

Policy Reform

7.1 Introduction

The range of FDI policies in the developing world is still very large. While there has been a general move towards liberalisation over the last decade, the starting points have been so different that current policy postures still show marked differences. Thus, many developing countries still have very restrictive conditions for MNE entry, while others have moved to completely open door policies. This chapter considers briefly the main policy trends in Africa, Latin America and Asia in recent years.⁵⁷ It ends with a note on some international treaties governing FDI.

7.2 Sub-Saharan Africa

Starting from a relatively small base of foreign investments and a relatively uncongenial environment for multinational enterprises, African countries have exhibited the most rapid policy and legislative changes in this field. A number of countries have revised existing laws to remove or reduce foreign ownership limitations, often as part of broader structural adjustment packages introduced by the World Bank. Many now permit liberal profit and capital repatriation, have free markets in foreign exchange and provide various incentives to foreign investors. They have simplified approval procedures, started promotion programmes and set up “one-stop shops”. Between 1982 and 1987 about half of all African countries either introduced investment codes or changed existing codes to attract FDI; this number increased further by decade end and subsequently, and included countries like Ethiopia and Mozambique that have been ideologically averse to FDI.

Many countries still restrict FDI in certain key industries – either totally or up to a certain

equity percentage – but the trend has been one of liberalisation. Ghana’s 1985 Investment Code, for example, reduced the number of industries closed to FDI from 24 to 2. In Namibia, the 1990 Foreign Investment Act, while clearly encouraging joint ventures with local partners, did not introduce restrictions on 100 percent foreign ownership. Similarly, Nigeria removed regulations limiting foreign ownership in a number of industries to 40 percent in 1989. Although the measure is not retroactive, new FDIs in all enterprises with the exception of banking, insurance, oil processing and mining are now authorised to full ownership. Numerous African countries set up approval and promotion facilities such as the National Investment Board in the Gambia, the Ghana Investment Centre, the Investment Promotion Centre of Kenya, the Nigerian Investment Promotion Centre, and the National Investment Promotion Office of Zaire.

Fiscal incentives in the form of concessions on the rate of corporate taxes and import and export duties are applied virtually across the whole region, and are in some cases (e.g. Tanzania and Zaire) negotiable with the government on a case-by-case basis. Such concessions tend to vary by industry and type of investment, essentially reflecting government priorities and development strategy. For example, Kenya gives special incentives to FDI in lesser developed areas, Lesotho in labour-intensive manufacturing, and both Kenya and Uganda in agro-processing. In addition, tax-free export-processing zones have been established in Botswana, Ghana, Kenya and Mauritius, and are planned in Comoros, Malawi, Namibia, Nigeria and Zimbabwe. With the only exception of Mauritius, such experiments have had rather

limited success so far. This may be traced to a number of factors, such as low labour productivity and insufficient skills, slow and bureaucratic procedures, inadequate infrastructure and risky political regimes.

In addition to the necessary reform in investment regulations, the 1980s saw an extensive review of sectoral laws, so as to bring them in line with the general trend of FDI policy liberalisation. In Africa, this trend has been particularly significant in the minerals and oil sector. New legislation governing mining exploration, for example, was enacted in Ghana, Kenya, Nigeria, Tanzania, Uganda, and Zambia. The new policy reflected in these laws is that adequate public interest controls can be achieved by the government in its capacity as a regulator.

However, as the earlier section showed, FDI has been slow to respond to Sub-Saharan Africa's policy reforms. The region continued to lose its share of global investment flows, and the FDI that did go there was highly concentrated in the nine oil-rich countries, which accounted for over 70 percent of inflows to Africa.⁵⁸ There was relatively little privatisation and debt-equity swaps, factors that accounted for substantial inflows to Latin America. The poor economic performance of the region, continuing unrest and political uncertainty, weak and often deteriorating infrastructure, hesitant reforms on trade and industry, poor macro management, low levels of education and technological capabilities and deficiencies in local entrepreneurship, all contributed to the region's lag.⁵⁹

It should be noted, however, that privatisation could be used to stimulate FDI into Africa in the future. There are many public enterprises that governments can place on the market, and the most likely buyers will be foreign investors. The important ingredient is to create favourable conditions for privatisation, and to set up a regulatory structure within which privatised utilities can operate in the national interest. Similarly, debt-equity swaps can be used to encourage privatisation as they were in Latin America,

reducing the value of the local debt for the buyer. This would help to make the enterprises more viable and so ultimately reduce the burden they place on the state budget.

