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South Africa's experience with FDI flows

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Abstract

This paper analyses South Africa's experience with FDI flows. Since 1994 South Africa has experienced an increase in FDI flows. The paper highlights the South African experience in an international comparative context, and shows that, while South Africa has performed on par with comparator countries in terms of FDI outflows, it is mostly below par in attracting FDI inflows. This is also contextualised within an attraction and potential index that delivers largely the same result. The paper also sheds light on the structuring of post-crisis FDI flows by utilising a novel FDI flow database to analyse South African FDI flows per sector, mode of entry, financing instrument and geographic origin or destination. Despite the recent problems related to labour and cost pressures, the South African mining sector attracted the lion's share of FDI inflows. M&A's were the dominant mode of entry and exit for FDI flows and the geographic patterns reveal that flows to and from South Africa makes significant use of offshore financial centres or tax havens to channel their investments. Often this adds to the complexity of FDI flow analysis. Attention is also drawn to the influence of FDI flows and stock positions on the current account of the balance of payments. Bi-directional causality results indicate a probable positive impact on the trade account but the net income and dividend payments in the income account have contributed around 50 per cent of the current account deficit since 2004.

South Africa's experience with FDI flows

"The road to foreign direct investment (FDI) recovery is bumpy" (UNCTAD, 2013)

1 Introduction

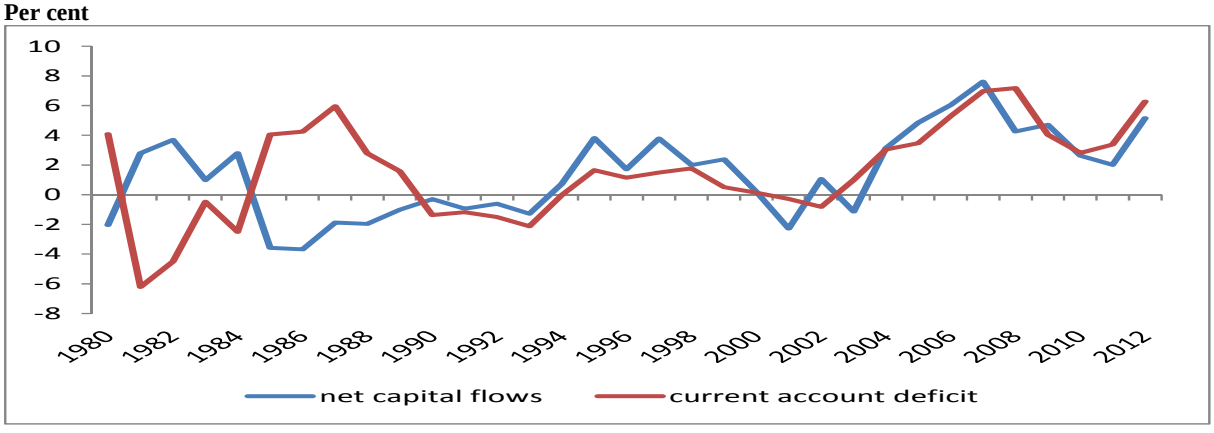
There has been a significant surge of capital flows to emerging market economies over the last decade. While capital inflows give access to foreign savings and can have a positive impact on financial development and economic growth, it can also pose major challenges for policymakers. For example, the volatility and nature of foreign inflows can adversely impact economic outcomes. Thus, the consensus is that capital flows should be carefully managed to prevent the economy from overheating, loss of competitiveness and increased vulnerability to crises. In general, FDI inflows are preferable to other forms of investment by virtue of their nature (e.g. investments in "building" and "equipment", influence on technology spillovers and direct influence on the production of a business).

This paper analyses South Africa's experience with FDI flows. The paper is structured as follows. The next two sections analyse the SA experience with FDI flows in a historical and international comparative context. Section 4 provides an overview of the structure, financing and geographical distribution of South African FDI flows in the post crisis era. Section 5 analyses the impact of FDI flows on the current account balance. Some implications and conclusions are drawn in the last section.

2 South African capital flows in a historical context

Figure 1: Net capital flows into SA

Per cent

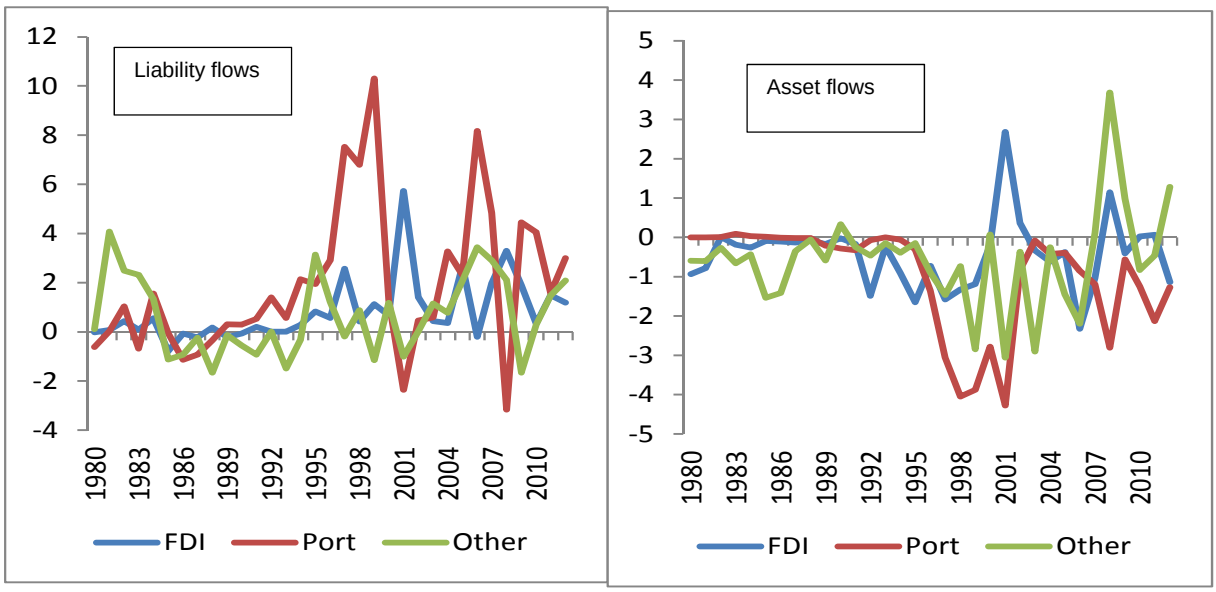


Source: SARB

Figure 1 depicts the net capital flows and the current account deficit expressed as a ratio of GDP for the period 1980 to 2012.[1] Following the debt crisis and the intensification of sanctions in the mid-1980s, there was a net outflow of capital from South Africa for much of decade preceding the advent to democracy in 1994. In essence, this forced the country to maintain a surplus on the current account in order to limit the constraint on domestic growth. The transition to democracy in April 1994 and the liberalisation of the capital account in 1995 led to an increase in net capital inflows. These inflows provided adequate support for the rising current account deficit by covering the shortfall in the domestic savings

Figure 2: Liability and Asset flows

Per cent



Source: SARB

Figure 2 depicts the composition of capital flows due to the actions of foreigners (liability) or domestic citizens (assets). In general, since 1994, net inflows have been dominated by portfolio flows. Foreign direct investment has increased but these flows have tended to be relatively low when compared to the volume of portfolio investment flows - portfolio inflows as a ratio of GDP has averaged 3,1 per cent as compared to 1,5 per cent for FDI for the period 1994 to 2012. On the asset side, for the same period, portfolio flows were approximately three times (1,65 per cent) higher than foreign direct investment (0,5 per cent).

