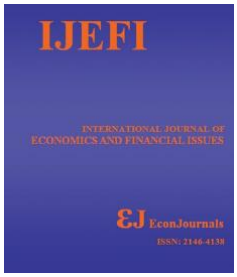

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Analysing the Impact of Foreign Direct Investment on Economic Growth in South Africa: The Role of Political Stability

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ABSTRACT

The complex relationship between foreign direct investment (FDI), political stability, and economic growth remains a critical area of study, particularly for developing economies like South Africa. This research investigates how FDI impacts economic growth in South Africa, with a special focus on the role political stability plays in moderating this effect. The study aims to contribute to the ongoing debate about the importance of political conditions for maximising the benefits of FDI. Using a dataset covering the period from 1994 to 2023, the study employs an Autoregressive Distributed Lag (ARDL) model, which allows for both short- and long-run dynamics to be captured between economic growth, FDI, political stability, labour force, and human capital growth. The ARDL approach was selected due to its flexibility in dealing with variables that are integrated at different levels, ensuring robust and reliable estimates. The results indicate that while human capital stock has a positive impact on long-term economic growth, both labour force expansion and human capital growth exhibit negative effects in the short and long run, suggesting inefficiencies in labour productivity and rapid educational growth. Contrary to earlier research that suggested stable political contexts inevitably promote the favourable effects of FDI, the interplay between FDI and political stability unexpectedly demonstrates a negative influence on growth. This study adds new insights by highlighting that the sectoral allocation of FDI and the quality of governance may be more important than political stability alone in driving growth. These findings fill a gap in the literature by addressing the specific case of South Africa and underscore the need for targeted FDI policies and labour market reforms to ensure that both FDI and labour contribute more effectively to economic development. The practical implications suggest that policymakers should focus on improving labour productivity and strategically managing FDI to promote sustainable growth.

Keywords: ARDL Model, Economic Growth, Foreign Direct Investment, Political Stability
JEL Classifications: E02, O11, O43

1. INTRODUCTION

The nexus between political stability, foreign direct investment (FDI) and economic growth is complex, interdependent, and has developed over time. It is well known that since the 1980s debt crisis, FDI has gained traction as a resource for funding and has the capacity to greatly boost the economies of developing nations (Adams, 2009). Most developing countries lack the necessary savings to support their internal investment initiative (Meyer and Habanabakize, 2018). Consequently, in order to achieve their economic objectives, many nations must rely on outside funding sources (Levine, 2005; Dupasquier and Osakwe, 2006). It is imperative that developing nations try to secure more funding for development initiatives from outside sources. However, because a variety of circumstances affect their investment decisions, investors do not simply make investments in any country (Mallampally and Suvant, 1999).

A few academics believe that political stability is a notion that should be obvious, meaning that a thorough explanation of its meaning is not necessary (Castles, 1974). However, this paper explains stability as a complex phenomenon and explains political stability as (1) consistency in governance and predictability, (2) social cohesion and inclusivity, and (3) respect for the rule of law. For FDI to flourish in the receiving nation, favourable conditions for investments must exist (Gani and Al-Abri, 2013). In the

dynamic political landscape of today, investors' concerns regarding the political stability of the recipient nation have increased (Baek and Qian, 2011). It can be understood that the reason the host nation's political landscape is of importance to investors is because, in the case of political instability, the profitability and return of their investment will be negatively affected (Busse, and Hefeker, 2007).

Although a great deal of study has been done on factors that influence FDI, the precise relationship between political stability, FDI inflows, and South Africa's economic expansion is unknown. Following its readmission to the world economy in 1994, South Africa's development has been significantly aided by increases in foreign direct investment (FDI) (Salisu, 2004). With its far higher FDI flows than the rest of the continent, South Africa was seen by many international investors as a desirable place to invest, offering bright future prospects (Meyer and Habanabakize, 2018). According to Makhoba and Zungu (2021), there are several advantageous economic factors that have made foreign investors eager to invest in South Africa, political stability being one of them. The country's performance was evident in its ranking in the 2011 AT Kearney FDI confidence index, according to the Global Business Policy Council (2017). In 2012, it was ranked 11th out of 25 regions that were the most desirable for investments.

South Africa has seen periods of political stability punctuated with difficulties like corruption since its reintegration into the global economy in 1994 (Singo, 2023). Corruption is a serious problem in developing economies, since it ultimately hinders the achievement of growth and sustainable development. Since corruption undermines the foundations of institutions and impedes regional economic growth, it has been demonstrated to be a major barrier to social and economic development (Qureshi et al., 2021). Furthermore, corruption is recognised as one of the factors influencing foreign direct investment because it increases corporate institutions' expenses, which lowers productivity (Dabour, 2000). Therefore, it is reasonable to predict that corruption will lower the expected productivity and efficacy of investment initiatives since 2015, when South Africa was removed from the AT Kearney FDI confidence index, FDI inflows have drastically decreased (Salisu, 2004). UNCTAD's (2022) Investment Trends Monitor states that in 2015, FDI flows into South Africa fell by 74% compared to the rest of the continent, with the reduction being much more severe. Xing (2015) claims that the country's political and macroeconomic uncertainties, as well as the government's consideration of changing the nation's laws and policies, are the primary causes of the fall in FDI. This serves as part of the consequences of the lack of consistency in governance and predictability within the country (Meyer and Habanabakize, 2018).

