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THESIS ON:

THE IMPLICATION OF EAC INTEGRATION ON FOREIGN DIRECT INVESTMENT (FDI) AND FDI DETERMINANTS IN KENYA

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MASTERS DEGREE

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DISCLAIMER

Submitted to the University of Nairobi -Kenya in fulfillment of the requirements of the Degree of Masters of Art in International Studies

NOVEMBER 2015

DECLARATION

This dissertation is my original work and has not been presented for any academic purposes in any institution.

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This study has been submitted to the University of Nairobi- Kenya, for Masters of Art Degree in International Studies with the approval of my Supervisor.

Mr. Gerrishon K. Ikiara: Signature.............................Date:..............

DEDICATION

This study is dedicated to my children Christine and Dennis who believe that there is no hurdle their mom can't jump.

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I would like to express my sincere appreciation to Lt. General Waweru, the Commandant NDC-Kenya, for giving me an opportunity to study in the Kenya National Defence College-Karen, though being a civilian.

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ABSTRACT

The overall goal of East African Community (EAC) integration is to improve the standard of living for it citizens through increased competitiveness, value added production, trade creation and increased investment among other initiatives. EAC has attractive investment opportunities in agro-processing, mining, manufacturing, services, tourism and energy *(EAC Industrial Policy 2012-2032).*

The year 2015 is the 15th year of the current EAC integration and it's important that member states evaluate the gains from this cooperation so as to make informed decisions on future engagements.

The purpose of this research therefore was to examine the implications of EAC integration on the performance of Foreign Direct Investments (FDI) in Kenya and ascertain what determinants influenced the decision of foreign investors to invest in Kenya. The findings would be used to improve FDI national and regional FDI policies and decisions that enhance FDI determinants.

The study confirmed that several determinants influenced investors' decision to invest in Kenya. Economic determinants especially the market size and search for raw materials had the highest impact. The market size was attributed to the provisions of the EAC Custom Union and EAC Common Market Protocols and an EAC market size of 143.5million people.

Kenya has the largest economy in the region yet it attracted the least FDI inflows in the last fifteen years but had the highest FDI outflows compared to other Partner States[1].

The study confirmed that, EAC integration facilitated FDI as to a certain extent it enhanced the FDI determinants but as reported in the World Bank Doing Business Report (2010), World Investment Report (2011) and other secondary and primary data analyzed; there are other internal factors that either encourage or discourage foreign investment in Kenya.

The research is based on both primary and secondary data. The primary data on FDI determinants in Kenya was collected by use of two different questionnaires targeting relevant government institutions and foreign investors operating in Kenya. The secondary data was collected from published books, journals, World Bank Reports, UNCTAD Reports and EAC Secretariat Publications.

[1]EAC Secretariat, EAC Trade Report, 2013, *EAC Publication, p. 77*

LIST OF ABBREVIATIONS

AGOA	African Growth Opportunities Act
AU	African Union
CBI	Cross Border Investment
CET	Common External Tariff
CMP	Common Market Protocol
COMESA	Common Market for East & Southern Africa
CU	Custom Union
EABC	East African Business Council
EAC	East African Community
EACSO	East African Common Services organization
EAHC	East African High Commission
EAMU	East African Monetary Union
EC	European Commission
ECOWAS	Economic Commission of Western African States
EPZ	Export Promotion Zones
EPC	Export Promotion Council
EU	European Union
EU-ACP	European Union- Africa Caribbean & Pacific
FDI	Foreign Direct Investment
GDP	Gross Domestic Product

ICT	Information Communication Technology
IGAD	Inter-Government Authority on Development
KENINVEST	Kenya Investment Authority
KNBS	Kenya National Bureau of Statistics
MNC	Multi- National Corporation
OAU	Organization of African Union
OLI	Ownership-location-International Theory
OPEC	Oil Producing Export Countries
RTA	Regional Trade Agreement
SADC	Southern African Development Countries
SAP	Structural Adjustment Program
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade & Development
USA	United States of America
WIR	World Investment Report
WTO	World Trade Organization

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CHAPTER ONE: BACKGROUND OF THE STUDY

1.0 Introduction

Many developed and developing countries attach a lot of importance to Foreign Direct Investment (FDI) as they believe it's one of the major factors that drive economic growth (Wang, 2009). Developing and least developed countries put a lot of emphasis to FDI as a solution to their socio-economic problems. There is a lot of expectation by less developed countries that FDI creates wealthy and employment hence resolving the poverty problem. This implies that FDI is of significant importance in the global economy and every state/region is enhancing the determinants that influence the FDI inflows. Kenya has not been left out in the search for FDI.

