

CHAPTER 1

INTRODUCTION

...Free markets embody no mechanism that is responsive to all the needs of the planet. Informed regulation is therefore essential to ensure sustainable development. Cleaver, Tony – Understanding the World Economy: Global issues shaping the future, 1997 p.23

1.1 Introduction

Public policy analysis is an important public management sub-discipline that provides the necessary tools for improving the levels of efficiency with which public institutions operate. In general terms, the analytical construct of the current thesis is grounded in public policy analysis and is based on gauging the effectiveness with which the South African government can deliver on its regulatory responsibilities whilst simultaneously giving priority to sustainable development objectives. More specifically, government must balance the need to regulate foreign direct investment with the need to attract much needed investment capital into the country.

Globalization refers to the trend-wise growth in the level of integration of economies and societies around the world (World Bank 2002:23). With the contemporary phenomenon of globalization taking its course, issues of poverty and development have found new perspectives from which analysis and the generation of workable resolutions are being created. Generally, globalization has been observed to have benefited some developing countries with rapid growth and prosperity, whilst simultaneously increasing inequality and environmental degradation in the poorest of countries. According to the World Bank (2002:85) the key to harnessing the benefits offered by globalization have less to do with open trade and investment policies but more to do with effective domestic policies and institutions in these and other areas (Cf. Paul and Garred December 2000:3-4). A very specific form in which globalization is taking place is through the foreign direct investment of multinational enterprises. Both, the benefits and the negative externalities associated with this type of investment in host countries is the general focus area of the current thesis.

Although big business (especially in the form of multinational enterprises) has much to contribute towards global economic advancement, a substantial proportion of the organizations that are in a position to operate monopolistically or as oligopolists also tend to operate internationally as multinational enterprises. This circumstance leads to a number of concerns with regards to regulating multinational enterprises least of which are the concern for the competitive effects on local economies as well as concerns over economic and political sovereignty.

Further, due to the fact that multinational enterprises are incorporated under the laws of one country whilst having the flexibility to establish subsidiary or branch operations in other countries, it will not always be possible to regulate, to the full

extent of the law, those multinational foreign businesses that choose to leave the jurisdictional boundaries of the host country.

A social problem exists or can be defined as done by Hoogerwerf (in Wittrock and Baehr (eds.) 1981:31) who states that “*a [social] problem exists if there is a discrepancy between a goal or some criterion and the perception of an existing or expected situation.*” In the case of multinational enterprise regulation therefore, in defining a problem, or assessing, or justifying policy it is necessary to start with a clear indication of the goals or expected benefits, if any, that the government intends to derive from its relationship with foreign multinational enterprises. Further, as Dunning (1993:566) has stated, “*the success of government policy towards ... inward direct investment depends upon the effectiveness of the administrative machinery set up to implement and monitor the policies decided upon.*” It follows then that it is not enough to espouse a general approach to foreign direct investment; but rather it is necessary to articulate the government’s policy formally and clearly within well defined organizational structures.

1.2 Point of Departure

The current study topic was motivated by the fact that other studies had neglected to address the issue of government policy concerning foreign direct investment and or multinational enterprise investment in South Africa. A preliminary database search (conducted in May 1999) of all registered research with the Human Sciences Research Council (HSRC) for all South African Universities showed that the topic of multinational enterprises in South Africa had scarcely been studied. By that date (May 1999) there were two other dissertations on multinational enterprises in South Africa. C.O. Howard 1993

(M.A. UCT) examines the Challenges of business and political risk faced by multinational enterprises considering investing in South Africa. R.V. Cohen 1979 (M.B.A. UCT) is also concerned with factors that influence the decisions of foreigners to invest in South Africa, and analyzes these factors to come up with methods of encouraging foreign investment into the country. Cohen's focus is on business management and making recommendations to South African entrepreneurs to engage multinational enterprises in licensing agreements and joint ventures.

The point of departure of the current study is to address and study the role of Government in controlling the entry and overseeing the activities of multinational enterprises in South Africa.

