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FOREIGN DIRECT INVESTMENT REGULATION: SHOULD AFRICA AVOID PERFORMANCE REQUIREMENT?

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ABSTRACT

This article assesses how African states should regulate **Foreign Direct Investment** (FDI). In particular, it focuses on whether African states should employ or avoid performance requirements as mechanism of regulation of FDI. The imposition of performance requirements, also known as operational requirements, in IIAs remains controversial. There is no consensus either on their effectiveness in helping countries to promote development, or in their distorting effects. Some host developing countries consider performance requirements to be an effective policy tool for enhancing the benefits of FDI and consider their disciplining to be undue interference with their policy space. In this paper argues that African states should use performance requirement in the course of their investment regulation with due care than avoiding it at all. The paper is doctrinal, thus, many literatures relating to the topic and the practice of some countries are analyzed. The paper concludes that the usage or imposition of such measures should be in manner that it cannot deter the future FDI inflow. African states should focus on regional cooperation than competition and this cooperation should go to the extent of having common model investment treaty.

Key Words: FDI, performance requirement, African States and Investment Regulation

LIST OF ABBREVIATIONS

BITS	Bilateral Investment Treaty
FDI	Foreign Direct Investment
OECD	Organization for Economic Co-operation and Development
TRIMs	Trade Related Investment Measures
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

FDI REGULATION IN GENERAL

FDI can play significant roles in the development process of the host country, in addition to the capital inflow which improves its balance of payment and earns foreign hard currency. It is occasioned by new technologies and advanced managerial skills (UNCTAD, 2003) which are all decisive for the development of a given country. As host countries are getting advantages of FDI, the investors are also not far behind in terms of the benefits to be earned from the same (TARUN, 2012). However, FDI's effect on the host country is not always positive. It depends on how the host country regulates it. Currently, Africa became very import destination for foreign direct investment. Many African countries are very busy for promotion and attraction of FDI. There is fierce competition among African states in this regard. While they are in such competition it seems that they have forgotten;

➤ Firstly, in this connection, cooperation is better than competition. Cooperation is better; not only to regulate FDI, but also to increase its inward flows. This is because regional integration and cooperation among states develop the market size which in many cases is determinant factor for FDI flows. Secondly, that FDI has negative effects like its “crowding out” effect on domestic investors (AUGUSTINA, 2007, p.67) which can be major factor for unemployment, environmental degradation, excessive exploitation of natural resources, and its effect on trade balance and potential contribution to social disorder and civil war which emanates from corruption and competition for subsistence among the victims of illegal eviction.

➤ Finally, that the optimal benefit to be earned from FDI depends on how the host country regulates them. The assumptions for promotion of FDI include, transfer of new technology, creation of employment opportunities, bringing

foreign hard currency and development of the domestic investors through competition. Unless host countries regulate FDI by crafting best policy which balances its promotional side and controlling side, these assumptions become mere wish. This is to say that African states should also give attention to effective regulation or controlling of FDI to obtain the said advantages of it.

Investment regulation has controlling and promotional sides. Investment promotion comprises of a wide range of activities that are aimed at creating favorable conditions for attracting foreign investment (UNCTAD, 2008). The means of attracting foreign investment includes the provision of incentives, advertisement and publicity campaigns, and the setting up of investment promotion agencies to facilitate the establishment of foreign investors (UNCTAD, 2008). In addition to grant of fiscal and financial incentives, arrangements and facilitation of the determinant variables of foreign investment is the ideal mechanism for promotion of FDI. These determinant variables include improvement of access to input, establishment and development of export processing zone, facilitation infrastructures, developing cheap and skilled labor (Elena, 2014). The role of investment promotion agency to have the good policy and strategies which is capable of attracting FDI is indispensable (UNCTAD 2008, p.37). Generally, we promote and encourage the inflow of foreign investments to reap their potential benefits and although it differs from state to state and factor to factor, African states are perceived to be doing their best on this regard.

The controlling side of investment regulation can have forms of complete prohibition by the host state or certain investment sector or it may have a form of imposing contingent conditions on foreign investors (NEPAD/OECD, 2005 p.5). In other words, the controlling aspect of investment regulation can have the exclusionary or restrictive effect on foreign investors. Moreover, the regulation can be implemented before foreign investment is established or during the time when the foreign investor is operating its investment after its establishment in accordance with the law of the host country; pre- and post- establishment regulation or requirements.