7.3 Latin America and the Caribbean

FDI has traditionally played a strong role in a number of Caribbean economies, notably tax heavens and offshore business centres. Their policies were very favourable to foreign investors: almost no direct taxes or exchange controls, and guaranteed confidentiality in business transactions. These policies were primarily geared towards attracting investors in banking and in tourism, and were very successful in this.

Other Caribbean CDCs had more restrictive policies to FDI, like those in many other developing countries, and started to move to more liberal FDI regimes during the 1970s. The liberalisation process accelerated during the 80s and 90s, and the number of industries closed to FDI is now very limited. The few remaining restrictions are for such cases as atomic energy (Trinidad and Tobago), inland public transport (Belize, Trinidad and Tobago), and fishing (Belize). Entry authorisation requirements have been eliminated in the majority of countries, with the notable exception of Belize, where prior authorisation is needed to be able to operate in the country, and to benefit from incentive schemes. Most limitations to the remittance of profits and the repatriation of capital have been abolished.

The effort to reduce bureaucratic procedures for the approval of FDI projects has led to the establishment of a number of one-stop shop facilities, especially in the largest countries. Examples are the Jamaica Promotion Corporation, and the Industrial Development Corporation in Trinidad and Tobago. As regards fiscal incentives, a number of countries in the region offer foreign investors preferential tax and custom treatment vis à vis domestic investors. In Belize, for example, fiscal and custom incentives may be granted to foreign investors on a case-by-case

basis, primarily according to the contribution of the MNE to local value added. Similarly, tax and tariffs exemptions are sometimes used to guide investment towards priority activities. For example, in Trinidad and Tobago the Hotel Development Law offers fiscal incentives to companies investing in the hotel industry.

The Latin American region was the main recipient of FDI in the developing world until the debt crisis of the 1980s, and suffered sharply declining investment inflows as a consequence. Since 1988, however, many countries have reversed this decline and have enjoyed sustained increases in inflows of FDI. A number of factors have contributed to the re-emergence of this region as an important (though no longer predominant) destination for FDI. An important one was clearly the fading away of the debt problem and improved macroeconomic management in many of the economies, leading to a revival of growth and exports. There was also widespread liberalisation of policies in the context of structural adjustment, with large scale privatisation of state-owned enterprises, lowering of import restrictions, opening up of infrastructure to private investors, swapping of external debt into equity and a sustained effort to improve conditions for, and attract more, foreign investment. The effects of privatisation on FDI have been noted earlier.

There are two important points to note about FDI policies in Latin America. First, the formation of regional trading blocs and other agreements has been an increasingly important feature of the economic scene. The most important policy here has been Mexico's participation in the North American Free Trade Agreement (NAFTA). NAFTA has provisions to increase investment flows within the region, and devotes a great deal of attention to provisions for the regulation of investment, including portfolio investment, certain loans and other contracts. It ensures national treatment for foreign investors, including MNEs from countries outside NAFTA under certain conditions.⁶⁰ It prohibits the im-

position of performance requirements (such as export or import requirements, local content, domestic purchasing, trade balancing, licensing of technology, exclusive sales, exchange control requirements) on multinational enterprises, and also prevents such measures from being linked to the granting of subsidies or other incentives. It does, however, permit the granting of incentives for worker training and promotion of R&D. No restrictions on the nationality of senior managements are permitted, though countries may require that the majority of the Board of Directors be of a particular nationality. It permits free transfers of all kinds at prevailing market rates of exchange. It also liberalises various sectoral restrictions and removes most trade barriers over time.