There are two theoretical factors, namely the push and pull factors, that affect how much FDI is made in developing nations (Ajayi, 2006). While push factors, which can be defined as externalities like growth or features of the financial market, indicate the overall reserves in the country, pull factors depend on local or domestic policy features in the host country to determine how these resources are distributed (Kida, 2014). Local market size, trade openness, institutional quality, political and economic liberalisation, and macroeconomic stability are some of the significant pull factors that influence FDI inflows (Sabir et al., 2019). This paper will focus on the so-called push factors, especially those linked to political stability and growth. This article focusses on South Africa because it is among the middle-income countries in Southern Africa, and it will be intriguing to observe what role FDI plays in its economic growth.

Debates regarding the connection between economic expansion, FDI and political stability have persisted for decades. There is a general acceptance of the fact that political stability is a fundamental and significant political institution within a country and that more politically stable countries attract a higher quantity of FDI, which consequently increases economic growth rates, reduces poverty, and closes the savings-investment gap in Africa by creating jobs, facilitating more effective access to global markets, and strengthening ties between foreign and local businesses, all of which increase domestic productivity (Dada and Abanikanda, 2022). According to a 2015 study by Keho on the South African economy, there is a causal relationship in both directions between FDI and economic expansion. Therefore, FDI has the ability to promote economic growth, which in turn can draw in additional FDI. Compared to other developing African nations, South Africa's economy has benefited greatly from FDI inflows in recent years (Makhoba and Zungu, 2021). The main reason for this is that the country has worked hard to implement prudent macroeconomic policies that would attract FDI and foster an environment that will allow investment to flourish in the economy.

However, there are few examinations of the mechanisms through which the positive relationship between these three variables is maintained concurrently, especially in developing countries like South Africa. Relatively little previous research has examined the link between FDI and growth in South Africa's economy, even though the two variables have been the focus of extensive studies in other places (Sunde, 2017; Strauss, 2015). In addition, there is a lack of information on FDI and South African economic growth. To our knowledge, there is no direct empirical evidence that identifies the precise routes through which foreign direct investment inflows are impacted by political stability (Chletsos and Andreas, 2024). Studying how FDI and growth are related in South Africa is essential in order to influence policy choices, encourage economic growth, and improve the nation's competitiveness internationally. Assessing the mechanisms and processes through which this causal relationship occurs will offer insightful information to legislators, investors, businesses, governments, and international organisations. This will provide an all-inclusive understanding of the trio influence of political stability, FDI and economic growth.

The primary objective of this research study is to analyse how political stability and FDI interact to shape South Africa's economic growth, as it aims to analyse the mechanisms through which political stability fosters an environment conducive to FDI and economic growth. This research will explore how political stability affects the confidence of investors, increases the level of certainty, and promotes long-term investment commitments in South Africa. It will analyse various ways in which political stability influences the economic value and quality of FDI in

South Africa. Another literary addition of this study is that it is a unique attempt to investigate the connection between economic expansion and FDI in a middle-income nation in Southern Africa. This research attempts to investigate the nexus between political stability, FDI, and economic growth with reference to South Africa, as it is a topic of intense theoretical and empirical debate. South Africa's economy is constantly observed on a worldwide scale as one of the BRICS countries. Studying the connection between political stability, FDI, and South Africa's economic expansion can provide insights that are more broadly applied to rising economies struggling with comparable problems.

2. LITERATURE REVIEW

The literature reviewed highlights the complex and multifaceted relationships between political stability, economic freedom, trade freedom, foreign direct investment (FDI), and economic growth. Each study provides unique insights into these dynamics, particularly within the context of specific countries or groups of countries. Here, we synthesize these findings, draw comparisons, and identify overarching themes and implications for policy and future research.

The nexus between political stability, foreign direct investment (FDI), and economic growth in South Africa can be analysed using several economic theories. Institutional theory explains how the quality of institutions, including political stability, influences FDI inflows and economic growth. Political stability reduces policy uncertainty, upholds the rule of law, and protects property rights, creating an environment conducive to long-term investments, which in turn promotes economic growth (North, 1990; Robinson and Acemoglu, 2012). High-quality institutions also ensure a transparent and efficient business environment, attracting FDI by reducing bureaucratic hurdles (Wernick et al., 2009; Sabir et al., 2019). Political stability also supports consistent trade policies, which help attract foreign investors (Busse and Hefeker, 2007). The Eclectic/Ownership-Location-Internalisation (OLI) theory further explains that firms invest in countries with stable political environments and institutional advantages such as strong governance and legal frameworks (Rjoub et al., 2017). FDI, driven by ownership and locational advantages, helps increase competition and innovation (Tegegne, 2024). Meanwhile, the Neoclassical growth theory links FDI to capital accumulation, highlighting that foreign investment increases the capital stock and promotes short-term economic expansion (Brems, 1970; Solow, 1956; 1957, 1999). However, the Endogenous growth theory emphasizes the role of FDI in promoting long-term growth through knowledge transfer, innovation, and human capital development (Romer, 1986; 1990; Blomström and Kokko, 1998). By fostering education and technological advancements, FDI has an enduring positive impact on South Africa's economic development (Aghion and Jaravel, 2015).

