A LEGAL AND POLICY PERSPECTIVE OF FOREIGN INVESTMENT IN KENYA : A CASE STUDY OF KENYA INVESTMENT AUTHORITY

BY

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DECLARATION

I, **KARANJA ANN WANGARI** declare that this project is my original work and has never been presented to any other university for award of any academic certificate or anything similar to such. I solemnly bear and stand to correct any inconsistence.

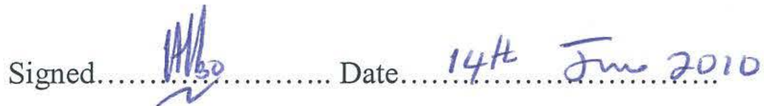
Signature

KARANJA ANN WANGARI

DATE :

14 - 06 - 2010
....

This is to certify that this research study of Karanja Ann, on the title, a legal and policy perspective of foreign investment in Kenya, a case study in Kenya Investment has been under my supervision. It's now ready for submission to the academic board of Kampala International University, with my approval.



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APPROVAL

This is to certify that this research study of Karanja Ann, on the title, a legal and policy perspective of foreign investment in Kenya, a case study in Kenya Investment has been under my supervision. It's now ready for submission to the academic board of Kampala International University, with my approval.

Signed…………………. Date…………………………..

Mr .Joseph Kyazze

Supervisor

DEDICATION

This work is affectionately dedicated to my parents Mr. Bernard Karanja and Mrs. Mary Njeri for their support patience and understanding during this period of study not forgetting all those who constantly wished me success.

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My gratitude first goes to God who has given me the strength and courage to undertake this research.

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DEFINITIONS OF KEY TERMS

Foreign investor: A company or other body corporate incorporated under the laws of a country other than Kenya.

Investment: The contribution of local or foreign capital by an investor, including the creation or acquisition of business assets by or for a business enterprise and includes the expansion, restructuring, improvement or rehabilitation of a business enterprise.

ABBREVIATIONS

ACP	Africa Caribbean Pacific
AGOA	African Growth and Opportunity Act
ARIPO	African Regional Industrial Property Organization
ATC	Agreement on Textiles and Clothing
BIT	Bilateral Investment Treaty
CAA	Civil Aviation Authority
CCK	Communications Commission of Kenya
COMESA	Common Market for Eastern and Southern Africa
DTT	Double Taxation Treaty
EAC	East African Community
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HCDA	Horticulture Crops Development Agency
ICAO	International Civil Aviation Authority
ICSID	International Center for Settlement of Investment Disputes
IPC	Investment Promotion Center
KACC	Kenya Anti-Corruption Commission
KARI	Kenya Agricultural Research Institute
KIA	Kenya Investment Authority
KIPI	Kenya Industrial Property Institute
KPA	Kenya Ports Authority
KPLC	Kenya Power and Lighting Company
KRA	Kenya Revenue Authority
LDC	Least Developed Country
MUB	Manufacturing Under Bond
NARC	National Rainbow Coalition
NEMA	National Environment Management Authority
TNC	Trans-National Corporation

TRIPS	Trade-Related Aspects of Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
UNESCO	United Nations Educational, Scientific and Cultural Organisation
WBES	World Business Environment Survey
WIPO	World Intellectual Property Organisation
WTO	World Trade Organisation

CHAPTER ONE

1.0 General Introduction

1.1 Background to the study

After gaining political independence in the 1960s, African countries like most developing nations were very skeptical about the virtues of free trade and investment. Consequently, in the 1970s and 1980s several countries in the region imposed trade restrictions and capital controls as part of a policy of .import-substitution industrialization aimed at protecting domestic industries and conserving scarce foreign exchange reserves. There is now substantial evidence that this inward-looking development strategy discouraged trade as well as foreign direct investment (FDI) and had deleterious effects on economic growth and living conditions in the region.

Kenya has had a long history of economic leadership in East Africa as one of the largest and most advanced economies in the region. Inconsistent efforts at structural reforms and poor policies over the past couple of decades, however, have generated a prolonged period of decline in development indicators and significantly eroded the leadership position, at a time when other countries in the region have made significant strides. While Kenya was a prime choice for foreign investors seeking to establish a presence in Eastern and Southern Africa in the 1960s and 1970s, poor economic policies or inconsistent efforts at structural reforms, rising problems of corruption and governance, and the deterioration of public services have discourage foreign direct investment FDI since the 1980s (Fischer et al, 1998).

The government elected in 2002 is well aware of the need to enact sweeping and lasting reforms of economic and social policy if it is to put Kenya on a sustained high-growth path. While it has started to enact some of the reforms underlined in its Economic Recovery Strategy for Wealth and Employment Creation adopted in 2003, much remains to be done. This research examines the efficacy of law and policy on the regulation of foreign direct investment in Kenya.

1.2 Definitions

According to the Oxford Advanced Learner's Dictionary[1], any investment flowing from one country into another is foreign investment. According to section 1 of the Investment Promotions Act[2], "foreign investor" means -

a) a natural person who is not a citizen of Kenya;

b) a partnership in which the controlling interest is owned by a person or persons who are not citizens of Kenya; or

c) a company or other body corporate incorporated under the laws of a country other than Kenya;

According to the Constitution of Kenya, Article 123[3] "investment" means the contribution of local or foreign capital by an investor, including the creation or acquisition of business assets by or for a business enterprise and includes the expansion, restructuring, improvement or rehabilitation of a business enterprise.

[1] Oxford Advanced Learner's Dictionary

[2] Section 1 ***Investment promotions act***, 2004, laws of kenya

[3] Article 123 Constitution of Kenya

1.3 Statement of the problem

The argument advanced is that legislation on its own is not sufficient to attract foreign investment. It is argued further that in attracting foreign investment to Kenya, there is need also to consider the socio-economic, political and cultural climate in the country and how all this has affected foreign investment of the country hence the need for this study.

1.4 Objectives of the study

1.4.1 General Objective

The general objective of the study is to investigate the legal, social, economic and political factors that hinder foreign direct investment in Kenya.

1.4.2 The specific objectives;

1) To investigate the benefits of foreign direct investment in Kenya.
2) To investigate the factors that has led to the poor investment record in Kenya.
3) To identify the steps that can be taken to improve the foreign direct investment in Kenya.

1.4.3 Research hypothesis;

The statement of the problem and the issues raised in this study are based on the researcher's supposition that in order to improve direct foreign investment in the context of agriculture, tourism, industrialization, it must be put in law, policy and institutional framework.

1.5 Significance of the Study

The study in intended to contribute to the knowledge in understanding the laws and policies relating to foreign investment. This will be achieved by elucidating on the meaning and principles underlying foreign investment, the background and development of foreign investment. A critical evaluation of the provisions of the Acts and Rules will

be undertaken. This evaluation coupled with a comparative analysis drawn from common law countries.

1.6 Methodology

The research was based on both quantitative and qualitative methods, this was intended to enable the researcher gather enough information on the subject, the researcher intended to undertake a detailed survey of the areas to be analyzed in this study, a detailed library research for literature related to the subject was examined and then critically analyzed to find out how many has been written on this subject.

Data was gathered mainly semi-structured intensive interviews of which some quotations had designed with predetermined answers, others had open-ended questions. Data was also collected from specialization and general libraries in the country and outside.

In addition to library and field information has been supplemented by more information which was obtained from the internet. Besides that, the researcher used context analysis for instance various research papers and booklets on the subject.

1.7 Scope of Study

The study covered the concern of the factors that promote and hinder foreign direct investment in the Kenya Investment Authority. Chapter one will include the introduction, back ground of the study, statement of the problems, objectives of the study, methodology, scope of study and literature review. Chapter two will analyze the legal basis of foreign investment. Further discussion will be on the regulatory frame work of foreign investment. Chapter three will discuss the costs and benefits as well as the barriers to foreign investment. Chapter four will analyze the measures that can be used to improve Foreign Direct Investment. Chapter five will consider the possible recommendations and the general conclusion.

1.8 Literature Review

Until recently, FDI was not fully embraced by African leaders as an essential feature of economic development, reflecting largely fears that it could lead to the loss of political sovereignty, push domestic firms into bankruptcy due to increased competition and, if entry is predominantly in the natural resource sector, accelerate the pace of environmental degradation. Much of African skepticism toward foreign investment is rooted in history, ideology, and the politics of the post-independence period. The prevailing attitudes and concerns in the region are due in part to the fact that policymakers in the region are not convinced that the potential benefits of FDI could be fully realized in the region. Clearly, the sector in which a country receives FDI affects the extent to which it could realize its potential benefits. In East Asia, substantial FDI went into the secondary sector thereby contributing to the diversification of the export base and to higher and sustained growth.[4]

Africa, on the other hand, receives FDI mostly in the primary sector, and so the benefits to the region have not been as significant as in East Asia. In this regard, a key challenge facing Africa is how to attract more FDI in dynamic products and sectors with high income elasticity of demand.

There is a small literature dealing with issues related to FDI flows to Africa (Schoeman et al, 2000). However, the existing literature focuses on the empirical determinants of FDI to the region, with very little discussion of concrete actions or strategies that could be adopted to promote FDI flows to the region. The present paper attempts to overcome this limitation. It emphasizes a new approach to the promotion of investment to the region

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[4] Moss, T., Ramachandran, V., & Shah, M. '*Is Africa's skepticism of foreign capital justified? Evidence from East African firm survey data. Center for Global Development*', Working Paper No. 41. 2004

that is based on improving relations with existing investors rather than focusing exclusively on costly activities of Investment Promotion Agencies. Furthermore, it identifies clearly what needs to be done at the national, regional, and international level to enhance FDI flows to Africa.

