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POLITICAL RISK AND FOREIGN DIRECT INVESTMENT IN SOUTH AFRICA: USING INDIGENOUS METHODS FOR ANALYSIS

By

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Johannesburg, July 2015
Declaration on plagiarism

I hereby declare that this thesis, submitted for the MA degree in Politics to the University of Johannesburg, is my own work and has not been formerly submitted to another university for a degree.

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Acknowledgements

In loving memory of my gran, Mamponie Rose Nyakale, and my brother, Abie Linda Makane. Always in my heart.
Abstract

This study is a political risk analysis using two indigenous models to review foreign direct investment in South Africa. Focus is placed on South Africa as it positions itself favourably for foreign direct investment (FDI) flows and participates actively in the global economy.

While there have been numerous studies on the determinants of FDI flows to developing countries, there is a lack of research surrounding the political dynamics and the impact this has on FDI. This is surprising as an absence of a clear understanding of how political risk analysis is approached may result in understating corporate risk strategies, foregoing opportunities, or the prospects of international capital flows that would otherwise add towards the growth of world trade. In spite of the recommendations and forecasts made, commercial political risk models do not explain or fully capture the politics behind risk analysis. The result is that they are not able to convey nuanced information that is likely to be captured in an indigenous model of political risk.

In South Africa Albert Venter (2005) set out to develop a locally informed approach towards the study of political risk analysis. The Venter (2005) model draws on the sterling findings of Howell and Chaddick (1994) to reconfigure a model for political risk analyses and moreover, to assemble a model that is responsive to the South African context. In addition, although not branded as a political risk analysis model, the African Peer Review Mechanism (APRM) forms an indigenous approach towards assessing elements of political risk through a self-appraisal mechanism designed to benchmark governance and accelerate socio-economic development. Focus is placed on findings made on the state of South Africa based on its four thematic areas. Parallels will be made based on the results from the Venter (2005) model, and those obtained from the APRM.

Keywords: political risk, FDI, Albert Venter, APRM, South Africa
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ABBREVIATIONS AND ACRONYMS

ANC: African National Congress
APRM: African Peer Review Mechanism
AsgiSA: Accelerated and Shared Growth Initiative for South Africa
AU: African Union
AWB: Afrikaner Weerstands beweging
BEE: Black Economic Empowerment
BERI: Business Environment Risk Index
BRIC: Brazil, Russia, India and China
CCMA: Commission for Conciliation, Mediation and Arbitration
CODESA: Convention for a Democratic South Africa
COPE: Congress of the People
CRR: Country Review Report
CSAR: Country Self-Assessment Report
CSSDCA: Conference for Stability, Security, Development and Cooperation for Africa
DA: Democratic Alliance
DRC: Democratic Republic of the Congo
EC: European Communities
EPWP: Expanded Public Works Programme
ETI: Employment tax incentive
EU: European Union
FDI: Foreign direct investment
Fedusa: Federation of Union of South Africa
GDP: Gross Domestic Product
GEAR: Growth, Employment, and Redistribution Plan
GMM: Generalised moment of methods

GNP: Gross national product

HDI: Human development index

IDZ: Industrial development zone

IFP: Inkatha Freedom Party

IMF: International Monetary Fund

JSE: Johannesburg Stock Exchange

JV: Joint venture

MDG: Millennium Development Goals

MIGA: Multilateral Investment Guarantee Agency

MNC: Multinational corporation

NACTU: National Council of Trade Unions

NDP: National Development Plan

NEPAD: New Partnership for Africa’s Development

NGC: National Governing Council

NGP: New Growth Path

NOCOC: National Operational Co-ordinating Committee

NP: National Party

NPA: National Prosecuting Authority

NPC: National Planning Commission

NPM: New Public Management

NPoA: National Programme of Action

OECD: Organisation for Economic Co-operation and Development

OECD: Organisation of Economic Cooperation and Development

OPIC: Overseas Private Investment Corporation
PAC: Pan African Congress
PAGAD: People Against Gangsterism and Drugs
PRA: Probabilistic risk analysis
PRI: Political risk insurance
PRS: Political Risk Services
R&D: Research and development
RDP: Reconstruction and Development Programme
REC: Regional Economic Community
SA: South Africa
SACP: South African Communist Party
SACTU: South African Congress of Trade Unions
SADC: Southern African Development Community
SADF: South African Defence Force
SADPA: South African Development Partnership Agency
SANDF: South African National Defence Force
SAPS: South African Police Service
SARS: South African Revenue Services
Setas: Sectoral Education and Training Authorities
SME: Small–medium enterprise
SOE: State-owned enterprises
SSA: Sub-Saharan Africa
TRI: Technical Research Institute
UDF: Union Defence Forces
UK: United Kingdom
UN: United Nations
US: United States

VAT: Value-added tax

WPRF: World Political Risk Forecast

WTO: World Trade Organisation

WWII: World War 2
Chapter 1: Problem formulation and objectives

1.1 Research problem and rationale of the study

The following study is a political risk analysis of South Africa leading into 2014. Political risk – the study of the political environment, the assessment of its impact on firms and private sector companies, and the interrogation of that information in light of decision-making – is a relatively under-researched area of political studies in South Africa. As a field of study, political risk is concerned with relevant political events and their effects on a firm or company, whether positive or negative (Kobrin, 1979:19). A political risk analysis is a method used to address political risks in a systematic way. It is used by governments as well as business and research organisations in determining ratings, stability, and development, and is also used for shaping decisions on flows of foreign direct investment (FDI). The aim of the study is to distinguish between predominately Western models of political risk and those developed within the local context, such as the Venter model, and to appraise the perceived political strengths and weaknesses of these models. The distinction/difference in outcomes between using predominantly Western-developed models in contrast to a locally developed model will be tested in assessing the political risk analysis of South Africa.

Even before a distinction is made between models, there is confusion over the concept and terminology associated with political risk. Whereas political risk assessment is a probability measure of future risk that acts as a warning signal of the level of threat, political risk analysis, the object of this study, considers the origins or causes of the threat. The aim of a political risk analysis is to concentrate on the theoretical aspect of political risk, and to offer a descriptive account of the levels of risk. This is often neglected in commercial political risk models, where variables are selected because they are topical, with the result that biased reasons are likely to be chosen by developers of the models (Howell, 2009:5).

Essentially, political risk captures the functioning of two different but interacting domains, namely business and politics. Given that the purpose of business is to create profit for itself and its stakeholders, and to conduct business within the confines of a political authority and
social organisation, it is naturally affected by politics and the laws of the state (McKellar, 2010:6).

In addition to the domestic nature of political risk analysis, there is an international element that contributes to the ‘intermestic’ nature of the understanding of political risk. This includes the elements that affect cross-border relations, most notably in the area of investments. Investors’ exposure to risk, which is associated with the transactions that take place between the many different states, has also become salient (Herring 1983:75). In today’s globalised world, the international environment also has an impact on shaping political risk within the country, including factors such as immigration, engagement in international trade and investment relations and policy development.

Even though political risk analysis is important, it has received greater consideration from economists than scholars of political science and international relations. Studies on the determinants of FDI flows to developing countries, such as Busse and Hefeker (2005:Internet), argue that there is a lack of research concerning descriptive analyses of political dynamics and other relevant policies in host countries and the impact that this has on FDI. This is surprising, as an absence of ‘a clear understanding of the link between FDI and the political environment may understate corporate risk strategies, forgo opportunities, or the prospects of international capital flows that would otherwise add towards the growth of world trade’ (Wafo, 1998:5). Many of the international studies that do exist are from developed countries and focus on specific indicators, such as democratic rights, property rights and trade policy. Consequently, they exclude broader aspects that constitute policy-related variables. There is, therefore, a vacuum to be filled from a politics point of view in terms of contributions to the development of political risk models from developing countries, as investors typically use narrow definitions of political risk that are created with developed countries in mind. Moreover, with emerging countries such as South Africa, China, India and Brazil increasingly looking to engage in international investment, a more nuanced approach that captures elements of both the domestic and international political economic contexts of a state should be included in an indigenous model of political risk analysis.
This analysis will consider the work of Venter (2005) as a South African approach to political risk analysis. In developing this approach, Venter (2005) draws on the findings of Howell and Chaddick (1994) in studying three of the most influential approaches to political risk assessment and identifying critical weaknesses. With this knowledge, Venter (2005) draws on the strengths of the Economist Intelligence Unit (EIU), the Political Risk Services model (PRS) and the Business Environment Risk Intelligence model (BERI) to configure a model for political risk analyses and assemble a model that is responsive to the South African context.

Furthermore, the research will examine the analysis of South Africa contained in the APRM Country Review performed in 2007. The APRM is a home-grown self-appraisal document created by Africans for Africa, with the purpose of benchmarking governance and accelerating socio-economic development. The Review contains information for a country that is based on in-depth analysis. Findings of South Africa’s Country Review document will be compared with those contained in the Venter (2005) model.

Considering that political risk assessment models provide forecasts that are used for risk insurance purposes and as preparatory models used before making investments (Howell, 2009:8), the Venter (2005) model or the APRM Country Review document, in contrast, may not provide singularly defined potential risk events. This is a disadvantage, particularly in the case of political risk insurance where risk threats are required to be identified clearly, quantified and calculated, rather than to be qualitatively explained. There is, however, opportunity for the Venter model to be incorporated and used prior to assessment.

The research report aims to use the indicators set out by Venter, which are based on the model’s 15 topics (encompassing political, economic, and social dimensions), to formulate a political risk profile of South Africa that will demonstrate the value of depicting risk through an indigenous political risk model. Drawing on this understanding, the research will establish the contribution of political risk towards FDI growth in the country. Such reflection is important because FDI and foreign lending have been identified as the key sectors that rely on political risk and the analysis thereof (Ripka 2007:19). So far, this sector has relied
on assessments created by developed countries that do not offer indigenous understandings. This has the ability to obscure choices concerning FDI.

Referring to South Africa, the study will answer a number of key questions, including:

- How is political risk defined?
- What factors shape the current approach to political risk?
- Do locally designed political risk models, such as the Venter model, offer a more nuanced approach to determining political risk than existing models?

The premium that states place on FDI as a source of economic growth has made it vital for individual countries to position themselves favourably in a way that will attract it. This can be achieved ‘by controlling political and economic variables, focusing on a country’s pull factors, making intelligent choices when coming to policy, and publicising the worthiness of the country’ (Lewis, 2000:101).

The past decade in particular has experienced a dramatic increase in FDI to developing countries, which has increased from $24 billion (representing 24% of the total) in 1990 to $178 billion (representing 61% of the total) in 2000 (Lewis, 2000:101). While these conditions show positive indications for poor countries that do not have access to international capital markets, in reality Africa is the poorest region, representing a minimal share of this boom. As stated by Bende-Nabende (2002:61), ‘the continent tends to be associated with political turmoil, economic instability, disease and natural disasters’. Across the continent, the distribution of FDI flows is uneven. For example, in the early 2000s the major recipients of FDI flows in the region were South Africa, Morocco, Nigeria, Angola, and Algeria. These countries accounted for more than half of the total inflows to the region (Cleeve, 2009:235).

The proposed study will be predominantly qualitative in nature. It aims to assess the theoretical concept of political risk analysis in South Africa. Furthermore, the study will look at the creation of political risk models and the effect that a more nuanced understanding of political risk through the Venter and APRM models has on FDI to South Africa. Data has been collected from numerous sources, particularly academic journals and books.
1.2 Chapter outline of the thesis

Chapter 1: provides the background to the research problem and rationale of the study, offering a framework of understanding of the key elements that constitutes political risk analysis and the related topic of FDI.

Chapter 2: explores the foundation of political risk analysis, including definitions, important concepts and assessment techniques.

Chapter 3: uses the Venter (2005) political risk model, along with its 15 criteria, in demonstrating the importance of a more nuanced and locally informed approach towards building a risk profile of the Republic of South Africa.

Chapter 4: provides a discussion on the APRM as an appraisal mechanism that has been used for African states, including South Africa, in view of promoting stable and economically viable economies.

Chapter 5: provides a discussion on the link between political risk and FDI, including definitions and implications for South Africa in the context of political risk.

Chapter 6: a conclusion that seeks to solidify the findings of the research relating to political risk models and their impact on FDI in South Africa.
Chapter 2: Political risk: a theoretical framework

2.1 Introduction

South Africa has emerged from a tumultuous period of segregationist policies that attracted negative global attention. The country’s political status during this time resulted not only in a divided nation, but also in a general exclusion from relations with the rest of the world. This was demonstrated in boycotts of the country in various international spheres. Among these were exclusions from global trade and commerce, sports and cultural activities, and the imposition of military embargoes.

The lead-up to the democratic elections of 1994 saw the introduction of reformist policies that saw the official collapse of the apartheid regime and the entry of South Africa into the global economy. This came with, among other things, trade liberalisation, which opened up the state’s borders, raising South Africa’s economic profile and attracting interest in the country from global society.

Throughout this analysis, foreign direct investment (FDI) is highlighted as a prospect that is much desired by states as a means to generate economic growth. National development policies such as the National Development Plan and the Draft White Paper on Foreign Policy highlight the importance of FDI for meeting South Africa’s development priorities in addressing the triple challenges of poverty, unemployment and inequality. While some determinants of FDI may be further from the control of government, such as natural resource endowments and a large domestic market, aspects such as a stable political and policy environment are within the reach of government and are attractive investment determinants.

In determining their investment in a country, investors (governmental and non-governmental) look to gather credible information to develop a framework of analysis that will allow them to assess fundamental political risks. This is important to prevent distortions that may emerge as a result of imperfect information or uncertainty.

The following chapter lays the foundation of political risk analysis. In an attempt to conceptualise political risk, the chapter explains exactly how expansive the term risk is, and
then proceeds to define risk as a political phenomenon that has its roots in the notion of uncertainty.

This will include a discussion on the thinking and influences that have shaped political risk, and how the discipline has evolved over time. In considering the political nature of the models of political risk, the thesis will assess models designed within a developed country context such as the Economist Method, Business Environment Risk Index (BERI), and Political Risk Services (PRS) model. Lastly, the conclusion will summarise the main findings of the chapter.

2.2 Conceptualising Risk

Risk arises from uncertainty. There has been a paradigm shift from the idea that risk is solely associated with some negative prospect. The new trend suggests that risk can also represent measures of opportunity. This implies that risk can provide a prospect for change for the better (Frei & Ruloff, 1988:2).

The term ‘risk’ in itself is broad, and can be abstract and difficult to operationalise. Vlek & Stallen (1981:27) point to the following definitions as frameworks that can be used to understand what it is that defines risk:

- The possibility of loss;
- The size of the possible loss;
- A function and mostly the product of probability and size of loss;
- Equal to the variance of the probability distribution of all possible consequences of a risky course of action;
- The semi variance of the distribution of all consequences, taken over negative consequence only, and with respect to some adopted reference value; and
- A weighted linear combination of the variance of and the expected value of the distribution of all possible consequences.
The abovementioned definitions of risk present the various ways in which one can understand and capture risk. In summary, risk usually refers to some or other loss, even though there is also scope for gain.

2.2.1 Contextualising political risk

The scope of the definition of political risk is truly diverse. Before considering the concept of political risk, this section first unpacks the idea of risk and the concept of politics. Mazareanu (2007:42) indicates that it is essential to identify what is at risk, including the importance of the related vulnerabilities, with the aim to reduce the associated risks. Risk is influenced by the probability that an event will depend on a series of external factors. While external factors are comprised of the social, technological, economic, environmental and political spheres, internal factors focus on elements such as the historical data for the entity for which the risk assessment is made.

Risk assessment is a preventive action. Corrective action, on the other hand, is taken through a disaster recovery plan (Mazareanu, 2007:43).

As risk is on the border of philosophy and mathematics, there are three domains within which risk can be classified – the real, the possible, and the impossible – all of which point to the essence of probability (Mazareanu, 2007:43).

Generally, politics refers to how a society is organised in terms of the laws of the land and its prevailing ideals. McKellar (2010:5) further describes politics as a phenomenon that occurs at various levels, namely global, regional or local. Social organisation can be influenced at these levels through official power. Political risk evaluation is then concerned with the predictive relationship between the political and risk environments. Dealing with political risk entails an interest in issues that exist in the political environment, and an assessment of their impact for investors through the analysis of that information. It involves dealing with all relevant political events, under conditions of certainty or uncertainty, or with perfect or imperfect information (Kobrin, 1979:19). Ultimately, investors are concerned with the actions within the political sphere that may disrupt investment activity and profitability,
for example, the decisions of government leaders with respect to tax laws, wage levels and environmental regulations.

The topic of political risk has become prominent because of growing interest relating to the intersection of politics and the globalisation of investment practices. The term ‘political risk’ is used frequently in business, investment and political economy literature, and similarly to the definition of ‘risk’, it is usually equated to unwanted consequences. These consequences are usually of a political nature, where governments intervene in or affect business operations or investment opportunities. Examples range from a failure of a government to manage environmental instabilities emanating from violence, expropriation and taxation injustices, to public sector competition impeding on the profitability or objectives of the investment (Kobrin 1979:68).

Similarly to the concept of risk, political risk can be seen in a number of dimensions. The study of political risk is multidisciplinary in nature, which can be explained by its diverse use. Political risk is heterogeneous in its epistemology and finds relevance between disciplines rather than within a singular discipline. For instance, in studies of international business, political risk will usually capture the concern of the management of exogenous factors that can influence market conditions (Jarvis, 2008:2). These exogenous factors refer to political decisions that can have an adverse effect on investor interests. They are government policies (fiscal, monetary, labour or industrial) that have the capability to asphyxiate the operations of a given foreign investment, creating transfer risk, or risk to capital payments; operational risk, or business continuity; and ownership risk (Jarvis, 2008:3).

For the political scientist, political risk is concerned with the exercise of power, and consequently, harm that could be incurred by individuals, populations, non-states, and the international system. Political risk also refers to the factors that may hinder the smooth operation of political institutions, the exercise of legitimate rule and the functioning of the domestic and international society. Political risk is often regarded as political instability that is manifested through civil disobedience, low government legitimacy, poor public administration and general state failure at the domestic level. At the international level,
political risk is represented by diplomatic hostility, mercantilism and trade wars (Jarvis, 2008:6).

The study of political risk considers the maturity and transparency of the state to administrate and balance the competing demands of different constituencies. In this regard, aspects such as the independence of institutions such as the judiciary, financial and economic bodies of national accounts, as well as the electoral system, become key features to assess. Political risk in this context pays attention to economic actors, to the extent that corrupt administration is measured in terms of its cost to business, investment and economic growth (Jarvis, 2008:6).

On the macro level, political risk concerns itself with the activities of governments and their impact on the interests of investment stakeholders. Change in any political parameter relating to policies that have a consequence for stakeholders (economic and non-economic) can thus be defined as political risk. The purpose of understanding political risk is the following: building institutional capacity; improving public administration; promoting transparency; increasing the efficiency and delivery outcomes of public administration to provide the necessary framework for economic growth; appraising various bodies on policy outcomes and inaction; helping business organisations to manage their exposures in foreign political environments; and preparing for, or mitigating the consequences of government action and public policy (Jarvis, 2008:6).

Over and above this, Calverly (1985:163) lists the following additional key areas for measuring political risk:

- Possible major devaluation;
- Major recession;
- Major shift in economic policy;
- Government pressure on multinational companies;
- Political unrest affecting economic performance; and
- Domestic banking failures.
The areas listed above represent a broad approach that has been adopted by investors from developed countries. Additional risk areas include: loss of copyright protection; discriminatory taxation; war damage; breach of contract due to political reasons; inconvertibility of currency or profit; and limits to remittances (Howell & Chaddick, 1994:73). Political risk emanating from the abovementioned sources has a substantial effect on industry and the growth prospects for a country. Efforts in these areas to promote stability and predictability result in labelling a country an ‘attractive investment destination’.

As far as acquiring information pertaining to country risk is concerned, Heinrichs and Stanoeva (Internet) suggest a number of indices for calculating country risk that can be obtained from public sources. These are: the Corruption Perception Index (which ranks 170 countries according to the perception of corruption in the public sector); the Doing Business rankings (which monitor ease of doing business); the Global Competitiveness Index (which analyses 100 economic indicators to establish the competitiveness of the economy of a country and factors that determine the level of productivity of a country); the Gini Coefficient (an income inequality metric measuring the distribution of family income in a country); the UN Human Development Index (or HDI, which measures the achievements of countries in terms of health); and the World Bank Political Risk Indicator.

Understanding the intermestic nature of political risk is critical given the interconnection of states. Globalisation promotes a functional interdependence among states, where the increasing standardisation of international norms competes with the sovereignty of states and their societies. The impact of this may be, as Kobrin (1979: 23) sets out, that what may appear to be economic nationalism to an investor (through certain restrictions of FDI) may also be regarded as an attempt by the host country to implement a policy of indigenous industrialisation.

Kobrin (1979:11) also reminds us that all investors interact with all aspects of their environment (such as economic, political, sociocultural, legal and physical), with the distinction between these aspects existing on the experiential level. This suggests that the political system of an environment has much to do with the economics of that environment. This can be seen in the way that politics largely determines the framework of economic
activity through economic policy, in that a society can see the result in a change from a market to a socialist economy or the reverse.

The links between politics and the economy are apparent in the South African context where the end of apartheid compelled the government to establish a new economic policy that would promote a more equal society through strengthening democracy. The Reconstruction and Development Programme (RDP), a neo-liberal programme that ran from 1996 to 2000, put emphasis on its extensive welfare component. The RDP was removed and replaced by a series of other programmes (discussed further later in the thesis), as it was unable to solve the prevailing problems of unemployment and the unequal distribution of wealth (Sherman, 2010: Internet).

Similarly, an economic event can be motivated by the need to maintain the power of the administration so as not to alienate important figures or interest groups (Kobrin, 1979:13).

2.3 Uncertainty

When it comes to political risk evaluation, it is generally accepted that the treatment of uncertainties in risk assessments, which is used in strategic decision-making, can be approached from different perspectives. Accordingly, the tools that are used provide useful support for decision-making because their outcomes inform the decision-maker’s choice (Aven and Zio, 2010:64). Commonly, the basic foundation that has been used in risk evaluation is ‘probabilistic risk analysis’ (PRA), which dates back to the early 1970s. PRA is a systematic approach to risk mitigation that synthesises knowledge and uncertainties by addressing three fundamental questions: 1) which sequence of undesirable events transform the hazard into an actual damage? 2) What is the probability of each of these sequences? 3) What are the consequences of each of these sequences? (Aven and Zio, 2010:64).

What will follow from the use of this framework is knowledge of the problem and related uncertainties, which will be systematically manipulated by rigorous and repeatable probability-based methods to provide a clear representation of the risk outcomes (Aven and
Zio, 2010:66). As the political risk levels of a firm operate as a component of its environment, it becomes important to establish the following: how do political events that occur in the environment impact on the firm? The answer to this question lies in the understanding or evaluation of the relationship that exists between the firm and the environment, and ‘the relationship between events and outcomes’ (Kobrin, 1978:14).

Concerning the relationship between events and outcomes, it is presumed that where there is a single outcome with a given event, or when a single outcome dominates all others, certainty exists (Kobrin, 1978:16). Under conditions of certainty, the multinational investor concerns him or herself only with determining the effect of political events on the magnitude of cash flows. While risk is not a relevant concern, a political evaluation is still necessary (Kobrin, 1978:22).

However, objective uncertainty would suggest that certainty does not exist, which means that the possibility of one outcome does not exist, but also that one possesses perfect knowledge of all possible outcomes relating to the event and the probability of each occurring (Kobrin, 1978:16). Under conditions of objective uncertainty, the contribution of political events to business risk is a function of only the events themselves. From the above assumption, the multinational decision-maker would concern him or herself with the impact of politics on the expected value of cash flows and their distribution. The extent of risk is marked by the distribution of the joint probability of a political event taking place and it having an effect on cash flows (Kobrin, 1978:22).