Akin (2019) used a first-generation panel data analysis method to examine the effect on the performance of the FDI appeal of trade freedom, economic freedom, and political stability in the Fragile 5 Countries, one of which is South Africa. Using the Kao (1999) and Pedroni (2004) tests, the cointegration analysis between series was carried out. The results of the research demonstrated that trade freedom and political stability significantly increase FDI in the fragile 5 countries. Furthermore, a statistically insignificant relationship was found between economic freedom and FDI. Thus, it was determined that political stability is the primary factor influencing the admission of FDI into nations. Furthermore, it was discovered that over time, trade freedom and political stability are what lead to FDI.

In 2017, Nazeer and Masih conducted an analysis to examine the impact of political instability on FDI and the economic growth of Malaysia. The autoregressive distributed lag method of cointegration, which was presented by Pesaran et al. (2001), is utilised in this work. It is predicated on a time series of data covering the 30 years. To their knowledge, no research has investigated the connections between political unrest, FDI, and economic expansion in Malaysia. Their research aims to fill this void in the body of knowledge and will be very helpful to economic decision-makers and policy makers. Empirical evidence indicates a favourable correlation between political instability, FDI and economic growth in Malaysia in both the short and long term, with economic growth acting as the primary catalyst for both FDI and political instability.

Meyer and Habanabakize (2018) examined the connection between political risk, FDI, and economic growth in South Africa. The purpose of the study was to investigate how political risk and economic expansion affected FDI in South Africa between 1995 and 2016. The study examined how sensitive FDI was to changes in the GDP and political risk assessments. Various econometric techniques, including the ARDL bound test for cointegration test, the Granger causality test, and residual testing, were utilised in the investigation. According to this study, there is a short-term and long-term increase in the level of FDI when the GDP and the political risk rating rise. Furthermore, the study found that, over the long-run, political risk had a much more significant influence on FDI than GDP. In other words, rather than being concerned about how the South African economy is expanding, many investors are more focused on the safety of their assets. FDI and GDP have a bidirectional causal link, according to the Granger causality test result, which also shows that changes in political risk lead to changes in FDI rather than the other way around.

The findings of Akın (2019) and Nazeer and Masih (2017) underscore the significant role political stability plays in attracting FDI. Akın's research on the Fragile 5 countries, including South Africa, demonstrated that political stability and trade freedom significantly improve FDI inflows, while economic freedom appears to have a lesser impact. This conclusion aligns with the study by Nazeer and Masih in Malaysia, which also indicates a favourable relationship between political stability and FDI. Both studies suggest that investors prioritise political stability as a key factor in their investment decisions, highlighting the critical need for stable political environments to foster economic development.

Meyer and Habanabakize (2018) research further support this notion, highlighting that political risk has a more substantial influence on FDI than GDP growth in South Africa. Their findings suggest that investors are more concerned with the safety of their

investments than with the current economic performance, which reinforces the importance of political stability for attracting and retaining FDI. The bidirectional causal link between FDI and GDP also indicates that while FDI can stimulate economic growth, the stability and predictability of the economic environment are crucial for sustained investment.

Mahembe and Odhiambo (2014) examine the relationship between foreign direct investment and economic growth with a stylised approach. Based on the theoretical studies considered in this research, FDI has played an important part in the growth of the receiving economy. This study has covered the theoretical connection between economic growth and FDI. The overview of theoretical investigations in this paper demonstrates that FDI plays an important role in the economic expansion of the receiving nation. According to external and internal growth analysis, FDI supports economic growth in both direct and indirect ways, and the expansion of the host nation may attract additional FDI. Additionally, it was noted that FDI has an impact on economic growth through two main avenues. Firstly, FDI can encourage the implementation of novel inventions in the manufacturing process using technological transfers. Secondly, using different leadership techniques, FDI can encourage the transmission of knowledge, as well as labour training and skill acquisition. Additionally, the study found that the social and economic conditions of the host country influence the overall effect of FDI on the growth of the economy.

Makhoba and Zungu (2021) examined how FDI affected South Africa's economic growth. The study used SARB annual time series data spanning 1960 to 2019. To analyse the intricate link between FDI and the growth of the South African economy, this study used impulse response procedures as part of a VAR technique. The research results suggest a mutually advantageous link between foreign investors and the expansion of economic activities that contribute to overall economic growth. The South African economy experiences significant growth in response to a positive shock in FDI. Similarly, FDI inflows into South Africa are encouraged by a positive shock in gross domestic product (GDP). According to the study, smart macroeconomic strategies that can draw FDI and promote overall economic success should be taken into consideration by legislators.

