

An Analysis Foreign Direct Investments and Exports as a new ‘Growth Path’ for South Africa: Granger-causality Approach

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Abstract

From the 1996’s GEAR to the NDP: vision 2030 the need to attract more foreign investors and promote exports in pursuit of growth and job creation is recognized and emphasized on. Various scholars also subscribe to this notion, as they concede that foreign direct investments (FDIs) and exports are sources of growth, development and job creation for most emerging economies. It is therefore against this background that this paper analysed the impact of FDIs and exports on economic growth in South Africa for the period of 25 years, thus from 1990 to 2014. From the findings, it is evident that both FDIs and exports have a significant impact on economic growth in South Africa. The Granger-causality test confirmed the direction of causality that runs from both FDIs and exports to GDP growth. These results suggest that the attraction of more foreign investors and promotion of exports can lead to economic growth and creation of jobs in South Africa. However, the quest to attract more foreign investors requires both government and private sector to take measures to provide skills to the labour market so that they can be absorbed in foreign modern technologically advanced environment. The paper recommends trade unions to emphasize on reducing labour disputes, especially in mining sector. The government should also emphasise more on fighting corruption, as it can discourage foreign investors. More importantly, the attraction of foreign investors and promotion of exports should however not be seen as an end in itself, but also as a means of supporting other initiatives such as reducing inequalities and poverty.

Keywords: Foreign direct investments; exports; economic growth; job creation.

INTRODUCTION

It’s been over 20 years since the advent of democracy, yet South Africa continues to grapple with the triple challenges of unemployment, poverty and high inequality. Despite the progress made to address these challenges, the struggle against ‘jobless’ growth and poverty still continues. The rate of economic growth is growing at a slower pace than the much desired

5% annual growth. Instead of decreasing, the rate of unemployment has increased from 17% in 1994 to 26.4% in the first quarter of 2015 (Stats SA, 2015).

At a time when the country is faced with such challenges, a plan or a policy for sustainable growth, poverty reduction and job creation would be warmly welcomed. In this regard, Foreign Direct Investments (FDIs) and exports are considered amongst the most important sources for sustainable growth, development and job creation. A number of scholars also subscribe to this notion, as they maintain that the panacea for growth and job creation can be achieved through the attraction of foreign investors and increasing exports.

These include amongst others scholars such as Asiedu (2006); Rusike (2007); Xolani (2011); Mpanju (2012) and Fuhman (2013). These proponents of FDIs have noted and emphasised on the importance of attracting foreign investors to enhance growth of emerging economies via the transfer of technology and skills, supplementing domestic investment, job creation, improving domestic infrastructures and other positive externalities that comes with the foreign investors.

For instance, Xolani (2011) suggests that developing countries like South Africa should try as much as possible to create an environment that is conducive to attract foreign investors. Xolani, maintains that the attraction of more FDIs can benefit South Africa not only by supplementing domestic investments, but also in terms of employment creation, transfer of skills and increased domestic competition. Similarly, Fuhman (2013) also acknowledges the significance of attracting FDIs into South Africa. He argues that FDIs can assist the country to overcome scarcities of resources such as capital, entrepreneurship, access to foreign markets, technology transfer and innovation.

Most importantly, the need to promote exports and attract more foreign investors in South Africa, has been recognised by the broad macroeconomic policy framework such as 1996's Growth, Employment and Redistribution Strategy (GEAR) to the National Development Plan: vision 2030. These policies amongst others highlights the need for South Africa to promote exports and attract more foreign investments as prerequisites for growth and h=job creation. Hence, it is important that this paper seek to analyse the impact of FDIs and exports on the South African economic growth the period of 25 years, thus from 1990 to 2014. To this end, the paper attempts to answer the following question, does FDIs and exports translate to economic growth in South Africa?

Apart from section one which dealt with the introduction, the remainder of the paper is structured as follows; section two unfolds the question of whether FDIs and exports translate to economic growth. To answer this question, two hypotheses are discussed, thus FDI-led growth and exports-led growth hypotheses. Section three reveals the types of FDIs that South Africa need to attract. Section four outlines the methodology used in the paper. Lastly, section five draws the conclusion together with recommendations.