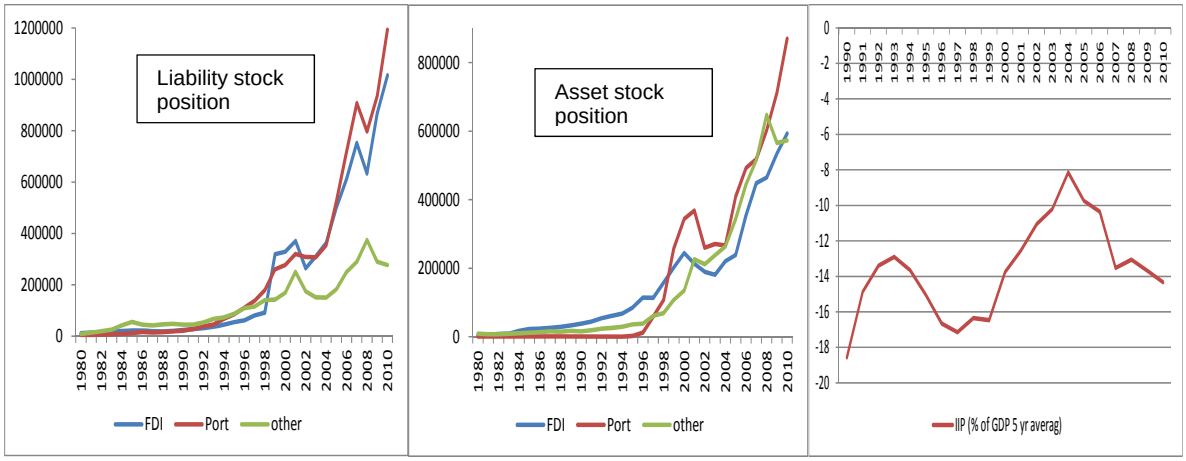
However, while portfolio flows have increased in significance, the stock positions display somewhat of a different picture. On the liability side, portfolio stock (R1,1 trillion) was very

[1] The current account deficit ratio has been inverted such that a positive value represents a deficit while a negative value represents a surplus.

similar to FDI stock (R1,0 trillion) at the end of 2010. On the asset side, the significant rise in portfolio acquisitions since 2004 has meant that portfolio stock (R800 billion) was around 20 per cent higher than FDI stock (R600billion) at the end of 2010. It is important to bear in mind that these stock positions have a direct bearing on the developments in the current account by virtue of their influence on the income and transfer account of the BOP. In addition, the deterioration in the country's net international investment position (figure 3 right-hand panel) implies that net income payments in the income account is likely to remain at elevated levels given that the indebtedness position of the country has worsened.

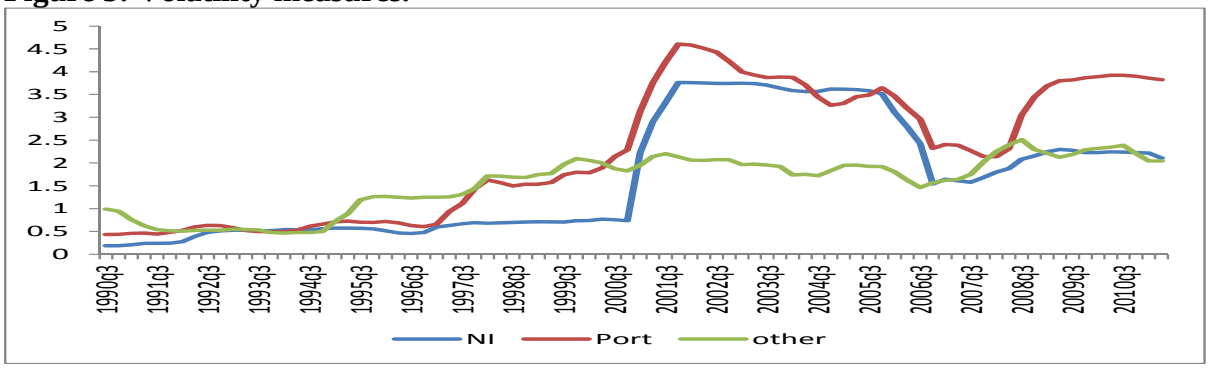
Figure 3: South Africa's asset and liability stock position and net international investment position.

R million **Per cent**



FDI is considered to be a more stable form of inflows since by definition it entails an equity ownership stake of at least 10 per cent. Figure 5 depicts the 5 year rolling standard deviation as a measure of volatility. FDI flows have not necessarily been less volatile than portfolio and other investment flows. From the graph it is apparent that FDI has at times been just as volatile as portfolio and other investment flows.

Figure 5: Volatility measures.



3 South African FDI flows in an international comparative context

This section provides a comparative analysis of South Africa's FDI flows. The primary concern here is to ascertain if the South African experience with FDI flows has been in line with those of a peer group of countries.

3.1 SA FDI experience versus comparator countries

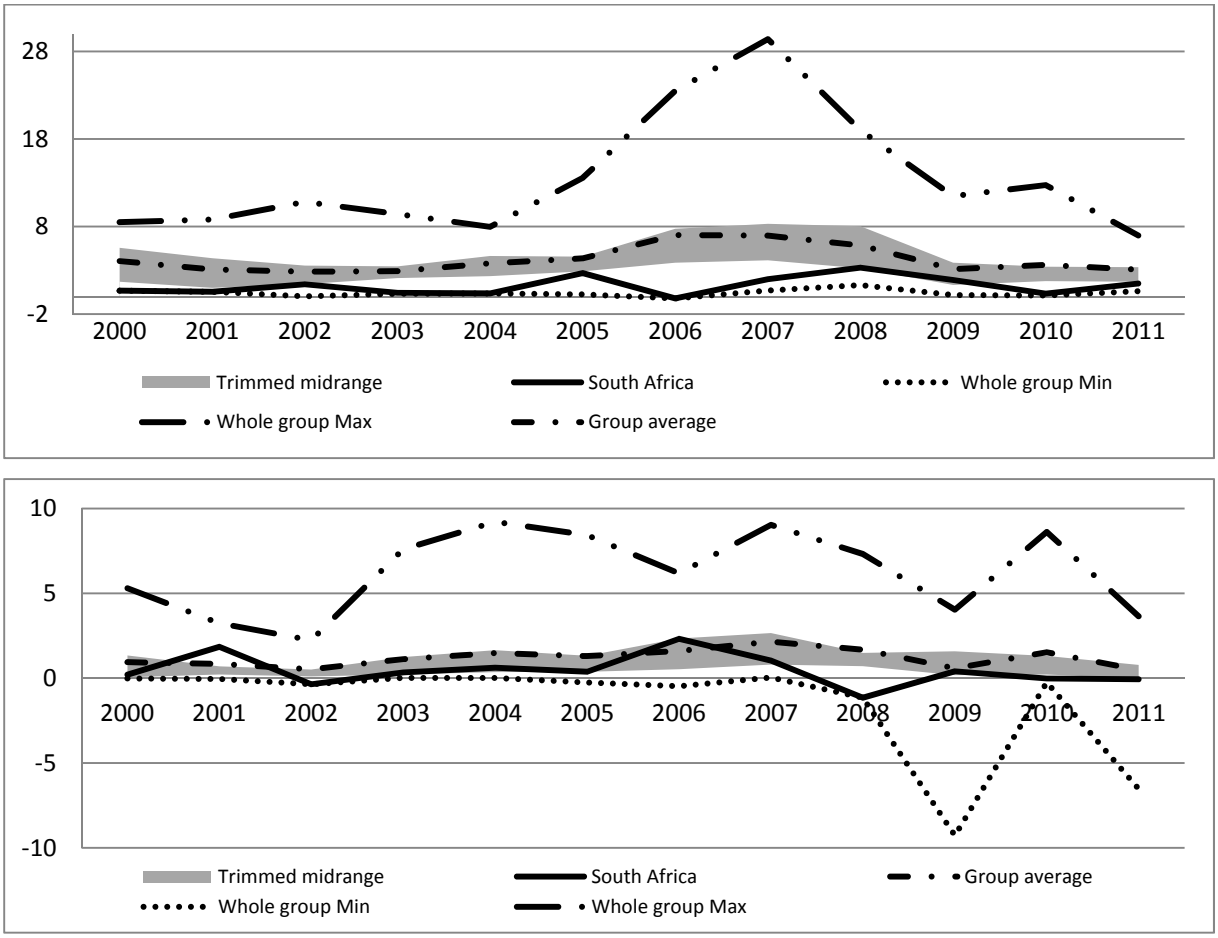
This section compares South Africa's experience of FDI flows with those of a group of comparator countries focusing on the period 2000 to 2011. The long-term credit ratings are used to identify a list of comparator countries.[2] Ratings indicate a relative credit risk and have become an important metric by which international investors allocate investment funds. Throughout the period under review South Africa had a BBB investment grade rating.[3] Sixteen comparator countries were identified for the years 2000, 2005 and 2010. Where necessary, countries with a credit rating of one level higher than that of South Africa were included in the group to allow for 16 comparator countries in the sample for the entire period. In effect, what this meant was that the sample was not fixed for the whole period. In essence, we had a rolling cross-sectional panel which meant that the countries in the group for every year had credit ratings similar to those of South Africa for the entire period. Credit ratings are fluid and reflective of changing economic outcomes and prospects. If the credit rating of a specific year was used to identify the comparator countries the group would not have been uniform since only five countries were in the group for the entire period (see Annex 1).

