The Effects of Black Economic Empowerment (BEE) on Foreign Direct Investment (FDI)

1. Introduction

South Africa is entering a controversial stage in her economic life. With the introduction of democracy only a decade ago, BEE was instituted to facilitate the transformation process in the public and private sectors. It is assumed that this strategy will continue over the remainder of this decade and further as spelled out by the various sectoral transformation charters and the draft Codes of Good Practice.

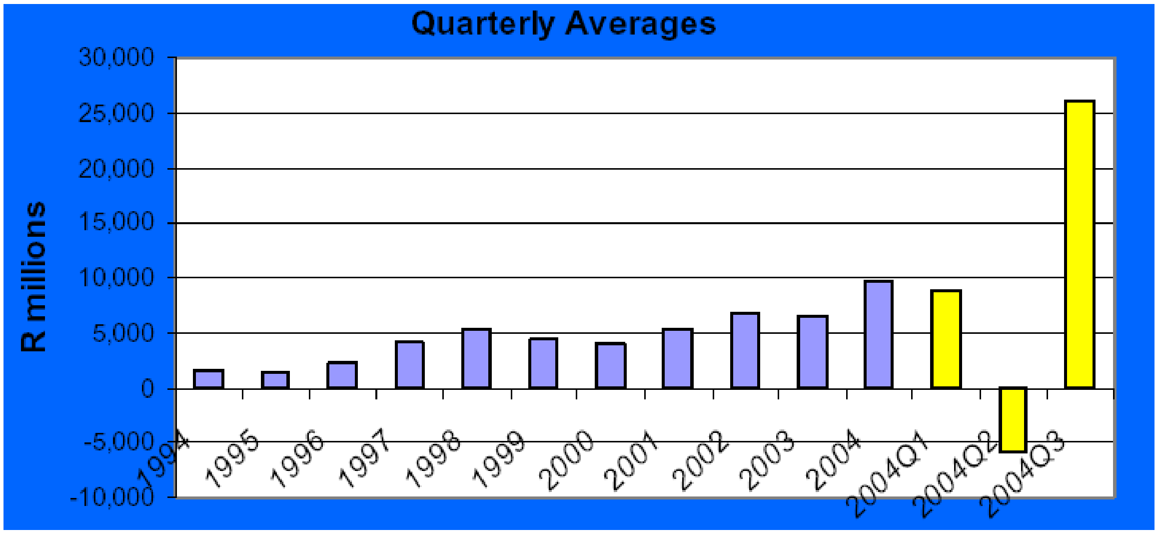
There have been several arguments surrounding the merits of BEE, including disinvestment in South Africa from abroad. The intention of this analytical document is to explore the plausibility or lack thereof in assessing this perception. The analysis presented here will quote a range of research from local and foreign sources from both a qualitative and quantitative approach.

With respect to the quantitative analysis of the effects of BEE on Foreign Direct Investment, several key indicators need to be examined. Further to this, the arguments of the perceived negative impact of BEE on FDI must be assessed. Qualitatively, the relevant motivating factors effecting FDI will be explored.

2. Current FDI Levels in South Africa

Tables 1 - 3 indicate that there has been volatility in the level of Foreign Direct Investment in South Africa over the past five to ten years. One can observe a general increase in the quarterly average rate since 2001 in Rand Terms. In US $ terms, as shown in table 2, it is evident that the level of FDI almost halved in 2002 - the volatility of the US$/Rand exchange rate no doubt affecting the rate during the period in question. Since 2003, however, the Rand has stabilised against the US$ and Table 1 illustrates a substantial increase in FDI in 2004. The question that remains, however, is the relationship between FDI and BEE transactions.