DOES FDIs AND EXPORTS TRANSLATE TO ECONOMIC GROWTH?

The question of whether FDIs and exports are the key factors to promote growth, development and employment in emerging economies has been the subject of debate for a number of scholars and policy makers over the past decades. This section discusses the two hypotheses that are believed to enhance growth, employment and development in most developing economies, thus FDI-led growth and Exports-led growth hypotheses.

FDI-led growth hypothesis

In support of FDI-led growth hypothesis, Denisia (2010) argues that FDIs can increase productivity and competitiveness in the host country. According to Denisia, encouraging more FDIs in the country can also increase GDP by increasing output produced, especially in the manufacturing sector which will help to increase exports. Nucu (2011) believes that FDI inflows can create new jobs and is capable of accessing modern technologies, resulting in positive effects on the balance of payments. In his study, Nucu further posits that FDI is also a catalyst for economic development in Central and Eastern European countries.

In addition, Liu, Wang, and Wei (2001) examined the causal relationship between foreign trade and FDI inflows to China from 19 countries during 1984 to 1998 through panel data analysis. Their results indicate that exports volume is affected by FDI inflows to China. Chaudhuri and Banerjee (2010) on the other hand, studied the impact of FDIs on agricultural land in developing economies using a Three-Sector General Equilibrium model with the simultaneous unemployment for both skilled and unskilled labor. The results ascertained that FDI in agriculture can increase the social welfare of the people in the host country.

Their study suggests that FDI can alleviate the unemployment problem in each type of labour. However, their results remain the subject of debate as to whether the focus on the agriculture, secondary, or services sector would lead to better economic growth and to reduce poverty in the developing country.

Vacaflares (2011) studied the effect of FDI on job creation for a group of Latin American countries for the period 1980 to 2006. Annual data was collected from 12 Latin American economies and the findings reveal that FDI has a positive and a significant effect on job creation in those 12 countries.

Similarly, Rusike (2007) posits that FDI contributes to employment in the local economies by directly adding new jobs and indirectly when local spending increases due to the purchases of goods and services by the new employees. According to Rusike (2007), all these in turn are expected to have positive multiplier effects on the host country's economy. Furthermore, FDI is also believed to be important especially for developing countries because these countries have much potential of human capital, but lack the technology and capital necessary for development and growth. FDI is therefore seen as a stimulus for capital accumulation and technology transfer in these economies.

Helpman and Kruman (1995), posit that there are many ways in which export-oriented FDI can help to enhance the host country's economy. In order to attract this type of investment and ensuring that it translates into development gains, they mentioned that the host country needs to find the most effective ways of making the choice of locations as well as the target segments conducive to the kind of export activities the host country aims to foster. Helpman and Kruman (1995) reiterates that export-oriented FDI can be an effective means of providing resources such as skills, training, technology, capital goods and intermediate inputs needed to exploit a country's existing comparative advantages.

Khan and Afia (1995) have a similar view with that of Helpman and Kruman (1995), however they also pointed out that expanding export is a means to a country's economic development, thus the promotion of export-oriented FDI should be an integral part of the overall development strategy. Moreover, Khan and Afia (1995) also mentioned that the attraction of FDI can help the host country in its efforts to raise exports in all kinds of industries by providing the missing elements that they need in order to compete and improve locally based skills.

Lall (2001) argues that the most prominent role played by export-oriented FDI in the exports of developing countries is in the manufacturing sector. In this sector, Lall maintains that foreign affiliates tend to be leaders in marketing. The direct effects occur when exporting firms establish backward linkages with local firms which then become indirect exporters. Moeti, (2005), however, emphasises that stable macroeconomic policies and political

environments are believed to be the key ingredients for attracting more foreign investors. The emphasis of providing incentives for foreign investors is also linked to the theoretical notion advanced by Moeti, (2005) who argues that governments should adopt friendly attitudes towards investors and provide incentives with efforts to attract the right type of FDI.