The relationship between FDI and economic growth is well documented in the reviewed literature. Mahembe and Odhiambo (2014) provide a theoretical framework, illustrating how FDI contributes to economic growth through technology transfer and knowledge dissemination. These findings are echoed in the empirical studies by Makhoba and Zungu (2021), who demonstrate that positive shocks in FDI lead to significant economic growth in South Africa. Similarly, FDI inflows are supported by GDP growth, indicating a mutually beneficial relationship.

Makhoba and Zungu's use of impulse response procedures within a VAR framework reveals that effective macroeconomic strategies can attract FDI, thereby promoting overall economic success. This aligns with the assertion of Mahembe and Odhiambo that FDI supports economic growth both directly and indirectly, depending on the social and economic conditions of the host country. The studies collectively suggest that FDI is a critical driver of economic development, provided that the host country creates conducive conditions for investment.

The reviewed literature collectively underscores the importance of political stability as a primary factor influencing FDI inflows. Although economic and trade freedoms are also significant, the stability of the political environment appears to be paramount for investors. This has important implications for policymakers in developing and emerging economies: ensuring political stability and reducing political risks should be top priorities to attract and retain foreign investment. In addition, the bidirectional relationship between FDI and economic growth suggests that policy makers should design strategies that not only attract FDI but also foster economic conditions that can sustain and enhance these investments. This involves creating robust institutions, maintaining stable and predictable economic policies, and promoting social and economic conditions conducive to growth.

3. METHODOLOGY

3.1. Data Source and Description

In efforts to achieve the primary objective of analysing how political stability and FDI interact to shape South Africa's economic growth, yearly time series data for the time period from 1994 to 2023 was used. The research design for the study was quantitative. Using secondary data covering the years 1994-2023, the study employed a secondary time series analysis. The scope of this study was expanded until 2023 to include the most recent advancements, trends, and modifications to the political, economic and investment environment of South Africa. This has allowed the research to present a more pertinent and current analysis of the connections between the important variables under study. The time frame was chosen to examine how well FDI, and political stability interacted following the end of the apartheid era. The World Development Indicators database was used to collect data for a total of 30 observations.

3.2. Econometric Methods of Analysis

A few econometric models and tests were used to accomplish the study's empirical objectives. To determine whether political stability in South Africa influences foreign direct investment inflows and economic growth, the study looked at both the long- and short-term correlations between the variables (Asenahabi et al., 2019). The model chosen, the ARDL technique, has several benefits, including being effective for variables that are integrated of order zero I(0), order one I(1), or a combination of I(0) and I(1) variables. In addition, it produces consistent results when used with tiny sample sizes of data. In addition, the ARDL model estimates both the short- and long-term using simultaneously. Therefore, in this instance, the ARDL model, or the bound testing technique, developed by Pesaran et al. (2001) is the most appropriate model. The simplified representation of the ARDL model is expressed as follows:

$$EG = f(LAB, CAP, HCG, FDI\_PS) \quad (1)$$

Where EG is economic growth and is the dependent variable, LAB is employed labour, CAP is physical capital stock, HCG is human capital growth, and FDI_PS is the interaction term between foreign direct investments (FDI) and political stability (PS).

The model above is the broad model was utilised to capture both short-run and long-run dynamics between the variables, as well as the role of political stability in moderating FDI's impact on economic growth. The model includes an interaction term, which served to demonstrate whether the impact of FDI on economic growth depends on the degree of political stability. In the literature, it is argued that government plays a crucial role in facilitating external resources, and the moderating effect of PS on FDI will measure the influence of government policy on economic growth through FDI. The models and methodologies used in this study build upon and contribute to the existing literature on the relationship between foreign direct investment (FDI), political stability, and economic growth, particularly in the context of South Africa. Explicitly modelling the interaction between FDI and political stability provided a more nuanced understanding of how these two factors work together to influence growth. The time-lag effects of FDI and labour on economic growth are clarified using the ARDL technique to capture both short- and long-run effects. Incorporating human capital growth and stock as central variables offered insights into how the quality and pace of human capital development influence economic outcomes.