Finally, bounded subjective uncertainty suggests that all possible outcomes and their probabilities are unknown, and only opinions to their relative likelihood are available. Uncertainty is subjective, meaning that there is neither knowledge of all possible outcomes, nor objective probabilities. The implication here is that the contribution of political events to risk is a function of both the event and the subjectivity factor (or the nature of perception). In this instance, the multinational decision-maker is concerned with the effect of political events on expected values of cash flows and risk. The difference, however, is that risk is further increased due to an existence of subjective factors, and the distortion that it causes, that cannot be completely eliminated, (Kobrin, 1978:22).
While the varying degrees of uncertainty explain the extent to which risk is present or is perceived, Kobrin (1978:17) reminds us that the effect of political events upon returns is provisional. This means that uncertainty is a function of both the environment and the firm. Risk itself is a property of the firm and the environment. Risk is expressed as the variation of a firm specific variable, from its expected value and can be caused by environmental events.

2.4 What Is a Political Risk Profile and Why Does It Matter?

A political risk profile is a depiction of a single country’s state of political risk, employing certain criteria to measure the existing levels of risk.

The importance of the evaluation and development of a political risk profile can be attributed to the following: firstly, classifying an investment by the country it concerns acts as a useful step in identifying a group of investments that are likely to have similar characteristics and common sources of uncertainties, for instance, a type of climate, or population growth and labour trends (Herring, 1983:81).

Secondly, the importance of developing a political risk profile is based on the existence of nation-states. All investments within a single state belong to the same government jurisdiction. Consequently, policies promoted by the government play a role in determining the profitability of the investments. This is to say that country risk analyses must consider the political policies and developments of the respective state (also known as sovereign risk) (Herring, 1983:81).

These two considerations deal with exogenous risk, or risk that is beyond the control of the investor. Political risk analysis is seen to reduce the investor’s subjective uncertainty about a large number of investments. The more favourable the outcome of this analysis is, the more likely the investor will be to transfer capital that will equate to the rate of return across borders (Herring, 1983:81).

Political risk and the evaluation thereof is not a recent practice, and has been linked to merchants, political leaders and military personnel as a way to counteract the impact of
political decisions on an economy’s condition. It has grown in prominence due to the exponential rise in foreign direct investment across the globe. This flow is seen as necessary to sustain economic development. Investors gather information about the countries where they plan to place their investment by studying indicators and models created by political risk analysts, through which countries are classified as high, medium or low risk. A negative analysis, showing high political risk, may make the terms of negotiation unfavourable for the recipient country, over and above reducing initial interest in investment. The converse applies for low to medium risk. As McKellar (2010:4) puts it: the one variable that effects international business operations that is exogenous, difficult to control and potentially hazardous is, in fact, political risk.

2.5 Formation of a country’s political risk

According to Simon (1984:127), the formation of political risk involves the interplay between the conditions that prevail in the host country, home country environment and global environment. Host-country and home-country conditions refer to government policies; societal attitudes; local business community actions; legal community rulings and media reports; while international country conditions refer to the foreign policies (economic, military, diplomatic) of nation-states; regional organisations’ policies; international activist groups policies and internal developments in nation-states. In contrast, the global environment refers to global organisation policies (such as those of the UN and IMF) and global developments (such as worldwide inflation, the oil crisis and external debt crises).

The formation of risk can be the result of direct external risks, such as protests in the investing (home) country against investments in certain states, home government restrictions on overseas operations, and attempts to monitor the operations of the organisation and impose codes of conduct. This interplay has the ability to strain and damage relations between the host and home countries (Simon, 1984:127).

Additional factors that may influence the formation of political risk include the stage of economic development and the degree of openness in the socio-political systems of the home and host countries.
2.6 Methods of Investigation

Political risk is a phenomenon that exists both for domestic and foreign investors. Political risk analysis is a technique that assesses the likelihood of loss due to a political situation in a state. It does not, however, consider or measure outcomes that could be caused by economic circumstances or business cycles or practices. Political risk assessments usually come in the form of a letter grade or a numerical score from a state as a whole, with a written justification of that particular grade or score (Howell & Chaddick, 1994:72). The kind of risk portrayed in the report can either represent an opportunity or a potentially damaging risk, which could entail a gain or gamble for the investor.

According to Howell (1998:9), there are limitations that prevent a precise prediction even with the use of various analytical methods. While a chosen model is designed to reveal situations that may bring harm to investor interests, social systems are notably complex, and social phenomena must often be simplified and abbreviated in the model. There is also the possibility that some of the representative variables are not necessarily the best choices. For instance, it may happen that certain variables are not included, and this will have some adverse effect on investment decisions, or alternatively, important variables may have been unforeseen or exist outside the scope of the analysis.

Though the research done to compile political risk models is meant to aid in-depth, descriptive analysis that offers explanatory insights for often complex and intricate political, economic and social phenomena, this may get lost in quantitative techniques, and there is always the possibility of incomplete and sometimes inaccurate information. Therefore, variation in the data will introduce some margin of error in projections, and there is also error created through human intervention (Howell, 1998:9).

Essentially, methodologies employed for a political risk evaluation can be quantitative (employing statistical or mathematical operations) or qualitative (standardised checklists, Delphi technique, and scenario analysis) in nature, and can also combine subjective and objective approaches.
Different methods may be used to assess the exposure to political risk that an investor possesses, and the methods employed depend on the following characteristics of the investor: the size of the firm, the firm’s degree of internationalisation and the type of industry (Anchor, 2012: Internet).

Combinations of more than one procedure per investigation may be employed in order to assist the analysis and render a forecast. According to Ascher & Overholt (1983:73), methods include the following:

- Extrapolation – the projection of a historically based quantitative trend at a constant or regular rate. This rate may be a particular numerical rate of increase or a particular rate of acceleration.
- Regressions – the prediction of one event or forecast based on its relationship with one or more other trends or variables.
- Leading indicators – with this method, the direction of change in the trend under examination is presumed to depend on changes in the direction of other trends. This is often used in economic forecasting.
- Multi-source forecasts – an amalgamation of several sources that involves the processing of other forecasts. It is the result of combining the results of expert interactions.

The type or combination of methods employed will generally be chosen based on various factors such as the availability of information, the size of the budget, the type of industry examined and the form of information required.
2.7 Evolving Methodologies in Political Risk Analysis

Throughout time, various influences have shaped the way in which political risk has been operationalised. Though the approaches have evolved with time, what has been constant is the recognition of the cross-pollination that exists between politics and investment.

The earliest approach to political risk can be traced back to the 1950s, and is referred to as the Catalogue School. Here, political risk is viewed as a consequence of actions taken by host governments that adversely affect the operations and profitability of investors. As a result, focus was placed on a list of negative activities of governments (or societal inertia) that hamper the functioning of efficient markets. A few flaws were identified in this approach, namely the assumptions that markets are perfect, prone to equilibrium, and self-regulating. In this approach, the possibility of imperfect markets, poor transparency, monopolistic tendencies or collusion were absent from consideration. The method presented a disjointed picture of foreign business operating as a separate entity outside of its socio-political surrounds, and as being affected negatively by state participation in business. The role of the state is disassociated from its role as an enabler of commercial practice and is instead viewed as a driver of greater levels of political risk (Jarvis & Griffiths, 2007:11). This method was accused of a lack of ‘operational traction … and conceptual and analytical looseness’ (Hudson & Leftwich, 2014:31).

The advent of second-generation approaches, such as the System–Event School, meant adopting a more intuitive approach to political risk by correlating certain types of states to certain levels of political risk. It was understood that economic growth was not indicative of low levels of political risk, and that there is a mutuality between political systems and markets. Second-generation approaches existed during a period characterised by political modernisation theories, which were examining the decolonisation process, the democratisation of societies and the emergence of fragile states following the Second World War (Jarvis & Griffiths, 2007:13). The question being raised was: what causes societies to develop politically, and for political cultures and political institutions to support economic systems and production networks? Characteristic of the System–Event School was the postulation that political risk and political instability had a negative relationship to
modernisation. Such an assumption is standard for developed, predominantly Western and capitalist economies. This view was widely criticised, as it ostracised developing economies based on their ethnic origins. It also proved untrue, as investors are known to operate successfully in certain African countries despite civil turbulence (for example, the Dutch Shell Company in Nigeria). The System–Event School therefore was unable to demonstrate causality between political events and an impact on investments (Jarvis & Griffiths, 2007:15–16).

Third-generation political risk analysis saw the debate between method and theory start to pay particular attention to developing nations and the political risks investors were met with. This entailed developing specific methods to understand political power and wealth distribution and the effect thereof on societies (Hudson & Leftwich, 2014:33). This was during a time when expropriation, nationalisation and protectionist policies were on the decline, and governments were actively positioning themselves to compete for FDI and attract prospective investors. Third-generation approaches endeavoured to focus on micro-analyses and stressed the importance of context rather than making grand theoretical correlations. This meant developing explanatory schemata and methods to evaluate the risk environment in relation to the investment. This led to the introduction of a plethora of qualitative techniques employing deductive reasoning, with none enjoying full authority or acceptance (Jarvis & Griffiths, 2007:18).

The ongoing evolution of political risk modelling seeks to address the drawbacks of earlier generations when faced with the challenge of providing data sets that can be used by analysts to depict the relationships between political and economic institutions, domestic norms and external forces. Today, fourth-generation methods are carrying the baton by using analytical precision in identifying which institutions matter when evaluating the interplay between politics and investment, in a way that can add to public policy delivery and public sector resource efficiency (Jarvis & Griffiths, 2007:21).

Though fourth-generation methods are overcoming weaknesses identified in previous schools of thought, they have not so far recognised indigenous approaches to political risk and the value of a local understanding and contextual nuance over the generally accessed
information sources found in most political risk assessment models. Can we trust the outcomes of rankings, or downgrades of international readings, when local knowledge is absent?

These sentiments are partially summarised by Ripka (2007:93) when he calls for the need to build up a ‘genuine’ theoretical framework when examining political risk. Political risk analysis assembles information that offers insight and allows the client to understand the environment where the potential investment is headed.

The following section is a discussion on the list of products that are commonly consulted for country and political risk surveys.

2.8 Products

Developed methods for analysing political risk refer to international political risk assessment products available on the market. The ones mentioned below are the most popularly used.

2.8.1 The Economist Intelligence Unit (EIU)

The Economist Intelligence Unit (EIU) method, or Economist method, is a concise technique that offers information that is especially relevant to businesspeople. It focuses on the advantages and disadvantages that certain political risks will have for their investment. The Economist method considers critical socio-political variables that would meet the requirements of the business investor. The weighted socio-political variables are measured against their relative roles or their risk contribution. The values assigned to the risk scores are combined and analysed. They are ranked in a way that will communicate an investment breakdown that is useful for investment considerations. This method creates an index of risk based on 100 points that are divided between economic factors, politics, and society (Howell & Chaddick, 1994:76).
Six political variables that equal 50 points in weighting and four social variables worth 17 points constitute political risk, as follows:

1. War (20 points) – the most prominent of the variables, as it has the ability to destroy physical infrastructures and dislocate the economy. During war, focus also shifts to war-required activities such as aid and the supply of goods.
2. Legitimacy (9 points) – implies acceptance from the population of the state. Political risk (or illegitimacy) will increase as the gap between acceptance and the government’s persistence in power grows.
3. Authoritarianism (7 points) – suggests that the lack of democracy in a state has an ability to incite violence and cause instability.
4. Generals in power (6 points) – if a state is run by generals or the military, this is seen as a political risk, as it is suggested that military staff does not have the ability to run a state and their involvement is better as an interventionist mechanism in times of a short instability.
5. Staleness (5 points) – considers the tenure of a political figure (usually the president of a state). A maximum of two terms or ten years is sufficient until the leader starts becoming stale or complacent.
6. Bad neighbours (3 points) – a state being situated near to a superpower implies trouble, as superpowers tend to control their peripheries, often with the use of force and incitement of violence.

Howell & Chaddick (1994:77) also mention the following social variables:

1. Corruption (6 points) – has the ability to distort the economy in a way that discourages an investor-friendly environment.
2. Ethnic tension – refers to tensions that arise due to religious, racial and ethnic differences. This can redirect the attention of government to issues of race relations and labour relations and addressing such difficulties.
3. Islamic fundamentalism (4 points) – the Economist method suggests that Muslim radicals have an influential effect, as where they exist they are likely to be a strong deterrent of investor interest.
4. Urbanisation pace (3 points) – when urbanisation is too rapid or is focused on a single area (city or industry), this can cause corruption and crime, irregularities or even stagnation.

The 10 abovementioned criteria in total are measured on a scale of 0 – 100, with 0 representing little risk to business operations and 100 representing very high risk. The 10 criteria consist of 66 indicators that are scored on a scale of 0 – 4, with 0 representing little risk and 4 representing high risk (Preventionweb, Internet: 2013).

A total or index is assigned that then becomes the indicator of the overall risk to the investor.

2.8.2 Business Environment Risk Intelligence Method (BERI)

Similarly to the Economist method, the BERI method is based on scores assigned to 10 socio-political variables. A score of 7 represents the least amount of risk, and an optimal situation would be represented by a 70, with the possibility of bonus points being added that could total 100 in the BERI Index. Typically, the BERI method would assign 70 – 100 points to a stable environment, which is likely to be industrialised and have an advanced economy. Moderate risk of 55 – 69 points would typify countries with complications in their day-to-day operations, with 40 – 54 representing a high-risk state and 0 – 39 representing unacceptable conditions for foreign-owned businesses.

The BERI method classifies the 10 variables into three categories: internal causes of political risk, external causes of political risk and symptoms of political risk. Howell & Chaddick (1994:79) explains these three levels as follows:

2.8.2.1 Internal causes

1. Factionalism – coming from the political continuum, representing divisions among political perspectives in the society. Some of these differences can be strong enough to disrupt the political rule or process.
2. Factionalism – coming from language, ethnic and religious groups – similar to that of the Economist method.
3. Restrictive (coercive measures) required to retain power – similar to the authoritarian measure in the Economist method.
4. Mentality – including xenophobia, nationalism, corruption, nepotism and willingness to compromise.
5. Social conditions – including population density and wealth distribution.

2.8.2.2 External causes

1. Dependence on a hostile major power – similar to the bad neighbour variable in the Economist model.
2. Negative influences of regional political forces – such as trouble spots (Howell & Chaddick, 1994:79).

2.8.2.3 Symptoms of political risk

1. Societal conflict involving demonstrations, strikes, and street violence.
2. Instability resulting from non-constitutional changes, assassinations and guerrilla wars (Howell & Chaddick, 1994:80).

The BERI method was developed in 1966. The BERI Institute is located in Geneva, and has published every four months since 1972 (Kurylyak, 2011:351).

2.8.3 Political Risk Services (PRS)

Coplin and O’Leary developed the World Political Risk Forecasts (WPRF), which provide 18-month and five-year projections focusing on the most likely regime based on the level of turmoil, transfer risk and export risk. These reports are compiled for 100 states, and supplied to subscribers on a monthly basis. The reports are compiled by experts from an array of specialities: academic, business, government, consulting and so forth. As with the other two methods, information is used based on indicators that relate to situations of potential loss for foreign investors. Estimates are then used on a decision chart to assess the current conditions and the likelihood that there will be a change in the situation with regard to conditions in the business climate.

This method consists of 12 variables, namely:
1. Political turmoil probability – or acts that contravene the rule of law and social norms.
2. Equity restrictions – equity that is forcibly shared through the imposition of regulations.
3. Personnel\procurement interference – interference by government relating to types of hiring, numbers, management positions and terms of employment, etc.
4. Taxation discrimination – where preferences can be awarded or withdrawn at any time.
5. Repatriation restrictions – concerning the problem of inconvertibility.
6. Exchange controls – also related to inconvertibility.
7. Tariff imposition – new and unexpected tariffs as a result of interactions between the government and economic sectors.
8. Non-tariff barrier imposition – usually created in cross-national economic conflicts.
9. Payment delays – or imposed limitations on the movement of funds.
10. Fiscal/monetary expansion – as a consequence of the government’s poor planning.
11. Labour cost expansion – as a result of inflation.
12. International borrowing liability – occurs as a result of excessive borrowing that is used in order to retain government programmes.

Frei & Ruloff (1988:1) also discuss the above as methods that may be employed in order to identify and classify political risk and perform assessments based on aggregate statistical data, online databases and scenarios.

2.9 Analysis of the Three Models

The three abovementioned models – those of the Economist, BERI and PRS – represent the three most widespread and most consulted political risk assessment models. While the objective of these models is to apply knowledge in order to sell its developer’s products, the models reveal considerable shortcomings, and these support the call for theoretical rigour – the kind that is offered by political risk analysis using more local approaches (Ripka, 2007:8).
The Economist, for instance, had a readership in the hundreds of thousands in the 1980s, and that figure has leaped to over one million globally. Subscribers to its assessment information are predominantly users of country risk information, government officials, and business and investment practitioners. The penetration of these assessment models is such that they are said to have replaced the use of academic journals, which are faced with answering the same question of political risk levels (Howell, 2008:2).

A criticism of the Economist model, however, is its weakness in forecasting losses to foreign investors in the countries surveyed. The premise of a political risk assessment model involves measuring current political risk levels, followed by creating expert regression projections or forecasts. In a test to examine the utility of the Economist model, political risk indices from BERI and the International Country Risk Guide (ICRG) (another much-used political risk assessment method) were correlated and compared using the equivalent risk data provided by each of the three models for the period 1992 –1997. The results of this test showed the Economist model to be the weakest, possessing a statistically insignificant ability to forecast losses, far worse than its rival counterparts. Such a weakness is grave considering that the purpose of a political risk assessment lies in its ability and accuracy in the provision of forecasts (Howell, 2008:2 – 3).

The model has additionally been criticised for discussing what can be referred to as the topical aspects of political risk, failing to adequately address some of the unassuming issues that may be imbedded in a country such as South Africa. The allocation of points to chosen political risk indices is also questionable. The existence of war or civil strife is notably an important area of focus for the potential investor, and this is assigned a heavy weighting (20 points), while a topic such as the rate of urbanisation is given a significantly lower weighting (3 points), when in fact the pace of urbanisation is a vital and relevant consideration for the potential investor (Howell, 2008:10). The variance in the weighting of the political risk indicators can obscure the real picture of risk levels.

The BERI and PRS methods are also massively acclaimed political risk tools, though doubt is cast on its expression of systematic theory, and its employment of impressionistic variables and general statements (Ripka, 2007:64). Despite achieving better results to the Economist model, a weak correlation existed between historical losses and forecasts
emanating from these methods. The PRS included an upgrade to its model in the form of the Prince model, which builds on game theory. Though the connection between the Prince model and the PRS model remains unclear, there is still dissatisfaction over its lack of political theory foundation (Ripka, 2007:71).

In the three models, it is commonly found that the process of evaluation is conducted by external experts, who despite being qualified lack the kind of insider understanding that can improve outputs. Despite their prominence, none of the three methods discussed have demonstrated solid predictive power or produced the kind of persuasive results that they claim when tested retrospectively (Ripka, 2007:93).

Notably, Ripka, (2007:56) makes a distinction between the concepts of ‘forecasting theory’, ‘theory of interaction’ and the supply of information on ‘political’ aspects. In terms of political risk assessments, the forecasting outcome must have a foundation on analysis that describes a state’s past and current conditions. This description must depict the key factors that make up the workings of the political conglomerate while accenting the events that may induce losses, with these being determined by the theory of interaction. In this way, what emerges is a systematic view of factors driving political risk that can better inform risk management strategies, or indeed the decision to invest.

The importance of a political risk analysis therefore lies in its ability to preserve the importance of the relationships among the variables in the assessment model. The following two chapters will discuss two indigenous models of political risk analysis that attempt this.

Not only do the Venter (2005) and APRM models offer descriptive analyses of political risk in South Africa, but they also satisfy the enquiry of the investor who seeks reliable information about future sources of loss within the country.
2.10 Conclusion

The discipline of political risk was once considered a ‘soft study’, offering limited contributions to issues of politics and economics. This position has not only been challenged, but the field has also been reinvigorated, as observed through its evolution, which has matched the globalisation of FDI and the demand for accuracy that is required for analysis. Ongoing improvements and development of local instruments are examples of attempts to foster precision and improve the quality of analysis models.

Political risk has become an even more pronounced topic as a result of increasingly intertwined and globalising world economies. Risk analysis is instrumental, as it allows potential investors to make more informed decisions, and more importantly, it raises the awareness of individual states of their need to engage in prudent activities and promote good governance practices. In South Africa, the Constitution represents a notable instrument of good governance that has informed a number of reformations, leading to increased levels of FDI in the country.

Political risk, as an all-embracing topic, can be seen as an integral consideration for an institution or in decision-making processes. An accurate political risk analysis can highlight opportunities that may have otherwise not been noticed, as well as assist to avoid costly, harmful investment mistakes.

Indeed, political risk and the evaluation thereof is not a task to be taken lightly. Globalised economies have brought about the kind of complexities that may be best navigated by using instruments such as thorough political risk analysis. An in-depth political risk analysis captures the mechanics and intricacies of a domestic environment – the legal framework, social codes, economic conditions and so forth.

There is an array of political risks to contend with when performing an analysis. In the next chapter, it will be demonstrated that political risks can be acquired from a country’s unique history. The evolution of a country (in this case, South Africa), the management of risk, and the negotiation of policies between the ‘old’ and the ‘new’, each present their own sets of complexities. Country reforms and programmes also present
opportunities, but are not without their struggles. Therefore, it is the unique combination of
the ‘pros and cons’ that will impact on the success of any one country.
Chapter 3: Unpacking South Africa’s Political Risk Analysis 2014

3.1 Introduction

The preceding chapter discussed political risk at length, in terms of what the discipline entails, how it has evolved, and the various methods that have been adopted by practitioners. Since political risk is unavoidable, it is fitting that in considering the implications of risk analyses for South Africa, a local instrument should be used.

The following chapter is a discussion of Albert Venter’s (2005) study of political risk analysis. The Venter (2005) model draws on the findings of Howell and Chaddick (1994), who study three of the most influential approaches to political risk assessment and identify critical weaknesses. With this knowledge, Venter (2005) draws on the strengths of the EIU, PRS and BERI models to reconfigure a model for political risk analyses, and moreover, to assemble a model that is responsive to the South African context. The study uses the Venter (2005) model as an indigenous recreation of political risk analyses, updating it and depicting South Africa’s current state of political risk through it. Using the Venter model to build a political risk profile (or a country risk review) for South Africa, a report is provided based on the model’s 15 topics (encompassing political, economic and social dimensions) that will lead to the assignment of a political risk classification for South Africa. This will be approached by analysing South Africa’s current state of affairs, drawing information from the state’s recent history of governance under an apartheid regime. This is to say that the political risk analysis will draw upon literature on the pre-1994 era in order to provide a context and a deeper understanding of where the country comes from, as well as to demonstrate the ideological evolutions that have shaped South Africa and that have informed the choices or policies of the present government. Wherever possible, a contrast will be provided between the current ruling African National Congress (ANC) government and the former apartheid regime.

A historical narrative of South Africa is provided in order to contextualise some of the important nuances that have come to shape the political landscape of South Africa. This refers to its policies, its economy, and most notably, the attitudes of its people.
3.2 Brief historical narrative of South Africa

In the description of South Africa, the mention of ‘1994’ refers to the era when the first democratic elections, open to all citizens of age, took place.

The year 1994 was a watershed time in South Africa’s political history, and symbolised the design and development of what was to be called ‘the new South Africa’ or the ‘rainbow nation’. The ANC won an indisputable 62.6% of the votes cast (Maharaj, 2008:8), and the election of the same year established a new social contract founded on the principles of social reconstruction, development, democratisation, transformation, reconciliation and nation-building (Kotze, 2000).