1.3 Problem Statement

Currently in the Republic of South Africa (RSA) there is no specific governmental body at any level of government that is charged with complete responsibility for policy-making and regulation of foreign direct investment in general and multinational enterprise investments in particular. As a result, foreign investment into the country is characterized by a lack of substantive policy, and what policy does exist in the current dispensation is highly fragmented across several departments, directorates and sub-directorates thus leading to high levels of inconsistent policy and low levels of coordination in the administration of such investments and projects. Thus, in light of the perceived effects of foreign direct investment upon the host country and given the size and scope of multinational enterprise business activity in South Africa, closer examination of government policy and administration applicable to these businesses is warranted.

1.4 Significance of the Study

The relevance of this study relates to the recognition of the importance of foreign capital investments to the local economy. In brief, the macro-economic implications associated with multinational enterprise investments are:

1. Employment creation;
2. Balance of payments effects;
3. Technology and skills transfer;
4. Competitive effects in the local economy;
5. Environmental damage and resource depletion.

Regarding employment creation, it may be argued that multinational enterprises enhance employment levels in the host country by increasing employment. However, this argument is countered by the possibility of job losses in less competitive domestic firms. With regard to the balance of payments considerations, a host country's balance may be improved by the inflow of new capital represented by a direct investment. While on the other hand, this initial gain may be offset by the long-term outflow of capital through repayment of loans and through dividend remittances. In the event that these outflows were to exceed the initial investment, then a net loss to the balance of payments would result. As to the question of technology and skills transfer, the case is often made that multinational enterprises can enhance a host economy through the transfer and dissemination of the advanced technology and managerial skills that they preeminently possess. This assertion, however, inflates the assumption of complete willingness on the part of the multinational enterprise to share its competitive advantages with local firms and workers as dictated by government policy.

In reference to competitive effects, it is often asserted that multinational enterprises will drive out local competition. However, the counter point is made that a multinational enterprise may buy many goods, services and supplies locally and thus may stimulate local entrepreneurship. Finally, environmental damage and resource depletion are most often seen as externalities associated with multinational enterprises as well as with misguided or weak regulation. The problem that makes this subject worthy of study is the apparent lack of administrative responsibility and control for the entry and activities of multinational enterprises in the Republic of South Africa (RSA).

1.5 The Hypothesis and Research Questions

Ho = There is a necessity to formalize a government administrative structure for policy setting and implementation of multinational enterprise regulations in South Africa.

Research Question 1: Is there a need for foreign direct investment policies that apply exclusively to multinational enterprises?

1.6 The Objectives

Given the important role that multinational enterprises play within a domestic economy, it becomes imperative then to go beyond merely describing their impact and influence. With this in mind, sequentially, the objectives of this study are:

- (a) to survey the literature on the theory of multinational enterprises as a backdrop against which an administrative structure for policy-making,

policy-implementation and control of multinational enterprises in South Africa may be designed, developed and/or proposed;

- (b) To examine the historical perspectives of South Africa's investment climate to highlight the crisis brought about by the trade sanctions and disinvestment campaigns against South Africa during the 1980s;
- (c) To examine the global foundations for establishing the regulation of multinational enterprises by considering the experiences of selected industrialized and developing countries;
- (d) To critically review the existing policy regime on foreign direct investment in South Africa including the rationalization of foreign direct investment policy structures thereof; and
- (e) To make policy recommendations on the desired government administrative structure for policy-setting and implementation on multinational enterprise regulation in South Africa.

1.7 Methodology

The methodological approach employed is essentially brought into existence by - and an abstraction of - the objectives defined for this study. Thus, although the subject concerning the economic implications of multinational enterprise operations in the host country is relevant to any discussion of these forms of business endeavor, the focus of this study is rather on the examination, design and development of the appropriate governmental policies and administrative structures for multinational enterprise regulation in the Republic of South Africa. The emphasis is on determining *how* and *where* policy should be formulated and implemented, as opposed to determining *what* the policy should be.

