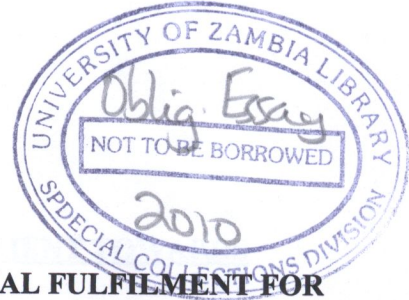


THE REGULATION OF FOREIGN DIRECT INVESTMENT TOWARDS
ECONOMIC DEVELOPMENT



**BEING A DIRECTED RESEARCH SUBMITTED IN PARTIAL FULFILMENT FOR
THE AWARD OF A BACHELOR OF LAWS DEGREE (LLB)**

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A handwritten signature in blue ink, appearing to be 'Kebby', written over a dotted line.

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THE REGULATION OF FOREIGN DIRECT INVESTMENT TOWARDS
ECONOMIC DEVELOPMENT

Be accepted for examination. I have checked it carefully and I am satisfied that it fulfils the requirements pertaining to the format as laid down in the regulations governing directed Researches.

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Date 7-04-2010

ABSTRACT

The dream of every least developed country is to one day reach the standard of the more developed Countries and also be considered a developed country. In order to reach this level of development which includes infrastructure changes and improvement in the well being of the population, these developing countries need capital for them to finance such projects.. Developing countries have found a panacea in Foreign Direct Investment FDI in that there is a high likelihood that returns will be huge dependant on the resources in that country. In order to attract this FDI, most developing countries engage in a massive incentive exercise which involves enticing foreign investors to make their investment in these developing countries.

This paper considers the impact of FDI and whether or not it does indeed promote economic development. In this regard, the paper looks at the Zambia Development Agency Act and other statutes providing for incentives especially under the mining sector. The paper further considers whether the regulatory mechanisms in existence at present are to the benefit or detriment of the country.

It is the recommendation of this paper that there should be laws in place that ensure economic development in the country including other measures such as protection of workers welfare and stronger linkages between foreign firms and the local industry.

DEDICATION

To my Nephews, Kumo and Bo boy, Nieces, Fota, Bibusa and your Grandparents....you guys
have not seen anything yet-the best is yet to come

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ABBREVIATIONS

FDI	Foreign Direct Investment
GATT	General Agreement on Trade and Tariffs
GDP	Gross Domestic Product
M&As	Mergers and Acquisitions
MNC	Multinational Corporation
R&D	Research and Development
TNCs	Trans-National Corporations
VAT	Value Added Tax
WTO	World Trade Organisation
ZDA	Zambia Development Agency

TABLE OF LEGISLATION

GATT Agreement 1947-1995

The Customs and Excise Duty Act Cap 322 of The Laws of Zambia

The Income Tax Act Chapter 323 of The Laws of Zambia

The Investment Act Chapter 385 of The Laws of Zambia (Repealed By The Zambia
Development Agency Act No: 11 Of 2006)

The Value Added Tax Act Chapter 331 of The Laws Of Zambia

The Zambia Development Agency Act No: 11 Of 2006

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CHAPTER ONE

FOREIGN DIRECT INVESTMENT AND ECONOMIC DEVELOPMENT

1.0 Introduction

Foreign Direct Investment (FDI) is seen as one of the many avenues through which a country may achieve economic development¹. FDI plays a significantly prominent role in designing economic development strategies with a view to alleviate the burden of poverty without having to accrue any further debts. Being crucial to their development, developing countries see FDI as an engine for growth mainly because it provides required capital for development generates employment and acts as an aid to local firms through technological transfer. Apart from facilitating capacity building in the host country, it is usually hoped that access to foreign markets will undoubtedly improve the integration of the host country into the global economy and result in economic growth².

Most developing countries encourage investment by offering attractive incentives to investors with the motive of benefiting economically and in many other ways. There is considerable evidence that FDI can affect growth and development by complementing domestic investment and by undertaking trade and transfer of knowledge and technology³. As a result of the potential role that FDI plays in accelerating economic growth, many developing countries and Africa in particular seek such investment in order to boost their development efforts⁴.

¹ P. J. Buckley, **International Investment**. (Vermont: Edward Elgar Publishing Company, 1990) p. 182

² S. I. Ajayi, FDI and Economic Development in Africa. Accelerating Africa's Development Five years into the Twenty-First Century. 2006.

³ Ibid

⁴ Ibid

Because of this investment, it is expected, at least in theory, that there should be economic development in the host country. This however seldom happens. Indeed, the role that FDI plays in accelerating growth and sustainable development has never been substantiated⁵. In most developing countries and indeed Zambia, when the Multinational Corporations (MNCs) acquire their profits, the capital earned hardly ever remains home as the bulk of it is externalized⁶. Furthermore, there is no indication of domestic gains due to the fact that corporate strategies are employed such as protective tariffs and transfer pricing which ultimately reduce the level of corporate tax that a host state receives. Coupled with this is the importation of intermediate goods, management fees, royalties and interest repayment on loans⁷. Such incentives offered to MNCs surely are to the host country's detriment. It can be argued that the benefits of FDI to host countries are just colourful glosses enticing the host to open their doors to investment not knowing that the main aim is to make quick profit and leave immediately after their tax havens expire.

It is against this background that this dissertation seeks to explore and examine whether or not Zambia's economy is really enjoying the benefits that come with Foreign Direct Investment ultimately leading to economic development. In this regard the paper will look at the arrival of investors, the laws and policies they are subjected to and all laws relating to the promotion of economic development. After a discussion of the above factors, the paper will proceed to analyze the laws alluded to above and suggest either review or amendment of laws. Ancillary to the main stated objective the paper will also tackle other pertinent issues such as damage to the host country, the advantages and disadvantages of relaxing laws to create a

⁵ S. Vaknin, **Malignant Self Love - Narcissism Revisited**. (Kumanovo: Euro College publications. 2007) p 356

⁶ S.P. N'gambi. Is Zambia fully Benefiting from Foreign Direct Investment? The Commerce Gazette. (May/June 2009). p. 6

⁷ D. Reid, **Sustainable Development "An Introductory Guide"**. (London: Earthscan Publications Ltd,1995) p. 122

favourable investment climate and consider a revision of the laws that will be found wanting in terms of economic development to the host country.

1.2 Rationale and Justification

This study comes at a time when the world is going through the global financial meltdown and now more than ever before, countries; especially least developed countries are further relaxing their already weak laws in order to attract Investors so as to counter the effects of the crisis. A striking example of this is the abolition of windfall taxes and a replacement with the variable taxes that allow mining firms to pay taxes only in accordance with the profits that they make as expressed by President Rupiah Banda in his Opening address to Parliament in September 2009. As a result of this, the least developed countries like Zambia are being exploited. In this regard, the paper suggests policies and laws that will ensure that the investment climate is still conducive but without losing sight of the need for economic development even in these very trying times.

1.3 Methodology

This research will be a qualitative one which will include desk research and field investigations in the form of interviews. Secondary data in the form of books, journals, scholarly articles as well as the internet will be consulted with a view to disseminating current information.

1.4 Understanding the Concepts of Foreign Direct Investment and Economic Development

With the many attributes that Zambia has, attraction of foreign direct investment (FDI) is certain. Zambia is a mining economy with decades of experience in mining-related activities and the quality of its mineral resources is equivalent, if not better, than those found in many

successful mining economies⁸. Zambia does indeed have great potential for deepening investment as it boasts of underutilized rural resources, inter alia unspoiled wilderness areas for tourism, which, if properly exploited, could help attract considerable amounts of FDI⁹.

Zambia's export potential does not end here because it is enhanced by regional trading arrangements and privileged market access opportunities granted by developed countries. With the opening up of the Zambian economy in the 1990s, FDI inflows increased considerably reaching \$334 million in 2004. This was largely due to the implementation of an ambitious privatization programme (1994-2001), investments in copper and cobalt extraction, and Greenfield investments in the agricultural sector, in particular horticulture and floriculture production, and in tourism¹⁰.

1.4.1 What is Foreign Direct Investment?

The term Foreign Direct Investment has defied a singular definition but many of the definitions share common characteristics. One such definition is that contained in the Balance of Payments Manual¹¹. Here, FDI is defined as an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor. Overall, the purpose of the investor is to gain an effective voice in the management of the enterprise. The World Trade Organisation defines FDI as what occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset¹². The Zambia Development Agency Act¹³ defines foreign investment as investment brought in by an investor from outside Zambia and further defines foreign investor as a person who makes direct

⁸United Nations Conference on Trade and Development. Investment Policy Review of Zambia. (Switzerland: United Nations Publications. 2007). p. 3

⁹ Ibid

¹⁰ Ibid

¹¹ International Monetary Fund. Balance of Payments Manual 5th Edition (Washington, D.C. 1993)

¹² www.wto.org. accessed on 28th November 2009

¹³ No: 11 of 2006

investment in the country and who in the case of a natural person is not a citizen or permanent resident of Zambia and in the case of a company is incorporated outside Zambia.