Before this period, South Africa was characterised by a protracted period of conflict between its civilians where divisions were sown between the races, with whites enjoying political participation and competition and non-whites (blacks, coloureds and Indians) having only limited political rights. This was called apartheid, meaning ‘separation’, and this policy was officially adopted by the National Party (NP) in 1948. The South African government was considered a ‘racial oligarchy’, a regime where political power is consigned to a small fragment of society (in this case, the white minority), and this consequently led to the isolation of the state from global economic participation in the form of sanctions (Seo, 2008:2). The government’s separatist polices related to all forms of life, including an inferior education system aimed at preparing non-whites for subordinate positions in the workplace (Henrard, 2002:20). Although the apartheid system was officialised in 1948, it must be considered that it was built on a legacy of 200 years of white colonial rule, where racial exclusion and economic exploitation were promulgated for successive generations by Dutch and British colonists. Organised resistance to colonialism and apartheid was led by the African National Congress (ANC), which was formed in 1912 and banned by the apartheid government in 1960. Apartheid was declared a crime against humanity by the United Nations, and a large-scale international campaign was developed to isolate the South African government and support the ANC and other liberation movements.
It took more than four years from the date of Nelson Mandela’s (a political activist and leader of the ANC) release from the Robben Island prison in 1990 to negotiate the democratic transition. These negotiations involved the NP, at that time the incumbent government; the ANC, representing the majority blacks, coloureds and Indians; and the Inkatha Freedom Party (IFP), representing the rural blacks of the KwaZulu region. Agreement was reached in creating an interim outline, called the Interim Constitution, which was to spell out the broad framework of the new democracy (Inman, 2013:2).

3.3 The Venter (2005) Political Risk Model for South Africa

The political risk profile of South Africa created in this study is based on the work of Venter (2005), who employed 15 risk indicators to determine political risk. These are: threatening neighbouring states and foreign policy environment; authoritarian measures to retain power; staleness of incumbency and leadership succession; legitimacy of government; military involvement in politics; social risk (including terrorism and religious fundamentalism); socio-economic conditions; racial, ethnic and religious cleavages; black economic empowerment; trade union activism; safety and security; labour policy; macro political and economic circumstances; administrative (in)competence in government; and the security of private property.

Venter’s work built on the studies of Howell and Chaddick (1994) and Tarzi and Simon in their evaluation of political risk indicators by utilising three of the most common risk indices, namely the BERI, PRS, and EIU. The importance of using the Venter (2005) model is that while it is an adaptation of other political risk models, it is a local instrument, and it is responsive to the South African context. Further to that, the model was last consulted in 2005, and therefore the information below represents a revision of the method, and depicts the country’s political risk profile as at 2014.

The assessment aims to provide a basic outline of indicators that determine the political risk profile of South Africa, and drawing on this to understand the impact or contribution of political risk towards FDI growth in the country.
What follows is an analysis of South Africa according to Venter’s (2005) fifteen risk indicators.

3.3.1 Threatening neighbouring states and foreign policy environment

After the ANC assumed power in 1994, there was a need to reform policies from the apartheid system in order to reflect a new philosophy of political inclusion aimed at nation-building. This was a period in South African history when it was also important to craft a foreign policy that would be responsive to international relations and engage with a globalising environment. In March of 1994, the ANC-led government published a comprehensive foreign policy document called ‘Foreign Policy Perspectives in a Democratic South Africa’. This document was based on the values of upholding human rights, promoting of democracy and adhering to international law (Le Pere, n.d.: Internet). Furthermore, because of South Africa’s liberation history, its international relations are based on two pillars, namely pan-Africanism and South–South solidarity. This means that South Africa recognises itself as an integral part of the African continent and realises that part of its success is linked to Africa’s stability, unity and prosperity. South Africa’s foreign policy further commits ‘to the centrality of multilateralism, consolidating relations with the North, and the strengthening of bilateral social, political and economic relations’ (DIRCO, 2011:5–6).

Depicting them as concentric circles, and in order of importance, Landsberg (2006:11) describes South Africa’s foreign policy obligations as being first to the national interest, then to the Southern African Development Community (SADC), Africa, the formation of South-South relations, the formation of North-South relations, multilateral commitments, and finally, to the establishment of strategic bilateral partnerships.

South Africa’s foreign policy has been such that priority has been placed on Africa’s regional integration in order to gain economic competitiveness and greater economies of scale (PMG, 12 March 2014).

It can be said that South Africa does not face an immediate threat by so-called ‘bad neighbours’ in terms of issues such as potential armed insurrection or terrorism; however, Southern Africa is characterised by a long history of large-scale migration. There is debate
about the real extent of foreign-born persons in South Africa and it is not uncommon to see newspaper reports citing as many as 8 million immigrants in the country, most of them undocumented. However, according to Kraxberger and McClaughry (2013), this figure is grossly inflated, and they provide an estimate of 1 – 1.5 million immigrants.

Perhaps the most important feature surrounding immigrants residing in the country, especially those from other parts of Africa, is the notable anti-immigrant sentiment that has led to xenophobic violence, which is often at a low level, but sometimes emerges in intense outbursts, such as those seen in May and June of 2008 (Kraxberger & McClaughry, 2013) and in January to March of 2015.

This situation can be explained as follows: the pursuit of democracy by the ANC-led government has involved initially disassociating itself from the apartheid political system of strict control of human movement. Through the creation of the Refugee Act of 1998, the ‘new’ South Africa is known to have been accommodating in its policy of international movement and has adopted a more humane approach, to the extent of granting asylum to black Africans fleeing wars in frontline states, poverty or other forms of oppression. South Africa also provides freedom of movement within South Africa for legal immigrants, and assists in acclimatising a much greater percentage of migrants from other African countries (Kraxberger & McClaughry, 2013).

As unemployment figures started to rise sharply in South Africa, a key change could be observed with respect to African immigrants and related government policy, with the ANC shifting course and displaying a clear preference for skilled African immigrants. South Africa’s Immigration Act of 2002 is the main piece of legislation that promotes the application of immigrants who will advance the state by means of their skills – particularly in those areas where there is a shortage in the country. This highly restrictionist immigration policy covers a small number of the migrants entering South Africa, and is the most encouraged (Khan 2007:4). This is in contrast to the former apartheid state, which had a clear preference for unskilled black migrant labourers, most of whom worked in the mines before the structural changes of capitalisation took place. With current national unemployment rates consistently running at 25 – 35%, and a large pool of unskilled labour
already available, there has been little interest in large-scale unskilled immigration from SADC states or beyond (Kraxberger & McClaughry 2013).

3.3.2 Authoritarian measures to retain power

As explained by Boysen (2013), power refers to the relationship between ‘control’ and ‘consent’ that governs the ‘ruler’ and the ‘ruled’. Political power refers to leaders/parties/governments that operate within the public sphere, muster public resources, and make decisions and take directions that will affect the greater population. This sort of control is fuelled by the electoral engine, of which voter support is the key driver. South Africa comes from a history of colonial conquest during the 19th century, and a tumultuous 20th century characterised by the segregation policies of apartheid (an Afrikaans word meaning ‘apartness’). Various Acts¹ were enforced from 1913, beginning with the Land Act, according to which black citizens were prohibited from buying land outside of their tribe-specific homelands (O’Connor, 2011). After WWII, when the political climate was against racial discrimination, and with the continent progressively decolonising, the NP, a white pro-segregation party, was elected to power. The party began introducing racial legislation in earnest that was to be followed by several other Acts whose basis was regulating interracial relationships. This was done in a way that would ultimately limit the economic, political and educational opportunities of black South African citizens. The international community refused to recognise the homelands (territories set aside for black South Africans) as independent states, or the numerous segregatory laws, and mounted pressure on the South African government in the form of economic sanctions, exclusion from international organisations, and the divestment of foreign companies. The anti-apartheid movements and the violence that pervaded South Africa galvanised support and led to an eventual denunciation of apartheid in 1990 along with the unbanning of the ANC, and a negotiated peace was agreed upon, leading to the first democratic elections for all South African citizens in 1994 (Laverty, 2007:Internet). Nelson Mandela became South Africa’s first democratically elected president in the multiracial elections of 1994. He retired

¹ In 1949 the Mixed Marriages Act became law, prohibiting the joining of whites and blacks in any marital union. In 1950, the Immorality Act made it a crime for any white to have sexual relations with any other race, and the Population Registration Act required all persons living in the South Africa to register their race, and any child being born would immediately be registered according to their colour/ethnicity (ICE 2011).
after one term of leadership, making a decision to relinquish control after five years, a rare gesture in multiparty Africa (Wild & Cohen, 2013). Mandela assigned the operations of policymaking and management to Thabo Mbeki, who succeeded him in 1999 (Landsberg 2006:11).

Today, the political power held by the ANC is based on the party’s positioning as the liberation movement that effectively delivered the country from an extended period of authoritarian rule and its oppressive past (Booysen, 2011). Despite the fact that the South African government is based on a power-sharing or multiparty system, it is evident that only one party is dominant – that is, the ANC – and that it holds power over the state. While this dominance is attained through a legitimate electoral system, Brooks (2004:2) warns that a dominant party system is unfavourable to democracy, as it can lead to a scenario where there is an erosion of office, and the dominant party responds less and less to public opinion, as it is guaranteed re-election.

Rivero (2014:7) further warns that if, under the current administration of the Zuma presidency, the ANC government does not withdraw from acts of nepotism, abuses of political power and cadre deployment, it will continue to witness revolts such as the ‘brain drain’, protest action and increased voter apathy. Notably, there has been something of a decrease in the ideological gap between the population groups in the country, and the race factor (which has been a notable point in favour of the ANC among the black population) is beginning to lose prominence, being replaced by class indicators. Perhaps this is best demonstrated by the emergence of the Democratic Alliance (DA), a historically white-dominated political party, which is steadily gaining traction as the official opposition party, with support rising from 12.4 percent in 2004, to 16.7 percent in 2009 (Waller, 2004) and now 22.2 percent.

3.3.3 Staleness of incumbency and leadership succession

According to the Institute for Security Studies (ISS) (2007), the general shift towards democracy has brought with it the entrenchment of term limits (usually ten years) that the ANC respects. Staleness of incumbency relates to the hegemonic position of a party, and
in South Africa this applies to the ruling ANC, which has been in power since 1994 (Neethling, 2014:40).

The transition to democracy has seen the ANC consistently receiving approximately 70 percent of electoral support, and it has ultimately become the dominant party in South Africa. Its symbolic association with the anti-apartheid liberation movement has largely carried it through elections with staggering margins. Wieczorek (2012:28) speaks about the concept of democratic consolidation, which is generally viewed as the ultimate end goal of democratisation, where democracy becomes ‘the only game in town’. Here no-one can imagine acting outside of established institutions and democratic practices, because those institutions and practices have become deeply ingrained within the society. The destiny of a country is not intertwined with that of the individual in power, as is the case during one-party and military dictatorships, because the rule of law and institutions guide the exercise of power.

In a dominant party system, multiple parties compete for power, but the ruling party wins consecutive elections, largely exploiting incumbency and state resources. In South Africa, the absence of a formidable opposition to the ruling party ultimately eliminates the threat of losing power, which affects the accountability of the government and explains undemocratic acts such as looting the economy, intimidating minorities, and holding elections in which the ANC worries about only the margin of its victory (Wieczorek, 2012:28).

The rise to presidency of Jacob Zuma was expected to herald the end of the 12 years of neoliberal policies seen under Thabo Mbeki. Mbeki’s macroeconomic policies (many of which were developed in the Mandela era) were thought to have led to the rising levels of township and community protests over service delivery demands. According to Dwyer (2010:10), service delivery protests reached levels that had never been experienced in any country in the world before. These strikes rendered Mbeki unpopular, and provided an opportunity for a faction of the ANC to recall him. The ANC Polokwane Congress, through the influence of the South African Communist Party (SACP) and the trade union COSATU, elected a Zuma-led faction in December 2007 to head the party. Despite his brushes with
the law,\textsuperscript{2} Zuma was viewed as ‘a man of the people’ and a friend of the workers who was best placed to address their concerns. Zuma defeated Mbeki by more than double the votes that Mbeki secured (Dwyer, 2010:10). The recall of Mbeki was followed by the resignation of several cabinet ministers allied to him.

The Congress of the People (COPE) was formed in 2008 following a series of scuffles and an eventual split in the top brass of the ANC leadership in 2005. This rift was a notable event within the ANC, as COPE represented the first black political party to oppose the dominant ANC, giving South Africans a sense of democratic electoral competition heading to the 2009 national election.

Unlike the DA, which for many South Africans carries the image of a political party with roots that can be linked to the apartheid past, COPE could be recognised as the alternative party to the ANC (Suttner, 2010:23). COPE’s dismal performance in the 2011 municipal elections, in which it secured 7.68% of the total votes cast, plummeted to 0.67% during the national elections, and has removed any notion that the party could pose a challenge to the ANC (Wieczorek, 2012:32).

As South Africa’s head of state since 2009, Zuma has been severely criticised in the media by analysts and commentators for his poor leadership. Zuma has blamed emerging middle-class blacks, as well as whites, for consistently finding fault with his government – a situation that could partly be attributed to his involvement in a string of court cases for corruption and disreputable sexual behaviour, as well as his reputation as a leader who relies on his homespun intelligence and canny ability to mediate between people and the many factions that make up the ANC (Neethling, 2014:41).

\textsuperscript{2}In 2002, Zuma was implicated in a publicised corruption scandal in connection with his close ally Schabir Shaik, where it was alleged that Zuma used his position in the government to get kickbacks through Shaik and his companies in a government arms acquisition deal.

In 2005, Zuma was accused of raping a woman whose father was a member of the apartheid resistance movement Mkhonto we Sizwe with Zuma and who served in prison together with him on Robben Island. Zuma was acquitted of the rape charge, and after his acquittal he was re-instated as ANC deputy president.

Zuma is embroiled in a major controversy related to costly upgrades to his private home in Nkandla, KwaZulu-Natal. State security personnel recommended improvements of around R27.9m, but by 2013 it was found that costs had risen to just under R250m (SA History, 2014: Internet).
Zuma’s position as ANC leader was reaffirmed at the ANC’s Mangaung (Bloemfontein) Conference in December 2012. For many commentators, the election of ANC veteran and business magnate Cyril Ramaphosa as deputy president of the governing ANC brought hope that he would inject new energy into the party and help Zuma to steer the country along a new trajectory (Neethling, 2014:41).

3.3.4 Legitimacy of government

The emergence of the ANC government after the 1994 national democratic elections was followed by the party almost immediately gaining the upper hand, as the demographics of the country (i.e. the black vote) appeared to guarantee the ANC a majority victory. Since then, Mattes (2007:3) says that the goal of the ruling party has been specifically that of transforming South African society, both politically and economically, as well as reshaping social life as it was known. With such a mammoth task at hand, it would be important for the ANC government to instil a great sense of patriotism and gain the commitment of the entire nation, and this was attempted through the concept born in this era of the ‘new South Africa’. The ‘new South Africa’ strives for a unified commitment to democratic rules, an extensive trust and respect for the institutions embedded within the regime and an active participatory citizenship. Furthermore, there was recognition of the need to acknowledge a kind of strength in diversity, and allocate equal status to the vast cultural, religious and linguistic identities that are shared by South Africans. In this way, the ANC government was carving for itself a legitimate rule. Indeed, the nature of South Africa’s political transformation made it clear that political institutions could not survive simply through coercion (Mattes, 2007:4).

It is interesting to note that even during the apartheid regime there existed democratic and legitimate institutions such as Parliament, political parties, political rights for whites, and an independent judiciary – all structures that legitimised the ruling NP. These structures, however, were implemented in a way that promulgated racial inequalities, favouring the white population (Broch Graver, 2005:6). This begs the question: where do the sources of a legitimate government lie? To answer this question, Broch Graver (2005:32) describes three types of authority that give rise to legitimate governance, namely: legal rule (where legitimacy is based on the law and administration of the state), traditional rule (where
legitimacy is based on inherited power) and charismatic rule (where legitimacy is based on the leader’s personal character). It is the charismatic source of legitimacy that Broch Graver (2005:33) describes as the most relevant to the ANC ruling government, as it usually involves the leader needing to prove his or her authority through the achievement of some form of success; for example, the attainment of liberation. If the performance of the leader declines, then the legitimacy of that leader will decline. This point is especially relevant in South Africa, where the divide between the rich minority and the poor majority is large. The ANC government’s legitimate authority can be seen to be eroding, which has been depicted in recent months through a number of protests and strikes in the country, owing to a lack of service delivery and frustrations stemming from high unemployment levels.

Twala (2014:564–567) focuses on the various election campaigns since the first democratic election of April 1994, to demonstrate how the ANC party has sought to legitimise itself in the eyes of the voters. During that year’s elections, Mandela himself was used as the biggest electoral asset. The leader was demystified as the figure who spent 27 years behind bars, and became ‘one of the people’ while offering a series of roadshows, surrounded by other political leaders also possessing similar political credibility. The ANC manifesto was titled ‘A better life for all … working together for jobs, peace and freedom’.

The 1999 Thabo Mbeki campaign was not very different, as it relied on the ANC’s liberation credentials to gain favour and legitimacy, employing public imbizos (a Zulu word for gatherings) as platforms to connect with supporters. In Mbeki’s second term in public office, allegations of the corruption of his deputy Jacob Zuma had surfaced, and led to Zuma’s dismissal, which in turn led to an internal revolt for him to be re-instated. This event was to backfire for Mbeki when he was overturned and voted out of the ANC leadership before the expiry of his full term in 2009, with accusations of his leadership style lacking consultation and often being centralised. Zuma came to represent the image of a leader with a concern for the people, and one to bridge the gap with the masses, a characteristic often perceived to be lacking in Mbeki. To regain the hearts of the masses, Jacob Zuma’s campaign was given the slogan ‘Working together we can do more’.

It is during the same period in 2014, during preparation for Zuma’s election manifesto, that a damning report by Public Protector Thuli Madonsela revealed President Zuma’s
awareness of the inflated spending of taxpayers’ money (over R200 million) in upgrading his private home in Nkandla. Questions arose about the legitimacy of the ANC, and it became clear that, along with the passing of Nelson Mandela, the party could not enjoy the same prestige and legitimacy enjoyed by its veteran leaders, as their credibility was based on trust and their deeds (Suttner, 2014).

3.3.5 Military involvement in politics

The development of South Africa’s military culture and the military’s transformation are based on parallels of events that shaped the state’s political landscape. The first of these transformations occurred in 1912, when the colonial forces of the four British colonies came together to form the Union Defence Forces (UDF) of the new Union of South Africa. The second process followed the 1948 election and the rise to power of the NP, with the creation of the South African Defence Force (SADF). The third transformation took place after the democratic elections in 1994, and led to the formation of the South African National Defence Force (SANDF) (van der Waag, 2013:2).

South Africa was characterised as a highly militarised, war-orientated state during the apartheid years. It was the role of the military to act as the backbone of the apartheid system, giving shape to the security of the regime nationally and further afield, in order to protect South Africa’s borders (Pringle 2010). With the transition into democracy in 1994, it would happen that the new (ANC) regime would inherit a sophisticated military machine, as well as the reputation of being the regional tyrants. Through demilitarising its image, the newly elected ANC government sought to replace its former reputation and become a nation that is committed to the conciliatory functions of promoting peace and security throughout the continent (Pringle, 2010). This was seen through the various phases of leadership starting with Nelson Mandela and his implementation of budgetary downscales, together with a closer focus on transforming the military in terms of its structure and introducing an ethos of national reconciliation. The budgetary cuts of the Mandela administration and the remnants of the changes made revealed themselves during the Mbeki period, where the military started to show signs of wear and tear and the loss of key personnel resulted in problems with the coordination and overall coherence of security-related initiatives. The situation has not improved much under the Zuma administration, as
this period has been characterised by a further continuation of the prevailing weaknesses of the military force. The increased demand for peacekeeping intervention, combined with a deteriorating military force, an outflow of qualified personnel and obsolete policy documents has led to the former military machine of South Africa somewhat losing face (Pringle, 2010). While this may be so, what is perhaps important to understand about South Africa’s position in light of its military involvement in politics is that the SANDF has taken up its role as the defence force of South Africa against external military aggression for two reasons. First, the new ruling party was painfully aware of the results of allowing the apartheid SADF to become involved in political and internal stability matters. The ANC accepted the need for a defence force, but wanted one that would be truly apolitical (non-partisan) and professional; therefore, one that was restricted to purely conventional military tasks (le Roux, 2005:257).

The White Paper on Defence was developed over the period from 1994 to 1996 and had as its primary aim aligning defence with the new South African democracy. It also describes the national strategy for the defence and protection of the state and its people through the hierarchy of:

- Political, economic and military co-operation with other states;
- The prevention, management and resolution of conflict through nonviolent means; and
- The use or threat of force as a measure of last resort (le Roux, 2005:256).

3.3.6 Social risk: extremism, religious tensions and terrorism

Marginalisation; injustice; structural violence owing to socio-economic inequalities; poverty; political exclusion and lawlessness have the capacity to push people, especially youths, into extremist ideologies. Although South Africa has not suffered from extremist violence, service delivery protests, xenophobic violence and violent crime are variants of extremism and are indicative of the socio-economic fissures in South Africa’s society that need to be addressed to guarantee the country’s stability and enhance democracy.

Ogbonnaya (2013:60) defines extremism as the sort of philosophy or act – whether religious, political, socio-cultural or economic – that is perceived to infringe on the common
moral and acceptable standards that exist mostly in the political arena. In contemporary political discourse, however, the term extremism is almost invariably linked to religious activities. Religious extremism usually finds comfort in its brutal acts, as religion is used to provide justification for the violence (Michael 2007:40). Terrorism – which refers to the intended use of violence in order to terrify certain groups of society – is an extension of extremism. It deploys calculated politically motivated violence, usually against civilian targets, through underground agents. In an analogy by Michael (2007:36), terrorism is a tree, and extremism provides support to grow the tree properly, and the terrorist groups are the branches to this tree.

One of the most prominent movements of the 80s and 90s, led by former policeman Eugène Terre’Blanche, was the South African right wing group called the Afrikaner Weerstandsbeweging (AWB) (Afrikaner Resistance Movement). This organisation was founded in 1973 with an estimated 14 900 members, and a following of 300 000 right-wingers.

The movement’s ideology was based on the belief that whites were superior to blacks and the (Afrikaner) Boer culture and nation were sacred and needed to be preserved (Visser, 2007: 7).

The AWB was notorious for the use of violence and violent rhetoric to further its aim of defeating a black uprising. Such examples included acts of vigilantism, the illegal possession of explosives and arms, and conspiring to blow up the multiracial casino resort Sun City and government structures in Cape Town (Visser, 2007:8). The AWB was responsible for more than 50 acts of terror during the course of 1990, which represented 15 percent of all acts of violence committed during that year. Leading to South Africa's first democratic election in April 1994, AWB members set off a series of bomb blasts, targeted mainly at taxi ranks, bus stops and terminuses where black people usually congregated, but also at polling stations, ANC and NP offices, and the Johannesburg International Airport, killing about two dozen people and injuring some 200 (Visser, 2007:9).
With South Africa an unlikely target for terrorist attacks by al-Qaeda, the state was beginning to present itself as a safe haven where support infrastructure could be used. With Al-Qaeda attracting much global attention, and South Africa’s particular characteristics lent themselves to attracting some of that unwanted attention, namely: long borders and coastlines making the country easily penetrable; well-known corruption with government officials that could aid in obtaining fraudulent passports; and South Africa’s particularly weak organs of state, which are prone to corruption. Despite this, South Africa cannot be classified as weak, but it presents the best combination of circumstances for organised crime to flourish (Solomon, 2013:6).

