THE UNIVERSITY OF ZAMBIA

SCHOOL OF LAW

I recommend that the obligatory essay prepared under my supervision
By
MULENGA IVEN KUNDA
Entitled
THE ROLE OF THE LEGAL FACTOR IN REALISING THE BENEFITS OF FOREIGN INVESTMENT

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Signed by the said Dr. F Ng'andu as Supervisor

Signature......FNg'andu.................

Submission

The Role of the Legal Factor in Realizing the Benefits of Foreign Investment

By

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An Obligatory Essay submitted to the University of Zambia, Faculty of Law in partial fulfillment of o the Requirement for the award of the Degree of Bachelor of Laws (LL.B)

21st November 2003

DECLARATION

I, **MULENGA IVEN KUNDA**, COMPUTER \NUMBER 97070131 HEREBY DECLARE THAT I AM THE AUTHOR OF THIS DIRECTED RESEARCH PAPER ENTITLED " THE ROLE OF THE LEGAL FACTOR IN REALISING THE BENEFITS OF FOREIGN INVESTMENT". AND THAT IT IS A CREATION OF MY OWN INGENUITY DUE ACKNOWLEDGEMENT HAS BEEN GIVEN WHERE OTHER SCHOLARS' WORK HAVE BEEN USED OR CITED. I TRULY BELIEVE THAT THIS RESEARCH HAS NOT BEEN PREVIUSLY PRESENTED IN THE SCHOOL FOR ACADEMIC WORK.

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DATED ________________ THIS 24th DAY OF NOVEMBER, 2003

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DEDICATION

RABSON and RHODA MULENGA

For being the best Mom and Dad in the whole world, for being there for me and all the sacrifices they have made for me in ensuring that I get support, spiritually, financially and morally.

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For contributing a lot to my spiritual enlightenment and ensuring that I know how to call upon the Lord when I am in need.

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For making me happy and giving me the support spiritually, emotionally, financially and for making the counsel in me.

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Thanks to **Shula Agartha**, for helping in typing, **Chris Muhongo,** my computer technician for ensuring that the computer was in the best working condition during the time this essay was been worked on and also thanks to the rest of the members of **Deeper Life Bible Church** without whose prayers and encouragement, the completion of this work would have not been possible.

PREFACE

It is a generally accepted notion that foreign capital is needed if accelerated economic development is to be seen to bear on both the host nations' economy and the world economy at large. This is paper looks at the role of the law in realizing the benefits of foreign investment in the emerging economies, particularly those of Africa and Asia.

Quiet a number of students have written on this subject, even if on different aspects. However, it was urged upon me that there was still a place for this paper especially when I realized that the law alone is not enough when it comes to realizing the benefits of foreign investment. I thought it necessary to draw a line as to where 'the role of law in realizing the benefits of foreign investment ends' and where the role of other factors begins from.

It is my heartfelt desire that this my work will contribute to the welfare of this nation in its fight to attain economic development as well as economic independence. Because I feel duty bound to contribute to this 'our' nation.
In conclusion I would like to express my gratitude to all those that helped me in making this work a success especially **Mr. Kelvin Fube Bwalya** who offered me free printing services.

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Introduction

Foreign Direct Investment is one way of promoting international economic development because it has the potential to make substantial social and economic development bear both on the economy of the host nation and on the world economy at large. To Zambia foreign investment is not a new phenomenon, it stems way back form 1890 when the British South African (BSA) company started its operations in Northern Rhodesia.

Through out history, Zambia has had little benefit from foreign investment ventures. Despite this, the government of Zambia has been trying to find ways of how to make the country benefit from foreign investment. Several reforms accompanied by legislation have been introduced at different periods of development but still not much has been seen in terms of social and economical development. This paper is concerned with the role that the law plays in realizing the benefits of foreign investment to the host nation, in this case Zambia. There is put the thesis that law alone is not enough when it comes to attracting foreign investment nor is it enough to help in realizing the benefits there from. Other factors also need to be at play. This is not to deny the fact that the law has a role to play in bringing about these factors. Hence the title: "The Role of the Legal Factor in Realizing the Benefits of Foreign Investment".

To explain the title a little bit is to say that the paper is concerned with the part that the law plays in realizing the benefits of foreign investment. It is shown that the role of law is only to the extent that it has to be used through social engineering to bring about the realization of all the other factors necessary to enable a country attract and benefit from foreign investment. In other words the function of the law cuts across all other factors, implying that for every factor to be in place, the law acts as a level to realize and actualize that factor.

The paper is divided into five chapters. The first chapter is concerned with definition and concept of foreign investment. The chapter also looks at risks and benefits associated with foreign investment. The second chapter is concerned with other factors apart from the law that favours foreign investment. Chapter three gives the historical experience of Zambia in foreign investment ventures. Chapter four is an analysis of the law as a whole in relation to foreign investment. This chapter does not limit itself only to the investment act but goes to analyze other Acts related to the subject or those that regulate other factors that favour FDI. Chapter five is the conclusion of the paper. It gives observations and recommendations on the subject.

CHAPTER ONE

THE NEED AND CONSEQUENCES OF FOREIGN INVESTMENT

'If anything both home and host countries would be worse off in a world without globe trotting multinationals.'
Robert Lipsey

1.1 Introduction

Studies on Foreign Investments often carry with them their academic problems. Some writers approach the subject by concentrating on one particular aspect such as a nation's foreign investment policy with regard to a region, whilst others seek to reflect upon a nation's foreign investment policy by taking time to study various policies from different countries on the subject. Regardless of which approach is adopted a good study is one that offers more solutions to problems than it exposes them. Without going into details there is one point on which most authors commence their studies; and this is on the point of definition.

1.2 Definition and Concept of Foreign Investment

1.2.0 Definition

Like many other concepts, the concept of foreign investment does not have a readily acceptable definition. However, draftsmen, scholars and legal experts have tried to define it by derivative method: by defining the words "foreign" and "investment" individually and then combing the two definitions.

Campbell Black has defined the term "foreign" as belonging to another nation or country: belonging or attached to another jurisdiction. Curzon L.B. in his "Dictionary of Law" has defined the term "investment" by first stating the meaning of the term "invest". He says that the verb to "invest" when used in an investment clause may safely be said to include, as one of its meanings "...to apply money in the purchase of some property from which interest or profit is expected and which property is purchased in order to be held for the sake of the income which it will yield." Generally the term means the laying of money with a view to earning an income from it, by way of interest, dividend, rent or profit etc". From here we can now define foreign investment as:

> *Applying capital in money or goods or in kind from a foreign land called the home country into another country called the host country with a view of profit*[1]

Investment may be by way of buying shares in an existing company, or by establishing a new enterprise or by taking over the running of an existing enterprise with a view to expand or rehabilitate the same or by away of the purchase of an existing business enterprise from the host nation.

1.2.1 Statutory definition

Notwithstanding the definition given above foreign investment has a statutory definition under the Investment Act cap 385 of the laws of Zambia. Section 3 of the Investment Act defines foreign Investment as:

> Inves*tment brought by an investor from outside Zambia and invested in Zambia.*

From the definition, one can note that the Act refers to foreign investment as '*investment from outside Zambia*'. It is so easily defined that one, if not careful, cannot see the complexity of the definition. To appreciate it more one needs to look at the definition of investment in the same section of Cap 385. The Act defines investment as:

> *The contribution of capital, in cash or in kind, by an investor, to new business enterprise, to the expansion or rehabilitation of an existing business enterprise or to the purchase of an existing business enterprise from the state;*

[1] This definition is actually one of my own creations without necessarily getting it from any author on this topic.

In light of the definition of the term '*investment*' one can deduce that foreign investment under the Act:

> *"Is the contribution of capital, in cash or in kind...to a new business enterprise; to the expansion or rehabilitation of an existing business enterprise or to the purchase of an existing business enterprise from the state*[2]*"... "brought in by an investor from outside Zambia and invested in Zambia"*[3].

The definition has prescribed the form which capital can take, that is, it can either be cash or in kind. It has also given a possible number of ways in which capital can be injected into Zambia. These ways are basically divided into three categories:

- Contributing for the sake of establishing a new business enterprise
- Contributing in order to expand or rehabilitate an existing business enterprise and;
- Contributing for the purchase of an existing business enterprise, from the state

It is argued that the use of the idiom '*in* kind' to refer to capital is not so clear. According to the Oxford learner's Dictionary the Idiom '*in kind*' is used in relation to payments made in terms of goods, produce or services and not in money. It is not clear especially when one looks at what it means when we substitute the phrase *'in kind'* with capital in terms produce or services. Can an individual be deemed to have brought foreign investment to Zambia by virtue of performing services in an already existing enterprise, for example?

Another thing worth noting is that what determines whether investment is foreign or local under Zambian law is not the citizenship of the investor. To support this position the privatization Act Cap 386, defines a foreign investor as " a person, being a *citizen of Zambia or not*, who brings into Zambia foreign Exchange for the purpose of shares in a state owned

[2] Investment Act Section 3 detracted from the definition of investment
[3] ibid, detracted from the definition of foreign investment under the Act

enterprise or for additional investment in a state owned enterprise[4]. By this definition one understands that even a Zambian citizen can qualify to be a foreign investor. What matters is the source of the contribution of capital. If the contribution is from outside the country then it is foreign investment.

1.2.3 The Conceptual Framework of Foreign Direct Investment

The study of multinational corporations, as a primary channel for transmitting foreign direct investment to developing countries has received increasing attention in the last two decades.[5] In fact the study of foreign trade and finance is among the oldest specialties with economic inquiry[6]. Nevertheless studies in this area still flourish today because the facts and problems that brought it into being still compel our urgent attention[7]. The rationale behind foreign investment is that foreign capital and technology are necessary for economic development. The world bank guidelines on the treatment of Foreign direct investment in the preamble states...that a greater flow of foreign direct investment brings substantial benefits to bear on the world economy and on the economies of countries in particular, in terms of improving the long term efficiency of the host country through greater competition, transfer of capital, technology and managerial skills and enhancement of market access and in terms of the expansion of international trade.[8] But the paradox of foreign investment is that it reflects the conflict between the pursuit for economic development and economic self-determination.[9] Whilst it brings the foreign capital and technology needed for economic development, it contradicts with the principle of economic self-determination on part of the host nation. For

[4] Section 2, Privatization Act, Cap 386 of the laws of Zambia.
[5] K.K. Mwenda **Contemporary Issues In Corporate Finance and Investment Law.** p2 (2000) Washington DC: Penn Press.
[6] P.B. Kenen. **International Economics, (**2nd ed. 1967). Englewood cliffs: New Jersey.
[7] Ibid p8
[8] **Charter of Economic Rights and Duties of States.** Preamble to the World Bank Guidelines on the Treatment of Foreign Direct Investment.
[9] Mwangala Kamuwanga. **Negotiating Investment Contracts**. p 6 (1995) Lusaka: Multimedia Publication.

it *Ipso facto* rests the control of a segment of the economy in foreign hands, and this prima facie detracts, from indigenous hands, the control of the economy. As a result there is a possibility of decapitalising effect on the economy due to probable huge out flows in excess of inflows of capital. There is also the complicated fact of foreign investors taking advantage of the desperate need for investment among developing nations such that they use the incentives that extend to them only to benefit themselves without necessarily benefiting the host nations. There have been instances for example where after the tax holiday incentive expires investors had opted to leave and re-invest in other countries or in their home country.[10] Despite all these an exhaustive review of research into the effects of "foreign direct investment" credits multinationals with being far more beneficial than detrimental for both their "home" and "host" countries, hence the need to look at the necessity of foreign investment in both developed and developing countries as well as the international economy.[11]

1.3 The Necessity of Foreign Direct Investment

The need for foreign direct investment can be seen to stem from two compelling factors. The first stems from the conceptual framework of foreign investment itself. Under this factor, foreign investment is to be viewed as the source of capital, knowledge and technology in boasting the economies of developing countries. On the expectation that some of the knowledge brought by the foreign companies may spill over to the host country's domestic firms, governments across the world have lowered various entry barriers and opened up new

[10] Supreme Furnitures is just about to stop its operations in Zambia, another example is Smart Center a clothing shop from South Africa which ceased operating in 2002. See Chapter Four for more on Supreme Furnitures.