Generally, countries control foreign investment to have enough policy space for their economic and political development concern, to reduce foreign investment drawbacks and to maximize the benefits thereof. As already mentioned, we can use various mechanism of controlling FDI among which the main concern of this paper is performance (operational) requirement.

PERFORMANCE REQUIREMENTS AS REGULATION OF FDI

Performance requirements are stipulations, imposed on investors, requiring them to meet certain specified goals with respect to their operations in the host country (UNCTAD 2003). That means they are measures requiring investors to behave in a particular way or to achieve certain outcomes in the host country. It may tell the investor to use locally produced goods for its production in the host country or it may prescribe a specified percentage of products to be exported to a foreign market by a foreign investor.

Noncompliance by the investor of this requirement may result in different sanction by the host country which may include revocation of investment permit. Some requirements are mandatory requirements, in which non-compliance by foreign investor may lead to the revocation of investment permit (IISD, 2012). However, there are some requirements the application of which entitle foreign investor to incentives (IISD, 2012). This depends on the way the host country uses them; some countries impose the mandatory requirements while others provide the foreign investors incentives. The non-compliance of such requirements by investor might not result in the revocation of investment permit rather the investor loses the incentive that could have obtained if requirements were followed.

There are divergent views regarding employment and performance requirements on FDI and their effect on the economy. While scholars regard them as an essential instrument in a country's FDI policy Package, others tend to argue that they are counter-productive.

Firstly there is an approach that supports for non-use of performance requirement as a restriction on FDI by the host state. This view, mostly, is the view of developed countries, especially US and members of EU. They argue that the imposition of performance requirements is less effective and counter-productive. According to the developer of this view, it is less effective because there are other policy instruments which can be used instead by host country and that can be easily implemented for the purpose for which they are designed. And it is counter-productive because, the imposition of some performance requirement affects not only the investors but also the host country itself. It seems that this view is more or less inherited from the classical economic theory of FDI.

Secondly, there is an approach which advocates the usage of performance requirement for they are important in case of policy guidelines. This as opposed to the first approach is the position of developing countries. This position of developing countries is manifested at the Uruguay Round Agenda of WTO. They argued that the effectiveness and productivity of performance requirement is proved from the experience of developed countries as they extensively use them for their development policies (NAGESH, 2003). Chang in this regard strongly argued that now developed countries systematically discriminated against foreign investment by employing performance requirement and other instruments (CHANG, 2004). The historical experiences of today's developed countries show that a well-devised set of restrictions and performance requirements on foreign investment has been a key ingredient in their recipes for success (CHANG, 2003).

To sum up the above discussion, performance requirements have been employed extensively by developed as well as developing countries to improve the quality of FDI and to maximize its contribution to their development (NEGASH, 2003, p. 72). As it can be evidenced from some literatures, developed capital-exporting states are against performance requirements. Developing countries are also more or less against the mandatory performance requirements. Many developing countries including African states employ incentive based performance requirements. This comes from the fear that impositions of such measures deter the future FDI. This is the result of lack of cooperation among developing countries. If at least majority of them use these measures in similar manner, they will be benefit from it. Imposition of all these requirements can be counterproductive but using specific measure in specific circumstances can greatly benefit African states. The following points are some list of performance requirements.

Export performance

Export performance requirement is the host country's regulating instrument towards the FDI, in which the former determine that the foreign investor should export the prescribed percentage of its product or service to foreign markets. A host country employs the export requirement to preserve the local markets for the domestic enterprise or to earn foreign hard currency from the export by the foreign investor (SORNARAJAH, 2000) Since the big TNCs (transnational corporations) come with huge capital and resource, allowing them local market in equal bases with the domestic enterprises has a crowding out effect on the latter from market. It is for the protection of domestic enterprise that the host country employs the export requirement. Further, the host country imposes the export performance for the purpose of ensuring that more foreign exchange is earned for the host state than profits made for the foreign investor through sales on the local market, because there is a fear that the profit will be repatriated (SORNARAJAH).