Figure 6 depicts the FDI flows for the group during the period 2000 to 2011. South Africa has persistently recorded lower inflows of FDI as a percentage of GDP compared to the comparator countries (Figure 6, top panel). There were only two years within the review period that South Africa barely managed to penetrate the inter-quartile range. In 2008, against the backdrop of global FDI inflows recording their second largest annual level of US$1,7 trillion, South Africa experienced record FDI inflows of US$9 billion.4 However, despite the record inflows, South Africa's inward FDI flows as a ratio of GDP of 3,3 per cent was still considerably lower than the average of 5,9 per cent for the comparator group. In 2009, South

[2] Fitch credit ratings were used in the identification of the comparator countries.
[3] BBB is deemed a good credit quality rating with a low default risk. The capacity for payment of financial commitments is considered adequate but adverse economic conditions are more likely to impair this capacity.
[4] Global inflows in 2008 were marginally lower than US$ 1,9 trillion recorded in 2007.

Figure 6: Inward (top) and outward (bottom) FDI flows as per cent of GDP

Per cent



Source: UNCTAD

Africa's FDI ratio of 1,9 per cent edged closer to the comparator group average of 3,1 per cent. This should however be seen against the backdrop of the commodity price boom and the significant global curtailment in FDI investment activity as the effects of the global financial crisis became more pervasive.[5] The reduction of inward FDI flows to South Africa became more pronounced in 2010 and 2011. For the period as a whole, South Africa's inward FDI/GDP ratio was, on average, 3,0 per cent below that of the comparator countries.

Of interest however, is that South African outward FDI as a percentage of GDP tended to move in sync with that of the comparator countries, particularly in the pre-crisis period (Figure 6, bottom panel). Between 2003 and 2007, South Africa's outward FDI stayed within the interquartile range and even edged toward the top end of the range in 2006 as South

[5] Global FDI inflows declined to US$1,2 trillion in 2009 and the commodity price boom meant that SA was a more favourable investment destination vis-à-vis the comparator countries.

African multinational enterprises increased their presence outside of South Africa.[6] There were however periods of large swings in South Africa's outward FDI flows with the outward FDI to GDP ratio ranging between 2,3 per cent and negative 1,1 per cent between 2006 and 2008.[7] The general observation from the gross inward and outward FDI flow data is that South Africa's attraction of inward FDI trends lower than that of the comparator countries while its outward FDI flows are much more in line with that of the comparator countries.

3.2 Attraction versus potential

So in essence, FDI inflows have been much lower while the FDI outflows have been in line with those of the comparator countries. Credit ratings are one measure of a country's potential to attract FDI. Since 2002, UNCTAD has published a FDI potential index for a number of developed and emerging countries. The Potential Index captures four key economic determinants of inward FDI - namely market attractiveness of the host country, availability of low cost labour and skills, infrastructure development and availability of natural resources – and measures a country's potential in attracting inward FDI. [8] In addition, UNCTAD also publishes an inward FDI potential index which measures a country's success in attracting FDI.

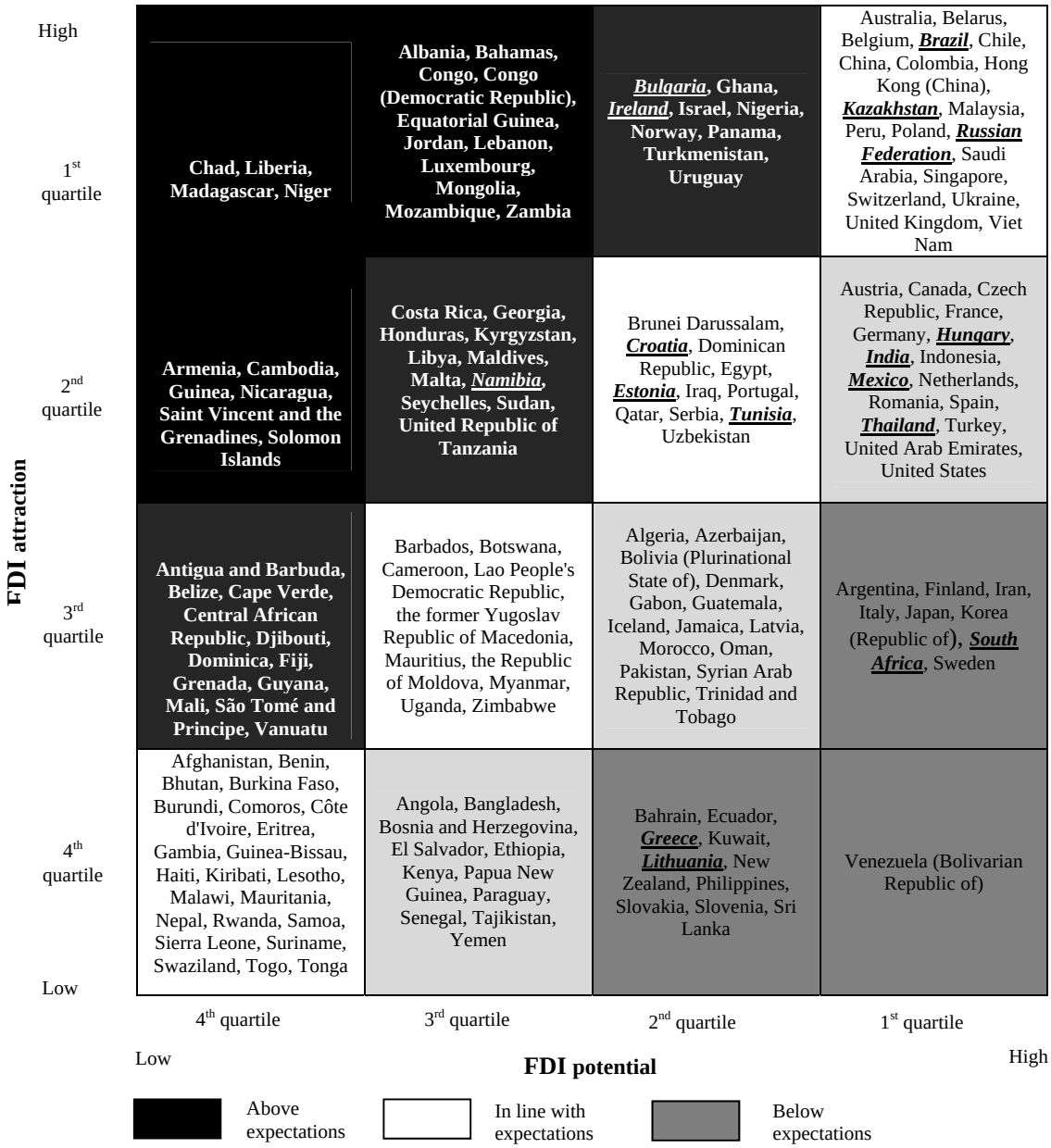
Figure 7 reflects the FDI attraction and potential index for a list of countries for the year 2011 In terms of the classification, countries are grouped into four quartiles according to their level of attractiveness and potential. The comparator countries identified in section 3.1 are reflected in bold italics.

