Second Carnegie Inquiry into Poverty and Development in Southern Africa

International Capital Flows & Welfare in South Africa

by

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PREFACE

At the end of August 1986, a two-day workshop entitled Macroeconomic Policy and Poverty in South Africa: The Crucial Issues was held at the University of Cape Town. The impetus for this Workshop arose out of a perceived void in South African economic thinking. Researchers on poverty deal with microlevel issues in great detail, but often lose sight of the broader context within which ground-level issues are placed. Macroeconomists, by contrast, tend to theorise about financial and monetary matters and overlook the implications of macro-economic policy for the poorer sections of the population.

Accordingly, in December 1985, Terence Moll began working on the topic and travelled round the country. He spoke to various academics from Economics Departments in the Transvaal, Natal, Orange Free State and the Cape, trying to draw on existing research and encouraging people to think about this area. These were eventually drawn together in a Workshop designed to encourage economists to think at the macroeconomic level about poverty and welfare issues in South Africa.

The Workshop was hosted by the School of Economics and the Southern African Labour and Development Research Unit. Thirteen papers were presented and about 25 economists from a number of different South African universities attended. Arising out of the vigorous discussion and debate, it was suggested that some of the papers be published in revised form in the post-Carnegie Working Paper series. A review and critique of the Workshop papers by Terence Moll will be appearing in due course.

We are grateful not only for this support but also for the continued interest in research work of this nature.

Francis Wilson

1. INTRODUCTION

Although interesting in itself, and relevant to the theme of this workshop, a consideration of the links between foreign capital flows and welfare in South Africa has assumed greater importance in the light of the allegations and counter-allegations that are being made with respect to the possible implications of investment sanctions for this country. It is not, however, the purpose of this paper to deal directly with the disinvestment debate, but rather to trace out the links between capital flows and the creation, perpetuation and/or alleviation of poverty in South Africa.

Interpretation of the economic relationships is hindered by the fragmentary nature of the available data and, in the case of the author, by the lack of a suitable model for the South African economy with which to explore the interrelationships of capital flows, exchange rate changes, the behaviour of the current account of the balance of payments and poverty and income distribution. The topic of this paper is closely linked to that of international trade, but trade flows and policy are not considered specifically in this study, simply because it would have extended the scope of the topic too considerably.

In the following two sections the distributions of foreign investment by country of origin and by kind of economic activity are explained. Thereafter, the contribution of foreign capital to welfare in the South African economy is described, focusing on indicators such as the levels of national income and expenditure, the distribution of income, resource transfers, industrial concentration, the level of employment, effects of changes in the rate of exchange and the extent of national autonomy. More detailed and rigorous research is needed. This paper aims to explore some of the possibilities, and to open up the issues for further research and debate.

2. THE DISTRIBUTION OF FOREIGN INVESTMENT BY COUNTRY OF ORIGIN

Like most other middle-order economies, South Africa is dependent on foreign capital from industrial countries. The countries of origin of foreign capital have been mainly those with which close trade links are maintained, with the exception of Japan, where legislation forbids direct investment in South Africa. Since 1956, by far the largest part of total foreign investment originated from the European Economic Community (EEC), followed by North and South America and the other European countries. Only a small proportion of total foreign investment was made by investors in the other three continents. As can be seen from Table 1, the relative share of the EEC countries in South Africa's total foreign liabilities has been declining, from 71,3 per cent in 1956 to 50,2 per cent in 1983. This decline was due to a rapid increase in investment by countries in North and South America, the rest of Europe and, to a lesser extent, Asia.

Table 1 Distribution of Foreign Investment in South Africa by Geographical Area as at selected year-ends, 1956-1983

	1956	1961	1966	1971	1976	1981	1982	1983
EEC countries	71,3	68,3	65,5	63,8	57,2	55,1	53,8	50,2
Rest of Europe	4,9	5,8	7,1	9,1	9,7	12,9	11,8	12,8
N & S America	14,3	13,8	16,3	17,5	24,0	23,1	23,5	25,1
Africa	2,6	3,8	4,9	3,8	2,6	2,4	2,1	2,3
Asia	0,9	1,0	1,4	1,9	2,0	3,6	2,8	3,5
Oceania	0,5	0,6	0,7	0,7	0,4	0,7	0,7	0,7
International Organisations	4,8	5,9	3,3	2,4	3,2	1,6	4,3	4,4
Unallocated	0,7	0,8	0,8	0,8	0,9	0,6	1,1	1,0
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0

Source: "A statistical presentation of South Africa's foreign liabilities and assets, 1956 to 1981" Supplement to SA Reserve Bank *Quarterly Bulletin*, June 1983; SA Reserve Bank *Quarterly Bulletin*, June 1985.