It is the management dimension that draws a distinction between FDI and portfolio investment in foreign stocks, bonds and other financial instruments. It will be noticed that in most instances, the investor and the asset being managed abroad are business firms and the investor is typically referred to as the parent firm and the asset as the affiliate or subsidiary¹⁴. Portfolio investment therefore does not qualify as FDI within the WTO definition and this is simply because in FDI there is a management of the asset as opposed to stock market control.

In summation, FDI is the relation that exists between a parent business enterprise and its foreign affiliate¹⁵ which together comprise an MNC. The main or primary purpose of the parent enterprise through its foreign direct investment effort is the exercise of substantial control over the foreign affiliate company.¹⁶

The various forms of investment envisaged by direct investment are equity capital, reinvestment of earnings and the provision of long-term and short-term intra-company loans (between parent and affiliate enterprises)¹⁷.

A further classification of the various types of foreign direct investment is by their set target. Reference here is made to the areas of Greenfield investment and Mergers and Acquisitions (M & As). Considering Greenfield investments, there is an involvement of the flow

¹⁴ Supra note 12. accessed on 28th November 2009

¹⁵ www.economywatch.com. accessed on 14th December 2009.

¹⁶ Ibid

¹⁷ United Nations Conference on Trade and Development. **Trade and Development Board Commission on Investment, Technology and Related Financial Issues**. 11th session Geneva, 8–14 March 2007 Item 3 of the provisional agenda

of FDI which involves the building up of new production capacities in the host country or in other cases the expansion of already existent production facilities in the host country. This form of investment has the advantage of increased employment opportunities, relatively high wages, Research & Development (R&D) activities and capacity enhancement¹⁸.

Regarding the other classification on which most MNCs rely to bring in FDI, Mergers and Acquisitions (M&As), these are defined as the acquisition of more than 10% equity share, involved in transfer of ownership from domestic to foreign hands, and do not create new productive facilities¹⁹. These M&As, also referred to as Portfolio Investment have become a popular mode of investment of companies, especially those that have the desire to protect, consolidate and advance their positions through acquisition of other companies that eventually enhance their level of competitiveness. As compared to Greenfield investments, this sort of FDI flow through acquisitions does not render any long run advantage to the economy of the host nation and particular concerns are raised such as the extent to which they bring new resources to the economy, the denationalization of domestic firms, employment reduction, loss of technological assets, and increased market concentration with implications for the restriction of competition²⁰. Indeed a research on the World Investment Report 2000 found that the benefits that accrue to the host country through M&As are lower and that the risks associated with negative effects are far greater when compared to Greenfield investments, especially at the time of entry over the short term²¹.

¹⁸ Supra note 15. accessed on 14th December 2009.

¹⁹ N. Mwilima. **Foreign Direct Investment In Africa**. Africa Labour Research Network Labour Resource and Research Institute. September 2003

²⁰ Supra note 19

²¹ United Nations Conference on Trade and Development. **World Investment Report 2000**.

It is because of the inherent characteristics of portfolio investment that it cannot be considered as FDI. Here, the investor takes it upon himself all the risks that are involved in the making of such investments such that if he were to suffer any loss, he is unable to sue the domestic stock market and this is so because under customary international law, portfolio investments are not protected as opposed to the protection of physical property through the principles of diplomatic protection and state responsibility. FDI is generally given differential treatment because the foreign investor will move resources from his home state which resources may have been used by that home state and as such, it is justified that such investments are protected. For portfolio investments on the other hand, these can be made on stock exchanges almost anywhere in the world and since the host state has no capacity of knowing to whom linkages are created, there exists no relationship that impinges responsibility²².

For the purposes of this paper, the WTO definition of investment will be adopted and on that premise advance arguments that are in line with that definition especially with regards management of the assets in the host country.

1.4.2 What is Economic Growth/Development?

Just like the subject under consideration in the preceding paragraphs, economic development is a multifaceted term with no precise definition meaning different things to different people depending on the region. For instance, on a broad scale, anything a community does to foster and create a healthy economy can fall under the auspices of economic development. There are probably as many definitions for economic development as there are

²² M. Sornarajah, The International Law on Foreign Direct Investment. 2nd Ed. (Cambridge: Cambridge University Press, 2009) p. 8

people who practice it²³. Considered from a public perspective for instance, local economic development involves the allocation of limited resources, which include land, labor, capital and entrepreneurship in a way that has a positive effect on the level of business activity, employment, income distribution patterns, and fiscal solvency²⁴.

A definition that will be used and referred to in this paper and one that is accepted as encompassing many factors that are associated with this term is that “economic development is a concerted effort on the part of the responsible governing body in a city or county to influence the direction of private sector investment toward opportunities that can lead to sustained economic growth. Sustained economic growth can provide sufficient incomes for the local labor force, profitable business opportunities for employers and tax revenues for maintaining an infrastructure to support this continued growth”²⁵.

Though the terms economic growth and economic development are used synonymously, there appears to be a difference because as many economists have argued²⁶, economic growth is one of the surest signs of a countries overall wealth. For instance, if the GDP of a country in one year is \$100 million US Dollars (USD) and the next year is \$125 USD million, then there has been economic growth of 25 percent. If, on the other hand, the GDP was only \$75 USD million, the growth would be negative 25 percent.

The economic growth indicators are also considered in labeling the differences between economic growth and economic development and as such, some jurisdictions measure economic

²³ www.wisegeek.com. Accessed on 14th December 2009
²⁴ Supra note 15. Accessed on 14th December 2009.
²⁵ D. Lal, **Development Economics**, (Vermont: Edward Elgar Publishing Company, 1992) p. 1192
²⁶ Supra note 23. Accessed on 14th December 2009

growth through other means regardless of the fact that some anomalies usually occur for instance, a city that receives most of its money through property taxes may consider it economic growth if property values go up.²⁷ Other indicators as measured by the public may include the number of jobs created. This may be, perhaps, one of the best measures of economic growth. If jobs are not being created or are being lost, this generally leads to a depressed economic state, especially for those affected individuals and perhaps for the region at large²⁸.

1.4 Conclusion

This chapter has explored the definitions of the terms FDI and Economic Development including some of the indicators that show whether development is taking place. FDI does indeed have the potential to harness both economic growth and economic development in a country such as Zambia especially if channelled and managed properly. This paper will essentially explore the onset of foreign direct investment paying attention to the aims of FDI and the benefits that accrue to the host country once the MNC's have invested. The paper further considers whether or not the laws in place are really to the benefit of the Zambian populace.

²⁷ Supra note 23. accessed on 14th December 2009

²⁸ Ibid

CHAPTER TWO

THE ROLE OF FOREIGN DIRECT INVESTMENT IN ECONOMIC DEVELOPMENT

2.0 Introduction

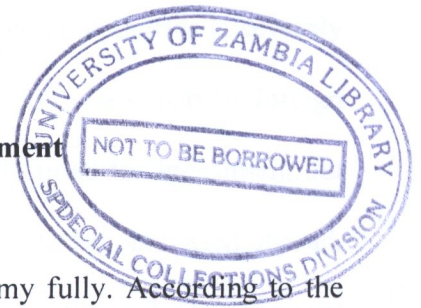
Under this chapter, consideration will be ^{given} had to the theories of economic development assessing which one best describes the Zambian system. From this footing, the aims and benefits of foreign direct investment especially with regard to the host country will also be considered determining whether the theories are justified. The chapter also considers the shift in policy from nationalization of the economy to that of liberalization which substantially led to an increase in foreign investments.

2.1 Theories of Foreign Direct Investment and Economic Development

2.1.1 Classical Theory

This theory takes the view that FDI benefits the host economy fully. According to the theory, the fact that foreign capital is brought in by the MNC that capital may be used for a number of developmental projects. The investor also brings with him into the host economy technology that is absent in the host country which ultimately leads to the diffusion of that technology within the economy. Furthermore, there is employment created with the added advantage of acquisition of new skills that are associated with the foreign investor's technology. A number of other benefits flow from the foreign investors entry and these include infrastructure and upgrading of transport, health or education sectors²⁹.

²⁹ Supra note 22 at. p. 51



2.1.2 Dependency Theory

This theory argues and is in stark contrast to the afore discussed theory in that it does not accept the possibility of any sort of development in the periphery but only the development of underdevelopment. This theory affirms that what is decisive is that the economic development of under developed states is inimical to the interests of the advanced capitalist countries³⁰. In ensuring that development does not trickle down to the developing nations, the more advanced developed states form alliances with the pre capitalist domestic elites with the intention of inhibiting any such form of transformation.

By acting in such a manner, the advanced nation states will continuously have ease of access to all domestic resources thereby maintaining their traditional models of surplus extraction. As a result of this, any prospects of development for dependant countries is severely restricted because the entire surplus they generate would be expropriated in large part by foreign capital. This situation would not only reduce the resources that are destined for investment but even the internal multiplying effect because capital goods would have to be purchased abroad. As a result of this, there would definitely be economic stagnation ensuring the underdevelopment of the dependant peripherals.³¹

These theories seek to show just how much a country can benefit from FDI. In the case of many developing countries the dependency theory seems to best describe their position. This is because the MNCs will usually enter the country and make their profits after which they leave the host country in the same or even worse position than before that investment. It is only in theory that it is thought that there is actual development. It can be argued therefore that there is

³⁰ D. Seers. Dependency Theory: A Critical Analysis. (London: Frances inter publishers ltd) 1991. p. 44

³¹ Ibid p. 44

indeed the development of underdevelopment. However, it will be important for the purposes of this paper to examine the benefits of FDI.