The matrix in figure 7 reveals three broad sets of countries. Firstly there are those countries that are attracting FDI inflows in line with expectations. Secondly there are those countries attracting more FDI than what has been expected. And thirdly there are those countries attracting less FDI than what has been expected. According to this ranking, South Africa fares very poorly in attracting levels of FDI (3rd quartile) despite having a high potential to attract

[6] The 2006 spike was largely due to a South African MNE strategically focusing its outward drive into Africa and the Middle East.
[7] The reversal of inflows in 2008 was accentuated by a significant unbundling transaction by a large South African MNE and coincided with the general downward trend of outward FDI in the comparator countries.
[8] See UNCTAD (2012) for a more detailed description of the indices.

FDI (1st quartile). This is in contrast to most of the comparator countries attracting FDI close to or above their potential.[9]

Figure 7: FDI attraction versus FDI potential



Source: UNCTAD

Providing a definitive reason for the poor performance of South Africa in attracting FDI flows is beyond the scope of this paper. Various empirical studies[10] have found that multiple factors are important in FDI attraction, with decisions behind FDI varying not only due to the overarching driver of the initial FDI but also due to the context of individual FDI projects.

[9] The notable exceptions are Greece and Lithuania
[10] World Bank note number 327

The majority of the studies have found that although size and growth potential of markets is significantly associated with FDI attraction, the investment climate (institutional and regulatory structure) and trade openness also matter significantly. Thus, the advantages of market size and growth potential could be negatively affected by market risks and the costs of doing business, which includes the level of taxes in the host economy, labour costs relative to productivity, and infrastructure. In addition, these factors hinge on an economy's institutional environment. In South Africa's case a lack of skills in the labour force, a low work ethic[11], stringent regulations and a high tax burden have been cited as some of the factors having a bearing on the country's potential to attract FDI. [12]

4 South African FDI flows in the post crisis era.

The data in this section is sourced from a unique FDI flow database that has been compiled by the SARB – the database recorded the microstructure of FDI flows between the fourth quarter of 2010 and the first quarter of 2013 and thus provides a good indication of the trends and nature of South African FDI flows in the post-crisis era.[13]

4.1 Structure of FDI inflows

Despite the increasing contribution of the secondary and tertiary sectors to South Africa's GDP, the primary sector remains an important destination for FDI inflows. The majority of FDI liability flows were directed at the South African mining sector, with this sector attracting R40,9 billion of the R66,3 billion recorded under this category in the two and half years since the fourth quarter of 2010. The wholesale and retail sector and the transport, storage and telecommunications sector attracted net liability inflows of R18,6 billion and R10,7 billion respectively.

Thus, the commodity boom was an important factor driving the liability flows into the mining sector. However, many challenges have confronted the mining industry recently. In addition

[11] http://www.fm.co.za/business/fox/2013/07/25/new-work-ethic-needed

[12] For example, over the period 2006 to 2013 the only region with a higher average corporate tax rate than South Africa was North America. From 1 April 2012 the secondary tax on companies at a rate of 10 per cent was abolished and replaced by a dividend withholding tax at a rate of 15 per cent, which moves the dividend tax to a shareholder tax. This means that the effective corporate tax rate is 28 per cent going forward. However, the sensitivity of FDI to taxation probably varies and should be seen in conjunction with several other host country conditions and policies.

[13] The statistics have been recorded in accordance with the guidelines stipulated in the IMF 5th manual on balance of payments.

to structural challenges in industries like gold mining with gold ore increasingly having to be mined deeper, other impediments affecting South Africa's mining sector include labour unrest, infrastructural constraints, escalating input costs, etc. In addition, the recent corporate downgrades from ratings agencies and local mining companies moving their operations off-shore to what are perceived to be more profitable operating environments poses some questions as to ability of the South African mining industry being able to continue attracting FDI inflows.

Table 1: Sector distribution of FDI flows

R billion

Liabilities	SECTOR	Assets
0.1	Agriculture, Hunting, Forestry and fishing	0.0
40.9	Mining and Quarrying	-14.5
2.5	Manufacturing	-29.3
0.2	Electricity, gas and water supply	0.0
1.4	Construction	-0.4
18.6	Wholesale and retail trade; repair of motor vehicles, motor cycles and personal and household goods; hotels and restaurants	-1.0
10.7	Transport, storage and communication	21.3
-8.2	Financial intermediation, insurance, real estate and business services	0.9
-0.1	Community, social and personal services	-6.8
0.3	Diversified groups	-6.3
66.3	**Total**	-36.1

Source: SARB

On the asset side, there was a net asset outflow of R36,1 billion over the reference period. MNE's in the manufacturing sector have led this outward drive with net outward investment flows totalling R29,3 billion. Of interest is that the second largest net asset outflow was recorded in the mining sector. South African gold mining companies in particular have increasingly sought international investments to complement their South African assets. South Africa has large MNE's in the transport, storage and telecommunication sector with significant international interests. There have been significant in- and outflows in this sector as these MNE's continue to optimise their international capital structure, which led to large asset FDI inflows.

4.2 Modes of entry

Four modes of entry are considered, namely:

- Mergers and acquisitions (M&A) where international MNE's either made a new investment into South Africa or increased their existing ownership of a South African interest. (vice versa for assets) The benefits from M&A type of FDI for the host economy relates to the introduction of technological and other knowledge spill overs into the host economy.
- Existing Subsidiary Financing (ESF) refers to cross-border flows between parties that have an existing FDI relationship. To a large extent these flows represent funds supplied by international parent companies to South African subsidiaries to utilise as working capital or for the expansion of South African operations within an existing FDI relationship.
- Disinvestment represents situations where foreign MNE's disinvests out of a South African asset. (vice versa for assets).
- greenfield investment entails foreign investment in the creation of a completely new asset within the host economy.