The Wald-test (F-statistic)-based ARDL or the bound test is used to evaluate the long-term association. For the cointegration test, Pesaran et al. (2001) offers two key values. Therefore, the lower critical bound presupposes that all variables cointegrate at level I(0). All the variables are assumed to cointegrate at the first difference, I(1), by the upper bound. The null hypothesis (H_0) is rejected, indicating that the variables cointegrate, when the estimated F-statistic is greater than the upper bound critical value. On the other hand, if the F-statistic is less than the lower bound critical value, the hypothesis that there is no co-integration of the variables is not rejected. In the absence of additional information, the results are equivocal when the estimated F-statistics lie between the lower and higher bound (Dube and Zhou, 2013). The model that follows is designed to examine the long-term relationship between the identified variables (every variable was converted to its natural logarithm):

$$\Delta LEG = \alpha + \sum_{i=1}^{k} \eta \Delta LEG_{t-i} + \sum_{i=1}^{k} \varphi \Delta LLAB_{t-i} + \sum_{i=1}^{k} \beta \Delta LCAP_{t-i} + \sum_{i=1}^{k} \gamma \Delta LHCG_{t-i} + \sum_{I=1}^{k} I\Delta LFDI\_PS_{t-i} + \omega_1 \Delta LEG_t + \omega_2 \Delta LLAB_t + \omega_3 \Delta LCAP_t + \omega_4 \Delta LHCG_t + \omega_5 \Delta LFDI\_PS_t + \mu_{1t} \quad (2)$$

$\Delta LEGt$ denotes changes in the natural logarithm of economic growth, $\Delta LLABt$ denotes changes in the natural logarithm of employed labour, $\Delta LCAPt$ denotes changes in the natural logarithm of physical capital stock, $\Delta LHCGt$ denotes changes in the natural logarithm of human capital growth, $\Delta LFDI\_PSt$ denotes changes in the natural logarithm of the interaction term between FDI and political stability and denotes μ_t the error term.

The short-run coefficients are presented by η_i, α_i, β_i, γ_i, δ_i while k showcases the number of lags included in the model. Furthermore, the long-run coefficients are expressed by ω_1, $\omega_2 \ldots \omega_n$.

Based on Equation 2, the hypotheses to determine was formulated as the following:

- Null hypothesis (H_0): variables do not cointegrate in the long run
- Alternative hypothesis (H_1): variables cointegrate in the long run.

If the null hypothesis (H_0) is not accepted, the investigation proceeds to the estimation of the error correction model (ECM). The ECM is important because it makes it possible to gauge how quickly the system will respond following shocks to reach long-term equilibrium or a steady state. Here are the specifications for the error correction model:

$$\Delta LEG_t = \alpha_2 + \sum_{i=1}^{k} \eta_i \Delta LEG_{t-i} + \sum_{i=1}^{k} \varphi_i \Delta LLAB_{t-i} + \sum_{i=1}^{k} \beta_i \Delta LCAP_{t-i} + \sum_{i=1}^{k} \gamma_i \Delta LHCG_{t-i} + \sum_{i=1}^{k} \delta_i \Delta LFDI\_PS_{t-i} + \theta\, ECT_{t-1} + \mu_{2t} \quad (3)$$

With its estimated parameters, φ, β, γ, and δ, the long run equilibrium yields an error correction term, $ECTt-1$. The coefficient of the error correction term, denoted by θ, gauges how quickly an equilibrium level is reached following a shock. Narayan and Smyth (2009) posit that following the estimation of the long-term relationship and residuals, it is crucial to establish error-correction based on the Granger causality model.

4. RESULTS AND DISCUSSION

Correlation Analysis

The correlation matrix in Table 1 presents the relationships between key variables in the study. There is a moderate positive correlation between LCAP and LFDI_PS. This suggests that higher human capital stock is associated with an increase in the interaction term between FDI and political stability. This means that regions or periods with more educated/qualified labour tend to experience stronger FDI inflows, particularly under stable political conditions. The correlation between human capital stock and human capital growth is negative. This might indicate a trade-off; areas with a higher stock of human capital are experiencing slower growth in additional human capital accumulation. The strong negative correlation between LCAP and LLAB suggests that higher human capital stock is associated with a smaller employed labour force. This could reflect structural changes where higher human capital reduces dependence on sheer labour quantity. There is a negative correlation between LFDI_PS and LHCG, which implies that higher levels of FDI, especially when combined with political stability, are somewhat linked to lower growth in human capital.

One possible explanation is that regions attracting substantial FDI might already have well-established human capital stocks, leading to slower rates of increase. The correlation between LFDI_PS and LLAB is moderately negative. This suggests that areas receiving

more FDI under stable political conditions tend to have a lower labour force participation rate. One hypothesis could be that FDI focuses more on capital-intensive industries, reducing reliance on a large labour force. The positive correlation between LHCG and LLAB indicates that growth in human capital is associated with higher employment levels. As educational levels or workforce skills improve, more individuals enter the labour market, or labour becomes more productive, leading to an expansion in employment.

The employed labour force shows strong negative correlations with both human capital stock and the FDI-political stability interaction. This reinforces the idea that economies with larger labour forces tend to have lower human capital stock and attract less FDI under stable political conditions, possibly because these economies are less developed or rely more on labour-intensive industries.