2.2 Aims and benefits of foreign direct investment

Foreign Direct investment flows from the more developed states to those least developed ones. Multinational Corporations (MNCs) are the main channel through which investment is brought to Africa. There are a number of reasons for investing by MNCs in developing countries, and these include safety in the host country, creation of profit when the host country is productive and attraction of market for the said production. Other reasons are cheap labour, adequate resources, large markets, political stability and low risks in order to obtain the said profit. Developed countries therefore consider Africa as conducive for investors to operate their activities due to low production costs and ready markets for the produced goods³².

A host country whenever it attracts FDI is sure to amass a number of benefits which may ultimately lead to economic growth and development of that country. The benefits accruing to host countries can more or less be looked at in terms of three aspects these being spillovers, linkage effects, and competition effects³³. Each of the benefits will now be considered.

2.2.1 Spillovers

When MNCs invest in a particular country, there are some theoretical benefits some of which include technological advantages allowing the MNCs to compete successfully with local firms. As a consequence of this, the host country firms have the potential to learn from the

³² S. Venance. Role of Foreign Direct Investment (FDI) in Development of Low Developing Countries (LDC's): with experience from Tanzania. (Dar es Salaam: Muzumbe University. 2008).

³³ L. Kay. et.al, The Role of FDI in Economic Development. Nordic Journal of Political Economy. Volume 28 (2002), 109-126

foreign affiliates. These technological spillovers, because of their ability to foster higher factor productivity for local firms and in higher factor rewards, should not be taken for granted. It is a common practice that Parent companies support their foreign subsidiaries by ensuring adequate human resources and infrastructure are in place. With particular regard to Greenfield investments into new business sectors, there may indeed be a stimulation of new infrastructure development and technologies to host economies³⁴.

Furthermore, MNCs have been said to improve labour skills through mechanisms such as on-the-job training, seminars, and formal education. For instance, in Malaysia, FDI facilitated technology transfer and improved the skills of the labour force³⁵. It is further argued that FDI contributes indirectly to growth through the emulation of foreign affiliates by domestic firms and also through diffusion of skills throughout the economy as employees move to domestically owned firms. The major contribution by MNCs generally is the provision of technical assistance, training and other information to raise the quality of the suppliers' products. In this way, many local suppliers are assisted in purchasing raw materials and intermediate goods and in modernising or upgrading production facilities³⁶. These aforementioned developments can also result in social and environmental benefits, but only where they spill over into host communities and businesses³⁷. Furthermore, where there is Investment in R&D from parent companies there will be stimulation and innovation in the production and processing techniques in the host country. FDI provided in form of technology is best looked at in terms of the money that comes

³⁴ Supra note 15. accessed on 14th December 2009.

³⁵ L. Katerina et.al, Direct Investment and Economic Growth in Transition Economies. South Eastern Europe Journal of Economics (1). (2004), 97-110

³⁶ Organisation for Economic Co-Operation and Development, **Foreign Direct Investment for Development: Maximising Benefits Minimizing Costs**. (Paris: OECD Publication Service, 2002) p 13

³⁷ C. Dupasquier and P. N. Osakwe, **Foreign Direct Investment in Africa: Performance, Challenges and Responsibilities**. Geneva: United Nations Economic Commission for Africa. 2005. p. 15

in a country through the investments which can be made use of by buying or importing technology from other countries. In this way FDI plays an important role in the context of economic development³⁸.

2.2.2 Linkages

Related to the aspect of spillovers, is whether foreign firms develop linkages to local firms which if strong imply that the employment effect of FDI is potentially large. The interaction between local suppliers of intermediates and the foreign affiliate may be one channel through which learning may take place as in the instance where foreign firms place higher demands on the quality of the intermediates and on timely delivery, forcing local suppliers to become more efficient. This will have the effect of benefiting locally owned downstream firms due to their efficiency. There seems to be relatively strong linkages between import substituting MNCs and local firms in large economies, particularly those countries with strict requirements of local content. This also applies to MNCs that make shifts from import substituting to export oriented production, especially those that rely on stable and unsophisticated technologies. This may be a somewhat indirect benefit of FDI to the host country but FDI in developing countries helps to boost host country exports. This will most likely be the case where MNCs assist developing host countries to process and export locally produced raw materials, using their marketing skills, superior technology, and general know-how. Exports of local products are also facilitated through the MNCs distribution networks, and they often account for a significant share of host country exports³⁹.

³⁸ Supra note 15. Accessed on 14th December 2009.

³⁹ Supra note 35 at pp. 97-110

2.2.3 Competition

Entry by MNCs into local markets may reduce the concentration of firms in a market with the result that there is an increase in competition. The ultimate benefit of this to consumers is lower prices, perhaps a wider choice of goods and reduction in organizational inefficiencies⁴⁰.

2.2.4 Stimulation of National Economy

National economies are set to benefit from FDI in that it contributes to Gross Domestic product (GDP), Gross Fixed Capital Formation (total investment in a host economy) and balance of payments. Subsidiaries of Trans-National Corporations (TNCs), which bring the vast portion of FDI, are estimated to produce around a third of total global exports⁴¹. However, it must be noted that the impact of FDI will largely depend on the conditions of the host economy, such as the level of domestic investment or savings, the mode of entry and the sector involved, as well as a country's ability to regulate foreign investment. FDI will also stimulate the economy in relation to foreign participation in the privatisation of government-owned enterprises. The experiences of most transition economies of East and Central Europe have shown positive strides in the participation by MNCs in privatizations especially the improved efficiency of the acquired enterprises⁴².

2.2.5 Social development

FDI has the effect, where it generates and expands businesses, of stimulating employment, raise wages and replace declining market sectors. These investments may be

⁴⁰ A Blomstrom et al., Multinational Corporations and Spillovers. Journal of Economic Surveys, (2) (2006) 1-31.

⁴¹ United Nations Conference on Trade and Development, **World Investment Report 1999**.

⁴² Supra note 36 at p. 18

helpful in assisting the host countries to set up mass educational programs which in the long run may help them educate the disadvantaged sections of the society. This form of assistance to these sectors is often provided by non-governmental organizations in the form of subsidies. It will also be seen that developing countries can actually tackle a number of healthcare issues with the help of FDI⁴³. There may also be cultural and social impacts that may accompany investment especially those directed at nontraditional goods. This will most likely be the case if financial resources are diverted away from food and subsistence production towards more sophisticated products and encouraging a culture of consumerism can also have negative environmental impacts.

Looked at from this point of view, FDI does indeed lead to economic development because of the many benefits that flow with it. For a country with decades of experience in attracting foreign investment, Zambia is clearly not benefiting to its fullest potential. This position does in fact buttress the argument that it is the dependency theory that best defines what happens in most developing countries with regards economic development.

To speak of the benefits that accrue to the host country is real. However, the economic benefits of FDI do not accrue automatically. In order that the maximum benefits from FDI are reaped there is a requirement that a healthy enabling environment for business is present, which encourages both domestic and foreign investment, provides incentives for innovation and improvements of skills and contributes to a competitive corporate climate. Other factors holding back the full benefits of FDI in some developing countries include the level of general education

⁴³ Supra note 15 accessed on 14th December 2009.

and health, the technological level of host-country enterprises, insufficient openness to trade, weak competition and inadequate regulatory frameworks.⁴⁴

If the factors considered above are carefully studied by a host country the benefits of having such MNCs present will reap results that would eventually lead to the host country's economic development.

2.3 Trends in Foreign Direct Investment for Zambia

The era of FDI can be said to cover the period beginning in the 1980s and up to the present time. The main trends in FDI in Zambia are linked to the dawn of democratic transition in which there was a shift from the era of one party state to multiparty state. The new democratic dispensation came generally with the neo-liberal economic policy that became the path for economic policy which was not only adopted by Zambia but by many other developing and developed countries⁴⁵ under the auspices of the Multilateral trading regime, the World Trade Organisation which encourages opening up of national markets, removal of trade barriers to allow for free movement of capital, goods, services and creation of appropriate environment⁴⁶.

During the one party state rule there was state intervention in the economy better known as nationalisation. However, regardless of the fact that there was state intervention in the economy, discrepancies existed between the planned objectives and resource allocations as well as implementation. As a result of this, balance of payments problems emerged which made it difficult for the government to import goods and service its external debt thereby reducing

⁴⁴ Supra note 36 at p 21

⁴⁵ M. Muweme. **Foreign Direct Investment: What Difference for Zambia?** Jesuit Centre for Theological Reflection Bulletin article 50. 2009

⁴⁶ Supra note 12. accessed on 28th November 2009

government expenditure on development. A number of other factors are responsible for the poor economic performance recorded by Zambia⁴⁷. First, the government's lack of accumulation of savings during periods of high copper prices to cushion the impact of any fall in copper prices worsened the economic situation since the mid-1970s. Instead, government increased expenditure on socio-economic services like health, education and infrastructure, imported luxury goods and compensated workers with high wages, especially mine workers⁴⁸.