Table 1. FDI Quarterly Averages For South Africa



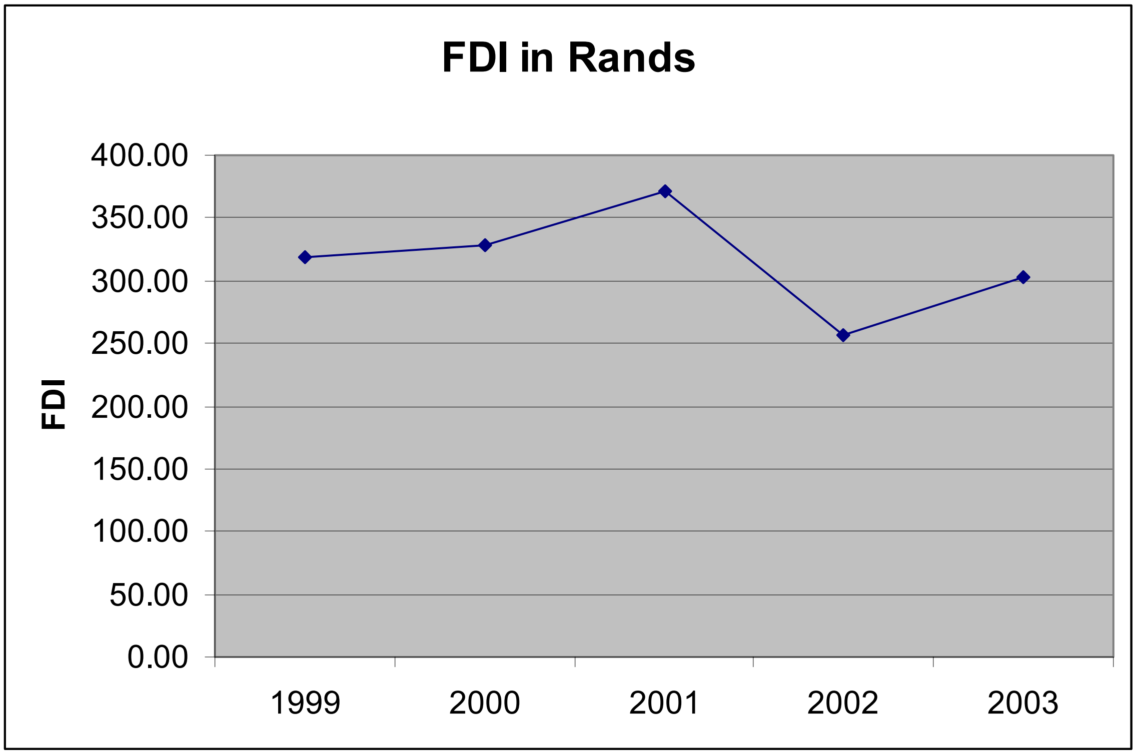
Source: The Business Map Foundation: October 2004

Table 2 FDI GDP and Ex Rate

		1999	2000	2001	2002	2003
FDI	Rands (Bn)	318.63	328.86	370.70	255.84	303.44
FDI	US$ (Bn)	52.15	47.39	43.10	24.32	40.14
GDP	Rands (Bn)	813.68	922.15	1020.01	1164.94	1251.47
FDI	% GDP	39.2	35.7	36.3	22	24.3
Ex Rate	US$/Rand	6.11	6.94	8.6	10.57	7.56

Source: South African Reserve Bank, September 2004: Amended

Table 3 : FDI in South Africa From 1999 to 2003



Source: South African Reserve Bank Quarterly Bulletin : March 2005

3. Drivers of FDI

A global report released by McKinsey Global Institute (MGI) in 2004 found that both the incentives used to attract foreign direct investment and the restrictions placed on it do not affect levels of foreign investment. Governments around the world attempt to attract foreign direct investment by offering costly tax breaks, import duty exemptions, land and power subsidies, and other incentives. Yet the evidence suggests that these incentives are largely ineffective. McKinsey's view reccomends abandoning incentive schemes and regulations and concentrating on strengthening economic foundations and more specifically, stabilising the economy and promoting competitive markets. "Macroeconomic instability discourages long-term investment by making demand, prices, and interest rates difficult to forecast." [1]

Mckinsey's studies have shown that the primary considerations of multi-national companies (MNC's) when investing abroad are the following: quality of infrastructure and labour force; size and growth of the domestic market and the accessibility of the

[1] http://www.mckinseyquarterly.com/article_page.aspx?ar=1386&L2=7&L3=10

location. Thus FDI has a stronger correlation to business and economic confidence in a country than a regulatory framework. The McKinsey report cites examples of developing nations such as Mexico and Brazil that have implemented costly regulations and tax breaks with little effect in terms of increased FDI.