By far the major portion of foreign direct investment has originated in the EEC countries, as can be seen in Table 2. As a proportion of total foreign direct investment, however, the share of EEC countries has declined from 76,3 per cent at the end of 1956 to 64,1 per cent in 1983. This fall reflects an increase in foreign direct investment by other European countries and by countries in North and South America. The declining share of EEC countries in indirect investment has been even more marked. Whereas in 1956, 66,5 per cent of foreign indirect investment in South Africa originated in these countries, since about 1980 this region has supplied less than 50 per cent of total indirect investment; the rest of Europe and North and South America again increasing in importance. It should also be noted that international organisations, like the International Monetary Fund, have been a relatively important source of indirect investment funds for the South African economy over the 27-year period.

A breakdown of the distribution of foreign investment by country of origin is difficult to compile since the relevant official records were published only until 1960. The South African Reserve Bank has discontinued its statistical series on the national origins of capital flows into the country in order to avoid possible political embarrassment. Therefore, for later years unofficial estimates must be used.

According to unofficial sources, Britain has the major share of foreign investment in South Africa, although this has declined from about 62 per cent in 1956 to 37 per cent in 1976. In 1974 British direct investments were valued at 997,2 million of which more than 70 per cent was in industry and 10 per cent each in trade and mining. This involved some 400 British companies with about 1 000 subsidiaries in the South African market (1). The United Kingdom-South Africa Trade Association (UKSATA) estimated that in January 1982 the current value of British investment was 11 000 million, of which 5 000 million was direct and 6 000

Table 2 Distribution of Foreign Direct and Indirect Investment in South Africa by Geographical Area as at selected Year-ends, 1956 - 1983

Direct Investment	1956	1961	1966	1971	1976	1981	1982	1983
EEC countries	76,3	77,4	71,8	70,0	63,8	62,6	63,3	64,1
Rest of Europe	3,0	3,9	5,7	6,3	7,8	8,3	8,3	8,4
N. and S. America	18,7	15,8	19,2	20,8	24,5	25,5	24,9	23,3
Africa	1,0	1,8	2,0	1,7	1,7	1,5	0,9	1,8
Asia	0,3	0,3	0,4	0,4	1,3	1,0	1,4	1,2
Oceania	0,7	0,7	0,8	0,7	0,8	1,1	1,1	1,2
International Organisations	-	-	-	-	-	-	-	-
Unallocated	-	0,1	0,0	0,0	0,1	0,1	0,1	0,1
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100.0
Indirect Investment								
EEC countries	66,5	58,2	57,0	56,4	52,5	48,8	46,5	40,3
Rest of Europe	6,8	8,0	9,0	12,4	11,0	16,8	14,4	15,9
N. and S. America	10,0	11,6	12,3	13,6	23,7	21,2	22,2	26,5
Africa	4,3	6,0	8,8	6,2	3,2	3,2	3,0	2,7
Asia	1,4	1,8	2,7	3,6	2,4	5,7	3,9	5,2
Oceania	0,3	0,4	0,6	0,7	0,2	0,5	0,4	0,3
International Organisations	9,6	12,5	7,8	5,3	5,6	3,0	7,7	7,6
Unallocated	1,2	1,4	1,8	1,7	1,4	0,9	1,9	1,4
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0

Sources : "Statistical Presentation of South Africa's Foreign Liabilities and Assets, 1956 to 1981", Supplement to SA Reserve Bank Quarterly Bulletin, June 1983.

SA Reserve Bank Quarterly Bulletin, June 1984 p.S - 73, June 1985 p.S - 71.

million indirect investment (2). Although Western European and American investment proceeded at a much faster rate than British during the 1970s, in 1978 Britain still had substantial interests in one quarter of South Africa's top 100 companies, twelve of which are direct subsidiaries of British firms. British investment in South Africa is of considerable importance to the domestic British economy, accounting for some nine per cent of total foreign investment and fourteen per cent of total foreign earnings in 1978 (3). These proportions were unchanged in 1983 (4).