Second, the highly capital-intensive technology utilized in mining and manufacturing meant that there was little contribution by parastatals to employment creation, eradication of poverty, and improvement in standards of living for the mass population. The effectiveness and viability of parastatal enterprises and government bureaucracy was further reduced by mismanagement and corruption⁴⁹. Third, Zambia's support for liberation movements in southern Africa seriously affected the implementation of development plans as resources were diverted from productive to infrastructural facilities, including the Tanzania Zambia Railway⁵⁰.

Before the re-introduction of multiparty democracy in 1991, there were reforms suggested by the World Bank and IMF in order that Zambia may receive more financial aid. During that period however, the reforms were not fully implemented as there was still nationalisation of the economy in which the state controlled and owned most of the industries⁵¹. It was only in 1991 that the new multiparty government of the day pursued vigorous liberal

⁴⁷ O. Hwedi, *The State and Development in Southern Africa: A Comparative Analysis of Botswana and Mauritius with Angola, Malawi and Zambia*. The African Quarterly Online Journal. Available at www.africa.ufl.edu. Accessed on 28th November 2009.

⁴⁸ *ibid*

⁴⁹ *ibid*

⁵⁰ *ibid*

⁵¹ Zambia Development Agency, The Economic Impact of Direct Investment on the Zambian Economy. [Lusaka: Research, Policy and Planning Division. 2008]. p. 15

economic policies. The most important aspect of these new policies was to embark 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 management⁵².

The economic management approach adopted included 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. There was also during this period the Privatisation programme which 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 Zambia⁵³.

In living up to these economic changes, Zambia's policy was to change drastically and in so doing had to begin to attract foreign investment, an avenue to which Zambia was relatively new. Zambia was to strive to become an attractive destination for foreign investment and a number of specific incentives were to be offered to ensure that investment was drawn to Zambia⁵⁴. The repealed Investment Act⁵⁵ of 1993 was to the panacea for the attraction of investment to Zambia. In the Act were to be found various incentives that would make Zambia an attractive destination. Some of the incentives that were offered included guarantees under

⁵² Supra note 45

⁵³ Fitz Townsend. **Zambia: A Review of Industry, Commerce and Tourism**. [Lusaka: Directory Publishers of Zambia. 2001]. p. 9

⁵⁴ Supra note 45

⁵⁵ CAP 385 of the Laws of Zambia

which the investors were assured that property rights were to be respected and that no investment of any description was to be expropriated unless Parliament had passed an Act relating to the compulsory acquisition of that property⁵⁶. Moreover in case of expropriation, full compensation was to be made on the market value and must be convertible at the current exchange rate. Investors were further guaranteed under the Act that their investments would not be adversely affected by any changes in the investment Act for a period of seven years, thereby giving them a sort of assurance that despite any changes they would operate at the same terms agreed when the investment contract was signed⁵⁷. This was essentially a stabilisation clause.

Because of the new policy which involved opening up of key sectors of the economy to both local and foreign direct investment, there was an increase in the inflow of investment. The investment promotion agency created under the Investment Act continued to encourage investment in all sectors of the economy, with priority given to the agriculture, tourism, mining and manufacturing sectors. Indeed statistical information from the Zambia Development Agency shows that from 1993 to 2006, the Investment Centre registered a total of 2,273 projects with corresponding pledged investments of US\$4.176 billion and employment of up to 200,000⁵⁸.

With such figures in mind, one would expect that a country would be developed. However, this is sadly not the case. One would tend to agree with scholars that suggest that there is indeed a development of underdevelopment in Africa.

⁵⁶ Section 35 of the Investment Act 1993

⁵⁷ Supra note 45

⁵⁸ Supra note 51 at p. 16

2.4 Conclusion.

The focus of this chapter has been the aims of FDI and the benefits to the host country. The chapter has shown that there is potential by the host country to benefit from FDI because of spillovers in terms of technological transfer and linkages with regards improved labour and efficiency. Despite these benefits that accrue to the host country most countries still remain poor and this may be said to fall within the ambit of the dependency theory that suggests that there is a continued underdevelopment of LDCs.

CHAPTER THREE

COSTS AND BENEFITS OF FOREIGN DIRECT INVESTMENT

3.0 Introduction

It is now clear that where the various policies of a host country are tuned to be in sync with those of the MNCs and to ensure that the masses are empowered then economic development is ensured. As noted earlier in this work, the level of development will differ in each country and it is only those that effectively apply certain mechanisms that will reap the benefits. The bulk of developing countries have however remained even poorer after the investors left their countries. In fact, looked at theoretically, foreign direct investment is good as it brings a number of benefits to the developing country. In Zambia however, events have not unfolded in such a manner⁵⁹.

This chapter considers the damage that is suffered by host countries and obligations that are imposed upon the MNCs. The paper further looks at the negotiation of investment contracts and explore what needs to be done by the host country in order to reap the benefits that FDI brings.

It will however be a safe course of action to avoid making any comprehensive list as observed by Dickens⁶⁰ when he states 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 economies and their populations - is not at all easy to determine. It is particularly dangerous to make broad, sweeping

⁵⁹ Supra note 6 at p.. 6

⁶⁰ P. Dickens, Global Shift: The Internationalisation of Economic Activity (London: Paul Chapman Ltd., 1992) p. 392

both unreliable for developing countries. Furthermore, it has become a trend that MNCs hurry to repatriate earnings and repay inter-firm loans with the early harbingers of trouble. This is coupled with the fact that once the MNCs gain their profits, the capital will hardly ever remain in the country as a bulk of it is usually externalized. The situation is perpetuated by the export being largely currency and also the tax havens or holidays that are offered to the MNCs resulting in loss of revenue because the only avenue through which the government could benefit from the capital inflows is left unutilized for half a decade after which many investors would have left the country⁶⁴.

Considering the employment sector, FDI is seen as being the panacea for most developing countries. However, as will be seen, this is far from it. This is simply because the foreign owned projects are capital-intensive and labor-efficient. Major investments are made in machinery and intellectual property, not in wages. Because of this, skilled workers get paid well above the local norm, all others languishing. It is also the practice that MNCs employ subcontractors and these, to do their job, frequently haul entire workforces across continents. This has the result that natives rarely benefit and when they do actually find employment it is short-term and badly paid⁶⁵. Indeed, even though MNCs do create jobs, in Zambia for instance, labourers are employed for but a pittance. The facts on the ground actually point to the fact that sometimes even the most basic of jobs are offered to non-Zambian workers regardless of the existence of a surfeit Zambian workforce⁶⁶. A further effect to the employment sector is that FDI may cause shortage of labour in government sector as many workers tend to move to MNCs looking for green pastures. An example of this has occurred in Tanzania, where some employees

⁶⁴ Supra note 6 at p. 6

⁶⁵ Supra note 5 at p 356

⁶⁶ Supra note 6 at p.6

moved from government to mining sector, where salaries are high compared to what is paid in the government⁶⁷.

FDI has been said to improve the competitive nature of business that is carried out by local firms⁶⁸. In as much as this is a welcome move, it has become common cause that these MNCs are funded by foreign loans that are hefty and as such may invest in modern machinery which does in fact encourage production of high quality products⁶⁹. Within the local economies exist small scale and rural businesses of host countries that have less capacity to attract foreign investment and bank credit/loans, and because of this unfortunate fact, certain domestic businesses may either be forced out of business or to use more informal sources of finance or in other words the small enterprises will be crowded out of business. A major concern raised among smaller developing countries or LDCs, is that a few, large developing country MNCs might become dominant players in their economies with the result that monopolization of that particular sector by the MNC⁷⁰.

The foregoing seems to suggest that it is the downside of FDI that is prevalent in Zambia. One need not look too far in order to find that there is more pain and hardship caused to the Zambians in terms of FDI than there are benefits. Zambia and many other developing countries remain poor largely because the laws in place are weak and make more provision for attraction of investment and only in the most rare of circumstances do they make provision for spill over of benefits.

⁶⁷ Supra note 32
⁶⁸ Supra note 36 at p 21
⁶⁹ Supra note 5 at p 356

⁷⁰United Nations Conference on Trade and Development. World Investment Report 2006. FDI from developing and transition economies: implications for development. *Statement by Supachai Panitchpakdi*, Secretary-General of UNCTAD

3.2 Growth Effects of Foreign Direct Investment

Evidence from economic theory suggests that international investment has the domino effect of more efficient allocation of world savings, more inter temporal consumption smoothing, and more risk reduction through asset diversification and finally international technology transfers.⁷¹ Indeed from the foregoing, there seems to be a suggestion that international investment is good for economic growth.

It has however been argued that the role that FDI plays in accelerating growth and sustainable development has never been substantiated⁷². Furthermore, the relationship between FDI and growth is a complex one⁷³ and has been said to be partly due to econometrics⁷⁴.