Brendan Vickers from the office of the South African President vindicates the South African case:

> "For SA to win the confidence of foreign investors as a viable market to invest in, domestic firms need to lead the way and show trust in the economy. This will involve addressing the underlying confidence issues in the economy."[2]

This is confirmed by the South African Chamber Of Business (SACOB) Business Confidence Index (BCI) as demonstrated in Table 4 below. The BCI has escalated from a low of 90.0 in September 1998 to a record high of 130.9 in September 2004, and remains over 125 in all months recorded in 2005.

[2] DFID Case Study for WDR 2005: Investment Climate Reform in South Africa, by Brendan Vickers

Table 4: SACOB Business Confidence Index

Month	1998	1999	2000	2001	2002	2003	2004	2005
January	102.0	90.5	100.9	105.8	101.1	105.7	122.3	125.8
February	101.7	91.5	102.4	110.6	101.0	105.2	120.8	126.9
March	103.4	96.3	100.1	106.9	99.3	105.8	121.9	127.5
April	102.9	92.7	96.1	102.5	101.3	106.8	124.0	**127.2**
May	101.3	92.4	98.6	103.6	107.0	102.4	123.6	
June	98.0	94.7	97.8	108.0	108.1	105.8	123.1	
July	93.8	95.2	99.3	109.0	106.5	108.0	122.5	
August	96.8	94.2	99.8	109.0	104.8	110.9	127.8	
September	90.0	93.6	98.9	104.7	106.3	112.3	130.9	
October	91.9	95.5	101.8	103.2	104.5	116.5	126.5	
November	91.5	97.5	99.8	107.7	105.5	119.7	125.1	
December	91.4	99.7	104.6	101.3	104.3	122.4	124.5	
Average	**97.1**	**94.5**	**100.0**	**106.0**	**104.1**	**110.1**	**124.4**	

Source: Sacob Business Confidence Index www.sacob.co.za

With respect to MNC's with local opetations, a survey of foreign firms operating in South Africa conducted by the Bilateral Chamber Consultative Committee (BCCC) which investigated the period from May to June 2004 and which involved 252 of its member companies, found a sharp increase in business confidence compared to 2002, with the majority of respondents very positive about the country's economy and future prospects.[3]

4. Perceived Negativity with Respect to BEE's Effect on FDI

A recent public comment compared the BEE charter requirements similar to those of India in the 1970's[4]. The socialist Indian government at the time feared that the country's economy would be dictated by multi-national companies. All MNC's were required to either sell 60 percent of their equity to local investors or to disinvest. Companies such as

[3] http://www.southafrica.info/doing_business/investment/bccc-survey.htm
[4] http://quantifier.blogspot.com/2005/04/how-to-chase-away-fdi.html

Coca-Cola and IBM which refused to comply were forced to exit India's economy. Consequently little in the way of new investment entered the country until these regulations were relaxed.