Descriptive Statistics

Table 2 provides descriptive statistics for key variables used in the research. These statistics are crucial in understanding the central tendencies, variability, and distribution characteristics of the data. For LEG, the maximum is 26.62 and the minimum is 25.99, implying that economic growth doesn't vary significantly between its extreme values. For LLAB, the maximum is 3.91, and the minimum is 3.68, suggesting a fairly narrow range of labour force values. LHCG has a slightly negative minimum (−0.0022), indicating that in at least one observation, human capital growth slightly decreased. LFDI_PS ranges from 18.85 to 22.96, showing a somewhat wider variation in the FDI-political stability interaction term. The standard deviation measures the dispersion or spread of the data around the mean. A higher standard deviation indicates more variability. LEG has a standard deviation of 0.21, showing relatively low variability in economic growth. LLAB, with a standard deviation of 0.07, indicates very low variability in labour. LCAP has a standard deviation that shows slightly more variability in human capital stock (0.32). LHCG's standard deviation indicates that human capital growth varies only slightly across observations. LFDI_PS has a standard deviation of 1.02, showing that the FDI-political stability interaction term has more variability compared to other variables. The Jarque-Bera test checks for normality of the distribution. It compares the skewness and kurtosis to see if the data is normally distributed. All variables have $P > 0.05$, indicating that they do not significantly deviate from a normal distribution. Therefore, they are roughly normal.

Table 1: Correlation matrix

	LCAP	LFDI_PS	LHCG	LLAB
LCAP	1			
LFDI_PS	0.384016	1		
LHCG	−0.424043	−0.251586	1	
LLAB	−0.723013	−0.523924	0.394030	1

Source: Author's compilation

Table 2: Descriptive statistics

	LEG	LLAB	LCAP	LHCG	LFDI_PS
Mean	26.38087	3.823792	24.52668	0.000554	20.54176
Median	26.45071	3.831940	24.68266	0.000772	20.71050
Maximum	26.61733	3.911143	24.85745	0.004104	22.95791
Minimum	25.98694	3.681804	23.93353	−0.002220	18.84716
Std. Dev.	0.214540	0.070725	0.324116	0.001458	1.023307
Skewness	−0.514610	−0.393808	−0.586096	−0.070501	0.299925
Kurtosis	1.739957	1.835285	1.675124	2.810336	2.629319
Jarque-Bera	3.198460	2.388754	3.781273	0.067490	0.600814
Probability	0.202052	0.302893	0.150976	0.966818	0.740517
Observations	30	30	30	29	30

Source: Authors4 compilation

Table 3: Unit root test

Test	LEG	LLAB	LCAP	LHCG	LFDI_PS
ADF test					
Level:					
None	5.243364	-1.238761	1.162087	-3.737028***	0.663924
	[1.0000]	[0.1928]	[0.9327]	[0.0006]	[0.8536]
Constant	-2.457223	-0.898161	-1.621027	-3.679769**	-4.141334***
	[0.1359]	[0.7743]	[0.4590]	[0.0102]	[0.0032]
Trend	-0.199395	-2.988369	-0.585817	-3.971548**	-5.312415***
[p-value]	[0.9899]	[0.1523]	[0.9723]	[0.0219]	[0.0009]
1st diff.:					
None	-2.699821***	-5.226237***	-3.070076***	-5.540993***	-10.28293***
	[0.0088]	[0.0000]	[0.0034]	[0.0000]	[0.0000]
Constant	-4.105468***	-5.442049***	-3.307307**	-7.038464***	-10.22035***
	[0.0036]	[0.0001]	[0.0242]	[0.0000]	[0.0000]
Trend	-4.872857***	-5.320736***	-3.506343*	-7.653102***	-10.03376***
[p-value]	[0.0028]	[0.0010]	[0.0581]	[0.0000]	[0.0000]

Asterisks ***, ** and * denote the level of significance at 1%, 5%, and 10%, respectively. The [P-values] are shown in parentheses.

Unit Root Test

Verifying the stationary or non-stationary nature of specific economic variables is crucial prior to performing cointegration research. ADF, or the augmented Dickey-Fuller test, has drawn a lot of interest when applied to time series data where the null hypothesis is non-stationary. Asteriou and Hall (2007) state that false regression findings may result from the use of non-stationary variables in econometric estimation. The order of integration of each variable was tested using the Augmented Dickey-Fuller (ADF) test. The test results are displayed in Table 3. The results indicate that all the variables are stationary at first difference, except the interaction term. Therefore, LEG, LLAB, LCAP and LHCG are stationary at first difference (I[1]), and LFDI*PS is stationary at level (I(0)).

Lag Selection and the Cointegration Test

Lag length is significant in time series analysis because the number of delays in the model influences the research result. As a result, using the ideal number of delays is required. The ideal number of delays chosen for the model 2, 2, 1, 2, 3, was determined by applying the Akaike Information Criterion (AIC). In other words, two lags were used for LEG, two for LLAB, 1 for LCAP, 2 for LHCG, and 3 for LFDI_PS. Table 4 displays the outcome of the ARDL Bounds test. The computed F-value of 5.350993 is greater than all critical values of the upper bound. As a result, the alternative hypothesis is accepted, and the null hypothesis is rejected. This indicates that there is a long-term link between the variables.