Apart from NAFTA, there are a number of other intra-regional links being established, while a number of other countries have expressed the wish to join NAFTA. During 1985-93, as many as thirty three trade and investment related agreements were concluded in the region. Prominent among these was Mercosur, covering the southern countries of the continent and Brazil; the others were of more limited coverage. Partly as a response, and partly due to emerging economic forces, intra-Latin American trade and investment have in fact increased recently. Some industries led by multinational enterprises, most importantly automobiles, are rationalising production across countries, leading to greater trade and specialisation. These policy trends portend an increasingly open environment for FDI and trade, with growing integration within the region.

As noted earlier, however, the formation of regional blocs, especially NAFTA, may have adverse consequences for host countries that are outside the blocs, like those in the Commonwealth Caribbean. There is an offsetting arrangement in the form of the Caribbean Basin Initiative, which was launched in 1983 and made permanent in 1990. This provides duty free access to the US market for all products of the region (with the exception of those from Cuba), and includes tax incentives to US enter-

prises to invest in new plant and equipment in the region. It is not clear, however, if this will be enough to fully compensate for the advantages to foreign investors offered within NAFTA.

The second notable feature of recent FDI in Latin America is, as noted above, that much of the investment inflow has gone into services and infrastructure rather than into manufacturing. Investments in manufacturing have gone mainly into restructuring existing activities that started as import-substitutes and have matured behind protective barriers into internationally competitive industries – the main example is the automobile industry in Mexico. Some have also gone into downstream processing of natural resources for export, such as fruit, fish and forest products in Chile.⁶¹ This form of FDI has yielded major benefits to the region, especially to its service industries, but the pattern is very different from that in Asia, where FDI has concentrated on manufacturing industry and in countries like Taiwan, Malaysia and Thailand has upgraded rapidly to high value-added and high technology activities for export. The Asian economies have not liberalised their economies as rapidly or sweepingly as in Latin America, and have retained tools of industrial policy to guide their dynamic comparative advantages. The Asian NIEs have performed much better than their Latin American counterparts because they have been able to use such policy to diversify and deepen their economies, and to extract greater benefits from FDI.⁶²

7.4 Asia

The general move to liberalisation on foreign investment is also evident in Asia, set in a highly variegated set of national development strategies. The region has emerged as the developing world's most dynamic region and as a destination for FDI. In 1992 it attracted nearly \$30 billion of the total of \$52 billion of FDI going to the developing world. FDI to the region grew by a massive 45 percent in 1992, with much of the surge accounted for by investments in China (\$11

Box 3: Recent FDI Policies in India

The liberalisation of the Indian economy has been accompanied by improvements to the FDI regime. From 1991, projects with up to 51% foreign ownership received automatic approval in 34 priority industries, and local content provisions were withdrawn. In the next two years further liberalisation was announced. The Foreign Exchange Regulation Act was amended to accord foreign investors national treatment. Full foreign ownership was allowed on a case-by-case basis. Multinational enterprises were allowed into infrastructure projects like power, roads, bridges and the operation of telecommunication services. Technology imports were liberalised, with agreements involving payments below certain limits granted automatic approval. Import duties were lowered on various goods, and the rupee was made convertible on the current account. Several incentives to FDI were announced. As a result, several major multinational enterprises launched operations in India, including some that had left the country earlier. Actual inflows of FDI are expected to reach \$2 billion by 1995, as realisations of approved investments rise. The investment climate has also improved dramatically for portfolio investors, and the inflow of funds to the stock market has been very large.

There is still room for considerable liberalisation of FDI rules, and multinationals express concern at the complexity of regulatory controls and bureaucratic interventions. The infrastructure is weak, and the low base of education may pose skill problems in the longer term. Trade policies also need considerable relaxation to bring them into line with the more dynamic economies of East Asia. Tax rates are still relatively high. However, there is general consensus that the prospects for FDI in India are bright, and that if present trends to liberalisation continue the economy could draw investments at something approaching rates seen in China.

