THE NATURE AND EFFECTS OF IMMIGRATION LAWS ON FOREIGN DIRECT INVESTMENT IN KENYA (1990-2012)

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2013

DECLARATION

I hereby declare that this is my original work and has never been presented in any other institution, the sources have been well acknowledged.

SIGN…………………………. Date………………………..

MWAURA JANE K.

This project has been submitted for examination with my approval as university supervisor.

SIGN………………………….. Date…………………………

GERRISHON K. IKIARA

DEDICATION

This project is dedicated to my parents Mr. and Mrs. John Mwaura Kimani, for believing in me and to my son Raymon Perez Mwaura, for giving me in special way a very strong heart to always strives for the best and tackles anything in this world.

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An exercise of this nature cannot be the work of an individual, I am therefore indebted to everyone who has in one way or the other contributed to the realization of this study.

I am grateful to the Lord for the gift of life and health to the very end of the study, thank you my God for the blessings and guidance.

To the Supervisor, your constant intellectual guidance, inspiration and support were invaluable you rekindled my dreams and provided me with fresh impetus to read on. The lecturers and staffs of the Institute of Diplomacy and International studies, May God reward you for the support you provided;

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To my Family I dedicate all the good things that may accrue from this study, to my parent's John Mwaura and Damaris Wanjiru, from whom the river of life originated, am forever grateful to you for making me who I am. My lovely sister Beatrice Mwaura thanks for always be there for us, for the guidance and help you offered me, may our lord bless you abundantly. My other siblings the Mwaura's, I thank you in a special way for always wishing me well in my dreams. My nephew Francis thanks for staying with me during the study you gave my son Raymon Perez company that no one else could have offered, keep your aspirations alive and may our lord protect and guide you. To my son Raymon Perez Mwaura, may you live to enjoy the fruits of my study, may the loneliness you endured not be in vain, but be a humbling experience, and know that mummy loves you to bits.

In acknowledging the many that contributed to this study, I in no way intend to make to make them accountable for any shortcoming herein. This remain my sole responsibility, for which I accept the blame

God bless you all.

Love, Jane Mwaura

ABSTRACT

The study aims to look at the nature and effects of Immigration laws on foreign direct investment in Kenya covering the period 1990-2012, in the context of Kenya's regulatory environment and investor permits issued by the Immigration Department in particular in the period year1990-2012. The study presents FDI trends in Kenya, using official government data from immigration department of Kenya, the KNBS, and the World Bank. To add on the official data, the study also discusses investor permits as issued by the Immigration Department of Kenya; it gives an overview on regulations on Immigration processes in investor permits issuance, provides comparative analysis of laws in effect and amendments introduced. It gives statistical data on the annual investor permits issued annually as well as some key points of the Kenyan immigration laws their amendments and regulations the study is guided by the following objectives; To establish the state of legal and regulatory framework for FDI in Kenya, To determine how immigration laws impacts on Kenya's economic development and To examine the trends of FDI in Kenya, the study has been done on the Kenya Immigration department and among foreigners who have invested in the country. Data have been collected through Questionnaires, books and Documentary Review and reports. Questionnaires were open-ended questions, which allowed individuals to express their views concerning Immigration laws and FDI in Kenya. Thus both qualitative and quantitative methods have been collectively employed in the process of collecting data and information required in this research. The analysis of data has been done on tables and graphs. The study finding shows that Immigration laws should be reviewed from time to time to keep in tab with the globalizing world. Also the study notes that such infrastructure as Roads, Airports and Railways need significant improvement for attracting more Foreign Direct Investments in Kenya. Indeed it is important to review incentives granted to Investors from time to time in order to make sure that they serve the intended objectives. Plus all the institutions involved in the FDI process should work together to create and have a common ground on foreign investments.

LIST OF ABBREVIATIONS

EAC - East Africa Community

FDI - Foreign direct investment

FTA - Free Trade Agreement

GATT - General Agreement on Tariffs and Trade

IMF - International Monetary Fund

MFN - Most Favored Nation

NIEs - Newly Industrialized Economies

OECD - Organization of Economic Cooperation for Development

SPSS - Statistical Package for Social Sciences

UNCTAD - United Nations Conference on Trade and Development

WTO - World Trade Organization

Ken invest- Kenya investment Authority

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CHAPTER ONE

1.0 Introduction

The project aims to look at the effects of immigration laws in Kenya on foreign direct investment on the period 1990- 2012. This will show how the amendments on the immigration laws have impacted on the trend of FDI in Kenya.

According to WTO foreign direct investment (FDI) around the world has dramatically increased in the last two decades[1]. As a consequence, many countries have enacted their foreign investment rules with the purpose of attracting foreign investment to their territories. For Kenya and other developing countries, attracting FDI has been a key aspect of its outward-oriented development strategy, as investment is considered a crucial element for output growth and employment generation[2]. The last decade of the 20th century saw major shifts in the size and composition of cross-border capital flows into developing countries. The Kenyan immigration law plays a crucial role in the facilitation of entry and operations of foreign direct investment. The amendment of the Kenyan constitution also led to changes in the immigration act which was subdivided into the Kenya citizenship and immigration at 2011, the Kenya citizens and foreign national management service act 2011 both spells out new immigration operations shows how migration policies can be translated into more or less restrictive regulatory frameworks comprising of immigration laws for the entry, residence and employment of foreigners. In comparison with other east African countries; Kenya's FDIs dropped by 27.04 per cent to $259 million from $355 million. While Uganda's FDI jumped by 92.51 per cent to $1.721 billion from $894 million in 2011, while Tanzania

[1] WTO Secretariat, Trade and Foreign Direct Investment (Annual Report), 1 (Oct. 9, 1996).
[2] Kayonga, George William (2008). A Comparative study of foreign direct investment policy in Eastern Africa: The case of Rwanda and Tanzania (2000-2006). Thesis (M.A.) - University of Nairobi.

attracted $1.706 billion in 2012, a 38.81 per cent increase from the previous year's $1.229 billion. Rwanda's rose by 50.94 per cent to $160 million last year from $106 million, while Burundi, which lagged the five East African countries, attracted $1 million, a 66.67 per cent decrease from $3 million in 2011". This is according to the World Bank report 2012.

The drop in Kenya's FDI inflows means there will be fewer new jobs as the freeze in corporate hiring continues. New capital is expected to create new jobs and help the government reverse the high unemployment rate estimated at about 50 per cent, meaning half of the people are unable to find work despite their willingness and ability. Unemployed youth, for instance, have been blamed for the chaos in 2008 after the disputed elections and are seen as a threat to future social stability. Foreign direct investment is critical to country's development, especially in times of economic crisis. It brings new and more committed capital, introduces new technologies and management styles, helps create jobs, and stimulates competition to bring down local prices and improve people's access to goods and services. With few people in employment, demand for goods and services also slows down, thus limiting business growth.

Countries need effective regulatory mechanism to be able to benefit from FDI. The success of the Newly Industrialized Economies (NIEs) is often used as model of other developing countries. The experience of these countries in particular Singapore, Taiwan, Hong Kong shows that a mix of regulation and openness to FDI may become more beneficial to the host country. The same position is believed to be applicable to most of other developing countries. This is because FDI is believed to be able to contribute to growth and development through injection of capital, introduction of new and beneficial technology, creation of employment opportunities and market access necessary for sustained development[3].

1.1 Statement of the Research Problem

There is always a clear interaction between the FDI and the legal regulatory framework that exists in a country. The laws dictate the kind of FDI that will be established in a country and also their operations.

Foreign investors in Kenya have tended to make relatively small investments but they are numerous and established across a wide variety of sectors. They have contributed significantly to some of the more dynamic sectors in the economy, including horticulture, and to export diversification this is according to World Bank report, 2004).

The institutions and investment authorities are very important in determining the kind of FDI a country will have; in Kenya they are weak, fragmented and uncoordinated leading to diminishing of FDI in Kenya

At the entry stage, a host country's administrative agency screens the FDI proposal based on the proposal's general suitability to the host's development objectives and the level or likelihood of its expected benefits. The host may restrict entry to those investments that satisfy certain government objectives, such as locating in a particular region of the country, engaging in a particular high-priority sector, or undertaking a particular type of direct investment, such as a joint venture with local partners. The host government denies entry to proposals that do not satisfy the government's criteria.

[3] Pradhan J, Foreign Direct Investment and Economic Growth in Developing Countries, *Asian Economic Review* 45.2 pp 197-217

If, however, the host government determines that the proposal contributes to the government's development goals it may, at this stage, impose certain operational restrictions on the direct investment before allowing entry. The range of operational restrictions, also known as performance requirements, is broad, and the choice of restriction imposed depends upon the particular objectives of the host country. Common operational restrictions include: local content restrictions, trade balancing requirements, export performance requirements, limitations on imports, foreign exchange and remittance restrictions, minimum local equity restrictions, technology transfer requirements, local employment requirements, personnel entry restrictions, and product licensing requirements.

There are several reasons why Kenya cannot compete favorably when compared to investment opportunities within developed countries and in many other developing countries of the world. Many countries in Africa, Kenya included are known to suffer from inadequacies of their regulatory and administrative practices with respect to the treatment of foreign investors and the protection of their investments which greatly diminishes the attractiveness of these nations for receiving incoming FDI.

In Kenya the Immigration legal framework is inefficient and ineffective, has excessive bureaucracy slowing the pace of FDI in Kenya. There is no clear collaboration legal framework for example between Kenivest and Immigration department on the authorized FDI, leading to a disconnect and poor update and follow-ups on the operations of FDI in Kenya.

Kenya has had a long history with foreign firms. In the 1970s it was one of the most favored destinations for FDI in East Africa. However over the years, Kenya lost its appeal to foreign firms a phenomenon that has continued to the present. The level of FDI in Kenya has been low and stagnant over the past couple of years and well below Kenya's potential. There has also been a worrying trend of foreign investors moving out of Kenya and gravitating to other countries. It is therefore, against this backdrop that this study seeks to fill in this gap by establishing the nature and the effects of immigration restrictions on FDI in Kenya which includes regular review of the Immigration laws to cope with the globalizing world as very few studies, if any, have been done.

1.2 General Objective

The general objective of this study is to establish the nature and effects of immigration laws on foreign direct investment in Kenya.

1.3 Specific Objectives

i. To establish the state of legal and regulatory framework for FDI in Kenya.
ii. To determine how immigration laws impacts on Kenya's economic development.
iii. To examine the trends of FDI in Kenya

1.4 Literature Review

Introduction

This section is organized into the following sub topics: legal and regulatory framework on FDI; the nature and functions of immigration laws in Kenya; foreign direct investment, the various forms of foreign direct investment, foreign direct investment in Kenya. The last section examines how foreign investors are treated highlighting the fiscal incentives and attraction of foreign investments.

1.4.1 Legal and regulatory framework on FDI

Kenya has during the past decade begun liberalizing investment policies to establish a hospitable regulatory framework for FDI by relaxing rules regarding market entry and foreign ownership, improving the standards of treatment accorded to foreign firms and improving the functioning of markets[4]. Cunningham further notes that these core policies are important because FDI will simply not take place where it is forbidden or strongly impeded. However, Cunningham argues that changes in policies have an asymmetric effect on the location of FDI, i.e. changes in the direction of greater openness allow firms to establish themselves in the direction of less openness (e.g. nationalization or closure to entry) will ensure a reduction in FDI.

Banga hypothesizes that various forms of restrictions have been applied to FDI in host countries in the pre-liberalized era, the nature of which either attracts or deters FDI[5]. Banga further explain that these restrictions relate to admission and establishment, ownership and control, and other operational measures. According to Banga, admission and establishment restrictions include closing certain sectors, industries or activities of FDI; screening, authorization and registration of investment; and minimum capital requirements. Ownership and control restrictions according to Banga exist in various forms, for example allowing only a fixed percentage of foreign-owned capital in an enterprise; compulsory joint ventures; mandatory transfer of ownership to local private firms, usually over a period of time; and restrictions on reimbursement of capital upon liquidation[6].

[4] Cunningham, W. 2000. Localization of Industry. *Economic Journal*, 12:501–506.
[5] Banga, R. 2003. *Impact of Government Policies and Investment Agreements on FDI flows*. India: Habitat Centre.
[6] ibid

According to Rachel MeCulloch host country investment measures fall into two general categories: entry restrictions and operational requirements. Rachel MeCulloch explains that the host countries usually impose both types of restrictions on an investment at entry. In this way, Rachel notes that hosts can condition entry on the acceptance of specific operational requirement

Kenya Investment Authority (Ken Invest) is a statutory body established in 2004 through an Act of parliament. It is responsible for promoting investment, facilitate the implementation of new projects, providing after care services for existing investments in Kenya, as well as organizing investment promotion activities both locally and internationally. Kenya has had a long history with foreign companies. In the 1970s it was one of most favored destinations for FDI in East Africa. However over the years, Kenya lost its appeal to foreign firms a phenomenon that has continued to the present. This forced Kenya in 2008 to launch vision 2030 where it hopes to achieve global competitiveness and prosperity of the nation

According to Robertson policies towards liberalization of international capital flows have been subject to considerable controversy[7]. Robertson explains that this is because free capital movements raise concerns about loss of national sovereignty and other possible adverse consequences. Robertson argues that foreign direct investment, even more than other types of capital flows, has historically given rise to such concerns; since it may involve a controlling stake by large multinational corporations over which domestic authorities, it is feared, have little power. Kenya has performed below expectations due to lack of coordination between various institutions involved with FDI, little attention has been given on the importance of

[7] ROBERTSON, D. (2002), "Multilateral Investment Rules," in Bora, B. (ed.) *Foreign Direct Investment: Research Issues,* Routledge, London.

proper linkages and regular review of immigration laws in Kenya to keep in tab with the globalizing world.

According to Sornarajah most developing countries today subscribe to the view that in spite of the potential negative effects of FDI on host country economies, the potential economic benefits of FDI render the investment desirable as long as the potential FDI costs are controlled and the FDI is "properly harnessed.[8] To this end, Sornarajah explains that developing countries subject inward FDI to various investment measures and performance requirements. According to Rachel MeCulloch these FDI measures are important elements of host country economic and industrial policy, as host countries design them to minimize the potential costs of the investment and to integrate the investment with development goals' to achieve certain standards of development[9]. Rachel MeCulloch explains that by giving the host country a greater scope of control over the investment; help ensure "credible commitments" by the foreign investors in terms of the promised benefits to the host economy. In contrast, the foreign investors may view host country investment measures as a *quid pro quo* for the right to invest[10].

According to a World Bank Report, “even after entry, foreign firms could face certain restrictions on their operations, such as employment of foreign key personnel and performance requirements, such as sourcing or local content requirements, and export targets”[11].this leaves the Immigration Department with the duty of doing a follow up in order

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[8] M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVEMENT 4-8 (1994) (offering a succinct exposition on the various definitions of foreign direct investment and distinguishing it from other forms of investment).
[9] Rachel MeCulloch, Investment Policies in the GATT, 13 WORLD ECON. 541, 545 (1990) (noting various types of national investment policies).
[10] ibid
[11] World Bank Report. 2003. *Global Economic Prospects and Developing Countries*. Washington, DC: Global Opportunities.

to establish whether what they approved is what is being done. Owing to the enforcement of trade-related investment measures (TRIMS), many of these restrictions have now been withdrawn and the types of restrictions relating to FDI have been greatly relaxed in a large number of countries. The World Bank Report explains that many of these restrictions now do not require investment approvals or licensing except for few sectors that are closed to FDI (mainly for security reasons). The impact of the removal of some restrictions according to the World Bank Report has a positive effect on attracting FDI and hence causes a higher flow of FDI into an economy[12].

1.4.2 Substantive Laws and Regulatory Frameworks Related To Foreign Direct Investment in Kenya

Larossi notes that among the countries in Sub-Saharan Africa covered by the investing across sectors indicators, Kenya restricts foreign ownership in more sectors than most other economies. According to Larossi laws and regulations in Kenya have been put in place to provide a legal framework conducive to the functioning of a market economy. They include laws dealing with capital markets, mining investments, farming, telecommunication, banking and financial institutions, land ownership, taxation, foreign exchange, petroleum exploration and development, and export-processing zones. Larossi notes that a number of practical regulations liberalizing conduct of business and reducing red tape have been introduced in Kenya.

[12] ibid

According to Aswani, 2012 "Migration policies can be defined as those government interventions that regulate the arrival or departure of foreigners according to their nationality, purpose of their arrival and duration of their stay"[13]. The migration policies include those governing emigration, migration, seasonal Migration and refugees.

Aswani further notes that the policies can be translated into more or less restrictive regulatory frameworks comprising of immigration laws for the entry, residence and employment of foreigners. The migration policies mainly seek to limit access of employment to foreigners while promoting employment of nationals. This makes it hard for non-nationals to access the labour market within the territories or even change jobs once the contract has expired since the re-employment of foreigners will be dependent on permits they are in possession of. The Kenya Citizenship and Immigration Regulations 2012 came into force on the 15th of June, 2012 and are made pursuant to the Kenya Citizenship and Immigration Act 2011 which came into force on 30th August 2011. Amongst other things, the Regulations brought in higher fees, employer compliance inspections, re-classified entry/work permits, and scrapped the business visa. Foreigners who want own, or run a business in Kenya, need to have a work permit from the Ministry of Immigration or risk deportation. There are generally two types of permits that foreigners would apply for: a Class H permit or a Class A permits. The type of permit applied for depends on whether the foreigner will be an owner of the business or simply an employee; this acts as identification and gives status to that particular individual.