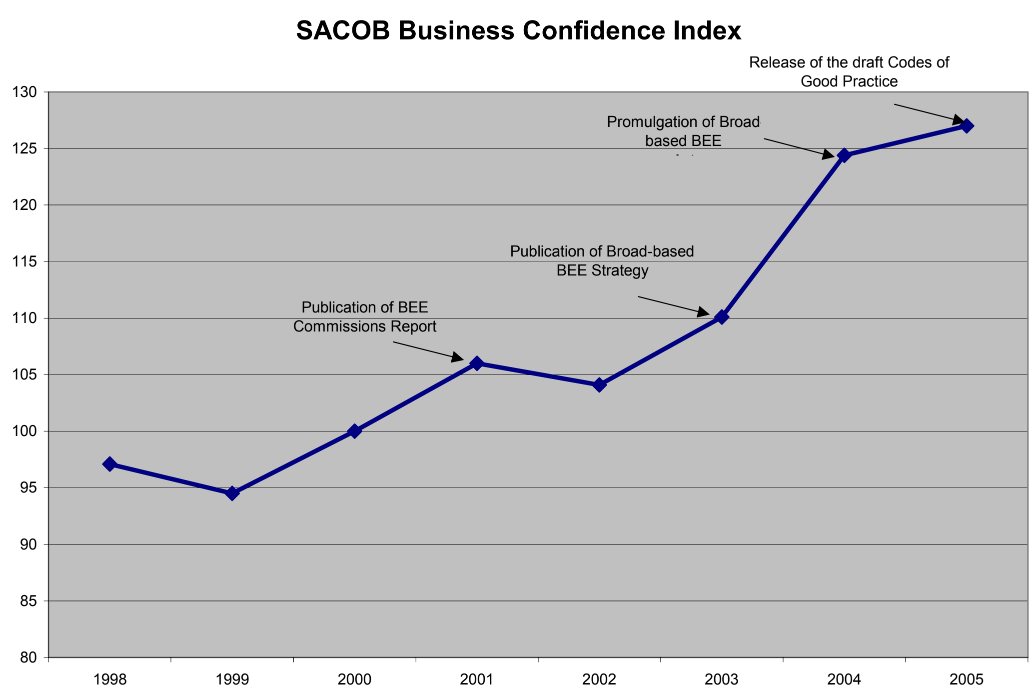
South African empowerment charters are not nearly as severe as the Indian foreign exchange regulations. Historical occurrences such as this, however, may be one of the sources of the perceived fear surrounding transformation charters. The major difference is clearly in intention. The objective of the dti's Strategy on Broad-Based Black Economic Empowerment and the BEE Act of 2003, is to reverse the inequalities of the past, and this explicitly expressed in most charters.

A further potential reason for the perceived negative link between BEE and FDI is the concern over some of the details of BEE documentation and how certain BEE initiatives will be implemented. There seems to be concern about the lack of clarity and consistency with respect to BEE charters and regulations. A major concern is whether black equity ownership will become mandatory and will therefore translate into a cost of doing business with the public sector, and, by deduction with the private sector by means of pressure to transform in order to benefit from private and public sector procurement opportunities.

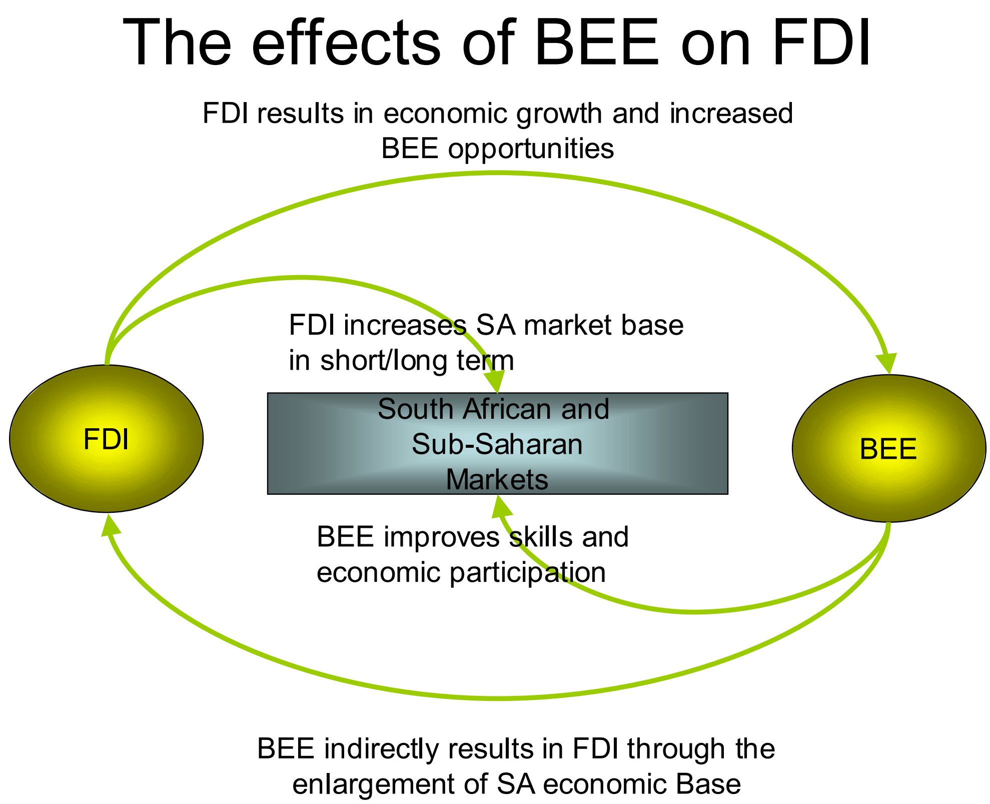
5. A Positive Relationship between BEE and FDI