[11] **Robert Lipsey** in **Home and Host Country Effects of FDI** (NBER Working Paper No. 9293), http://www.nber.org/papers/w9293 23 rd June, 2003 at 15:30 hours. **Robert Lipsey** is actually a NBER Research Associate.

sectors to foreign investment. In this vain an increasing number of governments provide various forms of investment incentives to encourage foreign owned companies to invest in their jurisdiction.

The second factor that makes it a necessity and not an option for countries to engage in activities aimed at promoting foreign investment is the globalizations and regionalization of the international economy. Trade liberalization –be it globally through GATT and WTO, or regionally, in the form of COMESA, E.U, NAFTA, AFTA and other regional agreements- has led to increasing market integration and reduced the importance of market size as a determinant of investment location.[12] This means that for small countries, like Zambia, to compete on the global economy, favorably, they need new capital in form of knowledge and technology. They however do not have enough resources in terms of finances to inject such capital into their economies to produce goods that can compete favorably on the global market. The only option available to them is to find means and ways in which foreign capital can be used to bring home the necessary knowledge and technology needed. Hence, even small countries like Zambia are now competing for foreign direct investment, as long as they can provide a sufficiently attractive package.

1.4 Benefits and Risks Associated With Foreign Direct Investment

The activities of Multinational (MNCs) or transnational corporations (TNCs) have the potential to bear, on the economy of a host country such as Zambia, both positive and negative effects although this conclusion is still under question. As Nankani has observed:

[12]Magnus Blomström and Ari Kokko, **The Economics of Foreign Direct Investment Incentives** in NBER Working Paper Series http://www.nber.org/papers/w9489 23 rd June, 2003 at 15:00 hours

The quest has been for an under standing of both the causes of FDI and the consequences (for the home country, host countries and the international economic and political order) of its rapid growth.

To date there is no acceptable conclusion as to the effects of the activities of MNCs or TNCs on the economy of both the host and home countries. On the negative side, as explained in section **1.2.3** of this chapter above, the paradox of FDI is that it reflects the conflict between the pursuit for economic development and economic self-determination.[13] Foreign investment ipso facto rests control of a segment of the economy in foreign hands, prima facie detracting form indigenous control[14]. This for the host country means that the economy is left to be run and controlled by foreigners who have no interest at all in developing the economy of the host country except for the maximization of their profits.

On the other hand it has the potential to help the developmental process in that there is potential prospect for knowledge spillovers. Since the technology and knowledge employed by foreign firms are to some extent public goods, foreign investment can result in benefits for their host countries even if the MNCs carry out their foreign operations in wholly owned affiliates. These benefits take the form of various types of externalities or "spillovers". For instance, local firms may be able to improve their productivity as a result of forward or backward linkages with MNC affiliates; they may imitate MNC technologies, or hire workers trained by MNCs.[15] The increase in competition that occurs as a result of foreign entry may also be considered a benefit, in particular if it forces local firms to introduce new technology and work harder. Thus Dickens writing on MNCs observes that:

Their potential impact on employment-not just on the number of jobs but on their type- is likewise immense. But the direction of these effects – whether positive or negative, beneficial or detrimental to national

[13] Mwangala Kamuwanga, supra note 9 P6.
[14] Ibid p6
[15] The best example here is how Zamtel has improved its mobile phone services from Analogue to GSM as a result of Celtel and Telecel two Multinational companies that introduced Mobile Phones in Zambia and the GSM system.

> *economies and their populations-is not at all easy to determine. It is particularly dangerous to make broad, sweeping generalization about the effects of TNCs... a single judgment applicable at all times and in all places, is simply not possible.... The bottom line is the net effect, which takes into account the opportunities forgone by the presence or absence of TNCs.*

The suggestion by Dickens is that it is not easy to determine whether or not foreign investment has positive or negative effects on the economy. Nevertheless a country still stands to lose by the absence or presence of FDI. If anything, writes **Robert Lipsey,** both home and host countries would be worse off in a world without globe trotting multinationals[16]. For example, considering the charge that foreign investment leads to depressed wages and thus exploits "host country" workers, Lipsey finds that the opposite is true. "Within host countries it has been abundantly shown that foreign-owned firms pay higher wages than domestically-owned firms," he writes. Lipsey notes that foreign firms tend to be in "higher wage sectors," generally hire "better educated and more qualified workers" than locally owned firms, and "tend to be larger and more capital intensive." He finds only sparse evidence of those higher wages having a "spillover" effect on wages paid by local companies, but he claims that whatever evidence there was, it points to an increase in average wages. On the other hand on examining the critique that a company's foreign operations inevitably will affect production at home, Lipsey argues that it's not always or even often the case that an investment in production abroad "substitutes" for or displaces what would otherwise be production capacity at home. Looking at exports alone, Lipsey notes that economists have found more evidence associating foreign investments with an

[16] **Robert Lipsey,** supra note 11.

increase in home country exports than a decrease. Lipsey notes that among those who have studied the situation, such fears have "mostly dissipated."[17]

1.6 Preliminary conclusion

Although there is no concrete conclusion on the effects of foreign investment on both the economy of the home and host country, it still remains an important factor in the developmental process. This is because a country still stands to lose in both ways; that is whether or not foreign investment is present. As a consequence developing Countries like Zambia still need to put in place laws and policies that encourage foreign investment. Due to its nature however, such law and policy should endeavor to serve a dual purpose, vis., to legitimized foreign participation in the local economy, and to simultaneously protect the interests of the citizenry. The objective of the government policy on investment must be, therefore, to scrutinize foreign investment entry and control its participation within the economy.

The gist of the preceding chapters is to provide alternative ways host nation governments like Zambia can adopt in order to realize the benefits as well as protect the citizenry of the country from experiencing the pervasive effects of foreign investment. In this vain we shall first look at the factors that attract foreign investment, and then the historical experience of Zambia with foreign investment and we will move on to look at a critical analysis of the current law in the light of the factors highlighted and finally a conclusion , some observations and recommendations will be given.

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[17] Ibid

CHAPTER TWO

FACTORS THAT ATTRACT THE FLOW OF FOREIGN DIRECT INVESTMENT AND ITS BENEFITS

'The law alone is not enough when it comes to attracting foreign investment nor is it enough to help in realizing its benefits. Other factors also need be at play.' Iven Mulenga, 2003.

2.1 introduction

Development, it has always been said, is a multifaceted concept. It generates from several factors such that focusing on only one factor becomes misleading and deceptive. So much has been said about foreign investment in Zambia and elsewhere, particularly in the last decade. No doubt Foreign Direct Investment (FDI) has played a significant role in the economic development in many countries. However, it should be stated that much of the talk about FDI, particularly in as far as factors attracting it to Zambia, has been more or less "perfunctory".[18] It is therefore put forward here the thesis that there are factors other than law and legislation as well as economic policies that need to be given greater attention if Zambia is to be an attractive FDI destination as well as a beneficially of it.

This chapter is aimed at highlighting some of the factors other than law that have proven to be crucial to a country's attractiveness to FDI as well as its benefits. After this highlight is given, the paper shall proceed to show 'the role of the legal factor in realizing the benefits of foreign investment'.

2.2 Factors that attract Foreign Direct Investment

Studies all over the world concerning foreign investment have shown that there are many factors other than the law that makes a particular country an attractive FDI destination. Most works done so far have indicated that to attract FDI there are certain policies that a country must pay attention to before experiencing an inflow of FDI. These include trade

[18] JCTR Bulletin 50 Article- **Foreign Direct Investment.** http://www.jctr.org.zm/buleetins/for-di-invest.htm

liberalization, tax policy, privatization, social amenities, and stability in all spheres to mention but a few. Trade liberalization entails free movement of goods and services. Stability on the other hand includes social political and economic stability. There are also such factors like market size, resources availability—both human and natural resources. In the case of human resources, we are talking about skilled human resource predicated on sound education that is accessible to the people. All these factors together create an appropriate environment, sometimes called the enabling environment. In this paper, however, we shall refer to it as 'a suitable investment climate'. On this note we can then proceed to look at some of these factors one by one.

2.2.1 Stability In all Spheres

Firstly, the issue of security of investment is one such factor that is one of the important determinants of FDI inflows. It is important because apart from a clear legal system of property rights, it adds to the security of investment even much more. This makes investors certain of their security of tenure. Here it should firmly be stated that, Zambia has stabilized a long time ago. One thing however, worthy noting is the fact that this factor is crucial to the investor in his investment decisions. There several examples of TNC decisions, in particular outside the primary sector, being influenced by the political situation of a country. For example, apparently, one of the reasons why Hyundai decided in 1993 to established its car assembly plant in Botswana.[19]

Secondly, a country must have economic stability. By economic stability is meant that all such factors like inflation, tax rates, interest rates, the per capital income and other economic determinants must be reasonably favourable for investment. The World Investment Report states that a trend towards increased macroeconomic stability has contributed to the high

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[19] ibid p180

record of investment inflows to the seven investments frontrunner countries in Africa. It however concludes that although the frontrunner countries were showing high inflation rates except for Tunisia with an inflation rate of 5.2 percent for the 1990s, it did affect so much FDI inflows. The reason for this, the report further reads, would be the frontrunner efforts to improve the macroeconomic picture which could have been perceived by the foreign investors as evidence of the long term commitment of the governments to create a more stable and business friendly environment.

In summary high inflation levels, exchange rates tax rates and interest rates, low per capital income and low GDP mean less attraction to investors.

2.2.2 Trade liberalization

It has been generally observed that trade liberalization opens up new market access, thereby enlarging the market size for manufacturers. It was actually pointed out in chapter one that trade liberalization –be it globally through GATT and WTO, or regionally, in the form of COMESA, E.U, NAFTA, AFTA and other regional agreements- has led to increasing market integration and reduced the importance of market size as a determinant of investment location.[20] Thus a county's chances of attracting and retaining FDI are higher when it has a more open trade regime. The 1998 World Investment Report by the UN when giving the heterogeneity of the most successful African countries in attracting and benefiting from FDI indicated that trade policies are an important factor influencing FDI flows to a country. It cites Tunisia, Egypt, Mauritius and Morocco as countries that have managed to attract efficiency-seeking FDI in such industries like textiles and apparel, among other things with the help of appropriate trade policies. To give but a few, the report indicated that 'among other measures that this has involved is offering special incentives, such as exemption from

[20]Magnus Blomström and Ari Kokko, supra note 12

import duties for inputs into export goods manufactured in the country or other trade privileges for companies operating in export processing zones.[21]

2.2.3 Tax policy

At the outset, it must be pointed out that customary international law recognizes the sovereign right of each state to tax aliens resident or owning property within its territory.[22] However, the establishment of unfair tax discrimination against foreign nationals and their property use to be regarded in international practice as an unfriendly act which may give rise to protest or retaliation by restoration.[23] The current position however is slightly different in that a country can discriminate against non-nationals as long as such discrimination is within internationally acceptable standards.