The Authority precedes to issues an investment certificate, which allows the holder a legal entitlement to certain licenses. A certificate holder is also entitled to three entry work permits for Management and technical staff, as well as three others for owners, shareholders, partners

[13] Kenya citizenship and foreign regulation acts p.g 16-17

and dependants. Both are for an initial, but renewable, two-year period. Capital repatriation and remittance of dividends and interests are guaranteed to foreign investors under the IPA.[14] Other conditions that may be considered include whether such investment will achieve any of the following: technology transfer; increase in foreign exchange, either through exports or import substitution; use of domestic raw materials, supplies and services; value addition in the processing of local, natural and agricultural resources; and the utilization, promotion, development and implementation of ICT and any other factors the Authority considers beneficial to Kenya.

The Investment Promotion Act, 2004, currently provides an allowance for six key personnel but the Minister of Immigration is required to sign each permit approval and there are no published procedures and criteria for approval. Overlapping and inconsistent regulations contribute to making the process cumbersome. For example, foreigners are not allowed to open a bank account without a work permit but they are allowed to get a work permit without a bank account.

1.4.3 Foreign Direct Investment (FDI)

Buckley defines foreign direct investment as a term used to denote the acquisition abroad of physical assets, such as plant and equipment, with operational control ultimately residing with the parent company in the home country[15]. According to Buckley FDI may take different forms such as the establishment of new enterprises in an overseas country either as a subsidiary or branch, the expansion of overseas branch or subsidiary and the acquisition of overseas business enterprise or its assets. Buckley explains that FDI differs from foreign

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[14] The Kenya citizenship and immigration act 2011 (permits issuance regulation p.g 16)

[15] Buckley, J. Peter, Jeremy Clegg, and Chengqi Wang (2002). “The impact of inward FDI on the performance of China’s manufacturing firms”, *Journal of International Business Studies*, 33(4), pp. 637-655.

portfolio investment where a stake is taken in an overseas business without operational control, but with the view to acquiring an investment income stream through dividends, capital gains and so on. FDI is furthermore, defined as a situation where a foreign company create a subsidiary to provide goods and services. Thus a firm undertakes FDI in a foreign market if it possesses an ownership advantage over the local competitors. The ownership of the foreign investment usually remains in the investing (home) country. According to Buckley FDI represents the primary means of transfer of private capital (i.e. physical or financial), technology personnel and access to the brand names and marketing advantage.
While according to Sornarajah FDI occurs when there is a transfer of tangible or intangible assets from a natural person or a company whose majority of shares are directly or indirectly held by natural persons of foreign nationality, into a host country with the specific purpose of use in that country to generate wealth under the total or partial control of the owner of the assets.[16]

FDI is the act of purchasing an asset and at the same time acquiring control of it. Control by the latter is understood as the acquisition of a significant degree of influence over the decision making of the direct investment entity. The concept of control as a determinant of FDI can be found in the definitions found in the frameworks of the International Monetary Fund (IMF) and the Organization of Economic Cooperation for Development (OECD).[17] Their definitions are the most commonly used guidelines. The IMF defines the concept in its Balance of payments Manual as; "Direct investment is the category of international

[16] Sornarajah, M, (2004). The International Law on foreign Investment, Cambridge University Press, Cambridge, pp 4.
[17] Organisation for Economic Co-Operation and Development, OECD (1996), Detailed Benchmark Definition of Foreign Direct Investment, 3(1), 7-10.

investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy”.[18]

The lasting interest implies the existence of a long term relationship between the direct investor and the enterprise with a significant degree of influence by the investor on the management of the enterprise. According to the IMF direct investment comprises not only the initial transactions establishing the relationship between the investor and the enterprise but also all subsequent transactions between them and among affiliated enterprises; both incorporated and unincorporated.[19]

The OECD, in the guidelines contained in its detailed benchmark definition of foreign direct investment, applies a definition with a slightly different formulation though with exactly the same components: according to OECD a lasting interest by a resident entity in one’s economy is an entity located in a host economy, which is considered to exist when two interdependent and interrelated situations are present: the existence of a long-term relationship between the direct investor and the local entity and a significant degree of influence on the management of the local entity. The entity in the home country according to OECD can be referred to as the direct investor and the one in the host country as the direct investment entity.[20]

The United Nations Statistics Division defines FDI as investments made to acquire a lasting management interest in an enterprise operating in a country other than that of the investor, according to United Nations Statistics Division the investor’s purpose is to be an effective

[18] International Monetary Fund, IMF (1993). Balance of payment Manual, Fifth edition, Washington D.C., page 86.

[19] International Monetary Fund, IMF (1993). Balance of payment Manual, Fifth edition, Washington D.C., page 86.

[20] Organisation for Economic Co-Operation and Development, OECD (1996), Detailed Benchmark Definition of Foreign Direct Investment, 3(1), 7-10.

voice in the management of the enterprise.[21] OECD highlights that absolute control by the foreign direct investor is not required and that it should be considered enough that the investor's transaction enables him to participate in or influence, the management of the direct investment entity, and considers those conditions evidenced by an ownership of at least 10 percent.

1.4.4 Forms of foreign direct investment

FDI can take various forms. A distinction can be made between Greenfield investments, mergers and acquisitions (M&A), reinvestment of earnings and other kinds of direct investment capital inflows.[22] However the main forms that FDI takes are Greenfield investments and international mergers and acquisitions (M & A).

Green field FDI: The category of Greenfield FDI refers to an investment in new assets; *i.e.*, the creation of an entirely new business entity. The construction of a factory in the host country would for example be qualified as a Greenfield investment. Greenfield *FDI* can be opposed to an investment in an already existing business entity which only results in a change of the ownership of that entity; *i.e.*, a merger or other kind of acquisition. Greenfield investments constitute the major part of FDI transactions in developing countries.

Mergers and Acquisition: M&A in FDI can be defined as an investment by which a foreign investor acquires existing assets in the host economy.[23] The concept of outbound *M&A* is used when the operation involves a national buyer and a non-local target, whereas inbound *M&A* refers to the reverse situation. This form of FDI is predominant in developed countries.

[21] UN STATISTICS (http://unstats.un.org/unsd/cdb/cdb_dict_xrxx.asp?def_code=400).
[22] Jean-Yves Ph. L. Steyt 2006. Comparative Foreign Direct Investment Law. Determinants of the Legal Framework and the
Level of openness and attractiveness of host economies. Page 28.
[23] C CALDERON, Cesar; LOAYZA, Norman and SERVEN, Luis, Greenfield Foreign Direct Investment and Mergers and Acquisitions: Feedback and Macroeconomic Effects, Policy Research Working Paper, Worldbank, no. WPS 3192, 2 (http://www-wds.worldbank.org).

1.4.5 Foreign direct investment in Kenya

Kenya is a relatively big country with a total land area of 580,400km square. Its location is strategic within East Africa and has a population of approximately 40 million people. The country is well endowed with a broad range of natural resources, flora and fauna and arable land. Foreign investment has been of considerable significance in financing development in Kenya not only in the manufacturing but also in the primary and tertiary sectors.

Kenya government encourages investment ,From agriculture to mining to tourism to energy, investment opportunities abound. With the aim of harnessing this potential to promote economic growth and development in Kenya, the government has set various regulations to attract Investment and Industrial Development.

The regulations seek to, rationalize investments as well as harmonize investment incentives with a view to promoting foreign investment**.** The doctrine of state sovereignty which is a basic principle of international law in the context of foreign investment means that a state can decide at its discretion how to regulate foreign investment and how to treat foreign investors. Consequently, the government can freely decide whether to establish a liberal and hospitable FDI climate or not. It can prohibit the entry of foreign investment; establish barriers, conditions, restrictions or limits on FDI inflows. Sornarajah stresses that the power of exclusion implies the power to admit conditionally[24]. States can freely decide whether their system should discriminate foreign investors compared to their local counter parts, or whether foreign investors from certain countries should be treated differently than those of others.

[24] Sornarajah, M, (2004). The International Law on foreign Investment, Cambridge University Press, Cambridge, pp 4.

Thus, Kenya has its own foreign direct investment laws despite the existence of international and regional legal frameworks. Their FDI laws are in most instances similar and in some cases; countries have adopted the same international instrument on settlement of investment disputes. The pertinent elements in the laws can broadly be regrouped into four categories of provisions: the rule that apply to the entry of FDI, those applying to the treatment and protection of foreign settlement of investment disputes. On the basis of these four categories of rules common to all foreign investment legislation Kenya, the following broad areas will be discussed: the types of entry procedures that can be encountered, the exclusion of certain sectors of the economy from FDI and the underlying rationales for such carve-outs, foreign ownership restrictions; entry conditions and performance requirements, employment of locals, minimum capital, local content and export quotas; the treatment of foreign investors; legal protection and guarantees including the issue of expropriation; financial and other incentives to attract foreign direct investors; the regime applicable to the settlement of disputes between foreign direct investors and the host States.

The national provisions governing the entry and establishment of foreign direct investments are essential characteristics of a host country's investment system. As noted on, the application of the doctrine of state sovereignty to the issue of FDI means that a State can decide at its discretion to exclude or restrict foreign investment and consequently also to admit conditionally. At the occasion of the entry of FDI, the foreign investor has to opt for a particular business structure.

The FDI entry procedures can be broadly divided in two categories; notification and approval procedures. The concept of an FDI notification system is used as meaning that the foreign direct investor has the obligation to declare the investment transaction to the administrative authority designated by the national law for those purposes. Kenya Investment Authority,[25] is the administrative authorities for foreign direct investment in Kenya.

On the other hand, in an approval and screening system, the foreign investor cannot proceed with his projected FDI transaction before having obtained administrative approval. The evidence of compliance with the different entry and foreign investment requirement is the licence, Certificate of Registration and Investment Certificate issued by the administrative authorities of the different partner States.[26]

After the disappointing period of the 1990s, Kenya resumed the path to rapid economic growth in 2002 through the implementation of the Economic Recovery Strategy Paper which was replaced by vision 2030 after it expired in 2007. During this period the government embarked on establishment of free trade zones like the Export Processing Zones (EPZ), improvement of business climate, infrastructure, and development of incentives among initiatives. These efforts are aimed at building a momentum that can sustain economic growth and promote development. At the centre of these efforts is a commitment to attract foreign direct investment which was hoped would assist in the industrialization process.

1.4.6 Treatment of Foreign Investors

National Treatment is the commitment by a country to treat foreign investors and investments no less favorably than domestic investors and investments. It is a core principle through which Free Trade Agreement (FTA) parties seek to liberalize investment flows. The granting of national treatment to investors in the pre establishment phase is important because it determine the level of liberalization. In the OECD Draft Multilateral Agreement on

[25] Section 14 of The Investment Promotion Act , 2004
[26] Issued by Kenya Investment Authority under section 4 of The Investment Promotion Act, 2004

Investment of April 24 1998,[27] it has been stated that the host country has an obligation to treat foreign investors and their investments in the same manner the country treat its own investors with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposition of investments. In Kenya, a foreign investor is required to invest Five Hundred thousand dollars to be issued with investment certificate as opposed to local investors who are required to invest five million Kenya shillings only.[28]

According to Sornarajah foreign investment legislations often include a provision guaranteeing compensation in case of expropriation of the investment property. Such provisions Sornarajah notes that they have a 'signaling function' and are especially important in countries with a substantial expropriations history.[29] The World Bank recommends that States expropriate in pursuance of a public purpose and without discrimination between nationals and foreign investors. The World Bank guidelines also stress the importance of an adequate, effective and appropriate compensation in case of expropriation.[30] Since in Kenya, the law is silent on acquisition and compensation of foreign investment property, it leaves the investors with a lot of uncertainties which makes its foreign investment climate unattractive and below the generally accepted standards.

1.4.7 Fiscal Incentives and Attraction of Foreign Investments

According to Seid incentives includes all governmental measures or actions from which direct investors benefit or could benefit. Incentives also refer to measures which are directly in relation with the foreign investment and that impact directly on the facto cost of a project

[27] http://www.oecd.org/dataoecd/46/40/1895712.pdf
[28] Section 4 (1) of the Kenya Investment Promotion Act, 2004.
[29] Sornarajah, M, (2004). The International Law on foreign Investment, Cambridge University Press, Cambridge,
[30] Article 4 of the World bank Guide Lines on the Treatment of Foreign Direct Investment.

or on the returns from the sale of a project's product.[31] According to Seid's definition, it does not include measures to improve the host country's infrastructure, the relaxing of environmental or labor standards, or investment promotion activities, but rather measures such as subsidies, tax holidays or incentives, exemption of import duties for equipment or raw material, and many others.[32]

Seid notes that providing incentives is a frequently used strategy to attract foreign direct investors. Seid argues that host countries are interested in FDI that is most productive for its national economy and that incentives are often available to selected categories of foreign direct investors.

According to Nwogugu international law recognizes the sovereign right of each state to tax aliens' resident or owning property within its territory.[33] However, Nwogugu notes that the establishment of unfair tax discrimination against foreign nationals and their property is regarded in international practice as an unfriendly act which may give rise to protest or retaliation by restoration.

1.5 Justification of the Study

Promoting foreign direct investment (FDI) has always been a primary concern for economic growth, especially in developing countries. Countries, therefore, need an effective regulatory mechanism. The study is useful to policy makers in Kenya especially the legal team that design the kind of laws that are going to be in operation. Country competitiveness is not only improved by implementing economic policies that bring forward growth and stability, but

[31] Seid, S. H. (2002). Global Regulation of Foreign Direct Investment, Ashgate, Alderhot, page 40.
[32] Seid, S. H. (2002). Global Regulation of Foreign Direct Investment, Ashgate, Alderhot, page 40.
[33] Nwogugu, E. I. (1965). The Legal Problems of Foreign Investment in Developing Countries, Manchester University Press, pp. 9-10.

also by promoting changes that will strengthen democracy, law & order, and a coherent institutional framework that is in synch with the dynamism of international trade, markets and practices (Montoya (2007)). By coherent policies and institutional framework, there are many instances in which governments have to work and redouble their efforts.

Areas such as political transparency, low corruption, applicability of legislation to business decisions and protection of rights, will create trust in the investor, increasing the chances of attracting FDI, putting the country in a position to benefit from FDI.

The findings of this study is significant to both academicians and policymakers in the following way; first, it will add to the knowledge of the researchers in this field of study and secondly, it will serve as a guide to both policy makers and academicians.

1.6: Theoretical Framework

1.6.1 Neoclassical Theory

The neoclassical theory explains international capital flows with differentiated rates of return across countries that lead to capital arbitrage, with capital seeking the highest return. Cockcroft and Riddell argue that the future investment flows are directly related to the package of incentives, which influence the expected rate of return; the security of the investment; the scope and speed with which companies are able to disinvest[34]. The tax regime; investment code or guidelines; and overall macroeconomic policies are all elements affecting FDI.

Despite these changes, there is still need for action for improvement of factors that inhibited investment. These factors include lack of formal legislation, lack of legal infrastructure such as patents, price controls, labour legislation, taxation policy and foreign exchange controls.

[34] Cockcroft, L., Riddell, R., 1991. Foreign Direct Investment in Sub-Saharan Africa. World Bank Publications.

Cockcroft and Riddell suggest that addressing these problems would certainly help improve the foreign investment climate[35].

According to Meier (1994), the major supply-side determinant of FDI in developing countries is the expectation of higher returns or higher profits by firms. Developed countries will tend to invest in poorer countries that have higher rate of return[36].

1.6.2: The market imperfections theory.

The market imperfections theory states that firms constantly seek market opportunities and their decision to invest overseas is explained as a strategy to capitalize on certain capabilities not shared by competitors in foreign countries. The capabilities or advantages of firms are explained by market imperfections for products and factors of production. That is, the theory of perfect competition dictates that firms produce homogeneous products and enjoy the same level of access to factors of production. However, the reality of imperfect competition, which is reflected in industrial organization theory,[37] determines that firms gain different types of competitive advantages and each to varying degrees. Nonetheless, market imperfections theory does not explain why foreign production is considered the most desirable means of harnessing the firm's advantage.[38]

1.6.3 International production theory

International production theory suggests that the propensity of a firm to initiate foreign production will depend on the specific attractions of its home country compared with

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[35] ibid
[36] Ekpo, A.H. (1996) "Pattern of Public Expenditure in Nigeria, 1960-1992" in Ariyo, A (ed) Economic Reform And Marcroeconomic Management in Nigeria, Ibadan, University of Ibadan Press, pp. 219-241.
[37] Porter, M.E. (1985), Competitive Advantage: Creating and Sustaining Superior Performance, Free Press, New York, NY.,
[38] Dunning, J.H. (1980), "Toward an eclectic theory of international production: some empirical tests", Journal of International Business Studies, Vol. 11 No.1, pp.9-31.

resource implications and advantages of locating in another country. This theory makes it explicit that not only do resource differentials and the advantages of the firm play a part in determining overseas investment activities, but foreign government actions may significantly influence the piecemeal attractiveness and entry conditions for firms.[39]

1.7: Hypotheses

The study will be guided by the following hypothesis:

i. Immigration laws adversely affect foreign direct investment in Kenya.
ii. The trend of FDI affects Kenya's economy.
iii. Immigration laws dictate the quality of FDI

1.8 Research Methodology

This section sets out various stages that will be followed in carrying out the study. They include; research design, target population, sampling design, data collection instruments, data collection procedures and finally data analysis.