To find out whether FDI does actually promote economic development, a number of factors will have to be considered. The first question that must be asked is whether or not FDI expands or crowds out domestic investment. Scholars have found that FDI has an almost identical impact on domestic saving, which implies that the growth effects of FDI are negligible. FDI is only seen to have a positive correlation with growth in the small group of Asian countries ((Indonesia, Malaysia, Philippines, Republic of Korea, Singapore and Thailand), but not the larger group of developing countries because for this group, the economic growth was found to have reduced with FDI inflows⁷⁵. A study carried out found that there existed a positive relation between FDI and growth especially for the higher income group of developing countries but not

⁷¹ P. H. Gray, Multinational Corporations and Global Welfare: An Extension of Kojima and Ozawa. Hitotsubashi Journal of Economics, (26 December 1985), 125-133.
⁷² Supra note 5 at p 356
⁷³ Supra note 71
⁷⁴ ibid
⁷⁵ M, Fry, et. al. Foreign Direct Investment, other Capital Flows and Current Account Deficits: What Causes What?”(1995), Policy Research Working Paper No. 1527 [Washington, DC: The World Bank, October].

lower income group of countries. It was stated that “from this comparison, one might conclude that there is a threshold level of income below which foreign investment has no significant effect”⁷⁶.

In terms of causality higher-income developing countries are presumed to be more likely to have better absorptive capacity in terms of capturing technology spillovers and attraction of market-seeking FDI. It is thus reasonable to assert that the pursuit of FDI is more reasonable on the part of development strategies for middle-income countries and not for low income countries, which seem to lack the absorptive capacity required in order to attract FDI for any reason other than low wages⁷⁷.

Much has been written and said about the ability to absorb new and modern technologies by developing countries if their economies are opened to investment from abroad. However, most discussions of how FDI transfers technology usually focus on developing economies. The largest FDI flows actually occur between the more developed economies these being countries that are already at or near the cutting edge of technological development rather than those that are further away from the cutting edge⁷⁸.

Considering employment and linkages, it is to be seen that FDI does indeed provide the much needed employment especially in the mining sector and other related industries. However, the overall direct impact has not been large because of the low labour-intensity of this sector⁷⁹. This can be viewed from the developments in the year 2002 when the mining sector employed

⁷⁶ Supra note 40 at pp.1-31.

⁷⁷ Ibid.

⁷⁸ C, David, T., H. Elhana, International R&D Spillovers.. European Economic Review. (39), 859-87.

⁷⁹ Supra note 8 at p. 3 1995

fewer than ten percent of formal sector workers or what may be termed white collar jobs. Indeed, it is common practice in many MNCs to seldom offer Zambian citizens employment in the upper echelons of management⁸⁰ as is the case at the Barclays Bank where a new Managing Director has been appointed after taking over from another foreign national when there a plethora able Zambians to take over such jobs. Those receiving the indirect benefits of FDI and employment creation are largely suppliers of goods and services to the mining sector.

Furthermore, there is a limit in terms of the business relationships between foreign affiliates and local companies, for instance in the mining industry there is only the link to some support sectors providing maintenance and basic machinery. In the case of machinery, however, the supporting companies are also often foreign affiliates who only have a marketing presence in Zambia, importing their products from abroad⁸¹.

3.3 Obligations on Multinational Corporations

MNCs are obligated by implication to promote economic development or to act in a manner that deters that development. There is a further implied obligation on the part of the home state to ensure that its corporate nationals, entering a treaty partners territory do not act in a manner that does not harm the economic development of the host state which may include avoidance of restrictive business practices and corrupt practices. Most investment instruments have as one of their spillover effects, the assumption that such foreign investment promotes economic development. For instance, bilateral treaties and regional treaties promoting

⁸⁰ Supra note 6 at p. 6

⁸¹ ibid

investment contain in their preambular statements that development comes about due to the investment flows⁸².

3.4 Conclusion

This chapter has shown that to every advantage lies a downside. This is expressed through the damage that occurs to the host country despite the huge investments that are attracted to LDCs, The chapter has also explored the growth effects of FDI showing that in as much as FDI is perceived to promote economic development, the pace at which this is done is not impressive and change is inevitable especially the legal and institutional framework. This chapter shows that governments of LDCs need to do more than just offer incentives but rather reap the benefits that FDI has to bring in order that its growth effects are realised.

⁸² Supra note 22 at p. 181

CHAPTER FOUR

REGULATION OF FOREIGN DIRECT INVESTMENT

4.0 Introduction

This chapter considers the methods and policies that are put in place to ensure that the investments by MNCs benefit the host country and encourage economic development. In so doing the chapter considers the general regulation of foreign investment as practiced by other countries which form the case studies and also due regard will be had to some international instruments that promote regulation of foreign direct investment so that the host country does achieve a measure of economic growth. The chapter further considers a flow of FDI to Zambia by sector and contribution to the GDP which will be useful in determining whether Zambia is really benefiting from the FDI flow.

4.1 Regulation of Investments

Recently, the world went through a global financial meltdown and now, during the recovery period, more than ever, countries; especially least developed countries are further relaxing their already weak laws in order to attract Investors so as to counter the effects of the crisis. A striking example of this is the abolition of windfall taxes and a replacement with variable taxes that taxes only profits made. However, competing for FDI by lowering taxes or offering subsidies can lead to what has been called a race to the bottom, where the foreign firms end up appropriating all the benefits associated with their investment⁸³.

⁸³ Oman, C. Policy Competition for Foreign Direct Investment: A Study of Competition among Governments to Attract FDI. [Paris: OECD Development Centre, 2000] p. 35

4.2 Available Methods and Policies for Enhancing Economic Development

4.2.1 Investment negotiations by host country's

Kamuwanga⁸⁴ advocates for mutually advantageous contracts of investment for developing countries. She focuses on the bargaining power of developing countries and how much they lose when they sign such contracts. Host countries should ensure that during the negotiation process, the negotiators should include provisions such as those relating to the transfer of technology paying particular focus on how technology should actually be transferred.

4.3 Impact of International Instruments and Treaties

4.3.1 General Agreement on Trade and Tariffs

GATT has a number of programs that are very important in looking out for the welfare of developing countries. These programs and policies include the Trade Policy Review Mechanism (TPRM) whose main objective is to monitor trade policies in every member state and to ensure adherence to the agreement; it also has what is referred to as the Generalized System of Preferences (GSP) which is a derogation from Article 1 of the agreement allowing developed countries to enter into individual country packages with developing countries of their choice. This derogation was in line with the 'special and differential treatment' granted to developing countries under Part IV of the General Agreement.

The importance of entering into multilateral relations anchored on GATT is that all contracting parties will have to adhere to the core principles of the agreement. The core principles are contained in Articles 1 and 3 of GATT. These articles refer to the most favoured

⁸⁴M. Kamuwanga, Negotiating Investment Contracts: Investment Law in the Context of Development. (Lusaka: ZPC Publications. 1995)

nation treatment and national treatment respectively. In article 2 of GATT it is provided that member countries undertake to adhere to the rules under GATT and WTO and also that they will not breach the concessions entered into with other nations. This is important particularly for developing countries as it ensures that they will not be bullied as a result of their disadvantaged position in international economic relations. The most significant benefit developing countries have obtained from the agreement is contained in Part IV of the agreement which calls for 'special and differential treatment' of developing countries and primary products from them. The GATT/WTO system is very important for the welfare of developing countries because it has shown, particularly in the last two or three decades, greater participation by developing countries in multilateral negotiations. Greater participation has meant the ability to include important aspects of trade that may influence the economic fortunes of these developing countries in a positive manner. The greater strength of these developing countries and the ability to influence change in their favour has been brought about by working in concert when negotiations are in progress. An organised block of developing countries has had and will continue to have a greater effect on influencing decisions than each member state could ever have if it worked in isolation when negotiating.

4.4 Foreign Direct Investment Growth in Zambia.

It must be noted from the outset that FDI growth in Zambia has maintained a steady and unchanging trend over the past twenty years if one considers the increase in population and the economy size⁸⁵.

Zambia can be considered to be a mining economy with copper as its main export mineral and due to this, in the year 2006, Zambia's economy grew by an estimated 5.8 percent

⁸⁵ P. Langmead, **Tax Policy Issues in Zambia. Selected papers**.(Lusaka: Langmead & Baker Ltd, 2006) .p.32

due to the increase in copper production, soaring copper prices, exceptional agricultural performance and the trends in the construction industry. It was projected that GDP in the years 2007 and 2008 would remain around 6 percent due to the ever increasing investments in the mining sector coupled with an upsurge in the demand for housing which would have substantially increased the already high demand for housing which would further expand construction. In tandem with such gains in the economic performance of the country were the macroeconomic fundamentals which saw a considerable improvement expressed mainly through the achievement of a major fiscal consolidation and undertaken public-sector reforms that triggered the cancellation of \$3.9 billion of external debt in 2005⁸⁶.