Responding to these signals, in early 1996, the South African Police Service (SAPS) and the SANDF jointly responded to the terrorist threat in the greater Cape Town area through the National Operational Co-Ordinating Committee (NOCOC) mechanism, whose mission was to execute special counter-terrorism operations.

Another cause for concern for the South African government was the establishment of People Against Gangsterism And Drugs (PAGAD) in Cape Town in 1996. PAGAD was positioned as a community anti-crime group. The group saw the government as ineffective in solving the crime problem, and further regarded the police as a corrupt force that shared links with gangsters. As a result, PAGAD members embarked on a course of vigilantism (Kalidheen, 2008:94).

It is important to note that PAGAD’s emergence was based on the ideological and spiritual environment created by Qibla. The Qibla movement was identified in South Africa in the early 1980s. The movement aimed to promote the ideals of the Iranian revolution in South Africa and transform South Africa into an Islamic state, under the slogan ‘One Solution, Islamic Revolution’. Qibla in South Africa is affiliated to Iran and the Iranian Intelligence Agency (Kalidheen, 2008:96).

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3 Al-Qaeda is the radical group allegedly accountable for the US September 11, 2001 attacks, carried out under that leadership of Osama bin Laden. Its core objective is to establish an Islamic caliphate governed by Sharia law. Al-Qaeda believes the West, and particularly the United States, is the primary physical and ideological obstacle to fulfilling this objective (CSIS, 2011: Internet).
The South African counter-terrorism strategy became prevalent in reacting to imminent threats of terrorism. The most popular and crucial counter-terrorism response was required against the threats posed by PAGAD and the Boeremag. Both these terrorist entities had the capability of destabilising the state of order in South Africa. The response by the South African government was an integrated approach by key departments such as the SAPS, SANDF and the intelligence community (Kalidheen, 2008:105).

Just when South Africa could describe itself as a country that had triumphed over racially motivated violence, Harris (2002:169) describes ‘a new pathology for a “new South Africa”’, this being the emergence of xenophobic attacks on foreign nationals.

This type of violence has typically been motivated by competition for political and economic power and involved in many instances the mobilisation of small business owners in inciting violence and evicting the foreign nationals as a way to regain territory (Polzer, 2010:2).

In just one month in May 2008, 138 different locations across South Africa reported attacks against ethnic minorities. These included murders, over 100 000 people being displaced, and millions of rands in damaged property (Polzer, 2010:3).

Following the murder of Eugène Terre’Blanche in April 2010, the South African flag was set on fire in Stockholm (Sweden) in solidarity with the plight of white farmers, as reports started to circulate suggesting that attacks on white Afrikaans farmers were on the rise (Steyn, 2011:1). A rally titled ‘Red October’ consisting of about 400 white South Africans set out to protest against the killings of white farmers in Pretoria in October of 2013, demanding the end to a ‘white genocide’. While crime in South Africa is prevalent, there is no evidence to support a type of white genocide, or a link of crime to race (Al Jazeera, 7 November 2013).

### 3.3.7 Socio-economic conditions

In spite of its middle-income status, South Africa faces numerous socio-economic challenges that if not addressed could endanger the country’s long-term stability. The ANC government has made efforts in tackling the legacy of apartheid to ensure that the majority black population, who were previously consigned to the margins of the mainstream economy, are brought into it. It is a daunting challenge compounded by the dearth of skills,
poor education for the majority of black children, and poverty and its attendant consequences.

In an effort to redress past imbalances, the post-1994 ANC-led government has undertaken extensive policy reforms. The numerous policies created by the government have been inspired by the fundamental goals of building a united and prosperous society. The world events during this time, such as the changes in Central and Eastern Europe, the growth explosion of the Pacific Rim, the economic structural adjustment approach of the World Bank and the International Monetary Fund (IMF), the neo-conservatism of the US and Britain, and the globalisation and regionalisation of economies were inevitably also able to exert their influence in South Africa. Moreover, these influences expressed themselves in two distinctly defined ideas of development and related philosophies of democracy: on the one hand, growth (meaning profit maximisation), and on the other hand, development and redistribution (meaning social equity) (Kotze, 2000).

One of the first of these macroeconomic policies was contained in the Ready to Govern (R2G) document, and this was translated into a programme in the 1994 RDP.\textsuperscript{4} The RDP was followed by an economic policy framework document in 1996: ‘Growth, Employment and Redistribution (GEAR)\textsuperscript{5} – A Macro-economic Framework’. GEAR was drafted by a team consisting of officials from the World Bank, the South African Reserve Bank, the Development Bank of South Africa and academics. GEAR was crafted in order to stabilise and rescue an economy that was already falling apart during the time of recession when the ANC regime came into office in 1994 (Gumede, 2013:1).

GEAR was replaced in 2005 by the Accelerated and Shared Growth Initiative for South Africa (AsgiSA)\textsuperscript{6}. AsgiSA intended to accelerate the growth of South Africa’s economy, as well as accelerate wealth redistribution. However, AsgiSA was short-lived, as it was soon replaced by the New Growth Path (NGP),\textsuperscript{7} which was introduced in 2010. The NGP focuses

\textsuperscript{4} The RDP’s outline was to meet basic needs, develop human resources, build the economy and democratise the state (MDG, 2013:17).
\textsuperscript{5} GEAR’s outline was to restructure the economy, create jobs, create an inductive environment to attract FDI, and create and apply policies to counter high inflation (MDG, 2013:17).
\textsuperscript{6} AsgiSA’s outline was to halve unemployment and poverty; improve state efficiency and minimise the regulatory burden on small–medium enterprises (SMEs) (MDG, 2013:17).
\textsuperscript{7} The NGP’s major aim was job creation (MDG, 2013:18).
on job creation, the need to create decent work and a new policy orientation towards labour-intensive approaches. It aspires to grow employment by 5 million by 2020 and reduce narrow unemployment by 10%, largely through a public infrastructure programme. This was followed by the 2012 National Development Plan (NDP)\textsuperscript{8} or Vision 2030 of the National Planning Commission (NPC). Instead of being a policy document, the NDP is more a consensus-building mechanism towards some envisaged end state where poverty, inequality and unemployment will have been drastically reduced (Gumede, 2013:2).

Today, South Africa is classified as a middle-income, emerging-market country. It is characterised by a sophisticated financial system and the liquidity of its capital markets. Sound macroeconomic and fiscal management have improved the country’s position, as well as re-establishing global economic links that were sanctioned during the time of apartheid (JSE, 2009:2). Ironically, in an article discussing South Africa’s ‘reconciliation barometer’, Everett (2012:7) highlights that South African unemployment figures constitute 72 percent of youth. This is the same category of the population that is at the forefront of service delivery protests and acts that can lead to social upheaval, risking social stability in South Africa, (see figure 1). The biggest challenge facing South Africa is bridging the widening gap that prevails between the rich and poor, and making sure that the reforms undertaken post 1994 translate into a better life for all. GDP per capita in South Africa is far below that of the world’s wealthiest nations (see figure 2), weighed down by income inequalities – shown by a Gini\textsuperscript{9} index of 57.8 and high poverty levels (42.9% of the population live on $2 a day) – and this is aggravated by the spread of HIV/Aids and tuberculosis (life expectancy in South Africa is 49.6 years). The poorest 10 percent of the population contribute 1.3 percent of the country’s income, and the richest 10 percent of the country contribute 44.9 percent of the country’s income. All together these factors construct the country’s human development index, which places South Africa at position 129 out of 182 countries (JSE, 2009: 2).

\textsuperscript{8} The NDP’s outline has been to eliminate poverty and reduce unemployment, improve school education, deconstruct the spatial patterns of the apartheid system, reduce unemployment from 27% to 14% by 2020 and to 6% by 2030, decrease the level of inequality as measured by the Gini coefficient from 0.7 in 2007 to 0.6 in 2030, become a less resource-intensive economy and adopt sustainable development practices (MDG, 2013:18).

\textsuperscript{9} The Gini index measures the extent to which income distribution among the individuals of an economy deviates from a perfectly equal distribution. A Gini index of 0 indicates perfect equality, and an index of 100 indicates perfect inequality (World Bank, 2014: Internet).
Figure 1: Employment-to-population ratio (percentage)

Figure 1 shows that South Africa’s absorption rate of 42% in 2010 declining from 44% of 2008. Prior to this phase, the years between 1994 and 1996 experienced strong economic growth with the country creating jobs throughout 2007 and 2008, and recording 1.9 million new workers between 2004 and 2008. The global economic crisis put an end to this trend and since the first quarter of 2008, more than 1 million jobs have been lost (MDG, 2013:110)
While poverty levels and depth of poverty are declining, levels of inequality in South Africa have remained high. The Gini coefficient has remained at around 0.7 since 2000; a level that places South Africa among some of the most unequal countries in the world (MDG, 2013:28).

### 3.3.8 Racial, ethnic and religious cleavages

Apartheid ended in 1994, but the brutality of the system still lingers in South Africa. Racial divisions are still rife and are prominently expressed in political discourse and election choices, in the sense that despite unethical practices in the ANC, the majority of black voters still regard it as the liberation party and deserving of their support.

Key to the topic of diversity is its importance as a determinant of economic growth, while polarised societies are prone to competitive rent-seeking behaviour that causes conflict in the distribution of public goods as redistributive policies are determined along ethnic lines (Fedderke, Luiz and Kadt, 2004:2).

In South Africa a major attempt was made to socially and politically divide the country along racial lines. Blacks, whites, coloureds and Indians were separated geographically, politically, and economically. Socially, according to Fedderke et al (2004:13), South Africa is divided by race, but also by language and tribal differences.
South Africa currently has 11 official national languages, and has inherited a complex system of racial classification from the apartheid era. The state of language identity in South Africa, and particularly that of white South Africans, can be explained by the outbreak of the two Boer Wars (1880 – 1881 and 1899 – 1902) between British troops and Dutch settlers over territorial conflicts. A victory for the English was sealed with the 1902 Treaty of Vereeniging, bringing most of what is now South Africa under English control (de Kadt, 2005:12).

This victory also brought about the benefits of whites becoming more educated and wealthier, with English whites residing in urban parts such as the Cape and Natal, whereas Afrikaners were the opposite of this, and more likely to be situated in agrarian areas such as the Orange Free State and Transvaal (de Kadt, 2005:12).

This was to become an important feature of social and political life well into the apartheid period (1948 – 1994). During the same period, South Africans were organised into four racial groups: blacks (about 80%), whites (about 9%), coloureds (about 9%) and Indians (about 2%). Under the separatist designs of white rule during this era, the majority black population was further sub-divided into 10 ethnic groups (Zulu, Sotho, Venda, Xhosa and so forth) that would occupy their respective homelands, which were far flung from the cities, away from developed dwellings and made up 13% of the entire Republic. This was done so that the white population (including white Afrikaners) could be the largest group in the country (Yoichi, n.d.:10). Language politics under the current political dispensation undoubtedly continues to influence the nature of democratic competition in South Africa today. Parliament itself has been accused of ‘tribalism’ in its deployment process, with the origins (language/ethnicity) of the leader of the time usually favouring a complement of cadres who have the same roots. This became evident during the presidency of Thabo Mbeki when he was recalled from his position of state president. The supporters of the ousted Xhosa president formed a new party called COPE, while leaders remaining in the ANC supported the new Zulu president, Jacob Zuma.

The DA, which is the state’s official opposition political party, is not exempt from these linguistic undercurrents, and these have played out in the Western Cape, where the DA party has won the only provincial premiership not held by the ANC. Winning support from
Xhosa voters is crucial in the Western Cape, and the DA’s white leader Helen Zille has been reported to sometimes open speeches with Xhosa phrases (Dunning, 2010).

3.3.9 Black economic empowerment

As part of trying to stabilise the country, the ANC government devised a policy that is meant to economically empower the black majority previously marginalised under apartheid. This policy is based on the understanding that a sizeable middle class is the anchor to South Africa’s democracy, and thus political stability. The philosophy behind this policy is sound, but its execution has reduced Black Economic Empowerment (BEE) to an incestuous programme that has spawned a tiny clique of millionaires without substantively bettering the lot of the poor majority. In fact, some would argue that as currently designed and implemented, BEE could pose a threat to the country’s political stability, as it ensures that the black constituency remains excluded from economic opportunities. The South African government has embarked upon a broad-based BEE policy that has the aim of promoting black shares in business ownership and economic empowerment (van Wyk, Dahmer and Custy, 2004:265). At its core, BEE prescribes the way that business is conducted, relating to factors such as equity ownership; executive control; employment; affirmative procurement and supply; the transfer of skills; corporate social investment in disadvantaged communities; and the development of entrepreneurship for small–medium enterprises (SMEs).

Gelb, Acemoglu and Robinson (2007:6) explain BEE by describing it by its stages. In the first stage, BEE involved white companies selling a proportion of their unissued equity to a few pre-selected black purchasers. The sales were financed by loans that were often provided by the seller and usually secured by future earnings. In many instances, the buyer was a consortium consisting of one or two black individuals, usually with a high political profile but with limited experience in business. This stage of BEE deals was characterised by little government intervention until the period of 1996, where the government became actively involved in the promotion of affirmative action legislation and the promotion of black enterprises in various forms.
The second stage of BEE promotion was during the stock market decline of 1998, which influenced the untying of financial deals. In 1999 the government was displaying greater support for BEE transactions by creating institutions such as the BEE Commission under the chairmanship of Cyril Ramaphosa. This was to be followed by a broadening in definition and constitution of BEE – including aspects of human resources, employment equity, enterprise development, preferential procurement, as well as investment, ownership and control of enterprises and economic assets (Gelb et al, 2007:7).

A part of the objectives of the Commission was to achieve a reformation of the South African economy through the following goals: transferal of at least 30% of productive land to black peasants and collective organisations; an increase of the black equity participation in the economy to 25%; 25% black ownership of JSE-listed shares; 40% of non-executive and executive directors in JSE-listed companies being black; 50% of government procurement being directed to black-owned companies; 30% of private sector procurement being directed to black-owned companies; 40% black executives in the private sector; 50% of the borrowers from public finance institutions being black-owned companies; 30% of contracts and concessions made by the government involving black companies and 40% of government incentives to the private sector going to black companies (Gelb et al, 2007:8).

BEE was not without its criticisms and a debate between government and business circles has questioned whether it is the best conduit to empower blacks economically. According to Sasol, South Africa’s leading petrochemical company, BEE is listed as one of 30 risk factors the company has faced in South Africa. BEE was said to pose a risk to shareholders because its transactions cannot be guaranteed at fair market price, as disadvantaged prices were used in such undertakings. An example is cited by Sasol where shareholders have had to pledge a portion of the company’s assets (up to R15 billion) to finance BEE partners in their acquisition of a 25 percent stake in the company (van Wyk et al, 2004:265).

More than a decade after its implementation, some members of the ruling government are not convinced by the policy. In 2010, Pravin Gordhan, the then minister of finance, was quoted as saying that BEE policies have not worked and have not made South Africa a fairer or more prosperous country. Similar views were echoed by Lawrence Mavundla, the
president of the National African Federated Chamber of Commerce and Industry, who said that BEE and preferential procurement had sidelined small businesses and stimulated the presence of those that have come to be called ‘tenderpreneurs’ who have managed to access lucrative deals through their political connections (Mail & Guardian, 18 January 2013).

In 2012, Gwede Mantashe, the ANC secretary general, also criticised preferential procurement, stating that its pursuit of creating a black middle class has led to instances of costs of services being over-inflated by more than threefold. Perhaps an unmistakable feature of BEE policies is that it has created a small class of wealthy black elites, or an ‘entrepreneurial bourgeoisie’ as it has been put by Moeletsi Mbeki, an economist, analyst, and brother of former president Thabo Mbeki (Mail & Guardian, 18 January 2013).

Affirmative procurement under BEE guidelines has raised uncertainties for foreign firms that seek government contracts, as well as creating risk in the repatriation of earned income. The dominant narrative, however, is that of BEE acting as a conduit for foreign firms wishing to invest in the country. While the principle of BEE is sound, as captured in a delivery made by the state president of South Africa, President Jacob Zuma, as at 2013 there has been an estimated recording of R600 billion in BEE transactions since 1995. This is particularly important when the target of the ruling party is to create equity within the economy (Paton, n.d.: Internet). It is the belief that BEE will ultimately contribute to substantial economic transformation and black empowerment (van Wyk et al, 2004:266).

3.3.10 Trade union activism

The role of trade unions in South Africa’s democratisation process is complex. The importance of trade unions in democratic South Africa stems from a history of injustices against black workers under apartheid. Nevertheless, the cosy relationship between sections of labour and the ANC has tended to compromise the commitment of these organisations to the workers’ plight, as some of the trade unionists have been consumed by factional politics, patronage and self-aggrandisement. The role of trade unions is primarily to participate in the following broad categories: wage-setting activities, political
activities, and acting as the mid-point between members and their employers (Armstrong & Steenkamp, 2008:3).

The early 1990s heralded a new phase in South African history marked by a new political dispensation that based its values on an equal society that would enjoy equal opportunities in the social, economic and political spheres. A series of legislation was passed in order to redress the past imbalances and inequalities. Some of the actions that followed ranged from the unbanning of political parties such as the ANC, Pan African Congress (PAC) and SACP to the disbanding of the South African Congress of Trade Unions (SACTU), which was to merge with COSATU, and the establishment of the Convention for a Democratic South Africa (CODESA). These actions culminated in the eventual agreement on various issues such as a new Constitution, transitional structures and a date for democratic elections (Nyathi, 2010:20).

This tumultuous period saw a number of initiatives aimed at correcting the labour injustices of the past, such as the implementation of strategic plans that would merge labour relations with the Constitution, which were articulated in the document from the then labour minister Tito Mboweni called ‘A Strategic Approach for the Ministry of Labour’. Enshrined in the Constitution were numerous rights that would uphold fair and inclusive labour practices, including, but not limited to the right to form and join trade unions and employers’ organisations, to organise and bargain collectively and to strike (Nyathi, 2010:21).

The formation of Nedlac (the National Economic Development and Labour Council) in 1995 involved representatives of the state, organised business, organised labour and communities. At the core of its mandate was ensuring a balanced and fair working environment for all and to consider all proposed labour legislation and significant changes to social and economic policy before introduction and implementation in parliament, trade unions (Trade Unions, 2014:Internet).

The formation of the new Labour Relations Act in 1995 provided for the right to strike and organise at plant level, and created the Commission for Conciliation, Mediation and Arbitration (CCMA). The new government confronted the legacy of the apartheid regime by introducing a Skills Development Act to accelerate skill development and an Employment
Equity Act to provide equal opportunities for previously disadvantaged sections of the workforce (Nyathi, 2010:28).

Of note was also the formation of the tripartite alliance (the ANC, SACP and COSATU). The fundamental objective of the tripartite alliance was founded on a common commitment to the National Democratic Revolution: to establish a democratic and non-racial South Africa where there is continued economic transformation, continued political and economic democratisation; and the need to unite the largest possible cross-section of South Africans behind these objectives (COSATU, n.d.: Internet). COSATU today represents the largest trade union, and having the mass of the workers in South Africa as members, COSATU is able to offer a significant contribution and exert a profound influence on national economic and political policies.

South Africa today is experiencing high levels of protest action, and according to SAPA (2013: Internet), a total of 99 strikes were recorded in 2012, with many of them unprotected or illegal strikes characterised by violence. The strikes involved 241 391 workers, and resulted in workers losing R6.6 billion in wages. The year after, in 2013, 120 separate strikes were recorded across a range of sectors (Counterfire, 2014: Internet), which compares starkly to the 67 industrial actions recorded in 2011, 74 in 2010, 51 in 2009, and 57 in 2008 (SAPA, 2013: Internet).

These types of civil society outbursts are a reminder of just how the labour movement has become one of the most instrumental civil society institutions in post-apartheid South Africa.

Today, the largest modern trade unions are: COSATU, the National Council of Trade Unions (NACTU) and the Federation of Unions of South Africa (FEDUSA). Combined, these union federations represent millions of workers across the country. While the role of trade unions in South Africa pre 1994 related to the political struggle for democracy, including the democratisation of the workplace, today trade unions can be seen being actively involved in other domains such as matters relating to economic inequality, inadequate social welfare, food and energy prices, and the eradication of e-tolls (Gordon et al, 2013: Internet).

3.3.11 Safety and security
South Africa has to contend with a high crime rate not unconnected to the legacy of discrimination and economic marginalisation under apartheid, under which the majority was confined to the fringes of the mainstream economy. It is for this reason that South Africa’s state of crime is often described tautologically as violent crime considering the overwhelming violence and callousness that accompany it. The country’s legal system is relatively independent of political meddling, and so acts as a bulwark against lawlessness, be it in the political realm or in society generally. This is significant because strong institutions such as the judiciary are indispensable to democratic consolidation, as they ensure safety and security for all.

This indicator or variable is also sometimes described as ‘law and order’. Law entails an assessment of the strength and impartiality of the legal system, whereas order relates to an assessment of the popular observance of the law of a country (Fouché, 2003:36). Venter uses this indicator to reflect on crime rates in South Africa, as well as the measure of corruption in society.

South Africa’s transition from an apartheid state to a constitutional democracy led to the creation of the Constitutional Court. The Constitutional Court symbolised an institution of change, entrusted with the mandate of advancing the reform of the South African jurisprudence, thereby ensuring that the law, including all legislation and common law, are aligned to the Constitution (Department of Justice & Constitutional Development, 2012: Internet).

It is believed that the insistence on the rule of law was embodied in the late President Nelson Mandela. While apartheid may have been a crime against humanity, its response was not met by revolutionary justice (Campbell & Bunche, 2013: Internet).

There were other notable exceptions in individuals representing the judicial system of the apartheid era; however, the years before 1994 were predominantly characterised by injustice, unaccountability and hopelessness. Dyzenhaus (2007:3) mentions that the fact that the law was used as an instrument of apartheid ideology demonstrates that the principle of legality or the rule of law can sometimes consist of an absence of morality. What then become important are the contents of the law and the nature of the ideology of which
the law is the instrument. Accordingly, The South African legal environment has changed radically since 1994. The Bill of Rights and legislation flowing from it paved the way to establishing a legal environment that is adversative to corruption. The culture of secrecy and authoritarianism that existed before 1994 has been replaced by legal norms favouring democracy, accountability and transparency. Legislation such as the Promotion of Access to Information Act and the Promotion of Administrative Justice Act, together with institutions such as the Competition Commission and the Chapter 9 bodies make it possible for civil society and concerned citizens to hold the state and private bodies to account in ways that would have been inconceivable in the past (CASAC, 2011:8).

Protected by the right of freedom of expression under Section 16 of the Constitution, the media now play an important role in the detection and exposure of corruption.

Institutions such as the Asset Forfeiture Unit and the Special Investigations Unit have had several notable successes in apprehending and prosecuting corrupt individuals and recovering the proceeds of crime (CASAC, 2011:8).

The South African Constitution, which is the bedrock that lays the foundation for an open society based on democratic values, social justice and fundamental human rights, is hailed worldwide as being one of the most progressive (AgangSA, 2013:Internet). South Africa further belongs to four major conventions of the UN, AU, OECD, and SADC, compelling the state to actively combat corrupt activities, prevent organised crime, promote whistle-blowing, and enforce punitive measures (Corruptionwatch, 2013:Internet).

The World Justice Project, which commits itself to the rule of law globally, has recently released its latest Rule of Law Index, which includes 97 countries, of which South Africa is one. According to their measurement, there is noticeable improvement being made by South Africa in entrenching the rule of law in the governance of the country. These scores place South Africa in the mid-range of global scores and toward the upper end of regional rankings (Hoffman, 2013: Internet).