1.8.1 Research Design

A research design entails the conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with the economy in the procedure.[40] In addition Kothari[41] observed that research design is a blue print which facilitates the smooth sailing of the various research operations, thereby making research as efficient as possible hence yielding maximum information with minimal expenditure of effort, time and money.

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[39] Buckley, P.J. (1988), "The limits of explanation: testing the internalization theory of the multinational", Journal of International Business Studies, Vol. 19 pp.181-93.
[40] Babbie, E. (2002). Survey research methods (2nd ed.). Belmont: Wodsworth.

[41] Kothari, C. R. (2004). *Research methodology*: *Methods and techniques*. New Delhi: New Age International (P) Limited Publishers.

The study will adopt a descriptive research design. A descriptive study is concerned with finding out the what, where and how of a phenomenon and a cross-sectional survey will be used because data collected at one point in time from a sample selected represents a larger population.

1.8.2 Target Population

The target population of study will be 50 foreign investors doing business in Nairobi County. The study will also interview 6 key informants from the Kenya Immigration service permit issuance committee.

1.8.3 Research Instrument

The primary data was collected through Questionnaires distributed to foreign investors in Kenya and to officers from permit approval committee in the Department of Kenya Immigration while the secondary data is from books, reports magazines and Documentary Review. Questionnaires were open-ended questions, which allowed individuals to express their views concerning Immigration laws and FDI in Kenya. Thus both qualitative and quantitative methods have been collectively employed in the process of collecting data and information required in this research.

1.8.4 Data Analysis Methods

The data collected was coded and entered into Statistical Package for Social Sciences (SPSS) for analysis through descriptive statistics for quantitative data. Descriptive statistics comprises of the use of frequencies, percentage (relative frequency), mean and standard deviation. Quantitative data is presented in form of tables and pie chart, while explanation to the same has been presented in prose.

1.9 Chapter Outline

This project is organized into six chapters with an introduction and conclusion of the themes discussed in every chapter. Chapter one gives a general introduction to the project. It provides the problem statement, objectives, hypothesis, theoretical framework, literature review and methodology in relation to the nature and effects of immigration laws on foreign direct investment in Kenya. Chapter two looks at the nature of Kenya Immigration laws and the Investment approval process, Chapter three address the legal and regulatory framework for FDI in Kenya, Chapter four gives the strategies to attract FDI in Kenya, chapter five gives the trend of FDI in Kenya in the period between year 1990-2012 and finally Chapter six present summary, conclusion and recommendations.

CHAPTER TWO

THE NATURE OF KENYA IMMIGRATION LAWS AND THE PERMIT APPROVAL PROCESS AND THE IMPACT ON FDI

2.1 Introduction

This chapter analyzes the process of Permits issuance system in the Immigration Department of Kenya and other Institutions that are involved in the process of FDI in Kenya and the state of the legal and regulatory framework for FDI and the impact on the economy. It seeks to explain the relationship between FDI and the legal and regulatory framework in a country. The chapter examines Kenya Government efforts to regulate investment and look at standards of treatment of foreign investment in the Kenyan constitution with the aim of assessing the nature and scope of the core principles of foreign investment law.

2.2 Kenya Immigration Foreign Investment Permit

A work permit is a legal document that a Foreign National is required to have in order to work in a foreign country. The Kenyan Immigration Act prohibits a foreigner to reside, work or engage in any employment or business in Kenya without a valid work/entry permit, or a Special Pass issued by the Immigration Department. [42]

Special Passes are issued to any non-Kenyan who may need to come into Kenya to work for short periods to enable them to work in Kenya for a temporary period of 3 months (renewable twice). The requirements for a special pass are; a copy of the certificate of

[42] The Kenya citizenship and foreign Nationals management Act.

registration of the employer and a letter from the employer indicating what the person will be doing in Kenya.[43]

There are generally two types of permits that foreigners would apply for: a Class G permit or a Class A permit. The type of permit applied for depends on whether the foreigner will be an owner of the business or simply an employee. The class G permit indicates that the Foreigner will be the owner of the business while class A is for expatriates who will be employees and there must be an approval that there is no Kenyan citizen available for that Job, which in this case a Kenyan citizen will be attached to that Employee and take over the job after some time through the process called Kenyanisation which is controlled by the Immigration Department.

2.3 Legal Provisions Regarding Work Permits

The Constitution of Kenya states clearly that it is illegal for any non Kenyan to enter or work in Kenya without a valid work permit. The exact provisions of the Immigration Act (Cap 172, Laws of Kenya) are as follows: -

Section 4 (1) “Subject to this Section, no person who is not a citizen of Kenya shall enter Kenya unless he is in possession of a valid entry permit or a valid pass.” (2) “…the presence in Kenya of any person who is not a citizen of Kenya shall, unless otherwise authorized under this Act, be unlawful unless that person is in possession of a valid entry permit or a valid pass.”44

Section 13(2) (f): - “A person who, not being a citizen of Kenya, engages in any employment, occupation, trade, business or profession, whether or not for profit or reward, without being authorized to do so by an entry permit….shall be guilty of an offence and be

[43] The Kenya citizenship and Foreign management Act 2011- p.g 26-27
[44] The Immigration Act (cap 172, laws of Kenya)

liable to a fine not exceeding twenty thousand shillings or imprisonment for a term not exceeding one year or to both."45

Section 13(2) (g) provides for a similar penalty for "Any person who employs any person (whether or not for reward) whom he knows or has reasonable cause to believe is committing an offence under paragraph (f) by engaging in that employment." If convicted of either of these two offences, deportation will invariably follow. The fact that an application for a work permit has been lodged does not entitle someone to work in Kenya, and cannot therefore be a defence in the event of a criminal prosecution. The Immigration officers have a duty of ensuring that all foreigners working in Kenya have legal Documents and the kind of Business they are engaging in is beneficial to Kenyan Economy, that is it is creating Employment of the youths and it is generally contributing to the GDP of the country. For certain types of businesses, there are legal restrictions on foreign ownership either wholly or partly. For instance, private companies that intend to purchase agricultural property in Kenya cannot have foreign shareholders at all. For telecommunications companies, at least 30% of the shareholding must be taken up by Kenyans.46

There are certain businesses where the various laws require certain limits of nominal capital to be met (regardless of whether it is owned by locals or foreigners). For instance the businesses of banking, insurance, foreign exchange, and security firms require certain minimums for nominal capital.

[45] ibid
[46] The Kenya citizenship and foreign management Act 2011

2.4 The Kenya Permits Approval Committee

The Kenya Permit Approval Committee is Normally based at the Immigration head quarters where all permits and special passes are launched and processed, the committee consists of; Chairperson appointed by the Director General who is normally the Deputy Director of Immigration Department ; Officer responsible for issue of permits that is the Immigration Officers involved in permits processing and they are normally five in number in a sitting; officer responsible for Kenyanization, an Immigration Officer ; representative from the Ministry for the time being in charge of labor relations; a representative of the Ministry for the time being in charge of internal security; a representative of the Ministry for the time being in charge of foreign affairs; a representative of the Ministry for the time being in charge of education; and a representative of the Ministry for the time being in charge of tourism; a representative from the Ministry for the time being in charge of investment ;The officer responsible for issue of permits shall be Secretary of the Determination Committee. This is normally an Immigration Officer from permit section, who are also the custodians of all the permits files.[47]

The committee considers the following issues when deciding whether to approve or reject the application: The amount of investment and its impact on Kenya's economy, which is determined by the auditors' report or bank statement provided by the applicant; The number of jobs that will be created for Kenyans, which is determined by the application letter submitted by the applicant's agent; The nationality of the applicant. An applicant has a higher chance of approval of his application if his or her country of origin has a stronger economy than that of Kenya, and lower criminal statistics and security threats.

[47] The Kenya Immigration Act(cap 172)

Applications may be considered when submitted by prospective employers on behalf of their prospective employees. These may not normally be approved unless the prospective employer(s) can show evidence that they have been unable to fill the particular post(s) due to lack of suitably qualified personnel in the Kenya Labour Market. Those seeking to work in Kenya must therefore ensure that their prospective employers have secured appropriate Entry/Work Permits before they proceed to Kenya.

Foreigners who wish to engage either alone or in Partnership in Business, specific trade or profession would have to furnish evidence that they have obtained or are assured of obtaining relevant licence(s), Registration or other authority that may be necessary in order to engage in the contemplated business, trade or profession. In addition, they would be required to prove that they have sufficient capital derived from sources outside Kenya which is certain to be remitted to Kenya for the purpose. [48]

Those who have attained retirement age and wish to immigrate to Kenya may make application for issue of Entry/Work Permit under Class K They should have in their own right and at their full and fee disposition on assured annual income derived from sources outside Kenya and will be remitted to Kenya or derived from property situated, or a pension or annuity payable from a sufficient investment capital to produce such assured income that will be brought into and invested in Kenya.

Once the application is submitted at the Ministry of Immigration it shall be presented to a committee for approval. This process currently takes between two and six months depending on how many times the committee sits and the number of applications they must process.

[48] The Kenya Permit Issuance Manual p.g 26-30

The committee shall not issue a residence or work permit to any person unless that person has at his or her full and free disposition an assured annual income of at least $24,000 or its equivalent in Kenya shillings. Foreigners aged 35 years or less have also been banned from being issued with work permits. This is well stated in the Kenya Citizenship and Foreign National Management Act of 2011.

2.4.1 Immigration laws and mining investments

Mining and mineral extraction, including petroleum, is another emerging economic sector in Kenya. Although about 90% of Kenya is geologically mapped and mineral occurrence documented, the mining industry is not significantly developed. The Immigration Act requires that foreigners working in Kenya to obtain relevant entry permits. There are a number of classes of entry permits available and obtaining such permits usually takes between 6 weeks and 6 months.[49]

The Kenya Investment Authority ("KIA") is mandated with promoting investment in Kenya. Currently, foreign investors (granted an Investment Certificate) are entitled to: Three work permits for employees and three for directors of the company; VAT and customs duty exemption on equipment and machinery; a tax holiday if total disclosure is made in the annual financial reports and various conditions met.

Foreign investors qualify for an Investment Certificate if they plan on injecting a minimum investment of US$ 100,000. In evaluating the investment, KIA ordinarily looks at the cost of machinery, equipment and bank statements. There are no application fees and the certification procedure takes between one week and a month.

[49] The Kenya citizenship and immigration act 2012

The government recently passed a regulation requiring that all foreign firms in the mining sector should have at least 35 per cent local shareholding. Investors in the industry have widely opposed the rule, and the Kenya government is still weighing the options.

2.4.2 Immigration laws and farming

Most foreign investor who concentrate on farming mainly do the large scale farming of crops in Kenya, the procedure for allowing foreign investors o own land and do the farming must be approved in line with the land ownership procedure in Kenya and the individuals must be approved by the immigration ministry.

Foreign governments and private companies have intensified investments in agricultural land in poor countries for the production of oil-producing crops as well as for the production of food. In July 2009, the government of Ethiopia reportedly marked out 1.6 million ha. of land, extendable to 2.7 million, for investors willing to develop commercial farms[50]. In Kenya, the government (through the County Council of Siaya) granted a concessional lease to Dominion Farms, an American company, over 20,000 acres for 25 years, over the valued and expansive Yala Swamp. In 2009, it was widely reported in the media that Kenya would lease out about 100,000 acres of land in the Tana River Delta (another wetland) to the Gulf State of Qatar for agriculture at a time when the country was facing serious food shortage[51]. In contrast, a lot of the African countries that openly welcome foreign land acquisitions for agriculture are so acutely food-insecure that they depend on aid from the World Food Program (WFP)[52].

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[50] Lorenzo Cotula and Sonja Vermeulen "Deal or no deal: the outlook for agricultural land investment in Africa" p 1234

[51] Kenya, Qatar land deal questioned" Capital Business (Nairobi)19 May 2009

[52] Michael Kugelman, "Introduction" in Michael Kugelman and Susan L. Levenstein (eds) 2009 LAND GRAB? The Race for the World's Farmland Woodrow Wilson International Center for Scholars, Washington, D.C. p. 10

2.4.3 Immigration laws and telecommunication

In Kenya foreign capital participation in telecommunications is limited to a maximum of 70%. However, the law provides foreign investors with a grace period of 3 years to build up the required domestic capital contribution of 30%.

The Kenya government reviewed the laws in the telecoms sector to allow a local ownership requirement of 20 per cent from 30 per cent, though it has still proved to be a headache for firms in the industry. As have been seen for example; access Kenya and Airtel Kenya, have had to seek exemptions from the government to facilitate foreign ownership because of the difficulties they were undergoing. Airtel, which is 95 per cent owned by India's Bharti Airtel, has plans to sell at least a 15 per cent stake to local shareholders through the Nairobi Securities Exchange to meet the set local ownership limits after failing to find a buyer for a 15 per cent stake in the company this is for the company to comply with the present FDI rules in operation.[53]

2.4.4 Immigration laws and transportation

In the transportation sector in Kenya, there are ownership restrictions in railway freight, port and airport operation, in which foreign investment is allowed only up to 50%. On the other hand, unlike in most other countries covered by the Investing Across Sectors indicators, domestic as well as international passenger air transportation is fully open to foreign capital participation.

[53] 45th report of the communication commission of Kenya,- p.g 36-46

2.4.5 Immigration law and access to investment land

The acquisition of land by foreigners in developing countries has emerged as a key mechanism for Foreign Direct Investment. With land as a significant basic factor of production, the entry of FDI in most countries often requires a non-citizen investor to engage with public authorities and private citizens on the acquisition of rights over land for investment purposes. Foreign acquisition of land in developing countries, such as Kenya, has been there for many years, since colonial times.

In Kenya, the 2011 *Citizenship and Immigration Act* sets out the normative content of these rights and privileges, for instance, including the right to own land and other property in any part of the country; and entitlement to any document of registration given to citizens, including a “certificate of registration. This immigration law defines a foreign national to mean “any person who is not a citizen of Kenya.” These statutes however appear to concern the status of natural persons, and not corporations, which are the principal players in foreign direct investments. Thus, while the nationality of a natural person, even with respect to investments will be determined on the basis of immigration law, the question of citizenship concerning corporations, and the specific national criteria adopted to determine whether a company or other corporation is a foreign national involves concepts and laws regarding corporate bodies and investments. Nonetheless, the immigration status or citizenship of natural persons remains relevant, particularly in context of the doctrine of foreign control, whereby the nationality of a body corporate could be determined on the basis of the citizenship of the natural persons that hold decision making control over such body corporate. The 2010 Constitution of Kenya specifies that a non-citizen can only hold a leasehold interest in land that should not exceed 99 years. Further, the law prohibits non-citizens from holding *mailo* or freehold land. In Nairobi, the process of leasing land is governed by several laws that deal with the registration and disposition of interests in land. Only companies that are 100% domestically owned can acquire land controlled under the Land Control Act, such as agricultural land. Nonetheless, foreign companies seeking to access land in Kenya have the option to lease or buy land from private and public landholders. Commercial leases cannot be issued for a period of less than 5 years and lease contracts can be as long as 999 years. Lease contracts can offer the lessee the right to subdivide, sublease, and mortgage the leased land. Land-related information can be found in the land registry and cadastre, which are located in different agencies and are not linked or coordinated to share data. Most of the relevant data related to land is available, in principle, but it may be a time-consuming process to obtain the information, as it requires dealing with several different authorities.

2.4.6 Immigration laws and tourism

The tourism sector, one of the country's most prosperous industries, is fully open to foreign companies as well, as are other manufacturing and primary sectors.the immigration department of Kenya approves tourism investment permits in line with the requirements of the Kenya tourism board. Some foreign investors lease land and collaborate with local organization and local communities to conserve land and keep animals and attract tourists. Example of foreign owned animal conservancy includes sweet waters conservancy and lewa conservancy in nanyuki.the foreigners are allowed and given permits to run the conservancy for a certain period of time if only it will be beneficial to the country another requirement as stated on the Immigration act 2011 is that it should be owned in partnership with a Kenyan national.

2.4.7 Immigration laws and service sectors regulation

There are approximately forty (40) insurance companies and three (3) re-insurance companies operating in Kenya. Foreign equity participation in an insurance company has a ceiling of 66.7%. The governing statute for insurance matters is the Insurance Act (Chapter 487, Laws of Kenya) (the “IA”). Foreign brokerage and fund management firms are only allowed to participate in the local capital market through locally incorporate companies, which must have a Kenyan ownership of at least 51 and 30 per cent respectively. Agriculture, mining and forestry have attracted minimal FDI mainly because of inappropriate policies to encourage foreign investors these sectors. Nevertheless, Agriculture supports 80% of Uganda’s population through subsistence farming. Foreign firms investing in the agricultural sector are mainly involved in projects such as production of flowers for export markets, growing of oil seed and processing it to finished product, cotton growing, processing, spinning and knitting, producing and processing of livestock products such as milk and hides. They also engage in farming of horticultural crops such as fruits and vegetables while on the other hand they buy locally produced coffee and cereals for value addition (Kenya Bureau of Statistics, 2011).

CHAPER THREE

LEGAL AND REGULATORY FRAMEWORK FOR FOREIGN DIRECT INVESTMENT IN KENYA

3.0 Introduction

A country's legal and regulatory framework is a tool to support its policy choices towards FDI. The framework consists of a set of commercial laws and regulations, as well as the institutions established for their enforcement; it provides the overall framework to govern its market transactions and a process to settle disputes. The framework provides a degree of confidence required by foreign investors to enter into business transactions in a country. It seeks to assure private investors that a particular business transaction is permitted, and that once entered into, the transaction will be protected and the supporting agreements enforced. Especially in situations where a government is introducing a major departure from the previous treatment of foreign investors, such a framework serves to promote the government's objectives and policies for attracting, facilitating, and safeguarding foreign investment.