An identification of responsibilities and actions needed at the national, regional, and international level is important for two reasons. The first is that globalization has increased the competition for FDI flows among developing countries. Since Africa is not one of the preferred destinations for investment among foreign investors, it is increasingly being recognized that actions by African countries would have to be complemented by efforts at the regional and international levels in order to improve the prospects for FDI flows to the region (CCFA, 2003).

Consequently, it is important to identify the responsibilities that are required at the various levels in order to reverse Africa's dismal FDI record. Second, the New Partnership for Africa's Development (NEPAD) and the G8 "Africa Action Plan" call for a new relationship between African countries and their development partners that is based on shared responsibility for development effectiveness and outcomes (G8, 2002; ECA, 2003; World Bank, 2003). One of the areas in which there is clearly a need for shared responsibility is the attraction of private capital flows to the region. It is therefore important to identify areas of responsibilities at different levels to give African policy makers and their development partners concrete ideas on what they can do to increase FDI flows to the region.

Political risk, investment environment, infrastructure, regulatory framework, bureaucratic hurdles and red tape, judicial transparency, and the extent of corruption in the host country are found insignificant as determinants of FDI or have mixed influence on FDI inflow. For example, ***Wheeler and Mody (1992) and Singh and Jun (1995***) found that political risk and administrative efficiency are insignificant in determining FDI. ***Root and Ahmed (1979) and Schneider and Frey (1985),*** on the other hand found that political strikes and riots and regular constitutional changes in government significantly determine

FDI inflow. The mixed result might stems from the problems of getting reliable proxies for the qualitative phenomena, such as political instability (Korbin, 1981; Lim, 2001). It is, however, might be the case that high communication, information and transportation costs, pervasive corruption and poor infrastructural facilities can increase the transaction costs and risks to the foreign investors and thus can affect FDI inflow negatively. Thus, it is reasonable to postulate the following hypothesis:

H1: Countries with better physical infrastructure and business friendly environment, receive more FDI compared to others

UNCTAD (1998, 2000) emphasizes that some of foreign investors invest to developing countries mainly to serve the host countries' market. Domestic market size and market potentials might be the major determinants in attracting such type of foreign investors. Empirical literature often found the size of the market and the market potentiality, typically proxied by the level of GDP and GDP growth rate, significantly affect FDI inflow (e.g., Nunnenkamp and Spatz, 2002; Bandera and White, 1968; Schmitz and Bieri, 1972; Root and Ahmed, 1979; Torrisi, 1985;Schneider and Frey, 1985; Petrochilas, 1989; Wheeler and Mody, 1992; Jun and Singh, 1996). Thus, it is reasonable to postulate the following hypothesis:

H2: *Countries with higher per capita GDP and higher GDP growth rate are more likely to receive larger amount of FDI compared to others*

It is widely recognized that foreign direct investment (FDI) produces economic benefits to the recipient countries by providing capital, foreign exchange, technology, competition and by enhancing access to foreign markets (e.g., Brooks and Sumulong, 2003; World Bank, 1999; Caves, 1974; Crespo and Fontura, 2007; Romer, 1993; UNCTAD, 1991). It is argued that FDI can also enhance domestic investment and innovation (Brooks and Sumulong, 2003). To empirically examine the role of FDI on economic growth, it is reasonable to postulate the following hypothesis:

H3: FDI positively affects the GDP growth rate.

An econometric model has developed to empirically examine Hypotheses 1, 2 and 3 but before going to explain the model in details, the next section explains the general trends of FDI inflow in the developing countries

Developing countries are not only lagging behind in attracting FDI, but also the pattern of FDI inflow to the developing countries is highly uneven. A few developing countries enjoy massive FDI inflow, whereas other developing countries even face the problem of FDI outflow (negative FDI inflow). An analysis of the UNCTAD (2007) report reveals that lower-middle income countries, that is developing countries with per capita GNI lies between US$ 755 to US$ 2995 are more likely to be successful in attracting FDI, but low-income countries that is developing countries with per capita GNI less than 755 USD are comparatively less likely to be successful in attracting FDI. Table 2 presents the uneven pattern of FDI inflow into the developing countries. In Table 2, sample 60 countries are divided into two groups based on the amount of FDI they have received in 2005. The first group consists of top 20 FDI recipient countries and the second group consists of 40 low FDI countries in 2005.

Among the top 20 FDI recipient countries, six countries were from Africa, 10 countries were from Asia and four countries were from Latin America. In 2005, these top 20 FDI recipient countries received a total of 129738 million (USD) FDI and on average each top FDI recipient country received 6436.9 million USD as FDI. The performance in receiving FDI, however, varies across the continents. The top performing six African countries on average received FDI less than 2500 million USD in 2005, whereas the top performing 10 Asian countries received on an average 9823.6 million USD in the same year. The top performing four Latin American countries, on the other hand received FDI on an average 3895.8 million USD in 2005. Thus, among the top performing countries inflow of FDI is uneven and the Asian countries are performing the best.

In 2005 among the 20 top FDI recipient countries, 16 countries were the lower-middle income countries and only four countries were the low-income countries. Thus, lower-middle income developing countries tend to be more successful in attracting FDI and

they are the dominant recipient of FDI. The four low- income but four among the top 20 FDI recipient countries in 2005 were Nigeria, Vietnam, India and Pakistan.

Table 2 also presents the average and total inflow of FDI into 40 low-income countries (whose per capita GNI are less than US$ 755). Among 40 low FDI recipient countries, 24 were from Africa, 10 were from Asia and six were from Latin America. low income countries in general less successful in attracting FDI. In 2005, these 40 low FDI recipient countries received FDI only 5992 million USD in total with per country average FDI 149.8 million USD. Thus, the performance gap between top 20 FDI recipient countries and 40 low FDI recipient countries is very visible. The performance of the low recipient countries in terms of receiving FDI also varies across the continents. Table 2 shows that low FDI recipient Asian and Latin American countries on an average receive more FDI compared to the African countries.

Among 40 low FDI recipient countries, a total of 28 countries were the low- income countries and only 12 countries belonged to the lower-middle income group countries. These low FDI recipient but lower-middle income countries were: Nicaragua, Angola, Georgia, Honduras, Sri Lanka, Bhutan, Bolivia, Paraguay, Guatemala, Iran, Namibia and El Salvador. Thus, in general low-income countries were the low FDI recipient countries in 2005

Conclusion and Policy Implications

By bridging the gap between domestic savings and investment and by enhancing knowledge spillover, FDI can play important role in industrial advancement and economic growth in the developing countries. Although most of the developing countries have been taking measures to attract FDI, such as by offering incentive packages and liberalizing the trade regimes, only a few countries are successful in attracting a FDI. In this study, we tried to find out the influential factors that determine the FDI inflow. To find out the influential factors, the socio-economic condition of the sample top and low FDI recipient countries is compared. The findings show that top FDI recipient countries

in 2005 have large domestic market with high GDP growth rate. They are also well equipped with modern infrastructure, such as telephone and internet. Moreover, business environment in the top FDI recipient countries in 2005 is friendlier compared to other countries indicated by high score of corruption perception index and low business start-up costs. Thus the paper concludes that large GDP and high GDP growth rate, business friendly environment and modern communication facilities, such as internet encourage FDI inflow in the developing countries

CHAPTER TWO:

2.0 The Legal Basis for Foreign Investment in Kenya

2.1 Foreign Investment policy

Kenya, once the top performer in East Africa, has experienced stagnation over the past two decades, even though it remains the second largest economy in the region after Sudan, and is one of the more developed ones. The rapid rise in agricultural output and the development of the industrial sector under high tariff protection generated strong growth in the 1960s and 1970s, bringing real GDP per capita in 1980 65 percent higher than in 1964. The second oil crisis of 1979 took Kenya unprepared to respond to the shock, however, as the limitations to agricultural output growth and import substitution policies became obvious[5].

The 1980s and 1990s were characterized by a series of muted, incomplete and non-sustained attempts at macroeconomic and structural reforms. These never succeeded in putting Kenya on a sustained high-growth path, however, and only provided temporary relief based on the evolution of the world economic environment[6]. The Government's attempts to control the fiscal deficit, although relatively successful, failed to address the issue of current expenditure and succeeded only through a drastic reduction in capital spending. This has been accompanied by the deterioration of the once reasonably efficient and well-developed public infrastructure and increasing problems of governance and insecurity, which further discouraged private investment. Despite some resurgence in

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[5] Bende-Nabenfe, A. '*Foreign direct investment determinants in Sub-Saharan Africa: a cointegration analysis*'. Economics Bulletin 6, (2002). p.1-19.

[6] ECA. '*Assessing regional integration in Africa*'. Economic Commission for Africa Policy Research Report. Addis Ababa: ECA, (2004). p 23-27

growth in 1986-89 and 1995-96, real GDP per capita ended 5 percent lower in 2003 than in 1980.

In spite of its poor performance over the past two decades, Kenya still benefits from a more diversified economy than most of its neighbours. Agriculture remains the single largest sector, accounting for 23 percent of GDP in 2002. Some new sources of production have emerged strongly in recent years, however[7]. Floriculture and horticulture have been some of the fastest growing areas and important sources of export earnings. The services sector also gained considerable importance after independence, with tourism as one of the main success stories, even though it has suffered in recent years from domestic insecurity and travel advisories in several Western countries. Manufacturing as a share of total production has fluctuated throughout the past couple of decades, but was about 13 percent of GDP in 2002, similar to the level in the mid 1960s. The manufacturing sector has nevertheless been in difficulty in recent years as it has not been able to compete in global markets and has lost market shares in its traditional export markets within the region.