Zambia has been favoured among nations in that even donor confidence was restored due to the good economic policies implemented during the period 2001-2006 and this translated into increased confidence in the leadership by donors who have offered larger inflows of aid as such increasing budget support. Because of the factors enunciated above, the Zambian kwacha saw a sharp appreciation in late 2005 and early 2006. This was also coupled with a bumper harvest in 2006, eased inflationary pressure averaging at 9 percent which was a sight for sore eyes in that it was the first time in over thirty years that Zambia had ever achieved such a level of inflation⁸⁷.

Over the period 2000-05, Zambia recorded an average growth rate of around 4.8 percent, which was mainly driven by mining activities, agriculture and construction. A year later, growth was recorded at 5.8 percent largely spurred by strong copper output together with sizeable investment, due to rising copper prices and strengthened economic performance⁸⁸.

⁸⁶ Organisation for Economic Co-Operation and Development, Zambia. African Economic Outlook. (2007), 547-562

⁸⁷ *ibid*

⁸⁸ *Supra* note 86 at p.547

The agricultural sector posted a growth rate of 3.9 percent in the year 2006 which was largely due to the good climatic conditions. This was a bumper harvest as compared to the previous agricultural season that recorded losses because of the scant rains and drought that was prevalent in most if not all southern African countries⁸⁹.

Statistically, 2006 saw copper production increase by an estimated 8 percent because of the buoyant world demand which was reflected in the record high prices. This was so regardless of the fact that there was production of about 492 000 tonnes which was 4 percent down from what was originally forecasted. These production shortfalls at the biggest mines were expected to be compensated for by the opening up of new mines such as the Lumwana mine which is an investment undertaken by Equinox Resources in the North-Western province. Other investors were scheduled to launch the Mopani Copper Mines expansion smelter which was expected to become Africa's largest, with total capacity of 850 000 tonnes of copper concentrate per year in the years 2007 and 2008. furthermore, a \$200 million smelter, with a planned capacity of 150 000 tonnes per year was to be built by China Non Ferrous Metals Group⁹⁰ and scheduled to be completed by 2008⁹⁰.

The tourism sector continued to record positive growth with an increase in investment and tourist arrivals. Both the number of tourists and investments increased in 2006 by 3.1 percent to 670 000 from 650 000 in 2005. Despite these positive developments, several challenges have hit the sector in terms of tourism infrastructure which is largely underdeveloped, including, telecommunications, transport, and accommodation facilities. Secondly, there are inadequate resources for the industry's long-term development although a Credit Facility was established by

⁸⁹ Supra note 88 at p. 548

⁹⁰ Ibid at p. 549

the government to ensure provision of affordable credit to Zambians. Third, although tourism has been identified as a form of rural development, the interests of the local communities have not been fully incorporated into most business models. Fourth, there is inadequate environmental management⁹¹.

The purpose of this exposition is to show how there have been major investments in the Zambian economy and the growth rates that have been recorded in each sector. Judging by the investments in each sector it is expected that the growth rates and inflation in the economy should be good. This is however not the case and may be largely attributed to the incentives that are offered to investors who do not even stay in the country for a considerable period of time to ensure the economic development of the country. Their only goal is the maximization of profits with minimum cost. This has left the Zambian populace in a destitute position with nothing to look forward to and only being hurt when they see heavy laden trucks carrying their copper out of their country via the Kafue and Great North Roads. It is also sad to note that despite all these achievements and gains from such seemingly God ordained favours, sustaining broad-based growth remains a major challenge. There are innumerable reasons why this is so and includes inter alia little diversification of the economy thereby remaining highly vulnerable to both climatic and terms of trade shocks.

With copper being the main resource it is expected that the gains should be at peak due to the high copper prices on the London Metal Exchange. This does not happen because copper mines benefit from substantial tax holidays and generate few spill-overs to the rest of the

⁹¹ Supra note 88 at p. 550

economy. The result of this is that the majority of the population lives in very unsatisfactory conditions with about 70 per cent of the population living below the poverty line.

4.5 Legislative framework

4.5.1 Foreign Exchange Control and Trade Permits

In 1994, the government, in order to attract more investment into the country repealed The Foreign Exchange Control Act. An investor may now transfer capital outside the country without any form of control or restriction. In fact, the Zambia Development Agency Act⁹² in section 20 provides that notwithstanding any other written law relating to externalization of funds, a foreign investor may transfer out of Zambia in foreign currency and after payment of the relevant taxes dividends or after-tax income; the principal and interest of any foreign loan; management fees, royalties and other charges in respect of any agreement; or the net proceeds of sale or liquidation of a business enterprise. There is furthermore no need for export permits. It would indeed be better if the government imposed some stringent legislation on the outflow of capital⁹³ because to carry out such a measure would ensure that the money or foreign currency beefs up the foreign reserves thus leading to a stabilization of the economy.

4.5.2 Zambia Development Agency Act No: 11 of 2006

In order to stimulate private sector investment in the country, the government through the Zambia Development Agency Act⁹⁴ put in place a package of incentives to attract investment. The incentives that are favourable to the investors include; statutory protection of investment and the right to repatriate 100 percent of profits and dividends without any restrictions, a maximum

⁹² No. 11 of 2006
⁹³ Supra note 6 at p.6
⁹⁴ No. 11 of 2006

of 37.5 percent personal income tax; 2 percent tax discount (valid for one year only) from the normal corporate tax rate applicable for each sector for companies listed on the Lusaka Stock Exchange, 15 percent tax on income from farming and non-traditional exports, dividends from a rural enterprise exempt from tax for the first five years of operation, wear and tear allowance of 50 percent per annum for the first two years on implements used for farming, tourism or manufacturing; and Capital expenditure on the growing of coffee, tea, bananas, citrus fruit or similar plants qualify for a development allowance of 10 percent for the first year of production.

Further, investors investing not less than US\$500,000 in the Multi Facility Economic Zones (MFEZ) and in a sector or product provided for as a priority sector or product under the ZDA Act⁹⁵, in addition to being entitled to the general incentives, qualify for special incentives namely; zero percent tax rate on dividends for 5 years from year of first declaration of dividends, zero percent tax on profits for 5 years from the first year profits are made. Further, from the 6th to 8th years, only 50 percent of profits are taxable and for years 9 and 10, only 75 percent of profits are taxable. There is a zero percent import duty rate on raw materials, capital goods, machinery including trucks and specialised motor vehicles for five years and deferment of VAT on machinery and equipment including trucks and specialised motor vehicles.

A closer look at the ZDA Act⁹⁶ reveals that there are more incentives offered to the investor in order to ensure that the investment climate is conducive. The restrictions and regulations mainly relate to the granting of licenses with the strongest example of this being the introduction of compulsory licensing of investors, which gives the ZDA some power of approval

⁹⁵ Section 56 of the ZDA Act No: 11 of 2006

⁹⁶ No: 11 of 2006

over investors prior to their investment⁹⁷ which may be based on the belief that the investment promotion agency should be able to determine whether or not the business plan of an investor is good or not and also to monitor the operations so as to ensure compliance with the plans⁹⁸.

4.5.3 Taxation

The Zambian taxation system is governed by Income Tax Act⁹⁹, Value Added Tax Act¹⁰⁰ and the Customs and Excise Act¹⁰¹. The Zambian government also levies a general corporate tax. These taxes are not static and are made subject to a number of longstanding preferential rates and generous allowances especially in sectors that Government has wished to promote. For example, the agriculture sector enjoys a rate of 15 percent and successor mining companies to ZCCM pay a concessionary rate of 25 percent¹⁰². Companies listed on the Lusaka Stock Exchange pay 33 percent to promote financial deepening. Commercial banks are taxed at 45 percent of their profits above 250 million kwacha (\$83,500)¹⁰³. The mining sector is also included under this head as witnessed by the recent support for the maintenance of the variable profit formula by the minister of Commerce Trade and Industry. A clearer example of the preferential treatment lies in the ZDA Act which introduced a new set of incentives applicable to investments that are over \$500,000, are licensed by the Zambia Development Agency and are operating within a sector designated as a priority by the Minister of Commerce, Trade and Industry¹⁰⁴.

A look at the 2006 budget reveals that there were specified incentives and stipulations that for the first five years of operation: corporate tax calculated on 50 percent of profits;

⁹⁷ Section 68 of the ZDA Act
⁹⁸ Supra note 8 at p. 3
⁹⁹ Cap 323 of the Laws of Zambia
¹⁰⁰ Cap 331 of the Laws of Zambia
¹⁰¹ Cap 322 of the Laws of Zambia
¹⁰² Supra note 8 at p. 3
¹⁰³ *ibid*
¹⁰⁴ Section 56 of the Zambia Development Agency Act No: 11 of 2006

dividends exempt from tax and that capital expenditure on the improvement or upgrading of *infrastructure qualifying for an improvement allowance of 100 percent. In addition, imported machinery and equipment was exempt from customs duty*¹⁰⁵.