According to Fabry and Zeghni legal and regulatory framework of a country encompasses the entire body of formal laws and informal rules and not only administrations and bureaucracy[54]. Fabry and Zeghni explain that these legal and regulatory institutions can be economic, political or social depending on what part of the life they regulate. Economic institutions are for example tax laws and property laws; laws that regulate political life are political institutions; social institutions regulate the social sphere[55]. Economic, political and social institutions matter most as determinants of foreign investment decisions to invest. Economic

[54] Fabry, N. & Zeghni, S. 2006, "How former communist countries in Europe attract inward foreign direct investment? A matter of institutions.", *Communist and Post-Communist Studies*, , no. 39, pp. 201.

[55] ibid

institutions determine very important part of the investment climate – for example the degree of property rights protection and the enforcement of contracts. Political institutions determine the political regime and regulate political power – civil rights and liberties, political rights, veto players, constitutions, etc.

Freund and Bolaky argued that countries may benefit from foreign investment inflows only if they have appropriate local government regulations and institutions in place[56]. According to Freund and Bolaky excessive regulations are likely to restrict growth through FDI if human and capital resources are prevented from reallocating. For example, Freund and Bolaky noted that if starting and closing down a business is hindered by extensive and costly government regulations, which involve many bureaucratic procedures demanding entrepreneurs' time and resources, then capital flows are prevented from being reallocated to the most productive sectors.

Likewise, if restrictive employment laws for the hiring and firing of employees cause a lower labour market turnover, technology spillovers to domestic firms are less likely to occur[57]. A similar argument by Javorcik and Spatareanu notes that government regulations, such as protecting foreign and domestic investors by ensuring creditor rights and enforcement of contracts. Both are difficult tasks involving high uncertainty, considerable time and very large expenses. Hence, multinationals would reduce forward and backward linkages with the local economy, thereby affecting the likelihood of horizontal or vertical spillovers taking place.

Law and regulation can be key determinants of the quantity and quality of FDI received and legal regimes governing FDI can incentivize and encourage beneficial FDI, whilst preventing

[56] Freund, C. and B. Bolaky (2008), 'Trade, Regulations, and Income', Journal of Development Economics, forthcoming.
[57] Javorcik, B. and M. Spatareanu (2005), 'Do Foreign Investors Care about Labor Market Regulations?', Review of World Economics, 141, 3, 375–403.

or at least minimizing damage to the national economy and resources. Generally, these legal regimes are made up of a number of components, including: regional free trade agreements; multilateral and bilateral investment treaties; specific investment legislation and regulations; and elements of domestic commercial, antitrust, intellectual property, tax, labour and environmental laws.

According to Bevan and Estrin countries with poor regulations and inefficient processes for foreign companies receive less FDI and have smaller accumulated stocks of FDI[58]. Bevan and Estrin explains that countries tend to attract more FDI if they allow foreign ownership of companies in a variety of sectors, make start-up, land acquisition, and commercial arbitration procedures efficient and transparent, and have strong laws protecting investor interests.

3.1 Favorable FDI Environment

This essentially means a transparent and non-discriminatory regulatory environment, effective competition policies and an efficient judicial system. Low and stable tax rates are also important. Fiscal incentives may increase the attractiveness of a country but cannot substitute for the lack of a healthy FDI environment. Promotion activities may also help attract FDI but only when the basic framework is in place, including equal treatment of foreign and local investors and fast dispute settlement mechanisms.

In general, while the FDI regime is improving in Africa, serious deficiencies remain. These are aggravated by inadequacies in complementary areas. Legal and judicial systems are inadequate to support the needs of investors in many African countries. Reform is needed in corporate law, contract law, bankruptcy, labor law and property rights. Judicial systems,

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58 Bevan, A. and S. Estrin. 2000. “The determinants of foreign direct investment in transition economies”. WP 342, William Davidson Institute, University of Michigan, Ann Arbor, Michigan.

which are critical to ensure that the laws are applied properly, are corrupt and inefficient in many countries.

3.2 Common Features of Legal Frameworks

Key characteristics of legal regimes governing FDI include:

3.2.1 Investment Promotion and Incentives

Investment incentives are Foreign Direct Investment policy tools which government may use to attract foreign investors. Some of these include: special tax allowances, tax exemptions and reductions, and financial incentives such as low interests on loans. Also investment guarantees such as the guarantee for capital and profit repatriation and foreign currencies provision, may also be seen as ways of attracting foreign investors.

According to the United Nations, governments attract FDI by creating Investment Promotional Agencies (IPAs) which concentrate on activities of marketing the country as a preferred investment location and join the World Association of Investment Promotion Agencies which trains the Investment Promotion Agencies[59]. The United Nations argues that FDI promotion agencies address market failure on the imperfect information from the investors' and the host government sides, and emphasizes on the attractiveness of the country to the investors. Morriset argues that greater investment promotion is associated with increase in cross-country Foreign Direct Investment flows[60]. However, he notes that investment promotion will be more effective where there is good investment climate and there is a high level of development.

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[59] United Nations (2003). "FDI Policies for Development: National and International Perspectives," World Investment Report 2003, New York and Geneva.

[60] Morriset, J. (2003) "Does a Country Need a Promotional Agency to Attract Foreign Direct Investment? A Small Analytical Model of 58 Countries" World Bank Policy Working Research Paper, Nr 3028

According to Schneider and Fry many countries have introduced fiscal incentives such as tax holidays, reductions in employer contributions, allowances for skills training and waivers or rebates on corporation and export taxes[61]. Schneider and Fry also note that host countries are providing loan guarantees and subsidies to encourage investment. Schneider and Fry further explain that in areas where development is particularly needed, governments have created special enterprise zones. For example, in the Philippines various special economic zones dealing with particular investment priority areas such as information technology services and agro-industrial manufacturing have been created and are regulated by the Philippine Economic Zone Authority. In such a zone, a registered export manufacturing enterprise could be eligible for an income tax holiday of between 3-6 years depending on the type of project it is undertaking.

In Kenya, investment promotion is the responsibility of Kenya Investment Authority (KIA) and it's meant to serve as the focal point between the indigenous and foreign investors in the country. The agency's functions include: arranging contacts between suitable local and foreign investors, keeping close contact with all development finance institutions, gathering information from other countries on investment incentives, preparing investment guidance literature for foreign investors, arranging promotional activities such as investment workshops overseas with the aim of attracting foreign investors, providing guidance and advice to investors on issues touching on investments such as taxes, labor regulation, interest rates, credit access and infrastructure, and finally the agency advises the government on which policy changes are required and review of the investment laws so as to make the country more attractive to foreign investments

[61] Schneider, F. and B.S. Fry. 1985. "Economic and political determinants of foreign direct investment". *World Development*, 13: 161–75.

3.2.2 Investor Protection Measures

Typically FDI regimes contain provisions prohibiting differential treatment of foreign investors, limiting the circumstances in which expropriation of foreign assets is permitted and protecting foreign investors' rights to property. It is common for host countries to be obliged under these rules to provide fair compensation when expropriation takes place. For example, Uganda has enacted the Investment Code Act 2000. Part V of this Act deals with the protection of foreign investments and section 27 states that compulsory acquisition of any of the investor's interests or rights in an enterprise licensed under the legislation or its property must be in compliance with the Ugandan constitution and the fair market value of the interest or right must be paid in compensation. The Act also requires the compensation to be freely transferable – it is explicitly exempted from the Ugandan Exchange Control Act's restrictions7.

In addition, alternative dispute resolution procedures are important for foreign investors to ensure independent adjudication where disputes arise. Agreements often oblige parties to undertake arbitration at the International Centre for the Settlement of Investment Disputes to resolve their disputes.

The world has witnessed remarkable growth in FDI flows, spurred by strategies on investment by transnational corporations (TNCs) and liberalization of national FDI policies. It is believed that FDI offers benefits to host economies in terms of capital inflows, technology transfer, shared managerial skills and knowledge, improved access to export markets and so on. However, there are no guarantees that the opening up of a host country to foreign investment result in FDI inflows. Even when the adage proves true, development and other envisaged results differ considerably, depending on the circumstances. There are suggestions that governments need to consider what role they want inward FDI to play in their economies development process and design their FDI policies accordingly.

Following the rapid inflow of FDI the right to control foreign investment became topical in many countries. Up until the 1980s most countries made extensive use of restrictions on foreign investment. Since the 1980s there has been a complete reversal where countries start providing an open and predictable investment regime in their domestic reform agenda portraying an open handed welcome to foreign investment.

3.2.3 Kenya FDI Trend

According to Larossi Kenya has had a long history of economic leadership in East Africa as one of its largest and most advanced economies[62]. However, Larossi argues that inconsistent efforts at structural reforms and poor policies over the past couple of decades have generated a prolonged period of decline in development indicators and significantly eroded the leadership position at a time when other countries in the region have made significant strides. Larossi notes that while Kenya was a prime choice for foreign investors seeking to establish a presence in Eastern and Southern Africa in the 1960s and 1970s, poor economic policies and inconsistent efforts at structural reforms, growing problems of corruption and governance, and the deterioration of public services have discouraged FDI since the 1980s.

A new FDI entry regime was introduced in Kenya in 2004 saw one of the most liberal regimes replaced by more restrictive one. The Investment Promotion Act (2004) introduced a mandatory investment threshold and restrictive screening procedure for all foreign investments. It further required foreign investors to apply to newly established Kenya

[62] Larossi, G. (2009). “An assessment of the investment climate in Kenya.” The International Bank for Reconstruction and Development and The World Bank. Washington, USA.

Investment Authority (KIA) for an investment certificate. Some of the new requirements stipulated in the Investment promotion Act (2004) are:

There is a mandatory investment threshold. The amount to be invested by a foreign firm must be at least $500,000 or the equivalence in another currency while for domestic firms the minimum capital invested is $65,000.

Foreign investors are required to apply to the newly established KIA for an investment certificate and that a foreign investor shall not invest in Kenya unless it has been issued with an Investment Certificate.

Investment must be deemed by KIA to be to the benefit of Kenya that is, must lead to the creation of jobs for Kenyans, acquisition of new skills or technology and must contribute to tax revenues or other government revenues UNCTAD (2005).

3.3 The Impact of FDI on Economic Growth

Arguably, the importance of FDI stems from the fact that it tends to boost economic growth in host countries. In this context a number of studies have investigated this relationship. However, these studies vary in the methods used as well as the final results. Some studies are concerned with measuring the impact of FDI on the rate of economic growth in general, while others concentrate on specific economic or political variables and their impact on growth. For example, some studies focus on the impact of FDI on production, other studies assess the impact on the economic aspects such as foreign trade, different manufacturing strategies and what this means for growth, and local investment.

3.3.1 The Impact of FDI on Production

With respect to measuring the impact of FDI on production, and the subsequent effects on the rate of economic growth, it can be argued that MNCs are in possession of the appropriate production technology to activate otherwise unutilized or under-utilized economic resources. The MNCs, also, use modern management techniques to maximize the use of resources, as well as reduce production costs; consequently, attracting MNCs will increase the efficient use of resources by improving productivity qualitatively and quantitatively, thereby boosting competitiveness.

Moreover, FDI contributes to improving the skills of the local workforce, assisting the use of modern means of production. This implies that a skilled and literate workforce should be a major target irrespective of the nature of the economy. In this context, the studies discussed below confirm a direct relationship between FDI and the economic growth in developing countries through improving human capital. This concept simply refers to the level of skills and literacy of the local workforce: the argument is that the higher this levels then the better for attaining strong and sustainable economic growth.

Hong [63]in his study of Southern Korea investigated the role of FDI and commercial loans in boosting productivity during between 1970 and 1990. The study concluded that the flow of foreign capital has greater positive effects on productivity than commercial loans. Furthermore, the study emphasized that the private sector in Southern Korea succeeded in attracting foreign capital especially in areas such as oil exploration, electronics and the heavy industry.

Haddad and Harrison[64], examining the Moroccan case, conclude that FDI by MNCs have made a significant contribution in improving the performance of local companies. They argue that local companies benefited greatly from the advanced technology associated with foreign

[63] Hong, K. (2007). ―Foreign Capital and Economic Growth in Korea: 1970-1990. *Journal of Economic Development*, 22(1), 79-89.
[64] Haddad, M. and Harrison, A. (2003). ―Are There Positive Spillovers from Foreign Direct Investment? Evidence from Panel Data for Morocco. *Journal of Development Economics,* 42(1), 51-74.

investment, which have great impact on the productivity of these companies and the subsequent increase in economic growth. The same impact was found by Aitken[65], who investigated the effects of FDI on the growth in production in a number of countries from 1976-to 1999. He found that local companies achieved high production rates in sectors where the contributions of foreign capital were high; prior to the inflow of FDI productivity in those sectors was low.

Mathur[66] in his study in India reached similar findings. He noted that local low production sectors benefited significantly from FDI which improved the efficiency of these sectors. Richardson[67] also found that FDI played a major role in boosting economic growth in South East Asian countries, through its contribution to total production via the associated advanced technology. In turn, this boosted exports earnings in these countries. Blomström and Kokko[68] refer to the positive role that the MNCs have played in increasing productivity in Kenya, in relation to their contribution to promote advanced technology among local companies. The same results were also reached in a study on Cameroon by Ghura[69] and also by Djankov and Hoekman[70] for Czech Republic.

Haddad and Harrison pointed out that the positive impact form FDI was not apparent in all sectors. Blomström and Kokko indicated that FDI led to lower productivity levels in sectors that had failed to cope with the highly advanced technology associated with FDI. Kokko et al.

[65] Aitken, B., Hanson, G., et al. (2006). ―Spillovers, Foreign Investment, and Export Behaviour. *Journal of International Economics*, 43(1-2), 103-132.
[66] Mathur L., et al. (2007). ―The Determinants of India Outward Foreign Direct Investment. *Journal of International Business Studies*, 38(4), 499-518.
[67] Richardson C. (2009). *The Locational Behaviour of Foreign Direct Investment: Evidence from South East Asian*. New York: Springer.
[68] Blomström, M. and Kokko, A. (2006). ―The Impact of Foreign Investment on Host Countries: A Review of the Empirical Evidence. *World Bank Policy Research Working Paper*, 1745, 44-59.
[69] Ghura, D. (2007). ―Private Investment and Endogenous Growth: Evidence from Cameroon. *IMF Working Paper*, 97, 165.
[70] Djankov, S. and Hoekman, B. (2000). ―Foreign Investment and Productivity Growth in Czech Enterprises. *World Bank Economic Review*, 14(1), 47-70.

concluded that local manufacturing companies in Uruguay had taken advantage from FDI to improve productivity. However, they indicated that the impact of FDI on local companies varied depending on the level of technology used in these companies. In other words the lower the level of technology used the less positive impact the FDI on productivity. These results are consistent with previous studies regarding the importance of the establishment of a reliable technological base in different sectors in the host countries in order to create the conditions for improving productivity.

Djnkov and Hoekman studied the Czech Republic to investigate the overall impact of the technology associated with FDI on the components of production. The study relied on data from a sample of 513 companies representing a number of industries, of which 340 (66.3%) were purely local companies without foreign participation and 173 (33.7%) had some form of foreign participation. The productivity was measured using the per capita income of the work force against the total sales during the periods 1992-93, 1993-94, 1994-95 and 1995-96. The study concluded that the improvement in productivity of the sectors that had foreign participation was due to the fact that the local companies were technologically capable.

In another study Keller[71] investigated the impact of FDI on productivity in seven countries. He found that productivity varied depending on the components of production in the countries. He also noticed that the impact on production was strongly positive as the flow of FDI boosted R&D. According to a study by the OECD in 1998, the invasion of European markets by American companies benefited the former in a number of ways, including the introduction of advanced technology and high levels of competitiveness. However, the benefits had been confined to specific industries due to the variation in technological knowhow between the American companies and their European counterparts. The study

[71] Keller, W. (2000). ―Do Trade Patterns and Technology Flows Affect Productivity Growth? *World Bank Economic Review*, 14(1), 17-47.

highlighted the potential of local companies to cope with modern technology as a precondition for these companies to benefit from the technological know-how associated with FDI. This potential improves the chances of the local companies to compete with their foreign counterparts.

3.3.2 The Impact of FDI on Foreign Trade and Economic Growth

Many MNCs gain potential through promotion, marketing and selling products by the use of brand labels, which make those products desirable, facilitating entry in to foreign markets. Moreover, most foreign companies have branches and production centres in other markets to help promote and market their products. New international standards have come into effect in the aftermath of the emergence of WTO. However, most of the products from developing countries fail to meet these standards. The role of FDI is paramount in helping developing countries achieve the required international standards in order to compete in global markets and also to improve the quality of local production.

A number of studies have investigated the relationship between FDI and foreign trade. Chen and Zhang[72] found a positive relationship between inflows of FDI into China and Chinese exports. This can be compaired with the Kenya situation which can be explained that the manufacturing sector attracts more FDI because it has more exports. Aitken et al. emphasized the positive impact of MNCs on the overall exports of local companies as these companies benefit from the services provided by the MNCs particularly in the area of information technology and distribution. Likewise Thomsen[73] in a study focusing on the ASEAN countries highlighted a strong relationship between FDI and exports. He discovered that in these countries exports expressed as a ratio of GNP increased from 30.5% to 39.7% in three

[72] Chen, C., Chang, L., et al. (2005). ―The Role of Foreign Direct Investment in China‘s Post-1978 Economic Development. *World Development*, 23(4), 691-703.

