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***THE ROLE OF FOREIGN DIRECT INVESTMENT (FDI) ON DOMESTIC
ENTREPRENEURSHIP IN SOUTH AFRICA***

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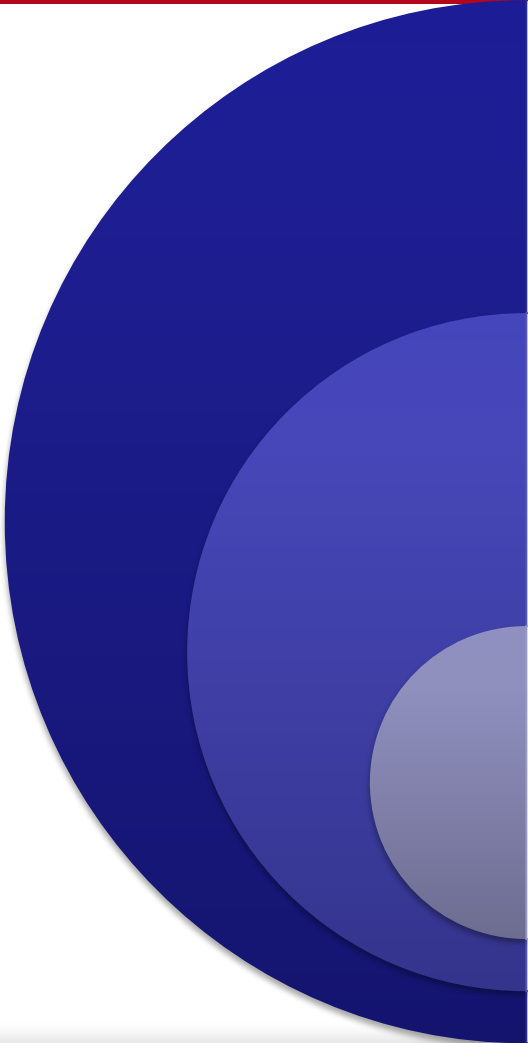
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Context and Background



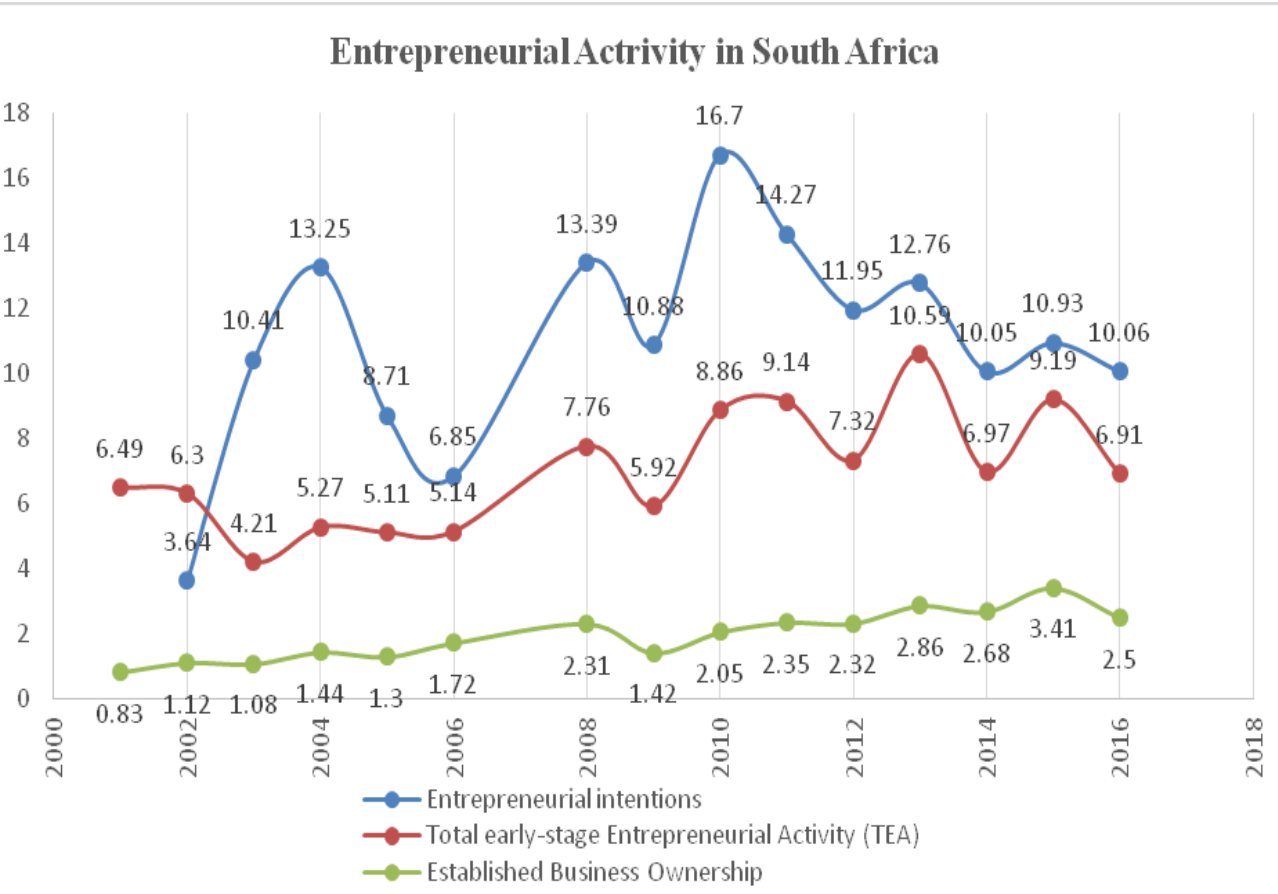
Due to a **lack of alternative funding models** for economic growth, most developing countries over the past few decades have placed much reliance on FDI.

