the principle of national treatment.^{133 134}

¹²⁶ Ibid.

¹²⁷ Ibid.

¹²⁸ Ibid.

¹²⁹ Op cit 46.

¹³⁰ Ibid.

¹³¹ Ibid, 46-47.

¹³² Ibid.

¹³³ Ibid, 47.

¹³⁴ For a reading on the incentives South Africa gives in order to promote exports and access to foreign markets, see the following documents (available from the Department of Trade and Industry):

(a) Exports Promotion and Marketing.

(b) Guidelines in respect of the Export Marketing Assistance Schemes (EMA) (3/95).

(c) Guidelines for the General Export Incentive Scheme ("GEIS"), Revision No.4 : 1995-04-01.

2.6.1.5 Performance requirements

In general, performance requirements include government mandates which affect the content and composition of the value-added activities within a country.¹³⁵ The most common requirements are minimum exports¹³⁶ and local content¹³⁷ requirements. The former is sometimes expressed in terms of a foreign exchange balancing requirement, while the latter is sometimes expressed in policies which limit the use of foreign personnel and other imported inputs.¹³⁸ In some instances the host government may also dictate the nature of technology the investor proposes to use, as well as the manufacturing capacity.¹³⁹ Offerdal¹⁴⁰ says that in a number of studies conducted (e.g. by Agarwal (1980) and OECD (1989)) on the impact of these and other government regulations, it has been shown that such regulations appear to have had a definite impact on foreign investment, both by introducing additional costs, and by creating an environment that may be interpreted as hostile toward foreign investment.

In South Africa, the General Export Incentive Scheme (GEIS) was originally introduced on 1 April 1990 for an initial period of five years which ended on 31 March 1995. The main objective of GEIS was to counteract the anti-export bias in the South African economy.¹⁴¹ The Scheme was also intended to encourage higher levels of beneficiation of products before export and the export of products with 'a high South African content'.¹⁴² Recently, a revised GEIS was developed which entails a downward adjustment of the GEIS benefit levels, the elimination of certain structural imbalances (eliminating relative primary products from benefits), with the objective of eventually terminating the Scheme on 31 December 1997 in compliance with South Africa's commitments under the WTO.¹⁴³ Now, whether the scrapping of GEIS and concomitant performance

¹³⁵ The 1991 UNCTC FDI Report op cit 10.

¹³⁶ For examples of these requirements in the context of South Africa, see EMA op cit 6 and 12.

¹³⁷ See GEIS op cit 4 and 9.

¹³⁸ The 1991 UNCTC FDI Report loc cit.

¹³⁹ Ibid.

¹⁴⁰ Loc cit.

¹⁴¹ See GEIS op cit 3.

¹⁴² Ibid.

¹⁴³ Ibid.

requirements will result in increased inward foreign investment flows is still a matter to be investigated.

2.6.1.6 Investment promotion and trade missions

Many countries, including South Africa, do from time to time undertake expensive investment promotion efforts and sponsor trade missions to and from their countries with the objective of encouraging potential foreign investors to move production to these areas. When undertaking these efforts, it is advisable and important, so Pfeffermann¹⁴⁴ argues, not to do so until the investment climate at home is satisfactory.

This is quite interesting in the light of numerous visits overseas and talk to foreign heads-of-state and investors by President Mandela and Deputy President Mbeki and others *before* and immediately after the transition to democratic rule. At that time (as was the case with transition countries of central and eastern Europe in early 1990), there was still uncertainty about the durability of the transition process in South Africa.

In their study of FDI trends in central Europe since 1990, Lansbury *et al*¹⁴⁵ observed that there is a considerable risk associated with investments in the transitional economies due to the relatively unknown and unpredictable economic and social environment. In central Europe, factors such as the tax regime and the structure of property rights which were been implemented in situations of uncertainty and expectations may have played a role in determining FDI in those countries. The second issue pointed out by Lansbury *et al*¹⁴⁶ is that, there may be an important role for expectations, with investments during the transitional period being dependent on estimates of potential economic growth, the long-run level of the real exchange rate, and (in the case of Eastern Europe) the impact of market competition of newly privatised companies.

¹⁴⁴ Loc cit.

¹⁴⁵ Loc cit.

¹⁴⁶ Ibid. See also : United Nations Economic Commission for Europe, Economic Survey of Europe in 1993-1994, N.Y., 1994, p.5. Andrei Shleifer, 'Establishing Property rights', in Proceedings of the World Bank Annual Conference on Development Economics 1994, The International Bank of Reconstruction and Development, The World Bank, Washington DC., 1995, p.93 *et seq.*

In the case of South Africa, although there is still much work to be done to address the chronic imbalances of apartheid, it is now fairly accepted that the political system is durable. For instance, a Constitution with a justiciable bill of rights which protects and guarantees rights (e.g. right to property) is in place; the government's macroeconomic strategy is being implemented; and a market system committed to privatisation is entrenched. Whether or not South Africa is likely to see increased FDI flows into this country, now that some of the crippling uncertainties have been made certain, remains to be seen.

2.6.1.7 Capital and price controls

The 'free marketeers' hold the view that capital controls are impediments to market access and can eliminate all flows as such controls tend to make international transactions more costly and consequently discourage FDI.¹⁴⁷ These 'theorists' argue further that, while capital controls and other restrictions have been designed to limit foreign ownership of 'sensitive' domestic industries, they have, at the same time reduced competition both within domestic financial systems and in the provision of financial services across countries.¹⁴⁸

However, according to McKnight,¹⁴⁹ unfettered capital inflows can be detrimental to a country's economic development and liberalisation processes. The learned writer cites a certain IMF report which concluded that in some circumstances, capital controls have been useful in managing large capital inflows and reducing short term inflows.¹⁵⁰ For instance, McKnight¹⁵¹ points out that a number of countries that have experienced strong economic growth, including Chile, Malaysia and South Korea, have used taxes on short-term foreign loans and other measures to limit capital inflows and encourage long-term investment.¹⁵²

¹⁴⁷ See Determinants and Systemic Consequences of International Capital Flows, loc cit.

¹⁴⁸ Ibid.

¹⁴⁹ Loc cit.

¹⁵⁰ Ibid.

¹⁵¹ Ibid.

¹⁵² For further reading on policies to encourage capital flows through MNCs see Ari Kokko and Magnus

2.6.2 Other determinants of FDI

2.6.2.1 Locational determinants

2.6.2.1.1 *Host comparative advantage*

Traditional international trade theory states that trade takes place between countries on the basis of each country's comparative advantage. In their analysis of the determinants of American firms' investment decisions, Milner and Pentecost¹⁵³ conclude that where the cost of servicing a distant foreign market through arm's length trade are sufficiently high for example, it could be argued that US firms would have a greater incentive to invest, *ceteris paribus*, where internalisation provides greater access to specific sources of comparative advantage in the host economy. In fact, the learned writers mention that Baldwin (1979) has recorded evidence, for instance, of US manufacturing firms investing abroad in order to take advantage of a relative abundance of unskilled labour.¹⁵⁴

Now, one of the defining structural characteristics of the South African labour market (and hence its comparative advantage?), is that there is abundance of unskilled (African) labour, the majority of whom are unemployed. *Ceteris paribus*, and according to the traditional international theory of comparative advantage, is South Africa likely to see inflow of FDI from those foreign firms wishing to invest for exports in labour intensive sectors and wishing to take advantage of South Africa's abundance of unskilled labour? If so, will South Africa be able to compete with eastern and central European countries which have an abundance of low cost labour, but which is highly skilled?¹⁵⁵

Blomstrom, 'Policies to encourage flows of technology through foreign multinationals', in World Development, Vol. 23., March 1995, pp.459-468.

¹⁵³ Loc cit.

¹⁵⁴ Ibid. See also Lansbury *et al* op cit 109 who suggest that the cost of labour in the host country is potentially a major factor in the location decision, particularly for firms seeking to produce labour intensive products for exports. However, the learned writers point out that wage levels reveal only a part of the story. As far as they are concerned, what matters to the firm are differences in unit costs, taking account of the productivity of labour as well as wage levels.

¹⁵⁵ See Lansbury *et al* ibid.

2.6.2.1.2 *Host market size*

It is assumed that when attractive locational advantages prevail, then it could be expected that more inward investment would go into those industries with the largest ‘host’ market.¹⁵⁶ In fact, it is argued that one of the critical factors which prompted Western firms to invest in the economies of central and eastern Europe, was the desire on the part of these firms to take advantage of a large and potentially growing market for the products of these firms.¹⁵⁷ The same argument has been made in the case of China. In the case of South Africa, this country is perceived by many as a gateway to accessing the markets of the whole Southern African region, if not the markets of the continent as a whole. Does that make South Africa a possible destination for FDI?

Milner and Pentecost¹⁵⁸ seem to suggest that one of the consequences of the broadened host market accessed by inward investment is that the host market is likely to be more competitive as more producers enter the market in a given product. The learned writers seem to suggest further that competitiveness is a two-edged sword; it increases efficiency while at the same time reduces the opportunity for monopoly profits, and further reduces the incentive for inward investment to try to capture the “abnormal” returns it (inward investment) may wish to get from exploiting its ownership advantages to the fullest.

2.6.3 *Structural determinants*

There are a number of country-specific factors that may influence the location of foreign investment. These include human capital endowments, long term trading links, technological endowments, economic infrastructure, expenditure on research and development, and number of registered patents.¹⁵⁹ The impact of these factors on FDI has been illustrated in the following examples:

¹⁵⁶ See Milner and Pentecost *op cit* 607.

¹⁵⁷ Lansbury *et al* *op cit* 110.

¹⁵⁸ *Loc cit*.

¹⁵⁹ See Lansbury *et al* *op cit* 106. Milner and Pentecost *op cit* 108 and 109. Padayachee *op cit* 166.

- (1) Lansbury *et al*¹⁶⁰ state that a number of studies¹⁶¹ have suggested that investment in developing countries is positively associated with indicators of 'openness', typically measured by the ratio of total trade (imports plus exports) to GDP. Thus, liberal regimes accompanied by privatisation programmes, can act as a signal of the host authorities' commitment to private ownership.¹⁶²
- (2) It is suggested that one of the main impediments to FDI in Poland has been the lack of investment in infrastructure, particularly in upgrading rail and road links and telecommunications.^{163 164}

It is fairly intuitive that economic and political instability (which often go together) may contribute to an unfavourable investment climate.¹⁶⁵

2.6.4 *Economic determinants*

There are a number of economic variables that may influence foreign investors' decision to move production abroad. These include real per capita growth rate, real interest rate, level of per capita income, public investment rate, domestic inflation rate, and the external debt burden.¹⁶⁶ A number of studies of the East Asia economic development¹⁶⁷ have suggested that these variables (coupled with sound macro-economic policies) have played a critical role in attracting FDI to that part of the developing world. In fact, Ranis¹⁶⁸ suggests that the inflow of FDI to East Asia followed industrialisation in these countries, which means that these countries had generally an attractive investment climate from an economic point of view.

¹⁶⁰ Op cit 108.

¹⁶¹ Conducted by Harrison and Revenga (1995) and Hufbauer *et al* (1994).

¹⁶² Lansbury *et al* op cit 106.

¹⁶³ Ibid, 109.

¹⁶⁴ The likely impact which these and other factors may have on South Africa's chance of attracting FDI is discussed fully in chapter 3 of this dissertation.

¹⁶⁵ See Cull op cit 37. Padayachee loc cit. Lansbury *et al* loc cit.

¹⁶⁶ Greene and Villanueva op cit 40-41.

¹⁶⁷ See the writers at footnote 112 *supra*.

¹⁶⁸ Ibid.

2.7 Concluding remarks

During the 1980s and early 1990s many countries (in particular, developing and transition countries) changed their policies (toward MNCs for example) with the objective of attracting FDI. These policy changes included reduction of taxes, elimination of capital controls, granting of subsidies, removing restrictions on foreign ownership, profit repatriation, and access to foreign exchange.¹⁶⁹

The World Investment Report 1991¹⁷⁰ states however that, despite such substantial changes in policies, flows of FDI to developing countries have increased only slightly, and that those increases have tended to be concentrated in the largest and most rapidly growing developing countries of East Asia. From this observation, it can be concluded that policy changes by themselves may have a limited or no impact at all on FDI flows. In fact, the Report¹⁷¹ states that in a sample of 300 policy changes analysed statistically to assess the relative importance of policy changes and economic variables in explaining changes in flows of FDI to host countries, it was observed that, for most countries, the policy changes explained very little of the observed changes in FDI inflows; and that for developing countries in the sample (except of the NICs), the policy changes explained almost none of the flows of FDI.

According to this Report,¹⁷² the size of host country market has the most important determinant in the analysis, while in the sample of NICs, extensive policy liberalisation was accompanied by a significant augmentation of FDI inflows, indicating that policy changes enhanced the growing economic attractiveness of these countries as hosts to FDI.¹⁷³ From the discussion of trends in FDI to developing countries in the 1990s, it is

¹⁶⁹ For a fuller discussion of these changes see 1991 UNCTC FDI Report op cit 12-20.

¹⁷⁰ See footnote 84 *supra* op cit 27.

¹⁷¹ *Ibid.*

¹⁷² *Ibid.*

¹⁷³ However, this Report is not unaware that statistical analysis of the type undertaken in the research is limited in its ability to provide definitive answers. For example, the Report points out that when a

manifestly clear that basic economic conditions are the most important determinants of where MNCs engage in foreign production, and of how much capital they transfer to their foreign production location.¹⁷⁴ ‘In general, however, while appropriate policies appear to be a necessary precondition for attracting FDI, they are not sufficient, by themselves, to improve the ability of host countries to obtain larger inflows of FDI’.¹⁷⁵ In short, when considering policy changes, it is difficult and inadvisable to make general statements about the effectiveness of FDI policies, since each policy instrument has a different effect on a different aspect of the firm’s operations.¹⁷⁶

policy change is recorded, it is not always possible to distinguish whether one type of policy change is more important than another.

¹⁷⁴ See World Investment Report 1991 op cit 29.

¹⁷⁵ Ibid.

¹⁷⁶ For a detailed treatment of the issues involved in policy changes and their impact on various aspects of the firm’s operations see the 1991 UNCTC FDI Report op cit 23-28.