[73] Thomsen, S. (1999). *Southeast Asia: The Role of Foreign Direct Investment Policies in Development*.

years starting from the end of 1980s. For example, Hoekman noted that Thailand achieved annual average growth of 2.6% between 1989 and 1992, which would not have been possible without the contribution of MNCs in boosting its exports especially in the electronic products. In another study, Blomström and Kokko emphasized that MNCs are more efficient than their local counterparts in achieving exports. They explained their findings by the fact that MNCs possess higher levels of technology, marketing skills and effective channels of communication with the outside world.

A number of studies have focused on the impact of FDI on economic growth by studying the type of manufacturing strategy prevalent in that country whether the strategy aims to boost exports or to restrict or replace imports. A study by Balasubramanyam et al.[74] considered the impact of FDI on economic growth in the host country in relation to variations in manufacturing strategies. They assumed that the capacity of investment to bring about economic growth varies according to the type of manufacturing strategy. They concluded that policies that aim at boosting exports attract FDI inflows and the subsequent increase in exports contributes to economic growth.

The OECD also conducted a number of studies on countries such as of which have featured countries such as concerning the relationship between FDI and manufacturing strategies and economic growth. These studies found a strong relationship between economic growth and the policies that involve changes from central planning to a market system and the removal of investment restrictions. They also concluded that FDI boosts economic growth through the associated capital and modern technology which improved the efficiency of local companies thereby improving their chances of competing globally.

[74] Balasubramanyam, V., Salisu, M., et al. (2006). ―Foreign Direct Investment and Growth in EP and IS Countries. *Economic Journal*, 106(434), 92-105.

Thomsen's study focusing on the ASEAN countries concluded that the policies adopted by these countries in favour of boosting exports as a means of attracting FDI, successfully boosted exports and subsequently brought about economic growth. He pointed out that the exports of these countries, expressed as a ratio of GNP had doubled since 1982, with only minor differences in the long term. In addition, variations existed among different sectors depending on the components of each sector.

A similar conclusion was reached by Hoekman and Djankov in studying exports. Likewise, Blondal and Christinsen[75] investigated the effects of the flow of foreign capital on the economies of the growing markets. They emphasized the significant contribution made by FDI towards economic growth through increasing foreign trade. However, the effects on trade varied from one country to another depending on the aims and the type of strategies.

3.3.3 The Impact of FDI on Local Investment and Economic Growth

In discussing the impact of FDI on growth, it is also important to assess the impact of FDI on domestic investment levels, and in particular if FDI and domestic investment are complementary or substitute each other. A number of studies have investigated this relationship with varying results. For example, in a study on Japan, Bayoumi and Lipworth[76] found that FDI integrated with the local capital in the host economy rather than replacing it. Consequently, in the case of Japan the injection of the foreign capital into the local economy provides additional financial resources to activate sectors of the economy which were not functioning effectively for economic growth.

[75] Blöndal, S. and Christiansen, H. (1999). ―The Recent Experience with Capital Flows to Emerging Market Economies. *OECD Economics Department Working Papers*, 211, 30-43.
[76] Bayoumi, T., Lipworth, G., et al. (1997). ―Japanese Foreign Direct Investment and Regional Trade. IMF, Working Paper WP/97/103t.

A study by De Mello[77] on the OECD countries spanning 1970 to 1992 found the relationship between the two variables could be described as integrative. FDI was found to have positive impact on economic growth rates in host countries. On the other hand De Mello found that the relationship between foreign investment and local investment in source countries was that of replacement.

In another study Agosin and Mayer[78] investigated the impact of FDI on local investment in Africa, Asia and Latin America between 1976 and 1996 through two sub-periods: 1976-1985 and 1986-1996. The effects of integration or substitution varied across the countries and between periods within the same country. For instance, it was found that replacement effects were incontrovertible in Africa between 1970 and 1996, but integration was obvious between 1976 and 1985 and 1986 and 1996. By contrast in Asia integration was always present all the time. However, in Latin America the relationship between foreign and local investment was that of substitution throughout.

[77] DeMello, L. (1997). ―Foreign Direct Investment in Developing Countries and Growth: A Selective Survey. *Journal of Development Studies,* 34(1), 1-34.
[78] Agosin, M. and Mayer, R. (2000). *Foreign Investment in Developing Countries: Does it Crowd in Domestic Investment?* Paper presented at the United Nations Conference on Trade and Development, February 2000, Geneva.

CHAPTER FOUR

STRATEGIES TO ATTRACT FDI IN KENYA

4.1 Introduction

This chapter examines the strategies to attract FDI in Kenya and how immigration laws should be designed to be in a position to collaborate with Kenya investment boards to attract FDI.this includes how all institutions involved in FDI should collaborate and lay better grounds for investment.

4.2 Attracting FDI in Kenya

To attract investment, the Government has enacted several reforms, which include abolishing export and import licensing, except for a few items listed in the Imports, Exports and Essential Supplies Act (Chapter 502); rationalizing and reducing import tariffs; revoking all export duties and current account restrictions; freeing the Kenya shilling's exchange rate; allowing residents and non-residents to open foreign currency accounts with domestic banks; and removing restrictions on borrowing by foreign as well as domestic companies.

According to Barnet and Brooks the availability of good infrastructure, reliable power supply, transportation, water and communication, is a significant factor determining the level of FDI[79]. Sethi et al. notes that when emergent economies struggle for FDI, the economy that is adequately equipped to minimize infrastructure drawbacks will attract a larger quantity of FDI[80].

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[79] Barnet, S. and R. Brooks (2006). What is Driving Investment in China? *International Monetary Fund working paper*, No. WP/06/265

[80] Sethi, D. Guisinger, S. E., Phelan, S. E., Berg, D. M. (2003) Trends in Foreign Direct Investment Flows. A theoretical and empirical Analysis, Palgrave Macmillan.

Multinational Enterprises are often attracted to developing countries by the abundance of low-priced man power. For instance Urata[81] contends that minimal wages, negligible inflation, underrated exchange tariffs are important determinants of cost-saving FDI. Low labor costs can attract investment in labor intensive activities and thus stimulate vertical FDI. Khadaroo & Seetanah used nominal wage as a proxy for labor cost[82]. They argue that for foreign investors, the market scale that in addition corresponds to the host economy's financial circumstances and the possible requirements for their productivity as well is an important element in the FDI decision-makings.

Sustainability of nominal price increases tells investors that the host countries are committed to prudent macro-economic strength and hence anticipation for further development. They use an average rate of inflation as an alternative for macro-economic permanence. Exchange rate volatility has been empirically proven as a disincentive to foreign investment inflows. Clustering countries have played a very vital role in attracting inward FDI to a host country. Kinoshita & Campos[83] uses one lag stock of FDI as an independent variable to acquire knowledge on the agglomeration effects. Other studies have employed the number of industrial zones or Economic Processing Zones as proxies to determine the impact of agglomeration. This variable also proxies for policy incentives like tax exemptions, tax holidays that influence foreign firms to locate in a certain geographical region.

Insecurity in host country has been established to deter FDI. Asante[84] assessed determinants of private investment behavior in Ghana and found out that political instability has a negative sign and highly significant, suggesting that military takeovers, may have created a climate

[81] Urata, S. (1997) FDI Diversion: US-China-Japan Trilateral Forum.
[82] Khadaroo A.J. and B.Seetanah (2008) Transport Infrastructure and Foreign Direct Investment, John and Wiley Sons, Ltd.
[83] Kinoshita Y. and Campos, N.F. (2002) The Location Determinants of Foreign Direct Research Consortium, Research Paper 100, Nairobi, Kenya
[84] Asante, Y. (2000) Determinants of Private Investment Behaviour, African Economic Research Consortium

hostile to private investment. Bulan[85] asserts that conflicts are a barrier to efforts at increasing a location's share of global FDI. Citing crime and violence, the author contends that such incidences have many direct economic costs that may hinder FDI inflows directly or indirectly.

Corruption has become a policy concern of most governments the world over. This is because it leads to increased outlay of investment. Houston[86] studied about the impact of corruption on FDI flows and the results show that corruption in the receiving economy has an unfavorable impact on FDI inflows: a one-point increase in the corruption leads to a reduction in per capita FDI inflows by about 11 percent. A negative relationship is postulated between corruption and FDI flows.

4.3 Political Risk and FDI in Kenya

Data from the World Bank shows that over the past three decades, Kenya has had its lowest growth periods in or just following election years, with GDP growth slumping one percentage point on average below the long-term trend.

According to Robert foreign corporations are usually faced with risks associated with hostile foreign investment climate, especially political factors. Volatile economies are usually the most risky, although after destruction that is brought about by politics, there usually arises numerous opportunities for investment. Investment decisions need to be made considering all the characteristics of the foreign country. Companies usually tend to limit the amount of investment in politically volatile regions no matter the opportunities available for investment. Robert argues that some regimes tend to change often, making it impossible to make long

[85] Bulan, L. T. (2001) Real options, irreversible investment and firm uncertainty: New evidence from U.S. firms. Waltham, MA: Brandeis University.
[86] Houston, D. (2007) Can Corruption Ever Improve an Economy? Cato Journal 27 (3): 325–42

term goals or investments[87]. Others interfere with operations through imposing tariffs and other barriers to trade that hinder competitiveness, especially with the intentions of protecting local organizations from foreign competition. Such interference may be disadvantageous to the foreign organization.

The delay in operationalising the Lands Commission could be exploited by unscrupulous officials at the Ministry of Lands to illegally allocate public land, or reject or allow extension of land leases with the records back-dated. This has been as a result of the failure to set up the new National Lands Commission has resulted in a hold-up in the renewing of land leases. This means that property owners are finding it difficult to access finance for investment, and production levels in agriculture could drop as farmers and livestock breeders are unsure about lease renewals. The Commission should have been in place by August 2012.

Such policy and institutional lapses have meant that Kenya's standing as East Africa's most attractive destination for foreign investment is under serious threat from neighboring states, who are cashing in on the country's lengthy licensing procedures and sluggish commercial dispute settlement to sharpen their competitiveness.

Foreign Direct Investment is influenced by various other factors, including incentives that are offered by the host country to encourage establishment of foreign industries in the local market. Governments may exempt foreign organizations from taxes to encourage them to introduce more capital in to the local market. According to Bowles generating an enabling investment climate through offering security for investors is also an important strategy of encouraging foreign investment[88]. Bowles notes that issues such as terrorism and destruction of property are the major factors that contribute to the avoidance of investing in most less

[87] Robert P. A. (1997) Political Risk Analysis and Tourism. Annals of Tourism Research. Vol.24, No.3, 675-686.

[88] Bowles, S. (2004) Microeconomics: Behavior, Institutions, and Evolution. Princeton University Press

developed countries by foreign companies. Dugan et al. argues that government policies are important since they protect the foreign investors from drastic changes in the operating environment[89].

Political considerations have been widely investigated in the FDI literature. Political risk is defined as changes in the operating conditions of foreign enterprises that arise out of political processes, either directly through war, or insurrection, or political violence, or through changes in government policies that affect the ownership and behaviour of the firm. Political risk can be conceptualized as an event, or a series of events, in the national or international environment, that can affect the physical assets, personnel, and operations of foreign firms[90]. Another explanation was provided by Fatehi-Sedah and Safizadeh[91] which considers political instability as a negative perception emanating from internal instability, inter-governmental relationships, anticipated or unanticipated government actions, or government discontinuities, all brought about by social, economic, or political imperatives existing in country's internal or relevant external environment.

Many studies have been carried out into the impact of political stability, or conversely, political instability, on the inflows of FDI by MNCs. According to Brewer[92], political instability in a host country's government results in uncertain investment outcomes. In a study investigating the flow of FDI in 80 LDCs by Schnieder and Frey[93], it was found that political instability significantly decreases the flow of FDI. El-Haddad[94] found that political stability

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[89] Dugan C., Rubins N,. D, Wallace D. & Sabahi B. (2008) Investor-State Arbitration, Oxford University Press
[90] Jodice, D.A. (2005), "Political Risk Assessment: an Annotated Bibliography", Greenwood press, Westport.
[91] Fatehi-Sedah, K. and Safizadeh, M.H. (1989), 'The Association Between Political Instability and Flow of Foreign Direct Investment", Management International Review, Vol. 29, No. 4, pp. 4-13.
[92] Brewer, T.L. (2003), "Government Policies, Market Imperfections, and Foreign Direct Investment", Journal of International Business Studies, Vol. 24, No. 1, pp. 101-120.
[93] Schnieder, F. and Frey, B. (2004), "Economic and Political Determinants of Foreign Direct Investment", World Development, Vol. 13, No. 2, pp. 161-175.
[94] El-Haddad, A.B. (2008), "Determinants of Foreign Direct Investment in Developing Countries: the Egyptian Situation", L'Egepte Contemporaine, Vol. 77, No. January, pp. 65- 93.

ranked among the top determinants of FDI. Boddewyn[95] explains that Political considerations have a profound influence on the multinational corporations, and affects the value of a multinational company through change in future cash flow and investors' required return[96].

In a survey conducted by the Overseas Development Institute (ODI) in South Asia and sub-Saharan Africa to measure the political risk in terms of crime level, riots, labour disputes and corruption (Overseas Development Institute, 1997) found that political risk is an important factor restraining foreign investments. A politically stable environment can give investors the confidence that laws and regulations governing their investment and the market in which they operate will remain stable over the long term. The capital risked in FDI usually requires a long term period in order to generate the expected profits, therefore foreign investors think about not only the current situation, but also the political and economic outlook of the host country.

4.4 Policies towards Foreign Companies

Changes in government policies on FDI in the past decade confirm and strengthen the trend towards the liberalization of FDI. Most of the new policies that were adopted by developing countries reduced restrictions to foreign entry, or liberalized operations in industries that were restricted to FDI[97]. Other restrictions that relate to the ownership of land and real estate, and limitations on the number of foreign employees and foreign exchange controls were reduced or removed. Some of the incentive regimes were revised and rationalized, while additional incentives were offered to promote investment in priority industries. As discussed in the

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[95] Boddewyn, J.J. (2006), "Political Aspects of MNE Theory", Journal of International Business Studies, Vol. fall, pp. 342-363.

[96] Butler, K.C. and Joaquin, D. (2007), "A Note on Political Risk and the Required Return on Foreign Direct Investment", *Journal of International Business Studies*, Vol. 29, No. 3.

[97] Butler, K.C. and Joaquin, D. (2007), "A Note on Political Risk and the Required Return on Foreign Direct Investment", *Journal of International Business Studies*, Vol. 29, No. 3.

previous chapter, the number of countries that changed their investment regimes according to the UNCTAD has increased from a meagre in 1991 to as many as by the year 2001. The number of regulatory changes introduced by different countries of the world has also increased from 82 in 1991 to 208 in 2001, and most of these regulatory changes were introduced to make FDI more favourable. Brewer[98] categorized the various types of government policies towards FDI into five main types. These policies include monetary policies (such as money supply, foreign exchange rates and interest rates), capital controls policies, transfer pricing policies, antitrust or competition policies, and labour relations policies. He concludes that market imperfections can be increased and/or decreased by government policies, even by a single given policy. Promotion programs, as mentioned in a report by UNCTAD[99], might involve building an image for the host country within the investment community as an investment location that is favoured by foreign investors. The report also mentioned that an image building program involves advertising in the media, conducting seminars and general investment missions and participating in exhibitions.

4.5 Infrastructure and FDI in Kenya

Some empirical studies, have mentioned the importance of infrastructure in the attraction of increased FDI inflows into a country. Some of these authors have argued that unavailable public inputs and poor infrastructure increases costs for firms. However, good infrastructure is attractive to Foreign Direct Investments[100]. This is because it reduces the costs of doing business for profit maximizing local and multinational enterprises. Good infrastructure therefore is necessary for improved investment climate for Foreign Direct Investments.

[98] Brewer, T.L. (2003), "Government Policies, Market Imperfections, and Foreign Direct Investment", Journal of International Business Studies, Vol. 24, No. 1, pp. 101-120.
[99] UNCTAD (2005), "World Investment Report 1995: Transnational Corporations and Competitiveness, Policies on Inward Foreign Direct Investment", UN, New York and Geneva.
[100] El-Haddad, A.B. (2008), "Determinants of Foreign Direct Investment in Developing Countries: the Egyptian Situation", L'Egepte Contemporaine, Vol. 77, No. January, pp. 65- 93.

There are a few channels which can be used to explain how good infrastructure is essential in uplifting of the economic activity. The direct channel of explaining infrastructure to growth revolves around the productivity enhancing effects of infrastructure improvements by expanding the capacity of that factor of production[101]. When there is an increase in the infrastructure stock, it indirectly increases the productivity of other factors of production. For example providing reliable and efficient source of power such as electricity, may yield a positive productivity effect on the businesses and firms, while at the same time, improves the investment environment for other projects. This explains the fact that good infrastructure has the potential reduce the business costs and encourage investments.

Investors driven with the motive of both resource and asset seeking in Kenya, the availability of good infrastructure is vital. The structure and availability of infrastructural network is a positive aspect for all the sectors in the economy. There are some overlaps between investment motives and locational preferences sometimes. As with the development of infrastructural network, the overlap is quite obvious. Before going further, the meaning of the aspect of "infrastructure" needs to be elaborated. In some FDI literature, infrastructure role includes the development of education and health care system, however in this study limits the definition of infrastructure to mean roads, ports, railways, communication network, airports and availability of electricity.