Though there are contradictory views in the literature regarding the question as to how and to what extent, FDIs affect economic growth, there is however an overwhelming support that FDIs positively affect economic growth because it contributes to capital accumulation, and the transfer of new technologies to the recipient country.

Export-Led growth Hypothesis

Developing countries around the world have been liberalizing their trade regimes and moving away from import-substitution investment regimes to export-promotion development policies (Mpanju, 2012). In light of these trends, much of the investment that has sought entry into developing countries in recent years has been investment oriented toward export markets. The flow of foreign investment into the host differs through the types and motives of foreign investment to invest in the host country.

According to Mpanju (2012), the basic idea of increasing exports is that it increases total factors of production because of its impact on economies of scale and other positive externalities such as transfer of technology, improving local skills of workers, managerial skills and productive capacity of the economy. Ramaphosa, (2013) believes that a stronger export sector also drives job creation. Increasing exports, particularly in manufacturing, may be crucial for the low-skilled job creation needed to substantially reduce high overall and youth unemployment. Exports are especially critical amid South Africa's widening current account deficit and the external vulnerability arising from its reliance on volatile capital flows to fund the deficit (Ramaphosa, 2013).

In addition, Giles and Williams (2001) agree that economic growth could lead to improved skills and technology, which in turn creates comparative advantage for the country that facilitates its exports, hence a growth-led export is also possible. Economic theory also predicts that countries gain from trade if they specialise and trade goods in which they have a comparative advantage. However, Rangasamy, (2009) argues that in many African countries, lack of sufficient manufactured exports is often seen as a major reason for the continent's lack of industrialisation resulting in low growth. Most of the studies with regard to export-led

growth found a positive relationship between exports and economic growth. Rangasamy (2009) used an Error Correction Model (ECM) and found a uni-directional Granger-causality from exports to GDP in South Africa.

Most importantly, recent government policies also call for the need to reignite the exports performance. The New Growth Path (NGP, 2011), the NDP: vision 2030 and the Industrial Policy Action Plan (IPAP) all identified exports growth as a priority to enhance growth in South Africa. These policies concede that the export engine is critical to reviving and strengthening economic growth and to develop a more diversified export base (SARB 2014).

The Department of Trade and Industry (DTI) reported that the South African export sectors are underperforming. The report suggests that South Africa have to improve on its export performance to achieve the targeted 6% per year of export growth. In Addition, the NDP also proposed that to increase employment and growth, South Africa should increase exports focusing on areas where it has comparative advantage. This include areas such mining, construction, agriculture, tourism and business services, (DTI, 2013).

In 2013, the United Nations Conference on Trade and Development (UNCTAD) published a report of regional sources of FDI in South Africa for the period 2001 to 2010. The analysis shows Europe as the largest source of FDI in South Africa, followed by America, Asia, Africa and Australia. Total inward FDI stock from Europe amounted to R4 758 177 million accounting for 84.2% of total inward FDI from all regions (UNCTAD, 2013).

In addition, the SARB (2014) noted that the success of exports in South Africa is not determined solely by trade-specific issues, such as tariffs and nontariff barriers, trade facilitation costs, and export promotion nor is it determined solely by the real exchange rate. Many causes shape firm and sector competitiveness, including deep, economy wide structural factors that impact how exports respond to real exchange rate movements.

However, unreliable power supply has become a key constraint to growth and competitiveness in South Africa. This is also noted by the State President, Jacob Zuma in his state of nation address that the impediments electricity supply has become the key constraints of the country's economic growth, (State of Nation Address, 2015). The President stressed that the government will move quickly to address the issues of electricity as it has negative repercussions on the economy.

From the discussion, FDI and exports seem to be interconnected. This is also noted by Nguyen, (2011) who stated that FDI and exports are related, however the relationship may be positive or negative depending on whether FDI is market seeking or efficiency seeking, hence he indicates that FDI and exports volume are complementary.