The government elected in 2002, was thus handed over the reins of a country in crisis following a long period of poor economic and industrial policies and where rampant corruption contributed to a weak investment climate. The new administration is aware of the need to drastically improve policies and provide a favourable setting for private investment to generate wealth and reduce poverty. The Economic Recovery Strategy for Wealth and Employment Creation adopted in 2003 aims to ensure that the public sector plays its regulatory and facilitator role for private investment. The Strategy is articulated around seven key areas: (1) the macroeconomic framework; (2) governance, security and

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[7] Morrisset, P. '***Foreign direct investment to Africa: policies also matter***'. Transnational Corporation, (2000). p 28-29

the rule of law; (3) public sector reforms; (4) infrastructure; (5) sectoral policies in agriculture, tourism, trade and industry; (6) social policies, and; (7) cross cutting issues such as the financial sector, land or research and development policies[8]. While foreign investors would benefit from improvements in all these areas, FDI could also contribute significantly in advancing the government's objectives and setting Kenya on a higher growth path.

2.1.1 FDI Trends and Performance

FDI grew steadily through the 1970s as Kenya was a prime choice for foreign investors seeking to establish a presence in Eastern and Southern Africa. The relatively high level of development, good infrastructure, market size, growth and openness to FDI at a time when other countries in the region had relatively closed regimes all contributed to TNCs choosing Kenya as their regional hub. FDI started at a low of around $10 million a year in the early 1970s before peaking at $80 million in 1979-1980.[9]

The deterioration in economic performance highlighted above, together with rising problems of corruption, governance, inconsistency in economic policies and structural reforms and the deterioration of public services and infrastructure generated a long period of low FDI that started in the early 1980s and continues to date. Inflows of FDI in the period 1981-1999 averaged only $22 million a year. Although the sale of mobile phone licences to Kenyan-foreign joint ventures pushed FDI to over $100 million in 2000, inflows fell again to around their average of the 1980s and 1990s, before rising again in

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[8] Sachs, J. & Sievers, S. '*FDI in Africa. Africa Competitiveness Report 1998*'. Geneva: World Economic Forum, (1998). 67-59

[9] UNCTAD. '*World Investment Report 2003. Geneva*': United Nations Conference on Trade and Development, (2003). p 211-132

2003 on the back of textile investments in export processing zones (EPZs) that may not prove sustainable.

Although Kenya was the lead destination of FDI to the East African Community (EAC) in the 1970s and 1980s, the relative level of inflows was never high by developing countries standards, as illustrated by the stock of FDI, which was only 7.5 percent of GDP in 2003, compared with 25.3 percent for Africa as a whole and 31.5 percent for developing countries. Kenya's regional leadership in attracting FDI also disappeared as soon as Tanzania and Uganda started reforming their economies and opening up to foreign investors in the early 1990s, at a time when Kenya itself was suffering from economic stagnation. The end of apartheid in South Africa in 1994 also increased competition in the attraction of large FDI seeking a single production or headquarter centre in Anglophone Africa.

FDI inflows in 1996-2003 averaged $39 million a year, while inflows to Tanzania and Uganda surged to $280 million and $220 million, respectively, from negligible levels in the 1980s. In relative terms, Kenya fares even worse, as its economy was about 30 percent larger than Tanzania's and twice as big as Uganda's in 2002. While developing countries as a whole attracted an annual average of $41 of FDI per capita in 1996-2003, Kenya only drew average inflows of $1.3 per capita. This ranks Kenya as 129th (out of 140 countries) on UNCTAD's FDI performance index in 2001-031. It has also never ranked better than 111th at any time since 1990.

2.1.2 Distribution by Sector and Industry

The most notable recent trends in sectoral composition of FDI are investments in the horticulture, floriculture and garments areas, in addition to continued investment in tourism. Interest in horticulture and floriculture has been in response to favourable local conditions linked to climate and transport infrastructure. Garment investment has been in response to the U.S. granting preferential access to its market under the African Growth and Opportunity Act (AGOA). AGOA has had such a great influence in promoting investment in Kenya. There is a strong possibility, however, that Kenya will not continue

to attract such investments in the future following the full elimination of quotas in 2005 with the integration of textile trade under normal WTO rules[10].

Kenya does not keep comprehensive data on the value of actual foreign direct investment by sector and industry. The sectoral breakdown of the 820 projects with a foreign participation that the Investment Promotion Centre (IPC) registered between 1997 and 2004. The list is not indicative of all foreign investment in the country as investors are not required to liaise with the IPC and not all projects are implemented. Foreign participation in the economy has been diversified, with "other manufacturing" and "other sectors" accounting for half of the foreign investment recorded by the IPC. Other manufacturing consists of a wide variety of basic consumer and industrial goods. Other sectors include services such as transportation and construction, assembly and trading. The largest sectors of note are investments in power generation, tourism, agriculture and agro processing.[11]

Foreign investors play a major role in floriculture and horticulture, with close to 90 percent of flower production controlled by foreign affiliates. Foreign investors have also been in good part at the origin of the success of the sector. A Dutch company, Dansk Chrysanthemum and Kultuur (DCK), the then largest world producer of chrysanthemum cuttings, was the first to set up a large flower firm in 1969, with the benefit of government incentives and a Dutch government grant3. Many of its employees subsequently went on to play a role in other flower and vegetable companies. Brooke Bond of the U.K. also invested in a former DCK farm that became a major flower and vegetable firm. It was taken over by Homegrown in 2002 and renamed Kingfisher Farm.

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[10] UNCTAD ***Prospects for foreign direct investment and the strategies of transnational corporations,*** 2004-2007. Geneva: United Nations Conference on Trade and Development, (2004). p 142-143

[11] World Bank Strategic Partnership with Africa: ***From strategy to implementation. African Region, World Bank,*** (2003). P. 561- 570

In the 1980s, Dutch investors formed the Oserian Development Company, which is now a leading horticulture player with 4,500 workers[12].

The initial development and growth in horticulture was favoured by spillovers from the tourism sector. Frequent passenger air connections with Europe offered the essential cargo space for transporting fresh produce from Kenya at a time when volumes would not justify the use of dedicated cargo planes. Rapidly growing export volumes subsequently made the use and development of cargo facilities economical, but the initial spillover from tourism was essential. The growing use of high-quality fruit and vegetables by local hotels and restaurants also gave farmers more experience in horticulture and an outlet for produce not meeting export standards.

Kenya's success in growing vegetables is also related to the growth of the Asian community in the U.K. and the expertise and knowledge brought by Asians who were expelled from Uganda and had good knowledge of and close links with Kenya. This increased the demand for Asian vegetables, for which Kenya has an advantage in production as they can be grown throughout the year. The presence of the Asian community in Kenya means that there are many family ties with traders in London, reducing transaction costs. The involvement of small scale producers has also been important in the growth of the sectors. They entered production due to low prices for coffee and tea in the 1970s. Most exporters have contracts with large U.K. and European retailers. They have processing factories near Nairobi airport where vegetables grown in rural areas are prepared for delivery. In the early 1990s smallholders represented the majority of vegetable production for export, though by the end of the decade they had been superseded by large commercial farms and exporters' own farms.

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[12] Akinlo, A. E. ***'Foreign direct investment and economic growth in Sub-Saharan Africa'*** International Review of Economics and Business 50, (2003). P. 569-80

Manufacturing FDI has concentrated on consumer goods sectors, such as the food and beverage industry. This has changed in recent years, however, with the growth of the garments sector due to AGOA. Of 34 companies producing garments for the US market, are fully foreign-owned. AGOA related investments in the past couple of years have represented around 80 percent of FDI. Though these investments have increased employment and exports, the dominance of garments-related FDI is of concern as it may not be sustainable. Foreign enterprises have entered to take advantage of the duty and quota-free access available to the U.S. With the elimination of remaining quotas in 2005 and the integration of trade in textiles and clothing under normal WTO rules, it is likely that China and other Asian countries will supply a large part of the US apparel market due to their cost and quality advantage over many countries, including Kenya.[13]

FDI in services has been directed to a wide array of sub-sectors, including tourism, financial and business services and telecommunications. The country's diversified tourism sector has long been a magnet for foreign investment. Tour operators are dominated by foreign operators such as United Touring Company (U.K.), Express Travel (U.S.), Abercrombie and Kent (U.K.) and Pollmans (Germany). The largest projects are in the establishment of hotels and lodges for coastal and safari tourism. A number of the major international hotel chains are present, including Hilton, Intercontinental, Serena, Block Hotels and Holiday Inn. New trends have been timeshare holidays and ecotourism.

Kenya has also attracted foreign investors in banking and professional services. Companies such as Deloitte Touche Tohmatsu, Ernst and Young and KPMG base their main East African operations in Kenya. Thirteen of the 43 banks in Kenya are foreign, controlling 51 percent of total banking assets in the country. The largest are Barclays (U.K., 21 percent of assets), Standard Chartered (U.K., 14 percent), Citibank (U.S., 7

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[13] Annual USAID report, Kenya, 2004

percent), and Stanbic (South Africa, 2 percent). Two of these international banks (Barclays and Standard Chartered) dominate commercial banking along with the state-controlled Kenya Commercial Bank.[14]

The power sector has seen investment through the award of Independent Power Producer (IPP) contracts to foreign investors: IberAfrica Power (Spain), Westmont Power (U.S.), OrPower4 (U.S.), and Tsavo Power (a consortium). Four of the 14 IPPs in Africa are based in Kenya.[15]

Foreign investors have been involved in the telecommunication sector through their shareholding in the two mobile phone operators and the purchase of licences in 1999 and 2000. Safaricom is 40 percent owned by Vodafone of the U.K. and Kencel is currently 60 percent owned by Celtel of the Netherlands (which purchased Vivendi's participation in 2004). Both consortiums purchased licences through auctions for $55 million each. A third national mobile operator, Econet of South Africa, was awarded a licence in 2003, but has not been able to operate due initially to litigation by the other bidders and subsequently to internal disagreements within the consortium. The end of Telkom Kenya's monopoly on voice telephony and internet backbone provision in July 2004 has opened the way for new entrants in the sector. Safaricom, among others, has bid for an internet gateway licence. A second fixed line operator was selected in July 2004 through competitive bidding but the process has been subsequently put on hold due to a dispute between the regulator and the Government regarding the bid price[16].