The UNCTAD 2005 Report describes the infrastructural network in Kenya as "fairly well developed than its regional neighbors." The country has a total road network of approximately 151,000 kilometers, there is also one railway line which runs from the port city of Mombasa to the Kenya/Ugandan border and covers 2700 kilometers. There are also three main international airports, with the largest being Jomo-Kenyatta airport in Nairobi. The port of Mombasa is the gateway to the East African region for most of the shipping

[101] El-Haddad, A.B. (2008), "Determinants of Foreign Direct Investment in Developing Countries: the Egyptian Situation", L'Egepte Contemporaine, Vol. 77, No. January, pp. 65- 93.

freight. In terms of communication network, UNCTAD[102] report notes that still the penetration of internet and telephone density is relatively low, there is 1 per 100 fixed line telephone connections, and this is low but better than others in the region. It is important to note that the development of good infrastructure cannot be underestimated. When foreign firms plan to move to developing countries to take advantage of low labor costs, and may still have to deal with disrupted services and high transportation costs due to inadequate infrastructure, they may opt not to move[103]. Cargo transportation ought to be fast and reliable, since the speed of transportation will be a determinant of the vast life of the product and the price it will be offered to the producer .

So far, Kenya offers the best road and freight network in the whole of the East African region, although there is still room for improvements. The development of the infrastructural network has for some investors been the key driver of investing in the country, over its neighbors such as Uganda and Tanzania.

4.6 Export Processing Zones

Most developing countries offer a variety of incentives to investors with the aim of attracting more FDI[104]. In the case of Kenya, the government offers several fiscal incentives such as reduced tax rates and tax holidays to foreign investors. Most of these incentives are normally directed to firms which are engaged in the Export Processing Zones (EPZ). Over the last decade, it was seen that trade liberalization through global and regional free-trade agreements was the solution to economic development in developing countries. The EPZ initiatives act as an example of such free-trade agreements. The main roles of the EPZs is promoting exports

[102] UNCTAD (2003), Transnational Corporations in World Development: Third Survey, London; Graham & Trotman Limited (for the United Nations Centre on Transnational Corporations).

[103] Temu, Andrew and Jean M. Due (1998). “The Success of Newly Privatized Companies: New Evidence from Tanzania,” Canadian Journal of Development Studies, 19(2), 315-341.

[104] Asiedu, E., (2001). “On the Determinants of Foreign Direct Investment to Developing Countries: Is Africa Different?” Mimeo, University of Kansas, forthcoming in World Development.

and stimulating FDI. According to UNCTAD[105] there are 40 EPZs in Kenya which have 99 companies.

The government of Kenya provides incentives to firms wishing to get involved in the export processing zones. The export processing zones were created under the Export Processing Zones Act (1990). There are three types of activities that firms may engage in while in the EPZs, these are namely, manufacturing, commercial and services. Firms involved in the EPZs have more incentives than other firms in other sectors. According to UNCTAD (2005) these firms will amongst other things get an exemption from the VAT Act, be exempted from paying stamp duties, will not be required to pay withholding tax on dividends for both domestic and foreign investors for a period of the first 10 years of operation, after which they are expected to pay a 25% flat rate for the next 10 years after that. Other incentives include exemption from payment of customs and excise taxes, and less procedural requirements when establishing the business.

All the goods and services produced in the EPZs and are sold out of the country are considered as Kenyan exports, and so they are payable in foreign currency, on the other hand, EPZs can also produce for the Kenyan domestic markets, and all the goods which are produced by the EPZs for the domestic markets are treated as imports from a third and most favored nation, and they undergo the usual import procedure apart from the exemptions. The policy which regulates the EPZs in Kenya at the moment only approves companies which are planning to produce goods which 80% are to be exported and only 20% of the goods are allowed to be sold in the domestic market.

Many empirical studies have criticized the contribution of EPZs in the economic development[106]. This criticism is part of the larger discussion on the contributions of FDI on

[105] United Nations (2005). "Investment Policy Review: Kenya." United Nations Conference on Trade and Development. New York and Geneva.

economic development. The wages of Skilled and Unskilled workers in Kenya are higher than all their strategic competitors and neighbors at spot exchange rates[107]. Real wages have doubled or even tripled in the past decade, while productivity has remained stagnant over the same period. The rise in wages has made most of the investments in the EPZs short-term and footloose. These footloose investments result from short-term investments which are not rooted in the local economy through supply and demand linkages[108]. These kinds of investments make most of the money coming into Kenya not spillover hence leading to temporal economic development.

4.7 Privatization

Privatization provides a good platform for the Trans-National Corporations to invest in a country. Privatization has also generated substantial amounts of Foreign Direct Investments into many developing economies. Good privatization programs are made up of three main characteristics: Business orientation, political commitment and transparency. Large scale privatization programs send a message to the foreign investors that the government taking measures to create business friendly environment to Foreign Direct Investments. Hence, privatization of industrial enterprises and infrastructure enterprises would have a positive impact on Foreign Direct Investment flows.[109]

From the beginning of early 1990s, the Kenyan government began the process of privatizing the partly government owned parastatals to the private sector. The government identified

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[106] Buthe and Milner, 2008; Rolfe, Woodward and Kagira, 2004

[107] World Bank (2007). "Snapshot Africa – Kenya: Benchmarking FDI Competitiveness." World Bank Group/MIGA. United States: Washington.

[108] Caves, R. (1996). "Multinational Enterprise and Economic Analysis." Cambridge, U.K. Cambridge University Press.

[109] IFC and FIAS (1997) "IFC Lessons of Experience 5, Foreign Direct Investment" Washington D.C. U.S.A

approximately 200 enterprises which were then earmarked for privatization[110]. Although the process of privatization has been going on since then, it is also important to mention that the government actually did start this process without a proper privatization law in place. While most of the government owned enterprises have been put up for private ownership, there are some big enterprises which the government has been slow and reluctant to open up for privatization, some of these are the banking sector, telecommunication and electricity generation, among other big enterprises.

The World Bank and the IMF have been working with the government to help in the privatization of the other enterprises, and through the introduction of a privatization law in parliament last year, the government now seeks to be able to sell some of the remaining enterprises it holds majority share. If the privatization law is passed in parliament and becomes law, it will bring some desired changes to the privatization process. The privatization law outlines the ways and means to be used in the privatization process, that is, negotiated sales, offering shares through a public offer, concessions or leases and other methods which will follow the laid out rules (UNCTAD, 2005).

The law also established a privatization commission, which will then be in charge of fairly conduction all the processes and ensure that the public is given a chance at owning some of these enterprises. Both investors will be allowed to participate in the process of privatization regardless whether they are domestic investors or foreign investors, both will enjoy almost the same rights, although in some cases the minister for finance may have to make a decision on the limit of level of ownership for both the domestic investor and the foreign investor alike.

[110] United Nations Conference on Trade and Development(UNCTAD) 2005, "Investment Policy Review Kenya", United Nations, New York

4.8 Investment Incentives

Investment incentives are the promotional or regulatory activities that are adopted by the host government in order to make their location more attractive for foreign investments. In other words, they are the benefits offered by host economies to foreign companies in order to attract more FDI, or retain those already present in a country. The definition of FDI incentives, according to OECD[111], is that investment incentives are the measures designed to influence the size, location or industry of a FDI investment project by affecting its relative cost or by altering the risks attached to it through inducements that are not available to comparable domestic investors.

MNCs are mainly attracted by strong economic fundamentals in the host economies. The most important ones are market size and income levels, skill levels in the host economy, the availability of infrastructure and other resources that facilitates efficient specialization of production, trade policies, and political and macro-economic stability. The relative importance of the different fundamentals varies depending on the type and location of investment. For instance, foreigners investing in the United States have been attracted mainly by the large market size, while multinationals investing in Singapore focus mainly on the availability of skilled labour, good infrastructure, and political and economic stability.

An increasing number of host governments provide various forms of investment incentives to encourage foreign-owned companies to invest in their countries. Examples of FDI incentives are tax incentives, guarantees against expropriation, government provision of utilities such as water, power and communication at subsidised prices, reduction/elimination of import duties on inputs, interest rate subsidies, guarantees on loans and coverage for exchange rate risks, wage subsidies, training grants as well as relaxation of legal obligations towards employees.

[111] OECD (2000), "Investing in Developing Countries", Organisation for Economic Cooperation and Development, Paris.

4.8.1 Types of Investment Incentives

There is a wide variety of FDI incentives, including fiscal incentives such as tax holidays and lower taxes for foreign investors, financial incentives such as grants and preferential loans to MNCs, as well as other incentive measures like market preferences, infrastructure, and sometimes even monopoly rights. The location of FDI may be influenced by the various incentives offered by governments to attract multinationals. As mentioned earlier, these incentives take a variety of forms. FDI incentives are commonly divided into three categories namely fiscal, financial, and other incentive measures, all of which are financed and/or offered by authorities in the host area.

Financial incentives include relocation and expatriation support when authorities offer grants to help meet enterprises' additional capital spending and concrete relocation costs. Administrative assistance is practiced when authorities resort to implicit subsidisation, whereby for example, investment promotion agencies take it upon themselves to perform a range of tasks that would otherwise have fallen to the investing enterprises. Examples include preferential treatment by regulatory authorities, whereby administrative impediments, for example the speed of obtaining permissions, are eased.

In developing countries, incentive schemes that are based on tax holidays and other fiscal measures that do not require direct payments of scarce public funds are popular. The other incentive category includes regulatory FDI incentives, which are policies of attracting foreign-owned enterprises by means of offering them derogations from national regulation. Such incentives are almost exclusively granted in connection with targeted strategies, or they are specially negotiated as part of the strategies for luring large individual investment projects. However, many incentives are also applicable when it comes to attracting domestic companies or even in cases where local companies have enough bargaining power to force governments to come up with incentives.

Promotional activities by the host country are also an important factor for countries that are trying to attract foreign investments. These promotional activities include advertising locally or internationally, establishing representative offices in countries that have the potential of providing FDI, investment delegations, investment conferences and seminars, and providing various kinds of services to potential investors. In a study by Friedman et al., a coefficient of promotion was found to be a positive and significant factor for enticing foreign companies to conduct foreign investment activities[112].

4.8.2 Subsidies

Examples of subsidies that are provided by the host countries are subsidized infrastructure, including the provision of energy (fuel, power, water, etc.), transportation and telecommunication at lower costs, and subsidized purchase/rental of land, buildings, and industrial plants. Subsidies might also include a subsidized exchange rate, export subsidies, capital subsidies, loan subsidies, subsidized buildings and subsidized services. Subsidized services may include assistance in implementing and managing projects, carrying out pre-investment studies, information on markets, availability of raw materials, advice on production processes and marketing techniques, assistance with training, technical facilities for developing know-how or improving quality control. Job training subsidies, particularly when investment is sought in activities that are new to the host economy, are offered for investors that are faced with a shortfall of qualified labour. In these cases, authorities offer to alleviate this shortfall through supported education programs.

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[112] Friedman, J., Gerlowski, D., Daniel, A. and Silberman, J. (2002), "What Attracts Foreign Multinational Corporations? Evidence From Branch Plant Location in the United States", *Journal of Regional Science*, Vol. 32, No. 4, pp. 403-418.

4.8.3 Tax incentives

Tax incentives can be defined as any incentives that reduce the tax burden of enterprises in order to induce them to invest in particular projects or sectors, and are exceptions to the general tax regime. Tax incentives would include, for example, reduced tax rates on profits, tax holidays, accounting rules that allow accelerated depreciation and loss carry forwards for tax purposes, and reduced tariffs on imported equipment, components, and raw materials, or increased tariffs to protect the domestic market for import substituting investment projects. Because tax incentives are intended to encourage investment in certain sectors or geographic areas, they are rarely provided without conditions attached[113]. Very often countries design special incentive regimes that detail the tax benefits as well as the key restrictions. For instance, these regimes may require that a facility be established in a certain region or regions, have a certain turnover, require the transfer of technology from abroad, or employ a certain number of individuals. For example, China offers foreign investors a tax refund of up to 40 percent on profits that are reinvested to increase the capital of the firm or to launch another firm. The profits must be reinvested for at least five years. I f the reinvested amounts are withdrawn within five years, the firm has to pay the taxes. Similarly, India offers a tax exemption on profits of firms engaged in tourism or travel.

The impact of tax policies on the volume and location of FDI has for long been an area of interest of scholars in the field of international business and economics, however the findings have been less than conclusive[114]. Agodo, in his study of 33 United States companies that have 46 manufacturing investments in 20 African countries, discovered that tax concessions

[113] Milward, B.H. and Newman, H.H. (2009), "State Incentives Packages and Therefore, Investment Location Decision", Economic Development Quarterly, Vol. 3, No. August, pp. 203-222.
[114] Milward, B.H. and Newman, H.H. (2009), "State Incentives Packages and Therefore, Investment Location Decision", Economic Development Quarterly, Vol. 3, No. August, pp. 203-222.

were insignificant as a determinant of FDI in his statistical regression analysis[115]. Rolfe and White found only a slightly significant relationship between the presence of a fifteen year tax holiday and the attractiveness of a country as a site for FDI[116]. On the other hand, Woodward and Rolfe conclude that tax holidays and free zones would increase the probability of a country receiving foreign investments[117].

Examples of tax-related incentives might include granting tax reductions, granting tax holidays, corporate income-tax reductions, exemption from income tax, and exemption from sales tax, tax credits and preferential tax treatment.

4.8.4 Streamlining of Policies

Streamlining of policies can be an important influencing factor in foreign investment activities as it involves reducing bureaucracy and red tape, easing entrance procedures, simplifying administrative procedures, and the availability of one agency to deal with and coordinate between ministries and entities that are involved in investments. An example of streamlining of policies is the Malaysian Industrial Development Authority (MIDA) and the Thai Board of Investment (BOI), wherein both established a centre through which investors can obtain approval and make arrangements for all their investment needs[118].

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115 Agodo, O. (2000), 'The Determinants of Private Manufacturing Investment in Africa", Journal of International Business Studies, Vol. 9, No. 3, pp. 95-107.

116 Rolfe, R. and White, R. (1999), "The Influence of Tax Incentives in Determining the Location of Foreign Direct Investment in Developing Countries", Journal of the American Taxation Association, Vol. 13, No. 2, pp. 39-57.

117 Woodward, D.P. and Rolfe, R.J. (2001), "The Location of Export Oriented FDI in the Caribbean Basin", Journal of International Business Studies, Vol. 24, No. 1, pp. 121-144.

118 Wells, L.T. and Wint, A.G. (2001), "Marketing a Country-Promotion and Tools for Attracting Foreign Direct Investment", International Finance Corporation, Multilateral Investment Guarantees Agency, Washington D. C.

4.8.5 Government Agreements and Guarantees

The government of the host country can enter into agreements with other foreign governments in order to facilitate foreign trade and make it easier for foreign investors to invest by solving financial and managerial problems. These agreements include common market and regional economic agreements, and can act as an important attracting factor for FDI. Multiple tax treaties and double taxation agreements are also important attracting factors for FDI.

Government guarantees for investments are commitments made by the government to back a private investment and to back a third-party lender if investment is lost for political or other reasons[119]. Examples of guarantees that a host country might offer to foreign investors are guarantees against expropriation, guarantees of stable tax rates, guarantees of stability of laws and regulations, and sometimes, guarantees of protection against competition through disallowing new investments in the same industry.

4.8.6 Government Intervention Policies

The effects of FDI on a host country's economy, in particular its growth and development prospects, are of special interest to developing countries. Concerns in this respect have sometimes led to government intervention. Several other strategic and socio-economic considerations have also regularly figured in host government intervention processes, such as employment effects, technology transfer, and environmental and cultural effects. Host government policies in this respect emerge from the specific mix of political and economic circumstances characterizing particular countries.

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[119] Lubetzky, D. (1994), "Incentives for Peace and Profits: Federal Legislation to Encourage US Enterprises to Invest in Arab-Israeli Joint Ventures", Michigan Journal of International Law, Vol. 15, No. 2, pp. 405-458.

Many government interventions to promote development may cause constraints rather than help growth and welfare. The most successful developing countries in recent economic history are the newly industrializing Asian economies that intervened intensively in markets to build up their competitive capabilities. Their experience suggests that there is a significant role for government in providing the collective goods needed for sustained development. A study conducted by the UNCTC[120] suggests that the issue is not whether governments should intervene, but how should they intervene.

Regarding the issue of competition among governments (national or local) to attract FDI, some problems may be created as a result of this competition. When governments compete to attract FDI there is a tendency to overbid and the subsidies may very well surpass the level of the benefits, with welfare losses as a result. These problems may be particularly severe if the incentives discriminate against local firms and cause losses of local market shares and employment.

[120] UNCTC (1992), "Formulation and implementation of Foreign Investment Policies", UN Publications, Sales No. E.92.JXA.2.

CHAPTER FIVE

TREND OF FDI IN KENYA BETWEEN THE YEARS 1990-2012

5.0 Introduction

This chapter gives a detailed analysis of F.D.I operation in Kenya on the period 1990-2012, basing on the primary data from the questionnaire and also secondary data as given by the world bank, UNCTAD and KPMG reports, it displays the number of permits approved on the given years which indicates how the F.D.I have been operating in Kenya. There is also analysis of sector by sector of investment which will show the most preferred sector of investment and those ones that attract more investors in comparison with the others; this will give a clear picture on the trend of F.D.I in Kenya.