Kenya trades and has FDI inflows from across the globe as it enjoys good diplomatic relationship with almost all the countries of the world[2]. It has signed several bilateral trade agreements with European countries, Egypt, China, Pakistan, Bangladesh, India, Brazil, USA, Japan, South Korea, and Russia among others[3]. It has been trading with other East African countries long before European invasion and it continued during the colonial days.

Globalization on the other hand has caused the countries of the world to be interdependent. To survive in an anarchic environment, countries are on the lookout for partnership or cooperation for mutual benefit, either by forming

[2] Ministry of Foreign Affairs, Kenya, *Kenya Foreign Policy*
[3] Ibid

economic integration blocks or through bilateral agreements. Countries aim at widening and deepening co-operation in socio-political, security and economic integration to fast track the development and also to collectively face the challenges of the globalization[4].

Research has shown that no country can increase the well being of it citizens without being part of the global economy[5]. The growth of regional trade and investment are major development in the international relations. Countries belong to one or multiple blocks (Schiff & Winters, 2003) to maximize their relative gains. Africa alone host several regional groups such as African Union (AU), Common Market for East and Southern Africa (COMESA), Economic Commission of Western African States (ECOWAS), South African Development Commission (SADC) and East African Community (EAC) among others.

Within Africa, Kenya is a member of AU, COMESA, Inter-Government Association Development (IGAD) and EAC and at the global level Kenya is a member of; European Union- Africa Caribbean Pacific Group (EU-ACP), World Trade Organization (WTO), African Growth Opportunity Act (AGOA), a signatory to United Nations (UN) and Commonwealth among others.

The question which lingers, in the minds of many is *whether these arrangements create or divert trade and how they impact on the foreign direct investment (FDI)? Do they really improve the welfare of the member states and*

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[4]Mangachi M.W. *Regional Integration in Africa, East African Experience* , Chief Joop Berkhout Publishers; 2011), p150

[5] Mwangi K. , Discussion paper on*: "Expectation of East African Integration",* presented at an EAC seminar in Arusha 2001

how fairly are the benefits shared? Another major concern is whether lowering the trade barriers among the member states, leads to a healthy competition. The expectations are that states operating in a custom union arrangement through comparative advantage principle and specialization are able to produce and enjoy benefits of economies of scale, spur productive efficiency leading to a low unit cost of production, increase quality and quantity goods (Dollar, 1992). It's also expected that such arrangement attracts foreign investors to take advantage of the larger market, reduced taxes and reduced trade barriers.

Although some of the integration agreements were formed on the basis of trying to create political stability within the geographical area, it's evident that the major goal is economic returns. The member states expect to benefit economically as regional integration stimulates intra-regional trade and investments. Regional Trade Agreements (RTA) creates and expands opportunities for export and employment growth. This cooperation in the long run is expected to boost socio-economic development of the member states.

This uncertainty as to whether RTA creates trade or diverts trade and FDI, that leads to economic growth and improved welfare of the citizens is the basis of this study, with specific reference to EAC and Kenya as the target country.

In 1999, a new East African Treaty was signed and that gave birth to the current East African Community whose original members were Uganda, Tanzania and Kenya. This treaty came to force on 7th July 2000 with Rwanda and Burundi acceding to it on 18th June 2007 and admitted as full members on 1st July 2007.

EAC targets to boost the Partners States economic growth through promotion of trade, investments and industrial development[6] by exploiting it vast resources. EAC has competitive and attractive investment opportunities such as in agro-processing, mining, manufacturing, services, tourism, and energy[7]. This study evaluated whether Kenya had gained in terms of FDI, taking advantage of the abundance investment opportunities in EAC.

1.1 Statement of the research problem

Global statistics show there has been an increase in the FDI flows to developing countries[8] though the value varies from country to country. Several researches have been conducted on FDI flows into Kenya or into East Africa. Most studies were on relationship between FDI and economic growth or just studying the factors that drive FDI. Such studies include: a paper on "*Foreign Direct Investment and Economic Growth: An Empirical Analysis of Kenya data",* (Daniel Abala, 2014), which concluded that the major drivers of FDI were the market size, political stability, openness of the economy and infrastructural. A KIPPRA Discussion Paper No.153, 2013, on the *"Effect of regional Integration on Net inward FDI flow in East Africa countries"* (Manasseh Otieno, 2013), made a conclusion that FDI flows greatly depended on the degree of political risk and financial stability. Such differing opinions on the determinants of FDI flows in

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[6] EAC Secretariat, The Treaty for the establishment of EAC, Article 79, *EAC Publication, revised version 2007*, p. 58
[7] EAC Secretariat , EAC Industrial Development Policy & Strategy 2013-2032
[8] UNCTAD Secretariat, World Investment Report 2011, UN-New York 2011, pp.40-42.