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[14] Anderson. K. ,Dimaranan .B. ,Francois. J., Hertel. T., Hoekman. B. &Martin. W., '*The cost of rich (and poor) country protection to developing countries*'. Journal of African Economies 2001, p. 227-257.

[15]Ibid.

[16] Anderson, K., Dimaranan, B., Francois, J., Hertel, T., Hoekman, B., & Martin. W. '*The cost of rich (and poor) country protection to developing countries*'. *Journal of African Economies* 10, (2001). 227-257.

2.3 Regulatory Framework

Kenya's legal system is based on English common law. It is based mostly on sound principles, although in some areas it does not reflect modern approaches to regulating investment and commercial transactions. Actual practices also do not necessarily respect the spirit and principles of the law. The authorities have nevertheless made good progress in modernising the legal regime in certain key areas over the past decade, including for telecommunications, electricity and intellectual property. Parliament also adopted the Investment Promotion Bill at the end of 2004 and is currently examining a Privatisation Bill.

2.3.1 Entry, Treatment and Protection of FDI

For decades, Kenya had one of the most open regimes for FDI in Africa. The principal restrictions were contained in the Trade Licensing Act (1968, with subsequent amendments), even though the FDI-related restrictions had not been enforced recently. Apart from this Act, the only formal limits on foreign ownership were in telecommunications and insurance (in which foreign ownership of a business is limited by policy to 70 percent and 77 percent respectively) and for companies listed on the Nairobi Stock Exchange, which are required to have at least 25 percent national ownership. Moreover, FDI did not require screening for approval.

A new FDI entry regime was introduced in late 2004, which overturned this approach. As a result, one of the most liberal entry regimes for FDI in Sub-Saharan Africa has been replaced by one of the more restrictive ones. The Investment Promotion Act (2004)[17], which the President ratified on December 31, 2004, introduces a mandatory investment threshold and restrictive screening procedure for all foreign investments. These are set to become a significant impediment to FDI inflows. The Act makes a formal distinction

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[17] Sec. 12

between domestic and foreign investors, and requires the latter to apply to the newly established Kenya Investment Authority (KIA) for an Investment Certificate by stating that "a foreign investor shall not invest in Kenya unless [it] has been issued with an investment certificate.[18]

The conditions under which KIA is allowed to issue an Investment Certificate to a foreign investor are restrictive and include the following requirements:

• The amount invested must be at least $500,000 or the equivalent in another currency.

• The investment must be deemed by KIA to be to the benefit of Kenya, including at least as a result of: (1) the creation of employment for Kenyans; (2) the acquisition of new skills or technology by Kenyans and; (3) the contribution to tax revenues or other Government revenues. Other factors such as the contribution to foreign exchange earnings or utilisation of domestic inputs are to be taken into account as well, but are not part of the requirements as the three items listed above.[19]

In contrast, domestic investors are not required to obtain Investment Certificates, but those that do not seek them are nevertheless required to register their investment with KIA. The minimum capital investment for domestic investors seeking an Investment Certificate is lower at Ksh5 million ($65,000), but they must fulfill the same requirements to be deemed "beneficial to Kenya[20]."

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[18] Sec. 3(3)

[19] Sec. 3(4)

[20] Asiedu, E. '*The determinants of foreign direct investment to developing countries: is Africa different?*' World Development 30, (2002). p. 107-119

The principle of national treatment of FDI is not enshrined in law. In general, however, foreign investors receive the same treatment as domestic investors once established in Kenya. The main deviation from national treatment (aside from those related to trade licenses described above) is in terms of access to agricultural land.

Section 24 of the Land Control Act[21] (1967, with subsequent amendments) specifically forbids noncitizens and private companies any of whose members is non-citizen to acquire or lease agricultural land. The Act nevertheless also allows the President to grant exemptions to the restrictions mentioned above, without having to provide justification or impose conditions on the transaction. His discretionary power in this matter is thus total and not limited by law.

Protection of private property, including for foreign investors, is enshrined in Article 75 of the Constitution[22]. Private property may be compulsorily acquired by the Government only for reasons pertaining to public safety or public interest, and with "prompt payment of full compensation". The owner of the property also has a right of direct access to the High Court if he wishes to contest the legality of the expropriation, the amount of the compensation, or to enforce prompt payment of the compensation. The draft Constitution, which is currently discussed in a Commission, offers stronger protection yet, as it would require prompt payment in full of just compensation before the property is expropriated.

Foreign investors also have the option to have recourse to the International Centre for Settlement of Investment Disputes (ICSID), as Kenya has been a member of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards since 1967. The effect of the aforementioned convention gives powers to judges of commercial

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[21] Section 24 of the 1967 Land Control Act.

[22] Article 75 of constitution.

courts to take arbitration as an option to resolve disputes. Recourse to ICSID[23] for conciliation or arbitration requires consent of both parties involved in the dispute, as specified by the ICSID convention.

Investment disputes are purely commercial. Because of this fact, investors would prefer their disputes to be resolved commercially. One of the preferable methods of commercial disputes resolution is arbitration. In understanding the importance of arbitration, many commercial contracts carry with them arbitration clauses. An arbitration clause is a clause in a contract, which provides that in the event of any dispute between the contracting parties the same will be settled by arbitration. Thus protection of investor's interests when disputes or differences arise is of critical importance in commerce.[24] The Arbitration Act[25] applies to domestic and international arbitration. It largely adopted the UNCITRAL[26] Modal Law in as much as interim measures, peremptory orders, conciliation, court interventions, procedures on reference and powers and duties of the arbitral tribunal are concerned. The Investment Disputes Convention Act[27] (1967) stipulates that awards granted by the ICSID Arbitration Tribunal are binding in Kenya and have the same validity as final decrees of the High Court. Kenya is also investors to

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[23] Established by the World Bank pursuant to Article I of the Convention on the Settlement of Investment Dispute between States and Nationals of other states in October 1966. It specifically designed to facilitate the settlement of disputes between Governments and Foreign Investors with a view to helping in promotion an increase flow on international investment.

[24] Peter C.M., '*Settlement of Investment Disputes*', Journal of International Arbitration, Vol.5, No. 1 Geneva, 1988. P.68

[25] Section 14

[26] This is the core legal body within the United Natons system in the field of Interantional Trade law. It was established by the General Assembly in 1966.

[27] Section 18

seek cover for currency transfer risks, expropriation, breach of contract or war and civil disturbance[28].

Kenya has negotiated Bilateral Investment Treaties (BITs) only with Germany, Italy, the Netherlands and the United Kingdom. Of these, only the latter two have been ratified and Come into force. In contrast, Uganda has 11 BITs ratified under negotiation, Tanzania 10, and Egypt 88. The provisions in the BITs are standard in that they provide for national treatment as regards management, maintenance, use, enjoyment or disposal of investment, most favoured nation status and compensation for war, national emergency and other related losses. They also guarantee transfer rights and provide protection against arbitrary expropriation and prompt, adequate and effective compensation in case of expropriation. The BITs usually bind the States to consent to international arbitration to ICSID if the investor requests it, and if local remedies have been ineffective after a set period of time (typically a few months). As of end-2004, only one case had been filed to ICSID, by the World Duty Free Company Ltd, relative to issues of bribery in connection with the Goldenberg case.[29]

2.3.2 General Measures for Regulating Business Taxation

Kenya's tax system is relatively straightforward and is not widely used to provide targeted sectoral incentives. The administration of the system is efficient and fair relative to other developing countries. Kenya compares favourably with other countries in the region and elsewhere in terms of revenue collection as a percentage of GDP, which averaged 21.2 percent between 2000 and 2003. It relies relatively heavily on customs and

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[28] **Bhattacharya, A., Montiel**, P., & Sharma, S.. How can Sub-Saharan Africa attract more private capital inflows? Finance & Development, June. (1997) P 311-312

[29] Supra p.69

excise duties, which represent close to 50 percent of total revenue, although this is also the case among comparable countries[30].

Investors' concerns about the tax regime are focused less on the structure of the system itself or the level of taxation, and more on what they perceive as a rather "aggressive" attitude of the Kenya Revenue Authorities (KRA) with respect to compliant tax payers, and the "punitive" levels of penalties in case of delay in payments or minor mistakes in reporting. They often perceive KRA as expanding too much effort on chasing existing tax payers at the expense of its efforts to widen the tax basis. They also raised concerns about delays in reimbursements of excess VAT payments and duty drawbacks, and the administration of customs. The overall efficiency and competence of the KRA must be commended; however, as efficient tax collection is key to the functioning of the economy.

Although the tax regime is generally appropriate and competitive, both within the region and globally, a few issues raise significant concern for investors and are impediments to the use of Kenya as a business platform for the region. The main concerns that need to be addressed include:

The Income Tax Act[31], is on Double taxation of profits or income from operations within the region. The absence of unilateral tax credits and DTTs with partners in the region is a major impediment to the development of Kenya as regional hub. Ratification of the EAC treaty and the conclusion of DTTs with other countries in the region are essential to make real Kenya's ambition to become a regional hub for manufacturing and services activities.