1.7.1 Research methods and research approach

The principal research method followed is based on surveying the academic literature on foreign direct investment to establish theoretical and practical principles and guidelines for resolving the pertinent policy and structural questions raised thereof. Although this approach is followed throughout the study, the second chapter – A Survey of the Theory of Multinational Enterprises – is dedicated toward this end. More specifically, chapter two seeks to identify the issues of relevance that must be considered prior to formulating, amending and implementing regulatory policy for foreign direct investment. Generally, these issues pertain to understanding the motivation for organizations to become multinational in their operations and the possible positive as well as negative effects of their activities that may occur within the host country.

The second research approach incorporated in the study is comparative policy analysis – which serves as a tool to guide policies and policy structures toward international best practices that may be adaptable to the uniquely South African context. Thirdly, empirical research is conducted by way of discovery and analysis of the currently existing implicit and explicit policy measures and policy structures in South Africa.

Fourthly, an empirical historical review and analysis of the issues and policies of foreign direct investment in South Africa is utilized to gain an understanding of how these have evolved over time as well as providing the contextual setting within which current policy measures can be holistically perceived. Finally, the nature of the study calls upon the active engagement and discourse in subjects spanning various academic disciplines and is focused mainly on the theory of

public policy processes as well as general administrative sciences and economic theory.

1.7.2 Target population

The target population under study is the majority foreign owned business enterprises operating in South Africa. Majority owned meaning that one person, or a group of persons who share a common interest, hold the controlling share of ownership (51% or more) in the enterprise.

1.7.3 Perceived constraints

The perceived constraints considered for the study are the following:

- (a) A complicating factor in studying today's multinationals is the fact that over time many multinational enterprises have combined or shared resources by way of mergers and acquisitions that categorization of a multinational enterprise as an organization with a specific home country of origin gains much complexity. However, the study focus is on host government policies and structures thus, the nationality of the multinational enterprises home country is rendered somewhat extraneous.
- (b) Classifying domestic firms that are in partnership with foreign interests as multinational foreign investors is also problematic. This situation can be addressed by focusing on the majority ownership of the business in question. Thus the study will define as foreign investors those businesses that are majority (51percent or more) foreign-owned.

1.8 Scope

Defining a multinational enterprise is complicated by the fact that there are varying degrees of involvement of foreign businesses into a host country's economy. As stated by Robock and Simmonds (1989:7) "the dividing line to mark the stage at which a company becomes multinational is difficult to determine". Thus it can be ascertained that cross border involvement of business enterprises runs the gamut from the low end of exporting, to intermediately establishing warehouses and marketing operations abroad and at the high end of the spectrum opening up manufacturing operations abroad.

In limiting the scope of the study to manageable proportions, the multinational enterprises dealt with here are those at the high end of the spectrum. That is those enterprises that maintain manufacturing and/or service operations within a host economy/country - such that the country in which the enterprise is incorporated is the home country and the overseas states where production, service provision, employment and sales takes place are the host countries.

The geographic coverage of the study topic is limited to the sovereign boundaries of the Republic of South Africa. Further the focus is on South African policy where South Africa is the host country of foreign direct investment. No significant attempt at coverage of South African policy in regulating it's own (or home) multinationals is undertaken.

The host country's political, social and economic environments within which the multinational enterprise operates set the frame of reference from which regulation and policies evolve. Further, the policy process does not take place instantaneously, but rather occurs incrementally. Thus, although the study's

temporal focus is on present and proposed future policy initiatives, historical events are discussed as they are philosophically influential to the current states of affairs and additionally serve to define future states as either possible or feasible.

Hierarchically, the study would gain marginally by leaving itself open to policy issues at all three spheres of government. However, the main focus is on national policy and national legislation as these are much more readily accessible than is the case at the sub-national levels of government.

1.9 Sequence of the presentation

Chapter 1, the Introduction of the dissertation identifies the problem to be addressed in the statement of the problem, proposes hypotheses and research questions to be explored in order to resolve the problem, identifies the methodological approach to be used and sets limitations on the scope of the study. Chapter 2 reviews the literature that is relevant to the study topic with the anticipation that later chapters will be made easier to contextualize as a result thereof. In chapter 2 examination is made of early as well as contemporary academic literature that informs policy on the regulation of multinational enterprises (MNEs). Much of the seminal literature was motivated by concerns over the market power that these corporations tend to possess.