There are other measures by host country which have the same effect and are used side by side with export performance requirement and they are sometimes used as incentive for the investors who export their product (UNCTAD, 2003). These measures include various incentives, tariff cuts, and facilitation of infrastructures (UNCTAD, 2003). It has been argued that imposition of this requirement will affect not only the foreign investor but also the host country. If a firm is able to export competitively, it will do so on its own initiatives to maximize its profits (NEGASH, p.67) requiring it to export beyond what is commercially viable on the other hand will be a loss, this in turn affects the host countries future FDI inflow and its competitive capacity at international market. However, we can still use this requirement within what is commercially viable by seeing the potential and nature of specific investor on case by case grounds.

It is clear that performance requirement is among the trade related investment measures because its imposition has more or less an effect on trade. But export performance requirement are not prohibited under TRIMS agreement. As will be dealt with in following sections, articles of TRIMS agreement dealing with performance requirement cross refer to the article III and XI of the 1994 GAAT, under which export performance requirement is not prohibited. Indeed, it was one of the debating points between the developed and developing countries whether it should be prohibited in TRIMS agreement for its effect on trade. Thus, African states including those who are members of WTO can use this requirement.

Local content requirement

It is a requirement whereby a foreign investor will be required to purchase a certain percentage of raw materials from the market or locally produced goods. Local content requirements could be an important means of deepening the commitment of TNCs entering an economy and of generating local value-added, hence employment is created and the related spillovers of knowledge and technology (NEGASH). It promotes a value addition. For example, in case of agriculture, export of processed agricultural product is better in value than export of agricultural raw materials. In some cases it becomes difficult for foreign investors to get the raw material from the local market of the host country in terms of the cost and quality of the raw material or the foreign investor may need the product which has some specifications and designs which are patented. In such cases, local content requirement obliged them to license these patented products to the host countries producer (NEGASH) which in turn create the employment opportunity and increase the knowledge and technology diffusion to the domestic enterprises of the host country (NEGASH, p.65). Since the use of this requirement will ensure that local products are utilized in the manufacture of products made by the foreign investor and not imported from abroad (M.SORNARAJHA), it is also used for the import substitution purpose. Local content requirement is prohibited under TRIMS because it is supposed to have the trade distortive effect. Imposition of this requirement is considered as counter-productive for it affects the decision making power of the investor and this becomes worse when foreign investors could not find the products of good quality at fair price. This means if the price of the raw materials produced in the host country are of lesser quality or\and high price, it affects the export capacity of the investor and even it can affect the export capacity of the host state. The experience of some countries like Canada, Korea, Japan and Taiwan becomes a case in focus on how they have strategically used the local content requirement to increase the benefit of the FDI in their economic environment (HA- JOON CHANG, 2004). African states which are not members of WTO can use this requirement. This requirement can be used in better manner if states identify and arrange the specific nature of the local products that particular investment needs.

Local employment requirement

As it has been said so far, one of the FDI's advantages is the transfer of managerial skills and creation of employment opportunities. On the other hand, there is the reasonable fear on the side of the host states in materialization of this benefit as the investors always tend to come up with their personnel who are to be employed at different post or positions. It is this fear that initiates the host country to impose local employment requirement. Local employment requirement is not confined to the employment of the personnel of the host country; it sometimes includes the training of these personnel by the foreign investor (UNCTAD 2003, p.30). The argument against the imposition of this requirement assert that it affects the foreign investors where there is no skilled man power required for running the business and where trainings costs much. Hence, this makes the foreign investors uncompetitive in the international market. This requirement is not prohibited under TRIM, but it can be prohibited under other international investment agreements like incase of BITS or regional investment treaties. In short, African states can effectively use this requirement by producing skilled man power or increasing the quality of education to be given their nationals.

Technology Transfer requirement

Studies show that FDI is among the major means of international technology transfer beside trade (AMY & SAGGI, p.1). Foreign investors, usually the MNEs or TNCs, *are the developed world's most important source of corporate research and development (R&D) activity, and they generally possess a higher level of technology than is available in developing*

countries, so they have the potential to generate considerable technological spillovers in the host country (OECD 2002, p.12). Technology transfer requirement is the host country's regulatory policy which requires foreign investors transfer and diffusion of technology.