The majority of the net liability FDI inflows of R66,3 billion were in the form of mergers and acquisitions (M&A's), accounting for R55,2 billion. Over the database period international MNE's disinvested R28,4 billion from the South African economy.[14] Of the R66,3 billion net liability FDI inflows for the reference period only 6 per cent (R4,2 billion) could directly be linked to greenfield investment.

Table2: Type of FDI flows
R billion

Liabilities	MODE OF ENTRY	Assets
-28.4	Disinvestment	47.3
35.2	Existing subsidiary financing (ESF)	-20.1
55.2	Mergers and acquisitions (M&A)	-61.5
4.2	Greenfield	-1.6
66.3	**Total**	-36.0

Source: SARB

[14] It has to be noted that some of the liability disinvestments were due to restructuring of operations. In these instances there may well have been a disinvestment transaction with an accompanying M&A transaction which will have been included under ESF or M&A.

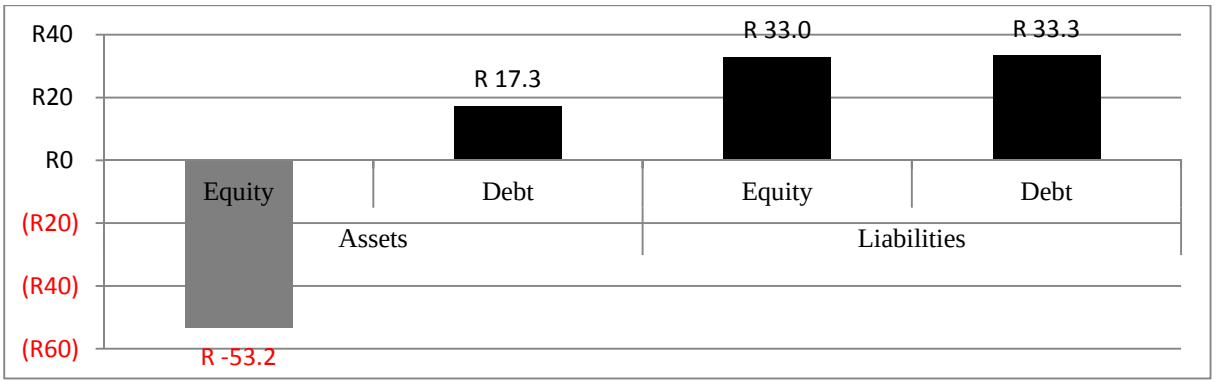
South African MNE's expanded their international operations through M&A's to the value of R61,5 billion over the reference period - this was 11 per cent more than the inward M&A FDI flows. For South African MNE's the ESF category was however much smaller, recording a net outflow of R20,1 billion. South African disinvestment from foreign assets amounted to R47,3 billion. As mentioned earlier, these disinvestments also include individual transactions where large restructurings took place where a disinvestment is recorded under one leg of the transaction and an M&A transaction is recorded for another leg of the same overall transaction. Of the R36 billion net asset FDI outflows only R1,7 billion could be directly linked to greenfield investment.

4.3 Financing of FDI flows

FDI can either be undertaken via traditional equity and debt driven investment (internalisation of FDI) or via non-equity modes of international production and trade (externalisation of FDI). The more conventional approach to FDI has been for MNE's to internalise their global operations by acquiring majority or complete control of an international subsidiary. The instruments used to facilitate this control is either equity or debt investment. Usually there will be some component of equity investment to establish the control or partial ownership of the international asset, with funding channelled either through additional equity or debt.

Figure 8: Equity / debt distribution of net FDI flows

R billion



Source: SARB

Equity investments have played a major role in the outward flow of South African MNE's over the reference period (see figure 8). Equity investment accounted for an outflow of R53,2 billion while debt instruments recorded an inflow of R17,3 billion. A large component of the inward debt flows under the asset category related to large South African MNE's

restructuring their international capital structure by reducing their debt financing to their international subsidiaries.

On the liabilities side international MNE's distributed their investment into South Africa roughly equally between equity and debt instruments. The more even distribution of equity and debt financing on the liabilities side could also be attributed to the larger share that ESF plays in inward liability FDI flows, where existing local subsidiaries received debt financing from their parent companies. Depending on the structuring of the terms of these loans it could imply a larger structured loan and interest repayment commitment on the liability side as opposed to that on the asset side. This in turn could have implications for the income account of the balance of payments, an issue we take up later in this paper.

4.4 Geographical distribution of FDI flows

There has been a shift internationally in the geographical origins and destinations of FDI. The traditional North-South flow regime has changed markedly over the past decade to a regime where South-South and South-North flows have become much more prominent. Increasingly, developing country MNE's are playing a more active role in global FDI flows.

MNE's from the USA were the largest FDI investors into South Africa over the period covered in the database, resulting in a net liability FDI inflow of R17,9 billion. MNE's located in the Netherlands, China, Luxembourg, UK and Australia all had net liability FDI investments into South Africa in excess of R5 billion.

Since the 2008 financial crisis there has been renewed focus on the channels via which international FDI flows gets transmitted. The 2013 World Investment Report (UNCTAD, 2013) identifies two main offshore finance mechanisms, namely, Offshore Financial Centres (OFC's), also known as "tax havens" and Special Purpose Entities (SPE's).

SPE's are established for a special purpose, often of an administrative nature and houses a special structure such as a holding company through which investments are channelled. They tend to be established in low-tax countries or in countries that provide special tax benefits to SPEs. Often these SPE's do not conduct any economic activity of their own and have a skeleton staff and minimal assets and is mainly used to channel funds to and from third countries.

On the other hand, OFC's operate on the assumption that they have limited productive capacity to compete with other nations in the traditional economic spheres. They attempt to provide an attractive route of channelling FDI by virtue of their low rates of taxation. What these OFC's forfeit in direct taxes they endeavour to make up in the form of indirect taxes, increased professional services rendered, tourism and real estate transactions.

Modern "tax havens" can be broadly classified into three categories[15]. The first is the UK based tax havens. These include British Crown dependencies such as the Channel Islands, Jersey, Guernsey and the Isle of Man and British overseas territories such as the Cayman Islands, Bermuda, British Virgin Islands, etc. The second relates to the "European havens" consisting mainly of Belgium, Netherlands, Luxembourg, Ireland, Switzerland and Lichtenstein. The third category, and probably of increasing interest to South Africa, relates to the "new" tax havens of the transitional economies. This category includes countries such as Mauritius, Seychelles, Panama, etc. From the geographical breakdown provided for the South African FDI flows over the reference period in figure 9 it is clear that both liability and asset FDI flows made significant use of these OFC's. Countries like Netherlands, Luxembourg, Mauritius, British Virgin Islands, Isle of Man, and Switzerland probably all acted as tax haven channels and thus obscure the true origin or destination of FDI flows.