CHAPTER THREE

FOSTERING FOREIGN DIRECT INVESTMENT: CHALLENGES AND OPPORTUNITIES FOR THE 'NEW' SOUTH AFRICA

3.1 Introductory remarks

In the previous chapter, we discussed some of the policies and factors which are regarded as important determinants of FDI. In this chapter, we shall discuss some of these determinants in the context of South Africa, in an attempt to assess this country's chances of ever being a possible destination for FDI in the context of the prevailing world trading environment. As discussed in chapter one, the prevailing world trading system is characterised by, *inter alia*, globalisation of world markets, internationalisation of production, and a proliferation of inward looking regional trading blocs. In seeking to address the problems currently besieging both the developing countries and countries in transition, these countries (including the NICs) are destined to compete fiercely to attract FDI flows into their respective economies. The major policy changes introduced by many developing countries and countries in transition during the late 1980s and early 1990s with the objective of creating a domestic climate conducive to FDI and improved beneficial trade links with the international community¹ are cases in point.

It is intuitive that the 'new' South Africa will enter that competition, more so because it 'has shed some of its share in world trade over the period 1965 to 1985', and that '[M]ost probably the newly industrialising countries have conquered part of South Africa's market'.² No doubt, South Africa will introduce new policy changes (like scrapping GEIS and other export incentive schemes for instance?) which would be interpreted by potential foreign investors as conducive to FDI. The adoption of the new macroeconomic

¹ See Stephen Haggard and Sylvia Maxfield, 'The political economy of financial internationalisation in the developing world', in John S. Odell *et al* (eds.), *International Organisation*, Vol. 50., Winter 1996, p.35. See also discussion in chapter two of this dissertation.

² Timothy M. Shaw, 'South and Southern Africa in the new international division of labour and power : Development prospects in the 1990', in Adebayo Adedeji (ed.), *South Africa : Within or Apart?*, African Centre for Development and Strategic Studies, SADRI Books, Cape Town, Zed Books, London and New

strategic (by the GNU) which received the blessing of international financial institutions is a case in point.

3.2 Challenges for South Africa

3.2.1 *On the international level*

3.2.1.1 The 'Africa' factor

The previous apartheid government and its leadership sought to create a perception that South Africa was 'different' and apart from 'the rest of Africa'. That perception was false. South Africa is an inextricable part of the African continent, and its destiny is tied to that of the entire continent.

It is incontrovertible therefore, that the impact of the prevailing world trading system on Africa's trade and position in global trade will be felt in South Africa. This country entered a larger community of nations (after 1994) at the time when perceptions of foreign investors about Africa were negative (and still are). In the eyes of foreign investors and the powerful international financial institutions, Africa is a 'basket case' as far as world trade and FDI are concerned. In fact, some analysts (such as Coker³) have suggested that, after apartheid, South Africa will become irrelevant to the EU for instance and to the world at large. Nolutshungu on the other hand has suggested that the world in which South Africa emerged in 1994 is one

'in which South Africa has no greater salience than other semi-industrialised countries and, barring major changes in the international security situation, no particular strategic interest, apart from its minerals (now, however, likely to be quoted at a discount with the opening of supplies

Jersey, 1996, p.75, (quoting Strydom, 1987 : 205).

³ See Christopher Coker, 'Experiencing Southern Africa in the twenty-first century', in International Affairs, Vol. 67., 1991, pp.281-292. Coker's views on this point are shared by G.M.E. Leistner, 'Towards closer economic union in southern Africa', in D.J. van Vuuren, N.E. Wiehahn, N.J. Rhodie, and M. Wiechers (eds.), South Africa in the Nineties, HSRC Publishers, Pretoria, 1991, p.419. See also John Daniel, 'Southern Africa in a global context; Forever in the slow lane?', in The South African Journal of International Affairs (incorporating International Affairs Bulletin), Vol. 4., Summer 1996. p.86 who quotes one US corporate executive who is reported as having stated: 'who cares about Africa, it is not important to us; leave it to the International Monetary Fund (IMF) and the World Bank'.

from the former Soviet Union and with the Cold War over). The 'new' South Africa may expect no special consideration as far as economic assistance, foreign investment and access to markets are concerned'.⁴

Given the prevailing trends in world trade, FDI and regional integration,⁵ Cheru⁶ observes that MNCs will probably move away from further 'Third World' production. According to Cheru, this factor, and the fact that the rampant political and economic instability in Africa is inimical to investment, Africa - unlike South Asia - no longer has a comparative advantage in either low-cost labour or agricultural commodities.⁷ The triad (US, EU and Japan) is likely to be the relevant dominant force in world trade and FDI in the 1990s and beyond. These three power blocs are the major global investors, and are, at the same time the major recipients of investment.⁸ As far as Cheru is concerned '[A]s investment becomes concentrated among these powers⁹ few developing countries will benefit, other than some of the NICs and second tier countries'.¹⁰ Africa on the other hand, which barely accounts for one per cent of world trade, will certainly be the loser 'despite a decade of liberalisation at great social cost'.¹¹ As can be seen, the prevailing patterns of world trade and FDI that have excluded Africa, imply that most African nations will have little hope of attracting investment, and since Africa is not linked to any one of the triad blocs in a substantive way, this continent will be completely shut out of effective participation in global trade.¹²

⁴ John Daniel, 'South Africa's role in the changing world and its impact on the region', in Minnie Venter (ed.), Prospects for Progress : Critical Choices for Southern Africa, Maskew Miller Longman, Cape Town, 1994, p.28 (quoting Sam Nolutshungu).

⁵ These trends are discussed in detail in chapter one of this dissertation. See also Robert Swain, 'The European Communities and South Africa - new threats, new opportunities', in South Africa International, Vol. 23., July 1992 p.12.

⁶ Fantu Cheru, 'Africa and the new world order : Rethinking development planning in the age of globalisation', in Adebayo Adedeji (ed.), South Africa : Within or Apart?, African Centre for Development and Strategic Studies, SADRI Books, Cape Town, Zed Books, London and New Jersey, 1996, p.45

⁷ Ibid.

⁸ Ibid., 46.

⁹ Which account for approximately 80 per cent of investment, world-wide.

¹⁰ Cheru op cit 46.

¹¹ Ibid.

¹² Ibid., 49. See also Lawrence R. Klein, 'Future trends and issues in world trade and economic development', in Keio Economic Studies, Vol. 2., International Academic Printing Co, Tokyo, Japan, 1995, p.2.

South Africa, like its neighbouring African countries, faces a harsh international trading environment because it is still dependent on primary and semi-processed exports, against which the terms of trade have turned.¹³ Cheru maintains that most of South Africa's products are uncompetitive on international markets,¹⁴ and that this country's economy lacks the diversified human resource base that is a vital component of economic prosperity.¹⁵ Further, during the period 1980 - 1989, South African economy performed badly compared with the neighbouring countries.¹⁶ For instance, this economy performed at an average of 1,3 per cent, 'a strikingly depressing performance' compared with countries such as Botswana (11,4 per cent), Lesotho (2,9 per cent), Malawi (2.6 per cent), and Zimbabwe (2.7 per cent).¹⁷ It is clear therefore that South Africa is not likely to be any different from other African countries, nor it is it likely to emulate the NIC model in the near future.¹⁸ The daunting challenge facing South Africa therefore is, having to compete in a global economy dominated by the existing centres of power in North America, Europe and Japan, whilst also having to compete with the now well established NICs of mainly South, and South East Asia.¹⁹

3.2.1.2 The international 'political' factors

Munch²⁰ opines that South Africa's pariah status within the international community severely affected South Africa's ability to attract FDI from the early 1970s onwards; a phenomenon which eventually culminated in the almost unprecedented exclusion of this country from world financial markets in 1985.²¹ The punitive economic sanctions

¹³ Ibid., 63.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ibid.

¹⁷ Ibid.

¹⁸ See R. Stephen Brent, 'South Africa : Tough road to prosperity', in Foreign Affairs, Vol. 75., March/April 1996, p.118.

¹⁹ Shahid Qadir, 'A new South Africa', in Third World Quarterly, Vol. 15., June 1994, p.183.

²⁰ Ronaldo Munch, 'South Africa : The great economic debate', in Third World Quarterly, Vol. 15., 1994, p.205.

²¹ See Michael Duggan, 'Out from the cold : South Africa and international capital markets', in South Africa International, Vol. 22., July 1991, p.4 who suggests that after 1990 the international community, bankers and governments started relaxing their attitude toward South Africa (in the light of major positive political changes that were taking place then). In fact, Duggan mentions that the first new

imposed on South Africa by the international community (in an attempt to pressure this country to change its internal racial policies, and to force this country to implement the UN Security Council resolution 435 in Namibia²²) during the 1980s, have somewhat retarded the progress and integration of this country's economy into the world economy by at least a decade.

The negative perceptions which have built up in the minds of private investors and bankers after years of isolation, sanctions, violence, poor economic performance and political instability will take time to disappear.²³ According to Padayachee,²⁴ foreign companies which disinvested in the 1980s may be reluctant to make the psychological and logistical adjustments, and undertake the strategic calculations necessary to return so quickly. Padayachee points out further that some foreign companies may in fact be prevented from reinvesting in terms of agreements reached with the South African companies which bought them out.²⁵

The end of the Cold War is one of the factors poised to have great impact on countries such as South Africa.²⁶ In the context of southern Africa this has meant that superpower interest in this region, for strategic and political reasons, has declined;²⁷ and that overtime this part of the world will slowly be relegated to the 'forgotten past'.²⁸ This factor,

money borrowing on the international capital markets by any South African entity since the first half of 1985, was when the South African government raised (in 1991?) a \$50m, four-year bond on a private placement basis from a group of German banks and chartered West LB - the London-based merchant bank jointly owned by Standard Chartered Bank and Westdeutsche Landesbank. See also Deon Geldenhuys, 'The changing nature of foreign involvement in South Africa', in South Africa International, Vol. 23., April 1993, pp.147-155 where the learned professor discusses the involvement of international organisations (UN, OAU, the Commonwealth, as well as the EU) in the political life of South Africa in the period leading to the first all-inclusive general election of April 1994.

²² UN Security Council resolution 435 was adopted in the late 1970s calling for the holding of a general election in South West Africa/Namibia under UN supervision, with the objective of facilitating full Namibian independence and the ending of South African colonial rule in that country.

²³ Vishnu Padayachee, 'Foreign capital and economic development in South Africa : Recent trends and postapartheid prospects', in World Development, Vol. 23., Pergamon, February 1995, p.172.

²⁴ Ibid.

²⁵ Ibid.

²⁶ Ibid.,171.

²⁷ Ibid.

²⁸ Contrast the position of South Africa and the region with that of East Asia. Some commentators on the East Asian economic development suggest that the continued involvement of the US in the politics of the East Asian region has had a positive impact on the economic 'miracle' of East Asia. These commentators argue that American presence in that part of the world (which is primarily aimed at

combined with the increased competition for global funds from 'post Cold War' regions such as Eastern and Central Europe and the former Soviet Union, will tend to affect negatively the chances of South Africa of been able to play a dominant role in attracting FDI.²⁹ Some commentators³⁰ predict that in the future, major FDI flows to the developing countries will be concentrated in the NICs, the transition countries of Eastern and Central Europe, the former Soviet Union, and China.

Some analysts (such as Munch³¹ and Christie³²) argue that the position and attitude of the ANC immediately after the release of Nelson Mandela in 1990 and during the Convention for a Democratic South Africa (CODESA) talks, towards nationalisation (of mines, banks and monopolies), as well as the ANC's view that a post-apartheid ANC government may not feel obliged to honour the obligations of apartheid South Africa to international financial institutions and bankers, send wrong signals to potential investors and that these phenomena contributed to a reluctance on the part of potential foreign investors to invest as soon as an ANC-led GNU was installed.³³

'containing' Communist North Korea, Vietnam, Cambodia, and the People's Republic of China) meant massive injection of foreign funds (in the form of US dollars) into the economies of those East Asian countries (such as Taiwan, South Korea, Hong Kong, and Singapore) which had expressed a 'dislike' of centrally-planned economic activity typified by Communist economic philosophy. With the civil wars (sponsored by the US, the (former) Soviet Union, Cuba and apartheid South Africa) in Angola and Mozambique over; Namibia independent; and South Africa free, this region is no longer in the limelight of international focus and the funds which were coming into this region to finance the war effort have dried up completely.

²⁹ See Swain loc cit.

³⁰ See Cheru op cit 45. Margaret M. Pearson, [Joint ventures in the People's Republic of China : The Control of Foreign Direct Investment Under Socialism, Princeton, New Jersey, Princeton University Press, 1991], in Economic Development and Cultural Change, Vol. 44., October 1995, p.230 (Book Review). Dani Rodrik, 'Co-ordination failures and government policy : A model with applications to East Asia and Eastern Europe', in Journal of International Economics, Vol. 40., February 1996, p.1 *et seq.* Padayachee op cit 171.

³¹ Loc cit.

³² Michael Christie, 'US perceptions', in South Africa International, Vol. 23., July 1992, p.50.

³³ The ANC has since somersaulted on that position, and has in fact rejected nationalism (of banks etc.) as a principle.

3.2.1.3 The international 'economic' factors

It is a trite point, but worth emphasising, that South Africa, like any other country in the world, will be affected by developments in the global economy, and that its policies (designed to attract FDI) ought to take into account the prevailing trends in world trade and FDI.

Padayachee³⁴ observes that forecasts of economic growth, both globally and in Europe, for the rest of the decade remain mixed. The learned writer predicts that GDP per capita for the world as a whole is forecast to increase by just 1,8 per cent between 1990 - 2000, though the prospects for China (4,2 per cent), South and East Asia (3,9 per cent), and Eastern Europe (including the former Soviet Union) (3,0 per cent) are much brighter.³⁵ According to Padayachee, the developed market economies (DMEs) are expected to grow per capita at only 2,6 per cent during the same period.³⁶ As mentioned above, all these global developments will obviously affect South Africa's trade and investments prospects adversely, as they will those of other highly open developing countries.³⁷

It was mentioned in chapter one that in the context of the global economy, South Africa remains a small, open, mainly primary exporting country that plays a marginal role in the global economy. It was further mentioned that this country's share of world trade and world economic growth has been steadily reduced in the 1980s, and its role has been further reduced by decades of economic isolation.³⁸

Now, South Africa's impressive minerals and metals base will be affected by a continued decline in demand for such products from the Western industrialised countries, accounted for by substitutes resulting from advances in biotechnology, micro-technology and bio-

³⁴ Loc cit.