The share of US investment in this country has been rising, growing from $140 million in 1950 to about $13 384,9 million in 1983 (5), of which $2 319 million was direct investment, $4 637 million was bank lending and $6 428,8 million portfolio investment, particularly in gold mining shares. South African holdings account for just over one per cent of total US direct foreign investment, and about twenty per cent of total foreign direct investment in this country. These investments are, therefore, of far greater importance to the South African economy than to that of the US, making this country vulnerable to the investment policy decisions of the US government and corporations.

West Germany is the third most important foreign investor in this country, with an estimated 1 875 million invested in January 1982 of which 240 million was estimated to be direct and 1 635 million indirect (6). From an original role as a lender, Switzerland is now increasing its direct investment in this country having established about twelve companies, and total Swiss investment was estimated to be about 944 million in January 1982 (7). In July 1981, France's total investment was estimated to be about 1 247 million, about five per cent of total foreign investment in South Africa (8).

More detailed data for the manufacturing sector are

available from the data base constructed by Rogerson for the year 1978 (9). Defining foreign control as ownership of more than 50 per cent of equity share capital, or as control over the composition of and membership of the board of directors, Rogerson found that in 1978 there were some 930 foreign-controlled enterprises in the manufacturing sector in South Africa, operating 1284 plants and employing 380 000 people (approximately 28 per cent of all manufacturing employment). Rogerson notes that relative to similar studies in other countries, the degree of foreign penetration in South African manufacturing is similar to that in New Zealand, less than that in Australia and considerably below that in Canada. It should be pointed out, however, that within South African industry, there exists a significant sub-component of foreign-controlled branches and associated enterprises. If a weaker definition of foreign control were used, the proportion of foreign-controlled manufacturing would be much higher.

As can be seen in Table 3, the Rogerson data base reveals, not unexpectedly, that the United Kingdom and the US are the two main sources of overseas investment. Together these countries

Table 3 Foreign-controlled Manufacturing in South Africa by Country of Origin, 1978.

Country of Origin	Enterprises		Plants		Employment	
	No.	%	No.	%	No.	%
United Kingdom	551	59,2	767	59,7	210816	55,7
United States	228	24,5	304	23,7	95818	25,4
West Germany	67	7,2	90	7,0	25932	6,9
Switzerland	21	2,3	36	2,8	9583	2,5
France	18	1,9	24	1,9	7575	2,0
Netherlands	15	1,6	21	1,6	10409	2,8
Others	30	3,2	42	3,3	17596	4,7
Total	930	100,0	1248	100,0	377099	100,0

Source: Rogerson (1982) p.126

account for 80 per cent of all foreign-controlled manufacturing, whether it is measured by numbers of enterprises, plants or total employment. West Germany emerges as the third most important source of foreign manufacturing investment. Estimates of the number of British firms in South Africa vary considerably. UKSATA records a figure of 1200 subsidiaries in January 1982. In a footnote, they write that they "consider the UK figure would be much lower if one counted only significant investment" (10). This would explain why Rogerson, with a strong definition of foreign control, reaches a much lower figure of 767 plants in 1978. According to UKSATA some 340 American companies employing over 150 000 people were operating in South Africa in 1982; about 300 subsidiaries employing some 50 000 people are responsible for German direct investment; and about 40 French companies are operating in this country.

3. THE DISTRIBUTION OF FOREIGN INVESTMENT BY KIND OF ECONOMIC ACTIVITY

Sectoral data on the importance of foreign investment were last published for the year 1980. Direct investment is defined by the South African Reserve Bank (following IMF practice) to include the investment of a non-resident in a South African organisation in which he has a controlling interest. Control is determined in this definition by ownership of a branch or participation in a partnership by non-residents, or ownership of at least 25 per cent of the voting rights by one non-resident or several affiliated non-residents, or ownership of at least 50 per cent of the voting rights by various residents of one foreign country (11).

The sectoral breakdown of long-term liabilities for 1980 is shown in Table 4. From the table it is evident that foreign-controlled investment contributed most to capital formation in manufacturing in 1980, with direct investment in this sector

Table 4 — Sectoral Distribution of South Africa's Long-term Foreign Liabilities related to the Fixed Capital Stock for 1980

	Fixed capital* Stock (Rm)	Direct long-term liability (Rm)	% Direct liability in capital stock	Indirect long-term liability (Rm)	% Indirect liability in capital stock
Agriculture, forestry and fishing	9 419	102	1,1	4	0,0
Mining and quarrying	10 934	953	8,7	2 315	21,1
Manufacturing	20 555	4 308	21,0	1 985	9,7
Electricity, gas and water	14 641	9	0,1	2 056	14,0
Construction	1 392	74	5,3	7	0,5
Wholesale and retail trade	8 238	1 503	18,2	85	1,0
Transport, storage, communication	25 726	88	0,3	976	3,8
Finance, insurance, business services	31 007	3 510	11,3	1 841	5,9
Other	42 456	76	0,2	830	2,0
Total	164 367	10 623	6,5	10,099	6,1

* In current 1980 prices, adjusted by the ratio of current fixed investment in current 1980 prices to fixed investment in 1980 at constant 1975 prices.