The above notwithstanding, it has been generally recognized that a good tax policy will attract foreign investment to a country. Lowenferd however has observed that it is not at all clear whether or not fiscal incentives are the major foreign investment determinants.[24] Studies in countries like Mexico, Jamaica and Singapore have indicated for example that fiscal incentives were not important determinants of foreign investors' decisions to invest in these countries.[25] On the other hand, similar studies in Korea have revealed that fiscal incentives were second to development of markets and management growth in attracting Japanese and American investors to Korea.[26] One thing, however, that needs realization is the fact that development, as already stated, is a multifaceted concept that needs multi-faceted efforts to

[21] UN World Investment Report, Trends and Determinants(New York .United Nations Publications, 1998) pp180-181
[22] See E.I. Nwogogu, (1965) The Legal Problems of Foreign Investment in Developing Countries. Manchester: Manchester University Press.pp9-10. G. Schwarzernberger (1969). Foreign Investment and International Law London: Stevens& Sons.pp3-11.
[23] See ibid p10,
[24] A.F. Lowenferd, 'Obstacles and Incentives', in F.E. Nattier (Ed) (1972), Investment in Developing Countries. New York: practicing Law Institute.pp17-18
[25] Kenneth K. Mwenda , supra note 5, p12

[26] ibid p12

be attained. Thus whether or not tax policy is an important determinant of foreign direct investment, a developing country like Zambia still needs to offer an attractive package in this area.

2.2.4 Privatization

Privatization may be defined as the transfer or return to the private sector or management of activities previously undertaken by the state or by municipal or other public authorities.[27] Privatization in itself has advantages as for example in relieving governments on certain budgetary strains and improving the efficiency of enterprise performance.[28] Apart from these advantages that come with Privatization, it has been observed that it also improves the allocation efficiency of investment. The 1998 World Investment Report reports that according to the South African Reserve Bank, Investment inflows into South Africa showed a significant increase in 1997 from $760 million in 1996 to $1.7 billion in 1997. The report indicates that the increase is due to the revival of the privatization programme by the new government when it announced the sale of 30 percent of Telkom to a Consortium of a United States and Malaysian investor as well as the sale of six radio stations, the domestic airline Sun Air, and a hotel and food group. It further indicated that FDI unrelated to privatization seems to have decreased between 1996 and 1997.[29]

2.2.5 Market size

There is also fear among investors that the market opportunities in Zambia are limited because of competition from the developed world. One can confidently say that primary producing countries, particularly in the field of agriculture, in the third world are

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[27] H. Sasson, **Privatization: The Conceptual Framework And Justification;** Seminar on Privatization for MPs, Mulungushi Conference Centre, 10th February, 1992.
[28] V.V. Ramanahham, (Ed), Privatization In developing Countries. p419 (1989), London and New York: Rout ledge
[29] UN World Investment Report, Trends and Determinants(New York .United Nations Publications, 1998) pp164-165

overshadowed by large stocks of food which are either rotting or being dumped on the world market. This has a very adverse effect on our ability to market our own surpluses, and also for investors to take advantage of the world trade liberalization system through GATT/ WTO.[30]

It is hard actually to derive any conclusion that the national market has lost its importance as a result of the global trade liberalization. This is because comparisons over time are difficult in that the measures of investment, the measures of determinants, and the range of countries examined differ from study to study. In addition, the failure of the Cancún WTO trade talks simply shows the fact that market size is still a factor that needs attention. This is because the failure of the September 2003 World Trade Organisation meeting in Cancún may have halted the global trade liberalization.[31]

This for developing countries means that there is still need for the national or internal market to be developed if developing countries like Zambia are going to attract and benefit from FDI. In fact, traditionally the market size of the host country or more precisely, of the host country's internal market has for long being one of the variables required for investment.[32]

2.2.6 An efficient and transparent Administration

Corruption in Africa has created difficulties for the continent to attract direct investment.[33] It is seen as the single most important problem for Investors. It is usually associated with gaining the necessary approvals, or with subsequently meeting the conditions associated with approvals.

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[30] see the GATT/WTO trade liberalization rules

[31] See the recommendation on the way forward following the failure of the Cancún WTO talks and how regional trading agreement can be a solution to the problem of market size in the last chapter

[32] UN World Investment Report, Trends and Determinants(New York .United Nations Publications, 1998) p135

[33] Deputy Minister of Trade Eugene Appel, The Post News Paper, Tuesday July 22, 2003. Article entitled **'Corruption has made it difficult for Africa to attract Investment'.**

Corruption in Africa is a great concern that the Transparency International Corruption Index indicated that too many African countries were amongst the most corrupt in the world, of which Zambia is among.[34] Eliminating corruption is a long-term process of simplifying regulations developing transparent legal and regulatory systems, imposing penalties on corrupt officials, and increasing public service pay rates. In a short term, it may be possible to reduce significantly the undesirable aspects of corruption for investors by restructuring FDI approval procedures to be more user friendly; giving one-stop or first-stop shops the authority to act on behalf of investors in securing necessary approvals; imposing strict anti-corruption guidelines on the staff of the one stop-shops; and allowing one-stop shops to charge investors for the services provided with respect to gaining the necessary approvals, but requiring that the charges be transparent and clearly related to the services and approvals required.[35]

2.2.7 Regional competition

Finally, in relation to the investment climate, it is essential that investment in Zambia be viewed in the context of international economic environment. For the foreign investor investing in Zambia is only one of the options available. Its attractiveness is weighed up against the other alternatives. This means that policies pursued by the country have to take into account what other countries are doing. It also means that there may be little that Zambia can do positively to attract and encourage investment.[36]

[34]Transparency International 2001 Report places Zambia at 76 out of 90 countries on its scale of its scale of "Corruption Perception Index." Only 14 places from bottom., supra note 13

[35] Handbook on Foreign Direct Investment by Small and Medium sized Enterprises: lessons from Asia. UN, 1998 New York and Geneva

[36] Mr. Dennis Norman, Chairman of the Beira Corrido Group. Report of the seminar for Businessmen held in Gaborone, Botswana. Investing in Production

This is actually the reason why, for example, the World Bank reports show that the distribution of FDI is such that it is primarily taking place in developed countries or high-income countries. For example, the World Bank reports that in 1999, the value of FDI quoted in US Million Dollars in high-income countries was about 727,130 compared to low-income countries with only 9,750.

It should be mentioned also that distribution of FDI is disproportionate among low-income countries, with Africa having the least share of FDI. It is also the case that even within Africa, the distribution of FDI is uneven, and for example, it ranges in value from (US$ Millions, 1999 figures) 1,376 in South Africa to 40 in Cameroon.[37] This situation raises the question "Why should there be so much emphasis on FDI as a way of fostering development, particularly on the part of those countries that have the least share of FDI?'

There is also a further question relating to this situation. Is it that low incomes countries have not put in place policies such as mentioned above that attract FDI inflows? Or could there be other reasons that might help us find an explanation to this situation? To answer fully the above question requires in-depth studies. But the task for Zambia is still to strive to create a suitable investment climate. If there isn't one today still the government efforts to create one must be seen by the foreign investors.

2.3 The role of the legal factor in realizing the benefits of foreign investment

The role of the law in human endeavor cannot be over emphasized. This is because a legal framework is required for most human endeavors, whether it be to apply justice, to establish codes of public conduct of social or economic life by regulating and enabling them to be

[37]JCTR Bulletin 50 Article- **Foreign Direct Investment**. Supra note

carried on in an orderly manner.[38] In case of foreign investment it sweeps across all the factors that have been mentioned above. All the policies that the governments may put in place concerning any factor above, for example on liberalization, tax policy and so on, can only be effectively realized through law and legislation. The need for legislation by developing countries in foreign investment activities goes beyond mere legislation; it must be legislation that is able to realize and promote the aspirations of the people of these countries. It is the job of the law makers to turn, through social engineering, into reality all the aspirations of the people by expressing it through well articulated law and legislation.

2.4 Preliminary Conclusion

One realization from this chapter is that foreign investment like other activities does, not only need law to control and promote its operations. For instance, a government will not control crime only by sanctions but will also cub it by providing an environment that favors a crime free society. This may be by providing social services like recreation and entertainment, which together with criminal sanctions will help to prevent crime. The same thing applies to foreign investment. The law alone is not enough when it comes to attracting foreign investment nor is it enough to help in realizing its benefits. Other factors also need be at play. These factors are collectively referred to as 'a suitable investment climate'. In other words there must be a suitable investment climate for a developing country like Zambia to both attract and benefit from foreign investment. The role of the legal factor then only becomes to ensure the fulfillment or attainment of a suitable investment climate by providing an effective legal framework for each individual factor, recognized as necessary for the creation of a suitable investment climate.

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[38] Muna Ndulo (1976). **Mining Rights in Zambia**. A thesis submitted for the degree of Doctor of Philosophy to the Board of Faculty of Law in the University of Oxford, Trinity College. P 16

CHAPTER THREE

HISTORICAL EXPERIENCE OF ZAMBIA IN FOREIGN INVESTMENT VENTURES

'If we look at the philosophies of the past with our eyes upon the laws of the time ...and the exigencies of the stage of the legal development in which they were formulated, we shall be able to appreciate them more justly, and so far as the law of the time and place or the stage of legal development was similar to or different from the present, [and we shall be able] to utilize them for the purpose of today.' Roscoe Pound

3.1 Introduction

Foreign investment is not a new phenomenon to Zambia. Its history can be traced as far back as 1890 when the first investors came to Zambia under the British South African Company (BSA). Through out history foreign investment has had little benefit to the general citizenry of the country or rather it has contributed very little to the Zambian economy, although there has not been a comprehensive report in this regard[39]. This chapter is dedicated to outline the various experiences Zambia has been exposed to by foreign investment activities. To achieve this, an analysis of investment policies and law at different periods after independence is given. In this vain the chapter endeavors to identify the weaknesses associated with all such policies and law on foreign investment.

3.2.0 The Colonial Policy and Law on Foreign Investment

3.2.1 The British South African Company Rule

The history of foreign investment can be traced as far back as 1890 when the BSA Company began its operations in Zambia. The BSA Company major area of investment was the mining sector. History has not been fair in terms of foreign investment benefits to the Zambian

[39] Kuphukile Mlambo, Capital flows, Savings and Investments in SADC, in **Trade and Investment in Southern Africa:** Towards Regional Economic Co-operation and Integration, 1998-Edited by Chinyamata Chipeta: Southern Africa Regional Institute for Policy Studies.

economy. The first Investors as history can tell were never interested in re-investing the company's profits in the development of the then Northern Rhodesia. The statement by Lord Robin, Chairman, to the shareholders of the BSA Company shows the lack of concern associated with foreign investors when it comes to affairs concerning the host country. He said that:

> *We shall continue to seek profitable outlets, but have resisted and will continue to resist suggestions that it would benefit the country or its people to invest in failures and squander capital for propaganda purposes*[40]

During the rule of the British South African Company, there was basically no law designed to regulate the activities of foreign investors, as the government itself was a foreign investor with the sole purpose of exploiting mineral resources.

3.2.2 The British Government Rule

In 1924, however, the BSA Company handed over the administration of Northern Rhodesia to the British government. The takeover by the British government of the administration of the affairs of Northern Rhodesia did not also have much to offer in terms realizing the benefits of foreign investment. There were no effective legal measures that were specifically designed to protect the interests of the citizenry in relation to foreign investment. The laws and policies that existed were discriminatory in form in that they were designed to further the interests of the white population-- foreign investors.