³⁵ Ibid.

³⁶ Ibid.

³⁷ Ibid.

³⁸ Ibid.

engineering in these countries.³⁹ The only other countries that may still demand South Africa's minerals and metals are countries such as Japan, Taiwan, South Korea and Hong Kong, which may continue to be 'dependent for their economic growth on further imports of minerals and raw materials'.⁴⁰ Be that as it may, it seems that other long term structural changes in the international division of labour due to technological breakthroughs in, for instance, electronics, information technology and bio-engineering, as well as resource saving processing methods in other branches, threaten to marginalise minerals and metals producers (like South Africa that has depended, to a very large extent, on gold exports for its foreign exchange).

As far as primary agricultural products are concerned, South Africa is not likely to be treated any differently from a typical primary producer from the 'Third World'.

Pervasive protectionist policies, practices and measures in the industrialised countries will make it harder for new producers to penetrate many developed country markets.⁴¹

With the developed world now having organised itself into major powerful inward-looking regional trade blocs,⁴² most notably the EU and NAFTA, market access for countries like South Africa will increasingly be predicated upon separate, often bilateral negotiations that are less firmly based on non-discriminatory principles enshrined in the GATT/WTO system.⁴³ The current negotiations between the EU and South Africa on trade and market access are cases in point. The fact that such bilateral negotiations are not firmly based on non-discriminatory principles, but on reciprocal ones, may place a

³⁹ Ibid. See also Cheru loc cit.

⁴⁰ Padayachee, *ibid.*

⁴¹ Jesmond Blumenfeld, 'Sustainable growth after sanctions : Opportunities and constraints', in Ken Cole (ed.), Sustainable Development for a Democratic South Africa, Earthscan Publications, London, 1994, p.23. See also Swain op cit 15. John B Goodman, Debora Spa and David B Yoffie, 'Foreign direct investment and the demand for protection in the United States', in John S. Odell *et al* (eds.), International Organisation, Vol. 50., Autumn 1996, pp.565-589 where the learned writers discuss the demands of American firms for greater protection against imports from other (developing and developed) countries. Edward John Ray, 'Changing patterns of protectionism : The fall in tariffs and the rise in non-tariff barriers', in Jeffrey A. Frieden and David A. Lake (eds.), International Political Economy : Perspectives on Global Power and Wealth (2nd ed.), UNWIN HYMAN, London, 1991, Chapter 21.

⁴² For a discussion of intra-regional trade in the three major regional trading blocs, see Marc L Busch and Helen V. Milner, 'The future of the international trading system : International firms, regionalism and domestic policies', in Richard Stubb and Geoffrey R.D. Underhill (eds.), Political Economy and the Changing Global Order, MacMillan, London, 1994, p.260 *et seq.*

⁴³ Blumenfeld, *ibid.*

'weaker' party in a tight spot, in having to make reciprocal concessions (such as been forced to open its markets to the imports of a 'stronger' party) which may be injurious to its (i.e. the 'weaker party') trade patterns. Going back to the current South Africa-EU trade negotiations; South Africa will, no doubt, seek to persuade the EU to open its markets to South African agricultural exports - a matter that is likely to cause tension among various stakeholders and some members of the Lome Convention.⁴⁴

3.2.2 *On the national level*

Foreign-direct-investment-flows are not only determined by international events. There are some country-specific factors (such as government policies, human and natural resource endowments, level of economic growth, etc.) which play a crucial, if not a decisive role, in determining the final destination of foreign investment. We turn now to discuss some of those internal/domestic factors that are likely to be stumbling blocks in the way of inward FDI in South Africa.

3.2.2.1 The apartheid economy

Economic performance in apartheid South Africa has, since the early 1970s, been on a declining trend.⁴⁵ Abedian and Standish⁴⁶ claim that, in spite of dramatic increases in the gold price, the economy registered an average annual growth rate of only 2.9 per cent over that decade. According to the learned writers this poor economic performance was attributable to three factors. First, 'the internal and external pressure in South Africa led to declining confidence on the part of both foreign and domestic investors, and investment time horizons were shortened'. Second, 'the policy of import substitution

⁴⁴ Swain op cit 14. See also Martin Holland, 'From pariah to partner : Relations with the EU', in Greg Mills (ed.), From Pariah to Participant : South Africa's Evolving Foreign Relations 1990-1994, The South African Institute of International Affairs, Johannesburg, with assistance from the Standard Bank Foundation, April 1994, p.133.

⁴⁵ Peter Brixen and Finn Tarp, 'South Africa : Macroeconomic perspectives for the medium term', in World Development, Vol. 24, Pergamon, June 1996, p. 989. See also Iraj Abedian and Barry Standish, 'The South African economy : and historical overview', in Iraj Abedian and Barry Standish (eds.), Economic Growth in South Africa : Selected Policy Issues, Oxford University Press, Cape Town, 1992, p.9. Blumenfeld, op cit 15.

⁴⁶ Ibid.

reached its limits, yet export promotion (despite being recommended by the Reynders Commission in 1972) was never pursued seriously. Industrialisation slowed and manufacturing became dependent on the whims of the gold market'. Third, 'the poor conduct of monetary and exchange rate policies led to substantial inflation and inflationary expectations which further reduced investment'.⁴⁷

It is interesting to compare the economic developments in South Africa during that time (the 70s) with the developments in some East Asian countries. After the oil shock of 1973, global economic growth slowed down dramatically, and this factor had a devastating impact on South Africa's economic growth during that period. What is noteworthy is that, during the same period, a group of Asian developing countries were able not only to sustain their growth, but to do so in an outward oriented fashion.⁴⁸

Lawrence⁴⁹ points out that, in an era in which natural resources (such as oil and gold) and primary commodity prices soared it was, paradoxically, these poorly endowed nations in Asia that outperformed the rest. While the rest of non-oil producing developing countries were 'price takers' on the international commodity markets, the Asian developing countries⁵⁰ that had reoriented their economies toward export-led growth in the 1960s were able to penetrate foreign international markets for basic commodities, particularly steel, consumer electronics and textiles.

South Africa on the other hand, suffered severely in terms of trade and investment when economic sanctions were imposed and the importation into the EU of certain iron and steel products was banned.⁵¹ It is therefore not surprising that some analysts (such as Brent⁵²) have suggested that it is unlikely that South Africa will emulate the NIC model in the near future.

⁴⁷ Ibid.

⁴⁸ Robert Z. Lawrence, 'Trends in world trade and foreign direct investment', in Pauline H. Baker, Alex Boraine and Warren Krafchik (eds.), *South Africa and the World Economy in the 1990s*, David Phillip : Cape Town and Johannesburg, The Brookings Institutions : Washington DC, in association with IDASA and The Aspen Institute, 1993, p.19. (hereinafter, 'Baker *et al* (eds.)').

⁴⁹ Ibid.

⁵⁰ For example, South Korea, Hong Kong, Singapore, Taiwan.

⁵¹ Holland *op cit* 129. See also Brixen and Tarp *loc cit*.

⁵² *Loc cit*. See also Cheru *op cit* 64.

Traditionally, South Africa has relied heavily on exports of minerals, especially gold, for the bulk of its export earnings. Although the price of gold rose during the late 70s, by 1992 however, earnings from gold exports had fallen to less than 23 per cent (from the previous high of some 30 to 35 per cent) of total export earnings.⁵³ For this reason, and the fact that South Africa's minerals are likely to be quoted at a discount with the resulting competition due to the opening of supplies from the former Soviet Union, this country (South Africa) faces a major challenge (on the international front) of finding ways to diversify and to strengthen exports.⁵⁴ The experience of East Asia shows that those countries that adopted export-led economic policies were able to expand trade and increase inward FDI. As Bell (1990): p 22)⁵⁵ explains, in these developing countries FDI has generally been a consequence rather than a cause of rapid industrialisation.

South Africa's industry developed behind protective barriers and is, as a result, inefficient by international standards.⁵⁶ Low productivity and high unit labour costs of production have made most South African products/exports uncompetitive on international markets.⁵⁷ Blumenfeld⁵⁸ explains that this situation was aggravated by the labour policies of the apartheid era which, in seeking to deliver supposedly 'cheap' (African) labour, severely prejudiced the productivity of the workforce by depriving it of skills, training, motivation and a stake in the mainstream of economic activity.

The learned writer explains further that, by concentrating wealth in the hands of the few (whites), apartheid also had an adverse impact on efficiency in that production was necessarily restricted to a small scale due to the limited size of the domestic markets.⁵⁹ It goes without saying therefore that, the 'new' South Africa is faced with a daunting task of improving export performance, by having to make its exports internationally competitive

⁵³ Blumenfeld op cit 20. See also Leo Katzen, 'The employment problem in post-apartheid South Africa', in Ken Cole (ed.), Sustainable Development for a Democratic South Africa, Earthscan Publications, London, 1994, p55.

⁵⁴ Blumenfeld, *ibid.*

⁵⁵ Referred to by Padayachee op cit 164.

⁵⁶ Blumenfeld op cit 24. See also Sanjaya Lall, 'What will make South Africa internationally competitive', in Baker *et al* (eds.) op cit 50^r. Cheru op cit 63.

⁵⁷ Blumenfeld, *ibid.* Cheru, *ibid.*

⁵⁸ *Ibid.*

⁵⁹ *Ibid.*

and its production efficient. This is not an easy task, and it threatens to create some painful dilemmas for policy making in the 'new' South Africa.⁶⁰ For instance, in order to improve efficiency and competitiveness in the manufacturing industry, it is argued that it will require a reduction in production costs per unit of output, or greater productivity per unit of input (or both).⁶¹ It is further argued that wage increases may have to be halted as they cannot be allowed to run ahead of productivity increases. This point is destined to be a thorny one to black trade unions that are bent at improving their members' wages.⁶²

3.2.2.2 The apartheid education and training system

One of South Africa's greatest weaknesses when compared to other developing countries (like Singapore, Taiwan, Hong Kong) which successfully made the transition to high growth, is the poor quality of its education and training system, which has affected the quality levels of its workforce.⁶³ Some of the defining characteristics of 'bantu education' are as follows. Compared with whites, Africans in education had a worse pupil-teacher ratio (38:1 vs 17:1), more underqualified teachers (52% vs 0%), lower per capita education expenditure (R765 vs R3082), and a significantly worse std 10 pass rate (40,7% vs 96%).⁶⁴ Munslow and Fitzgerald⁶⁵ point out that, perhaps the most startling educational statistics is that 53% of the white labour force matriculated compared with only 2.2% of blacks, a phenomenon which, according to the learned writers, is not surprising, given the fact that in 1987 for instance, only one seventh of the amount spent on each white child's education was spent on each black child.

The university students to population ratio is 31 per 1000 for whites, which is among the highest in the world.⁶⁶ For blacks it is 2,5 per 1000.⁶⁷ According to Padayachee,⁶⁸ fifty

⁶⁰ Ibid.

⁶¹ Ibid.

⁶² Blumenfeld op cit 25.

⁶³ Padayachee op cit 172.

⁶⁴ Barry Munslow and Patrick Fitzgerald, 'South Africa : The sustainable development challenge', in Third World Quarterly, Vol. 15., 1994, p.228.

⁶⁵ Ibid.

⁶⁶ Padayachee, loc cit.

⁶⁷ Ibid.

⁶⁸ Ibid.

one per cent of African students are located in the historically black universities (which are faced with crippling financial difficulties). Further, there is a highly racially skewed output of professionals from the universities, 87% of engineering and science graduates being white.⁶⁹ As can be seen, technical knowledge is restricted almost exclusively to a minority of whites (some of whom are constantly threatening to leave, while others are emigrating from South Africa).

It is axiomatic that the development of South Africa's human resource base is essential to the efficient use of advanced information technologies, and the present limitations may pose an obstacle to those potential foreign direct investors whose operations are heavily reliant on a highly skilled and technologically advanced labour force.⁷⁰

It has been argued⁷¹ that MNCs may seek to locate in host countries with a well-established research base, and a reasonably high expenditure on research and development (R&D). As far as South Africa is concerned, Clark⁷² maintains that this country has been allocating a declining percentage of its GDP to R&D over the last few years, while most of the developed nations have, over the last 10 - 20 years, been spending a higher and higher percentage of GDP on R&D. Contrast this position (in South Africa) with the one in South Korea. Clark mentions that South Korea which spent less in the 1950s than South Africa is currently spending on R&D, is now spending more than the United States in percentage terms, and that the Koreans plan to spend in excess of 4,5 per cent of their GDP on R&D by the end of the century.⁷³ In South Africa, much of expenditure on R&D was accounted for by government, and not by the private sector as it happens in developed countries like Japan and US.

Clark says although it is difficult to evaluate the return on investment on science and technology (S&T) in the way that one would measure return on investment in a business,

⁶⁹ Ibid.

⁷⁰ Ibid. A worrying factor was reported in Sunday Times of 24 November 1996, p.1 showing that South African kids scored the lowest points in both mathematics and science in an international test. The list was headed by children from East Asian countries.

⁷¹ See Melanie Lansbury, Nigel Pain and Katerine Smidkova, 'Foreign direct investment in Central Europe since 1990 : An econometric study', in National Institute Economic Review, 2/96, May 1996, p.109.

⁷² J.B. Clark, 'The intraregional transfer of technology', in Africa Insight, Vol. 21, 1991, p.20.

⁷³ Ibid.

some studies (done by Solow in the 1950s on impact of S&T on economic growth in the US over a period of almost a century, and in the EU) indicate that typically, 40-90 per cent of economic growth in the developed nations of the world is directly attributable to the implementation of new S&T.⁷⁴ In other words, according to Clark, the value of S&T for the nation does not lie in the pursuit of S&T for its sake, but in the benefits a nation derives from the implementation of the products of S&T. South Africa will have to re-adjust its budget to ensure that S&T and R&D are given the priority they deserve. Whether the 'new' South Africa will be able to do this in the face of other pressing issues such as housing, unemployment etc. remains to be seen.

3.2.2.3 Other apartheid consequences

Successive white minority governments (before and after 1948) were bent at excluding Africans from mainstream economic activity through various measures, notable so, through legislation. Abedian and Standish⁷⁵ say that while inherently racialistic legislation existed before 1948 (e.g., the Land Acts of 1913 and 1936), apartheid marked a turning point in racially repressive legislation.