Source : "Third Census of Foreign Transactions, Liabilities and Assets, 31 December 1980" Supplement to SA Reserve Bank *Quarterly Bulletin*, December 1982.

accounting for 21 per cent of the fixed capital stock. In the wholesale and retail trade sector, the share was 18,2 per cent. Long-term indirect investment was relatively more important in the mining sector, where it was equal to 21,2 per cent of the fixed capital stock. In mining and quarrying, in electricity, gas and water and in manufacturing, indirect investment accounted respectively for twenty-one per cent, fourteen per cent and close on ten per cent of the fixed capital stock.

Rogerson's findings accord with these observations as to the strategic importance of FDI in South Africa. He records that foreign-controlled enterprises manifest an industrial mix which is markedly different to that of domestic firms (12). Rogerson found that in 1978 foreign control was high in two strategic industrial sectors, namely, "fabricated metals, machinery and equipment", and "chemicals, rubber and plastics" as shown in Table 5. Together these two sectors account for nearly two-thirds of all foreign-controlled manufacturing in South Africa (using Rogerson's strong definition of control). Domestically controlled manufacturing was most predominantly concentrated in "textiles, clothing and leather", if indexed by numbers of employees, although the "fabricated metals, machinery and equipment" sector accounts for the major share of plants. In terms of the pattern of numbers employed, domestic control is greatest in the "wood and wood products", the "textiles, clothing and leather" and the "other manufacturing" sectors. Rogerson's findings highlight the dependence of South Africa on the contribution of FDI to industrial sophistication in this country.

US investment was crucial to the main growth sectors of the economy in the 1960s and 1970s. Ford, General Motors and Chrysler were important in developing an indigenous automobile industry, and in 1980 still controlled one-third of the market. American companies are also in the forefront of oil exploration in South Africa, providing the capital, expertise and technology that the local economy lacks. Four US companies have established

Table 5

Indigenous and Foreign Control of South African Manufacturing, by Industry Group

	Foreign-Controlled Enterprises				South African-Controlled Enterprises				Pattern of Employment Control	
	Plants	Percent	Employ-ment	Percent	Plants	Percent	Employ-ment	Percent	Foreign Percent	Indigenous Percent
Food, Beverages and Tobacco	151	11,8	42 637	11,3	2 013	14,2	159 317	16,2	21,1	78,9
Textiles, Clothing and Leather	92	7,2	33 092	8,8	2 021	14,3	230 281	23,4	12,6	87,4
Wood and Wood Products	18	1,4	5 468	1,5	1 465	10,3	73 594	7,5	6,9	93,1
Paper and Paper Products	65	5,1	16 298	4,3	1 290	9,1	59 633	6,1	21,5	78,5
Chemicals, Rubber and Plastics	284	22,1	70 100	18,6	872	6,2	56 359	5,7	55,4	44,6
Non-Metallic Minerals	61	4,8	20 570	5,5	996	7,0	64 042	6,5	24,3	75,7
Basic Metals	51	4,0	18 263	4,8	191	1,3	94 270	9,6	16,3	83,7
Fabricated Metals, Machinery and Equipment	548	42,6	169 076	44,8	4 672	33,0	229 340	23,3	42,4	57,6
Other Manufacturing	14	1,1	1 595	0,4	657	4,6	16 004	1,6	9,1	90,9
Totals	1 284	100,0	377 099	100,0	14 177	100,0	982 840	100,0	27,7	72,3

Source : Rogerson (1982) p.127

country's imported oil. In addition US corporations have been dominant in the petrochemical, steel, computer and nuclear energy sectors. For example, American companies control over 70 per cent of the computer market in South Africa. Historically, British contribution to the mining industry and to subsidiary enterprises serving that industry has been significant. British investment is currently of greatest importance in manufacturing. France's most significant contribution to the South African economy has been in the development of the armaments industry, since the French have been prepared to ignore the UN embargo on the sale of offensive weapons to South Africa, and have supplied arms, aircraft and technical assistance. The contribution of foreign capital to the strategic sectors of the economy has undoubtedly been very high.