3.2.3 The federation of Northern and Southern Rhodesia and Nyasaland

The federation of Northern and Southern Rhodesia and Nyasaland also had its own package for the citizenry of this country in terms of foreign investment. During this period (19 53-

[40] British South African Company, Chairman's statement to the shareholders, 17th February 1912 as quoted by Rose Samakayi in '**The Role Of The Investment Centre As A One Stop Office Under The Investment Act 1993'** a thesis submitted to the University of Zambia in Partial fulfillment of Bachelors decree of laws, 1995. p4

1963) all business laws applied equally and without distinction between local and foreign enterprises. The federal government actively encouraged private investment. There was generally no protection as to the interests of the individual countries comprised in the federation in relation to the activities of foreign investors. The only protection that the federal government offered was that relating to tariffs on goods from outside the federal region. In other words tariffs were introduced to protect industries within the federal region only. There were no differential and favourable considerations given to weaker economies within the federal region. The reason for this might have been that the federal government had a vision to see a permanent single territory emerging.

The government therefore favored long term investments, which contributed directly or indirectly to the development of the federal region's natural resources. Thus in trying to protect the interests of the region as a whole, repatriation of capital was allowed freely only on approved investments, otherwise repatriation of the original capital was subject to ten-year deferral period. Approved investments included mining, agriculture processing of local raw materials, and secondary industries such as building and construction and tourist trade.

The negative impact that the federation had on the citizenry of the current Zambia in terms of Foreign Investment was that Northern Rhodesia, as it then was, was looked at as a country that only produced raw materials and that it also provided a market for finished products from Southern Rhodesia. Thus Northern Rhodesia was denied the chance and opportunity to build and develop manufacturing industries. This is because Northern Rhodesia depended on Industries and trade from Southern Rhodesia, which had a well-developed industrial sector. The other negative impact of the federation was siphoning of money generated in northern Rhodesia and Nyasaland to Southern Rhodesia. Southern Rhodesia being the headquarters meant that all the monies generated from the other two countries were siphoned there, and as a result there was very little investment activity in Northern Rhodesia as there was little left as re-investable income.

Thus at independence in 1964, the Zambia government inherited a system, which had few controls on the conduct of investors. The transitional Development plan approved by the legislative council in 1962 stated actually that "...the government believes that economic development will be accomplished mainly through the private enterprise of the individual cultivator or businessman or corporation and that government activity should therefore in general be limited to maintaining stable government and providing the necessary infrastructure including research and extension of services.[41]

3.3.0 THE POST COLONIAL PERIOD: LAW AND POLICY ON FOREIGN INVESTMENT

At independence, as already indicted in the foregoing paragraphs, Zambia inherited a free enterprise philosophy.[42] It actually can be stated that Zambia's leaders had a vision for foreign investment participation in the country's economic development process well before independence. In 1963 President Kaunda, then leader of the African Transitional government, stated that "...economically we have made it plain that we intend to create a society in which private enterprise will play an important role." President Kaunda re-affirmed, in 1967, the ruling party's policy of encouraging private enterprise in Zambia although this time with a condition.[43] The qualification was that private enterprise had to comply with acceptable

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[41] **Northern Rhodesia Development plan for the period 1 July, 1961 to 30th June, 1965**; Government Printers, Lusaka 1962 p.12 in M.B. Kamuwanga (1995), **Negotiating Investment Contracts**, investment law in the context of development negotiating. Lusaka: Multimedia Publication. P1.

[42] M.B. Kamuwanga, supra note 9 and 11, P1.

[43] This was during the Mulungushi Development Plan or famous Mulungushi reforms

government policy.[44] During this time it was also announced that a foreign investment Act would be enacted guaranteeing foreign investors, inter alia

(a) *Dividends and interests payments on foreign capital may be remitted abroad*

(b) *Capital brought into the country from foreign sources could be repatriated*

(c) *Investments would be free from expropriation for a specified number of years and compensation would be paid in case of nationalization.*[45]

The question that arises, however, is why it took about thirteen years since independence for Zambia to enact the Industrial Development Act, an Act that dealt directly with foreign investment issues. E.F. Ssempebwa has suggested that '…the answers must by and large be speculative.[46]' One of the reasons, he has suggested, may be that by 1968, when President Kaunda was still re-affirming the continued participation of the private sector in the developmental process, the role of private foreign investors was not yet well defined. It might have been that the government had not yet comprehensively appreciated both the negative and positive effects of foreign investment on the economy. This, he writes, can be seen in the speech of President Kaunda, how that he announced two contradictory policies in the same speech, that is, the continued participation of foreign private enterprises in the economy as well as the nationalization of a number of industries.

One may also say that the policy statement intimated that for developing countries like Zambia there are issues (such as expropriation tax evasion, transfer pricing, transfer of commercial technology), which needed research before legislation can be put in place. Actually, Kamuwanga[47] has observed that

[44] Kenneth Kaunda, 'Humanism in Zambia' reproduced in **After Mulungushi Reforms** edited by B. Fortman (1969) Nairobi: East Africa Publishing House. P.33
[45] Kenneth Kaunda, "Zambia Towards Economic Independence" in **After Mulungushi Reforms** edited by B. Fortman (1969) Nairobi: East Africa Publishing House. P.69 and p.139
[46] Zambia Law journal vol. 8 1977
[47] M.B. Kamuwanga (1995) supra notes 9, 11 and 42, at P 6.

> *The preceding statement governing foreign participation in Zambia's economy makes evident the predicament of developing countries regarding furnishing clear policy guidance in this area. Due to the nature of foreign investment the policy statement is meant to serve a dual purpose, vis., to legitimize foreign participation in the local economy, and to simultaneously protect the interests of the citizenry*

Because of this, and also agitated by the socialist theories of Humanism, the government thought it important that consequent laws to the policy statements on foreign investment was suppose to attempt to strike a precarious balance. In 1977 the government enacted the Industrial Development Act seen to have taken into account all the concerns the government had on foreign investment participation in the economy.

3.3.1 The Industrial Development Act 1977

The objective of the Act was summarized in its preamble as the provision of procedure for the licensing and control of manufacturing enterprise; provision of investment incentives to certain types of enterprises and the regulation of the making of contracts relating to technology transfer. Part I of the Act comprised of section 1 and 2 which dealt with the preliminaries and definitions of the terms found in the Act.

Part II dealt with the procedure for licensing and control. Section 3 required all persons involved in the manufacturing industries to have a license. Section 3(2) provided the penalty for contravening the section as six months imprisonment or payment of a fine or both. Section 4 provided for the procedure of getting the license as first describing the products, the place of manufacturing accompanied by a compressive study showing the economic validity of the proposed enterprise and describing technology to be employed. The minister had power to call for additional information if he required.

Part III of the Act dealt with the agreements for transfer of technology and expertise. Section 14 required every technology and expertise transfer agreement to be registered. Section 14(2) provided the penalty of not complying with this provision as a fine or six months imprisonment or both. Section 15 provided for conditions not to be contained in technology and expertise transfer agreements.

Part IV provided for incentives for certain types of industries that met the required standards. Section 18 provided that for an enterprise to attain eligibility for incentives described in section 20 it must be classified as a priority industry by the minister.[48] Section 20 provided for the type of incentives given to priority industries. Section 21 provided for incentives for those enterprises, which dealt in exports. The incentives were in form of tax relief on imported machinery and raw materials and also favourable conditions on tariffs as well as preferential treatment in the process of obtaining import licenses.

3.3.2 Problems with the Industrial Development Act 1977

One of the problems with the Industrial Development Act as Mwangala Kamuwanga has put was with the provision that dealt with the transfer of technology and expertise.[49] This provision prescribed conditions which must have been included in contracts for the transfer of technology or expertise. The first was that fees or royalties were supposed to bear a reasonable relationship to the use of such technology or expertise. The subsection laid down the criterion by which fees or royalties should have been determined, viz., the extent of the use to which the technology or expertise would be put to in the economy.

The implications of these provisions were that for the criterion to have been helpful those involved in the negotiations needed first to know how much the technology they were

[48] See Section 18(2) for the criteria used in the classification process
[49] M.B. Kamuwanga (1995), M.B. Kamuwanga (1995), supra note 9, 11, 42 and 47, at P38

negotiating for was going to be utilized by the enterprise in Zambian economy. To have this knowledge, of value of technology under negotiations, sufficient study and planning must have been done. After this, the question was whether the transferee would be allowed to use the technology or expertise in one factory or restricted premises or could freely use it anywhere as need arose.

This made the industrial development Act unrealistic in providing the so called 'use' criteria for determining the royalties or fees for technology or expertise transfer. Two problems manifest from the 'use' criteria. The first is that it is partially an *expost facto* criterion in so far as feasibility studies may not give the exact extent of actual use of the technology or expertise.[50] Negotiators could leave room for adjustments of fees or royalties should actual use turn out to be more or less than anticipated.

The second problem was the difference in criteria used for the determining of fees or royalties between the Zambia negotiators by trying to implement the provisions of the Industrial Development Act and the Foreign Investors' negotiators on the other hand. For one thing that the framers of this Act did not put into consideration was the fact that sellers of technology, like any other sellers of goods, apply the supply and demand law of the market. Demand is a schedule which shows the various amounts of product consumers are willing and able to purchase at each price in a series of possible prices during a specified period of time. Supply on the other hand is the schedule which shows the amounts of a product a producer is willing and able to produce and make available for sale at each price in series of possible prices during a specified period. And the laws of demand and supply are respectively stated as follows:

- *The law of demand states that other things being constant there is inverse relationship between price and quantity demanded. In other words all else being*

[50] M.B. Kamuwanga (1995), supra note 9, 11, 42 , 47 and 49 at.P39

constant, as price falls, the quantity demanded rises. Or, other things being equal, as price increases, the corresponding quantity demand falls.

- *The law of supply says that there is a direct relationship between price and quantity supplied. As prices rises, the corresponding quantity supplied rises; as price falls, the quantity supplied also falls.* [51]

From these theories one can see the unrealistic character of the 'use' criteria. It did not allow for market laws to determine how much technology transfer or expertise should cost and as such it did not attract foreign investors.

The other factors that determine pricing according to the theories of investment is the expense or in put involved in producing the technology or expertise in question. For Investment spending is guided by the profit motive; businesses buy capital goods only when they expect such purchases to be profitable. It will be therefore illogical for a seller of technology to follow the provisions of the Industrial development Act without first considering how much expenditure he incurred in producing the technology in question.

3.3.3 The investment Act of 1986

The Investment Act No 5 of 1986 repealed the Industrial Development Act of 1977. It sought to redefine the machinery used for co-ordinating investment in Zambia and secondly to revise the procedure for granting incentives, registration of Manufacturing enterprises and, for making technology or expertise transfer contract or agreements.

The new Act established two administrative bodies for the management and control of investment. These were:-

i. The investment council of Zambia and;

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[51] Campbell R. McConnell and Stanley L. Brue. **Economics, Principle, Problems and Policies** P39-46 (13th edition 1996). USA: Library of congress in publication data.

ii. The investment coordinating committee

The investment council of Zambia an 'autonomous' body comprised of the Prime Minister of the state as the chairman and ministers from the ministry of finance, commerce and industry, tourism, transport and communication, and agriculture as other members. It was established to supervise the administering and implementation of the Act and also to foster investment. To achieve this it was required to monitor the functioning of the Investment coordinating Committee.

The Investment coordinating Committee was on the other hand, responsible for the actual administering and implementation of the Act. Its membership comprised of a Director, as the chief executive officer, and representatives from a number of government ministries.[52]

Apart from establishing the investment council and the Investment coordinating Committee the Act also tried to revise the procedures on the application of licenses, by reducing the time taken in their procession; and it further attempted to provide a 'single window' service to investors. This was done through the investment council of Zambia secretariat, which would furnish investors with all relevant forms needed to be completed in respect of their investment and also to handle all their queries.