Despite the apparent perceived negativity surrounding BEE and its perceived negative effects on FDI, BEE transactions continue to forge ahead. The number and value of BEE transactions are staggering. The Mail and Guardian reports that the number of transactions in 2004 increased 29% to 244 from 189 the year before. There is, however, dissention among reporting constituents. Business Map Foundation reported R21.2 billion worth of deals disclosed in 2004, further commenting that undisclosed transactions would have pushed the total even higher. The Competition Commission reported that deals worth R30 billion had been concluded. Ernst and Young calculated that the value of empowerment deals to be R42.2 billion in 2004. This represents a 300% increase in value since 2002. Irrespective of who is reporting, there is clearly an increase in BEE transactions. This is demonstrated through EmpowerDEX/ Financial Mail's Top Empowerment Company surveys from 2003 to 2004. As at 30 September 2003, Black people directly and indirectly owned an estimated 15.7 percent or R 234.3 Billion of the market capitalisation of all companies listed on the main boards of the JSE. A similar assessment of the top 100 companies in 2003, estimated the black ownership of the JSE at around 9.5 percent. Although the direct black ownership figures are significantly lower, there was nonetheless a notable increase from 1.6% black ownership of the JSE as at 30 September 2003 to 3.3% as at 30 September 2004.

Granted, increases in BEE deals may purely be a result of BEE legislation, regulations and public sector procurement pressure trickling downward into the private sector. The fact remains, however, that if BEE were indeed an obstacle to business confidence, then it follows that an increase in BEE-related regulations and documentation, would result in a decrease in confidence levels. The opposite, however, has been found to be the case: as regulatory documentation and the drafting of transformation charters have increased in intensity over the past six years, business confidence has in fact increased. The graph below illustrates this trend:



Based on McKinsey's findings that FDI is stimulated by positive economic conditions and not by regulatory incentives, from a long term perspective, BEE can be seen to contribute to FDI since it promotes skills development, economic participation and the creation of an emerging middle class, which, in turn, supports an entrepreneurial class. All these factors contribute to a positive economic environment in which FDI can flourish.



Furthermore, a statement released by the US Bureau of Public Affairs explains that US Companies support the broad goals of South Africa's Black Economic Empowerment (BEE) policies[5]. It is stated that US Companies have contributed to the positive transformation of the economy, including through their employment and management practices.

[5] www.state.gov/e/eb/ifd/2005

6. Conclusion

FDI, it seems, is largely attracted by economic and business conditions, and not by focusing on incentive schemes. In addition, FDI is evidently not discouraged by regulatory restrictions. It therefore follows that the effects of the BEE regulatory framework will have little effect on FDI. In recent years, the number of BEE transactions has been gradually escalating, along with business confidence, both locally and abroad and at the same time, FDI levels have not fallen drastically. During the early part of this decade, the effects of a volatile rand had a far stronger effect on foreign inflows than BEE regulations. The publication of the US Bureau of Public Affairs is an explicit vote of confidence in the transformation process. The assumption that the South African BEE regulatory framework is a deterrent to FDI is therefore unfounded.