This requirement however is criticized for its ineffectiveness. The evidence on the effectiveness of technology transfer requirements is scarce and, where available, does not suggest much success; For instance in Japan and South Africa, the studies by UNCTAD show that the imposition of this requirement on FDI was of little importance in bringing of technology transfer and diffusion (UNCTAD 2003, p.30). Ineffectiveness of this requirement is attributed to different factors such as its dependence on the host state's absorptive capacity of the technology and the difficulties in determination of the extent and kind of desirable technology to the development (UNCTAD 2003, p.30). This means the host country should be able to have the educated man power that are ready and have the potential to absorb the new technology transferred in and then use in their local enterprises. Moreover it is difficult for the host states to control the implementation of the requirement by the investors, for the investor can transfer technology which is less desirable for the development of the former. The investor may transfer very little amount of technology, because usually the extent of technology to be transferred is not determined by the host.

Because of this reason some suggest the usage of local content, export and joint venture requirement for better transfer of technology in the host state than technology transfer requirement (NEGASH, p.70). However, there is no reason why the host state cannot impose the effective technology transfer requirement as far as they could increase their absorptive capacity and objectively identify type and extent of technology transfer they need. The absorbing capacity is increased with the increase in level of education, Even if there is lack of skilled man power what developing countries should do, to increase their absorptive capacity is, to increase the level of education of their citizens and then, limiting the extent and type of technology they want for their development to be transferred. African countries, as a developing and FDI control seekers, it is better for them to regionally integrate against capital exporting countries than competing with one other for their attraction at the expense of one another which may finally compel the TNCs to invest despite the use of technology transfer requirement and other performance requirement.

Joint venture requirement (JV)

The joint venture is a collaborative arrangement between two or more businesses to achieve a particular objective or to participate in another fresh project which may be more successfully pursued as a result of their pooling of resources or technology (SORNARAJHA). In this case the collaboration is either between government and foreign investor or between private, domestic and foreign investors. What the host country need in imposing the joint venture requirement is to limit the foreign ownership and ensure the indigenization of foreign capital. The collaboration increases the technology diffusion and the indigenization of the share helps to reduce the repatriation of the profit. This requirement is also advantageous for foreign investor since the domestic investor knows the situation of local market and other situation in the country which the foreign investor does not know. Therefore African states should use this requirement especially in areas of the technology and managerial skills they want.

These are not only the performance requirements which can be imposed by host state on foreign investment. As performance requirement are imposed for economic, political, environmental and other reasons too numerous to mention.

Some African associate the FDI as new form of colonization. This assertion may be true to some extent, so long as Africans remain divided and compete for the attractions of FDI to the extent of lifting all restrictions than cooperating and uniting the situation. This is no different from the divide and rule of the colonial system. Especially in mining industry where FDI come with little or no foreign capital and extract, exploit and degrade African minerals. For the sake of FDI attraction, some African countries lifted the minimum capital requirement. Cooperation and integration is a must. In this regard,

African Continental Free Trade Area (AFCFTA) which is signed on 21st March 2018 is a very good progress. Such progress should also include the FDI policy of states and should bring investment treaty model for regions.

CONCLUSION

FDI can play significant roles in the development process of the host country. FDI's effect on the host country is not always positive. It depends on how the host country regulates it. This shows regulation of investment is a determinant factor of FDI proper workability. Performance requirements are stipulations, imposed on investors, requiring them to meet certain specified goals with respect to their operations in the host country. It is one of the instruments of FDI regulation. The imposition of performance requirements, also known as operational requirements, in IIAs remains controversial. There are two ways of using these requirements, the mandatory and incentive based ways. Most developing states use the latter approach. Since the incentive based usage of performance requirement is a matter of choice for investors, they may lack commitments towards this requirement. Therefore, African states should use some mandatory requirements for regulation of FDI. When they use these measures states should take in to consideration first, their international commitment especially under WTO for some performance requirements have trade distortive effect and are prohibited under TRIMs. Secondly, they should also take into consideration the specific nature of these requirements in line with the nature of the FDI. States should reconsider their policies of performance requirements. Finally, African states should cooperate and at least have common investment treaty model which may avoid competition between them in FDI attraction.

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