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[30] Djankov, S., La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. ***The regulation of entry. National Bureau of Economic Research Working Paper*** *No.* 7892. (2000) P 230-240

[31] Section 12

Until the EAC treaty is ratified and additional DTTs are negotiated with countries in the region, the authorities would be well advised to allow unilateral foreign tax credits to the extent of the amount of foreign tax paid on the income derived from foreign operations.

The imposition of a 5% withholding tax on agency and consultancy fees between two resident entities is another impediment to the development of a regional services hub, in particular when potential refunds following income tax returns are processed slowly. The withholding tax generates a heavy burden on the cash flow of nascent services companies that may not generate significant profits and hence qualify for refunds once income tax returns are filed. A less detrimental way to ensure tax compliance would be to impose a relatively small nominal withholding tax on agency and consultancy fees, not to exceed a specified percentage of one to two percent of the amount, whichever is lower[32].

A major weakness of the Income Tax Act as far as international investors are concerned resides in the issue of transfer pricing. The VAT Act stipulates that the taxable value of goods traded among affiliated companies should be "the price at which the supply would have been provided in the ordinary course of business to a person independent of the registered person". The Income Tax Act[33], in turn, seeks to avoid tax evasion by stipulating that "the gains or profits of that resident person from that business shall be deemed to be the amount that might have been expected to accrue if the course of that business had been conducted by independent persons dealing at arm's length." The KRA has not determined clear guidelines as to how companies should determine transfer prices, however, and they have not adopted the widely accepted OECD principles. This absence of guidelines remains a concern to investors, who currently face uncertainty

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[32] ECA. '*Assessing regional integration in Africa*', Economic Commission for Africa Policy Research Report. Addis Ababa: ECA (2004) P 788-789

[33] Section 18

regarding KRA's position vis-à-vis their methods of assessing transfer prices, and hence their tax base. A clear position from KRA on such an important and sensitive issue is required to reassure investors and is an indispensable part of a modern and enforceable tax code[34].

2.3.3. Foreign Exchange control

Kenya switched from a fixed exchange rate regime (1966-1982) to a crawling peg tied to a basket of major currencies (1983-1993) before floating the Shilling in October 1993. It fully liberalised capital account transactions in 1994 and signed up to the IMF's Article VIII that ensures currency convertibility for current account transactions and bans multiple currency practices. The Exchange Control Act was repealed in 1995, and all foreign exchange transactions are free of any restriction[35].

There are no multiple currency practices, and the exchange rate is freely determined in the inter-bank foreign exchange market. The Central Bank of Kenya reports very little in terms of intervention on the inter-bank market to stabilise the Shilling. Its intervention occurred mainly in the years following the floating of the Shilling, and it reports only 3 interventions in 1999, 6 in 2000 and only one other intervention since then. The Shilling has nevertheless remained relatively stable against the dollar in recent years, as it depreciated from about Sh60/$1 in late 1998 to trade in a range of Sh73/$1 to Sh79/$1 between early 2000 and early 2005.

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[34] Fischer, S., Hernandez-Cata, E. & Khan, M. S. Africa: *'Is this the turning point? International Monetary Fund Paper on Policy Analysis and Assessment'* (1998). P 448-459

[35] Harrison, A. '*Determinants and effects of direct foreign investment in Cote d'Ivoire, Morocco, and Venezuela*'. In M. Roberts & J. Tybout (Eds.), Industrial evolution in developing countries, micro patterns of turnover, productivity and market structure. New York: Oxford University Press (1996). P 229-300.

2.3.4 Import controls

Imports were subject to seven tariff bands ranging from 0 percent to 35 percent until the end of 2004, with a weighted average MFN tariff of 13.3 percent in 2001. Under the protocol establishing the East African Community (EAC) Customs Union signed in March 2004, Kenya, Tanzania and Uganda adopted a common external tariff starting on January 1, 2005, however. Raw materials and capital goods are now subject to a tariff of 0 percent, with intermediate goods and final consumer goods taxed at 10 percent and 25 percent, respectively[36].

As for Value Added Tax (VAT) and income tax, investors raised the concern that KRA's focus on revenue collection is at the expense of other services/functions it should serve. In particular, the customs administration plays a crucial role beyond raising revenue, as it is key to facilitating trade and ensuring the enforcement of quality standards on imported goods. Symptomatically, while organisational performance is regularly and comprehensively assessed based on revenue targets, the customs department collects little information on clearance time and does not benchmark its performance. It also does not systematically keep track of compliance by traders, which prevents it from carrying differentiated physical inspections based on track records[37].

A customs duty drawback scheme is available to exporters. It allows domestic producers to claim exemptions (subject to a bond) on the payment of customs duties on their imported operating inputs. The scheme also allows domestic providers of inputs to direct exporters to claim exemptions on their own imported inputs, in order to encourage

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[36] Lemi, A. & Asefa, S. ***Foreign direct investment and uncertainty***: empirical evidence from Africa. Africa Finance Journal 5, (2003) 36-67.

[37] Sachs, J. & Sievers, S. ***FDI in Africa. Africa Competitiveness Report 1998.*** Geneva: World Economic Forum (1998). P 78-90

linkages between direct exporters and local suppliers. Exemptions for domestic suppliers of inputs to direct exporters can go back two stages of production, i.e. transactions either directly from a local supplier to a direct exporter, or from a local supplier to another local supplier providing input to a direct exporter.

2.3.5 Land

Access to land and the administration of land ownership titles raise serious concerns to foreign and domestic investors alike. As in other cases, the experience of foreign investors seems to be mixed, which is another reflection of the degree of discretionary powers granted under the law to its administrators. Land classification falls under three categories: government land (20 percent of the total), trust land (held by county councils, 60 percent of the total) and private land (20 percent of the total). There are also three main ownership titles: freehold, leasehold (generally, but not exclusively, 99 years) and customary tenure (which varies by region and ethnic groups).

The issues regarding access to agricultural land and land for industrial or offices purposes are quite distinct and are thus dealt with separately. Transactions in agricultural land are regulated by the Land Control Act (1967, with subsequent amendments). All areas of agricultural land, as defined by the Minister of Land, are administered by a Land Control Board, which must give its consent to all transactions, including sale, transfer, lease, mortgage and partition[38].

Aside from ensuring that agricultural land is actually used for agricultural purposes, land control boards are specifically required by the Land Control Act to refuse their consent to

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[38] UNCTAD. Prospects for foreign direct investment and the strategies of transnational corporations, 2004-2007. Geneva: United Nations Conference on Trade and Development.

any transaction that involves either a non-citizen or a private company or co-operative any of whose members is non-citizens. The very same Act, however, also gives full discretionary powers to the President to grant exemptions to any controlled transactions (including transactions involving foreigners), on a case-by-case or more general basis without being required to provide justification, and "on such conditions (if any) as he may think fit to impose."

Presidential exemption is thus the main channel through which foreign investors can acquire agricultural land. There are no procedures and publicised guidelines that investors can follow, however, as applications are considered on a case-by-case basis and on their own merit. Initial access to the Presidency is obviously the first hurdle to clear for foreign investors, as no clear procedure exists. The lack of guidelines in the granting of exemptions and the involvement of a number of Ministries (including the Ministries of Environment, Home Affairs and Land) also make the process very unpredictable and lengthy.

2.3.6. Environmental Regulations

The Environmental Management and Co-ordination Act (2000) recently introduced comprehensive and modern rules regulating environmental protection. The Act established both the National Environment Council, in charge of policy formulation and of promoting co-operation among public departments, and the National Environment Management Authority (NEMA), which has wide powers to implement the Act. The main features of the Act that are most likely to affect investors are as follows:

• The Act establishes the right of every person to a "clean and healthy" environment. It gives the power to any person (whether immediately affected by environmental damage or not) to apply to the High Court for relief. The High Court itself may order the shutdown of a polluting activity and order restoration and compensation.[39]

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[39] Section 4

• The Act entrenches the principles of polluter-pays and provides for the protection of special areas, including rivers, lakes, wetlands, hilltops and mountains, forests and coastal areas where activities are subject to specific rules.[40]

• Environmental impact assessments are required for a specified range of investments, which include mining, urban development, transportation, agriculture, electricity and many manufacturing industries.

The Act is modern and the principles underlying the environmental impact assessments are sound. It is vital to ensure that the process of granting licences is smooth and well coordinated among public agencies, however. It is encouraging in that respect that the Act specifically empowers the National Environment Council and NEMA to lead and coordinate all agencies dealing with environmental matters.

2.3.7. Labour Regulation

Labour market regulations offer a mix of flexibility in hiring and firing procedures with significant rigidities in the setting of minimum wages and indirect labour costs. In general, investors concur that labour relations are good and do not constitute a major source of problems. About 66 per cent of investors surveyed by the World Bank in 2000 in the World Business Environment Survey (WBES) stated that labour regulations were "no obstacle" or a "minor obstacle" to their operation and the growth of business. This is in sharp contrast to other countries in the region where labour disputes are more prevalent, in particular South Africa and the United Republic of Tanzania, where 85 per cent and 55 per cent of investors, respectively, stated that labour regulations were a "moderate obstacle" or "major obstacle".

The definition of gross misconduct that can justify summary dismissal for a lawful cause is relatively wide and includes absenteeism and neglect in performing duty. Termination of employment through redundancy, in contrast, is more rigid as it is considered a trade

[40] Section 8

dispute in all cases, regardless of whether there is an agreement between the employer and the employee(s) or not. This implies that all redundancies must be reported to the Ministry of Labour, which can either confirm the terms of the redundancy or invoke a settlement procedure if necessary. This procedure may involve a direct attempt at conciliation, or referring the case to the Industrial Court. Standard terms for redundancies require employers to pay two weeks of salary per year of employment.