The Investment Act 1986 had provisions on Technology Transfer. Part VII of the repealed Investment Act 1986, dealing with technology transfer agreements, provided inter alia:

> *Every agreement for the transfer of foreign technology or expertise shall be registered with the Director of Investments by any beneficiary...*

[52] section 8, Investment Act No 5 of 1986

An agreement for the transfer of foreign technology or expertise shall not contain any condition-

(a) which restricts the use of competitive techniques;

(b) providing for any form of control over the management of the licensee's enterprise;

(c) which restricts the sources of supply of inputs;

(d) which restricts the volume or structure of production: or

(e) which limits the ways in which any patent or other know-how may be used.[53]

Doctor Kenneth Kaoma Mwenda in trying to identify the weaknesses of the 1986 Act compares it with the Investment Code 1985 of Ghana.[54] He states that while the Act provided a list of conditions to be included in technology or expertise transfer agreements '... by contrast, the Investment Code 1985 of Ghana does not provide a list of conditions that should be included in the technology transfer agreement.' Instead, section 27(2) of the Ghanaian Investment Code provides as follows:

> *Where an approved enterprise involves a technology transfer agreement the Centre shall:*
>
> > *(a) evaluate such agreement;*
> > *(b) advise the investor with regard to the choice and suitability of technology;*
> > *(c) monitor and ensure compliance with terms and conditions of such agreements.*

The listing of conditions that could not be included in technology transfer agreements had its advantages and disadvantages, he says. On the one hand, the listing provided certainty to prospective investors on what they could do and what they could not do. Investors had the

5 Investment Act 1986, Sections 36(1) and 37(2).

[54] Kenneth K. Mwenda , supra note 6, at p17

opportunity to enter into contractual terms not covered by the list. These terms could have been either favourable or unfavourable to Zambia. Here, it must be pointed out that the approach in the Ghanaian Investment Code 1985 is a more flexible way of regulating technology transfer than the approach found in the repealed 1986 Investment Act of Zambia.

On the other hand, the listing made it difficult for the Zambian Government to stop foreign investors from using contractual terms and conditions which were not covered under the Act.[55] Investors had the opportunity to enter into contractual terms not covered by the list and these terms could have been either favourable or unfavourable to Zambia.

The point that Dr Mwenda tries to bring out is that, the Ghanaian approach hinges upon the Investment Centre's evaluation of the appropriateness of the technology. In other words the shortcomings of the 1986 Act were its failure to provide adequate provision for the evaluation of the appropriateness of the technology, to be brought into the country. Dr. K. K Mwenda actually sees this as a major problem even in the current Investment Act when he says:

> *Given the above analysis, it could be submitted that the major shortcoming of Zambia's legislation on regulating technology transfer is that whereas the Investment Act 1986 contained a list of conditions which could not be included in technology transfer agreements, the subsequent Investment Acts (the 1991 and 1993 Acts) are silent on the matter. There is need, however, to examine the costs and benefits of technology transfer to Zambia.*

The point that Dr. Mwenda is trying to bring home is that the question of the appropriateness of technology to be transferred from developed to developing countries is a crucial one if such technology will work out for developing countries. The provisions on technology transfer in 1986 Act should have addressed instead of providing a list of conditions not to be

[55] ibid p17-18

included in technology transfer agreements. The reason for this is that the Act overlooked the basis on which technology transfer agreements are suppose to be regulated. The basis on which technology transfer agreements are regulated is the appropriateness principle. The appropriate principle states that in the regulation of transfer of technology, the host governments should be able to determine the appropriateness of such technology to the economic, social and environmental life of the country. Technology is appropriate if it is seen to promote the aspirations of the general population.

The weakness of the 1986 investment Act is therefore that, it did no have adequate regulatory provisions on technology transfer. The reason for this was the failure by the government of Zambia to appreciate both the positive sides and negative sides of certain types of technology. In other words Technology Transfer should not only be seen in terms of closing the technological gap between developed and developing nations. It must be observed that more important than closing the gap between countries is the appropriateness (to the host country) of the technology being transferred to the host country.

The issue of 'appropriateness' is a question of value-judgments. In determining appropriateness, our concern is not with the viewpoint of foreign investors. From a host country point of view, the appropriateness of technology hinges on what is perceived necessary for the development needs of the host country. On this basis, the 'old' views of the UN Economic Commission for Europe should be received with strong reservations. The Commission argued that:

> *Where 'technological gaps' exist between countries, international trading opportunities are limited. Now, transfer of technology and of capital embodying high-level technologies is considered as an important means of closing this technological gap. Economic policy, therefore, aims at intensifying these transfers.*

This view asserts that the technologies which have worked out for developed countries in solving their economic problems will produce the same results in developing countries. But the authenticity of this argument however has come under question, especially after the 1960s. Literature on the subject has suggested that this argument assumes that '...the problems of developed countries for which such technology was developed are similar to those that are obtaining in developing countries.'[56] But this however, is not the case, for the problems of the developing countries are peculiar to them largely determined by factors ranging form political to economic and environmental. Thus the need for technology by developing countries goes beyond mere technology; it must be technology that is appropriate to the needs and aspirations of the developing countries.

What needs realization is the fact that, development is a multi-dimensional process and it does not only entail closing the gap (economic growth), but also calls for a sustained commitment to uplifting the general social, cultural and political standards of a people. Determining the appropriateness of the technology in question will ensure that a sustained commitment to uplifting the general social, cultural and political standards of a people. Indeed, the anatomy of the concept 'development' involves both quantitative and qualitative goals. Mwenda in summing up this argument states that:

> *It is important to observe, however, that in attracting foreign direct investment to Zambia, the Zambian Government must not only be pre-occupied with the positive sides of technology transfer. There is need also to examine the appropriateness of the technology being transferred to Zambia. This foreign technology must complement Zambia's socio-economic plans and needs.*

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[56] Liyoka Kakula, **Problems of Transfer of Technology to Developing Countries.** Un published post graduate degree thesis submitted in fulfillment of the requirement s for the Degree of Master of Laws (Wisconsin-Madison University USA., 1979) P 28

3.3.4 The Investment Act 1991

The investment Act of 1986 was repealed by the investment Act of 1991. Before the 1991 Investment Acts was enacted it was pointed out in the fourth National Development Plan that:

> *The 1986 Investment Act will be amended to specify more clearly where foreign entrepreneurs can invest.*[57]

The above policy directive was never carried out. Instead, the Investment Act 1986 was repealed and replaced by the investment Act 1991. Indeed the correlation between the political economy remains a major determinant variable in the development of law. With changes in Zambia's political economy, such as the worsening of her international debt position, state capitalism and the accompanying re-organisation, this development strategy was abandoned.

The major changes brought by the 1991 investment Act was the establishment of the investment centre. The functions of the investment centre is to promote, coordinate Government policies on, and facilitate, investment in Zambia, so as to provide a one stop support facility to investors and to monitor the performance of enterprises approved by it and enforce compliance with the terms and conditions of investment certificates approved under the Act.

The other things provided for under the 1991 investment act was special incentives for certain types of investors.

[57] Ministry of Finance, **Fourth National Development Plan 1986-1993,** Lusaka: Government Printers, (1989), p541.

3.3.5 Preliminary Conclusion and observations

This chapter has examined critical issues of policy and law on the regulation of foreign direct investment in Zambia as applied at different periods. Fiscal incentives, technology transfer, transfer pricing, costs and benefits of foreign direct investment and factors that deter investment from Zambia have been examined. It was argued that appropriateness of the technology is very crucial to the host county's possibility to benefit from foreign investment ventures.

It has been argued also that the 'use criterion' was not a practical way for the determination of royalties and fees for technology transfer agreements. In fact a distinction needs to be made between appropriateness of technology and 'use'. Appropriateness, it is suggested entails the extent to which the technology in question can be of practical value in realizing the benefits of foreign investment in line with the actual aspirations of the people of the host country. This for example will be its appropriateness to create employment, to preserve and develop the local industries and so forth. Use on the other hand may mean how useful such technology may be regardless of whether it promotes the general welfare of the people. What matters in this case is whether such technology is needed for the production of the much needed commodity without necessarily looking at other issues like the creation of employment. An example that can be used to illustrate this point is the use of a combiner harvest in Zambia. It is a settled argument that a combiner harvester is a very useful tool that can be used to boost production in the agriculture sector of Zambia. It is however a regret to realize that though useful a combiner harvest may be, it is not appropriate in the Zambian economy where the aspirations are that the technology brought should be able to create more jobs for the many unemployed Zambian population. The combiner harvester has the capacity to do the work that may be done by ten to twenty people, meaning that bringing a combiner harvester would mean reducing the employment population which is against the aspirations of every Zambian.

The late Dr. Liyoka Kakula suggests that for developing countries like Zambia to maximize the benefits from technology transfer such technology must be:-

- *Low in Capital costs : low capital technology has the advantage of easy accessibility by a large segment of the society*
- *Extensively using local raw materials wherever possible. The problem which many developing countries encounter, especially in the drive for self sufficiency, is the importation of technology to produce import substitution products.*[58]

The other observation that has been made is that there has been always the problem of insufficient administrative efficiency. It can be observed that most of the amendments that have been done to any of the Acts we have looked at in this chapter had in one or another tried to improve on the administrative efficiency. In other words insufficient administration of investment in Zambia has been a problem for some time. With all these weakness we have identified in this chapter on the laws and policies we have used in this area we can now proceed and look at the current law on Investment in the next chapter and see the extent to which it has reflected the factors in chapter Two and on how it has improved on the weaknesses of the historical policies and laws on foreign investment.

[58] Liyoka Kakula , Supra note 56, at p 29

CHAPTER FOUR

A critique of law and legislation on Foreign Direct Investment

One thing that needs realization is also the fact that no branch of law in a market economy that is created by the process of creating a suitable investment climate is an island in itself. Just like different organs of the human body have a role to play in the normal functioning of the human body, every branch of law also has an important part to play in the final creation of a suitable climate for investment. Iven Mulenga, 2003.

4.1.1 Introduction

The process of creating Zambia an attractive foreign investment destination is dependent on legal issues. As already pointed out the law sweeps across all the factors that are necessary for a suitable investment climate. It is only through law and legislation that our aspirations as Zambians can be brought into reality. One can quote from Professor Muna Ndulo who wrote 'a legal framework is required for most human endeavors, whether it be to apply justice, to establish codes of public conduct of social or economic life by regulating and enabling them to be carried on in an orderly manner.'[59]

A well functioning legal framework is therefore necessary or imperative to the creation of an attractive investment climate. Important aspects of business legislation, such as property law, competition law, tax law, foreign exchange regulations and rates should be developed. One thing that needs realization is also the fact that no branch of la w in a market economy that is created by the process of creating a suitable investment climate is an island in itself. Just like different organs of the human body has a role to play in the normal functioning of the human body, every branch of law also has an important part to play in the final creation of a suitable climate for investment. In other words, cohesive interaction is a critical element and the aim

[59] Muna Ndulo (1976). **Mining Rights in Zambia**. a thesis submitted for the degree of Doctor of Philosophy to the Board of Faculty of Law in the University of Oxford, Trinity College. P 16

is to guide the market economy in as limited and flexible manner as possible, that is intervening only where essential.[60]

To encourage investment and also to retain it, there is need to provide a basic framework for monitoring the development of a competitive environment. In this vain existing legislation must be reviewed in order to make legal changes necessary to achieve economic stability.