Source: UNCTAD (1994.a).

billion in 1992 and an estimated \$26 billion in 1993); however, even excluding China, the increase in 1992 came to 15 percent.⁶³ Countries like India, Pakistan and Sri Lanka that were traditionally hostile to FDI are opening up and becoming attractive to investors, though in India much of the interest is currently in portfolio investments.⁶⁴

The policy frameworks of Malaysia and India illustrate the difference in attitudes on FDI. Malaysia has been very keen to attract investment, particularly in manufacturing, but also in agriculture and tourism. Restrictions on foreign ownership have been relaxed, and wholly-foreign ownership is now allowed upon approval. FDI promotion policies have included the development of more than 160 industrial estates with the essential infrastructural facilities, and highly attractive incentive schemes. These measures have complemented a favourable exchange rate policy, and the availability of relatively skilled manpower. India has traditionally been hostile to FDI and has pursued a nationalistic approach to industrial development. However, Indian policies have been liberalised considerably recently, as shown in Box 3.

Other countries in South Asia have been more open to FDI. In Sri Lanka, all restrictions on currency transactions were removed in 1993. Bangladesh has been the most dynamic in promoting FDI, with a simplification of bureaucratic procedures for the approval of new investment (a one-stop centre is now in place), the establishment of export processing zones, and full foreign ownership allowed upon approval. Pakistan and Sri Lanka have encouraged investment in high-technology and export-oriented ventures – including the establishment of export-processing zones – and Pakistan now has totally open door policies on FDI.

Much of recent FDI into Asia has gone into manufacturing rather than into services and infrastructure, and only a small part (under 1 percent) has come from privatisation. However, infrastructure is now set to be a major growth area

for FDI (with large amounts coming from within the region itself), and service industries are also attracting increasing amounts of foreign interest as entry policies become more liberal. A very large part of MNE operations in Asia went into export-oriented industries, and within these there was considerable upgrading of activities into sophisticated products and components.

7.5 International Treaties in the Commonwealth

As part of their policy to improve their investment climate and attract FDI, Commonwealth countries have concluded a number of multilateral conventions and bilateral investment promotion and protection treaties. These treaties are a very important part of the international rules of the game for foreign investment flows, and can provide insurance against certain forms of non-commercial risk, incentives for investing in designated areas, information to prospective investors and access to markets. The setting up of MIGA under the auspices of the World Bank has been a major step forward in providing multilateral support for FDI, and individual capital exporting countries have their own schemes to promote and protect their overseas investors.

The emphasis of African CDCs has been primarily on multilateral treaties, especially those aimed at resolving investment disputes (the Washington Convention) and for insuring investors against non-commercial risk incurred in operating in unstable environments (MIGA).⁶⁵ Also well accepted were the New York Convention, for the settlement of claims and disputes arising in FDI operations, and the Paris Convention, which provides protection for patents and other intellectual property rights across national borders.

Countries in Asia and the Pacific region have signed multilateral treaties, but their emphasis has been more on bilateral agreements. This may partly reflect the lower risk attached to these economies by investors (see the earlier section on

risk perceptions). The overwhelming majority of bilateral treaties have been with developed market countries, although the number of agreements with other developing countries has been increasing, at least on the part of Asian CDCs. African countries are still primarily aimed at attracting developed countries investment, with a few exceptions such as the treaty between Mauritius and India⁶⁶ or Ghana and Romania. Notable is also that many African CDCs, such as

Kenya, Malawi, Swaziland, Tanzania and Zambia, do not have separate bilateral investment agreements with the United Kingdom.

The small countries in the Commonwealth Caribbean have shown little enthusiasm for signing either multilateral or bilateral agreements (with the exception of MIGA). However, the US-sponsored Caribbean Basin Initiative, noted above, is of great significance to them and may compensate for the lack of other initiatives.