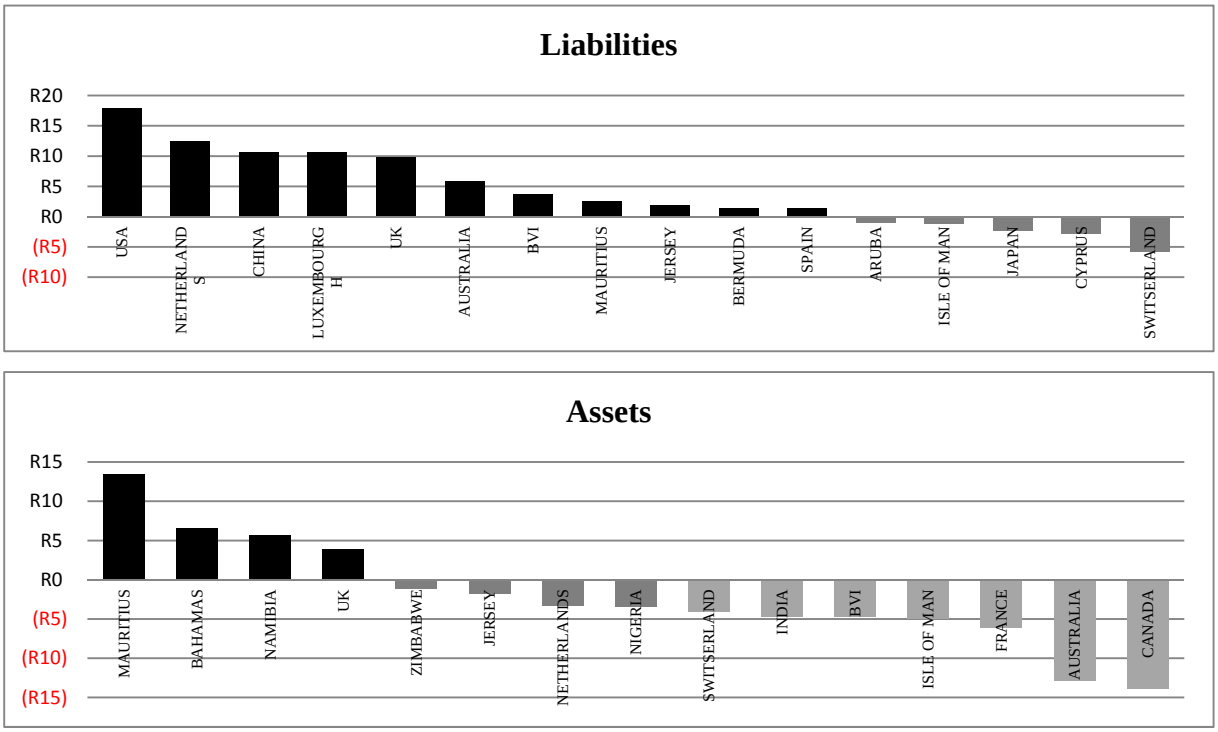
The most favoured destinations for South African MNE investments over the reference period were Canada and Australia. The Canadian investments were mostly centred around the Canadian energy sector while the Australian investments focused on the mining sector. Mauritius has increasingly become a preferred gateway for South African MNE's into international, and specifically African, investments. Mauritian based subsidiaries of South African MNE's are responsible for a large number of bi-directional FDI flows over any given period. The large inflow recorded under asset FDI flows over the reference period emphasises how important this channel has become for South African MNE's. Figure 9 only depicts the major destinations for South African MNE investments but the expanded list of destinations[16] reveals that South African MNE's have begun a significant move into various African

[15] http://www.thesait.org.za/news/96869/TaxTalk-Sovereign-Rights-Of-Tax-Havens-And-The-Charge-Of-Harmful-Tax-C.htm

[16] See annexure for complete list of geographical FDI flows

Figure 9: Major origins (liability) and destinations (assets) of South African FDI flows

R billion



Source: SARB * (full list of countries available in Annex)

countries. The initial investment is usually small and is then followed with small to medium sized investments as well as trade flows.

5 What has been the impact of Capital flows on the current account balance

As pointed out in section 1, since the mid-2000s South Africa has been very dependent on international capital flows to finance the deficit on the current account. Between 2003 and 2010 South Africa's average savings rate as a percentage of GDP amounted to 15,2 per cent, compared to the global average of 21, 2 per cent (maybe some figures for an earlier period). The low domestic savings rate has in effect meant that domestic gross fixed capital investment has become increasingly reliant on international capital (see figure B1 in annex).

However, while SA has been received sufficient inflows to cover the deficit on the current account, the income payments on these payments have in effect also contributed to the deficit on the current account. The influence of capital flows on the current account occurs through the trade and income accounts. For example, capital inflows can have an influence on trade (exports and imports) as well as on dividend flows. We use the MWald granger no causality

test of Toda and Yamamoto (1995) within a VAR framework to establish the relationship between FDI and the other variables of interest, namely, current account balance (CAB), exports and imports.[17] FDI, exports, imports and CAB are expressed as a ratio of GDP (FDI).[18]

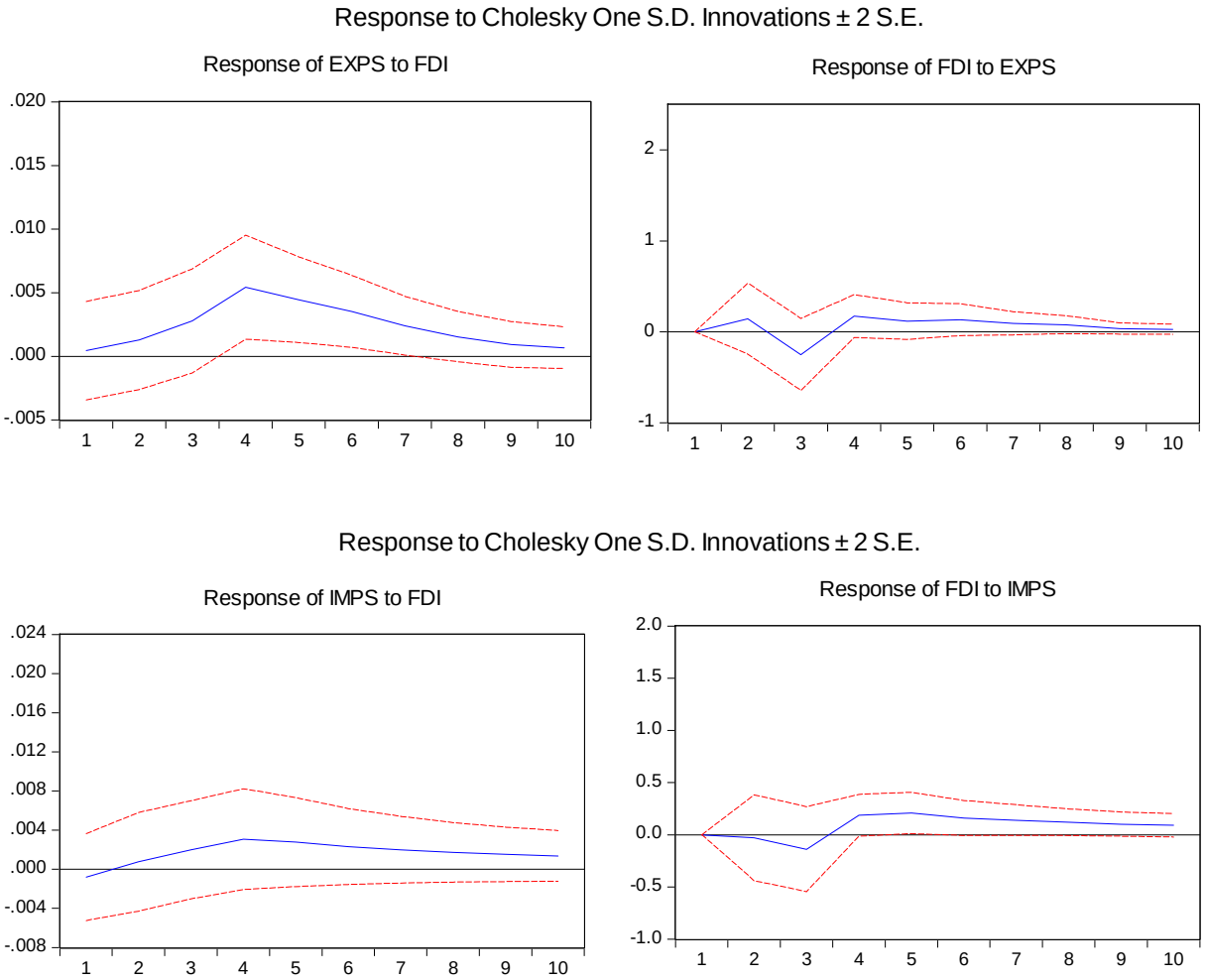
The results in table 3 indicate that the null hypothesis of no causality from FDI to the current account balance and exports is rejected. In addition, we can also reject the null of no causality from imports and exports to FDI. Interestingly, the null that FDI does not granger cause imports cannot be rejected.