4. THE CONTRIBUTION OF FOREIGN CAPITAL INFLOWS TO WELFARE IN SOUTH AFRICA

4.1 Filling the Gap between Domestic Income and Expenditure

The South African economy is crucially dependent on inflows of foreign capital for financing both domestic investment and persistent current account deficits. Since 1956, the country's net international indebtedness has increased at an average rate of ten per cent per annum, declining significantly only in the years following major incidents of political unrest, and standing in 1983 at 33,2 per cent of GNP.

The ability of the economy to finance its investment from its own savings declined in the 1970s and improved again between 1978 and 1981, falling again in the early 1980s. The propensity to invest of the economy has increased consistently and considerably, while the propensity to save has fluctuated, falling in the early 1970s, rising after 1978 and falling again from 1982. Persistent current account deficits since 1962 have

made South Africa increasingly dependent on foreign capital inflows to finance the overspending on both investment and consumption. This problem is compounded by the increased reliance on short-term borrowing to meet the current account shortfall and the consequent debt servicing burden that is placed on the economy.

While direct investment made up more than half of total foreign liabilities during the 1960s, it declined in relative importance during the 1970s, partly as a result of declining levels of profitability of direct foreign investment in South Africa and partly as a result of an increased reliance by the public sector on foreign loans. As a result, the country is evidencing signs of a growing dependence on indirect investment, which had risen to 60,9 per cent of total foreign liabilities in 1984.

The importance of foreign capital inflows as a supplement to domestic savings and for the financing of deficits on the current account are evidence of the need for continued foreign investment if South Africa is to maintain historical levels of absorption. A curtailment of these inflows will necessitate the implementation of restrictive economic policies if the gap between domestic income and expenditure is to be kept small. In fact the need to reduce the country's foreign indebtedness and disinvestment by investors and creditors has deepened the recession currently being experienced. At present gross domestic saving exceeds gross domestic investment, which is low due to the recessionary state of the economy. The increase in domestic saving during 1985 is not surprising in the light of the surplus on the current account of the balance of payments which has existed since the fourth quarter of 1984. This surplus is a result both of the rising dollar price of gold and the improved trade balance (excluding gold). The increase in exports and decline in imports can be attributed to the low level of economic activity and to the depreciation of the rand (13). The

depreciation has been occurring steadily since September 1983, although this trend has been reversed since the beginning of 1986, when exchange control regulations were changed and the dollar price of gold began to rise.

The situation is unlikely to improve markedly in the short term, however. Disinvestment pressures, together with South Africa's default on its short-term debt, have reduced access to foreign capital markets, at least until internationally acceptable political change occurs. The need to repay foreign debt places further pressure on the economy, since resources now have to be channelled abroad. Until repayment has occurred, or South Africa manages to attract foreign capital inflows again, real economic welfare as measured by the level of domestic expenditure will not increase as fast as the growth rate of the real GDP (14). Furthermore, if foreign investment allows for a more rapid growth in domestic income through relieving constraints on output, the present curtailing of capital inflows means that the rate of growth of the real GDP will be slow - if it is positive.

4.2 The Distribution of Income

Income inequality in South Africa is exceptionally high, and is particularly marked between the four race groups and between rural and urban areas. Foreign investment in itself appears to have had little impact on the racial shares of income which were found to have remained remarkably constant over a long period of time (from 1946 to 1970)(15). In fact, prior to the 1970s the wage and employment practices of foreign-controlled companies in South Africa did not appear to be very different from those of locally-controlled firms (16). This became apparent, for example, when a parliamentary inquiry into the wages paid by British companies operating in this country was made in the United Kingdom in 1973. Evidence given by firms to the House of

Commons showed that some British firms were practising complete racial segmentation in their job structures; others were exhibiting unequal pay practices, while yet others exhibited no job or wage discrimination. Research undertaken in the same year by the University of Natal revealed that there was no significant difference between the attitudes of foreign-owned firms and their South African-owned counterparts to either the formation of black trade unions or to the works committee system (17).

Although one cannot, therefore, argue that foreign firms have historically been leaders in progressive employment practices, the publicity given by the House of Commons Inquiry and, subsequently, civil rights movements in the United States ledto the scrutiny of the operations of foreign-controlled firms in South Africa. One outcome of this scrutiny was the establishment of codes of employment practice. The two most widely adopted foreign codes are the EEC Code, promulgated in September 1977 and the Sullivan Principles, introduced in February 1977.