The learned writers argue that it was as a direct result of these laws (e.g. Group Areas Act, Job reservation Act, Influx Control measures, etc.) that South Africa emerged with one of the most skewed distribution of income in the world (measured by Gini Co-efficient of 0,71).⁷⁶ Influx Control laws for example prevented people from improving their relative standard of living by urbanisation and confined Africans to the rural 'homelands'.

The cumulative impact of apartheid has left this country with many deep scars: serious overcrowding in townships, squatter camps and environmentally degraded 'homelands'; low per capita income among Africans; the majority of Africans live below the poverty

⁷⁴ Ibid., 19.

⁷⁵ Op cit 7.

⁷⁶ Abedian and Standish op cit 8 & 9. See also Munslow and Fitzgerald op cit 227. F. Wilson and M. Ramphela, Uprooting Poverty : The South African Challenge, David Phillip, Cape Town, 1989, p.18. Desmond Lachman and Kenneth Bercuson, Economic Policies for a New South Africa, Occasional Paper 91, IMF, Washington DC, January 1992, p.3 *et seq.* Brixen and Tarp loc cit.

datum line; illiteracy; unemployment; widespread poverty, *ad infinitum*. It is intuitive that an economy characterised by such a legacy is not a favourable location for foreign investment flows. Whether the introduction of new legislation and implementation of the RDP will reverse this legacy in order to create a climate conducive to foreign investment remains to be seen.

3.3 Opportunities for South Africa

3.3.1 *On the international level*

3.3.1.1 The end of international isolation

The advent of a democratic dispensation in South Africa and the end of apartheid rule have many positive things in store for the 'new' South Africa. For instance, the removal of politically motivated constraints (economic and financial sanctions) on South Africa's full participation in the world economy, is expected to bring many new opportunities for foreign trade, foreign investment and foreign economic assistance.⁷⁷ Although bilateral and multilateral financial assistance is unlikely to reach Marshall Plan proportions, South Africa stands a good chance of receiving some amounts of official development assistance as the international community seeks to 'reward' this country's transaction to democracy.⁷⁸

The opportunities following the ending of South Africa's international isolation, embrace increases in both trade and capital flows. According to Blumenfeld,⁷⁹ on the trade front, the removal of most trade sanctions has not merely allowed for re-entry to traditional markets, especially in Europe and North America (where sales of South African products were inhibited by sanctions in the mid-1980s) but has also opened up the possibility of developing new markets all over the world and which hitherto have been closed to a greater or lesser extent to South African producers for political reasons.

⁷⁷ Blumenfeld op cit 13. See also Padayachee op cit 170.

⁷⁸ Padayachee, Ibid.

⁷⁹ Op cit 15.

On the investment front, Blumenfeld opines that the multitudes of exploratory visits (and trade missions) from foreign corporations is testimony to the potential that they perceive not only for bi-lateral trade with , but also for investment in the 'new' South Africa.⁸⁰

3.3.1.2 The 'Southern Africa' factor

South Africa is viewed by many, including the international community as a 'gateway' to Africa, and Southern Africa's 'engine of growth'.⁸¹ Given its comparatively strong dynamic economy, South Africa is poised to attract to the region investments, entrepreneurship and skills from overseas. Padayachee⁸² claims that there has been enormous pressure both within and outside the World Bank about its role and lack of success in recent years, especially in Sub-Saharan Africa. According to Padayachee, South Africa appears (in the eyes of the World Bank and other institutions) to have been latched upon as a possible success story in this part of the continent where the World Bank and the IMF have failed miserably.⁸³ In other words, the fact that South Africa is viewed by its neighbours and the world as a catalyst of economic growth and development, and the last ray of hope of ever making the economies of Sub-Saharan Africa relevant and important in the broader changing world economy, suggests that this country is likely to receive foreign investment capital, the spin-offs of which will rejuvenate the entire region.⁸⁴ With the civil wars in Angola and Mozambique over, and stability restored in South Africa, this region is likely to be a viable destination for FDI, the bulk of which is expected to go to South Africa.^{85 86}

⁸⁰ Ibid.

⁸¹ Erich Leister, 'Post-apartheid South Africa's economic ties with neighbouring countries', in Development Southern Africa, Vol. 9., Halfway House, May 1992, p.169.

⁸² Loc cit.

⁸³ Ibid.

⁸⁴ See Desmond Colborne, 'South Africa and France - A new realism', in South Africa International, Vol.22, July 1991, p.43.

⁸⁵ Ibid. See also Padayachee op cit. 171-172. Swain op cit 16.

⁸⁶ Rudolf Gruber, 'Germany - the cost of unification', in South Africa International, Vol. 23, April 1993, p.170 maintains that there is a deep political perception and awareness that Europe cannot allow the neighbouring continent (Africa) to collapse into anarchy and destitution, and in this context, there is recognition that South Africa could be the kingpin to recovery and redevelopment.

3.3.1.3 The World Trade Organisation and implications for South Africa

The UR negotiations resulted in the firm commitment by as many as 124 nation participants from both developing and industrial countries to liberalise international trade, by reducing tariffs and nontariff measures substantially, and by reducing both nontariff support in agriculture and barriers to trade in services.⁸⁷

Zarrouk⁸⁸ maintains that these trade-liberalising measures will improve access to developed country markets, which is important for countries that have implemented macroeconomic and structural policy reforms aimed to increase efficient resource allocation. In the case of South Africa, Matona⁸⁹ is of the view that, despite having faced adverse external trading conditions due to political and economic sanctions for most of the past decade, this country stands to gain substantially from the WTO's market opening results, not only in its (South Africa) traditional markets (Europe and North America) but also in new ones (e.g. Asia, Latin America, and possibly Central and Eastern Europe).

The other notable result of the UR, is that it increased the rules-based security of access to world markets through strengthened and expanded disciplines, procedures, and institutions, within the multilateral trading system.⁹⁰ According to Zarrouk,⁹¹ such systemic improvements that protect the 'weak' and restrain the 'powerful' should benefit small developing countries (like South Africa). The installation of a legitimate democratic government in South Africa has resulted in the normalisation of this country's trade relations and the restoration of its trade rights within the WTO.⁹²

Matona⁹³ points out for instance that, a benevolent attitude toward South Africa (following the installation of democracy) is reflected in the granting of limited special concessions such as longer phase-in periods in agriculture and textiles and clothing in the

⁸⁷ Jamal Zarrouk, 'Policy implications of the Uruguay Round for Arab countries', in Said El-Naggar (ed.), The Uruguay Round and the Arab Countries, IMF, Washington DC, 1996, p.66.

⁸⁸ Ibid.

⁸⁹ Tsediso Matona, 'From GATT to the World Trade Organisation : Opportunities and constraints for South Africa', in Trade Monitor, Vol. 9, June 1995, p.18.

⁹⁰ Zarrouk loc cit.

⁹¹ Ibid.

⁹² Matona loc cit.

⁹³ Ibid. and 19.

UR, as well as of preferences (e.g., Generalised System of Preferences (GSP)) outside the GATT, which are in principle, effectively precluded by South Africa's traditional classification as a 'developed' economy in the GATT.^{94 95}

3.3.2 *On the national level*

3.3.2.1 The economic framework

South Africa is a relatively large country with a low population density, abundant natural resources, as well as a developed infrastructure and annual per capita income of US\$ 2800.⁹⁶ South Africa is thus placed among the upper middle-income countries, and is the dominant economic power in southern Africa.⁹⁷ Padayachee⁹⁸ says that aggregate net resource flows to developing countries mainly in the form of private direct and portfolio investment and banking lending in 1992, were destined for countries such as Argentina, Brazil, Mexico, Turkey and South Korea, mainly middle and upper income developing countries sharing many common characteristics with South Africa. In other words, South Africa's relatively strong economy (as compared to other African economies) is likely to be an attraction to potential foreign investors who may look for investment opportunities in this part of the world.

⁹⁴ Matona, *ibid*, 20 makes an interesting observation that, an argument against South Africa's formally reclassifying itself as a "developing" country (as opposed to the present "developed" status by GATT/WTO) has surfaced in South Africa; it is to the effect that a "developing" status may lower this country's investment profile! Alan Hirsch, 'The external environment and the South African trade policy debate', in Economic Trends Research Group, Development Policy Research Unit, Working Paper No. 13, UCT, Rondebosch, 1992, pp.1-2, on the other hand, argues that 'the moment of re-admittance to the world economic community will be a unique opportunity to re-negotiate South Africa's status from developed to developing country, which would remove some of the reciprocal obligations of the GATT[WTO] (though the trend in the GATT[WTO] is away from special conditions for developing countries'.

⁹⁵ For examples of preferences extended to South Africa by some OECD countries, after the installation of a democratic government, see P.D.F. Srydom, 'International trade and economic growth : The opening - up of the South African economy', in The South African Journal of Economics, Vol. 63., December 1995, p.557.

⁹⁶ See Munslow and Fitzgerald *loc cit*. See also GATT, Trade Review Policy : South Africa, Vol. 1, Geneva, September 1993, p.9. (hereinafter 'TRP : SA Vol. 1').

⁹⁷ TRP : SA Vol. 1, *ibid*. See also Leistner *op cit* 492.

⁹⁸ *Op cit* 170.

South Africa derives approximately 70 per cent of its export earnings from mining, of which gold accounts for one-half.⁹⁹ Belli *et al*¹⁰⁰ maintain that, among its mineral resources, South Africa accounts for approximately 44 per cent of all the gold produced in the world (excluding the former Soviet Union). South Africa is also the second largest producer of manganese, chrome, antimony and lithium.¹⁰¹ Other important mineral resources include asbestos, vanadium, uranium, nickel, coal and iron ore. This country also produces maize, wool, sugar, wheat and several fruits, including grapes 'which support a growing wine industry'.¹⁰² Further, South Africa has an extensive coastline with important fishing resources. As far as the manufacturing sector is concerned, although small by international standards, Belli *et al*¹⁰³ maintain that it is very diversified and includes chemicals, textiles, shipbuilding, pulp and paper, and various consumer goods industries, as well as a highly protected motor vehicle industry.

Besides these resources, South Africa has an impressive physical infrastructure (airports, harbours, railways, electricity, etc.), a sophisticated financial, banking, legal and communications network, as well as lengthy and (until the mid-1980s¹⁰⁴) impeccable standing and repayment record with the IMF, World Bank and private bankers.¹⁰⁵

When all these factors are taken together, they portray a country that is not a typical 'Third World' country. The determinants of FDI discussed in chapter two suggested that a country with South Africa's natural resources, a high annual per capita income, and superb physical and institutional infrastructure should be able to attract foreign investment.

South Africa has managed to keep strong trading links with major trading nations such as Japan, the US and the EU - even during the years of isolation. For instance, according to

⁹⁹ Pedro Belli, Michael Finger and Amparo Ballivian, South Africa : A Review of Trade Policies, Discussion Paper No.4., The World Bank Southern Africa Department, World Bank, Washington DC, 1993, p.44. (hereinafter 'Belli *et al*').

¹⁰⁰ *Ibid.*, 43.

¹⁰¹ *Ibid.*

¹⁰² *Ibid.*

¹⁰³ *Ibid.*

¹⁰⁴ At the end of 1985 South Africa introduced a debt standstill agreement.

¹⁰⁵ Padayachee *op cit* 171.

Belli *et al.*,¹⁰⁶ Germany was the leading exporter to South Africa in 1989, providing almost 17 per cent of the country's total imports, while the US represented almost 14 per cent, the UK 12 per cent and Japan 10 per cent. Developing countries in Asia on the other hand, provided approximately 4 per cent of South Africa's imports in 1989, while 2 per cent originated in various African countries and the same proportion in several Latin American countries.¹⁰⁷

As far as South African exports are concerned, the group of industrial countries represented 43 per cent of this country's exports in 1989, while the developing countries' share of South Africa's exports was 12 per cent in the same year.¹⁰⁸ Among industrial nations, the US and Japan are the most important markets for South African exports (8 per cent each in 1989), followed by the UK (6 per cent), the Netherlands (4 per cent), and Switzerland and Germany (3 per cent each).¹⁰⁹ South Africa's established trade links with the industrial countries as well as other advanced developing countries will provide a basis for this country's trade links with other countries (in Africa, Asia, and Central and Eastern Europe) which were not South Africa's traditional trading partners. As can be seen, this country stands a good chance of attracting foreign investment capital should other countries wish to establish trade and other links with South Africa. The recent (March 1997) tour of President Mandela of East, South and South-East Asia and India has further resulted in the signing of important trade and co-operation agreements with countries such as Malaysia, Brunei and others. These countries have indicated a desire to expand their trade links with the Republic of South Africa.

The GNU under the leadership of the ANC is committed to a free market economic system, embodied in its macroeconomic strategy which aims to achieve the following, *inter alia*, a faster fiscal deficit reduction programme to contain debt service obligations, counter inflation and free resources for investment; a further step in the gradual relaxation of exchange controls; speeding up the restructuring of state assets (privatisation) to optimise investment resources; and an expansion of trade and

¹⁰⁶ Op cit 44.

¹⁰⁷ Ibid.

¹⁰⁸ Ibid.

investment flows in Southern Africa.¹¹⁰ The strategy has received the blessing of the IMF and World Bank, and should therefore be good news to potential foreign investors who may wish to take advantage of the opportunities opening up in the South African economy due to the government's commitment to privatisation and relaxation of exchange controls- to mention but two.

3.3.2.2 The legal framework

The legal framework is one of the key determinants of FDI. In our discussion of the determinants of FDI (in chapter 2), it was mentioned that a number of developing countries and countries in transition enacted new legislation (e.g. privatisation laws, regulations providing for the removal of capital controls) during the 1980s and 1990s with the aim of creating a (legal) environment conducive to foreign investment. This is not surprising because, as Elster¹¹¹ explains, laws and regulations matter for economic performance insofar as they promote the values of stability, accountability, credibility and predictability.

In South Africa the laws and regulations of relevance to trade and investment include the Customs and Excise Act of 1964; Import and Export Control Act of 1963; Board on Tariffs and Trade Act of 1992; Industrial Development Act of 1940; Maintenance and Promotion of Competition Act of 1979; Marketing Act of 1968; Export Credit and Foreign Investments Reinsurance Act of 1957; Copyright Act of 1978; Convention on Agency in the International Sale of Goods Act of 1986; Agricultural Product Standards Act of 1990; Liquor Products Act of 1989; Sugar Act of 1978; State Tender Board Act

¹⁰⁹ Ibid.