Nevertheless, there have been failures in the advocacy of the rule of law. The Council for the Advancement of the South African Constitution (CASAC, 2011:1) defines corruption as the ‘antithesis to democracy and the rule of law’ and further points out that corruption is not
found only in government structures, but also in the private sector. There is a recent emergence of evidence of large-scale fraud and anti-competitive collusion by big businesses in many sectors of the South African economy, particularly the construction and food sectors.

Evidence of corruption is perhaps most notably witnessed in the government space, with a plethora of cases of government officials acting in breach of the law, dealt with by sweeping them under the carpet. Such instances include the 783 charges of corruption, money laundering and racketeering against President Jacob Zuma, which were withdrawn on a technicality. Expelled ANC Youth League (ANCYL) leader Julius Malema is charged with fraud, corruption and money laundering and tax evasion by the South African Revenue Services (SARS). The charges are temporarily suspended.

Similar outcomes have been seen for former intelligence head Richard Mdluli, police boss Bheki Cele and Minister of Public Works Gwen Mahlangu for a multimillion rand police headquarters lease deal (Hamadziripi & Newham, 2012: Internet).

A number of high-profile cases relating to fraud and corruption against politically connected officials have either vanished, or have been withdrawn by the National Prosecuting Authority (NPA) (Tamukamoyo, Newham, 2012: Internet).

3.3.12 Labour policy

The newly elected ANC government inherited a disjointed group of labour laws and polarised industrial relations between employers and worker representatives, with a systematically economically skewed population (Maziya, 999:1). For almost half a century, blacks had been subject to a deliberately designed second-class education, labour laws that excluded their advancement, business regulations that made many forms of firm ownership illegal, and laws that kept the black population from living in the urban areas that were the hubs of commercial activity.

By then, unemployment was about 15 percent. A dozen years later, all of these restrictions of the apartheid system have disappeared from the law. Over this same period,
unemployment has about doubled, and the same groups that struggled under apartheid now bear the costs of this unemployment (Levinsohn, 2007:1).

It is said that the most prominent representation of the welfare challenges facing post-apartheid South Africa is in the economy’s unemployment rate. South Africa contends with the irony of being formally labelled as an upper-middle-income country while possessing one of the highest unemployment rates in the world. This characteristic has placed market regulation high on the agenda of pertinent policy issues in South Africa. A combination of the complex nature of these issues and the fact that the society is characterised by strong, vocal trade unions and employer associations has meant that changes to the regulatory and institutional framework is a highly contested policy issue in South Africa (Bhorat & Cheadle, 2007:1).

There are several reasons for the increase in unemployment. Firstly, South Africa has been subject to the same skill-biased technological changes as many other parts of the world. This has hit especially hard in the mining and agriculture sectors, precisely where many unskilled blacks worked. At the same time, the huge influx of mostly under-educated black women into the labour market has been met by a decline in demand for less skilled workers. This increase in labour supply, coupled with a decline in labour demand, has led to wage declines that society has found to be unacceptable, and the result has been a substantial increase in unemployment (Levinsohn, 2007:1).

This challenge has placed the South African economy with the triple challenges of unemployment, inequality and poverty. It is noteworthy that among the three challenges, high unemployment (25.2% in quarter one of 2013) coincides with low economic growth (0.9% in quarter one of 2013). In addressing the post-apartheid challenges, the government needs to implement swift and effective programmes.

In response to the economic difficulties of the time, a plethora of regulations and policies have been formulated by the current government: the Labour Relations Act (1995); the Basic Conditions of Employment Act (1997); the Employment Equity Act (1998); and the Skills Development Empowerment Act (1998). It was the task of the state to transform the skills regime by moving the system away from its apartheid ‘low skill’ roots towards a
framework based on free market regulation, reviving the apprenticeship system, and creating a new institutional environment structured around industry training. This was achieved in the form of a split between the Ministry of Education (responsible for schools, adult education, colleges, and universities) and a Ministry of Labour that was in charge of ‘skills development’ (Allais, 2011:2).

The Department of Labour (1997) introduced a national Skills Development Strategy to replace the apartheid ‘skills’ system. Sectoral Education and Training Authorities (Setas)\textsuperscript{10} were set up to replace the Industry Training Boards.

There is also the National Skills Fund, which was intended to fund training for disadvantaged groups, particularly the unemployed. In a similar fashion, there was a phasing out of the apprenticeship system, to be replaced by ‘learnerships’, which would be ‘demand-led’, in the sense that they would be offered in response to social or economic needs, including, but not limited to, the formal sector’s needs (Allais, 2011:3).

The South African government has produced a large number of policies that intend to address the unemployment condition. The aim of these policies is to complement the already existing regulatory environment. For instance, there is the broad plan named AsgiSA and the Broad-based Black Economic Empowerment initiative. The shortfall in these policies is that they are unable to reach and affect the younger and the less educated segments of the population (where the majority of unemployment exists) (Brynard, 2011:73). The Expanded Public Works Programme (EPWP) is another South African policy to address unemployment. The public works programme can potentially employ large numbers of poorly educated and otherwise unemployed workers; however, it is short-term in nature and only provides temporary job creation (Brynard, 2011:74).

Criticism about South Africa’s labour policies mainly surrounds the vocal nature of its trade unions, which has had the impact of causing the real wage to outperform productivity or

\textsuperscript{10}Setas are stakeholder bodies, with employer and trade union representatives on their boards. They were set up through a levy-grant system, through which employers pay 1\% of payroll costs, 80\% of which goes to the Seta. The Setas distribute grants back to employers upon receipt of training plans and reports. The hope was that this would create an incentive for employers to train and supply information that would build an understanding of the training needs of each sector (Allais, 2011:2).
output. This sort of misalignment leads to the very job losses unions seek to prevent, exacerbating South Africa’s unemployment crisis and influencing firms to prefer the option of employing capital to human capital. South Africa is reported to have higher labour costs compared to other middle-income countries such as Brazil, China, Poland, and others. Making matters worse, South African salaries must contend with the ever-rising inflation rate causing further pressure on wage increases and decreasing the country’s global competitive attractiveness. Over and above the shortage in identifying or recruiting professional and technical staff, the South African labour laws make it difficult to dismiss incompetent workers, with an array of lengthy and often difficult-to-implement rules and steps that employers have to follow before they can prove incompetence (Meibo & Peiqiang, 2013:36 – 37).

3.3.13 Macro-political-economic circumstances

Venter (2005, 46 – 49) measures South Africa’s macro-political circumstances against the following variables: income tax; structural problems in the economy; some general macroeconomic indicators; and the ability to attract foreign direct investment.

In terms of these variables it is observed that South Africa possesses some of the symbols of a BRIC (Brazil, Russia, India, China) nation, such as a large population and emerging middle class. South Africa, however, struggles to close the inequality gap (an inheritance of apartheid), and continues to face an arduous public health problem with an estimated 21.5% of the population infected by HIV. In addition, the average level of education is low, which inevitably translates to skill shortages and high levels of unemployment of almost 25%. South Africa’s growth potential is additionally abridged owing to an inadequate infrastructure network and insufficient power supply, reflected in a low level of gross fixed capital formation (investment) of only 19% of GDP (Hammarlund, 2012:2).

Compared to its counterparts in the BRIC conglomerate, it has been shown that labour costs are an important determinant of FDI. It is due to this component that South Africa has been attracting far less foreign direct investment and exporting less industrial output than its peer group. South Africa is characterised by trade unions demanding salary hikes more
than double the rate of inflation, and this has the impact of raising labour costs, with low manufacturing productivity (Munyeka, 2014:129).

Munyeka (2014:129) cites the example of China, which has an abundant supply of human capital of 1.3 billion people and a labour participation rate of 59 percent. South Africa, on the other hand, has 49 million people and had a labour participation rate of 36 percent in 2010. Unit labour costs have also been higher for South Africa than in China. Additionally, South African managers earn nine times as much as unskilled workers, compared to about twice as much in China. While 80% of South African labourers reported that they had not received any training, between 60% and 80% of unskilled and skilled workers in China reported having received training. This enhances the quality of labour and skill abilities provided in China, and as a result, the country sees an inflow of multinational corporations (MNCs) wanting to build relationships with the state. Finally, South Africa’s FDI net inflows as a percentage of GDP are still low (0.37%) compared to China (3.12%).

Despite these conditions, with 10 out of the world’s 20 countries with the highest GDP growth rates being located in Africa, South Africa ranks an impressive second in Africa and 29th in world rankings, and is situated in the first tier of countries in Africa possessing the least political risk (Thomsen, 2014:Internet).

South Africa has made tremendous strides in economic liberalisation and in the improvement of market competitiveness; however, this transformation has reached a plateau. It is the view of market leaders that it is vital for the South African government to continue with the deregulation and privatisation of state-owned enterprises (SOEs). This will extend appropriate education and skills transfer endeavours, and will continue the promotion of small business entrepreneurship in order to meet long-term challenges. The high unemployment rate and poverty levels have potential destabilising effects for South Africa’s status in terms of political stability and the government’s adopted neo-liberal economic policies (van Wyk et al, 2004:265).

At the inception of the democratic Republic of South Africa, SARS became a semi-autonomous body, outside the usual government administration, and this resulted in a visible increase in efficacy of SARS.
This improvement is especially evident in the increase of tax collection from corporations, increasing from R23 billion in 1998/1999 to in excess of R150 billion in the 2011/12 Annual Report (Erasmus, 2013:Internet). In addition to responding to the challenges that face the South African population, and stimulating employment creation, South African businesses now have the opportunity to create new employment opportunities and claim rebates from the Employment Tax Incentive (ETI) (Grant Thornton, 2014:Internet).

3.3.14 Administrative (in)competence in government

The service delivery protests that South Africa experiences in the townships (apartheid designated black settlement areas) over the lack of amenities such as electricity; water; schools; tarred roads; and even jobs partially expose the dysfunction in the local tier of government, which can be attributed to patronage. This patronage sees incompetent but highly connected individuals within the ANC being appointed (in the party-speak, ‘deployed’) to senior positions. The consequence is the mismanagement of resources through malfeasance, a genuine lack of skills (inability to spend monies), the hiring of personnel on the basis of nepotism, and the entrenchment of careerism and factionalism, which render these local units dysfunctional sources of sinecures and personal enrichment. Judicious management of state resources at the local level, the hiring of competent individuals, and a general professionalisation of the state to decouple it from the ANC are prerequisites to addressing the myriad social economic and political challenges that result in service delivery protests, in which lives are disrupted, public property such as schools destroyed and even lives lost.

In the Republic of South Africa, the government is comprised of national, provincial and local pillars, which are distinct, but interdependent and interrelated. Two leading documents have been at the centre of restructuring local government in South Africa. These are the Constitution and the White Paper on Local Government Transformation, 1998. In terms of Section 40(1) and (2) of the Constitution, local government is one of the spheres of government that seeks to promote and enhance cooperative government (Sibanda, 2012:1).
In order to put into action the stipulations of the Constitution, legislative and policy frameworks were drawn up to facilitate the transition to the new local government. The Local Government Transition Act, 1993 represented the first phase of local government transformation and laid the foundation for legitimate local government in the Republic of South Africa. The December 2000 local government elections denoted the end of the transition period and reduced the number of municipalities from 843 to 284, which have now been reduced further to 278 after the May 2011 local government elections (Sibanda, 2012:1).

At the heart of the White Paper on transforming public service delivery was the concept that came to be known as ‘Batho Pele’, a Tswana phrase meaning ‘people first’. The purpose of coining this phrase was to articulate the strategy of putting public services in place that were effective, people-centric and sustainable (Raga & Taylor, n.d: Internet). The African Peer Review Mechanism (APRM) labels the ‘Batho Pele’ principles as innovative and recognises them as ‘best practice’ (World Bank, 2011:54).

The elevated status of local government and the associated participatory rights of citizens have led to many outbreaks of protests against the lack of service delivery by municipalities. Despite the tremendous strides made in democratising local government, poor service delivery and perceived corruption still result in some municipalities being dysfunctional. To be effective in monitoring service delivery, local governments both nationally and internationally are adopting New Public Management (NPM), private-sector or market-oriented practices (Sibanda, 2012:2).

In recent years, the impact of fraud has led to the declaration of special regulations and improvements in existing legislation that have led to the creation, among others, of the Directorate of Special Operations, commonly known as the ‘Scorpions’; the Asset Forfeiture Unit; the Public Protector; the Special Investigation Unit; Commercial Crime Units; Internal Audit Units; Special Investigation Units within departments; and the appointment of forensic consultants (Ambe & Badenhorst-Weiss, 2012:251).

Managa (2012:3) summarises the administration challenges of the present government as being owed to severe problems of institutional capacity. As mentioned earlier, this refers to
a lack of expertise that leads to many municipalities being ineffectively staffed, and has resulted in poor service delivery over the years that has left many communities with inadequate access to basic services. This skill shortage exists mostly in managerial and technical positions, which remain vacant in most rural municipalities, creating overwhelming backlogs that prevent efficiency and are felt by poor communities (Managa, 2012:3).

While some municipalities lack adequate funds to carry out their constitutional mandate to improve service delivery, some instead underspend their allocated funds because of a lack of critical skills required to operate municipalities. These skills are project management, financial management and general leadership skills. The result is incomplete projects or failure to start others (Managa, 2012:3 – 4).

The government’s mandate to deploy ANC comrades to public office positions limits access to qualified staff and worsens the prevalence of unsuitable incumbents that are unable to perform their duties successfully. Further to that, some of these political appointees enrich themselves, earning astronomical bonuses on the backs of collapsing municipalities (Managa, 2012:3 – 4).

There is also a ripple effect, where the lack of quality service provision leads to unsustainable budgetary management. Communities refuse to pay for inferior service, and also cite a lack of affordability due to unemployment as a reason for non-payment. In the 2010/2011 financial report, the auditor-general revealed that only seven out of the 283 municipalities audited around the country had received clean audits for the year (Managa, 2012:4).

The government may also be accused of disillusionment under these circumstances, or detachment from their presiding communities, as protesters have expressed dissatisfaction with their exclusion from local decision-making, including choosing which municipal officials and councillors should represent them in wards (Managa, 2012:4).

3.3.15 The security of private property
There are twin problems in South Africa when discussing private property: that of nationalisation, and that of land reform.

Since the discovery of minerals in the 19th century, South Africa has managed to place itself firmly on the resources map, benefiting considerably from private funding invested in the extraction, refinement and export of the precious commodities. Capitalism further helped the country to modernise, improving South Africa’s industrial state and bringing with it the development of railway and other transport infrastructure, the development of small towns and the emergence of Johannesburg. It is most notably the discovery of minerals that has propelled the entire South African economy, which is estimated to be worth R2 000 billion (Forrest, Rowley, Trickey and Underwood, 2010: 373).

The management of mineral resources in South Africa has always been in the hands of the government, in order to regulate exploration and mining practices. In South African law, the state is not defined as the owner of minerals, but merely exercises control over the exploration and mining of minerals. The involvement of the state in the exercise of such regulatory powers is traditionally and primarily with the maintenance of safety measures and protection of the environment (van der Vyver, 2002:127).

There have been public debates about nationalising the mining sector and other strategic sectors. Such discussions can cause apprehensions among the business community at large concerning the speculative consequences that nationalisation is thought to bring. For instance, after Zambia’s government nationalised Anglo American and Selection Trust's copper mines in 1969, copper production peaked at 750 000 tons in 1973 and then took a major drop to a mere 275 000 tons. This was a fall of more than three-fifths in less than 30 years. Similarly, the contribution of copper to Zambia’s GDP and government revenue declined rapidly once nationalisation had been instated, with the overall contribution to the government gradually shrinking to nothing (Forrest et al, 2010:374).

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11 Capitalism refers to an economic system where trade and the factors of production are mostly privately operated and managed for profit. A capitalist economy is characterised by agents who set the price of goods and services (Wikipedia, Internet).
The ANC government has not formally endorsed the prospect of nationalising any key sectors, with individuals such as Secretary-General Gwede Mantashe, and other key figures (Ministers Gordhan and Gigaba, and former Minister Shabangu) speaking against it outright. Some factions have, however, publicly shown their support for this type of policy change. The government’s biggest ally, COSATU, expressed its enthusiastic advocacy in recent times of such an ideal. COSATU’s economist, Chris Malekane, has not only been a vigorous supporter of nationalisation, but has been quoted as saying that the trade union federation would reject any report critical of nationalisation. COSATU is only open to a discussion relating to choosing between different models of nationalisation (du Plessis, 2011:3).

There are many arguments that oppose the route of nationalisation, and one of these is the efficiency argument. Quite simply, this argument claims that if the mining sector has been efficient and competitive, without having shown symptoms of market failure for this long, then it is not necessary to change anything (du Plessis, 2011:9).

There are also arguments of fiscal and distributional claims, and according to these arguments the ANCYL\textsuperscript{12} contends that the massive poverty challenges, unemployment and unequal spatial development realities that exist in South Africa call for an urgent focus on mineral resources. With that said, it would be remiss to not mention certain factors observed in history relating to nationalising a country’s minerals, such as that high commodity prices have been associated with nationalisation and low prices with privatisation. It is believed that nationalised firms also tend to have confused goals, and nationalising the resource sector will raise government debt and cost the government more than it receives, which will eventually undermine the scope of the distributive policies on the national budget (du Plessis, 2011:10 – 16).

\textsuperscript{12} While the discussion of ideologies of nationalisation was started by the ANCYL in 2010, while it was headed by Julius Malema, since his expulsion from the ANC party and the formation of the Economic Freedom Fighters, those notions have been championed by his newly formed political party.
Besides discouraging potential and current investors in the country, the nationalisation debate has been labelled a solution that will merely serve the short-run political goals of its proponents at the expense of long-run economic efficiency (du Plessis, 2011:10).

South Africa’s history of racial discrimination has left the country with a skewed pattern of land ownership that excludes the majority of the black population from land assets (DA, 2013). The legacy of dispossession and forced removal under colonialism and apartheid (Lahiff, 2001) now calls for the post-apartheid government to contend with issues surrounding land, where the state must mobilise resources to reverse the effects of displacement by previous land policies.

The current picture in South Africa is that of 13 million poverty-stricken black people remaining crowded in the homelands, where rights to land are unclear. There is an ongoing exodus of people from the rural areas into the cities. In the cities themselves, shack settlements are on the increase, and these are plagued with crime and a lack of basic services (Lahiff, 2001).

Land reform in South Africa has been pursued under a number of titles. The major objective relating to land, however, is to balance the demand for land in South Africa, ensuring economic development, food security and improved livelihoods. Measures have been put to resolution in the July 2011 ANC Lekgotla (lekgotla is a Setswana name meaning ‘public meeting’), and the string of related goals include the completion of a comprehensive rural development plan that should be supported with dedicated funding for social, economic, agricultural and non-agricultural infrastructure; the strengthening of funding and credit options from the Land Bank; the strengthening of skills development and the mobilisation of black people to attain increased participation in agriculture; and finalising the Expropriation Bill, which is in line with the Constitution (ANC, 2012).

3.4 Conclusion
Reflecting on the fifteen topics covered in the Venter (2005) model, the following areas emerge as political risks that require attention: socio-economic conditions, safety and
security (also known as law and order), labour policy and administrative (in)competence in
government.

The democratic dispensation of the ANC government has had to wrestle with the decision
of which method it will use to drive the country forward: either to employ growth strategies
that are profit-seeking in nature, or to employ redistribution strategies that focus on
redistributive and social equity practices. Coming from a period of apartheid policy,
expectations have been high regarding how the government will incorporate the majority
that was formally sidelined from participating in mainstream economic activity. The
development of various socio-economic policies, and the constant replacement and
recreation of others are evidence of the struggles of the ANC government to find the right
fit for the dynamics of the country.

The effect of this is the alarming growth rate in unemployment figures, with the hardest hit
being the youth, the same segment at the forefront of protest action. The South African
government has produced a large number of policies that intend to address unemployment
conditions. Unfortunately, these policies are either short-term in nature or are not directed
towards the younger and less-educated.

Moreover, while labour unions have grown in representation, their influence on the real
wage is unsettling. Demands of higher wages outstrip productivity. This mismatch between
higher wages and lower output has led to job cuts, and has been a stimulus for firms to
replace human capital with fixed capital (i.e. machinery and technology). Such ramifications
exacerbate what is known as the ‘triple threat’, making it even more arduous to bridge the
income inequality gap.

BEE was another of the policies formulated in order to incorporate and entrench black
business in South African society. BEE is a miscarriage for the greater population who had
hoped to feel its effects by way of greater representation in the economy. Instead, BEE is
responsible for the creation of a small black upper class and has been accused of being a
mechanism that has benefitted only those connected to the levers of power.

The same applies in local governments, where many regions are run by political
heavyweights who are in many instances unsuitable incumbents for their public office
positions. Municipalities have been exposed for mismanaging budgets, skills shortages and dubious acts of embezzlement. Failing municipalities have led to community protests becoming rife, and these are often characterised by vandalising public facilities and lawless behaviour as a response to inferior service. However, this is a double-edged sword, as these are the very same communities that do not pay for basic services, citing the unemployment problem.

Lawless conduct is not confined to public demonstrations, but has found a comfortable place in business and government structures. This is in the form of anti-competitive collusion and large-scale fraud. Most of the corruption emanates from government in the form of corruption and abuse of power. What is worrying is the sophistication of these crimes and the number of bodies that are available to respond to them. On many occasions, cases are dealt with lightly or swept under the carpet.

South Africa can nonetheless be congratulated for the strides that it has made in the rest of the areas of political risk. Through its liberation South Africa has made itself accountable to its people and to its greater continental neighbours in the development of a robust foreign policy environment. The country is governed by its Constitution, which lays its foundations on the promotion of democratic values and strength in diversity. South Africans further enjoy the benefits of an active civil society and a kind of stability that coexists with an apolitical military force. Though the ruling ANC party has hegemonic power, this dominance is acquired though an unfettered and uncorrupted electoral system that is open to all adult South African citizens.

Despite difficult global conditions, South Africa has been mapped as the economic gateway to the rest of Africa. This is due to the country’s stable structures (judicial and financial), its developed infrastructure and its extensive membership to worldwide regulatory organisations. These characteristics further position South Africa favourably in terms of attracting FDI. Despite the existence of public debates on issues of nationalising key industries, the ANC government has made decisive statements to assure investors that such notions do not form part of any strategic plans of governance.
The utility of the Venter (2005) political risk analysis model is in its ability to capture the general conditions that make up South Africa’s environment. Several political risk analysis models have been developed, as has been explained earlier in the study. However, the uniqueness of the Venter (2005) model is in its ability to offer coverage and include distinctively South African contextual insights and political risk events (for instance, BEE), and greater intuition on unrecognised and nuanced information relating to the state.

Based on the above country review analyses, South Africa’s political risk profile can be best described as being in a medium category.

With continual efforts towards minimising the high political risk areas, there is no doubt that South Africa can expect better conditions upon which the nation can continue to thrive.

Next will be a discussion on the African Peer Review Mechanism (ARPM). The APRM is one of Africa’s most innovative governance assessment instruments, used throughout the continent to review African countries. The APRM has completed reviews in many parts of Africa, including South Africa. These reviews provide critical information and recommendations on the governance and political challenges faced by African states.
Chapter 4: The APRM

4.1 Introduction

The following chapter highlights four of the most urgent political risks identified in South Africa that dominate political and investor dialogue when it comes to decisions regarding FDI.

Despite not being a political risk analysis model per se, the study turns its attention to the African Peer Review Mechanism (APRM), Africa’s most influential home-grown, world-acclaimed self-appraisal mechanism. The APRM provides descriptive analysis and contextual depth to political risk analysis in South Africa. Furthermore, some of the missions adopted by the APRM are emblematic of the core traits of a political risk analysis model. The research draws insight from what is a comprehensive, extensively consultative and sophisticated document whose ambitions are both lofty and noble. Like the Venter (2005) model, it has been developed locally, and as a result, includes elements to which other models do not necessarily accord priority.