Zambia has had a number of longstanding incentive schemes introduced prior to the ZDA Act. In the mining industry the fiscal regime is lighter than in many other countries in terms of royalties and taxes, and a number of financial incentives are also provided. For example, negotiations with Anglo American on the privatization of Zambia Consolidated Copper Mines (ZCCM) led to lower taxes on ZCCM's successor companies. These companies enjoyed the following reduced tax levels: Mineral royalty was reduced to 0.6 percent; Copper and cobalt price participation fees were tax deductible; excise on electricity was not charged (usual rate is 5 percent); Company tax rate was reduced to 25 percent (from 35 percent), and losses could be carried forward for a period of 20 years; Withholding tax on interest, dividends, royalties and management fees paid to shareholders and affiliates was exempted and duty free importation of capital equipment and utility vehicles was allowed¹⁰⁶. These concessions were granted to accelerate the privatization of the government-owned mining companies when there was an apparent lack of interest from potential buyers. The fiscal regime granted to the successor company had until recently become the norms for all new investment in the mining industry.

It is to be generally seen that the tax regime in Zambia favours the mining sector¹⁰⁷. There are various incentives offered to the mining industry in Zambia and these are; a corporate tax of 30 percent for profits as compared to 35 percent for profits in the manufacturing industry.

¹⁰⁵ Supra note 8 at p. 58

¹⁰⁶ *ibid*

¹⁰⁷ R. Thompson, *Zambia: A Supplement to the Mining Journal* [London: Aspermont] 2008 p. 11

At the exploration stage the mining firms are completely exempt from customs duty. Furthermore, all the equipment and machinery that is imported for mining purposes is also exempt from customs duty throughout the lifespan of that mining project¹⁰⁸. For companies that do not make a profit during the exploration stage are allowed a ten year carry forward of losses for purposes of tax¹⁰⁹. Considering royalties, these are calculated at 3 percent of the net back value of mineral products which refers to the market value of minerals free-on-board at the point of export from Zambia or in the case of consumption within Zambia, less the cost of smelting, refining or other processing, transportation, insurance and handling costs from the point of export or delivery for the case of Zambia¹¹⁰. All these increases in both the taxes and royalties were necessitated by the rise in copper prices on the international market. Even though the tax regime and tax rates currently existing were as a result of the increase in prices and good government policy, these levels are considerably low especially when the world benchmark is at 2.5 percent¹¹¹.

This discussion has shown that the current state of affairs is more incentivized than regulatory. One would expect that a country that is endowed with abundant resources should be at the peak in terms of development. It is a pity that the only thing that is regulated in Zambia is the amount of tax payable between different sectors with the result that Zambia has remained a poor state. The aim of regulation of investment is to ensure that the maximum benefits are amassed from the foreign investors. In Zambia however, it seems regulation does not play such a role. Zambia seems to be begging for investors to invest and just like the beggar on the streets of

¹⁰⁸ Supra note 88 at p. 11

¹⁰⁹ *ibid*

¹¹⁰ *ibid*

¹¹¹ *ibid*

Cairo Road cannot choose. This is shocking because the beggar in Zambia has so many resources and it is actually those that are giving alms in terms of investment that are supposed to be fighting to invest. Zambia and many other developing countries are sadly engaged in a race to the bottom and it is a sad development for a country that is so rich.

4.6 Conclusion

The focus of this chapter has been the regulation of foreign direct investment and whether or not such regulation benefits the host country in any way. It has been seen in this chapter that there a lot of tax incentives that are offered to MNCs with the result that there is no substantial development of the economy. Measured as against the GDP it is seen that Zambia, despite having a fair share of FDI inflows in Southern Africa has not posted any real or substantial growth rates leaving much doubt as to whether or not FDI really does promote economic development.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

The aim of this chapter, like every other concluding chapter in a research, is to draw some conclusions from the findings of the research and based on those conclusions come up with some relevant recommendations on the topic at hand with the aim of changing the situation prevailing currently. This chapter therefore draws conclusions from the discussion on investment law and how investment can lead to the economic development of a country and further make recommendations as to how the situation in Zambia can change with regard to what is transpiring.

5.1 General conclusions

From the foregoing, it can be concluded that developing countries world over realise the importance of attracting investment into their countries. This is because there is a correlation between FDI and economic development. Nations encourage investment into their countries because of the capital that these MNCs bring in order that their economies develop economically. These entities have the capacity of increasing government revenue tremendously which may be used for improvement of infrastructure and empower local corporations.

Despite these seemingly glorious benefits, developing countries continue to remain at the bottom of the food chain with regards the benefits that accrue from foreign direct investment. This is said to be due to a number of factors.

The main reason advanced in support of the proposition is that the developing countries have a low retention capacity. This is mainly in relation to technological transfers. It is assumed that the technology that is transferred to developing countries is too advanced for them to cope with and as such they cannot benefit from the improved technologies. This is however just an excuse in that the technologies that the MNCs bring into the developing countries are, to say the least, backward, some even dating back to the 1950s. This excuse could be used in the early 1980s because at that time the number of educated people was substantially low and as such they could not really absorb the technologies that were being introduced then. Today however, this excuse cannot hold any water because the number of educated people has increased since the 1980's and as such there is now a higher retention capacity by the workforce and they may actually be able to benefit fully from the new innovations.

Further, in relation to the absorptive capacity and levels of education, there is an argument that developing countries are not able to provide the much needed expertise. Once again this cannot and should not be entertained because the number of educated people has increased over the years and there a number of Zambian nationals that are able to carry out the jobs that are being offered to the "experts" that are also imported together with the machinery that is imported tax free.

Spill over's the other avenue through which developing countries are said to benefit from FDI. Spill over effects are supposed to be seen by developing countries but this seldom happens. There is a further argument that developing countries are not able to compete favourably with the multinational firms and as such they pull back the efforts being made by the MNCs. It is also argued that these spill over's can only have their effects felt when the developing country local

firms improve their facilities. All these arguments are to be placed on the shelf together with the colonial history because it is only at that time that such arguments could be entertained. At present there are firms owned by locals that employ advanced technologies and actually compete with the MNC machinery.

Considering the question, why developing countries are not benefiting, it can be said that it is their own fault. This is because in their quest to attract foreign direct investment they relax their already weak laws regardless of the fact that their resources are valuable and would be fought for by the many MNCs. The developing countries relax their laws to the extent that even their border become so porous those resources such as copper would leave the country without any intervention by the revenue authority.

The paper has shown the vast incentives that are offered to MNCs especially the mining sector. The investors take advantage of the many incentives offered to make their profits within the most minimal period of time and leave soon after their profits are exceeded coupled with the further externalisation of all the profits amassed within a minimal period of time. These incentives are particularly high in the mining sector where the investors are practically extracting the mineral resources for free. This is a detriment to the government because tax is the major source of revenue for the government. At present 76% of the budget is to be funded by the government while the other 14% is to be sourced from donors and other cooperating partners. It is clear that this 76% is no small figure and for the government to be able to fully fund its budget, the revenue sources have to be increased. This is not even a pipe dream if the incentives in the mining sector continue as this sector is Zambia's panacea for the much needed resources. To solidify this argument it can be said that the tax holidays that are given, that is, five years are

adequate for the investor to setup base, make profits and eternalise such profits leaving the once resource rich country with less resources. Due to this, the contributions to total tax revenue from the mining sector are low. There are many other factors that investors consider and not just tax holidays for instance when investing.

It can further be concluded statistically that Zambia receives the highest levels of investment when measured against the FDI/GDP measure in the region. Regardless of the fact that the government has undertaken various policy reforms in the past, it is clear that both the impact and effectiveness of such reforms has been limited in terms of attracting investment. This is coupled with the fact that the perceptions of the business community that the business climate is poor have not changed¹¹².

5.2 Recommendations

In order that the benefits of FDI may flow to Zambia and are enjoyed by the population, it is necessary that a few changes are made and implemented. The discussion in this section covers the changes that should be made for the benefits to show. These will be tackled in terms of policy changes and legal changes.

5.2.1 Policy recommendations

Zambia boasts of a number of advantages that have the potential of attracting foreign investors when compared to other countries in the region. The country is a peaceful haven with the political and security situation stable. It is endowed with many natural resources, the exploitation of which requires substantial capital investments. Although local markets in Zambia

¹¹² Supra note 85 at p.32

are small, it has free or preferential access to regional markets as a member of COMESA and SADC, and to developed country markets under GSP, the ACP-EU Agreement, the Cotonou Agreement, the EBA initiative (to the EU) and AGOA (to the United States)¹¹³.

As a consequence, Zambia is well-placed to attract export-oriented FDI, capitalizing on the country's comparative advantages and market access. In addition to all this, Zambia's mining possesses the potential of generating foreign exchange earnings which are required for the acquisition of capital goods and advanced technology. The economy is relatively open to trade due to the fact that most of the inhibitive policies that restricted private economic activities in the past.

FDI does indeed have the potential of attracting export-oriented FDI, especially in manufacturing and services such as tourism, where the competition among countries is particularly intense because Zambia's comparative advantage and access to markets may not be enough. It represents not only capital, but access to technology, technical and managerial skills, and the knowledge of, and access to, marketing channels. In order that FDI is attracted on a much larger scale than so far, Zambia has to create a supportive operational environment for firms, reduce the high costs of doing business in Zambia and improve infrastructure and the availability of producer services.