Being an **attractive destination for FDI** has become a top priority for their domestic programmes. This translates to a country's policies geared towards incentivizing the inward flow of FDI

With the focus **on job creation and poverty alleviation** in South Africa, conscious of the challenge that SA has **low levels of savings and brain drain**, the focus has moved to creating policies that enable a positive environment for inclusive growth and entrepreneurship.

Context and Background

Graph 1: Entrepreneurial activity rate in South Africa (2000 – 2016)

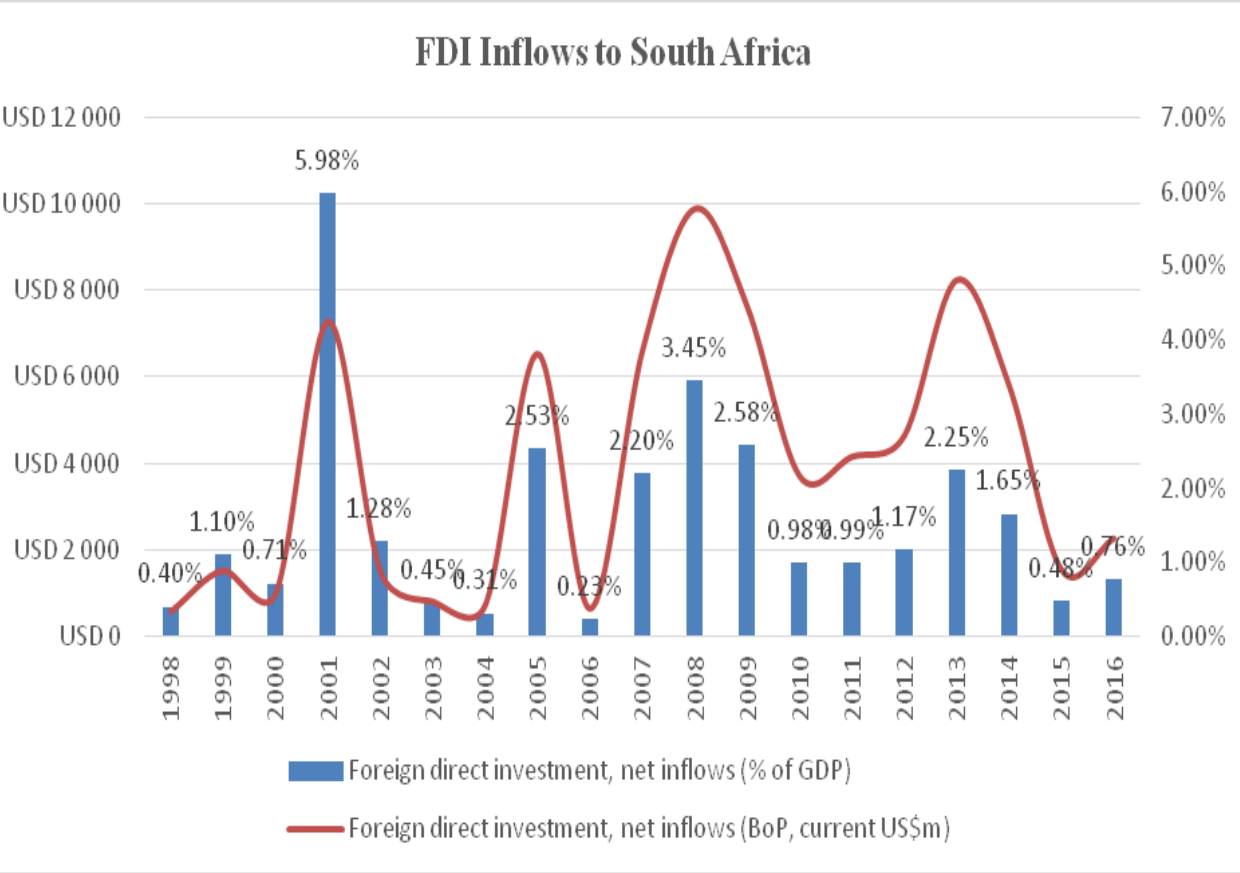


- Entrepreneurial intentions are a precursor to the TEA rate.
- TEA rate mirrors the entrepreneurial intentions trend but on a lagged basis.
- 2003 – 2006 marginal fluctuations.
- 2008 sees there are significant fluctuations in the data that mimic the intentions.
- Interpreted as more potential entrepreneurs acting on their intentions to start new enterprises

Source: Global Entrepreneurship Monitor (2017)

Context and Background

Graph 2: Foreign direct investments into South Africa (1998 – 2016)



- FDI has fluctuated between 1998 and 2016, with the highest FDI net inflows as a percentage of GDP being 6% in 2001 and the lowest being 0.23% in 2006, during the 19-year period.
- FDI net inflows to South Africa reached levels of up to 10 billion U.S. dollars over the period
- FDI has dwindled to levels of around just over 2 billion U.S. dollars as of 2016.

Source: World Bank (2017)

Problem Statement and Significance

Problem Statement

- South Africa is **plagued by high and growing levels of inequality, poverty, and unemployment.**
- Some of the drivers of unemployment in South Africa are **skills shortage and the poor public education system.**
- From the **21.8m labour force, 16 m** are employed, and the **remaining 5.8m are unemployed.**
- The total number of people that are **economically inactive is 15.1 million** (South Africa Labour and Development Research Unit [SALDRU], 2013; Stats SA, 2017). Refers to **active job seekers**
- Includes both **active job seekers** and **discouraged individuals** that are willing to work

Significance of Study

- Entrepreneurship is said to be the **backbone of an economy**, with small enterprises being the biggest job creators.
- The influence of FDI on domestic **entrepreneurship has not been the subject of much study** in the South African context.
- The existing studies have focused on the **influence of FDI on GDP, poverty, exports** and the determinants thereof.
- The GEM data is **able to determine the intentions of the entrepreneurs;**
- How FDI **affects these distinct groups** has also not yet been explored