In South Africa, government spending usually accounts for the greater portion of the total investments, therefore attracting additional investments would assist and complement domestic spending by the government. Hence, the section below discusses some of the investments that South Africa should attract more.

THE TYPES OF INVESTMENTS THAT SOUTH AFRICA NEEDS

Apart from export-oriented FDI, other type investments such as market-development FDI and government-initiated FDI are briefly discussed. These are the type of investments that South Africa should attract more and revise its strategies with the view that the country will realise the positive externalities of attract foreign investors.

Export-oriented FDI

Export-oriented investment is described by Reuber (1993), as the type that reflects a wide range of consideration such as the desire to develop secondary and more diversified sources of supply by a way of obtaining lower-cost products to be used either as inputs or for sale elsewhere. He argues that this is due to comparative advantage associated with different parts of the production process and transportation costs.

The World Investment Report (WIR, 1999) advocates that this type of investment is made with the intention of the investor to improve its competitive at home or internationally by taking advantage of the lower cost of production that the country offers. Helpman and Kruman (1995) argue that export-oriented FDI are geared towards the production of component part. After production, the component are normally exported to a central location or to a country other than the host country from assembly into finished goods confirming the fact that this investments are made with the objective of taking advantage of the lower cost in the host country.

The UNCTAD (2001) suggests that developing countries should actively seek to attract this type of FDI to be exposed to the international production system. According to the

UNCTAD (2001) report, such initiative can help emerging economies to learn more and also offers an opportunity to expand production in particular markets.

Market-development FDI

Bosworth (1999) contends that unlike export-oriented type of FDI, the objective of making a market-oriented FDI is to sell the final output in the host country's markets and this will have a potential growth in the size of the host country's market in the long-term. His argument is that, although this type of investment may not yield expected return in the short run, however if the long-term view of is that the host country's market will grow and hence become profitable then the market oriented FDI must be undertaken.

With market-development investments, Reuber (1993) maintains that host countries have considerable bargaining power in their relationship with the investors seeking to establish a base in their domestic markets. Hence, he argues that as the economy expands, new investors are attracted, creating competition among investors for the available market opportunities. In this case, it may be possible for market-development investors to assist local firms to improve the content of the products and reinvest without interfering significantly with the inflow of investment in the host economy, (Reuber, 1993).

Choe (2003) on the other hand contends that market development investments are marked by many uncertainties and raises a number of questions: how quickly will the market develop? Can the firm speed up the market-development process? What share of the market can the firm capture owing to these question, Choe (2003) argues that manufacturing firms are likely to explore the market by exporting and as the market grows, investors become more familiar with the risk involved and they may expand gradually within the domestic markets.

Government-initiated FDI

Reuber (1993) explains that the government-initiated FDI occurs through the provision of substantial incentive structures by the host country's government. For example, the government can introduce incentive to relax foreign exchange controls, tax concessions to investors who contribute to national development projects. To make the option of providing incentives to foreign investors efficient, such incentives are then directed to specific projects or industries.

In addition, Krueger (1990) indicates that the objective of government-initiated FDI is linked with the desire to increase output, create employment and promote regional development within the host country. Krueger (1990) argues that although such type of investment do not necessarily imply in import-displacing industries, this in fact has been the most common practice in the past.

Though it is generally accepted that these types of FDIs are important for the host country's economy, it is also worth noting that a host country's decision on which type of investment to attract depends on a wide range of factors and the country's long term objectives. Such a decision is also informed by considering the risks as each type of FDI comes with its own risks and uncertainties.

This notion is also emphasised by Wei, (2000) who suggests that each country needs to make its own judgement in the light of its conditions and the framework of its broader long term development objectives. It also need to assess the trade-offs involved, whether related to efficiency, the distribution of income, access to markets or various non-economic objectives. Therefore, South Africa just like any other FDI-seeking country should also consider these factors and compare the benefits and costs of attracting each type of FDI.