The original Sullivan Principles required that desegregation of the factory occur wherever possible; that equal and fair employment practices and equal pay for comparable work be implemented; that training programmes for non-Whites be initiated and developed; that the number of non-Whites in management and supervisory positions be increased; and that the quality of life of employees outside the work environment be improved. The EEC Code was more rigorous, requiring, in addition to the above, that the rights of workers to be represented by trade unions be recognised, and that the "effective minimum level" wage be paid. These provisions have now been included in a revised Sullivan Code, together with the requirement that firms involve themselves in changing political and social structures in South Africa.

By 1983, 147 of the approximately 350 American companies

operating in South Africa had signed the Sullivan Code, and 182 British companies were signatories of a code of conduct. It has been estimated that over 80 per cent of the workforce in foreign-controlled firms are subject to a code of conduct, accounting for some 12 per cent of the total labour force of the modern sector.

The precise effects of the employment codes are extremely difficult to ascertain. Some argue that the desegregation of work facilities, equal pay practices, trade union recognition and social upliftment programmes conducted by foreign affiliates have had a ripple effect throughout South African industry and commerce. Others believe that the codes are used by signatory companies to justify their continued presence in this country; that they are a public relations effort; and that they do not, and cannot, change the structure of apartheid or black working conditions in South Africa.

Whatever the true effect of the employment codes, the deliberate policy of increasing wages paid to Black employees was probably one of several factors responsible for rising Black real wages in the 1970s. This brought about some redistribution from Whites to Blacks, narrowing slightly the vast racial income disparity, but worsening the distribution between urban and rural African families (18). Manufacturing, which in 1975 employed about 28 per cent of Blacks outside domestic service and agriculture, led the field in increasing Black wage rates, which subsequently rose in the mining and government sectors, and multinational firms played a role in raising wage rates in the manufacturing sector. It has been argued, however, that the potential of foreign subsidiaries to encourage further reform in this area is limited, partly because multinationals now seem to feel that they have been successful in their compliance with the codes and that further change is unnecessary (19).

Some argue that continuously high rates of economic growth can transform South Africa's distribution of income into

something like that of other industrial countries. However the time required for this to occur will be considerable. With the presently low growth rates of employment, the prospects of the economy growing rapidly enough for "trickle down" benefits to accrue are slim. High growth rates require high rates of investment, but in a stagnating unstable economy, foreign investment is not attracted, and domestic surpluses become difficult to generate. The buoyant era of the 1960s may have encouraged hope that South Africa was approaching a solution to some aspects of the racial income problem. The world recession of the 1970s and early 1980s, coupled with waning foreign and local confidence in the political stability of Southern Africa, intensified a vicious circle of poverty and growing unemployment from which there may be no forseeable escape for an increasing portion of the population.

The possible positive effect of foreign investment on the distribution of income ought, therefore, not to be overstressed. Income levels and equality in distribution are far more closely connected to economic and political conditions than to the presence or absence of foreign capital. Concern with these issues should therefore be directed towards other aspects of government policy, which will ultimately determine the precise effects of foreign capital flows on the distribution of income in this country.

4.3 Resource Transfers to South Africa

It has been found (20) that foreign subsidiaries are not responsible for inducing large inflows of long-term direct investment. Their foreign affiliations are of no real benefit as far as the availablity of funds is concerned, and expansion occurs by the reinvestment of profits earned in South Africa. Between 30 and 76 per cent of gross profits are retained, and this forms the main source of capital formation in foreign-

controlled firms. In fact, retained profits and reserves account for an average of 83 per cent of new investment. Foreign loans, on the other hand, are an important source of investment funding, particularly for the public corporations and public authorities.

Foreign-controlled firms in the South African manufacturing sector display a considerable dependence on foreign technology and R&D, although the techniques of production used are not necessarily the latest methods, if older techniques are more economically efficient. Foreign firms, however, evidence a tendency towards increasing capital intensity, even if it results in excess capacity, primarily because this allows for greater efficiency and lower unit costs. Most product development occurs overseas. Although inconsistent with declared policy, a large portion of senior management consists of foreign personnel, primarily because it is felt that South Africans lack the required management skills. Some diffusion of skills does occur in multinationals which operate international exchange programmes for executive personnel and trainees. In an effort to combat the problems of poor basic education and backward social development among Black employees in particular, some foreign affiliates offer a range of training schemes. These are too numerous and varied to be listed here, but they include the exposure of trainees to international training centres established by the larger high-technology firms; the sponsoring of education in universities and technikons; in-house training programmes and seminars; apprenticeship schemes; and basic literacy and numeracy classes.