Research Question and Objective(s)

Research Question:

- What is the influence of FDI on entrepreneurship in South Africa?

Objective of the study:

- To determine the short-run relationship between FDI and domestic entrepreneurship in South Africa by determining how domestic entrepreneurship responds/reacts when there is a fluctuation in FDI stock;
- To determine the long-run relationship between FDI and domestic entrepreneurship in South Africa by determining how domestic entrepreneurship responds/reacts when there is a fluctuation in FDI stock; and
- To distil policy recommendations to support an environment conducive for domestic firms in an eco-system that has FDI.

Limitations of the study

The study **does not explore the effect of outward FDI** and only focuses on inward FDI, as **the aim of the paper is to determine the effect of foreign capital on domestic firm creation** and not the effect of capital flight.

Possibly beneficial for **future studies to research the influence of outward FDI on entrepreneurship**, as capital flight results in limited access to finance from which domestic entrepreneurs can pull, hence increasing the demand for foreign capital.

Furthermore, for inward FDI data, **only stock data was used** and not portfolio flows. [Danakol, Estrin, Reynolds and Weitzel (2014)].

There is a benefit for future studies to **perform a sectoral or industry analysis as studies have found that the influence of FDI differs across industries** (Basu, & Guariglia, 2007; Javorcik, 2004).

Literature Review

Theoretical Framework

- FDI is essentially economic colonialism, where ultimately there is a transfer of economic control and wealth from host economies to external powers (Landsburg, 1979; Ake, 1996; Heijdra & van der Ploeg, 2002).
- Conversely, free-market theorists are of the belief that there are extensive benefits of FDI for host economies (Matzner, 1995; Ugochokwe et al., 2013).
- Positive Spillovers (Fosfuri et al., 2001; Acs et al., 2008; Danakol et al., 2014).
- Negative Spillovers (Danakol et al., 2014), Waldkirch & Ofosu (2010).
- Impact on economic growth (Blomström & Wolf, 1994; Barrell & Pain, 1997; Ramirez, 2000; Fedderke, 2001).
- Effect on poverty and the role of policy [Borensztein et al. (1998), Hermes & Lensink (2003), and Lensink & Morrissey (2006)]

Empirical Studies

- Positive impact - (Botrić & Škuflić, 2006; Kersan-Skabic & Orlic, 2007).
- Negative impact - Waldkirch & Ofosu (2010), Aitken & Harrison (1999).
- U-curve impact of FDI - De Backer & Sleuwaegen (2003), Görg and Strobl (2005).
- Zero impact of FDI - Djankov & Hoekman (2000), Konings (2000).