Chapter 3 is entitled - Historical Perspective of South Africa's Investment Climate. This chapter aims to provide background and insight into the environments (political, economic and social) within which multinational enterprises operated in South Africa and examines how changes in these environments over time may have impacted on foreign investment decisions on

the part of multinational enterprises as well their impact on the evolvement of government policy in this area. Chapter 4, Global Foundations for Establishing a Need for the regulation of MNEs, critically examines a number of issues put forward in the literature that argue for a regulatory agenda for foreign investors. These issues are examined in the South African context. In chapter 5, entitled Critical Survey of Existing Policies on Foreign Direct Investment in South Africa, the evaluation of current policies and administrative structures relevant to the regulation of the foreign direct investment of multinational enterprises is conducted. The focus is on scanning, surveying and evaluating any existing, or emerging policies within the South African public sector that impacts on the activities of foreign multinational investors. This survey sets the bases upon which the next chapter (chapter 6) is founded to the extent that proposed changes in structure, or alternatively rationalization, can only be undertaken once the exact nature of the structures and the policies to be dealt with by those structures are made clear.

Chapter 6, Rationalization of Foreign Direct Investment Policy Structures in the South African Government, seeks to assess the scope for rationalization of those government structures identified in the previous chapter in terms of the normative principles of organization theory and cost-benefit analysis. In this regard, perceived shortcomings in the current administrative structural arrangements are identified in order that a more effective and efficient arrangement can be recommended in the final chapter, Chapter 7. Chapter 7, entitled Conclusion and Recommendations, highlights the most pertinent issues for consideration in attempting a restructuring exercise of foreign direct investment policy structures. Chapter 7 also formulates general conclusions and recommendations, and proposes issues for further study.

1.10 Key concepts and terms

(a) Multinational Enterprise - MNE

Of the many varied uses of the term multinational enterprises (MNEs), the term is used here to refer to enterprises that own (in whole or in part), control and manage production or service facilities outside the country in which they are based. Further, An MNE is classified here as a form of Foreign Direct Investment (FDI); FDI, however, is not limited to multinational enterprise investments, and also includes direct equity investment which normally results in little or no managerial control. Therefore, the term FDI can be (and is) used somewhat interchangeably with the term MNE as the latter is a subset of the former.

(b) Foreign Direct Investment - FDI

The usage of the term foreign direct investment in the context of the study shall refer to investments into a country made by foreign interests. These are capital investments (in terms of size and duration of commitment) and can occur as either physical or equity investments. Physical capital investments are investments in plant and equipment, as in the establishment or support of a multinational affiliate or subsidiary, and typically assume significant management control by the investors or parent company. In contrast, equity capital investments are investments in stock and/or bond ownership and consequently may or may not represent a controlling interest in the management of the investment (depending upon the size of the investment).

(c) Home Country

A precise definition of the term as it will be used in the study is that offered by Hoogvett and Puxtey (1987) in which they define a home country as " the country from which a foreign investment originates and where the parent company of a multinational corporation is domiciled".

(d) Host Country

The country in which business enterprises with foreign ownership and/or control are located.

(e) Monopoly

The term monopoly is used to refer to an organization that is the sole producer or supplier of a given good or service. This condition guarantees the organization excessive control over prices and supply of the good or service.

(f) Oligopoly

An oligopoly refers to the few large organizations competing in a given market against each other as well as against a larger number of small companies in that same market. This market characteristic tends to lead to monopolistic market conditions when the above-mentioned large organizations choose to collude with each other to control prices and supply rather than to engage each other in possibly destructive competition.

(g) Extraterritoriality

Under international law a country can normally only exercise its jurisdiction and sovereignty within its own territorial boundaries. However, exceptions to this international legal principle are referred to as cases of extraterritoriality and have been tested in cases of home country governments attempting to exercise control over business enterprises in another country on the basis that these enterprises are incorporated in, and contracted to uphold the laws of, the home country. This is an unresolved issue as many host countries also require foreign business enterprises to submit articles of incorporation in order to register to conduct business in the host country. Extraterritoriality has also been tested in cases of host governments attempting to hold foreign parent companies of subsidiaries liable for the acts of the subsidiary in the host country.