It may be concluded that foreign investment has provided the economy with access to advanced technology and skills, which is important for capitalist development. This may have proved costly for the economy, if the techniques of production and management skills available are inappropriate to the needs of the domestic economy. It is probably fair to say that both benefits and costs have been incurred, that the precise implications for

welfare differ according to circumstance, and therefore that each case needs to be assessed on its merits.

4.4 Industrial Concentration

Using two models, Tregenna-Piggott calculated the welfare loss arising from monopoly in different sectors of the South African manufacturing industry (21) and found that these losses were highest in the "fabricated metals, machinery and equipment" sector (between 28 and 31,3 per cent of output) and in the "chemicals, rubber and plastics" sector (about 24 per cent). These sectors were shown above to be subject to a high degree of foreign control (32). Welfare losses due to concentration were found to be lowest in the "wood and wood products" (0,2 per cent), "basic metals" (1,0 per cent), "textiles, clothing and leather" (between 1,7 and 1,9 per cent), and the "other manufacturing" sectors (about 2,1 per cent). These sectors are predominantly subject to domestic control. It may be concluded that losses due to industrial concentration are highest in sectors evidencing a high degree of foreign control, and that these sectors have a tendency towards greater concentration. Furthermore, welfare losses due to monopoly are lowest in sectors that are predominantly controlled by local entrepreneurs. Foreign investment may therefore be said to have resulted in a deterioration in welfare as a result of increased industrial concentration.

4.5 Employment

The theoretical links between foreign investment and the level of employment have received considerable attention, although, in the final analysis, it must be concluded that the effect of foreign capital inflows on employment in the receiving economy depends on the circumstances surrounding each investment.

Foreign investment may, however, have a positive effect on the general level of employment through :

(i) raising the rate of growth of the economy and consequently of employment;

(ii) precipitating the confidence of business in the future of the South African economy and thereby raising the propensity to invest;

(iii) causing surpluses on the capital account of the balance of payments and diminishing the need for contractionary economic policies in order to reduce absorption; and

(iv) providing to private and public corporations access to borrowing facilities overseas.

Empirically, these links are very difficult to measure. The impact of indirect investment cannot be isolated, and, while it is possible to establish, for example, that MNEs currently employ about 25 per cent of the South African labour force employed in manufacturing, it is not possible to isolate data on employment creation by foreign firms on an annual basis. Nor is it possible to quantify the employment-creating potential of feasible alternatives. Once established, subsidiaries of multinationals tend to expand by improving productivity rather than by providing further employment (22). Projections for some established subsidiaries are that potential employment trends over the next five and ten years will be static, with the caveat that the economic situation in South Africa over the next decade will be significant in determining the level of potential employment opportunities offered by multinationals. In the depressed economic climate of the last quarter of 1985, many firms were finding it necessary to cut back on current staff.

A curtailing of domestic (or new foreign) investment may lead to a fall in the employment-creating potential of the economy. Indeed, merely to hold constant the observed

unemployment rate of eleven per cent between 1978 and 1987 was argued in the EDP to require an annual real growth rate of GDP in excess of five per cent per annum (23), a rate which has been shown to require inflows of foreign capital (24).

4.7 Changes in the Rate of Exchange

The real depreciation of the rand since the end of 1983 has placed South African producers of tradable goods at a competitive advantage, increasing the quantity demanded of these goods, and has also had the effect of attracting resources into the production of tradables. The result is a rise in the price of tradable goods relative to nontradables and consequently, increasing profits in the tradables sector and decreasing real wages for producers of non-tradables. This means that the depreciation of the rand has caused shifts in the distribution of income within South Africa from consumers of tradable goods who experience falling real wages to producers of tradables. Expenditure studies for 1975 by the BMR and CSS show that urban Black households spend 61 per cent of their income on tradables, as compared with 50 per cent by urban White households (25). The depreciation of the rand has therefore had a particularly diletarious effect on real urban Black wages, although the general inflationary effect of depreciation has made itself felt on prices and costs throughout the economy.

The real depreciation of the rand has also caused severe problems for borrowers of foreign capital, particularly those engaged in long-term foreign borrowing, both in the servicing of the debt and in the repayment of the capital at the time of maturity.

Even with the re-introduction of the dual exchange rate system in September 1985, which has helped to some extent to control the alarming fall in the value of the rand, the effects

of the depreciation are still being felt, particularly in the high rate of inflation.