South African Context

- Akoto (2016) - causal relationship between FDI, GDP and exports in SA found that in the long run FDI has an effect on increasing exports.
- Gossel & Biekpe (2013) - growth in the SA economy is driven by fixed investment and trade, as opposed to capital flows.

Methodology

Study Design

- Threshold vector error correction model (TVECM) and the nonlinear causal relationship to test the causality and cointegration between FDI and domestic entrepreneurship. Similar to Wang et al (2009) examining relationship between FDI and GDI in Taiwan (1981–2006).

Data collection

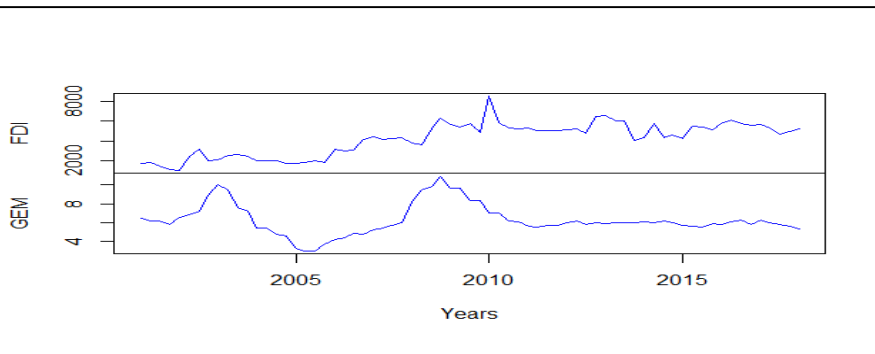
- Time-series data over the period of 17 years 6 months, commencing 2000 to 2018.
- Secondary data for FDI stock, as the independent variable and TEA as the dependent variable.

Model diagnostics checks

- Normality, Serial correlation, Heteroscedasticity, Non-linear unit root test, lag test, etc.

Results

Figure 1 and Table 1: South African Entrepreneurship and FDI



- Co-movement between the two variables and as a result accommodates the use of the proposed methods.
- Prior to imposing the transformation to the data, the movement from the year 2000 of the series suggests the possibility of cointegration.
- With financial and macroeconomic time series, volatility is expected and was observed through the up and down movement.
- The series is thus suitable for use as experimental units for the study.

Table Exploratory data analysis

Statistic	FDI	Entrepreneurship
Mean	6.724	6.505
<u>std dev</u>	0.606	0.006
JB	5.618	4.948
<u>Prob</u>	0.060	0.084

- On average, the mean of both FDI and Entrepreneurship revolves around 6%.
- SA is controlling a business ownership 6.7% base entry on quarterly bases, while it also encourages Entrepreneurship growth by 6.5% quarterly.

Key Findings

Statistically significant relationship between FDI and entrepreneurship in South Africa, both in the short-run and the long-run.

Estimated threshold is 168, meaning that an overall 1% increase in FDI will increase entrepreneurship by 16.8%.

The low intentions of starting businesses and the low TEA rate suggest that this is not due to would-be entrepreneurs opting to be employed in MNEs, but can be linked to the intrinsic structural challenges of inequality in South Africa.

In line with free-market theorists.

Free market theorists maintain that FDI has extensive benefits for the host country, especially in emerging markets (Danakol et al., 2014), where positive spillovers such as business management and ethics, human capital and the transfer of efficient production methods occur.

Recommendations

Long-run policy recommendations:

According to the literature, the effect of FDI on the local economy can only be ascertained over the longer term. Therefore, some policies associated with entrepreneurship need to have a long-term focus if desired returns are to be realised from the presence of FDI in South Africa, which include:

Offering entrepreneurship as a discipline of study at primary and secondary level schooling. This will ensure that those that do not make it to tertiary level are also equipped with knowledge and socialised with the benefits of creating their own enterprises.

Targeted sectoral incentives to encourage increased FDI to South Africa. For example, in primary industries: Offer tax breaks to corporate organisations that localise procurement and encourage value addition in country, versus exporting raw materials.

Subsidise small businesses that are participants in these sectors from a technological capability perspective.

The successful implementation of the suggested recommendations could result in:

Increased local participation in entrepreneurship;

Reduction in inequality and poverty; and

Encourage sustainable economic growth.

Short-run policy recommendations:

To foster a conducive environment to entrepreneurial activity in South Africa, some of the policy options that government should consider are:

Lower the regulatory burden on local start-up businesses, thereby increasing ease of doing business in South Africa;

Tighten the localisation policy around the inclusion of small businesses in the value chain of big corporate players in key sectors.

Thank you

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