4.1.2 A perusal through the law and legislation on investment

4.1.2.1 The investment Act 1993

In order to create an improved climate for private investment and the private sector, the Zambian government embarked on an exercise to remove legal and administrative obstacles so as to facilitate investment in the country.[61]

The first attempt in this area was the enactment of the Investment Act of 1991 which was repealed by the Investment Act N0. 39 of 1993, which states in its preamble that it

> *"An Act to revise the Law relating to Investment in Zambia so as to provide a comprehensive legal Framework for investment in Zambia; to repeal the Investment Act, and to provide for matters connected with or incidental to the foregoing"*

An investment Centre and Board were established under the 1991 Act and maintained by the 1993 Act for the purpose of promoting, coordinating government policies on investments and, facilitating investments in Zambia. This has somehow helped to reduce undesirable aspects of corruption by ensuring that investors secure all approvals and licenses from necessary government departments form one point. Thus in principle it simplifies procedural obstacles that used to be there in the past. It acts as a one stop shop that offers various services to the investors. This is also a move forward in reducing corruption in the area of investment.

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[60] European Economy: Shaping A Market System, Legal System(1993) p71

[61] The new Economic Recovery Plan, 1992-1994, **Para. 30.**

It has been argued that one major anomaly of the 1991 Investment Act, which has not been addressed by the 1993 Act, is the fact that under the definitions clause the term *"business enterprise"* does not include the Stock Exchange, Stock Exchange *Brokers* and *Dealers*. Hence, these financial institutions will not benefit from the incentives under the Act. However, the counter-argument is that investors do not invest into the Stock Exchange but into companies listed on it. Therefore, whatever incentives are available to an investor under the Investment Act will be applicable to an investor trading on the Stock Exchange. Basically, the Investment Act of 1993 has sought to provide a comprehensive legal framework for investment in Zambia. The Investment Centre has also been re-oriented towards effective investment servicing. Unlike the 1991 Act, which was seen as a desperate attempt by the government to attract any type of investment without regard to existing enterprises, the 1993 Act is a result of a much more thorough and analytical study.[62] This Act provides for *General Incentives*.[63] Unlike the 1991 Act which had special fiscal incentives in the form a five year exemption from income tax to every investor the 1993 Act only provides for deductions up to one-seventh of the tax chargeable from the income on rural enterprises for the first five years of operation.[64] The reasoning behind this incentive is that rural areas often lag behind when it comes to development, so that it is best to lure investors to these areas by means of incentives. The *Special Incentives*[65] under the 1993 Act that applied to foreign investors were designed to encourage foreigners to invest in otherwise loss-making enterprises as they will be greatly assisted and production will be boosted. But now the incentives under section 30 and 31 were removed by The Investment (Amendment) Act No. 5 of 1996 although all the investors issued with an Investment certificate before 27th January

[62] profit magazine, July 1992
[63] part IV
[64] section 21
[65] Part V

1996 were still entitled to continue enjoying the incentives.[66] What is left however is that the Current investment Act does not in the real sense provide for special incentives, like for tax holiday as the 1991 Act did. The incentives under that Act are therefore only the General ones provided in Part IV. It has been argued that there is need to re-introduce these kinds of incentives. The government, however this time should specifically define which kind of industries will be qualified to benefit under these incentives.

Generally, investment incentives, which are often in the form of *tax incentives,* encourage investors to purchase even those enterprises that are not normally very attractive to investors.[67]

The Investment Act restricts investors wanting to invest in any of the enterprises specified in the second schedule.[68] The Act provides that the Investment Board shall not issue an Investment Certificate to an investor until the Investor obtains the necessary licences, authorizations, or permits from the relevant ministry or body. The industries in the second schedule are industries that manufacture arms and ammunition, explosives, military vehicles and equipment, aircraft and any military hardware, any industry manufacturing poisons, narcotics, dangerous drugs and toxic hazardous and carcinogenic materials, any industry producing currency, coins and security documents. Apart from this restriction there is no any other that restricts participation of foreign investors in certain strategic areas of the economy. It is submitted that the Act needs to close certain sectors of the economy to foreign investors and reserve them for Zambians or local investors only. Commerce permanent secretary Dr Wamundila Mbikusita-Lewanika Speaking before the parliamentary select committee on government assurances towards reforming investment laws in Zambia intimated the need

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[66] Section 31(1) The Investment (amendment) Act No. 5 of 1996.

[67] European Economy, p.71

[68] section 8 of the Investment Act

'...transform the economy to where indigenous people benefited'.[69] This is going only to be achieved by reserving certain economic sectors exclusively to Zambians.[70] This can actually be seen in the Statement of the Permanent secretary Dr Wamundila Mbikusita-Lewanika when he said:

> *"Consultations are going on to amend the Investment Act to ensure that certain areas are exclusive to Zambians,"*

The other thing that the investment Act has not looked at is how to prevent or stop the tendency by some investors to close businesses immediately their tax grace period was over. This of course is a complicated problem that needs a complicated solution. This is because there are other factors like market size, increased communication and transportation expenses and so on, apart from paying tax that make a business unprofitable and thereby leading to its closure. Nevertheless scrupulous investors need to be checked in this area. One suggestion is that the investment Act should provide for scrutiny measures whereby the government will ask the investors to first clear with their embassies to show that they are genuine and good investors. This can be done by making Bilateral Investment Agreements with countries where investors come from which specifically provides for compensation from their home government in cases where the Zambian people are defrauded by these investors.[71]

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[69] The post newspaper issue No. 2387 Wednesday April 30, 2003. Title: **Investment Act to be amended**. by Larry Moonze

[70] For example the Investment Code of Ethiopia, in an effort to stimulate the indigenous economy, has reserved some sectors for domestic investors only. See **An Investment Guide to Ethiopia; Opportunities and Conditions.** United Nations. New York, 2000 p57-58

[71] see **Times of Zambia** , 29th July 2003, Article entitled **'State to review investment laws'**

4.1.2.2 The Privatization Act

The other Act that shows some close relation to FDI is the Privatization Act. As pointed above Privatization is one of the important Factors that Increases the Inflow of FDI, hence the need to have a comprehensive legal framework in this area also. The Privatization Act encourages both local and foreign investment and offers incentives to both groups of investors. The Privatization Act defines an investor as:

> *"An individual company, established fund, mutual fund, financial institution or foreign government intending to invest in a state-owned enterprise under this Act but does not include the Local Government, the Government of the republic of Zambia, and a state-owned enterprise."*

Foreign investors are also entitled to the incentives outlined in the Investment Act, if such an investor qualifies for the same under Section 30 of the Privatization Act.

It can be said that the Privatization Act has more or less addressed the main issues that an ideal Privatization Act should address. The Act has, at least, attempted to address the following issues:

- The valuation of enterprises
- The manner in which enterprises are to be sold
- The utilization of divestiture incomes
- The provision of special or Golden Share in strategic industries
- Accountability of the officials of Privatization Agency to the Public

Issues such as settlement of disputes and the aspect of eligible buyers have also been addressed.

However, one interesting feature that the Act has not tackled is that of pre-emptive rights of minority share-holders. This has attracted the attention of the public because wide share ownership is a major objective of the Act, and there is a common view that this stands to be defeated since most parastatal companies lined up for privatization would be bought by existing share-holders, who are mostly multinational companies, since legal arrangements give them priority to buy these companies.[72]

The other problem that has been identified with the privatization programme in Zambia has been administrative rather than legal. It has been argued that the privatization programme embarked on in the 1990s by the Zambian government was carried out massively but in a very short period of time such that it has affected the effectiveness of the programmes.

4.1.2.3 The Banking Act

The move to a market economy and, hence, the growth of the private sector generally require a financial system which collects and channels savings to their most productive uses and manages an effective system of payment.[73]

In Zambia, need has been found to amend the *Banking Act* in order to promote the privatization programme. At present, in defining "*banking business*", the Act recognizes only two institutions, namely *commercial banks* and *financial institutions*. This provides a very narrow definition of banking business. It has been proposed that *"banking business*" should include the following as banks*:* *Investment* or *Merchant Banks, Developments Banks and Import and Export Banks*. Similarly, *Insurance* companies, *Pension Funds, Mutual Funds* and similar institutions should be included in the definition of financial institutions.[74]

These amendments would result in a wider participation of organizations which supply the much needed capital in order to support an efficient and buoyant market.[75]The Banking Act

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[72] Mwila Mwaba, **The Zambian Privatization Experience: Legal Perspectives**. Undergraduate thesis thesis submitted in fulfillment of the requirements for the bachelors Degree of Laws (University of Zambia, 1994) P 28

[73] The observer, December 1993/ January 1994, p.12

[74] Ministry of Finance: Privatization – Legal Perspectives, (Unpublished), 1991, p.6

[75] ibid

needs immediate review in order to provide for the institutions which would be critical to the liberalized economy, especially the Stock Exchange.[76]Furthermore, the Act simply states that Merchant banking shall be carried out only by a Bank; [77]and in the Zambian context this refers to a commercial bank. It has been recommended that such banks be referred to as Investment Banks. The Banking Act in its present form is not capable of promoting a financial system in a liberalized economy, and it therefore needs reviewing.[78]

There is need to transform the Development Bank of Zambia (DBZ), Zambia National Commercial Bank (ZNCB), and National Savings and Credit Bank (NATSAVE) into institutions that could provide loans with affordable interest rates.[79]

4.1.2.4 The taxation Act

The first major step in the field of reform was made in 1991 *Budget* when protectionist tariffs were removed. A *Tax Policy Task Force* was set up in 1992 to overhaul the tax system as it applies to *Company Tax*, *Customs, Tariffs* and other matters. The purpose of the tax reforms was to create an economic environment based on private initiative and market forces. Tax inequities and politically motivated tax preferences were to be avoided. The ultimate goal of tax reforms was to create a modern tax system conducive to sustained economic growth and development.

These tax reforms are, however, yet to be followed through. This is because there are still cries from the general public that the Zambian tax system records the highest tax rates in the region. The theory regarding taxation is that high tax rates results in businesses and

[76] Establishment Of A Stock Market In Zambia – Submission The Ministry Of Finance,1991
[77] Section 2
[78] Establishment Of A Stock Market In Zambia – Submission To The Ministry Of Finance, 1991
[79] See: The post newspaper issue No. 2387 Wednesday April 30, 2003. Title: **Investment Act to be amended**. by Larry Moonze

individuals having less disposable income. This for investors means that their profit motive will be thwartered, in the end discouraging re-investments and investment.

PRELIMINARY CONCLUSIONS

The Acts discussed in this chapter are not the only specific Acts needing reforms. Most, if not all, Acts which regulate the operation of business in the country need thorough revisions to bring them in line with the process of making Zambia an attractive FDI destination.

For instance, the various *by-laws* under the *Local Government Act*, which regulate the issuance of numerous licenses for a business enterprise to operate, will need to be studied and either amended, updated or repealed in order that they can effectively guide a liberalized economy.

Finally, it is commendable that a Stock Exchange has been established as it is a vital support system for a liberalization programme.

CHAPTER FIVE

1 Concluding Remarks, Observations and Recommendations

5.1 Introduction

This paper has examined the need and consequences of foreign direct investment. It has examined critical issues of policy and law on the regulation foreign direct investment in Zambia as far back as the colonial periods. Fiscal incentives, technology transfer, costs and benefits of foreign direct investment and factors that deter investment in Zambia have been examined. It was argued that legislation on its own is not sufficient to attract foreign direct investment. This chapter intends to give the conclusion of the paper, observations made as to nature of the subject matter of the paper and finally recommendations on what must be done to spearhead economic development, whether they be FDI or not.