4.8 National Autonomy

While writers in the orthodox and Marxist traditions emphasise the conflicts that may arise between the operations of multinationals and the economic and political policies of host governments, it has also been suggested that MNEs do not exert enough influence on the development policies of receiving countries. In the case of South Africa, firms subject to codes of conduct now fall into the category of enlightened employers. The implementation of the codes does not conflict with the declared intentions of the government to eliminate discriminatory practices and to end wage discrimination. In fact, the South African government has maintained an attitude supportive of foreign capital, while at the same time stressing its national sovereignty. The Franzen Commission Report states that:

> "The government ... welcomes foreign investment and, in formulating economic policy, will also endeavour to retain a favourable investment climate for foreign-controlled enterprises. On the other hand, the government would also appreciate the creation of more opportunities for South African participation in the management of foreign-controlled enterprises. The government however, cannot allow foreign capital to be invested in such a manner or in such amounts as will enable foreign control to be exercised over the whole economy or over certain strategic sectors."

However, although as a group foreign-controlled firms are potentially a very powerful lobby, this power as yet seems virtually untapped. Were this power to be used to exert pressure on the state for fundamental social change, it is possible that conflict between the state and foreign capital might result, but

MNEs seem reluctant to become involved in South African politics. The contribution of some firms to corporate social responsibility programmes needs also to be recognised. In this regard, foreign firms subject to codes of conduct (and to divestment pressures at home) appear to outstrip their South African counterparts. Yet still, the political issues of particular relevance to labour, especially to Black labour, are not being addressed, and foreign firms are largely supportive of the status quo.

5. SUMMARY

The South African economy has been shown to be crucially dependent on inflows of foreign capital, with net international indebtedness increasing at an average annual rate of about ten per cent per annum and declining significantly only in the years following major incidents of political unrest in South Africa. The need for these inflows of foreign capital has been reflected both in the shortage of funds for domestic investment, and in persistent current account deficits. The composition of the country's foreign liabilities has also changed since the 1960s, indirect investment now amounting to over 60 per cent of total foreign liabilities. Declining levels of profitability of FDI and an increased dependence by the public sector on foreign loans have been responsible for this change, which has resulted in an increase in the debt-servicing burden of the economy. This has been accompanied by a shrinking in the time duration of loans and the depreciation of the rand, both of which are indications of the declining confidence of overseas lenders in the profitability of the South African economy, and both of which have precipitated the country's current debt crisis. South Africa's reliance on inflows of foreign capital, which predominate in strategic sectors of the economy, and the tenuousness of the country's foreign debt position highlight the vulnerability of the economy to changes in inflows of foreign capital.

This study has reported that foreign subsidiaries of multinationals are not responsible for inducing permanent large inflows of long-term direct investment. The expansion of direct investment has occurred by the reinvestment of profits earned in South Africa, with foreign companies retaining between 30 and 76 per cent of their gross profits over the years from 1960. The major benefits of FDI to this country have been argued to be the initial capital inflows, and the transfers of technology and management skills from more advanced countries. In some cases, however, where these are inappropriate to local conditions, or where they stifle local development, this might be argued to be a cost. Their impact on the distribution of income was argued to be small. The involvement of some multinationals in social upliftment programmes, and the contribution of foreign codes of conduct in the past to establishing more progressive employment practices in the manufacturing sector must also be considered a benefit. The potential of foreign firms for expanding employment opportunities and for encouraging further reforms in the workplace through the adherence to even improved codes of conduct appears, however, to be limited, and the role of these firms in lobbying for social change is, as yet, undeveloped.

Costs to the economy occur through the drain of profits and interest payments to overseas economies, which may also cause problems on the balance of payments, and through the welfare losses arising from industrial concentration which tends to take place in industries subject to a high degree of foreign control. Deficits emerging on the balance of payments, necessitate the use of deflationary economic policies to contract the economy in order to reduce spending on investment and consumption, and therefore on imports. Together these effects may cause a fall in the real incomes of all South Africans, and may also have the effect of worsening the distribution of income, since black unemployment, especially in the rural areas, and black wage increases will be depressed.

Foreign capital flows clearly have implications, both negative and positive, for the welfare of inhabitants of receiving economies. These ought not to be overstressed, however. In any given political and social order, the presence or absence of foreign capital can only have welfare effects within the economic structures that exist. It would be misleading to consider the issue of the consequences of foreign investment in South Africa in isolation from the rest of government policy, both political and economic.

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