Long Run Coefficients and Interpretation

Equation 3 shows the long-run relationship given by long-run coefficients. The negative coefficient for labour (LLAB) suggests that, in the long run, expanding the labour force is associated with reduced economic growth, possibly due to diminishing returns or over-reliance on unskilled labour. The positive coefficient for human capital stock (LCAP) indicates that increasing the stock of educated and skilled workers positively contributes to long-term economic growth. The large negative coefficient for human capital growth (LHCG) might indicate inefficiencies or challenges associated with rapid increases in education or skill levels that do not translate into immediate economic gains. The negative coefficient for the FDI-political stability interaction (LFDI_PS) is unexpected and may reflect challenges in how FDI is utilised in politically stable but potentially inefficient environments.

$$LEG = 23.23931 - 1.440766LLAB + 0.418011LCAP - 28.59914LHCG - 0.075475LFDI\_PS \quad (4)$$

The ECM and Short Run Relationship

The speed at which short-term corrections are made and the amount of time it takes for system changes to return to long-run equilibrium are both provided by the error correction term (ECT). Table 5 shows the empirical short-term results. The error correction term is significant, indicating that the system adjusts relatively quickly to restore long-run equilibrium in economic growth after short-run fluctuations in labour, capital stock, human capital, net inflow of foreign direct investment as influenced by political stability in South Africa.

Table 4: Bounds test results

F-bounds test		Null Hypothesis: No levels relationship		
Test Statistic	Value	Signifance (%)	I (0)	I (1)
F-statistic	5.350993	10	2.2	3.09
K	4	5	2.56	3.49
		2.5	2.88	3.87
		1	3.29	4.37

Source: Authors own estimation results

Table 5: ARDL short run estimated coefficients

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D (LEG [−1])	−0.254637	0.123731	−2.057980	0.0620**
D (LLAB)	−0.221223	0.073571	−3.006951	0.0109*
D (LLAB [−1])	0.156540	0.086437	1.811031	0.0952**
D (LCAP)	0.406939	0.046574	8.737532	0.0000*
D (LHCG)	−5.069136	1.665538	−3.043542	0.0102*
D (LHCG [−1])	7.666532	1.649488	4.647825	0.0006*
D (LFDI_PS)	−0.003869	0.002282	−1.695380	0.1158
D (LFDI_PS [−1])	0.016112	0.003812	4.226895	0.0012*
D (LFDI_PS [-2])	0.009934	0.003067	3.238858	0.0071*
CointEq (−1)*	−0.375205	0.055634	−6.744141	0.0000*

*Indicates significance at 5% and **indicates significance at 10% of the P-value
Source: Authors own estimation results

Causality Test

Table 6 presents results from a Granger causality test between the different variables. The test seeks to determine whether past values of one variable help predict another variable. If the null hypothesis is rejected, we can say that one variable Granger-causes another, meaning it provides useful information for predicting future values of the second variable. From the results, it is evident that economic growth (LEG) Granger-causes labour (LLAB), meaning past growth helps predict future labour force size. Human capital stock (LCAP) Granger-causes labour (LLAB), indicating that changes in human capital stock affect the labour force. Labour (LLAB) does not Granger-cause economic growth, but economic growth Granger-causes labour. There is no evidence that the FDI-political stability interaction (LFDI_PS) Granger-causes any of the other variables, including economic growth.

Diagnostic Tests

Finally, in Table 7 below a variety of diagnostic tests were run to determine the model's correctness and stability. Heteroscedasticity, normality, serial correlation, and stability tests were among these tests. The results displayed in Table 5 indicate no evidence of serial correlation, heteroscedasticity, and model misspecification.

Discussion

Political stability-FDI nexus and economic growth

The findings from the current study, particularly regarding the interaction between FDI and political stability (LFDI_PS) as related to economic growth align with the literature in in the short run but diverge in the long run with inverse relationship. The negative coefficient for LFDI_PS in the long-run model suggests that FDI inflows under politically stable conditions might not necessarily contribute positively to economic growth, which contrasts with much of the existing literature. Studies like those of Akın (2019) and Nazeer and Masih (2017) emphasize the positive role of political stability in attracting FDI and fostering growth, highlighting that political stability is often a key factor

Table 6: Granger causality test

Null Hypothesis	Obs	F-Statistic	Prob.
LLAB does not Granger Cause LEG	28	0.33128	0.7214
LEG does not Granger Cause LLAB		13.7084	0.0001
LCAP does not Granger Cause LEG	28	0.19199	0.8266
LEG does not Granger Cause LCAP		2.42175	0.1111
LHCG does not Granger Cause LEG	27	1.99246	0.1602
LEG does not Granger Cause LHCG		1.36842	0.2753
LFDI_PS does not Granger Cause LEG	28	0.68602	0.5136
LEG does not Granger Cause LFDI_PS		1.28821	0.2949
LCAP does not Granger Cause LLAB	28	6.51855	0.0057
LLAB does not Granger Cause LCAP		1.17781	0.3258
LHCG does not Granger Cause LLAB	27	3.10376	0.0650
LLAB does not Granger Cause LHCG		0.76247	0.4785
LFDI_PS does not Granger Cause LLAB	28	0.99354	0.3856
LLAB does not Granger Cause LFDI_PS		1.73503	0.1987
LHCG does not Granger Cause LCAP	27	1.08823	0.3543
LCAP does not Granger Cause LHCG		1.71313	0.2035
LFDI_PS does not Granger Cause LCAP	28	0.26466	0.7698
LCAP does not Granger Cause LFDI_PS		0.70039	0.5067
LFDI_PS does not Granger Cause LHCG	27	0.08369	0.9200
LHCG does not Granger Cause LFDI_PS		2.31426	0.1224