5.2 Concluding Remarks

Foreign direct investment can play an important role in raising a country's technological level, creating new employment, and promoting economic growth. Many countries are therefore actively trying to attract foreign investors in order to promote their economic development, particularly at times when the country's domestic growth prospects appear weak. However, designing efficient incentive programs is complicated task, and the competition between host governments trying to attract FDI is likely to complicate the task further, as it tends to shift profits and welfare from the host countries to foreign multinationals. A first-best solution for FDI incentive policy may therefore be multilateral policy coordination to set the "rules of the game", in the same way as

GATT/WTO has defined the rules for international trade policy. In fact, countries participating in regional integration agreements that go beyond GATT/WTO rules – most notably the European Union– have realized the need to harmonize the use of investment incentives and introduced specific guidelines for their use.

The failure of OECD's MAI initiative has, however, demonstrated that it will be difficult to achieve a broad multilateral solution in this area. Consequently, many countries will continue using FDI incentives as important policy tools. In this paper it has been argued that the use of investment incentives focusing exclusively on foreign firms, although motivated in some cases from a theoretical point of view (and in even more cases from political considerations), is generally not an efficient way to raise national welfare. The main reason is that the strongest theoretical motive for financial subsidies to inward FDI –spillovers of foreign technology and skills to local industry – is not an automatic consequence of foreign investment. The potential spillover benefits are realized only if local firms have the ability and motivation to invest in absorbing foreign technologies and skills. To motivate subsidization of foreign investment, it is therefore necessary, at the same time, to support learning and investment in local firms as well.

Hence, rather than proposing narrowly defined FDI policies, it is argued that good governance in the area of FDI policy is to consider the investment incentive packages as part of the country's overall industrial policy, and make any incentives available on equal terms to all investors, foreign as well as local. The incentives should focus in particular on those activities that create the strongest potential for spillovers, including linkages between foreign and local firms, education, and training. It should also be noted that the country's industrial policies in general are important determinants of FDI inflows and effects of FDI. By enhancing the local supply of human capital and modern infrastructure and by improving other fundamentals for economic growth, a country does not only become a more attractive site for multinational firms, but there is increased likelihood that its private sector benefits from the foreign participation through spillover benefits.

5.3 Observations

During the study and research concerning this paper certain facts have been observed on Foreign Direct Investment. The observation has stretched from the national to the global situation. This part of the chapter is devoted to giving certain observed facts about the subject of this research.

5.3.1 Global Situation

The state of the distribution of FDI is such that it is primarily taking place in developed countries or high-income countries. For example, the World Bank reports that in 1999, the value of FDI quoted in US Million Dollars in high-income countries was about 727,130 compared to low-income countries with only 9,750.It should be mentioned also that distribution of FDI is disproportionate among low-income countries, with Africa having the least share of FDI. It is also the case that even within Africa, the distribution of FDI is uneven, and for example, it ranges in value from (US$ Millions, 1999 figures) 1,376 in South Africa to 40 in Cameroon. This situation raises the question "Why should there be so much emphasis on FDI as a way of fostering development, particularly on the part of those countries that have the least share of FDI?'

There is also a further question relating to this situation. Is it that low incomes countries have not put in place policies such as mentioned above that attract FDI inflows? Or could there be other reasons that might help us find an explanation to this situation? To answer fully the above question requires in-depth studies. However, let me try to provide some insights by looking at Zambia's experience.

5.3.2 Zambian Experience

Since 1991 the government of Zambia has been pursuing liberal economic policies. Important to this policy framework has been embarking on a very rigid, rapid and far-reaching structural adjustment programme. This strategy (supported by IMF and World Bank) was a dramatic shift from the previous government controlled approach to economic management, where the private sector plays the driving role as government gives the directions to the final destination.

At the heart of the new order of economic management has been, *inter alia,* trade liberalisation, removal of foreign exchange controls, public service reform, introduction of cost sharing (arrangement where both government and citizens share the responsibilities of meeting the costs) with respect to the social sectors -- education and health, the heralded privatisation programme -- government withdrawal in running business. Privatisation has tended to stand out as the major driving force for economic development.

The private sector-driven economic approach went with the emphasis on calling foreign investors to come and invest in Zambia. But it must be mentioned here that not so much emphasis and enthusiasm has been given to Zambians to invest or indeed take over some of the parastatal companies that were being privatised. If there has been some Zambian investment such as Management Buy out (MBO), this took place only in those companies that were lukewarm in performance and vibrancy. In a situation where there are low levels or no savings, it would be unlikely that there can be capital formation for people to invest in or buy companies that were highly vibrant.

5.2.3 Specific Incentives

One undeniable fact is that Zambia has not only structurally adjusted its economy as shown above over the past decade but has also tried to make itself an attractive destination for FDI by improving the standards of treatment given to foreign firms. Key to this has been the Zambian Investment Centre which has been trying to make itself a "one stop shop."

Other efforts linked to the Investment Centre have involved for example, investment guarantees under which the Investment Act assures investors that property rights shall be respected and that no investment of any description can be expropriated unless Parliament has passed an Act relating to the compulsory acquisition of that property. Moreover in case of expropriation, full compensation shall be made on the market value and must be convertible at the current exchange rate.[80]

Investors are guaranteed that investments will not be adversely affected by any changes in the investment Act for a period of seven years[81]. The country has gone further by being a signatory to the Multi-lateral Investment Guarantee Agency (MIGA) and other international agreements which guarantees foreign investment protection in cases of civil strife, disasters, as well as other disturbances.

[80] Investment Act, cap 385 of the laws of Zambia ,section 39
[81] Section of the Investment Act ,Cap 385

At the bilateral level, Zambia has signed reciprocal promotional and protection of investment protocols with a number of countries.

In addition to the above incentives, Zambia could be considered an attractive destination to FDI because of its social and political stability. Since independence, the country has never experienced any civil strive.

5.2.4 Zambia's Record

Have these incentives made a difference in attracting FDI to Zambia? To be honest, it has been difficult to discover exactly what the levels of FDI inflows have been to Zambia, especially with the view to looking at trends over a certain period of time. At the time of gathering information for this research, only investment *pledges* were available. Of course it is not known whether or not these promises to invest may translate into actual investments. It is suggested that this area needs an isolated and detailed research on its own.

Nevertheless, the World Bank reports that in 1999, the value of FDI in Zambia was 163 Million US Dollars, compared to Mozambique's 384 Million US Dollars and Tanzania's 183 Million US Dollars. This of course does not give us a comprehensive picture of the situation over the past years. But we can say that Mozambique and Tanzania are relatively ahead in attracting FDI as compared to Zambia.

It is suggested; however, that even in the absence of statistical evidence of the amount of FDI inflows to Zambia, one can still, going by the current situation, conclude that much has not happened in the country with respect to FDI.

May be the question to address is why Zambia, despite all the efforts in terms of structural adjustment and additional foreign investor incentives, has not in fact been much of an FDI destination? Of course this is not to say we have not attracted any foreign investors. There certainly has been such as in the mining sector. But these outside investors are not in fact coming to establish new firms altogether. Most of them took over already existing firms and especially those that were vibrant.

5.2.5 Why this Situation?

There is need to offer some reasons as to why Zambia has not been so much of an FDI destination. In the first place, it is important to acknowledge, as has been established already, that the most attractive destinations for foreign investment are still the rich countries. The reason for this may not necessarily be that these countries have been offering more attractive investment incentives than poor ones. But it may be that these countries have a more comprehensive investment climate. That is to say, factors like a favourable market, good infrastructure, effective and corruption free administration and economy stability are at full play.

Zambia's being a landlocked country makes it inevitably a high cost area. The difference we have observed earlier between Zambia on one hand and Tanzania and Mozambique on the other could be due to this reason. Mozambique and Tanzania have direct access to sea transportation.

The other reason that one may be looking at, especially when comparing beyond Africa, is education and thus availability of skilled personnel. It is hopeless for one to expect an inflow of foreign investment, particularly which is long-term in orientation, with what is obtaining currently in the education sector.

We have also been caught-up in the "poverty trap." Reports of 80 per cent of the people living below the poverty line cannot in any way add value to investment attraction, as it adversely affects the market size. This is because high poverty levels drastically reduce the market size. This could be looked at as perhaps one of the major reasons for Zambia not being so much of an FDI destination. Just a matter of highlighting this point, writes, *Muweme* of the JCTR in the 2001 fourth quarter Article, Bulletin No 50:

> *I remember a representative of a foreign firm that was intending to come to invest in Zambia asking me about trends in the cost of the JCTR monthly Food Basket.*[82]

The monthly JCTR monthly Food Basket measures the cost of living in Lusaka and how that relates to household's incomes. It is a simple and shocking indication of poverty levels. It is shown here an inquiry pertaining to people's ability to buy goods and services.

Linked to poverty has been the dreaded HIV/AIDS pandemic that has continued to ravage countries in Sub-Sahara Africa. This pandemic continues to claim lives whose productive contribution is essential to any foreign firms investing in Zambia.

Another point to add to this discourse is that it is paradoxical that while on one hand we are trying to attract foreign investment, we have on the other hand allowed companies to collapse. The recent relocation of the Lever Brothers bath-soap plant (to a neighbouring

[82] JCTR Bulletin 50 Article- **Foreign Direct Investment.** Supra note 13

country) is one case in a line of companies finding difficulties to operate effectively and eventually winding-up operations.

A final invariable factor that discourages FDI in Zambia is the perception of high levels of corruption. The just released Transparency International 2003 Report places Zambia at 79 out of 90 countries on its scale of its scale of "Corruption Perception Index", only 11 places from bottom.[83]

5.4 Recommendations

Unless the issues highlighted above are dealt with, there is very little hope in significantly attracting foreign investment. In my view, there is great promise in investing in education beyond what is currently happening. It is through education that a lot of problems can be tackled -- poverty, HIV/AIDS, sustained availability of skilled human resource. We can and should do as much as we can at policy level and incentives to make Zambia an FDI destination. But without addressing fundamental issues like education, poverty, HIV/AIDS, corruption there will be little hope for FDI and the overall development of the country.

This is why it is strongly suggested that the Zambia Investment Centre should be working closely with institutions such as Ministry of Education, Anti Corruption Commission, and Central Statistical Office. In that way, when marketing Zambia, whatever is happening on the ground in terms of improvement could be highlighted.

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[83] ibid

There is need also for the government to realise the importance of a vibrant local industry if foreign investors are going to be attracted to this country. Investors are more likely to come to a country which already has a thriving local enterprise sector and an organised and structured business community. In this vain the government should devise ways in which Zambians are also going to be empowered economically. The Investment Act should be amended ensure that certain areas are exclusive to Zambians. No country can be rich if its own citizen are poor as the wealth of a country must reflect the per capital income. It is hoped that the closing remarks of President Mwanawasa at the 'National Indaba', a national conference on the problems facing the country, that 'all investment in Zambia must pass the empowerment test' will be taken seriously[84]. President Mwanawasa also emphasised they need for government to change in the way it treats local investors as compared to foreign ones. Local investors should be given the same treatment with foreign investors.

One thing that needs realisation is that although it is important to reduce the obstacles which inhibit the flow of capital from foreign lands into the country, the case for special incentives to foreign investors alone seems doubtful. The World Bank, in its 1985 report argued that "the impact of specific incentives for direct investment is uncertain. Numerous studies have suggested that business executives tend to ignore or down play incentives in making decisions on where to invest."[85] It is therefore suggested also here that the government need not so much to concentrate on offering special incentives to

[84] The Post News Paper,
[85] SADCC, the proceedings of the annual consultative conference held in Gaborone Republic of Botswana on 5-6th February, 1987: Gaborone Printing Works, Gaborone, Botswana. P28

foreign investors at the expense of local investors who have a direct interest in the affair of the country than foreign investors have.