¹¹⁰ Department of Finance, Growth, Employment and Redistribution : A macroeconomic strategy, p.3.

¹¹¹ Jon Elster, 'The impact of constitutions on economic performance', in Proceedings of the World Bank Annual Conference on Development Economics 1994, The International Bank for Reconstruction and Development, The World Bank, Washington DC, 1995, p.209. Elster discusses how various components, institutions and procedures in a constitutional democracy impact on economic performance and the trade-offs involved. For instance, Elster at p.217 suggests that there is conventional wisdom to the effect that (a) social rights promote social security, while at the same time they (social rights) may undermine economic efficiency; and (b) that economic rights promote economic efficiency, while at the same time they may undermine economic security. See however the criticism of Elster's propositions by "comments" made by Adam Przeworski at p.227 *et seq.* and Pranab Bardham at p.232 *et seq.* in *ibid.* on Elster's paper *supra*.

of 1968; Guidelines for the General Export Incentive Scheme (GEIS) and the final Constitution (Act 108 of 1996). Among these, the more important are the Customs and Excise Act, the Import and Export Control Act, the Board on Tariffs and Trade Act, and the Constitution.

The Customs and Excise Act provides the enabling legislation for tariffs, other import charges, including surcharges and antidumping and countervailing duties, and duty refunds and rebates. The Minister of Finance may amend the relevant Schedules to the Act with amendments published in the Government Gazette and reported once a year to Parliament, where they are subject to ratification. The Act also makes provision for appeals, to the High Court if necessary, on customs valuation and tariff decisions. The Import and Export Control Act provides statutory authority for quantitative border controls, with regulations issued by the Department of Agriculture and Land Affairs on products of concern to the latter.

The new Board on Tariffs and Trade Act changed the name of the Board from the Board of Trade and Industry and specified its functions more clearly. The Act defines dumping and subsidisation with respect to imports, as well as disruptive competition, and provides that regulations relating to anti-dumping and countervailing action be issued by the Minister of Trade and Industry. Previously the Board made recommendations to the Minister of Finance. Under the amended Act, the Minister of Trade and Industry assumes responsibility for the determination of action against unfair trading practices, in effect giving the Minister greater authority and allowing for co-ordination with overall trade policy. However, Customs and Excise Act still provides for the implementation of the relevant duties of the Minister of Finance.

One of the important issues about a legal framework to an investor, is the position, nature and scope of property rights thereof. According to Schmidt-Hebbel *et al*,¹¹² from a practical point of view, the formal definition of property rights must be complemented by a judicial system that guarantees their effective enforcement. In other words, 'the lack of

¹¹² Klaus Schmidt-Hebbel, Luis Serven and Andre Solimano, 'Saving and Investment : Paradigms, Puzzles, Policies', in The World Bank Research Observer, Vol. 11., February 1996, p.107.

impartial mechanisms to resolve contractual disputes increases the costs of doing business by increasing the probability that contracts will not be respected and that expenses such as bribes will become necessary to enforce them'.¹¹³ Needless to mention that FDI is likely to be fostered in a legal environment that guarantees and protects property rights, and provides mechanisms to enforce them.¹¹⁴

Now, in the case of South Africa the most important piece of legislation is the Constitution. The final Constitution¹¹⁵ guarantees certain fundamental rights, including the right to property (s25), right of access to court (s34), administrative justice (s33), and the right to economic activity (s22). Although the Constitution provides for expropriation of property (in s25(2)), it also sets out the grounds upon which such state action could be undertaken (see s25(2)(a),(b) and (3)), and the remedies (see s33(3)(a), (b) available to an aggrieved party for instance. As can be seen, the present and future trade and investment laws and regulations would be measured up against the dictates of the supreme law, thus guaranteeing to persons (both natural and juristic) a measure of protection, predictability and stability.

In addition to these domestic laws and regulations, South Africa is also party to a host of multilateral and bilateral agreements/arrangements that may have an impact on its trade and investment policies. On multilateral bases, South Africa was a founding member of the GATT and has participated in all subsequent rounds of multilateral trade negotiations. South Africa has accepted the MTN Tokyo Round Agreements on Customs Valuation and Import Licensing.¹¹⁶ [In 1993] South Africa had observer status in the MTN Agreement on Government Procurement, Subsidies and Countervailing Action and Anti-Dumping.¹¹⁷ This country also participates in the International Dairy Agreement and the Arrangement on Bovine Meat, but not in the Multifibre Arrangement.¹¹⁸

¹¹³ Ibid.

¹¹⁴ This point is also made by Paul Krugman, 'Changes in Capital Markets for developing Countries', in Baker *et al* (eds.), *op cit* 47.

¹¹⁵ Act 108 of 1996.

¹¹⁶ TRP : SA Vol. 1, *op cit* 47.

¹¹⁷ Ibid.

¹¹⁸ Ibid.

In addition to commodity arrangement in the GATT/WTO, South Africa is a member of the International Wheat Council and the International Cotton Advisory Committee. It has also acceded to the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) and the Montreal Protocol on Chlorofluorocarbons.¹¹⁹

On bilateral bases, in addition to the Southern African Customs Union, South Africa has trade agreements with Zimbabwe (since 1964 -but has since expired and a new one is been considered) and Malawi (1990, replacing a 1967 agreement).¹²⁰ South Africa also grants unilateral tariff concessions on certain imports from Mozambique and Turkey. The agreement with Zimbabwe applied only to imports into South Africa, while the Malawi agreement allows duty-free imports of all goods grown, produced or manufactured in Malawi.¹²¹ Some Central and Eastern European countries that concluded bilateral trade agreements with South Africa during the course of 1990 and 1991 include, Hungary, Romania and Poland. The GNU has further signed trade and co-operation agreements with countries such as Libya, Iran, Brunei, Malaysia, India and the People's Republic of China.

As can be seen, the legal framework for trade and investment in South Africa is quite extensive and covers many areas. Such an elaborate legal framework guarantees certainty and predictability (?), the two elements that are important to foreign investors.

3.4 Concluding remarks

Although South Africa faces huge macroeconomic problems (attributed to apartheid, international isolation, etc.) which may be stumbling blocks to trade and investment flows into this country, nevertheless, this country stands to gain from re-entry into the international community and market-opening policies enshrined in the GATT/WTO system. The challenge for policy makers is to see what appropriate interventions could be implemented to remove existing stumbling blocks to trade and investment, while at the

¹¹⁹ Ibid.

¹²⁰ Ibid., p.50.

¹²¹ Ibid.

same time maximising the potential that exists; and that is the subject of chapter four to which we now turn.

CHAPTER FOUR

FOREIGN DIRECT INVESTMENT IN THE 'NEW' SOUTH AFRICA: POLICY IMPLICATIONS

4.1 Introductory Remarks

The world trading system is currently undergoing profound changes in trade and investment patterns, as well as in regional integration arrangements. These changes are poised to influence the position of South Africa and the role it may play in the world economy of the 1990s and beyond. The challenge for South African policy-makers is to understand these changes and patterns, and forces behind them, as a basis for developing the ability to respond constructively and positively. In this chapter, we seek to explore some policy issues and/or recommendations that may maximise the opportunities provided by the new world trading environment. We will also consider those that could minimise the potential negative effects arising from increased world competition for trade and investment flows. It should always be borne in mind however, that the effectiveness of such policy recommendations will depend in large part on South Africa's efforts to adjust to the new opportunities and challenges of the international trading environment.

However, owing to space constraints and the complex nature of the issues under discussion in this and previous chapters, our discussion of various policy implications (in this chapter) must necessarily be brief and introductory in nature, and more so because some policy implications have already been alluded to in the previous three chapters.

4.2 Policy implications in the international context

4.2.1 The Results of the Uruguay Round

The end of the Uruguay Round (UR) of Multilateral Trade Negotiations, and the advent of the World Trade Organisation (WTO) have brought pressure to bear on many a country to liberalise trade and to open their markets to international capital. In pursuance

of its obligations under the WTO, South Africa will also be obliged to open up its markets to international competitors in various sectors. This country is likely to suffer from these market-opening pressures when, for instance, its gains from mining exports are competed away by mining exports from the former Soviet Union, and when other industrialised and NIC markets become competitive and efficient producers of products in which South Africa may have comparative advantage.

This problem is not only confined to South Africa, but also to other developing countries of the 'Third World'.¹ In the context of Arab countries (and this applies to South Africa too), Zarrouk² advises (rather paradoxically) that a durable solution (to an erosion of possible comparative advantage due to international competition) should be pursued by taking advantage of world market openings as a result of the UR. The learned writer suggests that these policies be pursued through a diversification strategy aiming at the wider perspectives of trade liberalisation with respect to more quality products that are competitive in world markets. The learned writer's policy advice is predicated upon the widespread belief that the positive results of the UR with respect to market access are likely to favour outward oriented developing countries with more efficient and diversified production structures at the cost of those relying on trade preferences for their market access.³

However, Bell⁴ argues that comprehensive import liberalisation in the case of South Africa, may aggravate existing macro-economic problems (e.g. unemployment and trade balance). Consequently, the learned writer suggests that comprehensive tariff reductions (in order to liberalise imports for instance), must await a substantial improvement in the performance of the economy, so that they can be implemented without the danger of foreign exchange or fiscal crises, or intolerable effects on output and employment in

¹ See Trevor Bell, 'Should South Africa further liberalise its foreign trade?', in Economic Trends Research Group, Development Policy Research Unit, Working Paper No. 16., UCT, Rondebosch, 1992, p.33.

² Jamal Zarrouk, 'Policy implications of the Uruguay- Round for Arab countries', in Said El-Naggar (ed.), The Uruguay Round and the Arab Countries, IMF., Washington DC., 1996, p.88. See also Tsedisio Matona, 'From GATT to the World Trade Organisation: opportunities and constraints for South Africa', in Trade Monitor, Vol. 9., June 1995, p.18.

³ Ibid.

⁴ Op cit 29-30.

import-competing industries.⁵ In other words, as far as Bell is concerned, improved economic performance is a prerequisite for further import-liberalisation, and that comprehensive tariff reductions are not only a necessary condition for such an improvement but conflict with it.⁶ Bell's argument would suggest that it is upon the government therefore to mobilise all the resources at its disposal to realise the objectives of the Reconstruction and Development Programme (RDP), *before* it can embrace comprehensive import liberalisation in pursuit of its obligations under the WTO.

As far as liberalisation of trade in services is concerned Zarrouk⁷ is of the opinion that the crucial policy issue of opening domestic markets (*in casu*, South African markets) to foreign service suppliers should be best dealt with by assessing whether there are efficiency gains that a country stands to reap as firms and customers obtain access to lower cost and higher-quality services. The learned writer maintains that when services are used as intermediate inputs in the production of goods (for instance, financial services and shipping), the access to lower-cost and higher quality services should increase the competitiveness of domestic producers of goods on world markets.⁸

In the opinion of Brown *et al.*,⁹ an open policy adopted by South Africa towards inward foreign service investment should provide for some exceptions, and that a future South African investment code (if finally adopted?) should give the Minister power to exclude foreign investors from participating in certain activities. The learned writers cite the case of Namibia (which enacted a new investment code in December 1990) which excludes foreign investors from participating in activities such as hair dressing and retail trading.¹⁰ The reason for this (in Namibia) was that there was concern that some very small investments might be made by foreigners in businesses that could perfectly well be carried on by Namibians who might not have had many other opportunities.¹¹ This

⁵ Ibid., 34.

⁶ Ibid.

⁷ Op cit 90.

⁸ Ibid.

⁹ Roland Brown, Mike Faber and Max Sisulu, 'Policies towards inward foreign investment', in Raphael Kaplinsky (ed.), Institute of Development Studies Bulletin, Vol. 1., January 1994, p.45.

¹⁰ Ibid.

¹¹ Ibid.

concern will be acute in South Africa given the fact that apartheid had deliberately excluded the majority of South Africans from meaningful participation not only in mainstream economic activity but also in small businesses.

Brown *et al* maintain further that in other countries foreign investors are excluded from participating in financial institutions, defence industries and the media.¹² When (if at all) South Africa adopts an investment code, South African policy makers would therefore be faced with a challenge of having to make a selection of those activities, businesses and services from which foreign investors will be excluded, while at the same time ensuring that domestic participation in those activities, businesses and services will best promote efficiency, competition and economic empowerment (particularly of the previously excluded).

One of the crucial issues addressed by the UR is subsidies; a widely used instrument of industrial policy for promoting national industries. The new Agreement on Subsidies and Countervailing Measures restricts the freedom of a country to use export subsidies.¹³ The Agreement lists three categories of industry subsidies: prohibited (export subsidies), actionable, and non-actionable. According to this Agreement, only nonactionable subsidies, which include subsidies for research and development (R&D) activities and aid for industries in disadvantaged regions of a country, are not prohibited and are non-actionable. All other specific production subsidies (that are not tied to exports) when limited to certain enterprises are actionable.¹⁴ In the circumstances, South Africa will be obliged to consider adjustment toward curtailing schemes (such as GEIS,) for export oriented enterprises. In such circumstances, Zarrouk advises that policy should be directed at rationalising these schemes 'by gradually replacing sectoral subsidies to

¹² Ibid. See also Sheila Page and Michael Davenport, World Trade Reform: Do Developing Countries Gain or Lose?, Overseas Development Institute, Special Report, London, 1994, pp. 70-71 where the learned writers discuss ways in which a country's treatment of services can be brought under the WTO. For instance, a country can make a decision whether a service will be opened to international regulation, i.e. incorporated in a country's offer at all. Page and Davenport say that for those which are, a country can register any of three types of control: restrictions on market access, limitations on national treatment of the supplier, or derogations from the rule of MFN among suppliers. In other words, it should be possible to avoid a country's services industries and to retain the right to increase current control or by imposing and registering strict regulations.

¹³ See *ibid.*, p.10. See also Zarrouk *loc cit.*

encourage exports with more horizontal subsidies, such as support for the development of national research capabilities to foster the long-term diversification of comparative advantage in the manufacturing sector'.¹⁵

The South African government plans to terminate the General Export Incentive Scheme (GEIS) on 31 December 1997, in compliance with its commitments under the WTO. As Bell¹⁶ explains, such a decision may have to be taken in the context of the overall economic performance, so that we avoid exacerbating the current structural problems of the South African economy: recession and unemployment for instance. In the meantime, as Clark has suggested,¹⁷ both government and private sector should find ways and means of increasing their expenditure in R&D, in the same way as other countries such as Korea have done.