The APRM was created by former heads of state, notably South African President Thabo Mbeki, and Nigerian President Olusegun Obasanjo. The APRM is designed to encourage African governments to benchmark their governance, drive and take ownership of their success and be accountable in areas that stifle economic growth. It is a transparent appraisal method put forward for African economies so that, among other goals, they can become self-reliant and accelerate their socio-economic development.

Part of this research is articulating political risk in terms of FDI, and this correlates strongly with the ambit of the APRM document. A part of crafting the APRM system was the recognition that Africa needs to strengthen its investment component in order to participate meaningfully in global FDI. The unfavourable investment climate in many African countries is a consequence of poor governance; weak legal systems; a lack of transparency in government departments; institutional failures; macroeconomic policy imperfections; inadequate infrastructure; corruption and bureaucratic red tape. These factors have made it difficult for the continent to attract considerable foreign capital. Foreign capital is a means through which countries can mobilise sustained levels of domestic private investment to
attain the levels of growth necessary for massive job creation and poverty reduction. The APRM serves as a way to assist African countries to put into place strategic planning and foresight with respect to systems of exploitation.

This chapter provides a discussion of the emergence and creation of the APRM. This entails an explanation of the rationale and purpose of the APRM, an outline of the steps entailed in conducting a country review, and a depiction of how South Africa has fared. South Africa submitted itself to the APRM process in 2003, and in 2006 an appraisal of the country was performed. Focus will be placed on four thematic areas: democracy and political governance, economic governance and management, corporate governance, and socio-economic development. A conclusion is set out to summarise the findings of the APRM.

4.2 Formation of the APRM

The origins of the APRM can be traced back to discussions about the Millennium Development Goals (MDGs) at the international level, and parallel discussions within Africa on what eventually became known as NEPAD (Bing-Pappoe, 2010:3). NEPAD’s governance instrument, the APRM, supports the vision of former South African President Thabo Mbeki’s ‘African Renaissance’ doctrine, which stresses the centrality of development through integration, regionalism, sovereignty, political stability and self-determination that is based on economic development and cultural, political and social regeneration. It also upholds the aims of former Nigerian President Olusegun Obasanjo’s Conference for Stability, Security, Development, and Co-operation, for Africa (CSSDCA), as it places governance at the forefront of the developmental agenda of Africa (Jacques & Lesetedi, 2005).

The primary purpose of NEPAD was to twofold: to craft a new structure for relations between Africa and Africans, and secondly, to structure new relations between Africa and the rich countries of the world. This structure would promote an Africa free of poverty, integrate Africa into the world economy, prioritise the empowerment of women and create a solid pathway to sustainable development (Bing-Pappoe, 2010:3). In order to make
NEPAD and its projects a success, an estimated $64 billion each year would be required (Bing-Pappoe, 2010:3). The ideas of NEPAD were solidified in the African Union’s Declaration on Democracy, Political, Economic and Corporate Governance, which was signed in 2002 by African leaders. The conduit for these ideas was to be the APRM (Bing-Pappoe, 2010:3).

4.3 Purpose and Landscape

Although the APRM is an independent operational mechanism, it is a brainchild of NEPAD, with its objective to verify and ensure the adoption of certain recommendations essential to the promotion and achievement of the overall objective of NEPAD. The APRM is the voluntary compliance and mutual learning mechanism of NEPAD, and is available to all member states of the AU who wish to participate in the review process. According to the APRM base document, its primary purpose is to ‘foster the adoption of policies, standards and practices that lead to political stability, high economic growth, sustainable development and accelerated sub-regional and continental economic integration through sharing of experiences and reinforcement of successful and best practice, including identifying deficiencies and assessing the needs for capacity building’ (Verwey, 2005:7).

The time of the development of NEPAD was to represent a resurgence in thinking that promoted on-going momentum and determination in African politics and development, and this led to the development of a self-owned system of appraisal with the broad objective to promote accountable and sustainable African economies (UNECA, 2010:11). The formation of the APRM therefore became a revolutionary African innovation and was arguably critical to the promotion of the ‘African Renaissance’ – a political, economic and cultural renewal of Africa and good governance – in order to attract FDI. The APRM was especially important because it was home-grown and internally driven, propelled by African people who wanted democracy and development, with progressive intellectuals playing a very important part in it. A further encouraging aspect of the APRM was that African countries were opening their borders and their books to enable other Africans, in a frank and non-intimidating way, to review their governance practices in the four APRM thematic areas (UNECA, 2010:12). These areas are: democracy and good political governance,
economic governance and management, corporate governance and socio-economic development (NEPAD, 2011).

4.4 APRM Values and Principles

The APRM is crafted to be a tool that promotes domestic accountability in governance systems, thereby replacing external accountability to the donor community. In light of this mission, new spaces for citizen participation in public affairs have been crucial. It is thought that active citizenry will foster a better understanding of democracy and greater awareness of the political issues at stake, and will prevent democratic reversals. For this to be fulfilled, the appropriate human, material and managerial capacities will be required (UNECA, 2010:12).

A major potential contribution of the APRM to national, regional and continental politics was its serving as an early-warning mechanism to avert national crises and their ripple effects in neighbouring countries. This was illustrated by the 2007 general elections crisis in Kenya and the outbursts of xenophobic attacks on non-national Africans in South Africa (UNECA, 2010:12).

While the APRM is an instrument to which African member states sign up voluntarily, participating countries also necessarily commit to complying with the principles, priorities and objectives of the AU Constitutive Act and other decisions of the AU and NEPAD. In their submission to the programme, countries further subscribe to the principles of the APRM, as it promotes democracy and good governance as ‘hot political issues’. South Africa is firm in the view that the APRM should make a link between governance, democracy, peace and security and development. African member states should comply with the APRM’s provisions, and all African states should ideally sign up to the APRM. Even though the APRM is a voluntary mechanism, as of January 2013, 35 countries have signed up, which represents more than 50% of AU members, showing that the APRM has attained a significant degree of support among African countries (Landsberg, 2009:13).

The questions then arise: what motivates countries to subscribe to the APRM? How do these countries stand to benefit? Two broad incentives can be distinguished. Firstly, where
reviewed countries demonstrate a will to address their governance and developmental shortcomings, it will be ‘incumbent upon participating governments to provide what assistance they can, as well as to urge donor governments and agencies to also come to the assistance of the country reviewed’ (UNECA, 2010:12). In other words, participation in the APRM positions respective countries to obtain technical and financial developmental assistance. The second benefit in complying with the APRM is its potential use as an evaluative device. This will inform prospective foreign investors of preferred investment and aid destinations, as they may not otherwise have sufficient information to distinguish between African countries and can consequently lump them all into the ‘high-risk’ category.

Both incentives suggest that the APRM assumes authority in terms of its legitimacy in the perceptions of African and international leaders and governments. Since participating countries send a strong message of their commitment to improving their governance environment, it is crucial, as suggested in the base document, for reviews to be ‘technically competent, credible and free of political manipulation’ (Verwey, 2005:9).

4.5 Implementation of the APRM

Once member countries have demonstrated interest in participating in the APRM by means of signing a Memorandum of Understanding with the continental APRM authorities, visits by the Country Review Team are arranged. These visits are intended to secure the widest possible range of consultations with the government, officials, political parties, parliamentarians and representatives of civil society organisations, including the media, academia, trade unions, business and professional bodies (Verwey, 2005:10). These visits are designed to diagnose deficiencies, propose solutions, share best practices and follow recommendations made by the APRM Panel of Eminent Persons, also known as the African Peer Review Panel (SAIIA, 2011:11).

The next step involves gathering information and documentation on the performance of the government and other stakeholders in key areas. Managing this process and gathering relevant data is the role of the APRM National Governing Council (NGC). This arm of the APRM is tasked with appointing Technical Research Institutes (TRIs), whose mission is to
carry out the technical aspects of the review (SAIIA, 2011:11). Furthermore, the APRM questionnaire is a tool that is assembled in order to determine the country’s performance in the four thematic areas of democracy and governance, socio-economic development, corporate governance and economic governance. These information-gathering methods could be regarded as tools for political risk analysis. The success of this stage relies on the openness of various parts of the society, namely civil society groups, religious institutions, labour and business groups, as well as the government, in answering a wide range of questions (SAIIA, 2011:11).

The results of this review will constitute the Country Self-Assessment Report (CSAR), which is drafted by the NGC and TRIs. The CSAR includes a National Programme of Action (NPoA), which sets out plans to address the problems identified in the peer review, and therefore in political risk. Once the CSAR is completed, the delegation of the Country Review Mission, which is made up of scholars and experts, will conduct an independent study of the country and produce their own report. They are led by a member of the APRM Panel of Eminent Persons, which is a small body of highly respected Africans who are responsible for managing the APRM process across the continent (SAIIA, 2011:11).

The Panel and its Secretariat submit a draft Country Review Report (CRR) to the country for comment. Recommendations are made to the participating country and the country is expected to amend its NPoA accordingly. A final CRR is then produced and presented to the Forum of the Heads of State for discussion and peer review (SAIIA, 2011:11). Following the Forum’s review, the country must agree to address the various problems that have been found. Other states undertake to assist the country in its efforts, and to take action should the country not attempt to address the highlighted issues (SAIIA 2011:11). Finally, the country must report annually on its progress in implementing the NPoA and prepare itself for subsequent reviews (SAIIA, 2011:11).

Having outlined the formation and processes of the APRM, the chapter will now turn its focus to the performance of the APRM as an indigenous approach to political risk analysis by considering South Africa’s APRM country reports.
4.6 Review of South Africa

South Africa, one of Africa’s largest economies, has attracted considerable FDI and is itself a significant investor on the continent. South Africa voluntarily submitted itself to the APRM process in March 2003 in Abuja, Nigeria. The Country Review Mission was conducted in 2006, and was followed by peer review in Accra, Ghana in 2007, under the leadership of Thabo Mbeki.

The Country Review Report is based on a substantial questionnaire and is generally a lengthy document of just under 400 pages. The thesis will focus on the APRM’s findings on the four thematic areas, namely: democracy and political governance, economic governance and management, corporate governance and socio-economic development.

4.6.1 Democracy and political governance

The 2007 APRM country report for South Africa expressed the impending danger relating to the competition among the citizenry for state resources and the disturbing rate of ex-combatants who are trapped in poverty, coupled with socio-economic inequalities, which are all sources of social conflict. South Africa suffers from high levels of crime and violence, and this is expressed in persistent acts of violence against women, much of which are underreported. This trend undermines the significant effort that has been made by the South African government in promoting the rights of women.

Adequate and enforceable legislation is also absent in cases of corruption and money laundering, owing to capacity constraints. It is cautioned that the act of political floor crossing to opposition parties is an additional factor that can potentially undermine democracy and good governance. A recommendation is made for the ruling government to put the necessary measures in place that will cultivate citizens’ upholding of democracy and political governance through a bottom-up decision-making process. Widespread violence, especially against women and children, coupled with corruption has the capacity to render South Africa a risky country, not only in terms of personal safety, but also for business and investment, particularly by foreigners. Inasmuch as there is no indication that these factors have impacted negatively on the country as an investment destination, there is no guarantee that this is indeed the case unless these challenges are addressed.
On the other hand, the South African legislature is commended for its inclusive nature, as witnessed in the establishment of what is called the House of Traditional Leaders. This is an initiative whereby national and provincial government members of parliament meet rural people to discuss matters that affect their daily lives (APRM, 2007:6 – 9).

4.6.2 Economic governance and management

The South African government is praised for attaining measurable progress in relative macroeconomic stability despite emerging from a past beset by economic sanctions. The country has escaped levels of absolute poverty as a result of widespread social services and grants. However, concerns are raised about South Africa’s failure to generate significant job creation. This condition intensifies the constraint of economic dualism – a sophisticated industrial economy existing beside an underdeveloped informal, low-productivity economy. There is also the concern of stiffened regional integration and trade protocols that favour and protect South African producers from competitors in some of the SADC countries.

The greatest calls for action in the Country Report are for robust efforts to redress the extreme income inequality gap, strengthen parliamentary oversight, and increase capacity and skills development in public finance management, particularly at provincial and municipal level (APRM, 2007:9 –12).

Other than creating poverty, wide economic inequalities also present a destabilising effect on South Africa’s democratic consolidation. Massive poverty in itself is bad, but the situation is accented by a condition where economic benefits in the post-apartheid period are seen to have disproportionately gone to a tiny group of black individuals who are well connected in business and politics. In view of political risk analysis, this sends a clear message that issues of social instability that could derive from poverty and inequality require special attention.

4.6.3 Corporate governance

Substantial progress can be claimed for South Africa in the area of corporate governance in its adoption of the principles of corporate governance designed by the Organisation of
Economic Cooperation and Development (OECD). A notable innovation is the compilation of the King I and King II Reports. These reports promote corporate integrity through their influence on legislative reforms, regulatory measures, Johannesburg Stock Exchange (JSE) listing requirements, banking sector regulations and the public sector. There are also drives by the government to bring legislation, regulation and accounting standards on par with international norms. Deficiencies are identified in the legislative framework in areas of shareholder activism and sufficient monitoring of companies by asset managers on behalf of minority shareholders. While platforms such as the Consumer Protection Act exist, there is a need for disclosure of material information that would assist investors to make informed decisions.

While labour laws have evolved to protect human and labour rights, instances of abuse in labour-intensive industries have been identified in the growing practice of hiring on a casual basis. BEE has raised the level of the black middle class, though not sufficiently, as the production side of the economy still lags behind demand. Further to this, BEE is unable to narrow the inequality gap. There is a recommendation for South Africa to consolidate some of its reporting obligations, as multiple compliance obligations may lead to enforcement difficulties (APRM, 2007:13 – 15).

### 4.6.4 Socio-economic development

South Africa’s country review describes a country in need of abundant government reforms that are aimed at wealth redistribution and raising living standards. The Report highlights that while policies have been crafted to satisfy this requirement, such as GEAR, there has been little success in job growth.

Social assistance has been the driving force behind poverty alleviation in South Africa, but it is unclear just how sustainable this mechanism is, as recipients continue to rise in number. Despite this, South Africa is applauded for almost completely independently financing its development expenditures, though this achievement can be reinforced by intensifying institutional and human capacity. Tremendous outcomes can be attributed to the ruling government, which has provided (at the time of the Report) approximately 2.4 million housing subsidies; 1.74 million housing units built for the poor; 3.5 million electrified homes;
access to improved water supply for 91 percent of the population; provision of basic sanitation to over 8.2 million people; nutrition programmes for underprivileged children; access to social assistance grants for over 10.5 million people; increases in primary and secondary school enrolment by 89 and 104 percent respectively; and a total of 1200 new clinics built. The majority of these deliveries have been through the 'indigent policy' that has allowed mass access to basic services within a short space of time (APRM, 2007:15 – 18).

South Africa’s social protection system is one of the most comprehensive in the world. It aims to, and in large measure has succeeded, in trying to mitigate the effects of poverty. This has increasingly been challenged by a small tax base caused by unemployment, and so the objective of the government must be to empower people to take care of themselves and their dependants through the provision of quality schooling and ensuring economic growth and development. In addition, concern is expressed that the provision of social grants has the potential to create a dependency syndrome and even denude people of their dignity, thus rendering its success its failure as well.

4.7 Conclusion

The APRM was meant to be Africa’s flagship self-appraisal process, by which African countries would volunteer to undergo review by a team of individuals on a range of issues within the wider spectrum of governance. The process is based on the understanding that good governance is the *sine qua non* for democratic tenets such as respect for the rule of law; respect for human rights; strong civil society; credible elections; blunting of vertical political association and mobilisation; and sound improvement in economic fortunes accompanied by rising living standards. The APRM came up against misconceptions from countries such as Kenya that volunteered to be peer reviewed, raising doubts about the commitment by these countries to good governance. In addition, APRM recommendations are often discarded, and there is a compliance mechanism lacking within the AU structures. It is argued that African countries are said to prefer advice by Western experts over APRM findings and recommendations, which goes against what was envisaged at the inception of the process. This is an indictment of these countries, and calls into question their dedication to resolving Africa’s challenges through home-grown mechanisms. It is partly
due to non-implementation of APRM recommendations that the continent is experiencing political upheavals related to third-term bids by heads of state, government steeped in neopatrimonial politics, controversial and violently disputed elections, the rise of extremist groups pandering to dangerous ideologies and even civil strife.

Nonetheless, the APRM is Africa’s self-made appraisal tool, with a mission to cultivate a culture of ownership of governance issues, to eradicate devastating human conditions such as poverty and war, and to position countries more favourably in attaining the spoils of global trade. Such a mechanism grows in relevance as the world shrinks in time and space, and as continental leveraging becomes the norm for economic advancement. The essence of the APRM is African countries taking accountability for their own success, and in a constructive way, obtaining appraisals and recommendations that will assist in mapping the way forward for participating states. It is created by Africans, for Africans.

The undertaking an APRM Country Review is an extensive and expensive exercise. A country review report is a sophisticated document that is constructed by a broad complement of experts in order to produce a world-class and thorough depiction of the country under evaluation. The APRM process goes above and beyond fulfilling the criterion of in-depth review in political risk enquiry. The APRM Country Review document, which is locally cultivated, investigates the origins and causes of political risk, providing a theoretical basis for levels of risk. Though it is not officially named a political risk analysis model, the characteristics of the APRM conform to the traits and purpose of a political risk analysis model. It is in-depth and highlights hazards and goes beyond description to provide solutions for a particular country.

The disadvantage in producing such a document is in the amount of effort and resources required to assemble it, making it unthinkable that a comprehensive document such as this could be produced on a regular basis. The nature of foreign direct investment, and the considerations that go with it, make it compulsory for information to be current and to reflect the contemporary context within which a potential investment will be made. While the APRM country review document is a valuable source of information, as it covers a spectrum of areas that make up a single country, in terms of foreign investment it can be found that certain sections of the review are dated.
South Africa's report, which was performed in 2007, projects a country that is still contending with the remnants of colonisation and apartheid, that has sown divisions and that has created a vastly unequal society. This, coupled with administrative failures, leads to social conflicts. While the country demonstrates macroeconomic stability, legal enforcement is missing. These conditions also emerge from the Venter (2005) model.

When countries agree to commence with the peer review process, they should be cautioned that while this practice is positive in light of maintaining momentum, measuring changes made in response to recommendations, and capturing changes in the country, it is subject to bias and political interference. In this regard, the participation of civil society, as stressed in the APRM document, is a key component that of upholding legitimacy.

As has been emphasised throughout the preceding chapters, political governance in all its forms is pivotal in evaluating political risk, which has implications for attracting foreign direct capital. The following chapter turns its focus to the impact these political risk models have had on foreign direct investment in South Africa.
Chapter 5: Political Risk Analysis and Foreign Direct Investment in South Africa

5.1 Introduction

While previous chapters have offered extensive explanations on political risk and how it has expressed itself in South Africa through the indigenous creations of the Venter (2005) model and the APRM Country Review, it is important to understand its relevance to FDI. The flow of foreign direct investment in any economic environment is influenced by sound economic management, political stability and judicious laws, which, as indicated in previous chapters, form key elements of political risk analysis. The strategy of economic diplomacy advanced by the South African government of the mid-1990s was a sign that foreign investors would play a key role after a protracted period of economic isolation.

This chapter considers the role of FDI and the implications it has had for South Africa. FDI and globalisation are inextricable, and South Africa has been subject to the latter’s effects. Once global sanctions collapsed and trade and economic liberalisation was introduced, the field was opened for investors to seek opportunities in South Africa.

A definition of FDI is provided, which includes a detailed explanation of the eclectic model, which is the theoretical foundation of FDI theory. The model specifies what considerations are made in participating in the international market. Similarly, there will be a discussion on whether FDI has positive or negative effects, and whether it is an agent of growth.

The research suggests that FDI activity is generally beneficial. The past decade has experienced tremendous FDI into developing countries, and an increasing portion of the global share has been obtained by Africa. The following chapter will examine the proportion of FDI flows that South Africa has received, as well as highlight the periodic trends of FDI acquisition in the country. Some of the periodic trends in FDI activity in South Africa have been shaped by the country’s unique DNA. An understanding of these FDI movements can be used in conjunction with the information contained in the two models, namely that of Venter (2005) and the APRM. A conclusion will follow that will summarise the key findings.

5.2 FDI Definition
Foreign direct investment represents investment in domestic structures, equipment, organisations, and physical assets in the host country. FDI is considered to be a stable source of investment, since equity investments are ‘hot’ money that can be easily divested out of a country at the first sign of trouble. FDI is durable, and remains in the country during good or bad cycles. (Lewis, 2000:100).

FDI is usually in the form of a factory or some other fixed object. This therefore makes it very illiquid, and thus a long-term investment. FDI is made up of three components, namely equity capital, reinvested earnings and other capital (Leshoro, 2014:233). FDI is a unique, safe type of investment that can raise the growth of a developing country – according to the World Bank, ‘There is empirical evidence to suggest that a dollar of FDI raises the sum of domestic and foreign investment by more than a dollar’. This suggests that FDI complements rather than replaces domestic investment (Lewis, 2000:100).

FDI constitutes a resource flow that can be useful for the economic progress of developing countries, especially for their industrial development path. FDI provides a combination of long-term finance, technology, training, know-how, managerial expertise and marketing experience (Bende-Nabende, 2002:9).

Investors who look for increased returns and aim to diversify risk have enlarged their investment interest in developing countries. Although investments in the economies of developing countries have increased, much of the capital is in the form of portfolio capital and bank-trade-related lending, which has a high degree of volatility and is subject to massive inflows or outflows resulting from speculative shocks. These types of investments are easily moved from one state to another in order to maximise profits and diversify investment packages. Because these forms of investment are highly volatile and liquid, they are also subject to investor ‘herding’ behaviour, where the reaction of a small group of investors can trigger a race to pull out investment. Even though the choice of an investor to reallocate money may be completely speculative and unfounded on underlying economic principles, it can be devastating to developing countries, leading to a state of economic chaos and social turmoil depending on how much the economy relies on the growth of financial instruments in these markets (Lewis, 2000:99).
South Africa has attracted high volumes of foreign portfolio investment in the form of long-term equity inflows. The value of South African equity securities held by foreign portfolio investors increased from 8 percent of GDP in 1995 to 31 percent in 2009. Data further indicates that the stock of foreign portfolio equity exceeds GDP (National Treasury, 2011:4). Despite portfolio investment representing a lesser commitment to the economy, this trend in South Africa can also be interpreted as representing a positive reflection of the size and sophistication of the local equity market and the maturity of the domestic corporate sector. Such development in the country’s banking and equity market is reported in both Venter (2005) and the APRM’s discussions.

While the principles of foreign portfolio equity investment and foreign direct investment are quite different, in practice the distinction between the two categories of investment may be less obvious. Ultimately, the difference between the two is in the motives of the investor. The motivation of portfolio equity investors is to participate in the earnings of local enterprises through capital gains and dividends, while foreign direct investors tend to be more interested in accessing markets and resources (Stocker, 2000:118).

Published data on FDI usually comprises three main categories:

1. Equity capital, which includes mergers, acquisitions and greenfield investment.
2. Reinvested earnings not distributed as dividends or remitted to the parent company.
3. Other capital that refers to short- or long-term borrowing and lending of funds between multinational corporations and local affiliates (Stocker, 2000:118).

According to Stocker (2000:118), statistics of FDI activity emanate from three sources, namely:

1. Records of ministries and agencies which administer the country’s laws and regulations on FDI. The request for a license or the fulfilment of notification requirements allows these agencies to record data on FDI flows.
2. FDI data is obtained from government and other surveys which evaluate financial and operating data of companies. The data obtained typically provides information
on sales (domestic and foreign), earnings, employment and the share of value added of foreign affiliates in domestic output.