Table3: Toda Yamamota Granger No Causality Test for FDI and Growth (1990-2012)

Null Hypothesis	Lags	Value
FDI does not granger cause CAB	8	16.24 (0.06)
CAB does not granger cause FDI	8	7.07 (0.25)
FDI does not granger cause imports	6	4.60 (0.60)
Imports does not granger cause FDI	6	17.68 (0.01)
FDI does not granger cause exports	7	15.84 (0.03)
Exports does not granger cause FDI	7	14.18 (0.05)

The impulse responses of exports and imports to a shock in FDI and vice versa are reflected below. The results indicate that FDI inflows have a positive impact on exports but no significant impact on imports. FDI responds marginally positively to rises in imports. These results suggest that the net effect of FDI inflows on the trade balance should be positive given its significant (insignificant) impact on exports (imports).

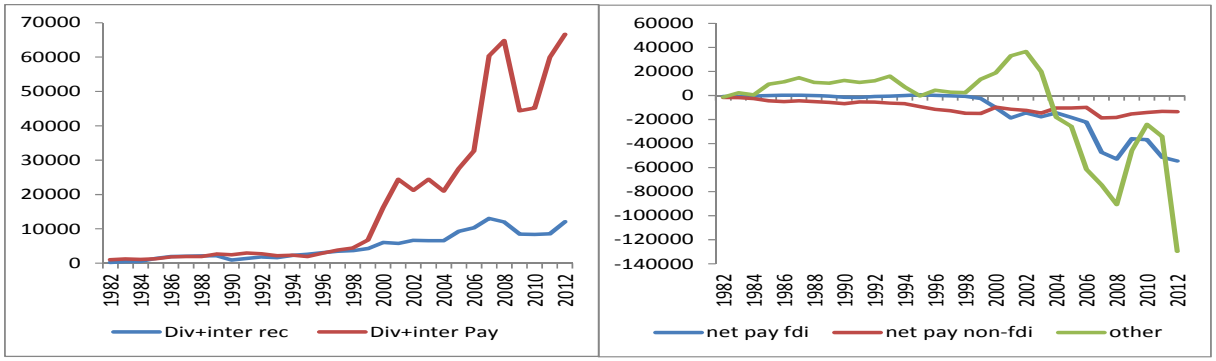
[17] In this case, the Wald tests have asymptotic χ^2 distributions irrespective of the order of integration of the variables or the cointegration properties of the system (Dolado and Lütkepohl, 1996; and Toda and Yamamoto, 1995).
[18] We include a dummy variable to account for the outliers in FDI inflows for 2001 (state detail here).



As pointed out earlier, it is important to bear in mind that the capital flows in the financial account are associated with dividend and loan payments and receipts in the current account of the balance of payments. Stated differently, capital inflows (outflows) in period *t* in the financial account are associated with capital outflows (inflows) in the current account in period *t+n*.

Figure 10 Dividend and interest payments and receipts related to FDI flows

R million



There has been a significant increase in dividend and interest flows related to FDI movements since the beginning of 2000. While dividend and interest receipts have increased marginally, there has been an exponential rise in payments (left-hand panel). In addition, net payments related to capital flows have been an important driver of developments on the current account. Of interest however, is that net payments related to portfolio and other investment has been relatively flat while those related to FDI have increased significantly.

Figure10 (right-hand panel) shows the contribution of net dividend and interest payments on FDI and non-FDI flows to the current account balance. The basic point here is that between 2004-2012, net payments on FDI contribution made up around 36 per cent of the current account deficit. The net payments on non-fdi related payments made up around 15 per cent of the current account deficit position for the period 2004 to 2012. Hence, 51 per cent of the current account deficit position for the period 2004 to 2012 was due to net payments on total investment flows (both FDI and non-FDI flow).

6 Some implications and conclusions

In general, since the advent to democracy in 1994 and the liberalisation of the capital account capital inflows into the South African economy has increased. However, the South African economy has become increasingly dependent on capital inflows with widening current account deficit since 2004. Net inflows have been dominated by portfolio flows. Foreign direct investment has increased but these flows have tended to be relatively low when compared to the volume of portfolio investment flows. In addition, South Africa has fared poorly as an FDI destination when compared to a peer group of countries.

However, while portfolio flows have increased in significance, the stock positions show that on the liability side, portfolio stock (R1,1 trillion) was very similar to FDI stock (R1,0 trillion) at the end of 2010. On the asset side, the significant rise in portfolio acquisitions since 2004 has meant that portfolio stock (R800 billion) was around 20 per cent higher than FDI stock (R600billion) at the end of 2010. The deterioration in the country's net international investment position has meant that the net income payments on capital flows – particularly the dividend and income payments on FDI inflows – has exerted and will continue to exert a significant influence on the current account deficit.

Given the current stock liability positions, the significant rise in dividend and interest payments since 2004 is likely to continue. Of the R66,3 billion FDI liability inflows over the database period the bulk were in the form of M&A's and ESF. This equity and debt investment places an obligation on future dividend and interest payments. In particular, the more structured repayment nature of debt, implies a constant drain on the current account through interest payments in the income account. In contrast most of the South African MNE's outward investment occurred via M&A's financed by equity injection. They could thus retain their profits abroad for further expansion purposes which could imply that the South African income receipts on dividends is much less than the income payments on liability investment dividends, coupled with the additional outward payment of interest on the sizeable inward debt financing.

Unless there is a significant rise (decline) in the exports (imports) of goods and services, the South African economy will be dependent on foreign capital inflows to offset the investment income repayments and the current account deficit in general. As far as FDI is concerned, the policy challenge is to ensure that these result in "greenfield investment" and technology spillovers. In this regard, the nature of the FDI, the manner in which it is funded and the impact on the trade balance and economic growth are important characteristics that warrant special attention when devising policies that encourage FDI inflows.