Although labour is relatively unionized, the Trade Disputes Act (1965, with subsequent revisions) restricts the right to strike and lock-outs. Until 2003, employees in EPZ companies were not allowed union representation. Industrial unrest in many EPZs, however, pushed the Government to lift the exemption, and all labour regulations currently apply equally to EPZ enterprises.

In addition to wages, employers are required under the Employment Act (1976, with subsequent amendments) to provide their employees with: (1) "reasonable housing accommodation" at or near the place of employment; (2) access to water; and (3) "proper medicines during illness and medical attendance during serious illness". In practice, most employers provide their employees with a housing allowance and private medical insurance.

Minimum wages are set separately for three regions: (1) Nairobi and Mombasa; (2) a number of the main municipalities and townships; and (3) all other areas of the country. While this regional differentiation in minimum wages is sensible given the wide regional disparities in cost of living, the Regulation of Wages and Conditions of Employment Act (1951, with subsequent amendments) also sets minimum wages for a near-exhaustive list of professions and functions. This level of detail is not justified and introduces unnecessary rigidities and administrative costs.

Minimum wages also appear relatively high compared with other countries at a similar level of development; this affects Kenya's competitiveness in low-skill, labour-intensive sectors subject to global competition and thin profit margins. As of 2002, the minimum

monthly wage ranged from about $24 for unskilled workers to $84 for a higher skilled position. Additionally, total labour costs are further increased by the allowances described above, as illustrated by average earnings data by sub-sectors.

2.3.8. Employment of Foreigners

Kenya follows a rather dated approach to granting work permits that creates uncertainty for applicants. This was reflected in interviews with foreign investors, as some reported no difficulties in obtaining work permits, while in other instances investment was frustrated by such problems, particularly in the services sector. There are essentially two types of permits that can be granted under the Immigration Act (1967, with subsequent amendments), which consolidate work permits and entry permit into a single pass:

• Class A or D permits can be granted to an individual who is offered specific employment by a specific employer.

• Class F to J permits are essentially "investors permits" for individuals who propose to invest in different types of activities, from agriculture to manufacturing or professional services. The Immigration Act does not prescribe any minimum amount of investment for such permits, although it specifies that the individual must have

> *"in his own right and at his full and free disposition sufficient capital and other resources for the purpose".*

Applications for work permits are examined on a case-by-case basis by a Committee chaired by the Department of Immigration, and which includes representatives from the Ministries of Foreign Affairs, Labour, Tourism, Trade and Industry and the Investment Promotion Centre. While the Immigration Act specifies that work permits can be granted to foreigners on condition that "employment will be of benefit to Kenya", the concept is not clearly defined by law. There are also no publicized guidelines as to how "benefit to Kenya" is to be understood. This increases the degree of discretion granted to the Committee and the level of uncertainty for investors.

A single application is filed that justifies the merit of hiring an expatriate for the position and the merit of the individual proposed for the position. The petitioner must justify the steps that have been attempted to fill the position with a Kenyan citizen and why this has not been possible. This involves, in most cases, an extensive labour market test and requires advertising the position domestically, collecting curricula vitae and interviewing citizens. In some instances, for example high technologies, where local skills are in obvious shortage, this requirement may be bypassed.

The granting of work permits to non-citizens is also conditional on a rigid understudy programme. Petitioners are required to recruit or designate a Kenyan employee as an understudy to the expatriate worker, with the aim of replacing the latter in a specified period of time. This arrangement has proved very rigid and is susceptible to many problems ranging from the understudy leaving the company before being trained to replace the expatriate employee to lack of competence of the individual, or manoeuvering by the firms to avoid replacing the expatriate with the understudy.

Work permits are typically issued for a two-year period that can be extended to a maximum of five years. They are also renewable. Circumstantial evidence from investors' experience tends to show that work permits are easier to secure when the capital investment is significant or when the investment is likely to generate significant export earnings. The immigration authorities also indicated that they tend to be more liberal in granting work permits for companies operating in export processing zones, as they tend to generate both a high level of employment for citizens and foreign currency earnings. Investments in services sectors that require a smaller injection of capital are scrutinized more carefully as the authorities fear an inflow of illegitimate workers. However, this seems to have also generated problems for legitimate investors in the skill-intensive but low-capital services sector in securing work permits.

Although the procedure for allocating work permits is rather cumbersome and discretionary, data show that the immigration authorities have issued a relatively significant number of work permits in relation to the total workforce in employment in

the past few years. The number of employee permits granted has hovered around 6,500 a year, with about 2,500 investor permits allocated every year (table II.4). These figures include renewals, however, which means that the pool of expatriate workers has decreased slightly over the past few years. This situation could thus be responsible for frustrations for new investors, who are likely to face greater problems in securing new permits than established investors face in obtaining renewals. The estimated number of expatriates working in Kenya relative to the total labour force in private sector formal employment is about 1.2 per cent for expatriates under A or D permits, and about 0.5 per cent for expatriates under "investor's permits".

	1998	1999	2000	2001	2002	2003
A&D, including renewals	7,342	5,452	6,504	6,116	6,591	5,134
A&D, stock as % of wage employment (est.)*	1.6	1.3	1.2	1.2	1.2	n.a.
F-J including renewals	2,635	2,061	2,162	2,970	2,938	2,489
F-J, stock as % of wage employment (est.)*	0.6	0.5	0.4	0.5	0.6	n.a.
Total private sector wage employment	967,200	989,900	1,002,900	1,018,700	1,040,900	n.a.

Table I: Allocation of Work Permits (Absolute numbers, unless specified)

**Outstanding stock of work permits is estimated on the assumption that all permits have a 2-year validity. The sum of all permits granted over the previous 2-year period should thus indicate the outstanding number of permits in any given year. Work permits granted to staff of embassies, the United Nations or missionaries are excluded from the data.*

The new Investment Promotion Act entitles holders of Investment Certificates (whether foreign or domestic investors) to three class A (employee) permits for management or technical staff and three class H, I or J (investors) permits for owners, shareholders or partners. The permits are to be issued for an initial period of two years, and holders of certificates are entitled to have the permits renewed or transferred to another employee or investor if necessary, without time limit. Security, credentials and health checks on nominated individuals will obviously still be conducted following regular procedures.

The entitlement to six permits is a step in the right direction. It will greatly facilitate the key foreign personnel requirements of foreign investors. This "key position" approach is increasingly used in other countries. The unusual feature of the Kenyan law is that this incentive mechanism has been extended into an outright ban on all foreign investment below the prescribed limit of $500,000. Elsewhere in this report it is recommended that the outright ban be reconsidered. If this occurs, a lower threshold for eligibility for key positions should also be considered. In other countries the thresholds are lower and key position entitlements increase with the size of the investment. Such a "sliding-scale" approach to entitlements to foreigners' work permits is recommended for Kenya. Conditioning the entitlements to screening by KIA and the Investment Certificate would ensure that the system is not abused to illegitimately bring in foreign workers.
Quite apart from the innovation of the "key position" system other features of work and residence policies would benefit from a more modern approach:

• The labour-market testing procedure should be replaced, at least for high-skill positions and jobs, with an Australian-type approach whereby a pre-determined list of skills shortages is drawn up. Investors seeking foreign employees of such kinds would not be required to demonstrate by an exhaustive local recruitment campaign that suitably qualified citizens were unavailable. With appropriate safeguards, approved employers would be entitled to hire such foreign workers, subject only to verification of the credentials and character of the individuals proposed for employment by the Immigration Department.

• The understudy programme as it is currently structured fails to ensure that Kenya derives maximum benefits from the presence of foreign workers in terms of transfers of skills and knowledge. The system excessively relies on individual factors and imposes too much rigidity on investors. Instead, Kenya should impose a much more flexible and company-wide system of transfers of skills and training of employees. Investors may be required to spend some minimum amount, proportional to turnover, on training of Kenyan employees, but it should be left to them to determine where the skill-shortage lies (among what types of employees and for what types of skills) and how they want to remedy it. This is much more likely to enhance the profitability of businesses and encourage transfer of skills on a widespread scale than a rigid and individually based understudy programme.

2.3.9. Competition Regulation

Kenya's competition framework is governed by the Restrictive Trade Practices, Monopolies and Price Control Act (1989, with subsequent amendments). The Act[41] is relatively modern and has worked well in avoiding anti-competitive practices since the abolition of price controls in 1994, but it suffers from a few key weaknesses, mostly related to the organisational structure, enforcement power and breadth of mandate of the Monopolies and Prices Commission[42].

The Commission is not structured as an independent regulatory body, and is instead placed under the direct tutelage of the Minister of Finance. While the Commission is independent in its investigation of competition-related issues, it must rely on ministerial

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[41] Section 14

[42] World Bank. '*Strategic partnership with Africa: from strategy to implementation. African Region*'. World Bank. (2003) P 21-36

powers to enforce orders on companies found to have breached competition rules. The standard procedure is for the Commission: (1) to investigate cases either following a complaint or of its own will; (2) to inform the party involved of its findings and to seek a response and potentially corrective measures; (3) if a response or corrective steps are not taken, the Commissioner may recommend an order to be enforced by the Minister, after a hearing between the Commission and the involved party has been conducted; (4) following the hearing, the Minister may or may not follow the Commission's advice and enforce an order requiring corrective action[43].

CONCLUSION

The mandate of the Commission is relatively wide as it is set up to investigate restrictive trade practices, predatory practices, concentration of economic powers, and mergers and acquisitions. Restrictive trade practices are defined broadly as acts that either reduce or eliminate the opportunities for people willing to enter into production at fair market prices, or that reduce or eliminate opportunities for potential buyers at fair market prices. Practices that seek to block entry into production and discrimination vis-à-vis buyers (for production, resale or final consumption) are thus illegal. The Commission has considered close to 150 cases of restrictive trade practices in the past ten years (1994-2003), the majority of which were resolved without ministerial order.