5.1 The period of operation of a business

The analysis gives the duration of operation of several businesses to get a clear indication whether the investors are comfortable doing business in Kenya or they relocate after some time. The interview conducted presented the following results;

Table 5.1: Years the business been in operation in the country

	Frequency	**Percentage**
Less than 5 years ago	6	17.0
5 to 10 years ago	16	35.5
11 to 15 years ago	11	28.6
15 to 20 years ago	5	12.7
Above 20 years ago	2	6.2
Total	**40**	**100**

Sources: the Ministry of Immigration Permits issuance records dated 1990-2012.

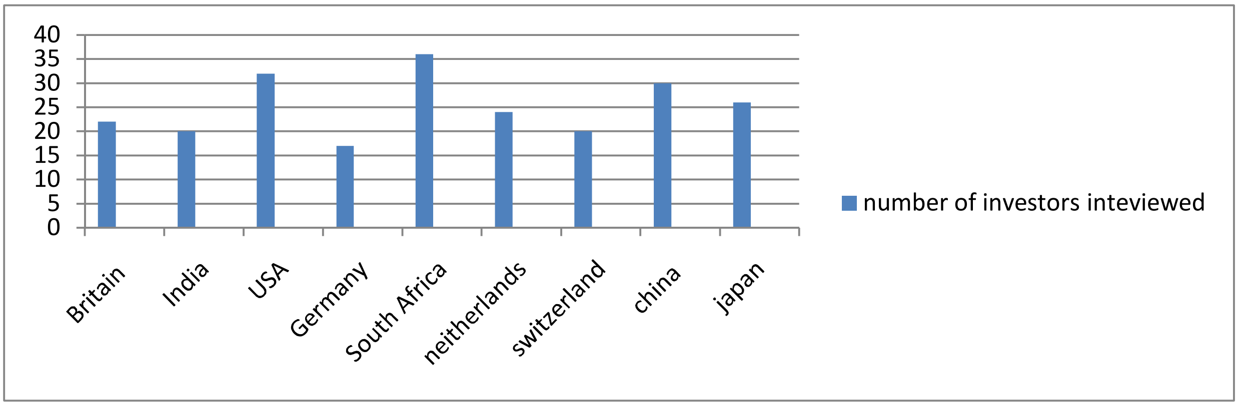
From the table above, most of the respondents/ investors, 35.5% indicated that the business has been in operation in the country 5 to 10 years ago, 28.6% said that the business has been in operation in the country 11 and 15 years ago and 17% indicated that the business has been in operation in the country for less than 5 years. Further, the table 4.4 above indicates that 12.7% and 6.2% the business has been in operation in the country for a period between 15 and 20 years and more than 20 years respectively.

The results indicated clearly that most investors prefer to stay in the country for a number of years then change the kind of investment or relocate business to neighboring countries. This came out clearly especially due to Kenya's political structure where elections are normally held after 5 years there is usually uncertainty on the political environment which directly affects the economy and the F.D.I.

5.2 Investors Country of Origin

On the country of origin the respondent the study established that they were from Britain, India, US and Germany, South Africa, Netherlands, Switzerland and of late China and Japan.

Figure 5.1; The number of investors interviwed per counrty.



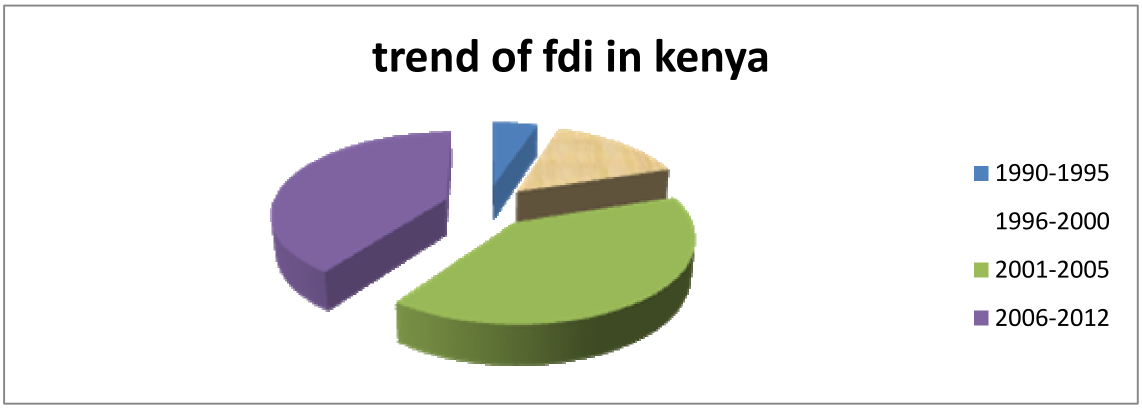
Sources: the Questionnaires distributed to various foreign investors in Kenya

The table 4.2 show the number of investors who responded to the questionnaires within the county of Nairobi Kenya, the number is based on the investor's accessibility. The table does not show the country preference on investment.

5.3 Branches in Cities and Towns in Kenya

According to the responses 55 % of the foreign firms are concentrated in Nairobi while Mombasa accounts for about 23 %, thus Nairobi and Mombasa account for over 78 percent of FDI in Kenya. While other cities and towns accounts for only 22% of all the foreign firms in the country, most of them first establish a head office in Nairobi, capital city of Kenya before settling to other counties in the country.

Figure 5.2; The Trend of FDI in Kenya in different periods 1990-2012



Sources; the results of the analysis of both primary and secondary data on foreign investment in Kenya

The pie chart shows the trend of FDI in Kenya in different periods between the years 1990-2012.

From the chart it is evident that FDI has continued to increase over the period, it was low in the period 1990- 1995 when structural adjustment was happening the country attracted few foreign investors, the period 1996-2000, the investment began to pick and there were a slight increase in the number of investment compared to the previous period. The period 2001-2005 when a new regime took over there was increase in foreign direct investment attributed to the changes in operation laws and system of government, the following period always there was increase in investments due to the changes in the new constitution and also measures were put to improve in the FDI in Kenya.

5.4 Sectors that attract FDI in Kenya

The different sectors that attract F.D.I in Kenya basing on the number of permits issued by the Immigration Department on the period 1990-2012, shows the most preferred sector of investment, and why it attracted most F.D.I during that period. The number of permits issued shows the trend of how a particular sector has followed over that period.

Table 5.2; The Immigration permits issuance trend per year; period 2001-2012

Number of permits issued per sector of investment (numbers)												
Sectors/year	1990	1992	1994	1996	1998	2000	2002	2004	2006	2008	2010	2012
Farming	67	70	86	86	87	102	48	32	57	63	89	123
Tourism	102	108	106	112	165	123	86	20	122	124	132	148
Mining	239	234	198	196	186	203	65	36	196	205	208	225
Manufacturing	306	316	336	324	325	328	296	192	203	326	346	348
Telecommunication	96	56	83	92	87	86	48	32	93	96	98	84
Construction industry	296	306	286	287	286	276	200	103	156	302	346	380
Transport	42	63	36	48	46	36	23	16	46	56	69	102
Horticulture	203	206	207	201	223	236	186	122	196	243	248	286
Fishing	65	62	63	67	68	70	57	43	39	69	78	87

Sources: the results of the findings from the questionnaires distributed on foreign investment in Kenya

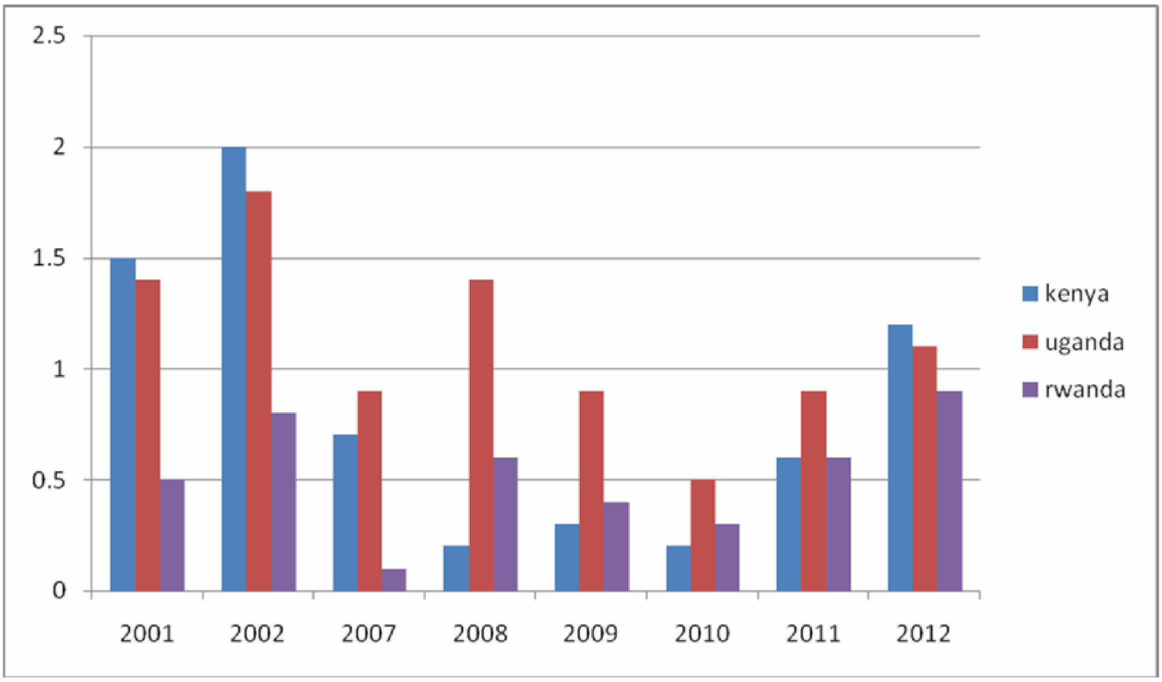
By the end of year 2012 the number of permits issued in all sector increased due to the changes that were made to the immigration regulatory framework, hence giving confidence to more number of investors. The changes made to the immigration laws made it easier for permits to be processed on time and the number of requirements were revised making it easier for investors to operate and run their business well. Between 2006 and 2008, foreign direct investment in agribusiness in Kenya rose by 42 per cent, while FDI into Kenyan manufacturing rose by 87 per cent. At the same time, global FDI fell by more than 10 per cent. This can be attributed to the ongoing reconstruction of infrastructure, rising activity in the mergers and acquisitions market.

The best FDI is the one that brings in several new and many positive externalities, such as manufacturing and service oriented as compared to just a few high-value natural resource seeking, because the former helps in diversifying and creating employment. The fact that Kenya recorded a lower absolute value in FDI mean that projects in Kenya are not necessarily capital intensive but labour intensive, such as IT and telecoms — which is a positive thing as it means more jobs in the economy. Also the emerging investment opportunities in tourism, banking and agriculture sectors will keep the FDI flowing.

From the findings the agribusiness and manufacturing stands as the most prominent opportunity for attracting and building foreign investment flows, with the support of improved infrastructure and regulatory encouragement, therefore country's manufacturing capabilities for the regional market, strengthen its position as a regional services hub, reinforce the Agri-business success, diversify FDI into EPZs, and improve infrastructure.

Kenya FDI IN Comparison With Other East African Countries

Figure 5.3 FDI inflow in kenya and other east african countries.

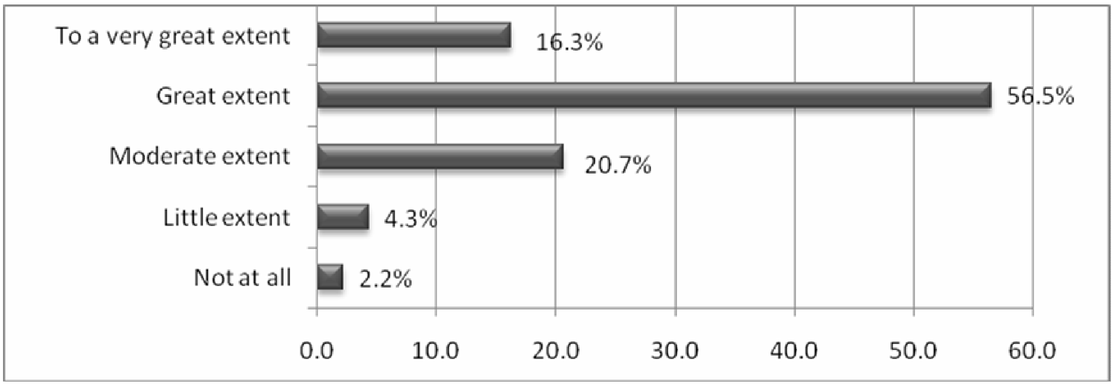


Sources: the results of the findings from the questionnaire distributed to foreign investors in Kenya in comparison with world bank report of 2012 on foreign direct investment in east Afican countries.

From the table Tanzania and Uganda have widened their lead over Kenya in the race for foreign direct investments (FDI) in the East African region, as lengthy licensing procedures and sluggish commercial dispute settlement turn multinationals away from Kenya this is according to the World Bank report of 2012.

New data released by the United Nations Conference on Trade and Development (UNCTAD) shows Uganda topped the region in attracting FDI in the year 2011, followed closely by Tanzania, on the back of increased investments in the oil and gas sector. Which showed that FDI to each of the two countries was seven times larger than what Kenya received in 2012, a lag analysts blamed on heightened political tensions and delays in removing cumbersome licensing procedures.

Figure 5.4 How immigration laws affects FDI in Kenya



Sources: the result of the analysis of Questionnaires Distributed to Foreign Investors in Kenya.

On the extent immigration laws affects FDI in Kenya, majority of the respondents, (56.5%) indicated that immigration laws influence FDI in Kenya to a great extent while 20.7% were of the opinion that immigration laws influence FDI in Kenya to a moderate extent. Further, 16.3% indicated that immigration laws influence FDI in Kenya to a very great extent, 4.3% and 2.2% to a little extent and to no extent respectively. From the results above, it is evident that immigration laws influence FDI in Kenya to a great extent.

5.6 Sectors that attract FDI in Kenya

Table 5.3: Sectors that attract FDI in Kenya

	Mean	**mode**
Mining and mineral extraction industry	20	15
Fishing industry	4	6
Telecommunication sector	7	13
Construction sector	26	48
Manufacturing sector	30	54
Tourism sector	16	42
farming	11	32
Transport sector	8	24
Banking and Insurance sector	12	18
Hotel sector	8	36
Horticulture sector	18	42

Sources: the Results of the findings Analyzed on Foreign direct Investment in Kenya

The study aimed at establishing the key sectors attracting FDIs in Kenya. According to the table above, majority of the respondents indicated manufacturing sector is the most attractive sector for FDI as shown by a mean score of 30, the construction sector is also an attractive sector for FDI as shown by a mean score of 26 and Mining and mineral extraction industry as well is also an attractive sector for FDI as shown by a mean score of 20. Further, the respondents indicated that manufacturing is an attractive sector for FDI as shown by a mean score of 30, hotel sector as shown by a mean score of 8; horticulture is also an attractive sector for FDI as shown by a mean score of 18 and farming as shown by a mean score of 11. The respondents also indicated Telecommunication sector is also attractive as shown by a mean score of 7, the transportation sector as shown by a mean score of 8, the fishing industry as shown by a mean score of 4and Banking and Insurance sector as shown by a mean score of 12

When the respondents were asked to comment on the permits issuance processes in Kenya and how it impacts on investment, some indicated that the processes is highly bureaucratic and thus slows down and discourages foreign investments. However, others indicated that for the last five years the process has improved and as a result the process has been made efficient which has helped investors to settle within a short period.

5.6 Factors that attract FDI in Kenya

Table 5.4: Factors that attract FDI in Kenya: Sources both secondary and primary data findings on investment

Factors	Mean	Std. Deviation
Political factors	4.4245	0.7109
Government policies (monetary policies, capital controls policies, transfer pricing policies, antitrust or competition policies, and labour relations policies)	4.1898	0.9723
Investment Incentives like tax holidays and lower taxes for foreign investors, financial incentives such as grants and preferential loans to MNCs, as well as other incentive measures like market preferences and sometimes even monopoly rights	4.1577	0.8271
Export Processing Zones (EPZ) with reduced tax rates and tax holidays to foreign investors	4.2188	0.9235
Privatization of National Corporations, industrial enterprises and infrastructure enterprises	4.1309	0.7247
Government Agreements and Guarantees	3.9621	1.0717
Infrastructure development	4.3245	0.7109

Source: Results from the questionnaire submitted on foreign direct investment

On the factors attracting investors, majority of the respondents indicated that politics is a key factor that attracts FDI as illustrated by a mean score of 4.4245. This is inline with Robert who argued that some regimes tend to change often, making it impossible to make long term goals or investments[121]. He noted that companies usually tend to limit the amount of investment in politically volatile regions no matter the opportunities available for investment. Schnieder and Frey[122] found that political instability significantly decreases the flow of FDI. Also Butler and Joaquin explains that political factors have a profound influence on the multinational corporations, and affects the value of a multinational company through change in future cash flow and investors' required return[123]. The study findings are also in line with a survey conducted by the Overseas Development Institute (ODI) in South Asia and sub-Saharan Africa to measure the political risk in terms of crime level, riots, labour disputes and corruption found that political risk is an important factor restraining foreign investments.