3. The final source of data is the national balance of payments statistics.

Unlike the majority of countries in Africa, South Africa has reasonably reliable data. With the significant role that FDI plays in a country, it becomes vital for individual countries to position themselves favourably in order to attract it. This can be achieved by controlling political and economic variables, focusing on a country’s ‘pull’ factors, such as a stable currency, good infrastructure, secure property rights and so forth, making intelligent choices when it comes to policy and publicising the worthiness of the country (Lewis, 2000:101).

Generally, a potential investor will consider the following aspects when considering which country to invest in:

- Past and present economic stability (which plays a role in informing predictability);
- Current economic welfare and capacity (as seen in the consistency of exchange rates, which makes it easy for the investor to repatriate fractions of the FDI profit);
- Level of human capital (efficient and educated population to harbour its investment); and
5.3 Determinants of FDI

An investor’s decision to make an investment in a country can be expected when the firm anticipates profits to be positive, and when the firm believes that it possesses some special advantage in doing so.

The investor has the option to build a plant and produce locally. This is called ‘horizontal’ FDI, as it duplicates the production of the donor country in the host country. According to Chen (2000:7), horizontal FDI tends to be important in industries with five characteristics, namely: high research and development (R&D); intensive input of technical workers; a new or technically complex product; product differentiation and a high level of advertising.

Another form of FDI is when the firm sources out parts of the production chain to a foreign country in order to exploit efficiency gains from lower labour costs and an abundance of natural resources. After production, the goods will be exported from the host country, often back to the donor country. This is called ‘vertical’ FDI (Neuhaus, 2006:142).

We now turn our focus to a framework for analysing and explaining the determinants of international production and FDI behaviour.

5.4 The Eclectic Approach: a theoretical framework

Economic theory relating to the determinants of FDI can be based on what is called the OLI paradigm or the eclectic approach, which was shaped by John Dunning (1997,1981). The OLI model is the most comprehensive explanation of international production by providing a wide analytical framework for explaining the determinants of international production (Adjei, 2007:24).

With increasing competitive pressure on firms to sustain or increase profits in a globalising world, the eclectic paradigm claims that at any given moment of time, the extent and pattern of international production can be determined by a set of three factors, which are ownership-specific advantage, location-specific advantage and internalisation advantage. These are required to be present and satisfied if it is profitable for a firm to undertake foreign
direct investment instead of pursuing export, licensing or a joint venture (Neary, 2007:Internet).

The OLI model represents the different classes of factors explaining FDI: ownership advantages (O) address the question of why some firms go abroad, suggesting some firm-specific advantages would allow them to overcome the costs of operating in a foreign country. Locational advantages (L) address where the MNC chooses to locate itself, and finally, internationalisation advantages (I) influence how a firm chooses to operate in a foreign country, trading off the savings in transactions and holding up costs of a wholly owned subsidiary versus the advantages of other entry modes such as exports, licensing, or joint venture (Neary, 2007:Internet).

The model explains the components necessary in order to participate in international production, and answers how best to serve the international market. According to the model, a firm that has ownership advantages, but has no internalisation or location-specific advantages, will be better off contracting (licensing) its international production. Furthermore, a firm that has both ownership advantages and internalisation advantages should not find it profitable to establish a new subsidiary abroad if there are no advantages from being located in the particular country. In such instance it would be better to serve the foreign market(s) by exporting. The model suggests that only those firms that possess ownership, internalisation and location-specific advantages should serve the foreign market through foreign direct investment (Cleeve, 2009:237).

This suggests that key elements must be present in order to participate in international production. A trade-off between the different advantages is what will inform the method of international production that the foreign firm will engage in.

The eclectic paradigm basically concerns itself with the ‘production financed by FDI and undertaken by the MNC’ (Dunning, 2001:176) and it can be described in terms of the various advantages.
5.4.1 Ownership Advantages (O)

Ownership advantages are often called competitive or monopolistic advantages, and are advantages a specific firm has compared to other firms. The key idea of ownership advantages, according to Neary (2007: Internet), is that firms are a collection of assets and the MNC possesses a higher than average level of assets. These assets can be applied to production at different locations without reducing their effectiveness. Neuhaus (2006:142) elaborates in saying that ownership advantages derive from knowledge-based, firm-specific assets that constitute cost advantages and lead to market power. Examples are patents; trade secrets; trademarks; human capital and management expertise. In South Africa, an example of ownership advantage is Russia’s global energy supremacy, as it prepares to develop the country’s nuclear energy sector (Katusa, 2014: Internet).

5.4.2. Locational advantages (L)

Locational advantages refer to those that put the multinational ahead in the recipient country. Locational advantages are concerned with where to produce and refer to: market and market-related factors, economic and political factors, and factors related to openness and integration (Neuhaus, 2006:143).

Market and market-related factors include:

*The size and growth of the market*, which is typically measured as the host country’s GDP. In order to establish market size and growth, the value of aggregate production can be studied, as this reflects the total income of the economy and thus the maximum amount that can be spent on consumer and investment products. One can also study the market potential of a country by taking into account the market size of the potential host country’s neighbouring countries, and the accessibility of these neighbouring countries. This reflects the total market volume that can be served through a local production plant. Understandably, the larger the market size, the larger the potential consumer base, the larger the expected profits. This can also lead to a situation where the MNC establishes economies of scale, reducing the fixed costs of the investment. The MNC will also consider the size and growth of future market potential pertaining to the long-run foreign investment (Neuhaus, 2006:143). Moolman et al (2006:8) add that a positive coefficient between
market size and FDI is further magnified if the foreign investor entrenches itself in the local market instead of exporting the produced goods. South Africa’s population of over 50 million people is considered a small populace, and further displays a high incidence of poverty, especially among its black majority, with an unequal distribution of income. Market-oriented FDI is therefore not a significant feature of South Africa’s FDI pattern (Adjei, 2007:102).

*Market entry barriers and market structure*, which mostly relate to entry barriers or impediments, known as ‘spatial market failures’ that may have a bearing on the location of the FDI. Examples of market entry barriers and structures are competition, the level of fixed costs associated with the investment, and restrictions on FDI such as capital controls, limitations to profit repatriations (Neuhaus, 2006:144).

*Market distance*, which has to do with answering the question of whether a FDI or trade will be better in light of the distance between the two localities (the host country and the donor country). According to what are called ‘gravity models’, trade flows between two countries depend negatively on distance. This is mainly due to increasing transport costs, which may result in the export of goods and services becoming less attractive than setting up a local production facility. However, the benefit of substituting FDI with export with increasing distance only applies for horizontal FDI and not for vertical FDI. This is because the purpose of vertical FDI is not to serve the local market, but rather to exploit efficiency gains from the host country, and after production, the final or the intermediate good will generally be exported to the donor country (Neuhaus, 2006:145).

*Input costs*, which comprise costs for labour, energy and raw materials. The abundance and costs of natural resources will matter especially for resource-seeking investments, while the abundance and costs of labour will matter especially for efficiency-seeking investments. In labour-intensive or efficiency-seeking investments, it is not only the wage level that matters, but also the productivity of the labour force and the capability of the labour force to adapt to new technologies (Neuhaus, 2006:145). Notably, South Africa’s labour regime is perceived as inflexible, over-regulated and cumbersome, often making it difficult to lay off incompetent workers. The real wage rate outperforms production, and a largely unskilled labour force creates a challenge to the adoption of new technologies. These characteristics pose a disincentive to foreign investment (Adjei, 2007:103).
In addition to market and market-related factors, economic and political factors consider macroeconomic stability and institutional and political stability:

*Macroeconomic stability* refers to economic growth, a low degree of inflation and exchange rate risk, low employment levels, as well as fiscal discipline and adequate reserve coverage. A stable macroeconomic environment lays the foundation for solid growth, which in turn raises the market potential, stabilises the economy and propels the country into a virtuous circle (Neuhaus, 2006:145). In extension to macroeconomic stability is the requirement for deeper financial markets. These enable the foreign firm to finance short and long-term capital needs, meet capital needs in the local market, and use debt instruments within a stable banking sector (Adrino, 2012:37). While South Africa has displayed sound macroeconomic and fiscal management, has re-established global economic links, and possesses a sophisticated financial system (JSE, 2009:2), Everett (2012:7) highlights the South African unemployment figures constituting 72 percent of the youth, a widening gap between the rich and poor, and GDP per capita that is far below that of the world’s wealthiest nations (see figure 4).

On the contrary, risks that emerge from a depreciation of the host country’s currency have a negative effect on FDI, as they reduce profits denominated in the host country’s currency. *Institutional and political stability* refers to a combination of factors that support FDI, such as market-supporting tax regimes in the form of moderate corporate taxes and no confiscatory taxation; strong legal regulations in the form of a transparent legal system, protection of property rights, repatriation of profits and law enforcement; low levels of corruption and high degrees of political freedom. Another desirable factor is a high degree of privatisation, as it symbolises support for private ownership and the establishment of corporate governance. The method of privatisation matters, however, and if it is in the form of direct sales with equal access to foreigners, this will send out a positive message for FDI. If, however, privatisation were done in a way that involved a sale to management and/or workers of a formerly state-owned enterprise, the same would not follow. Moolman *et al* (2006:9) state that a country’s debt burden will also inevitably be considered, as a high-risk state carries less favour for investment. A high-risk country is usually more likely to default on foreign debt, and could impose restrictions on the outflows of international capital.
Openness and integration refer to:

The optimal degree of openness and integration (otherwise called internationalisation), which will be reflected in the transaction costs of using the market and the organisational costs of running a firm.

5.4.3 Internationalisation advantages (I)

Internationalisation advantages are concerned with reasons why a firm would partake in FDI rather than license or franchise the foreign firm to use their patented assets (Stoian & Filippaios, 2007:5). It is generally accepted that the larger the firm, the greater the likelihood of internationalising the market is. A firm with high levels of R&D initiatives will be motivated to seek the internationalisation advantage. Highly technology-driven firms or industries enter foreign markets with the aim to recuperate their costly R&D, to prevent product obsolescence, and gain market share. FDI enables the firm to acquire new technologies. Increasing profitability and creating assets and structures that will aid in future expansion will also motivate the multinational to seek internationalisation advantages. Considering that the multinational is usually better placed to raise capital domestically and internationally, by virtue of this attribute, the firm is also more likely to seek international expansion. If the multinational has further advanced distribution channels, it will become easier to invest directly in the foreign region and engage in FDI activity (Stoian & Filippaios, 2007:9).

Over and above the factors mentioned above, Moolman et al (2006:10 – 12) highlight the luring effect a country’s well-constructed incentive policies can have, which in various ways support the relaxation of foreign investment regulations. These can range from exemptions from income tax, to implementing import tariffs that act as protection for the foreign firm, and may encourage further expansion in the domestic state. The same can be said for a country’s trade liberalisation policies, where a larger degree of trade openness opens a country to external markets and foreign capital. Lastly, the prevailing wage rate is also identified as an important determinant of FDI levels, as it governs how competitively a foreign firm can operate from one region to another. In this area, South Africa has been
notorious for its wage rates rising at a higher rate to production levels, as well as numerous strike actions.

Overall, the bulk of FDI in developing countries is motivated by market access, lower real cost advantages and the availability and price of natural resources. However, the local infrastructure and macroeconomic policy could be decisive in the location choice of foreign firms. Knowledge of a country or region is crucial in the location decisions of MNCs. Inadequate knowledge of a location can cause investors to underestimate opportunities and overestimate risks, pushing such locations to the sidelines of the location decision-making process. This is true for many Sub-Saharan African (SSA) countries. This further reinforces the crucial gap that is filled by local instruments that look beyond the superficial or topical areas of political risk, such as those of Venter (2005) and the APRM.

South Africa in particular has experienced that exporting and joint venture modes offer the best risk management options. They enable the MNC to minimise the costs associated with uncertainty or imperfect knowledge about the local policy and business environments, as well as about the product and factor markets (Bhaumik and Gelb, 2003: 4).

The desire of foreign investors to reduce risk exposure, as well as the government policy to promote BEE have made joint ventures (JVs) the most common mode of entry. A notable example of such transactions can be seen with Renault, the French automaker, forming a JV with Imperial Holdings Ltd., South Africa’s largest transport firm, to sell cars. Renault acquired 51 percent of the JV at a cost of $9.8 million. The JV operates 47 car dealerships in South Africa and has targeted an increase in market share from 4 to 7 percent in three years. Another notable example is the transaction that was recorded when the world’s largest marine salvage operator, the Tsavliris Salvage Group of Greece, formed a JV with black-owned Cape Diving & Salvage of South Africa (van Wyk, 2004).

5.5 FDI: a precursor for improved investment or a stumbling block for growth?

As the last decade has witnessed sharply increasing FDI flows, and various bubbles in financial markets, there has also been an increase in empirical studies that focus on the political risk and the FDI-growth nexus and the determinants of FDI inflows. However, in spite of the copious empirical literature, it is still open for debate what the link between
political risk analysis and FDI is, in terms of its overall contribution to growth. This is especially as in developing countries it has been found that despite several studies, researchers usually have to contend with poor, inaccurate or inadequate information.

Over and above this, there is also the argument that FDI is not a simple agent of growth and that it takes much more time for FDI to unfold its growth effect than is anticipated. Jacob, Umoh and Chuku (2012:54) state that early empirical works on the FDI-growth nexus modified the growth accounting method introduced by Solow (1957). This approach defined an augmented Solow model with technology, capital, labour, inward FDI and ancillary variables such as import and export volumes. Following this theory, most of the empirical works on the effects of FDI focused on their impacts on output and productivity, with special attention on the interaction of FDI with human capital and the level of technology.

According to Jacob et al (2012), recent empirical works, however, have been influenced by Mankiw’s (1992) pioneering research, which adds education to the standard growth equation as a proxy for human capital. Blomstrom (1994) and Coe (1997) found that for FDI to have positive impacts on growth, the host country must have attained a level of development that helps it to reap the benefits of higher productivity. In contrast, De Mello (1997) finds that the correlation between FDI and domestic investment is negative in developed countries.

Jacob et al (2012:55) continue to describe the findings of Li and Liu (2005), which purport for FDI impacting on growth directly and additionally indirectly through its interaction with human capital. Further, Li and Liu find a negative coefficient for FDI when it is regressed with the technology gap between the source and host economy using a large sample. Borensztein (1998, in Jacob et al, 2012:55) found a similar result – that is: inward FDI has positive effects on growth, with the strongest outcome expressed through the interaction between FDI and human capital.

De Mello (1997, in Jacob et al, 2012:55) found positive effects of FDI on economic growth in their study of both developing and developed countries, and summarises that the long-run growth in host countries is determined by the spillovers of knowledge and technology
from investing countries to host countries. Similarly, Balasubramanyam (1996, in Jacob, 2012:55) found support for their hypotheses that the growth effect of FDI is positive for export-promoting countries and potentially negative for import-substituting ones.

In their study Alfaro (2004) and Durham (2004, in Jacob et al, 2012:55) promote for FDI as a factor dependent on the strength of the domestic financial markets of the host country, and finding countries with well-developed banking and financial systems benefitting from FDI. Durham (2004) expands on this notion by purporting that only countries with strong institutional and investor-friendly legal environments are likely to benefit from FDI inflows. In another work, Hsiao and Shen (2003) add that a high level of urbanisation is also favourable to a positive impact of FDI on growth (Jacob et al, 2012:55).

Comparing evidence from developed and developing countries, Blonigen and Wang (2005) reject mixing wealthy and poor countries in FDI studies suggesting that the factors that affect FDI flows are different across the income groups. Interestingly, they find evidence of beneficial FDI only for developing countries and not for the developed ones, while they find the crowding-out effect of FDI on domestic investment to hold for the wealthy group of nations (Jacob et al, 2012:55).

Jacob et al (2012:56) also describe the recent findings of Vu and Noy (2009), who carry out a sectorial analysis of foreign direct investment and growth in developed countries. They focused on the sector-specific impacts of FDI on growth, finding that FDI has no statistically noticeable effect on economic growth through its interaction with labour. Moreover, they found that the effects seem to be very different across countries and economic sectors.

Carkovic and Levine (2005) argue that the positive results found in the empirical literature are due to biased estimation methodology. When they employed a different estimation technique – i.e. Arellano-Bond Generalised Moment of Methods (GMM) – they found no robust relationship between FDI inflows and domestic growth.

In line with the notion that there is an endogenous relationship between FDI and economic growth, Ruxanda and Muraru (2010, in Jacob et al, 2012: 56) investigated the relationship between FDI and economic growth in the Romanian economy, using simultaneous
equation models. They obtained evidence of the two-way connection between FDI and economic growth, demonstrating that incoming FDI stimulates economic growth and in turn, a higher GDP attracts FDI.

The reactions regarding the effects of FDI are mixed indeed, and according to Jacob et al. (2012:56), this is because the envisaged forward and backward linkages may not necessarily be there, and arguments that MNCs encourage increased productivity due to competition may not be true in practice. Additionally, the fact that MNCs tend to be located in high-productivity industries could force less productive firms to exit, suggesting a crowding out of domestic firms and possible contraction in total industry size and/or employment. However, this is a more rare event and FDI tends to be beneficial overall.

Further, as recently stated, the role of FDI in export promotion remains controversial and depends crucially on the motive for such investment. The consensus in the literature appears to be that FDI spillovers depend on the host country’s capacity to absorb the foreign technology and the type of investment climate. Finally, the relationship between FDI and growth is conditional upon the macroeconomic dispensation the country in question is passing through. This is to say that the extent to which FDI contributes to growth depends on the economic and social conditions, or put differently, the quality of the environment of the recipient country. In essence, the impact FDI has on the growth of any economy may be country- and period-specific, and in that respect country-related information would be best suited to capture that.
5.6 FDI Relating to Africa

While the past decade has experienced a dramatic increase in FDI to developing countries with it increasing from $24 billion (representing 24% of total FDI) in 1990 to $178 billion (representing 61% of total FDI) in 2000. While these conditions send positive indications for poor countries that do not have access to international capital markets, in reality, Africa, the poorest region, represents a very minimal share of this boom. As noted by Asiedu (2002:107), during the periods 1980 – 1989 and 1990 – 1998, FDI to Sub-Saharan Africa grew by only 59%, compared to an astronomical increase during the same period for Europe and Central Asia of 5,200% and 942% respectively. Further to that, Africa has a reputation for low income levels and low savings, and this becomes especially troubling as Africa has difficulty to attract FDI, which is another crucial component for development and is required in order to provide much-needed capital for investment. As stated by Bende-Nabende (2002:61), the continent tends to be associated with political turmoil, economic instability, disease and natural disasters.

Within the continent, the distribution of FDI flows is also uneven. For example, in the early 2000s, the major recipients of flows in the region were South Africa, Morocco, Nigeria, Angola and Algeria. These countries were responsible for more than half of the total inflows to the region. A new pattern has emerged where the main sources of FDI are also changing, shifting away from the OECD countries to emerging economies like South Africa, India, and China,. Emerging economies like India, Taiwan, Malaysia, and China, have developed into members of the top 10 sources of FDI into Africa. However, France, the UK, the Netherlands, South Africa, and the US still dominate FDI into Africa, accounting for more than 50% (Cleeve, 2009:235).

The primary sector, consisting of the mining and oil and gas sectors, remained the most important destination for FDI flows into the region, accounting for more than 50% of inflows from major investors to Africa over the late 1990s and early 2000s. Within the primary sector, oil and gas are the most important industries. Since 2000, there has been an growth in inflows into the tertiary (service) resulting in the attracting of more inflows than the primary sector. There is a growing body of evidence that indicates that, in recent years, the composition of flows is shifting away from countries with large oil and mineral reserves.
towards the industrial and service sectors, such as textiles, telecommunications and banking. This in itself means that the factors that determine FDI in the SSA region are also changing away from resource-seeking to efficiency-seeking (Cleeve, 2009:236).

Asiedu (2002:111) analyses the following traditional contributors of FDI promotion and discusses how they apply to the case of SSA:

1. Return on investment in the host country. Typically, FDI will go to countries that pay a higher return on capital. In a risky environment, higher return may not induce more investments, as the risk-adjusted return may be low, and so low that it may very well deter investment. Africa is perceived to be risky. Risk in Africa is mostly perceived to surround the uncertainty of government policy. In particular, the risk of policy reversal is regarded to be the gravest risk having an impact on FDI. This is because FDI is partially irreversible and irretrievable. Therefore, in the midst of excessive policy risk, higher returns may not be sufficient to compensate for the likelihood of a change in policy that may have an adverse effect on investment. This assumption resonates with the Venter/APRM analyses, affirming that the more a country is stable, the more likely it is to attract FDI.

2. Good infrastructure development. Such a condition increases the productivity of investments and therefore stimulates FDI flows. In the case of SSA, since most of the FDI flows are based on natural resources and extractive industries, infrastructure development is not as important, as many of these industries are located in remote areas. The dominant narrative, which expects FDI to be directed towards a stable, safe and secure environment, has been proven false. A good example would be Nigeria, which receives substantial amounts of FDI due to its oil reserves, despite its weak infrastructure.

3. Political risk that demonstrates the empirical relationship between political instability and FDI flows is unclear. Some experts have made a distinction between political instability (the probability of a change of government) and political violence (the sum of the frequency of political assignations, violent riots and politically motivated strikes), where the political instability variable is significant but the political violence
one is not. A nuanced approach such as in the Venter and APRM models demonstrates this difference. These models highlight the type of instability that is present, and depending on their definitions, this will inform whether an investment should be made or not. Interestingly, in Africa, certain African countries, Angola being one, ranked highly in FDI flows even though there is political instability. FDI to Angola relates to petroleum, where profits and the return after adjusting for risk are still substantial.

4. The openness of the host country, which highlights the measurement of the ratio of trade (imports + exports) in relation to GDP, portrays the level of FDI. This in turn demonstrates whether the investment is market seeking or export-oriented. When investments are market seeking, the foreign firm seeks to serve the local markets, and less openness may have a positive effect on FDI. The opposite effect would be true. Export-oriented investments thrive under an open economy, as the increased imperfections that accompany trade protection generally imply higher transaction costs in exporting. In the case of Africa, and its measure of openness to trade, it is found that while openness promotes FDI to SSA and non-SSA countries, SSA has received far less FDI than other regions because SSA is far less open than other regions. While African countries have introduced trade liberalisation as a mechanism to foster trade, this has been met with a subdued response due to a perception that this kind of reform is not credible, and that liberalisation may be transitory and subject to reversal with a government change (Corrigan, 2014:6). Both the Venter and APRM models assert that the criss-crossing of FDI is highly influenced by corporate governance, which provides a framework for business sustainability and value creation. This implies that countries that have fair legal and institutional frameworks will undoubtedly attract FDI.

5. SSA countries have on average received less FDI than other countries in other regions by virtue of their geographical location, and the negative effects on FDI of being an African country. Africa is perceived as being inherently risky by leading commercial risk-rating agencies. Due to the lack of knowledge about the countries in the continent, investment decisions are often not guided by country-specific
conditions, but rather based on inferences from the environment of neighbouring countries. Foreign investors have therefore had the imperfection of evaluating African countries to some extent as one big country. With the establishment of the APRM, with one of its objectives to present African countries individually according to their unique circumstances, investors are better equipped to evaluate each country based on reports on individual political, social, economic and corporate features.

5.7 Policies Aimed at Attracting FDI

A policy framework aimed at attracting FDI is not without its ambiguities, nor is it exempt from criticisms. This is because individual home policies towards multinational investment are not assigned to a single organ, but consist partially of foreign policy; trade policy; industrial policy; tax policy; social policy and many more domestic policies. The only way, according to Smekal and Sausgruber (2000:39), to distinguish between policies that target and are aimed at attracting FDI is to distinguish between those aimed at trade and sales, those promoting the attractiveness of the location and those enhancing the rate of technical progress.