5.4.1 Regional Integration/ WTO talks' failure

Finally, with the failure of the Cancún WTO talks, the problem of market size has even been compounded and it also shows unwillingness of the developed world to practically favour developing countries. One of the problems that have been confronting third world industries is the lack of fair and favourable access to the world the world market. This is because even if the issue of market had ceased to be an issue for investors with the formation of the World Trade Organisation –WTO- it has be seen that the problem of market access is still an issue which host governments in developing countries must critically look at.

The failure of the September 2003 World Trade Organisation meeting in Cancún may have halted the global trade liberalization. This is because the major reason why talks couldn't reach a conclusion is directly related to the problem of market access of third world investors. The situation is that, there is a strong movement in the developed world — especially in the US — in favour of protectionism.[86] The reason behind it is the slow rate of employment growth in the US. The unemployment rate continues to hover around 6.5 per cent, a figure which the social security system cannot easily cope with. In the end

[86] Guy de Jonquieres and Victor Mallet, Failure of WTO talks spurs trade initiatives in Asia. Published: October 15 2003 20:20 | Last Updated: October 15 2003 20:20 http://www.news.ft.com/servlet/ContentServer?pagename=FT.com/StoryFT/FullStory&c=StoryFT&cid=1059480620574

developed countries give subsidies to the tune of $350 billion plus to their farmers.[87] It is a kwon fact that there will be no quick and radical reduction of these subsidies in the coming year. What might take place is a more concerted effort at putting in place free trade processes on a mutual basis.

It is, however, suggested that the failure of the WTO talks should, instead of thwarting efforts by developing countries to increase access to the world market, galvanize efforts to press ahead with regional and bilateral trade deals. It suggested that to reduce the problem of small market size in most developing economies, there is need for these countries to enlarge their markets through regional trading. There is need for Zambia to concentrate, simultaneously, on bilateral processes and also get into groupings — such as COMESA. This process has to be speeded up further. While we pursue the WTO process, we must look at strategic free trade agreements with countries with which we have win-win options. Contrary to what many believe, a free trade agreement doesn't mean the immediate slashing of import duties. It actually means preferential trading in a phased manner.

[87] **N Vidyasagar,** WTO an inclusive platform for developing nations' THE AMIT MITRA INTERVIEW / N VIDYASAGAR TIMES NEWS NETWORK[THURSDAY, OCTOBER 16, 2003 01:23:43AM]www.economictimes.indiatimes.com/cms.dll/html/uncomp/articleshow?msid=235749&Curpg=1

Appendix 1

Mauritius as an example of a country that has managed to attract FDI by a combination of all other factors in addition to a sound legal system

FDI in Mauritius

Mauritius is one of Africa's most dynamic examples of economic growth. in the 30 years since independence, the country has successfully restructured itself form a predominantly mono-crop (sugar) economy to an export-oriented manufacturing one and has now reached the status of a middle income country with a per capital income that exceeds by far that of most other African countries ($3.380 in 1995).

FID has played a pivotal role in the development of the country's economy. Following the establishment of an export processing zone, and the implementation of an export- oriented development strategy in the 1970s, FDI flows to Mauritius' peaked in the early 1990s—the same time that flows to the East Asian economies were growing rapidly. Mauritius' success in attracting FDI was largely due to its key comparative advantages: skilled, low-cost labour; a reasonably efficient physical infrastructure including cost completive export processing zones; preferential access to the European Union and USA markets; a sound legal system for dispute settlement and yearly accounting practices; and clearly articulated policies favourable to FDI. Also compared to other African countries, Mauritius already had a strong business environment with a vibrant entrepreneurial culture very early in its development process. The economic advantages of the country attracted investment in labour intensive manufacturing industries, especially in garments and textiles. Investors in such other labour intensive manufactures as leather, rubber, fancy goods and toys were also attracted.

Box table. FDI inflows to Mauritius, 1985-1997

(Millions of dollars and percentage)

Country/group growth rate	1985- 1990 annual average	1985- 1990 annual growth rate	1991-1997 annual average	1991-1997 annual
Mauritius	22.0	49.5	23.0	13.9
Memorandum:				
Developing countries	24 720.0	22.0	92 181.0	23.6

In the early 1990s, however, flows to Mauritius slowed and even failed for a period, this at a time when flows to developing countries as whole continued to increase. Investments in Mauritius from three out of five major home countries of TNC investing in the country—Germany, china and United Kingdom—have also decreased in the last few years. Manufacturing industries, especially the traditionally dominant textiles and garment industries, have been the most affected, with investors moving to other lower-cost locations. The fact that low-skill activities continue to dominate FDI arrivals accounting for 98% of FDI in both 1985-1989 and 1990-1997 respectively, indicates that there has been little progress in upgrading and diversification since 1985. thus, there has been not only a slow down in attracting FDI into the traditional industries, but the country has also not yet been very successful in attracting FDI into high-skill and technology-intensive industries(the recent increase was mainly due to unreflectively large textile project from India).

There are a number of challenges Mauritius has to copy with in order to safeguard its earlier success in attracting FDI:

- **One challenge is posed by rising labour costs, an inevitable consequence of rapid development process of recent years, which has led to a decline in the competitiveness of Mauritian exports. The emergence of other viable low-cost host countries in Africa such as Kenya, Madagascar and Zimbabwe has also increased competition for FDI in industries** that have traditionally attracted it in Mauritius.

- Another challenge is the threat of elimination or reduction of preferential access to the European Union and the United States markets, as the Lome` convention comes up for review.
- A third challenge is posed by the combination of a limited supply of industrial skills, a lack of local supplies of inputs, a limited technological infrastructure and a low local demand for high technology products, which together have made it for Mauritius to increase the spread and quality of FDI.

Mauritius' FDI policy regime and promotion strategy, though largely favourable to attracting export-oriented FDI, could be further improved. There have been delays in getting foreign investment approvals in Mauritius. Overlaps in the activities of the different public institutions responsible for foreign investments approval and promotion could have resulted in bureaucratic and structural bottlenecks in the approval process. Moreover, the countries investment promotion strategy might benefit from more focus on a reduced number of potential sectors and home countries for attracting technological upgrading, creating linkages with local industries, increasing local value added, and facilitating research and development.

Like comparable economies in south East and East Asia, Mauritius now faces the challenge of moving to a new phase in its economic development. Likes the successful Asian economies, Mauritius needs to develop new comparative advantages in its established industries and competitive advantages in emerging industries. The loss of competitive advantages as a low –cost producer could, for example, be compensated for by developing the countries potential as a regional headquarters for TNCs. Its potential as an offshore financial centre could be realized with a more active approach to tapping new offshore business. Investment in relevant education and skills-building could be accorded priority. A re-engineering of the existing incentive package may also be needed, along with the streaming of investment promotion activities, in order to target the desired industries.

The Government of Mauritius has recognized the challenge and has started a number of initiatives to ensure competitiveness in the future, such as a skill development programme, a reprioritizing of the education and skill-building policies, the establishment of a National productive and competitive council, and other initiatives to support the technological upgrading of the domestic economy and to make Mauritius a more attractive place in higher-value-added activities. Also, the Government has taken steps to reduce delays in processing and approving investment projects through the establishment of a Board of investment –among other things—will implement a fast track approval procedure for investment projects, and has introduced other measures to facilitate investment, including the issuance of multi-entry visas for foreign investors. Furthermore, the Government also supports the increasing outward investment by Mauritius based companies in other African countries in order to strengthen the competitive edge of Mauritius based industries.

SOURCE: UNCTAD, based on Lall and WIngnaraja(1998) and information obtained from national sources as

Quoted by the world investment report (1998) trends and determinants, United Nations, New York and Geneva.

Appendix 2
Media Reports on Calls to amend the investment Act

Times of Zambia. 29th July 2003

'State to review investment laws'

by times reporter

GOVERNMENT is reviewing investment laws to stop the tendency by some firms, especially South African investors, to close businesses immediately after their tax grace period was over.

Vice-President Nevers Mumba said in Lusaka yesterday that some south African companies were defrauding Zambia by their unorthodox practices.

"We will be putting up new measures where the Ministry of commerce will start asking the investors to first clear with their embassy to show that they are genuine and good investors who will not take advantage of us," he said.

Dr Mumba said some firms did not promote the welfare of Zambians but instead exploited them.

It was realized that some investors falsified their annual turn over and this lowered the tax returns.

Dr Mumba however commended Zambia Breweries Plc for the commitment it had shown in paying tax faithfully without cheating. The firm had paid over $ 100 billion tax in the last financial year.

Dr Mumba said after touring the plant that he was impressed with the quality of investment and called on other foreign investors to emulate Zambia Breweries.

"I am impressed with the investment you have put in and the $80 billion you have pumped into this company is visible. Some investors come into the country pretending to be genuine investors and when their tax free period expires they decide to close down their business overnight, and I am happy tat you have shown commitment to the Zambian industry," he said.

He expressed concern that South Africans who had invested in the mines on the copper belt were engaging South African suppliers at the expense of Zambians.

Dr Mumba said that Zambians had been suppliers to the mining sector for a long time but their being sidelined had left them wallowing in poverty.

And Zambian breweries corporate director Augustine Seyuba dispelled reports that his company intended to shut down Northern Breweries plant in Ndola.

He said his management was willing to meet with

The post newspaper issue No. 2387
Wednesday April 30, 2003.

' Investment Act to be amended'

by Larry Moonze

We are amending the Investment Act to make certain areas of Zambia a preserve of Zambians, commerce permanent secretary Dr Wamundila Mbikusita-Lewanika said yesterday.

And Lewanika said Zambia was having difficulties in signing a bilateral agreement with the Democratic Republic of Congo (DRC), which is Zambia's biggest importer in the SADC region.

Speaking before the parliamentary select committee on government assurances, Lewanika said government wanted to transform the economy to where indigenous people benefited.

"Consultations are going on to amend the Investment Act to ensure that certain areas are exclusive to Zambians," He said.

Lewanika said the Development Bank of Zambia (DBZ), Zambia National Commercial Bank (ZNBC), and National Savings and Credit Bank (NATSAVE) were being transformed into institutions that could provide loans with affordable interest rates.

He said government has since liquidated 90 percent outstanding parastatal loans owed to ZNCB.

Lewanika said that government was not in a hurry to privatize ZNBC but that the Republic committed Zambia to the selling of the national bank.

"This is what became a trigger point by donor partners in realizing funds including HIPC," he said.

Lewanika said what the current administration did last year was to renegotiate the commitment so as to allow Zambians own more shares.

He said NATSAVE on the other hand was expanding micro credit lending to rural areas as it was seen as an important vessel in poverty reduction.

the committee set up by government so that they could chart the way forward and ensure that there was continuity and people did not lose jobs. Mr. Seyuba thanked Dr Mumba for the visit which was the first of its kind by sitting Vice-President and presented him with a gift of K 5 million which would be donated to a charity institution of the Vice-President's choice. At Setrec, company's chair man Sebastian Kopulande said the high interest rates on bank loans made it almost impossible for local investors to acquire loans for the machinery. He called on government to intervene and reduce tax on most raw materials for local manufacturing companies. Dr Mumba said the Government was aware of high interest rates and was working closely with Bank of Zambia (BoZ) to address the situation.	

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