Zambia's poor record in terms of harnessing economic development should not solely be blamed on the investors themselves but also poor government policy. This is because the amount of investment that a country receives also depends on the policies that are existent to encourage

¹¹³ Supra note 8 at p. 45

development. If the government cannot ensure that certain sectors of the economy are geared for development then it will all just be mere rhetoric to talk o economic development.

There is also some evidence to suggest that new technologies and skills have been transferred to Zambia as a result of recent FDI inflows. Their impact on the local economy, however, has not been significant. This is partly because of weak linkages between foreign affiliates and local enterprises and partly because of the absence of targeted policies and incentives to encourage technology and skill diffusion.

5.2.1.1 Tax Incentives given to Investors

It is the recommendation of this paper that the tax incentives given to foreign investors should not be in the form of tax holidays but rather they should take the form of capital allowances. It is improper for a government to simply relinquish corporate income in order to attract investment. The Zambian government should realise that though the primary objective is to attract FDI, this should not be done at the expense of government revenue. The lesson learnt from the mining houses is that taxes should be levied at all times not just when the profits have become large and a moral argument can be used to justify the sudden introduction of taxes. The investors that are granted these tax holidays have no reason to remain operational in the jurisdiction when these holidays' expire and past experience has shown that these investors withdraw from the economy as soon as the tax holidays nears an end. In this way the generosity of the state and government in granting these tax holidays ensure that the corporations maximise profits and never pay taxes. If tax holidays are to be granted then they should be accompanied by a minimum investment period which runs beyond the incentivised period.

The incentives that are existent to date were only there in order to promote investment when the country was undergoing some economic difficulties and had to find a way in order to pay back the huge debts accrued. All the policies were geared to that end. Today, this is not however the case. Most of Zambia's debts were forgiven placing the country in a better position. Looking at the mining sector, copper has reached unprecedented levels on the London Metal Exchange, that is, about \$7, 000 per metric tonne and as such the incentives that were offered at that time need to be reviewed in order that Zambians may actually enjoy the benefits of such good copper prices.

Major efforts should be made to ensure that the mining sector makes a greater contribution to government revenues. In parallel, the authorities need to make substantial progress in improving the accountability of public expenditure management, and in implementing the decentralisation policy, financial-sector reform and private-sector development initiatives.

5.2.1.2 Promotion of Investment and Transparent Policy

In order for the Zambians to benefit from the inflows of FDI it is essential that the Government explains in no uncertain terms its vision and objectives concerning the role and the potential long-term benefits of FDI. In this regard, individual government departments and agencies should master their roles in the attraction of investment and this should be spelt out clearly in order that there is an integrated approach to the implementation of FDI policy¹¹⁴. With the coming of the Zambia Development Agency there has been some improvement in the coherence of the investment promotion system and there have been fewer uncoordinated and

¹¹⁴ Supra note 8 at p. 64

counterproductive actions by individual institutions which ultimately reduces the efficiency of the investment promotion agency. It is however suggested that rather than just coordinate the roles of the investment promotion agencies, it would be a better move to actually have the investment promotion agency work hand in hand with the revenue collection agency to countercheck how much revenue is to be collected from a particular sector in order that the government can start financing its own budget. This move would have the potential of increasing the GDP growth rates and in the long term lead to economic development.

5.2.1.3 Infrastructure Services: Increase their Availability and Competitiveness

Investment attraction in Zambia faces a number of constraints. These factors include inter alia the cost and availability of essential services necessary for production and exports. This is further augmented by the Transportation, energy and telecommunication services that are not available in many far flung areas of the country which possess significant investment potential because of the nature of resources that are present there. In some cases where there is a road, it will most likely be in a poor state, unreliable and very expensive, typically several times more expensive than in the countries competing with Zambia for FDI. In order that Zambia continues to attract investment which will lead to more economic development, the primary policy objective towards infrastructure services should be the creation of an efficient and well managed enterprise that would ensure the provision of high-quality services. With the emergence of such enterprises will come more domestic investment, attraction of FDI, creation of employment, generation of sustained flow of revenue for the Government and generally benefit society as a whole.

5.2.1.4 Macroeconomic Policy

Even though this may seem a rather indirect policy concern, it is necessary that such changes are made in order that business confidence is strengthened and encourage the creation of a stable policy environment. For instance, in Zambia, as compared to Botswana which recently started attracting FDI, there are relatively high interest rates with the result that there lies a prohibitive cost of debt finance which lies as a major stumbling block to domestic enterprise development as well as to FDI in non-traditional activities where many investors are small- to medium-scale operators.

5.3 Legal recommendations

5.3.1 Strengthen Legal Framework Regarding Economic Development

The Zambia Development Agency Act¹¹⁵ provides in its section 14 that The Agency shall recommend, to State institutions, policy and institutional reforms and the measures necessary for equitable access by both gender and all business enterprises to economic and productive resources, in particular, the following.(a) the development of training systems that help increase productivity in both the formal and the informal sectors; (b)the availability of capital, credit, land and other property rights and their use; (c) the development of rural strategies aimed at establishing a framework for participatory decentralized planning, resource allocation and management ; (d) agriculture production strategies and sustainable development of natural resources; (e) economic and technological infrastructure and services, including transport, telecommunication systems, communication services and the development of an

¹¹⁵ No: 11 of 2006

information society; (f) the development of competitive industrial, mining and energy sectors while encouraging private sector involvement and development; (g) trade development; and (h) the development of scientific, technological and research infrastructure and services.

In as much as the Act seems to have covered all major aspects of economic development there should be an inclusion in the act expressly obliging the investors to train the work force and introduce new technologies which will ensure that the Zambians are not left uneducated as they were found. In this area of course, the investor may be offered some incentive as he is training the workforce.

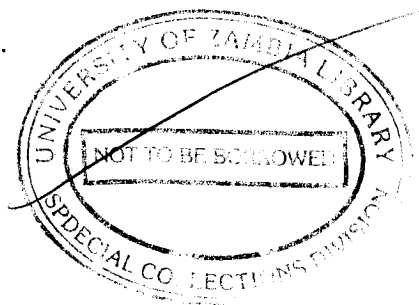
5.3.2 Strengthen the Legal Framework Providing for Workers Welfare

It is recommended further that the legal framework regulating the conditions of employment for citizens should be strengthened to ensure that the benefits of outsourcing of labour by multinational corporations are fully realised by the host nations. Workers in developing countries, Zambia inclusive, lack the rights, legal protection and union protection enjoyed by their counterparts in developed countries thus the benefits of FDI are harder for the workers to enjoy. Lacking in bargaining power, workers do not benefit from the demand for labour caused by the Direct Investment. In Zambia for instance, a mine worker gets a salary of about K335, 000 or \$80 per month as compared to \$1, 800 in Chile. The reason why multinationals outsource labour and relocate their factories is to cheapen the cost of labour relative to the output and as a nation, the labour laws should ensure that the minimum wages available from this form of investment should be able to cater for the basic needs of the least paid person. In this way the integration and the transfer of the means of production into the hands of individuals and corporations will still ensure that citizens are not taken advantage of.

4 Conclusion

Whenever there is foreign investment in a country it brings joy to all the inhabitants of that country. Just like when a parent buys bread in a household everyone rejoices because it is assumed that each will have a fair share of that bread. This is however the case only if there is a fair scheme of distribution. This analogy with the bread is similar to the attraction of foreign direct investment into a country. If the parent is to let the bread be distributed just by leaving it on the table then there will be no fair share by everyone in the house. It is therefore his role to ensure that the bread is shared equally. Similarly, it is the obligation of the state to ensure that the benefits of foreign direct investment accrue to each member of the state and this can only be achieved if there are rules and laws that regulate that investment. The benefits of FDI are real but they can only be achieved if there is regulation which ensures that such benefits trickle down to every citizen. In this regard, incentives are supposed to be offered where for example new equipment is purchased to modernize a particular plant or on condition that some of the shares in the MNC are transferred to the locals as is the case in Chile. Incentives should not be offered recklessly to the detriment of the host. There is also a need to encourage collaboration of foreign firms and local as is the case in countries like Botswana, and this, despite the low education levels in that country. In order that Zambia fully benefits from the inflows of FDI, it is essential that the government implement the policy and legal recommendations suggested. As things stand, Zambia is engaged in a race to the bottom by virtue of the fact that it offers so many incentives at the expense of its own economic development. In the Zambia Development Agency Act are to be found key provisions which if successfully implemented will be able to ensure economic development for Zambia. It is however necessary that more regulation and less incentive be offered in the various pieces of legislation providing for taxation

investments. It is the conclusion of this paper that Zambia still has a long way to go in
reaping all the benefits of FDI and this can only be done through the instrument of the law.
Zambia must begin to realize that with such resources it can be on top of things and can once
become the giant that it was just after attaining independence.



Overall a good dissertation.
Despite the scarcity of resources
you still manage to cite a lot
of books and articles.
Your content is brilliant. Although
descriptive at times generally have
clear good analysis and good
presentation.

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