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Foreign Direct Investment and the mining sector in South Africa: Implications for the current account balance

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Abstract

The mining sector contributes to South Africa's economic growth through tax revenue, employment creation and export revenue. Because of the abundance of the natural resource endowment of mining sector, it attracts FDI in line with the natural resource rents it fetches. However, the sector is subject to countervailing forces that threaten to hamper prospects of a positive economic growth contribution the sector can make.

With mining being the largest contributor of export revenue and investment income, there has been a trade balance and net investment income deficit over the past 10 years, due to South Africa importing more value-added goods and repatriating investment income to foreign investors. This raises the question of whether South Africa is attracting the appropriate FDI and encouraging the reinvestment of its export earnings.

This study reviews literature on the current account balance and how mining and FDI reflect theories identified in the literature. Government policies and incentives are analysed to evaluate their effectiveness in attracting appropriate kinds of FDI and the nature of their impact on economic growth. From the literature review, we identified a model for mapping the effect of FDI and the mining sector on the current account balance. Specifically, a VECM model is used to find the long-run and short-run effects of the variables considered to explain the impact of FDI inflows and outflows on the current account balance.

The first model examined the effects of relationship between FDI and the mining sector on the current account balance. The results showed that mining consumption has a positive relationship with the current account balance, and that FDI has a negative impact on the current account balance. There was, however, no short-run causality between FDI and mining consumption towards the current account.

The second model examined the relationship between the current account balance and FDI on GDP. The results show that the current account balance has a positive long-run relationship with GDP, and FDI has a negative impact on GDP. The probabilities yielded in the short run were significant in confirming short-run causality between the current account balance and FDI to GDP. The third model examined the relationship between FDI, mining consumption, exchange rate and commodity price index on GDP. The results show that mining consumption, FDI, commodity prices and real exchanges rate have a negative long-run relationship with GDP.

Overall, the results indicate the need for South Africa to encourage value-adding linkages within the mining sector in ways that will significantly shift the current account balance from a deficit to a surplus. Incentives that encourage a reinvestment of income to fund production activities that may come in the form of mergers and acquisition, brownfield investment and green field investments, are critical. The outcome of such guided production activities would result in a decrease in outflow of investment income from the economy.

Keywords: Current Account, Foreign Direct Investment, Mining Sector, South Africa