RESEARCH METHODOLOGY

Authors like Chowdhury and Mavrotas (2005) suggest that it would be worthwhile to have an individual country study which would help in ascertaining the causal links between FDI and economic growth in those countries since it is believed that the link is country specific. It is therefore important to employ Granger-causality test to examine the causal relationship between FDI, exports and GDP in South Africa for the period 1990 to 2014.

The Granger-causality test is a statistical hypothesis test for determining whether one series is useful in forecasting another. For instance, a time series X_t is said to Granger-cause Y_t , (Gujarati and Porter, 2009). Using t-tests and F-tests, the values of X_t can provide information about the future values of Y_t (Gujarati and Porter, 2009). The hypotheses of this paper are expressed as follows;

- ***Null Hypothesis 1:*** FDI does not granger-cause GDP growth in South Africa
- ***Null Hypothesis 2:*** Exports does not granger-cause GDP growth in South Africa.

The above hypotheses are formulated on the basis of following equation;

$$Y = \beta_0 + \beta_1 (\log FDI) + \beta_2 (\log EXP) + et \dots \dots \dots 1$$

Where; *Y* = Economic growth, measured in real GDP

FDI = Foreign Direct Investment

EXP = Exports

et = Error term

From the equation, GDP (Y) is measured and explained by changes in logFDI and logEXP. Hence it is assumed that any change FDI and exports will cause a change in GDP. The error term (*et*) is incorporated in the equation to account for omitted variables which affects GDP but were not included in the model. The ordinary least square model will be employed to ascertain the relationship between the inward FDIs, exports and GDP growth. Lastly, the goodness of fit test is carried out to ensure that the results of the paper are not spurious. The evaluation of goodness of fit includes the R² analyses of the pattern of residuals and hypothesis testing.

RESEARCH RESULTS

As denoted, economic growth measured by GDP growth is analysed as a function of FDI and exports. Hence, the dependent variable is identified as real GDP, while FDI and EXP are the independent variables. The table below presents the result from the Ordinary Least Squares model (specified model)

Table 1: Results of Ordinary Least Squares (Specified model)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.969688	0.092190	10.51841	0.0000
Log FDI	0.161914	0.030527	5.304039	0.0003****
Log EXPORT	0.000368	0.009828	0.037457	0.0709*
R-squared	0.740418			
F-statistic	15.54490			
Prob (F stat)	0.000854			

Note: [****] (*) indicates the rejection of the null hypothesis at [1%] (10%)

Source: Author's own estimation

Table 1 demonstrates the relationship between the logFDI, logexport and logGDP growth in South Africa. The coefficients are positively related, this is indicated by a positive sign. Thus, a one percentage change of FDI inflows had a positive effect of 0.9696880% on GDP growth and 0.000368% on exports. From the findings, it is evident that the probability value of FDI is 0.0003*** which is lower than 1% level of significance, thus suggest that we reject the null hypothesis and conclude that there a positive linear relationship between FDI and GDP growth. The probability value of 0.0709* for exports and thus also suggest that we reject the null hypothesis and conclude that there a positive relationship between exports and GDP growth in South Africa for the period reviewed.

The results shows 74.04% (R^2) of variance in the estimation of Y (GDP growth) is accounted for by a one percentage increase in FDI inflows and exports in South Africa for the period reviewed. The probability value for F statistic is reported at 15.54490, this indicate that the model is of good fit. Using the results from table 1, the following equation of the model is estimated as follows;

$$\hat{Y} = 0.96968 + 0.161914 (\log FDI) + 0.0003681(\log EXP) + e_t \dots \dots \dots (2)$$

The regression estimation confirms a positive relationship between the selected variables. This findings support the theoretical background and previous studies that found inflows of FDIs increase in exports to have a positive impact on economic growth in developing economies. Thus, implies that this paper also advocates for the notion of FDI-led growth and exports led growth hypotheses in South Africa.