Source: Authors own estimation results

Table 7: Diagnostics test results

Test	P-value
Breusch-Godfrey serial correlation test	0.8219
Breusch-Pagan-Godfrey Heteroscedasticity test	0.8435
Ramsey reset test (log likelihood ratio)	0.1556

Source: Authors computation

for investors. However, the negative coefficient in this study could be attributed to specific conditions in South Africa, where FDI might be concentrated in capital-intensive sectors that do not immediately generate broad-based economic growth, such as mining or extractive industries. These industries might not lead to immediate growth or even negatively affect the labour market, as the study's correlation analysis indicates that areas with more FDI tend to have lower labour force participation rates. This aligns with Meyer and Habanabakize (2018), who argue that political risk can outweigh economic performance in determining FDI flows, suggesting that investors may prioritise safety, but that FDI does not always translate into broader economic benefits.

Human capital and labour

One of the most intriguing findings of this study is the negative relationship between labour (LLAB) and economic growth in both the short and long run. This finding supports the notion of diminishing returns to labour in South Africa's economy, where expanding the labour force may not lead to proportional gains in growth, possibly due to low productivity or reliance on unskilled labour. The positive relationship between human capital stock (LCAP) and growth underscores the importance of investing in education and skills to drive long-term economic development, echoing Mahembe and Odhiambo's assertion that FDI contributes indirectly through its interaction with human capital. However, the negative short-run impact of human capital growth (LHCG) and its delayed positive effect highlights the potential inefficiencies in rapid human capital expansion, which may not translate into immediate productivity gains. This could reflect mismatches between the skills being developed and those demanded by the economy, a theme also explored by Mahembe and Odhiambo, who stress that FDI's benefits depend on the host country's social and economic conditions.

5. CONCLUSION

This research aimed to analyse the relationship between foreign direct investment (FDI), political stability, and economic growth in South Africa, with a focus on understanding how political conditions influence FDI's impact on long-term economic outcomes. The findings reveal a complex interplay between these factors, providing new insights into the conditions under which FDI can either stimulate or hinder growth. While the study confirmed the positive impact of human capital stock on economic growth, it also revealed that labour force expansion and human capital growth have a negative effect on economic performance, both in the short and long run. This outcome highlights inefficiencies in how South Africa's labour market and education systems translate into productivity gains, a finding that contrasts with the widely held assumption that a growing labour force and increasing educational attainment should always contribute positively to growth.

One of the most intriguing findings is the negative impact of the interaction between FDI and political stability on growth, which contradicts much of the existing literature that associates political stability with enhanced FDI effectiveness. This suggests that in the South African context, sectoral allocation of FDI or institutional weaknesses might prevent the expected benefits of FDI from materialising. Investors may be channelling funds into capital-intensive sectors such as mining, which, while profitable, do not contribute significantly to broad-based economic development or labour market improvements. This discovery underscores the need for policymakers to consider not only political stability but also how FDI is managed and directed toward productive sectors that align with national economic goals.

This study fills a crucial gap in the literature by examining the direct impact of FDI's interaction with political stability on economic growth in South Africa, a middle-income country with unique economic challenges. The results indicate that political stability alone is not enough to ensure FDI translates into growth; targeted investments that support labour productivity and human capital development are equally vital. The research suggests that policymakers should focus on creating strategic FDI policies that attract investments in industries with high growth potential, especially sectors that can boost employment and local production capabilities. Furthermore, labour market reforms are necessary to ensure that an expanding labour force contributes more effectively to economic growth, rather than acting as a drag on productivity.

For future research, a deeper exploration into the sector-specific impacts of FDI is recommended, particularly in areas where labour-intensive industries and capital-intensive investments diverge in their contributions to growth. Additionally, the role of institutional quality and governance should be examined to better understand how they might enhance or inhibit the benefits of FDI, even in politically stable environments. This study raises

several thought-provoking questions: How can South Africa better align its FDI policies with its development objectives? Could focusing on institutional and governance reforms alongside political stability enhance the productivity of FDI? Addressing these questions is crucial for shaping future strategies that will ensure FDI supports inclusive and sustainable growth in South Africa. The findings suggest that simply ensuring political stability is not sufficient; more refined and strategic approaches are required to fully harness FDI's potential for long-term economic development.

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