The new regulatory framework of the WTO¹⁸ poses new challenges for policy-makers in South Africa. In order to limit the possibility of a real negative impact on domestic industries (as a result of increasing imports following increased import liberalisation), the government needs to adopt regulatory measures and procedures that conform to the UR agreements. Zarrouk suggests the following three:¹⁹ 'First, there is a need to put into place antidumping and countervailing laws as well as customs valuation procedures that conform to the UR agreements. Second, there will be a need to develop an administrative capacity to administer these laws through 'trade remedies' machinery, to conduct material injury inquiries related to antidumping and countervailing duties actions as well as invocation of safeguard measures'.²⁰

¹⁴ Zarrouk, *ibid.*

¹⁵ *Ibid.*, p.90. Bell *op cit* 35 also seems to suggest that a 'piecemeal' downward curtailment of subsidies (to promote import liberalisation) should be preferable, BUT points out that such further import liberalisation should be effected 'as and when economic conditions permit, as has in fact been adopted in most other countries, including.....Korea and Turkey....'

¹⁶ *Ibid.*

¹⁷ J.B. Clark, 'The intraregional transfer of technology', in *Africa Insight*, Vol.21., 1991, pp.19-20.

¹⁸ For a discussion of this new regulatory framework (trade policy reviews, dispute settlement, safeguards, anti-dumping etc.) see Page and Davenport *op cit* 91-100. See also Jesus Seade, 'Results of the Uruguay Round', in Said El-Naggar *op cit* 19. Zarrouk *op cit* 66.

¹⁹ Zarrouk, *ibid.*, p.91.

²⁰ See also Matona *op cit* 19.

Now, South Africa has already in place trade laws and regulations (e.g., Customs and Excise Act of 1964, Import and Export Control Act of 1963, Board on Tariffs and Trade Act of 1992) designed to achieve policies recommended by Zarrouk above. The problem with all these trade laws and regulations however, is that they are far too complex; maybe a more simplified and streamlined code is desirable.

The third policy recommendation by Zarrouk²¹ is that a country like South Africa, in pursuance of future multilateral trade negotiations especially in services, should foster 'expertise of national trade administration in collecting adequate national statistical data and conducting related analyses, to enable the government to identify national trade interests accurately and develop a corresponding trade policy strategy'.²²

4.2.2 Trading with the European Union

The European Union (EU) (which is about a quarter of South Africa's export market²³) is very important to South Africa and the reasons for concentrating on it (EU) are manifold: many countries in the Union (e.g. the UK, Germany) are traditional trading partners of South Africa; South Africa has already adopted EU product standards, and this country has recognised the need to access EU markets;²⁴ and Europe (Western) is perceived as a good base for developing further trade with the EFTA states and eastern and central Europe. Further, closer trade relations with the EU is perceived by South Africa as a grand opportunity for accessing not only markets, but also technology, finance and foreign investment funds/capital.

²¹ Loc cit.

²² Matona loc cit explains that 'the South African Department of Trade and Industry's GATT section is inadequately staffed, needs technical expertise, is in insufficient co-ordination with the Board on Tariffs and Trade and other relevant government departments, and has a poor liaison and image with the business, academic, legal, and media communities affected by GATT/WTO matters. In all these respects, South Africa compares unfavourably with other countries similarly situated *vis-à-vis* the GATT, such as Australia and New Zealand'. In the light of these findings it is doubtful whether the Board on Tariffs and Trade will be able to steer South Africa's trade policy and administration in the right direction.

²³ Robert Swain, 'The European communities and South Africa - new threats, new opportunities', in Gavin Lewis (ed.), South Africa International, Vol. 23., July 1992, p.15.

²⁴ Ibid.

It is stating the obvious, that one of the critical policy issues South Africa will have to grapple with, is what shape should the trade relationship between this country and the EU take. A closely related policy issue is whether South Africa should open the debate and apply for a new classification i.e. from 'developed' (as is presently the case within the GATT/WTO framework) to 'developing' status. The latter policy issue is important as the (re-)classification of South Africa will determine to a great extent its trade relations within the GATT/WTO framework, and (for present purposes), with the EU.²⁵

There are six possible trade regimes that have been proposed to govern future South Africa - EU trade relations, viz. (a) Most Favoured Nation (MFN) status within the GATT/WTO framework, (b) the Generalised System of Preferences (GSP), a non-reciprocal association agreement, (d) associate Lome membership, (e) full Lome membership, and (f) a reciprocal association agreement.²⁶

We turn to discuss briefly each of these proposals to see what options are available to South Africa and what the policy implications are.

4.2:2.1 Most Favoured Nation Status

The trade regime between South Africa and the EU based on the MFN principle²⁷ within the GATT/WTO framework would be the simplest one to adopt, and no special action would be required in or out of GATT/WTO,²⁸ where South Africa is still classified as a 'developed' country.²⁹ However, according to Holland,³⁰ this trade regime would simply

²⁵ See *ibid.*, p.13. See also Sheila Page and Christopher Stevens, Trading with South Africa: The Policy Options for the EC, Overseas Development Institute, Special Report, London, 1992, p.7.

²⁶ Page and Stevens, *ibid.*, p.4. See also Martin Holland, 'From pariah to partner: relations with the EU,' in Greg Mills (ed.), From Pariah to Participant: South Africa's evolving Foreign Relations 1990-1994, The South African Institute of International Affairs, Johannesburg, with assistance from the Standard Bank Foundation, April 1994, p.134.

²⁷ MFN principle is based on the GATT principle/rule of non-discrimination. In terms of this principle, no GATT member state(s) should grant some members or group of members preferential treatment over the others. For example, if one GATT member decides to lower its tariffs against products of another GATT member, then such bilateral tariff reductions are automatically extended to other countries. In other words, if a country lowers its tariffs against imports from a certain country in order to gain access to that other country's market it has to lower its tariff on all such imports regardless from which GATT member they come.

²⁸ Page and Stevens *op cit* 12.

²⁹ Swain *op cit* 14.

reassert the economic *status quo*, and will fail to provide any extra support to South Africa's efforts to develop new exports.³¹ Page and Stevens,³² as well as Holland,³³ believe that the MFN arrangement will do nothing to address South Africa's development needs (spelt out in the RDP and the macroeconomic strategy) and will fail to stimulate European investment, and continue to hinder the intra-regional production of exports to the EU. As Page and Stevens³⁴ explain, 'it is important that any agreement between the [EU] and South Africa does not limit the scope for intra-regional trade and production, particularly at this time when the Southern African countries need to foster greater economic co-operation that ever before'.

4.2.2.2 The Generalised System of Preferences

Page and Stevens³⁵ argue that if South Africa is offered preferences under GSP, the EU (and any other industrial country which offered GSP) 'would be placing South Africa at an advantage relative to its present status and relative to those developed countries (the US, Canada, Japan, Australia and New Zealand) with which it does not have association agreements'. Holland³⁶ on the other hand, argues that the effects of a GSP trade regime would be difficult to assess, more so because the EU's GSP is currently under review,³⁷ and also because (of South Africa's isolation) there is no GSP precedent to go by in allocating country/product pairs³⁸ which is judged on past performance.³⁹ In any event,

³⁰ Loc cit.

³¹ See also Page and Stevens loc cit.

³² Ibid.

³³ Loc cit.

³⁴ Loc cit.

³⁵ Op cit 13.

³⁶ Loc cit.

³⁷ See also Page and Stevens op cit 12.

³⁸ Page and Stevens, *ibid.*, say that the European Commission's proposals to restructure the EU's GSP would replace the existing system with one in which there would be three possible treatments for each product/ country pair:

*duty-free entry without quantitative restrictions for most goods;

*reduction in the MFN duty (without quantitative restrictions) for products which are recognised as being sensitive;

*exclusion, pure and simple, of product/country pairs which cannot be fitted into either of the above categories, either because the product is extremely sensitive or because it is not possible to reduce the duty sufficiently to provide an acceptable margin of preference (EC, 1990: 11)'.

³⁹ *Ibid.*, p.13.

like the MFN, the GSP provides few advantages beyond South Africa's existing position, and Holland recommends that this trade regime be chosen only if other more preferential options prove impossible to negotiate.⁴⁰

4.2.2.3 A non-reciprocal association agreement

The term 'non-reciprocal association agreement' is used to describe an agreement such as the EU has negotiated with most of the Mediterranean states.⁴¹ This trade regime will benefit South Africa in the sense that it would increase the scope for tailoring the preferences to this country's particular needs and capacities without imposing the same obligations on South Africa.⁴² However, this regime is fraught with difficulties. For instance, it could damage the interests of any non-associated developing or developed country, 'in absolute or real terms', and 'might not provide the trade support to a new South Africa' during the early days of its young democracy.⁴³ In the long term, it could exclude products that become important exports to South Africa in which this country may gain comparative advantage. Finally, greater opposition to this trade regime could mount from groups in the EU on the grounds that it (this trade regime) does not provide for reciprocity.^{44 45}

4.2.2.4 Associate Lome membership

Under this trade regime, a bilateral agreement with South Africa is envisaged, that would include all the trade provisions of the Lome Convention, including cumulation with ACP production for the purposes of the rules of origin, except for a negative list of specific exemptions, but not the non-trade elements.⁴⁶ However, there is no precedent for such a

⁴⁰ Holland loc cit. For a discussion of the problems which South Africa and the region may experience should the former be granted GSP, see Page and Stevens, *ibid.* See also Swain loc cit.

⁴¹ Page and Stevens, *ibid.*, p.14.

⁴² *Ibid.*

⁴³ *Ibid.*

⁴⁴ *Ibid.*

⁴⁵ The other principle upon which the GATT is based is one of reciprocity. In terms of this principle, when one country lowers its tariffs against another's imports, it can expect the other country to lower its tariffs in return.

⁴⁶ Page and Stevens *op cit* 15.

status, and Holland argues that this option seems unlikely to be considered seriously, as 'no one has really specified what such a relationship would amount to, or how it might differ from full [Lome] membership or a bilateral association agreement'.⁴⁷

4.2.2.5 Full Lome membership

The granting of full Lome membership to South Africa could be a valuable trade option⁴⁸ and would benefit this country in a number of respects. First, this trade regime would probably offer the greatest trade preferences to this country⁴⁹ as the degree of preferences given to the ACP (under Lome) is the most substantial offered by the EU on a non-reciprocal basis to any group of states, although less than is offered in reciprocal agreements like that with EFTA.⁵⁰ Second, South African membership would assist regional co-operation (e.g. allow regional processing⁵¹) by placing this country on the same economic plateau with the EU as the other SADC states.⁵² Third, the Lome Convention provides preferences over a wide range, an important consideration should South Africa be able to diversify its production, and thus be in a better position to access the important EU export market (which access would be nominally guaranteed (under Lome)) for the remainder of this century.⁵³

The argument against membership focuses again on South Africa's imprecise developed/developing classification.⁵⁴ As a matter of fact, South Africa's GDP would put it well above the other now 70 Lome states, and the commodities for which trade preferences are available would give South Africa an advantage over other Lome states. This trade regime is likely to meet with resistance from certain member states offering similar agricultural products.⁵⁵ Holland claims that the SYSMIN⁵⁶ and

⁴⁷ Holland loc cit.

⁴⁸ Page and Stevens loc cit.

⁴⁹ Holland loc cit.

⁵⁰ Page and Stevens loc cit.

⁵¹ Ibid.

⁵² Holland loc cit.

⁵³ Page and Stevens op cit 15-16.

⁵⁴ Holland loc cit.

⁵⁵ Ibid.

⁵⁶ SYSMIN and STABEX are commodity price stabilisation funds/programmes within the Lome

STABEX⁵⁷ Lome schemes could not financially accommodate South Africa; but perhaps most crucially of all, to gain accession to the Lome Convention, South Africa would need the unanimous assent of all the other 70 signatories as well as the EU's agreement.⁵⁸ As far as Holland is concerned, it is far from certain that all other Lome countries would be willing to allow South Africa to join.⁵⁹

4.2.2.6 A reciprocal association agreement

This trade regime would be based on more or less the same terms as those existing between the EU on the one hand and countries like Israel and other EFTA states on the other.⁶⁰ A reciprocal association agreement would take the form of a free trade agreement geared specifically to South Africa's needs.⁶¹

According to Page and Stevens, this regime is best adapted to the 'developed country' aspect of South Africa.⁶² The learned writers maintain that this agreement will go a long way to helping strengthen the South African government's hand in pursuing its trade liberalisation policy.⁶³ However, the learned writers caution that this regime could be open to challenge under GATT/WTO 'because it would be neither a special non-reciprocal concession to a developing country nor a preliminary to full EC membership.'⁶⁴

The reciprocal association agreement is not problem-free. There are possible adverse consequences for both developing country and EU producer interests. For instance, the

Convention that provide ACP countries with minimum prices for specific primary products. SYSMIN covers mineral production/exports (for copper, phosphate, bauxite, alumina, manganese, iron ore and tin). Article 49 of the Lome Convention provides the legal framework for SYSMIN.

⁵⁷ STABEX is a similar scheme designed to stabilise earnings from specific agricultural primary products. Article 23 of the Lome Convention provides the legal framework for STABEX. (For footnotes 56 *supra* and 57 see also Alan Hirsch, 'The external environment and the South African trade policy debate', in Economic Trends Research Group, Development Policy Research Unit, Working Paper No. 13., UCT, Rondebosch, 1992, p.19.

⁵⁸ Holland loc cit. See also Swain loc cit. Hirsch, *ibid*.

⁵⁹ Holland, *ibid*.

⁶⁰ Page and Stevens op cit 13.

⁶¹ Holland loc cit.

⁶² Page and Stevens loc cit.

⁶³ *Ibid.*, p.14.