Granger-causality test

As indicated, if the F-Statistic value is greater than probability value, we then conclude by rejecting the null hypothesis and accept the alternative hypothesis. Similarly, if the F-Statistic is lower than the probability value, we then conclude by not rejecting the null.

Table 2: Results of Granger-causality test

<i>Null Hypothesis:</i>	<i>Obs</i>	<i>F-Statistic</i>	<i>Prob.</i>
<i>H0₁: Log FDI does not Granger Cause Log GDP</i>	23	0.8489	0.0452**
<i>H0₂: Log EXP does not Granger Cause Log GDP</i>	23	7.5116	0.0746*

Note: [**] (*) indicates the rejection of the null hypothesis at [5%] (10%)

Source: Author’s own estimates

The results reveal the existence of bi-directional relationship among the variables For H_{01} , the F statistic of 0.8489 is greater than the probability value of 0.0452 which implies the causal relationship that runs from log FDI to log GDP at 5% level of significance. For H_{02} , the F statistic of 7.5116 is greater than the probability value of 0.0746 which also indicates that the causality runs from log EXP to log GDP at 10% level of significance. From the results, it can be deduced that FDIs and exports have a significant impact on GDP for the period reviewed, thus from 1990 to 2014.

Goodness of Fit test results (diagnostic test)

The F test is used to test for the significance of the R squared (R^2) and for the whole regression model (OLS model). If probability value, F-statistic is greater than the probability value at 5% level of significance, we then reject the null hypothesis of no linear relationship between the dependent and independent and considered the model significant. Gujarati and Porter (2009) outlined five steps for hypothesis testing. Using the analysis from table 1, the results for the goodness of fit test are therefore presented as follows;

$$H_0: R^2 = 0 \text{ (no linear relationship among the variables)}$$

$$H_1: R^2 > 0 \text{ (there is linear relationship among the variables)}$$

Note: reject H_0 if F-statistic is greater than the probability value at 5% level of significance

Source: Author's own estimates

The results of goodness of fit test reveals that the model and tests employed in the paper are of good fit. Hence, the F-statistic of 15.54490 is greater than probability value of 0.000854 at 5% level of significance. The results are therefore not spurious and that the R^2 of 74% represents the percentage of the variance in GDP growth is explained jointly by one percent change in FDI inflows and increase in exports.

The results of this paper provide a stronger support to the hypotheses that both FDI inflows and exports have a significant impact on economic growth in South Africa. Therefore, this calls for the government to revise its policies regarding the attraction of FDIs and strategies new ways of attracting more foreign investors to compliment to government expenditure in terms of infrastructure development and job creation.

CONCLUSION

This paper employed a granger-causality test to determine the impact of FDIs and exports on economic growth in South Africa. From the findings, it is evident that FDI inflows and exports had a significant impact on GDP growth and job creation in South Africa for the period reviewed. The Granger-causality test ascertained that the causality runs from both FDIs and exports to GDP. The result implies that both FDI inflows and exports granger-caused economic growth, measured by GDP growth for the period review, thus from 1990 to 2014.

In addition, the Ordinary Least Squares model shows that there is a linear positive relationship between the selected variables. The nature of this relationship supports the traditional view and theoretical literature that attraction of FDIs and promotion of exports can enhance growth and development in developing economies. It can therefore be suggested that South Africa's capacity to grow, develop and create jobs for its citizens also depends on the country's performance in terms of attracting foreign investors and increasing its exports performance. Therefore the results of this paper and other studies that found similar results can be put forward as a guide for policy makers to take advantage of inward FDI spillover effects and exports.

For South Africa to reap the benefits of attracting foreign investors, one would recommend that the government and private sectors should take measures to provide skills to the labour market, so that they can be easily absorbed in foreign modern technologically advanced environment.

Trade unions on the other hand should emphasize more on stabilizing labour disputes, strikes especially in mining sector. More importantly, the government should also emphasise more on fighting corruption. Lastly, the attraction foreign investors and promotion of exports in South Africa should however not be seen as an end in itself, but also as a means of supporting other development initiatives such as reducing inequalities and poverty.

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