CHAPTER THREE

3.0 Benefits and Problems of Foreign Investment

[43] Lemi, A. & Asefa, S. *'Foreign direct investment and uncertainty : empirical evidence from Africa'*,Africa Finance Journal 5, (2003) 36-67.

3.1 Introduction

Experience has shown that if a host country creates an environment conducive to investment, foreign direct investment can play an important role in its development efforts. Its potential benefits include:

3.2 Benefits

3.2.1 Employment generation and growth

By providing additional capital to a host country, foreign direct investment can create new employment opportunities resulting in higher growth. It can also increase employment indirectly through increased linkages with domestic firms. More specifically, the location of a foreign firm in a host country generally leads to the establishment of domestic firms that provide inputs to it thereby increasing the demand for labour in the economy. Aaron[44] provides evidence on the positive impact of foreign direct investment on employment in developing countries.

3.2.2 Supplementing domestic savings

African countries have low savings rates thereby making it difficult to finance investment projects needed for accelerated growth and development. Available data indicate that in Sub-Saharan Africa gross domestic savings as a percentage of GDP fell from 21.3% over the period 1975-84 to 17.4% in the period 1995-2002. Furthermore, the gap between domestic savings and investment was 1.9% of GDP over the period 1975-84 and -1.0% of GDP during the period 1995-2002. foreign direct investment can fill this resource gap between domestic savings and investment requirements.[45]

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[44] Aaron, C. '*The contribution of FDI to poverty alleviation*' Washington, DC: Foreign Investment Advisory Service. 1999, p. 432

[45] Aaron, C. '*The contribution of FDI to poverty alleviation*' Washington, DC: Foreign Investment Advisory Service. 1999, p. 438

3.2.3 Integration into the global economy

Openness to foreign direct investment enhances international trade thereby contributing to the integration of the host-country into the world economy.[46]

Raising skills of local manpower: Through training of workers and learning by doing, foreign direct investment raises the skills of local manpower thereby increasing their productivity level. The idea that foreign direct investment enhances the productivity of the labour force is supported by empirical evidence suggesting that workers in foreign-owned enterprises are more productive than those in domestic-owned enterprises.[47]

3.2.4 Transfer of modern technologies

Foreign firms typically make significant investments in research and development. Consequently they tend to have superior technology relative to firms in developing countries. Foreign direct investment gives developing countries cheap access to new technologies and skills thereby enhancing local technological capabilities and their ability to compete on world markets. Blomstrom and Kokko[48] provide an interesting survey of the literature on FDI and transfer of technology.

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[46] Morrisset, P. '***Foreign direct investment to Africa: policies also matter transnational Corporation***' , 2000,p.107-25.

[47] Harrison, A. '***Determinants and effects of direct foreign investment in Cote d'Ivoire, Morocco, and Venezuela***'. In M. Roberts & J. Tybout (Eds.), Industrial evolution in developing countries, micro patterns of turnover, productivity and market structure. New York: Oxford University Press.1996.p. 213

[48] Blomstrom, M. & Kokko, A. '***Multinational corporations and spillovers. Journal of Economic Surveys***' 12: 1998.p.247-77.

Enhanced efficiency: Opening up an economy to foreign firms increases the degree of competition in product markets thereby forcing domestic firms to allocate and use resources more efficiently.

3.3 Problems

Various explanations have been adduced for Africa's poor foreign direct investment record. In the empirical literature, the following factors are important determinants of foreign direct investment flows to the region.

3.3.1 Uncertainty

One of the reasons why foreign investors are reluctant to invest in Africa, despite its enormous profitable opportunities, is the relatively high degree of uncertainty in the region, which exposes firms to significant risks. Uncertainty in the African region manifests itself in three different ways:

3.3.2 Political instability

The region is politically unstable because of the high incidence of wars, frequent military interventions in politics, and religious and ethnic conflicts. There is some evidence that the probability of war a measure of instability is very high in the region. In a recent study, Rogoff and Reinhart[49] computed regional susceptibility to war indices for the period 1960-2001. They found that wars are more likely to occur in Africa than in other regions. The regional susceptibility to war index is 26.3% for Africa compared to 19.4% and 9.9% for Asia and the Western Hemisphere respectively. The study also showed that there is a

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[49] Rogoff, K. & Reinhart, C. "*FDI to Africa: the role of price stability and currency instability*"International Monetary Fund, Working Paper 03/10. 2003p.104-108

statistically significant negative correlation between foreign direct investment and conflicts in Africa. Political stability is one of the most important determinants of foreign direct investment in Africa.[50]

3.3.3 Macroeconomic instability

Instability in macroeconomic variables as evidenced by the high incidence of currency crashes, double digit inflation, and excessive budget deficits, has also limited the regions ability to attract foreign investment. Recent evidence based on African data suggests that countries with high inflation tend to attract less foreign direct investment.[51]

3.3.4 Lack of policy transparency

In several African countries it is often difficult to tell what specific aspects of government policies are. This is due in part to the high frequency of government as well as policy changes in the region and the lack of transparency in macroeconomic policy. The lack of transparency in economic policy is of concern because it increases transaction costs thereby reducing the incentives for foreign investment.

3.3.5 Inhospitable regulatory environment

The lack of a favorable investment climate also contributed to the low foreign direct investment trend observed in the region. In the past, domestic investment policies for

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[50] Sachs, J. & Sievers, S. '*FDI in Africa. Africa Competitiveness Report 1998*'. Geneva: World Economic Forum. 1998

[51] Onyeiwu, S. & Shrestha, H. '*Determinants of foreign direct investment in Africa. Journal of Developing Societies*' 2004, p.89-106.

example on profit repatriation as well as on entry into some sectors of the economy were not conducive to the attraction of foreign direct investment.[52]

3.3.6 GDP growth and market size

Relative to several regions of the world, growth rates of real per capita output in Africa are low and domestic markets are quite small. This makes it difficult for foreign firms to exploit economies of scale and so discourages entry. Economic growth is an important determinant of foreign direct investment flows to the region.[53]

3.3.7 Poor infrastructure

The absence of adequate supporting infrastructure: telecommunication; transport; power supply; skilled labour, discourage foreign investment because it increases transaction costs. Furthermore poor infrastructure reduces the productivity of investments thereby discouraging inflows. Good infrastructure has a positive impact on foreign direct investment flows to Africa.[54] However, Onyeiwu and Shrestha[55] find no evidence that infrastructure has any impact on FDI flows to Africa.

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[52] Basu, A. & Srinivasan, K. "*Foreign direct investment in Africa: some case studies*" International Monetary Fund Working Paper, WP/02/61, March. 2002.p. 24

[53] Elbadawi, I. & Mwega, F. '*Regional integration and foreign direct investment in Sub-Saharan Africa. African Economic Research Consortium,*' Working Paper.1997p. 198

[54] Asiedu, E. '*Aggressive trade reform and infrastructure development: a solution to Africa's foreign direct investment woes*'. Mimeo, Department of Economics, University of Kansas, 2002 p. 111

[55] Onyeiwu, S. & Shrestha, H. '*Determinants of foreign direct investment in Africa. Journal of Developing Societies*' 2004 , p.89-106.

3.3.8 High protectionism

The low integration of Africa into the global economy as well as the high degree of barriers to trade and foreign investment has also been identified as a constraint to boosting foreign direct investment to the region. There is a positive relationship between openness and FDI flows to Africa.[56]

Other factors that account for the low foreign direct investment flows to the region but are rarely included in empirical studies presumably due to data limitations include:

3.3.9 High dependence on commodities

Several African countries rely on the export of a few primary commodities for foreign exchange earnings. Because the prices of these commodities are highly volatile, they are highly vulnerable to terms of trade shocks, which results in high country risk thereby discouraging foreign investment.[57]

3.3.10 Increased competition

Globalization has led to an increase in competition for foreign direct investment among developing countries thereby making it even more difficult for African countries to attract new investment flows. Relative to other regions of the world, Africa is regarded as a high-risk area. Consequently foreign investors are reluctant to make new investments in or move existing investments to the region. The intensification of competition due to globalization has made an already bad situation worse. It must be pointed out that the intense competition resulting from trade and financial liberalization puts African countries at a disadvantage because they have failed to take advantage of the

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[56] Bhattacharya, A., Montiel, P., & Sharma, S. '*How can Sub-Saharan Africa attract more private capital inflows?*' Finance & Development, June,1997.p. 82

[57] Asiedu, E. '*Aggressive trade reform and infrastructure development: a solution to Africa's foreign direct investment woes*'. Mimeo, Department of Economics, University of Kansas, 2002 p. 118

globalization process for example, through deepening economic reforms needed to increase their competitiveness and create a supportive environment for foreign investment.[58]

3.3.11 Corruption and weak governance

Weak law enforcement stemming from corruption and the lack of a credible mechanism for the protection of property rights are possible deterrents to foreign direct investment in the region. Foreign investors prefer to make investments in countries with very good legal and judicial systems to guarantee the security of their investments.[59]

3.3.12 Poor and ineffective marketing strategy

In the past, African governments set up agencies to promote foreign investment without taking adequate steps to lift the constraints on foreign direct investment in the region. It is therefore not surprising that investment promotion activities in the region have not been as successful as expected. For example, in Nigeria, foreign direct investment promotion in the 1990s was accompanied by increased political risk: frequent and abrupt changes in government; religious and ethnic conflicts; and border disputes.