In the Venter (2005) model, an illustration is made of the transition of the country from a phase of difficult trade due to embargoes from the global community, to a post-apartheid era where borders were removed to induce open trade, and South Africa was re-integrated into the global economy. The prominence of multinationals is generally an indication of the degree to which an economy opens to free trade. The opposite is also true. Countries wishing to attract FDI aimed at trade are better positioned when they have the support of long-standing and reliable trade relations, a positive attitude towards liberalisation and a good investment climate.

Policy instruments aimed at promoting the attractiveness of the location for inward investment reduce the costs of setup and production in foreign plants. This is also supported by the simplification of national regulations and authorisation procedures. In manufacturing industries, high social and environmental standards are a disadvantage, but
may have a positive effect on high-tech investments. Appealing policies also address labour market flexibility in order to attract labour-intensive production plants. MNCs are also particularly wary of tax policy instruments, especially in respect of policy continuity (Smekal & Sausgruber, 2000:39).

Policies enhancing the rate of technical progress should usually be examined to include the considerations and objectives of the society as a whole. Usually, an array of these sorts of policies exist in the form of training grants, technology-transfer support, subsidies and tax relief in high-growth and technology-intensive sectors, and attempts to attract technology clusters by means of financial support and public infrastructure (Smekal & Sausgruber, 2000:40).

It is also important to realise that with the close interaction between foreign investment and domestic institutions, the political process of a country can also act as an important anchor. Political stability, a consistent and future-orientated economic policy, openess, and a pro-investment climate all act to prolong and sustain the beneficial effects of FDI (Smekal & Sausgruber, 2000:41).

5.7.1 FDI in South Africa (pre 1994)

FDI played a critical role in South Africa’s early development, particularly in the extractive industries. Foreign mining companies gradually became South African companies through the first part of the 20th century, and later diversified into other sectors of the economy. The biggest contributions of FDI were by European, British and US companies, playing an important role in the development of secondary industries from the 1920s to the 1970s. Economic relations with South Africa were formally conditioned by the European Community (EC) code of conduct for European companies doing business in the country, as well as its US counterpart, the Sullivan Principles. The Canadians adopted a similar set of guidelines, all of which expected the companies involved in South Africa to promote particular socio-political ends. It was widely recognised that foreign investors were profiting immensely from the skewed political conditions of the time, often at the expense of the black majority and their cheap labour. It was shortly after this in the 1980s that a worldwide anti-apartheid consumer boycott targeted a host of these multinationals, beginning with
Barclays Bank, which witnessed a sharp decline in the student loan market share, declining from 27 to 15 percent under pressure from socially and ethically conscious clients (CUTS, 2003:11)

The 1980s saw an exodus of capital and disinvestments from the country, with many caving under the pressure of international sanctions, trade boycotts, global disinvestment campaigns and the withdrawal of loan funding to South Africa. It is estimated that 350 companies exited the country, while a few others remained.


5.7.2 FDI in South Africa (post-1994)

From the mid-1990s, sanctions were gradually lifted, until a fully democratic government led by the ANC assumed office in May 1994. Since then, the government has progressively introduced a number of FDI-friendly policies and removed a number of obstacles and barriers to business (CUTS, 2003:12).

Even though FDI has played a considerable role in the development of South Africa's economy, in more recent years FDI has remained at relatively low levels compared with other emerging market countries. It is generally agreed that foreign direct investment can act as a significant springboard for investment activities and greater economic development in South Africa.

Though it was replaced by AsgiSA (which includes the promotion of FDI, but for its role in raising living standards for the poor), the promotion of FDI was especially stressed by GEAR in 1996 and has been restated in official statements since then. FDI in South Africa is viewed as the instrument that will assist in ameliorating the low saving rates that are known to characterise the country (see figures 3 and 4). As it is, private investment has been limited by South Africa's low saving rates. The role of FDI is also reinforced by developments in the growth literature, such as those mentioned in earlier sections of the
paper. These theories stress the dependence of economic growth on the rate of technological progress, and the observation that FDI, by activating a flow of new technologies and management practices in host countries, can support a faster pace of economic growth. In addition, FDI represents a source of foreign exchange inflows that can help strengthen South Africa’s international reserves (Arvanitis, 2006:64).

Despite the numerous theories that stress the importance of FDI as a vehicle for economic growth, and the adoption by South Africa of these and similar views, in the last quarter of a century South Africa has attracted comparatively little foreign investment. Initially, this was mainly attributed to the political environment: the imposition of trade and financial sanctions in the mid-1980s, as stated earlier, the subsequent financial crisis, the tightening of capital controls, and the declaration of a moratorium on payments to external creditors, which effectively cut South Africa off from the international capital markets (Arvanitis, 2006:64).

During 1994 – 2002, FDI added modestly to capital formation in South Africa. As a percentage of GDP, South Africa receives about a half of the flows of Asian or Latin American countries. Much like the situation in the rest of Africa, South Africa attracts less FDI than its global peers and those countries with a non-investment credit rating.

The improvement of macroeconomic imbalances in the last several years has helped South Africa to acquire some of the FDI flows that have gone to emerging markets. South Africa comes in at 19 percent of GDP as at 2009 (figure 5), which can be compared to other countries with similar credit characteristics, such as China (44%) and India (40%). South Africa can be likened to countries such as Egypt, with FDI of 22% of GDP, Turkey (22%) and Brazil (19%) (MDG, 2012:8).

Domestic savings, at about 16.6 percent of GDP (as at 2013), has been inadequate to support significantly higher domestic investment rates. As a result, external capital is

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13 Domestic savings additionally protect a country from vulnerabilities that emerge as a result of being exposed to the global capital market (Leshoro, 2014:232). While domestic savings in South Africa are low, a case should be made for the patterns of saving that characterise household savings. Saving vehicles such as ‘stokvels’ are sometimes a unique way that individuals and groups save money. South Africa has approximately 350 000 saving stokvels, which have approximately 5.4 million members, generating an annual savings of approximately R25.4 billion. It is this unique pattern of saving that forms part of the country’s (nonetheless) low domestic savings pool (Leshoro, 2014:232).
required in order to supplement the domestic savings necessary for higher investment and growth (Arvanitis, 2006:64).

Reasons for the low savings rate, which has been cited as a cause of lower-than-expected FDI contributions to South Africa, include high levels of unemployment, the lack of skilled labour, socio-economic conditions (such as the prevalence of HIV/AIDS), administrative incompetence in government, the difficulty in securing work permits and the sometimes cumbersome labour legislations (Adrino, 2012:31).

Incidentally, the political risk analysis based on the Venter model and the APRM highlights the abovementioned shortfalls, which have affected current levels of FDI in the country.

Recent business reviews have additionally identified crime as the leading constraint on investment, followed by the cost of capital, labour regulations, and skills shortages. The concern about these factors is exhibited yet again when comparisons are being made between South Africa and its peers and the perceived costs to investing in the state Arvanitis (2006:73). The MNC or investor will usually place South Africa in a grouping with its comparable counterparts. An examination of the factors above is made in order to evaluate the country’s degree of infrastructure development, trade liberalisation, skills availability and potential market size.

In his article, Kransdorff (2010) makes an argument for South Africa’s lower foreign investment levels as a consequence of aspects of its corporate governance and an uncompetitive tax rate. Over and above what are described as tight-fisted fiscal incentives, South Africa has one of the highest nominal corporate tax rates among countries with similar FDI attractiveness. It comes in at 38 percent, which is 10 percent higher than the average rate (Kransdorff, 2010:74). Nevertheless, South Africa compensates in this area by adopting more competitive indirect tax incentives. This is true in the Industrial Development Zones (IDZs), where investors are exempt from excise duties, VAT and import duty on inputs used in the production of exports (Kransdorff, 2010:76).

The majority of the FDI that has taken place in South Africa has been in existing fixed assets. Cross-border mergers and acquisitions are increasingly prominent, accounting for more than 60 percent of the total. The restructuring and divestiture of state assets has been
an important tool to attract FDI (as witnessed by the sale of government shares in Telkom in 1997) (Arvanitis, 2006:67).

Notably, the European Union (EU) has been the largest investor, accounting for about 90 percent of total FDI inflows. Investment from the UK outperforms investment from all other countries and accounts for three-quarters of total FDI. The United States and Asian countries complete the list of investors in South Africa.

During the period of 2005, 2006 and 2007, the most notable investments to be made in South Africa came from the banking sector, with Barclay’s $3.1 billion purchase of a controlling stake of ABSA bank, as well as the Industrial and Commercial Bank of China’s $3.1 billion minority share purchase of Standard Bank. In addition, there was Vodafone’s share purchase in Vodacom, Nippon’s purchase of DiData (a large ICT company), and Walmart’s acquisition of Massmart (Wentworth, 2014: Internet).

The major FDI sectors have been mining, accounting for 33 percent (with the likes of AngloAmerican and ArcelorMittal leading the field in this area), finance accounting with 27 percent and retail/other services accounting for 11 percent (Wentworth, 2014: Internet).

While it is common practice for firms or governments to seek to attract foreign investment in order to meet their capital needs that may not be met by the domestic market, it is important to be aware of certain key elements when dealing with FDI. For instance, investment income receipts and payments during FDI dealings refer to income derived from FDI activity. These are calculated in the current account as net investment income. Net investment income for a country is the balance between income payments to foreign investors on their inward investments and income receipts to domestic investors on their outward offshore investments. The foreign investor is incentivised to make local investments based on the expected income earned. A point of concern should be highlighted here: an increase in investment income payments to multinational investors increases the current account deficit (figures 6 and 7), as it is an outflow that reduces the domestic capital resources available to the country. In the South African context, net investment income often represents the largest deficit in the current account balance. This has a potentially debilitating effect on a country’s economic position, especially during
phases of decreased economic activity, with an additional consequence of negative long-term effects of FDI on the balance of payments (Samuel, 2013:6 – 7).

Samuel (2013:16) recommends that a policy objective should maximise the number of re-investment instances in order to retain as much rent as possible on FDI in the domestic economy. This can be achieved by promoting various growth trajectories for the foreign firm, improving local skills, addressing some of the country’s socio-economic goals, and so forth.

Figure 3: GDP per capita in current and real prices (in thousands of rands)

Figure 3 depicts South Africa’s nominal GDP per capita and real GDP per capita. Moderate increases can be seen in income per capita. Improvements in per capita income then suffer the effects of the global recession of 2009, resulting in a slower growth in the domestic economy. Then the economy improves in 2011, surpassing levels last reached in 2008. A similar trend explains the pattern that is observed in figure 6 for gross savings (MDG, 2012:111).

Figure 4: Gross savings as a proportion of GDI
Figure 5: Investment share in GDP

Figure 5 depicts the level of investment in South Africa as a percentage of GDP. From the period of 2001 – 2008 there is a positive trend in investment in GDP of 14.8% to 23.1%. 2008 represents a period of economic slowdown caused by the global financial crisis, leading to a drop in investment to 21.6 in 2009, then 19% in 2011. This causes heightened government borrowing (known as public debt) as depicted in figure 6. Figure 6 further illustrates two phases: the first being a period during a boom, along with prudent fiscal policies. A second phase begins in 2008 during recession, with government debt increasing from 25.7% to 36.7% of GNI in response to a contraction in economic activity (MDG, 2012:111).
Figure 6: Public debt as a portion of GNI

Figure 7: Current account balances as a portion of GDP

In figure 7, South Africa experiences a current account surplus in 2002 of 0.8%, until a period of a rapid decline, then a plunge leading into the lowest level in 2008 of -7.2% of GDP. 2011 presents better prospects, as seen in a halving of the deficit to -3.4%. Figure 7 should be understood in conjunction with the preceding graphs (MDG, 2012:112).
5.8 Conclusion

Globalisation describes an unstoppable force that creates interconnecting regions, and presents a perfect platform for countries to trade openly, as borders become less visible. The exchange of various cultures or norms on the global level additionally raises the standard in competition and the need for compliance that is inherent in doing business.

Among the various pull factors required for FDI, South Africa performs poorly in the area of human capital, possessing a workforce with limited education. This area is a worrying form of political risk. While BEE has been accused of failing to produce the required trickle-down effect to the masses by absorbing the unemployment burden, in light of FDI it has assisted in reducing the amount of perceived risk, making it easier for foreign investors to participate in joint ventures.

Context is important when examining South Africa’s trajectory in FDI acquisition. Within the continent, South Africa can be praised for its above average acquisition of global market share, and this is due, among other factors, to its good infrastructure and world-class financial sector. For the past decade, the country enjoyed the status of being referred to as the African continent’s ‘economic gateway’, and today still benefits considerably from some of its favourable attributes. When placed on a global scale and compared to countries with similar dynamics, South Africa starts to appear a less favourable destination for foreign investment, as it displays political risk through a compromised labour policy, law and order, socio-economic conditions, administrative problems, corruption, incompetence, and the consequences these threats bring about. All these characteristics are highlighted in the indigenous models of Venter (2005) and the APRM.

These political risks form an integral part of FDI literature, as some of those indicators are considered before selecting a destination for investment. Because of this, it is little wonder that the country has acquired less of the global share than would be hoped.

South Africa’s unique history and the legacy of apartheid place the country under great pressure to ensure that systematic failures are redressed. While the government has launched wide-ranging industrial strategies to promote investment in an environment of macroeconomic stability, initiatives to address the skills shortage and bridging the gap
between the rich and poor are issues that will require continual effort, so that the majority poor can start to have meaningful participation in the domestic economy.
Chapter 6: The Future of Political Risk Analysis

6.1 Summary and Findings

The discipline of political risk analysis was once considered a ‘soft study’, offering limited contribution to issues of politics and economics. This thesis is testament to the need for a thorough and ongoing assessment of political risk analysis as an approach. The research picks up on the continuum created by the evaluation and evolution of political risk approaches by providing theoretical rigour and insightful analyses, using different approaches in the assessment of South Africa’s political risk. The research has sought to overcome weaknesses identified in commercial forecasting models, where the chosen variables are questionable, and retrospective accuracy in forecasting is implausible. The research carries on to suggest the significance of using indigenous methods of political risk analysis (which are offered by the Venter and APRM analyses) for the value that they have in the provision of domestic and contextual insights into country risk that are brought about by possessing local knowledge.

The uniqueness of the Venter (2005) framework is in its ability to offer coverage and include uniquely South African political risk events, such as BEE. Capturing this kind of variable is illustrative of a deeper nuanced understanding of the real impact of BEE, especially given the country’s past and present relationship with race. Venter (2005) builds on the assessment of Howell and Chaddick (1994), where weaknesses are highlighted in the three most commonly used political risk models, namely the EIU, BERI, and PRS approaches. Here, disparities are found in an exercise of comparing the projections made against actual losses accrued due to political risk events. Conclusions are then drawn to suggest that a better model for political risk analysis and improvement can be made by keeping some of the variables used in the models that generate predictive power for actual losses incurred. Venter (2005) draws on the identified strengths and weaknesses of these models in order to contribute an improved framework for political risk analysis. The Venter model further purports that it is possible to reveal ‘early warning signs’ for future risk on the basis of descriptive analysis.
The thesis additionally focuses on the APRM analysis framework. The APRM as a type of political risk analysis model differs from alternatives in that it has been developed as a consequence of the concerted effort, agreement and participation of African countries. The APRM is made up of a complement of Africans from academia, government and business, assigned with the task of extensive country review and analysis. The essence of the APRM is that of African countries taking accountability for their own success, and in a constructive way, to provide appraisals and recommendations based on a country review that will assist in mapping the way forward for participating states. South Africa is among the countries that have undergone a review.

The APRM country review document is a valuable source of information, as it covers a spectrum of areas that make up a single country’s environment. It is based on thematic areas also present within other models of political risk analysis, such as democracy and governance, socio-economic development, corporate governance and economic governance.

However, this study cautions that using the APRM country review document as a source of information in making foreign investment decisions may present the risk of dated information, depending on the period when the country review was produced, and the time at which it is consulted. This has been proven in the development of the research, as, despite similar outcomes being identified in the APRM and the Venter models, certain contents of the APRM country review document were excluded from the research as they were found to be inapplicable in current terms.

The APRM country review is not a static document, however, and continuity can be found in the NPoA, as it addresses highlighted areas of concern contained in the APRM Country Report. While this is so, a further recommendation is made by the researcher that due diligence must be applied in order to combat political interference or propaganda, therefore achieving an unfettered reflection of the country under evaluation.

The purpose of the Venter and APRM models is to report on the state of a country. Ultimately, the purpose of a single state is to reach equilibrium on issues of politics,
economics and human development. Though some states will be closer or farther to this objective than others, political risk arises as disequilibrium is threatened in these areas.

The significance of political risk analysis is that it is an instrument that merges the political, social and economic dimensions inherent in a country. The information obtained then forms part of the set of factors that an institution or a decision-making process will contemplate in view of making an investment. South Africa possesses medium political risk, and the reasons for the lower-than-required FDI in the country are cited in the appraisals of the Venter and the APRM models. This research distinguishes between global events that bring about economic recession and political risk events that discourage profit-seeking international firms from making investments in the host country. As part of the global network, the South African economy has suffered from economic downturns, such as those brought about by the sub-prime crisis, in the form of comparatively lower foreign investment – a global effect. These recessions should not be confused with those the thesis is most concerned about, which concern a loss in foreign earnings due to political risk events specific to a country.

Within the continent, South Africa continues to hold a prominent place in terms of FDI acquisition. This is due to the country’s stable structures, both judicial and financial, as well as its developed infrastructure and extensive membership to worldwide regulatory organisations. These characteristics further position South Africa favourably in terms of attracting FDI.

Reflecting on the 15 topics covered in the Venter (2005) model, and the four thematic areas covered by the APRM, the following areas show up as political risks that require attention: socio-economic conditions, safety and security, labour policy and administrative (in)competence in government.

These political risk threats can be explained as emerging when the democratic dispensation of the ANC government came into power and had to contend with the method it would use in order to drive the country forward. This choice involved either employing growth strategies that are profit-seeking in nature, or employing redistribution strategies that focus on redistributive and social equity practices. Coming from a period of apartheid
policy, expectations have been high in how the government will incorporate the majority that was formally sidelined from mainstream economic activity. The development of various socio-economic policies, and the constant replacement and recreation of others, is evidence of the struggles of the ANC government to find the right fit, in line with the dynamics of the country.

The effect of this is the alarming growth rate in unemployment figures, with the hardest hit being the youth, the same segment of the population that is at the forefront of protest action.

The South African government has produced a plethora of policies that intend to address the unemployment condition. Unfortunately, these policies are either short-term in nature or are not directed towards the youth and less educated. Because the country is largely unskilled, amid stringent labour laws, this has been identified as a barrier to doing business, inducing less FDI.

Fraud that emanates from government in the form of corruption and abuse of power has also emerged as a form of political risk. What is worrying is its sophistication and the number of bodies that are available to respond to these sorts of crimes. On many occasions, cases have dealt with lightly or swept under the carpet.

Through its liberation, South Africa has made itself accountable to its people and to its greater continental neighbours through the development of a robust foreign policy environment. The country is governed by the Constitution, which lays its foundation on the promotion of democratic values and strength in diversity. South Africans further enjoy the benefits of an active civil society and a kind of stability that coexists with an apolitical military force. Though the ruling ANC party has hegemonic power, this dominance is acquired though an unencumbered and uncorrupted electoral system that is open to all eligible South African citizens.

Political risk is indisputably vulnerable to the effects of globalisation. Globalisation forms an unstoppable force of interconnecting regions, where countries trade openly as borders become less visible. The exchange of various cultures or norms on this level additionally raises the standard of competition and the need for good business practices.
The effects of globalisation and intertwined global markets bring about the kind of complexities that may be best navigated by using instruments such as a local political risk analysis model. The analysis itself can be compared to a guidebook, one that provides middle ground for the host country (which is investment-seeking) and the multinational (which is profit-seeking). The research proves that an in-depth political risk analysis captures the mechanics and intricacies of a domestic environment – its legal framework, social codes, economic conditions and so forth. Based on the information provided, it is possible to draw conclusions on the likely impact the presiding conditions may have on FDI.

FDI is additionally magnified by the fluidity of globalisation. It is recognised that among the various pull factors required for FDI, South Africa performs poorly in the area of human capital and possesses an uneducated workforce. This area is a troubling form of political risk. While BEE has been accused of failing to produce the required ripple effect among the masses and absorbing the unemployment burden, it is welcomed when it comes to FDI, as it assists in reducing the amount of perceived risk, making it easier for foreign investors to participate in South African business.

When compared to the rest of Africa, South Africa is praised for its above average acquisition of global market share. South Africa is commonly referred to as the gateway to the rest of Africa. This is in spite of the fact that when the country is compared with countries of its own league, sharing similar dynamics, South Africa exemplifies a country that could still do more.

When a comparison is made between the pre-1994 and post-1994 period for FDI activity, the literature describes a block in FDI activity (in the former era) as a result of global condemnation over the skewed and unfair approach to human rights of the apartheid regime. The research mentions the approximately 350 multinational corporations that left the country as a result of such conditions. Such unanimous divestment action demonstrates the value that global economic community places on human rights.

A little over 20 years into democracy, South Africa's unique history and the legacy of apartheid still place the country under great pressure to ensure that the systematic failures of the past are redressed. While the government has launched wide-ranging industrial
strategies to promote investment in an environment of macroeconomic stability, initiatives to address the skills shortage, labour-related issues, safety and security, socio-economic conditions and administrative competency will require continual and substantial effort.

FDI is not a panacea for South Africa’s economic challenges. FDI, if it operates in a polity with weak institutions, predatory politics, an absence of the rule of law and a weak government, can cause more harm than good. In fact, FDI can easily cause political instability in such a political milieu owing to tax evasion, non-payment of royalties, patronage, corruption, repatriation of profits and even environmental degradation. FDI has to operate within a regulated political system; otherwise, it can exacerbate social, economic and political challenges such as poverty and socio-economic inequalities that could easily mutate into social unrest with destabilising consequences on the political situation of a country. Labour unrest in South Africa’s mining sector is indicative of the challenges that accompany FDI through multinationals.

6.2 Summary of Recommendations

The research sets out the following policy recommendations:

1. The Venter model is an adoption of other political risk assessment methods, and has been made versatile by including some of the features unique to the South African case (for instance, BEE). In the study’s discussion of both the pre- and post-apartheid periods of governance, it becomes clear that the benefits of global integration cannot be understated. The laws in South Africa whose aim was to ultimately to limit the economic, political, and educational opportunities of black South African citizens led to condemnation from international society. The refusal to recognise the homelands or the numerous segregatory laws mounted pressure on the South African government in the form of economic sanctions, exclusion from international organisations, and the divestment of foreign companies. This feature in South Africa’s history is demonstrative of the massive impact human rights had as a means of improving international relations with South Africa. Given the South African case, the researcher recommends the inclusion of ‘human rights’ as an
additional indicator of political risk in host economies. South Africa’s story clearly demonstrates that the state of human justice has the power to reverse prospects of FDI.

2. Particularly in Africa, several states experience exceptional wealth in natural resources. This blessing that has been bestowed on Africa has often been dubbed ‘the resource curse’, as the continent struggles to convert it into transformative economic and social benefits. Additionally, global economies are on high alert over environmental issues and countries’ energy sources as a part of plans to charter the future. A country’s natural resources and energy policy deserve to be included as an additional measurement of political risk. Maximising this aspect can unleash the full potential of the country’s natural capital and can further act as a mechanism that promotes accountable governance, once included in the Venter and APRM reports.

3. The researcher recommends that the same intensity seen during the formative stages of country review should be applied when compiling the APRM NPoA documents. Awareness is required, as these documents may be used for purposes of window-dressing and advancing government’s propaganda when left entirely in the hands of the country concerned.

4. Lastly, the research is in favour of local methods of investigating political risk, and in this has followed the Venter (2005) and the APRM models. These indigenous responses to political risk represent opportunities for further research, in the form of testing their durability and application in matters of political risk analysis.
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