⁶⁴ *Ibid*.

eligibility of South Africa for this agreement (and other options other than MFN status) would first of all be dependent on the submission to GATT/WTO, and while the SACU remains, any agreement (geared towards trade liberalisation) by South Africa would also extend to the SACU countries of Botswana, Lesotho, Namibia, Swaziland, (and any additional members).⁶⁵ Holland states that the EU Commission's External Economic Directorate has argued strongly in favour of this trade regime in keeping with the EU's commitment to trade liberalisation and competition.⁶⁶ The current trade negotiations under way between South Africa and the EU seem to be based upon the principles of a free trade agreement with reciprocal obligations.⁶⁷ Now, in the quest for a better deal with the EU, South African policy- and decision-makers should guard against jeopardising existing and emerging trade links with neighbouring African countries, East Asia and Eastern Europe.⁶⁸

4.2.3 *Trading with the United States of America*

The US is a powerful member of one of the most important trading blocs in the Western hemisphere, NAFTA.⁶⁹ It is envisaged that this regional trading arrangement could possibly be extended to include other Latin American countries.⁷⁰ The Enterprise for the Americas Initiative (EAI),⁷¹ which aims to achieve a free trade zone for the entire Western hemisphere,⁷² could lead to stronger formal economic links between the US and several Latin American countries.⁷³

⁶⁵ Ibid. See also Swain loc cit.

⁶⁶ Holland op cit 135.

⁶⁷ The SABC 1 TV News at 19h30 on 27 January 1997 reported that, at the trade negotiations meeting between the EU and South Africa, held on 26 January 1997 in Gauteng (South Africa), the former offered to open its markets to the latter's products faster than the other way round.

⁶⁸ This suggestion is made by Hirsch op cit 20.

⁶⁹ The North American Free Trade Agreement (NAFTA) comprises the US, Canada and Mexico.

⁷⁰ Hirsch op cit 18. See also World Economic and Financial Surveys, 'International Trade Policies: The Uruguay Round and Beyond', Volume II, Background Papers prepared by the team led by Naheed Kirmani, IMF, Washington DC., 1994, p.92 (hereinafter 'Kirmani *et al*').

⁷¹ Launched by the former US republican president, George Bush.

⁷² Kirmani *et al* op cit 115.

⁷³ Hirsch loc cit.

Hirsch maintains that such an arrangement could have serious negative implications for developing countries (like South Africa) hoping to export to the US, 'as they will increasingly be forced to compete at a severe disadvantage with what will probably become the new hinterland of the US'.⁷⁴ The learned writer argues that in such an arrangement, the US will favour its NAFTA partners with trade access and investment (to the detriment of developing 'outsiders' like South Africa ?).

Notwithstanding these potential setbacks, the US (under President Bill Clinton) seems to have adopted a benevolent attitude towards South Africa as far as trade and investment are concerned, more so in the wake of the latter's transition to democratic majority rule. The existing 'bi-national commission' co-chaired by Deputy-State President Thabo Mbeki and Vice-President Al Gore is a case in point. However, it is not clear whether this 'cordial' relationship between the US and South Africa will last when the euphoria of transition settles down in South Africa, or when/if a new Republican President enters the White House.

Any country having or hoping to establish (formal) trade links with the US, should always take into account a myriad of US statutes which govern that country's trade and investment policies. Various US trade statutes espouse the principle of non-discrimination as the fundamental principle upon which the US will do business with other countries.⁷⁵

The US principle of non-discrimination was first described in the 1934 Reciprocal Trade Agreements Act, and was extended in the Trade Expansion Act of 1962. The latter Act was intended to strengthen 'economic relations with foreign countries through the development of open and non-discriminatory trading'.⁷⁶ The US continued to advocate non-discriminatory policies in the Trade Act of 1974 and 1984. For instance, section 104A of the 1984 Trade Act called for non-discrimination in three areas, viz. services, foreign direct investment and high technology practices, and specified national treatment

⁷⁴ Ibid.

⁷⁵ Edward A. Laing, 'Equal access/non-discrimination and legitimate discrimination in international economic law', in Wisconsin International Law Journal, Vol. 14., Spring 1996, p.266.

⁷⁶ Ibid., 266-267.

as the required standard.⁷⁷ By this standard, treatment equivalent to that accorded to nationals must be accorded to US traders by foreign nations.⁷⁸

Perhaps a far more worrying factor about US trade legislation is the power of unilateralism⁷⁹ which the US wields through the Trade Act of 1974 and 1984, as well as the Omnibus Trade and Competitiveness Act of 1988.⁸⁰ Looking first at the 1974 Trade Act; the equivalent of section 301 (of the 1974 Trade Act) in the United States Code (Title 19) requires action if the US Trade Representative determines that the foreign country 'deprived the US of its trade agreements rights', and/or an act, policy or practice of a foreign country 'violates US trade agreements rights' or 'unjustifiably burdens US commerce'.⁸¹

In terms of this legislation, US mandatory action consists of suspension, withdrawal, or non-application of trade agreement benefits; duties (the preferred remedy), fees or other restrictions; and agreements to improve the situation in specified ways.⁸² Further, the Trade Representative may take action if/when (according to the US Code's version of the 1984 Trade Act), a foreign country is designated as having embarked on a conduct that is in 'violation of, or is inconsistent with the international legal rights of the US', and that such conduct denies national or MFN treatment to US trade and investment, or the right to the establishment or protection of intellectual property rights.⁸³

As far as the 1988 Omnibus Trade and Competitiveness Act is concerned, this Act introduced a new provision to counter any alleged unfairness toward US trade interests. Popularly known as 'special 301', this provision allows the US Trade Representative to name countries that 'deny adequate and effective protection of intellectual property rights' or 'fair and equitable access for [US] persons that rely on intellectual property

⁷⁷ Ibid., 267.

⁷⁸ Ibid.

⁷⁹ Which according to Hirsch, *ibid.* p.22 is entirely illegitimate in the GATT/WTO framework, which the US uses anyway because of its economic power, and the dependence of so many countries on the US as a market for exports.

⁸⁰ Hirsch, *ibid.*, p.21.

⁸¹ Laing *op cit* 305.

⁸² Ibid., fn 315 thereto.

⁸³ Ibid., 306.

protection'.⁸⁴ The Trade Representative is further allowed to identify countries termed 'priority foreign countries', which must be perceived as having the most egregious conduct.⁸⁵ Factors that are taken into account to determine the seriousness of the conduct include 'the extent of adverse impact on US products, the failure to enter into good faith negotiations, and failure to make significant progress in bilateral or multilateral negotiations'.⁸⁶

As can be seen, the main objective of these and similar US trade statutes is 'to pry open insulated markets, or defend against unfair subsidies',⁸⁷ while at the same time ensuring that the US ends up with a lion's share of the world's markets.⁸⁸ 'Special 301' or a similar statute is bad news to developing countries like South Africa. In the case of South Korea, 'special 301' was so effectively used that, once one of the biggest rice exporting countries to the US, South Korea became one of the biggest *importers* of rice from the US.⁸⁹ A scenario closer to home, was when the US threatened to take all sorts of unilateral retaliatory measures against South Africa in the wake of a proposed arms sale by the latter to Syria.⁹⁰

Now, South Africa under the leadership of the ANC has pledged undying solidarity and continued economic links with countries such as Fidel Castro's Cuba and Gadaffi's Libya, in full view of American campaign to 'punish' these 'regimes'. Whether the relationship with these or any other 'priority foreign country' will jeopardise South Africa's trade relations with the US is still a matter to be investigated.

⁸⁴ Ibid., 307.

⁸⁵ Ibid.

⁸⁶ Ibid. Although 'super 301' expired in 1990, Laing says that there have been persistent congressional efforts to re-enact section 301.

⁸⁷ Hirsch op cit 22.

⁸⁸ Laing op cit 309.

⁸⁹ A fuller exposition of how this was carried out is provided by Walden Bello and Shea Cunningham, 'Trade warfare and regional integration in the Pacific: the US, Japan and the Asian NICs', in Third World Quarterly, Vol. 15., September 1994, pp. 447 *et seq.*

⁹⁰ A country accused by the US of sponsoring 'international terrorism'.

4.3 Policy implications in the regional context

The return of political stability in Southern Africa offers countries in the region many opportunities for trade and investment. It is anticipated that South Africa, the economic giant of the region, will play a leading role in ensuring economic revitalisation of this part of the world.⁹¹ Although writers on Southern Africa agree that South Africa, because of its economic power, would play a critical role in influencing trade and investment patterns in the region, they are however, not in agreement on how South Africa should play that role. While Cassim⁹² suggests that South Africa should play this role through the process of deeper integration of regional economies, Sethi⁹³ argues that the solution to the economic problems of this region do not lie in deeper integration, but in economic co-operation and co-ordination of projects and activities.⁹⁴ Davies⁹⁵ on the other hand suggests that a blend of these (economic integration, co-operation and co-ordination) 'which can best advance the goals of contributing to growth and development' should be pursued.

⁹¹ See Rachad Cassim, 'Rethinking economic integration in Southern Africa', in *Trade Monitor*, Vol. 10., Trade Monitoring Project, September 1995, p.9. Iraj Abedian and Barry Standish, 'The way forward: policy guidelines for the 1990s', in Iraj Abedian and Barry Standish (eds.), *Economic Growth in South Africa: Selected Policy Issues*, Oxford University Press, Cape Town, 1992, p.225. Gavin Maasdorp, 'The advantages and disadvantages of current regional institutions for integration', in Pauline H. Baker, Alex Boraine and Warren Krafchik (eds.), *South Africa and the World Economy in the 1990s*, David Phillip: Cape Town and Johannesburg, The Brookings Institutions: Washington DC., in association with IDASA and Aspen Institute, 1993, p.244 (hereinafter 'Baker *et al* (eds.)'). Robert Davies, 'The case for economic integration in Southern Africa', in Baker *et al* (eds.), *ibid.*, p.218. This view was also shared by countries in the SADC and the Preferential Trade Area (PTA).

⁹² *Ibid.*, p.16.

⁹³ S. Prakash Sethi, 'A cautionary note on the prospect of regional economic integration in Southern Africa', in Baker *et al* (eds.), *op cit* 223.

⁹⁴ Davies *op cit* 217-8 suggests that the terms 'economic integration', 'economic co-operation', and 'economic co-ordination' that are often (erroneously) used interchangeably, do in fact refer to different things. According to Davis, 'economic integration', refers to 'a process in which the economies of individual states are merged (in whole or in part) into a distinct entity - a regional economy'. As far as 'economic co-operation' is concerned, it is 'a much more open-ended concept referring to a range of situations in which individual states act together for mutual benefit'. 'Economic co-ordination' on the other hand, 'refers to cases where policies, strategies or regulations are harmonised to bring them into line with those of partners, again in situations where this is seen to be of mutual benefit'. The learned writer points out that co-operation or co-ordination may or may not be undertaken with the aim of promoting economic integration.

⁹⁵ *Ibid.*, p.219.

In its interaction with regional economies, South Africa should guard against abusing its economic power. On the contrary, and notwithstanding the constraints that South Africa faces domestically (e.g. gross inequalities within the country, chronic unemployment, lack of investment capital), this country should ensure that any form of regional programme must promote equity and balanced development.⁹⁶ It is stating the obvious, that, the wider the disparity between South Africa and the rest of the regional economies, the bigger the impact (negative) would be on South Africa's resources.

When South Africa enters into trade negotiations/agreements with the EU, the US and Asia for instance, it should endeavour to balance the potential economic benefits of these agreements against the political costs of excluding its neighbours from these agreements.⁹⁷ Cassim⁹⁸ explains that there is some concern that any kind of trade agreement that South Africa concludes with countries outside the region will obstruct the process of regional integration in Southern Africa.⁹⁹

On a more practical note, Sethi¹⁰⁰ recommends that, the best course of action for the region (in which South Africa can play a meaningful role, given its developed infrastructure, technical know-how, etc.) lies in

‘creating project-based strategic alliances where major capital-intensive industrial projects and physical infrastructure are collectively developed, organised and managed, on the basis of considerations of scale economies of production, uniform product standards, a large tariff free internal market, and political guarantees of non-intervention on the part of national governments’.

According to Sethi, ‘these projects would have to be justified by productive efficiencies and distributive fairness’.¹⁰¹ The learned writer points out that, projects that by their very nature are best developed on a regional basis, e.g. common highway and railroad,

‘would be operated by professional management under common regional political oversight and with

⁹⁶ Point made by Cassim loc cit.

⁹⁷ Ibid., p.15. See also Vishnu Padayachee and Enver Motala, ‘Regional development in the post-cold war era’, in Minnie Venter (ed.), Prospects for Progress: Critical Choices for Southern Africa, Maskew Miller Longman, Cape Town, 1994, pp.76 *et seq.*

⁹⁸ Ibid.

⁹⁹ For a discussion of the potential hardships that regional economies will face, should South Africa conclude an FTA with the EU for instance, see *ibid.* See also *supra* discussion under 4.2.2.

¹⁰⁰ Loc cit.

¹⁰¹ Ibid.

investment capital raised in private markets and subject to the criteria of commercial feasibility'.¹⁰² The examples of how these projects can be managed, organised and co-ordinated are the Maputo corridor,¹⁰³ the proposed Benguela corridor¹⁰⁴ and the Lesotho Highlands Water Project.¹⁰⁵

The other critical issues that countries in the region should consider, is the possibility of harmonising their investment laws. This is important, as, without harmonisation of investment policies, the countries of the region will inevitably compete against each other by offering increasingly generous incentives to foreign investors, which will be to the detriment of the region as a whole.¹⁰⁶ A more balanced pattern of foreign investment would help strengthen weaker economies in the region and ensure a more balanced development process.

4.4 Policy implications in the national context

Many of the policy implications for fostering FDI in the 'new' South Africa have already been noted in passing in this and previous chapters. This section concludes by bringing together the general arguments and putting forward suggestions that policy- and decision-makers in this country could pursue in the quest for increased foreign-investment-flows.

First, Padayachee¹⁰⁷ has identified certain sectors in which little would be gained from more FDI. These are, mining and energy sectors, financial services and distribution (commerce, trade) activities,¹⁰⁸ and labour-intensive industries.¹⁰⁹ However, the learned

¹⁰² Ibid.

¹⁰³ The Maputo corridor joins South Africa's industrial heartland, Gauteng, with Maputo harbour in Mozambique. This project enjoys the co-operation of South Africa and Mozambique.

¹⁰⁴ The Benguela corridor is designed to connect South Africa and Botswana to Namibia. This project will greatly facilitate the exportation of Botswana products through Namibian ports.