The respondents also indicated that infrastructure development is a key factor that attracts FDI as illustrated by a mean score of 4.3245. The study findings are in line with El-Haddad who noted that unavailable public inputs and poor infrastructure increases costs for firms. However, good infrastructure is attractive to Foreign Direct Investments[124]. This is because it reduces the costs of doing business for profit maximizing local and multinational enterprises. El-Haddad noted that when there is an increase in the infrastructure stock, it indirectly increases that productivity of other factors of production. For example providing reliable and efficient source of power such as electricity, may yield a positive productivity effect on the businesses and firms, while at the same time, improves the investment environment for other

[121] Robert P. A. (1997) Political Risk Analysis and Tourism. Annals of Tourism Research. Vol.24, No.3, 675-686.
[122] Schnieder, F. and Frey, B. (2004), "Economic and Political Determinants of Foreign Direct Investment", World Development, Vol. 13, No. 2, pp. 161-175.
[123] Butler, K.C. and Joaquin, D. (2007), "A Note on Political Risk and the Required Return on Foreign Direct Investment", *Journal of International Business Studies*, Vol. 29, No. 3.
[124] El-Haddad, A.B. (2008), "Determinants of Foreign Direct Investment in Developing Countries: the Egyptian Situation", L'Egepte Contemporaine, Vol. 77, No. January, pp. 65- 93.

projects. This explains the fact that good infrastructure has the potential reduce the business costs and encourage investments.

The respondents also indicated that Export Processing Zones (EPZ) with reduced tax rates and tax holidays is a key factor that attracts FDI as illustrated by a mean score of 4.2188. The findings of the study are in line with United Nations that[125] there are 40 EPZs in Kenya which have 99 companies and that the government of Kenya provides incentives to firms wishing to get involved in the export processing zones. Firms involved in the EPZs have more incentives than other firms in other sectors. According to UNCTAD these firms amongst other things get an exemption from the VAT Act, exempted from paying stamp duties, are not be required to pay withholding tax on dividends for both domestic and foreign investors for a period of the first 10 years of operation, after which they are expected to pay a 25% flat rate for the next 10 years after that. Other incentives include exemption from payment of customs and excise taxes, and less procedural requirements when establishing the business.

The table above further shows that government policies (monetary policies, capital controls policies, transfer pricing policies, antitrust or competition policies, and labour relations policies) are also a key factors that attract FDI as illustrated by a mean score of 4.1898. this is as experienced in the newly industrializing Asian economies that intervened intensively in markets to build up their competitive capabilities. This suggests that there is a significant role for government in providing the collective goods needed for sustained development. This confirms the findings of a study conducted by the UNCTC[126] that noted that the issue is not whether governments should intervene, but how should they intervene.

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[125] United Nations (2005). “Investment Policy Review: Kenya.” United Nations Conference on Trade and Development. New York and Geneva.
[126] UNCTC (1992), "Formulation and implementation of Foreign Investment Policies", UN Publications, Sales No. E.92.JXA.2.

The table above further shows that investment incentives like tax holidays and lower taxes for foreign investors, financial incentives such as grants and preferential loans to MNCs, as well as other incentive measures like market preferences and sometimes even monopoly rights are factors that determine FDI as illustrated by a mean score of 4.1577. The study concurs with Milward and Newman that tax incentives are intended to encourage investment in certain sectors or geographic areas, as they are rarely provided without conditions attached. Milward and Newman noted that often countries design special incentive regimes that detail the tax benefits as well as the key restrictions.

The table above aswell shows that Privatization of National Corporations, industrial enterprises and infrastructure enterprises is also a key attraction to FDI as illustrated by a mean score of 4.1309. This confirms the United Nations Conference on Trade and Development report that privatization has also generated substantial amounts of foreign direct investments into many developing economies. The study confirms that large scale privatization programs send a message to the foreign investors that the government is taking measures to create business friendly environment to Foreign Direct Investments. Hence, privatization of industrial enterprises and infrastructure enterprises would have a positive impact on Foreign Direct Investment flows.[127]

Finally the table above also indicates that government agreements and guarantees attract FDI as illustrated by a mean score of 3.9621. This is inline with Lubetzky that agreements facilitate foreign trade and make it easier for foreign investors to invest by solving financial and managerial problems.

[127] IFC and FIAS (1997) “IFC Lessons of Experience 5, Foreign Direct Investment” Washington D.C. U.S.A

5.7 Challenges facing foreign direct investment in Kenya

The study aimed to establish the challenges facing foreign direct investment in Kenya and what should be done by the Kenyan government to create more favorable environment for FDIs

5.7.1 Corruption

Corruption in permits application creates a bad picture to the Kenyan investment environment, from the study it is clear that if corruption is done away with completely the investment in Kenya will raise as there will be increased confidence with the investors.

The study found out that corruption is one factor that has attracted so much attention in relation to FDI[128], and has been viewed as an inconvenience by all investors. Corruption in itself as a factor has no direct risk in relation to FDI, but creates a lot of disturbances. The study found that it is important to understand the role of corruption in FDI because it brings about a lot of distortions by providing false information, pitfalls, and ultimately increases uncertainty[129].

From the questionnaire responses investors in Kenya argued that all procedures required money. Most argued that the presence of brokers who insists on assisting the launch the application faster makes the process more cumber some, some ask for unimaginable amount and they end up not delivering. The payments made are normally divided into two parts; the official payments and the unofficial payments (bribes). This problem does not only apply to foreign investors in Kenya, but also affects the indigenous people as well. In 2006, Transparency International published its annual report which showed that at least 47% of Kenyans had to bribe officials to access basic services. Compared to the previous report of

[128] See: Habib and Zurawicki (2002); Eggar and Wines (2006); Okado and Sarameth (2010).

[129] Habib, M. & Zurawicki, L. (2002). “Corruption and Foreign Direct Investment.” Journal of International Business Studies. Vol. 33:2. p. 291-307.

2005, it showed an increase of 13%. However, most investors have named the Kenya Revenue Authority as the most corrupt, since they often have to encounter their officials on a regular basis.

Transparency International's Corruption Perception Index (2011), showed that, in the year 2010Kenya scored 2.1 on a scale of 10. According to this scale, a country with a higher score is seen to be less corrupt, while a country like Kenya with very low scores is perceived to be very corrupt. The index also measures the extent of corruption, in terms of size and frequency of the bribes in both private and public sectors.

Investors argue that corruption has penetrated all levels of the government system. Especially red tape makes the procedures unnecessarily difficult. The investors also mention that in each procedure, the officials will only carry out one step before explaining the rest, and thereby demanding bribes. Another problem is the lack of expertise on the officials' part. Some of these officials are not well acquainted with the whole procedures, and hence do not provide all the relevant information on time for the investors. This lack of information makes it hard for the investors to make their yearly budgets.

The Kenya Bribery Index 2008 (which is study undertaken by the Transparency International), showed that public servants and employees of the government are the most bribed, accounting for up to 99% of all the bribes. These are the same officials that most foreign investors have to deal with on a regular basis. The study also shows that the bribes can range from $2.5 (200 Kshs) to $625 (50,000 Kshs). The general conclusion is that corruption is high and rampant in Kenya. As some investors have put it, "it is sort of a way of life in the country." However, it may not be the only factor that will influence the decision of foreign investors into the country.

5.7.2 Macroeconomic instability

The study established that macroeconomic stability is another risk which is taken into consideration by foreign investors when deciding on where to invest. Inflation and exchange rates are key issue for businesses involved with trade. The study established that the Kenyan shilling had been perceived to be relatively stable against all the other major currencies in the last decade. However in 2008, as a result of the post-election violence, the shilling plummeted by losing about 13% of its value against the U.S. Dollar. After the political crisis, Kenya was seen to be unstable politically, which made foreign investors and tourists who make up bulk of the foreign exchange earnings go the relatively more stable neighboring countries. This made the international demand for the Kenyan shilling to decline. However, at the moment the study has established that the shilling has managed to recover, and is relatively stable again. When these kinds of fluctuations occur more often, it makes future investments insecure and unreliable as investors, who are involved in international businesses, will all be confronted by the adverse effect of the exchange rates.

For the Kenyan economy to attract more FDI there needs to be a transparent and non discriminatory regulatory environment, effective competition policies and an efficient judicial system. Low and stable tax rates are also important. Promotion activities may also help attract FDI but only when the basic framework is in place, including equal treatment of foreign and local investors and fast dispute settlement mechanisms all the FDI institution must work hand in hand and consult for easier operations.

5.7.3 Political Instability

The Kenya constitution states clearly that there would be a general election each after 5 years, this general elections in Kenya in the recent past has lead to political divide along tribal lines which has lead to political and tribal violence. The political instability in Kenya instill fear to investors and according to the study it is clear that most investors tend to with draw their investment when the election period draws near because they are not sure of the outcome, this has affected the Kenya FDI in a negative way as we have seen the country's GDP tends to go down just before the general election and immediately after.

According to Dupas and Robinson there is close correlation between political instability and economic growth. This observation may be explained by the fact that political unrest causes anxiety and uncertainty and hence increases the risk of investments made by both local and foreign investors can be lost. In most cases, political unrest is coupled by social unrest which also threatens the safety of the investors themselves.

The study established that in the run up to the general elections in 2007, Kenya had maintained an image of a relatively stable African country. This perception had created an ideal environment for both investors and tourists alike. The study also established that from independence, the country's economy had performed well, and despite a few disturbances especially in the electioneering periods, it had been seen as relatively stable. The study further established that both political stability and economic development were two factors that had made Kenya a good example for other African countries for a long time. However, the study noted that all this changed in the wake of the post-election violence which erupted in 2007. Investors' confidence in the country was shuttered and this lead to massive capital flight from the country during that particular period. As a consequence this slowed down the economic growth.

CHAPTER SIX

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

6.1 Introduction

This chapter presents summary of data findings, conclusions based on the findings and recommendations there-to. The chapter also presents recommendations on further studies.

6.2 Summary of Findings

The study aimed to establish the effects of Immigration laws on foreign Direct Investment in Kenya covering the period year 2001-2012. The study found out that Immigration laws influence FDI in Kenya to a great extent in all sectors. Therefore if proper Immigration policies are implemented, they can bring about faster upgrading of skills and technologies, secure more reinvestments of profits and protect the consumers and the environment. The study as well established that the Immigration Act requires that foreigners working in Kenya to obtain relevant entry permits and that the Kenya Investment Authority ("KIA") is mandated with promoting investment in Kenya.

The study also established that there are no follow ups on approved permits and some foreigner's ends up not doing what their permit dictates.

The study also established the major sectors that attract FDI in Kenya and established that construction sector is the most attractive sector for FDI in Kenya in the recent past this is due to the development of real estate's business in Kenya and also the recent devepolpment of infrastructure which includes construction of road networks in the major towns and also the railway construction has attracted a number of foreign investors, this is followed by the manufacturing sector and the horticulture, the tourism sector as well as Mining and mineral extraction industry. Finally the study established that Banking and Insurance sector is the least attractive as they are mostly controlled by the government.

Further the study also established that the permits issuance processes in Kenya is highly bureaucratic and thus slows down and discourages foreign investments. However, the study established that for the last five years the process has improved and as a result the process has been made efficient which has helped investors to settle within a short period. That is in comparison of the trend that permits issued in the period year 2001- 2012.

The study aimed to establish the factors affecting FDI in Kenya. The study established that politics is a key factor that attracts FDI.The change of regime after 5 years tend to bring change of preferences which leaves the investors with few choices. This is inline with Robert who argued that some regimes tend to change often, making it impossible to make long term goals or investments[130]. The study also established that infrastructure development is a key factor that attracts FDI that is in line with the recent construction of road network and the railway transport. The study findings are in line with El-Haddad who noted that unavailable public inputs and poor infrastructure increases costs for firms. However, good infrastructure is attractive to Foreign Direct Investments[131].

Further the study also established that Export Processing Zones (EPZ) with reduced tax rates and tax holidays is a key factor that attracts FDI. The findings of the study are in line with United Nations that[132] there are 40 EPZs in Kenya which have 99 companies and that the government of Kenya provides incentives to firms wishing to get involved in the export processing zones. The study as well established that government policies (monetary policies,

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[130] Robert P. A. (1997) Political Risk Analysis and Tourism. Annals of Tourism Research. Vol.24, No.3, 675-686.

[131] El-Haddad, A.B. (2008), "Determinants of Foreign Direct Investment in Developing Countries: the Egyptian Situation", L'Egepte Contemporaine, Vol. 77, No. January, pp. 65- 93.

[132] United Nations (2005). “Investment Policy Review: Kenya.” United Nations Conference on Trade and Development. New York and Geneva.

capital controls policies, transfer pricing policies, antitrust or competition policies, and labour relations policies) are also key factors that attract FDI. This confirms the findings of a study conducted by the UNCTC[133] that noted that the issue is not whether governments should intervene, but how should they intervene.

The study also established that investment incentives like tax holidays and lower taxes for foreign investors, financial incentives such as grants and preferential loans to MNCs, as well as other incentive measures like market preferences and sometimes even monopoly rights are factors that determine FDI. The study concurs with Milward and Newman that tax incentives are intended to encourage investment in certain sectors or geographic areas, as they are rarely provided without conditions attached.

Finally the study established that Privatization of National Corporations, industrial enterprises and infrastructure enterprises is also a key attraction to FDI. The study findings confirms that large scale privatization programs send a message to the foreign investors that the government is taking measures to create business friendly environment to Foreign Direct Investments. The study established that government agreements and guarantees attract FDI. This is inline with Lubetzky that agreements facilitate foreign trade and make it easier for foreign investors to invest by solving financial and managerial problems.

The study aimed to establish the challenges facing foreign direct investment in Kenya. The study found out that corruption is one factor that has attracted so much attention in relation to FDI[134], and has been viewed as an inconvenience by all investors. The study established that corruption has penetrated all levels of the government system especially, red tape, making the procedures unnecessarily difficult. The study also established that macroeconomic stability is

[133] UNCTC (1992), "Formulation and implementation of Foreign Investment Policies", UN Publications, Sales No. E.92.JXA.2.
[134] See: Habib and Zurawicki (2002); Eggar and Wines (2006); Okado and Sarameth (2010).

another risk which is taken into consideration by foreign investors when deciding on where to invest. The study established that inflation and exchange rates are key issue for businesses involved with trade.

The study finally established that there is close correlation between political instability and economic growth. He study found that political unrest causes anxiety and uncertainty and hence increases the risk of investments made by both local and foreign investors can be lost.

6.3 Conclusion

The results of this study reveal very useful insights in understanding the nature of Immigration laws and foreign investments environment in Kenya. The study concludes Immigration laws in Kenya regulate the FDI and therefore they should be reviewed from time to time to keep in tab with the changing world. There should also be regular follow-ups on unproved permits to make sure that the foreign investments approved are beneficial to the Kenyan economy. the main sources of foreign investments in Kenya are Britain, US and Germany, South Africa, Netherlands, Switzerland, India and of late are being overtaken by China and Japan who mainly investing on manufacturing and construction industry which currently in Kenya are ranked as the major attractions to FDI

The study also concludes that immigration laws influence FDI in Kenya to a great extent in all sectors. The study further concludes that construction sector is the most attractive sector for FDI in Kenya followed by manufacturing sector followed by mining and mineral extraction industry, , hotel and tourism and horticulture sector in that order. Finally the study concludes that the banking and insurance sector is the least attractive.

The study further concludes that the permits issuance processes in Kenya is highly bureaucratic and thus slows down and discourages foreign investments but the last five years the process has improved although there are no regular follow-ups on the already approved and operating permits

Further the study concludes that political stability and infrastructure development are key factors that attract FDI in Kenya. The study also concludes that Export Processing Zones (EPZ) with reduced tax rates and tax holidays and government policies (monetary policies, capital controls policies, transfer pricing policies, antitrust or competition policies, and labour relations policies) are key factors that attract FDI. The study also concludes that investment incentives like tax holidays and lower taxes for foreign investors, financial incentives such as grants and preferential loans to MNCs, as well as other incentive measures like market preferences and sometimes even monopoly rights are factors that determine FDI.

Finally the study concludes that Privatization of National Corporations, industrial enterprises and infrastructure enterprises as well as government agreements and guarantees attract also are key attraction to FDI.

The study finally concludes the role of the government and public agencies in encouraging FDI in Kenya is largely missing. Very few firms seem to have contacted the government for any form of assistance. There appears to be a lose link between the government and its related agencies with the foreign investors. Most foreign investors perceive the government to be unfriendly and hostile to their operations. There is need for a greater government's appreciation of the importance of FDI through provision for an avenue for interaction and collaboration in order to address their concerns.

6.4 Recommendations

The study recommends that with the hope of promoting FDI inflows, Kenya has to undertake several economic reforms. The Immigration laws needs to be reviewed time to time to keep in tab with the globalizing world, there also need to be a regular follow up on the already approved FDI to make sure that they are following the laws and whatever they are dealing with is still beneficial to Kenya, the non productive ones should be replaced with productive ones. The integral parts of the overall reforms should be mainly macroeconomic stabilization, streamlining and simplifying business regulations. After these reforms, the share of FDI inflows into the country will increase. The general assumption is that deterring factors of FDI inflows into Kenya are: low level of effective demand as a result of limited purchasing power of the people, low level of infrastructure development, unstable political environment, inefficient and ineffective legal system, and excessive bureaucracy, slow process of the privatization program and lack of skilled workforce. For a country to attract a sizeable diversified and non-resource seeking FDI, it should attain a certain minimum level of development.

The government needs to put more emphasis on improving the investment climate in the country through more measures of liberalization, and should also have efficient system which facilitates speedy and easy entry of foreign investors in to the market. The policy makers also need to enact measures which should encourage privatization and promotion of the domestic private sector, which also is important attraction ingredient to the inflows of foreign direct investments.

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