Annex

Table A1: List of comparator countries

	COUNTRY	_	2000	_	2005	_	2010
1	Greece	1	BBB+	1	A	1	BBB-
2	Hungary	1	BBB+	1	BBB+	1	BBB-
3	South Africa	1	BBB-	1	BBB+	1	BBB+
4	Thailand	1	BBB-	1	BBB+	1	BBB
5	Tunisia	1	BBB-	1	BBB	1	BBB
6	Bahrain	1	BBB-	1	A-		A
7	Brazil		BB-		BB-	1	BBB-
8	Bulgaria		B+	1	BBB	1	BBB-
9	Check Republic	1	BBB+		A		A+
10	Chile	1	A-		A		A
11	Croatia		BB+	1	BBB-	1	BBB-
12	Egypt	1	BBB-		BB+		BB+
13	Estonia	1	BBB+		A	1	BBB+
14	India		BB+		BB+	1	BBB-
15	Ireland		AAA		AAA	1	BBB+
16	Israel	1	A-		A-		A
17	Kazakstan		BB-	1	BBB	1	BBB-
18	Latvia	1	BBB	1	A-		BB+
19	Lithuania		BB+	1	A-	1	BBB
20	Malaysia	1	BBB	1	A-		A-
21	Mexico		BB+	1	BBB	1	BBB+
22	Namibia		NA	1	BBB-	1	BBB-
23	Poland	1	BBB+	1	BBB+		A-
24	Russia		B	1	BBB	1	BBB
25	South Korea	1	BBB+		A+		A+
26	Uruguay	1	BBB-		B+		BB
		16		16		16	

Source: Fitch Rating Agency

Table A2: Average corporate tax rates per region

Per cent

Region / country	2006	2007	2008	2009	2010	2011	2012	2013	Average for period
Africa	30.8	30.6	28.7	28.8	28.4	28.6	29.0	28.6	29.2
North America	38.1	38.1	36.8	36.5	35.5	34.0	33.0	33.0	35.6
Asia	29.0	28.5	28.0	25.7	24.0	23.1	22.9	22.4	25.4
Europe	23.7	23.0	22.0	21.6	21.5	20.8	20.4	20.6	21.7
Latin America	29.1	28.3	28.0	28.0	27.5	29.0	28.3	27.6	28.2
Oceania	30.6	30.2	29.6	29.2	29.0	28.6	28.6	27.0	29.1
EU	25.0	24.1	23.3	23.2	23.0	22.8	22.6	22.8	23.4
OECD	27.7	27.0	26.0	25.6	25.7	25.4	25.2	25.3	26.0
Global average	27.5	27.0	26.1	25.4	24.7	24.5	24.4	24.1	25.4
South Africa	**36.9**	**36.9**	**34.6**	**34.6**	**34.6**	**34.6**	**34.6**	**28.0**	**34.3**

Source: KPMG

Table A3: Liability flows per country

R billion

COUNTRY	VALUE
ARUBA	R -1.1
AUSTRALIA	R 5.8
AUSTRIA	R 0.1
BELGIUM	R -0.7
BERMUDA	R 1.4
BVI	R 3.6
CANADA	R 0.8
CAYMAN ISLANDS	R 0.3
CHINA	R 10.7
CYPRUS	R -2.9
FRANCE	R 0.4
GERMANY	R -0.9
GIBRALTAR	R 0.0
GUERNSEY	R 0.3
INDIA	R 0.1
IRELAND	R 0.3
ISLE OF MAN	R -1.1
JAPAN	R -2.4
JERSEY	R 1.9
LIECHTENSTEIN	R -0.0
LUXEMBOURGH	R 10.6
MALAYSIA	R 0.1
MAURITIUS	R 2.6
NETHERLANDS	R 12.5
NIGERIA	R -0.0
SAUDI ARABIA	R -0.3
SINGAPORE	R 0.2
SPAIN	R 1.4
SWEDEN	R 0.4
SWITSERLAND	R -5.8
UAE	R 0.2
UK	R 9.9
USA	R 17.9
TOTAL	**R 66.3**

Source: SARB

Table A4: Asset flows per country

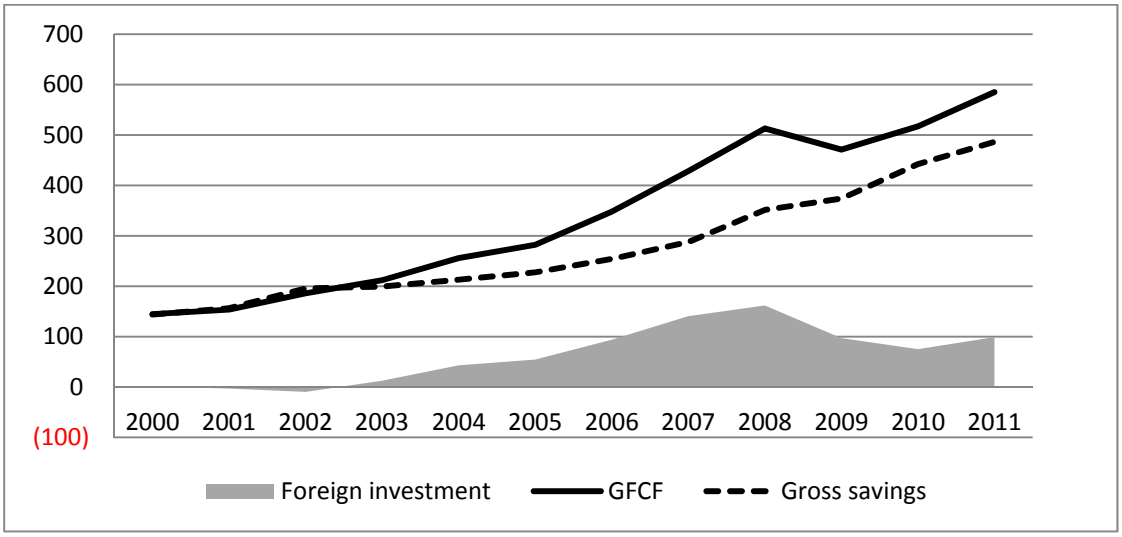
R billion

COUNTRY	VALUE
ANGOLA	R 0.0
AUSTRALIA	R -12.9
AUSTRIA	R -0.1
BAHAMAS	R 6.6
BARBADOS	R -0.7
BERMUDA	R -0.0
BOTSWANA	R -0.4
BRAZIL	R -0.1
BVI	R -4.8
CANADA	R -13.9
CHINA	R -0.0
DRC	R 0.0
DUBAI	R -0.0
ETHIOPEA	R -0.2
FRANCE	R -6.1
GHANA	R -0.0
GUERNSEY	R -0.3
GUINEA	R -0.0
HONG KONG	R -0.2
INDIA	R -4.7
ISLE OF MAN	R -5.0
IVORY COAST	R -0.0
JAPAN	R -0.2
JERSEY	R -1.8
KENYA	R -0.7
LESOTHO	R -0.0
LUXEMBOURGH	R 0.1
MAURITIUS	R 13.4
MOZAMBIQUE	R -0.8
NAMIBIA	R 5.7
NETHERLANDS	R -3.3
NIGERIA	R -3.5
SCOTLAND	R -0.1
SIERRA LEONE	R -0.0
SINGAPORE	R -0.0
SWAZILAND	R -0.0
SWITSERLAND	R -4.0
TANZANIA	R -0.1
UK	R 3.9
USA	R -0.8
UZBEKISTAN	R 0.7
VIETNAM	R -0.4
ZAMBIA	R -0.2
ZIMBABWE	**R -1.1**
TOTAL	**R -36.1**

Source: SARB

Figure B1: Financing South Africa's gross fixed capital formation

R billion



Source: SARB