Conclusion

Until recently, promotion activities went hand in hand with the intensification of war with Eritrea. Similar inconsistencies between government promotion activities and domestic

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[58] Basu, A. & Srinivasan, K. "*Foreign direct investment in Africa: some case studies*" International Monetary Fund Working Paper, WP/02/61, March. 2002.p.74

[59] Asiedu, E. '*Aggressive trade reform and infrastructure development: a solution to Africa's foreign direct investment woes*'. Mimeo, Department of Economics, University of Kansas, 2002 p. 120

political developments can be found in other African countries but the two examples given here are sufficient to illustrate the point. Apart from the idea that promotion activities in the region started earlier than necessary, there is also the problem that Investment Promotion Agencies (IPA) created by domestic governments were highly bureaucratic, expensive to maintain, and have not been successful in reversing the declining trend in foreign direct investment flows to the region.

CHAPTER FOUR

4.0 Steps That Can Be Taken to Improve the Foreign Direct Investment

4.1 Domestic Actions

Domestic actions involve actions to be taken by countries in the region: These include image building, domestic regulatory reforms, and marketing of investment opportunities.

Image building: Improving the currently bad image of the continent is key to reversing the dismal foreign direct investment trend of the region. This requires an increase in:

- Political stability;
- Macroeconomic stability; and
- The protection of property rights as well as the rule of law.

4.1.1 Supporting existing investors

Improving the investment climate for existing domestic and foreign investors through infrastructure development; provision of services and changes in the regulatory framework—relaxing laws on profit repatriation etc—will encourage them to increase their investments and also attract new investors. In the case of domestic investors, an improvement in the investment climate will also encourage them to keep their wealth in the region and reduce capital flight.

4.1.2 Marketing investment opportunities

Creating awareness of investment opportunities through the use of existing investors and information communication technologies such as the internet. Experience has shown that over-reliance on Investment Promotion Agencies for investment promotion has not been very effective in the African region, so there is the need for a shift of emphasis from Investment Promotion Agencies to existing investors. This is also relevant because studies have shown that existing investors play a very important role in attracting new investors to new investment locations. For example, in a recent study of foreign direct

investor perceptions conducted by the United Nations Industrial Development Organisation (UNIDO) in four African countries Ethiopia, Uganda, Nigeria, and Tanzania existing investors were found to be responsible for roughly 50% of foreign investor awareness of domestic investment opportunities (UNIDO, 2002). There is also the need for African countries to adopt a more targeted investment promotion strategy. In other words, they should identify sectors where they have comparative and competitive advantages and then promote foreign direct investment into those sectors. This would make investment promotion less costly and more effective.

4.1.3 Diversification of the economy

Several African countries rely on the export of a few primary commodities for foreign exchange earnings. This exposes them to significant terms of trade shocks. Diversification of the economy will enable them to cushion the effects of these shocks and reduce country risk. The reduction in country risk will increase the attractiveness of the economy to foreign direct investment in the secondary and tertiary sectors.

4.1.4 Trade liberalization

Openness to trade will signal commitment to outward-looking, market- oriented policies and enhance trading opportunities thereby attracting foreign investors' intent on taking advantage of the new trading opportunities.

4.1.5 Privatization

The privatization of inefficient state-owned enterprises will boost foreign investment. African countries have now recognized that the privatization of public corporations is necessary to reduce government fiscal deficits and several countries have instituted privatization programmes. However, progress in the privatization of enterprises has been slow in several countries because of domestic political pressure by powerful interest groups that are against the process.

4.2 Regional actions

Specific actions to be taken at the regional level fall under the following categories: market size; agency of restraint; promoting good governance; and infrastructure development.

4.2.1 Market size

Enhanced regional integration will increase market size in the region and help attract investors currently constrained in part by the small size of domestic markets in the region.

4.2.2 Agency of restraint

The formation of well-functioning regional economic communities and institutions is crucial to conflict prevention and resolution on the continent. The constructive role played by the African Union and the Economic Community of West African States in ending the conflicts in Liberia and Sierra Leone is worthy of emulation (ECA, 2004). Regional integration through the formation of regional groupings can also be used to reduce the incidence of domestic policy reversals and improve the credibility of economic policies in the region. The point here is that in an environment in which national governments have a credibility problem, regional groups can provide an external agency of restraint on domestic policies.

4.2.3 Promoting good governance

The use of a regional surveillance mechanism based on peer pressure will promote good governance and improve the investment climate.

4.2.4 Infrastructure development:

Initiating and encouraging more cooperation in infrastructure development projects for example, in telecommunication, transportation, power generation, and the provision of water at the regional level. This will increase access to and reduce the cost of provision of these facilities, thereby lowering transactions costs, boosting trade, and increasing the attraction of the region to foreign investors.

4. 3 International actions

governments of developed countries can assist the region in investment promotion through providing accurate information to investors in their countries about the investment environment and opportunities in the region.

4.3.1 Improved market access

Through the elimination of trade barriers and unfair subsidies on agricultural goods exported by African countries will enhance trading opportunities in the region and create an incentive for foreign investors to invest in the region. Recent evidence indicate that about 40% of the costs of trade barriers to developing countries are due to restrictions imposed by developed countries (Anderson et. al., 2001). Furthermore, there is evidence that the elimination of trade barriers and unfair subsidies on agricultural goods by the European Union, the United States, Japan, and Canada will increase Sub-Saharan Africa's non-oil exports by 14% and income by 1% (Ianchovichina et. al., 2001)

4.3.2 Investment promotion assistance

Since African countries are poor, and investment promotion is costly, governments of developed countries can assist the region in investment promotion through providing accurate information to investors in their countries about the investment environment and opportunities in the region. This type of investment promotion is likely to be more effective than the current approach used by African countries because investors in developed countries take the information received from their governments more seriously than those from developing countries.

Conclusion

In view of the foregoing, it is evident that the implementation of the above strategies is crucial to the effective realization of any investment scheme. Developed countries can also help improve investment conditions in the region and increase its attraction to foreign investors by providing more technical assistance in areas such as: capacity building, infrastructure development, health and education.

CHAPTER FIVE

5.0 Recommendations and General Conclusion

It was argued that in attracting foreign direct investment to Kenya there is need also to look at the socio-economic, political and cultural climate in the country. Indeed, to appreciate fully the arguments raised in this paper (e.g. on technology transfer), we must understand first the nature and agents of technology transfer. Secondly, we must understand the nature of international trade within which technology transfer occurs and thirdly, the terms and conditions of technology transfer.

Generally, multinational corporations have centralized operations. Their subsidiaries are integral units of the group. The group is in turn controlled by the parent company. Multinational corporations have economic power to finance research and development. Patent laws are the framework through which multinational corporations maintain their monopoly over technology. To this extent, multinational corporations usually have stronger bargaining power than the host country when it comes to negotiating technology transfer agreements.

In the case of multinational corporations, the appropriateness of the technology will depend on the economic viability and technical soundness of the technology. Furthermore, because of the market dominance of multinational corporations in international trade, the host country may not have access to information on other sources of technology transfer. This makes it problematic for the host country to regulate effectively against restrictive business practices and contractual terms such as grant-back provisions.

The foregoing provisions stipulate that any improvement made by the recipient of the technology to the technology goes to the credit of the supplier of the technology without any payment being made to the recipient of the technology.

In the final analysis, to regulate activities of multinational companies in foreign direct investment it is important to consider three levels of regulation. The first level is the national level. This involves regulation through the application of municipal laws and the implementation of government policy.

The second level of regulation relates to the application of regional treaty obligations. Here, we must also consider certain aspects of state practice and issues of customary international law in the region. The third level of regulating foreign direct invest in Kenya transcends the national and regional boundaries. This looks at regulation at the international level. Regulation at the international level calls for the application of rules of conventional and customary international law.

In this paper, however, the research has concentrated on regulation at the national level. The study of all the three levels of regulating foreign direct investment would comprise a separate dissertation altogether. The scope of discussion is vast and the area still requires contribution from scholars in the social sciences.

Conclusion

This paper has examined critical issues of policy and law on the regulation foreign investment in Kenya. Fiscal incentives, technology transfer, transfer pricing, costs and benefits of foreign investment and factors that deter investment from Kenya have been examined. It was argued that legislation on its own is not sufficient to attract foreign investment. Aforementioned are the problems encountered with foreign investment which is mainly poor governance, poor infrastructure, high dependence on commodities and high competition. However in my opinion foreign investment can be improved by enhancing regional integration so as to increase market size in the region and help attract investors currently constrained in part by the small size of domestic markets in the region, through the elimination of trade barriers and unfair subsidies on agricultural goods exported by African countries will enhance trading opportunities in the region and create an incentive for foreign investors to invest in the region governments of developed countries can assist the region in investment promotion through providing accurate

information to investors in their countries about the investment environment and opportunities in the region and also by improving international relations, avoiding corruption and advocating for good governance. Several African countries rely on the export of a few primary commodities for foreign exchange earnings. This exposes them to significant terms of trade shocks. Diversification of the economy will enable them to cushion the effects of these shocks and reduce country risk. The reduction in country risk will increase the attractiveness of the economy to foreign direct investment in the secondary and tertiary sectors. Governments of developed countries can assist the region in investment promotion through providing accurate information to investors in their countries about the investment environment and opportunities in the region.

APPENDICES

INTERVIEW GUIDE TO THE KENYA INVESTMENT AUTHORITY STAFF

1. What is the competent authority handling foreign investment in this country?

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2. What are the fiscal incentives in the attraction of foreign investment?

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3. What are the costs of foreign investment in this country?

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4. What are the benefits of foreign investment?

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5. What are the deterrents of foreign direct investment?

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