¹⁰⁵ This project is been co-ordinated by both Lesotho and South Africa. For a fuller discussion of these and other infrastructural networks in the region, see Oliver S. Saasa, 'The effectiveness of the regional transport networks in Southern Africa : some post-apartheid perspectives', in Bertil Oden (ed.), Southern Africa After Apartheid: Regional Integration and External Resources, The Scandinavian Institute of African Studies, Uppsala, 1993, pp.130 *et seq.*

¹⁰⁶ This point is made by Alan Hirsch, 'Prospects and policy implications', in Patrick Cull, Economic Growth and Foreign Investment in South Africa, IDASA, Cape Town, 1992, p.46.

¹⁰⁷ Vishnu Padayachee, 'Foreign capital and economic development in South Africa: recent trends and postapartheid prospects', in World Development, Vol. 23., February 1995, p. 173.

¹⁰⁸ Padayachee, *ibid.*, seems to suggest that foreign investors will be excluded from participating in these services, as the government may wish to see the previously marginalised majority taking part in these

writer maintains that the industries that may benefit from FDI would include advanced engineering and electronics and high-tech industries in general.¹¹⁰ According to Padayachee, the most appropriate type of FDI here will be those by innovation-driven 'global firms', where the potential for indigenous development (of all kinds) appears most strong.¹¹¹

4.4.1 *The role of the state*

One of the defining characteristics of technological development in the 1990s, is the increasing role that governments of various countries are playing in fostering technological effort.¹¹² Wangwe¹¹³ points out that governments have not only played a crucial role in forging new trade relations (e.g. NAFTA, EU), but have also been instrumental in assisting firms to acquire international competitiveness. For instance, the learned writer states that, in the OECD,

'there is evidence of renewed interest in funding industrial research and development (R&D), with a shift from ensuring public funding on terms favourable to enterprises to greater emphasis on the organisation of capital markets and banking policies and the manner in which these influence firms' investment decisions'.¹¹⁴

It is clear that one policy implication for these patterns is that the government can facilitate the expansion of the sources of competitive advantage over time.¹¹⁵ Classic examples of cases where government intervened directly in facilitating technological effort by selectively supporting specific high-potential industries, are Japan and the

activities in an attempt to empower them economically.

¹⁰⁹ It is argued (see *ibid.*) that it is the very nature of FDI to be concentrated in capital-intensive industries and not labour-intensive ones.

¹¹⁰ Padayachee *loc cit.*

¹¹¹ *Ibid.*

¹¹² *Ibid.* See also Samuel M. Wangwe (ed.), Exporting Africa: Technology, Trade and Industrialisation in Sub-Saharan Africa, UNU/INTECH Studies in New Technology and Development, Published in association with the UNU Press, Routledge, London and New York, 1995, pp. 78-79. Daim Zainuddin, 'Foreign direct investment: policies and experiences of Malaysia and other high-growth Asian economies', in Baker *et al* (eds.), *op cit* 88.

¹¹³ *Ibid.*

¹¹⁴ *Ibid.*

¹¹⁵ *Ibid.*

NICs.¹¹⁶ In Japan for instance, the government employed trade restrictions combined with limitations on FDI to encourage Japanese firms to invest aggressively in emerging technologies, at the time when the US had a first mover competitive advantage in mainframe computers and semi-conductors.¹¹⁷ In South Korea, the government intervened selectively and favoured industries that were deemed to have dynamic comparative advantage.¹¹⁸

In the case of South Africa, it will indeed be a big mistake to simply copy the various forms of government intervention employed by the NICs such as South Korea for instance.¹¹⁹ However, there is a lot that South Africa can learn from the experience of other countries that may be applicable in the South African context.¹²⁰ For instance, Lall¹²¹ suggests that, among other things, selective intervention can be used by the South African government to channel local and foreign (direct) investment ‘in particular activities, or negotiating with and regulating international investment and technological transfer to achieve technological objectives’.

According to Padayachee,¹²² reliance on FDI to build South Africa’s competitiveness and technological capacity should, however, be limited to instances where commitment is reasonably long term and where meaningful transfer of skills and technology is involved. The learned writer maintains that, foreign investment in sectors which will improve the country’s access to markets for certain products in EU and North America may be useful, given that industrialised countries are now organised into major trading blocs.¹²³ The other sectors in which foreign investment can be actively promoted, are those in which investment is made through licensing or franchise agreements or joint-ventures that

¹¹⁶ Ibid. See also Sanjaya Lall, ‘What will make South Africa internationally competitive’, in Baker *et al* (eds.), op cit 66. Duck-Woo Nam, ‘Trade policy and international competitiveness: the South Korean experience’, in Baker *et al* (eds.), op cit 72 *et seq.* Zainuddin op cit 82.

¹¹⁷ Wangwe, *ibid.*, p.79.

¹¹⁸ Ibid. and sources referred to in footnote 116 *supra*.

¹¹⁹ This point is emphasised by Nam op cit 71.

¹²⁰ South Africa can also learn *not* to repeat the mistakes that these countries made in their quest for technological development.

¹²¹ Op cit 67.

¹²² Loc cit.

¹²³ Ibid.

support black economic empowerment, and those which enhance the quality and productivity of the work force.¹²⁴

In South Africa presently, there are scores of foreign MNC affiliates operating in fields as diverse as mining, petroleum, manufacturing, etc. The crucial issue to consider in that regard, is what policy measures should South Africa adopt to get these affiliates to transfer more technology, and to increase the potential spill-overs. Does South Africa need to introduce new regulations to regulate the behaviour of these companies? Should South Africa put in place a new framework within which these companies could be encouraged/forced to transfer more technology, undertake local R&D, improve local content requirement, promote black economic empowerment and affirmative action?

Kokko and Blomstrom¹²⁵ say that in a study (conducted by them) examining how cross country differences in the technology imports of US affiliates in 33 host countries (including South Africa) (calculated from data on the affiliates' payments of royalties and licence fees and their imports of capital equipment from the US in 1982) showed, *inter alia*, that:

- 1) 'Policies making use of market forces may be preferable to conventional technology transfer requirements.¹²⁶ For instance, policies increasing the level of competition in the host country may erode the MNC affiliate's technological advantages, and force it to import new technology from its parent. Similarly, policies improving local learning capabilities and labour skills may reduce technology transfer costs, and encourage imports of technology'.
- 2) 'Those US affiliates which operated in conditions where they were required to use the most advanced technology available, perform R&D locally, have access to US parent's patents, or transfer skills to local personnel, these requirements increased the affiliate's technology transfer costs and therefore had a negative impact on the affiliates imports of technology.¹²⁷ Similarly, the various quantitative performance requirements (including import restrictions, minimum local content, and minimum local employment are also likely to increase the costs of

¹²⁴ Ibid.

¹²⁵ Ari Kokko and Magnus Blomstrom, 'Policies to encourage inflows of technology through foreign multinationals', in World Development, Vol. 23., March 1995, p.466.

¹²⁶ This point is also made by Paul Krugman, 'Changes in capital markets for developing countries', in Baker *et al* (eds.), op cit 47.

¹²⁷ Kokko and Blomstrom op cit 462.

importing and using advanced technologies, and thus had a negative impact on technology transfer'.¹²⁸

The South African government is therefore faced with a daunting task of having to reconcile its economic priorities (e.g. eradicating unemployment, fostering black economic empowerment, increasing inflow of foreign technology, capital and skills, etc.) with the interests of (say) MNCs. In devising a policy on MNCs doing business or wishing to invest in this country, South Africa should also be guided by the guidelines set by the OECD countries for their MNCs operating in other OECD countries.¹²⁹ For instance, as far as general policies are concerned, the guidelines provide that MNCs should, *inter alia*, 'take fully into account established general policy objectives of the member countries in which they operate', and in particular, 'give due consideration to those countries' aims and priorities with regard to economic and social progress, including industrial and regional development, the protection of the environment and consumer interests, the creation of employment opportunities, the promotion of innovation and the transfer of technology'.^{130 131}

In addition to selective intervention in channelling both local and foreign (direct) investment, the South African government will have to channel resources in infrastructure that will have a positive impact on FDI and technology transfer, e.g. schools for raising literacy rate and providing quality education and imparting skills, roads for improving transport networks and communication, and so on. In short, the government should actively create an enabling environment¹³² in which FDI and technology transfer, job creation and employment could be achieved.

¹²⁸ Ibid., p.463.

¹²⁹ See International Investment and Multinational Enterprises: The OECD Guidelines for Multinational Enterprises, OECD, Paris, 1986.

¹³⁰ Ibid., p.13.

¹³¹ It should however be noted that observance of the Guidelines is voluntary and not legally enforceable. For a detailed and interesting commentary on these guidelines by various Reports of the Committee on International Investment and MNEs (CIME), published by the OECD, see *ibid.*, pp.17 *et seq.*

¹³² This point is also made by Klaus Schmidt-Hebbel, Luis Servén and Andrés Solimano, 'Saving and investment: paradigms, puzzles, policies', in The World Bank Research Observer, Vol. 11., February 1996, p.110, where the learned writers say a supportive policy and institutional framework would consist of four ingredients, viz. (1) macroeconomic stability, to reduce uncertainty surrounding investment; (2) a

4.4.2 *Reforming South Africa's trade regime*

South Africa's trade regime is fraught with many problems. It is argued that it is not conducive to the development of competitive industrial capabilities,¹³³ and has a strong anti-export bias inherent in its policies.¹³⁴ According to Lall,¹³⁵ the current South African trade regime protects industries without regard to their competitive potential,¹³⁶ has no strategy for promoting new infant industries, and fails to offset the effects of protection by forcing firms to invest in building export markets. To cure this defect, Lall recommends that the protective regime be restructured, 'by lowering high levels of protection, making the system stable, removing many of the irrational elements of protection and, most important, gearing protection to the achievement of international competitiveness'.¹³⁷ Practically, Lall suggests that this would involve, inter alia, greater selectivity based on a detailed analysis of the competitive problems of each industry, than exist at present.¹³⁸

comparatively distortion-free relative price structure, to raise the productivity of investment; (3) a well-defined (and effectively enforced) code of property rights, to create an environment conducive to a low cost of doing business; and (4) adequate political institutions, to foster social consensus and political stability. See also Accelerating the Development Process: Challenges for National and International Policies in the 1990s, Report by the Secretary-General of UNCTAD to UNCTAD VIII, UNCTAD, UN, NY, 1991, P.26 where the importance of a suitable climate for FDI for instance, is emphasised.

¹³³ Lall op cit 61.

¹³⁴ Pedro Belli, Michael Finger and Amparo Ballivian, South Africa: A Review of Trade Policies, Discussion Paper No.4., The World Bank, Southern Africa Department, Washington DC., August 1993, p.30.

¹³⁵ Op cit 61-62.

¹³⁶ For instance, textiles and related industries (which, according to Lall, are mature, labour-intensive activities that are clearly not undergoing learning, and are being protected for no other reason but to preserve employment) receive the highest rates of protection, and equipment the lowest. See also the Sunday Times, Business Times, March 30th, 1997 on p.1 under the heading 'SA runs out of fuel in race to become competitive', where it is reported that this country slid to 45th place, second to last (Russia) among the 46 industrialised countries 'despite its [South Africa] best efforts to claim a higher ranking in the global economy'. The report shows the US and Singapore leading the rest in positions one and two respectively.

¹³⁷ Lall op cit 62.

¹³⁸ Ibid.

Both Lall¹³⁹ and Belli et al¹⁴⁰ agree that in order to foster international competitiveness, and to address the anti-export bias inherent in South Africa's trade policies, an element of trade liberalisation would be required. Further, the learned writers agree that liberalisation for the above stated objectives should be achieved by a gradual, pre-announced programme of tariff reductions, coupled with supporting supply-side measures (on skills, technology, etc.) and a strong push into exports, than by quick and substantial reduction of protection that exposes all domestic markets and industries to the same force of competition without regard to their capability development needs.¹⁴¹ Belli et al caution that the need for gradual liberalisation (as opposed to rapid and sweeping liberalisation), does not mean to imply that no changes to the import tariff structure are warranted.¹⁴² The learned writers maintain that the current South African import duties have the following problems that need to be addressed quickly, viz. unevenness in the duty schedule, an unduly complicated tariff structure, and a highly unstable tariff schedule.¹⁴³ The formulation of a new trade regime that will ultimately promote FDI, should also take into account a host of other issues (which cannot be discussed here), inter alia, exchange rate policy, macroeconomic issues, existing investment climate, etc..

4.5 Concluding remarks

The policy options for fostering FDI in the 'new' South Africa are many, complex and controversial. No attempt was made in this chapter to provide a definite policy framework within which the objectives of reconstruction and development could be achieved. On the contrary, only a few issues on policy were mentioned which could be considered in devising an appropriate policy framework. In formulating appropriate policies, South Africa would have to always consider the impact that its policies would

¹³⁹ Ibid.

¹⁴⁰ Op cit 31.

¹⁴¹ See Lall loc cit, and Belli *et al*, *ibid*.

¹⁴² Belli *et al*, *ibid*.

¹⁴³ *Ibid*. See also Avril Joffe, David Kaplan, Raphael Kaplinsky and David Lewis, 'Meeting the global challenge: A framework for industrial revival in South Africa', in Baker *et al* (eds.), op cit 98. Paul Hatty, 'The South African trade policy debate: A business perspective', in Baker *et al* (eds.), op cit 130.

have on its obligations under the GATT/WTO, on its neighbours, as well as on its economy. The challenge facing this country is to devise and implement those policies that maximise the opportunities provided by the new world trading system and minimise the potential negative effects associated with it.

CONCLUSION

The world trading environment of the 1990s is characterised by rapid structural transformations. The accelerating pace of change in patterns of trade, investment and regional integration, together with the high degree of internationalisation of production and globalisation of world markets have transformed the world of the 1990s into a truly global village. These far reaching changes will have a profound impact on the future trade relations among the various countries of the world.

The WTO in its turn, is poised to radically transform the way the world does business, and will be under pressure to remain effective in the trading environment increasingly dominated by rhetoric of trade liberalisation on the one hand, and the reality of growing protectionism on the other. It is against this background that South Africa's future trade and investment policy should be considered.

South Africa is now a full member of the international community of nations. In pursuit of its trade and investment interests, this country will be expected to play according to the rules of the prevailing world economic order. Although there are still stumbling blocks in the way of FDI, South Africa has tremendous potential of attracting foreign investment into this country and the region as a whole.

It is imperative for policy- and decision-makers to devise some ingenious strategies of ensuring that this country remains relevant and competitive in the changing world trading system of the 1990s. There is indeed a need for careful reassessment by government of its policies, especially in the crucial areas of investment strategy and international trade.

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