Kenya and EAC, created anxiety and need to conduct further research on what are the major drivers of FDI in Kenya?

Another study commissioned by the EAC secretariat on the *"impact of the EAC Custom Union on the existing EPZ firms*", (Vincent Leyaro, 2013), concluded that EAC Custom Union impacted negatively on the EPZ firms leading to the closure of 16 firms. This revelation that investors withdrew their investment from Kenya, after the ratification of EAC Custom Union, created interest to further investigate the actual implication of EAC Integration on the FDI flows in Kenya.

EAC integration initiatives are expected to facilitate market enlargement which in turn would enhance trade creation and creation of a favorable investment climate for both local and foreign investors. Kenya policy makers require facts on implications of these regional integration initiatives on the performance of FDI flows to formulate appropriate FDI policies.

Previous studies as highlighted in the 2nd paragraph have differing opinions on the major factors driving FDI in Kenya and none explicitly dwells on how the regional integration has enhanced the FDI determinants. This gap is what this study has attempted to bridge. The questions for investigation therefore were: *What are the determinants of the FDI inflows in Kenya?* and *"Has EAC integration enhanced FDI determinants in Kenya?"*

1.2 Objectives of the research

1. *To examine and establish the trend of Kenya FDI flows* for the period after the coming into force of the current EAC Treaty in 2000 and

after the signing of Custom Union Protocol in 2005 and ratification of the Common Market Protocol in 2010.

The two protocols provide for the reduction of tariffs, removal of internal taxes and promote free movement of capital and goods. The objective being to establish the impact of the EAC integration initiatives on FDI flows in Kenya.

2. *To analyze the determinants of FDI flows in Kenya.*

This confirms whether Kenya has gained in terms of FDI by being a member of EAC, which provides a large market for the investors. This will answer the question whether the large EAC market attracts FDI? The findings will inform Kenya policy makers what determinants needs to be enhanced to make Kenya more attractive to foreign investors.

1.3 Hypothesis

EAC integration has enhanced the Foreign Direct Investment determinants leading to increased FDI inflows in EAC Partner States.

1.4 Justification of the study

The year 2015 is the 15th year of the current EAC integration; it's time Kenya evaluated the implication of EAC integration on the performance of its FDI to give the policy makers facts on which to base the future policies on engagement with the EAC Partner States. This research established the implication of EAC integration on the performance of FDI in Kenya and what determinants influenced the foreign investors' decision.

It’s the assumption of most citizens in East Africa that the gains of integration are enormous, but they are still others especially investors in the EPZ who lost their market access to the EAC Partner States after the establishment of a EAC single custom territory who hold a contrary opinion. Others feel investor’s choice on where to locate their investment is influenced by other factors other than the market size. Their argument that Kenya is a regional hub and has reliable infrastructural connectivity with the rest of the world and an investor does not need to relocate his firm to EAC access the EAC market.

It’s also evidence that very few reports have detailed data on FDI flows in EAC. Even the World Investment Reports give a combined figure for sub-Sahara Africa, EAC included. This can only imply that there is a challenge in collecting reliable EAC FDI data. Kenya National Bureau of Statistics (KNBS) in collaboration with the Central Bank of Kenya and KENINEST, made an attempt to consolidate FDI statistics in Kenya and published Foreign Investment Survey 2010, published in December 2011. The document does consider the regional aspect of the FDI.

During the collection of the primary data, officers from KNBS and KENINEST confirmed that they are in the process of analyzing the just collected data on FDI to update the FDI Survey of 2010. Again data collected does not considered the region FDI trends or the effect of EAC integration on the FDI flows. The EAC Trade Reports have a chapter on investment yearly trends but does not attempt to analyze what factors have caused the investment. There is therefore a major information gap on FDI flows in Kenya and the region.

The region also lacks an EAC Region Investment Policy Framework to guide on the region investment agenda. The situation is worsened by the fact Kenya does not have a National Investment Policy, but instead issues of investment are anchored in various sector policy documents. This has created a major knowledge gap on the actual data on FDI flows in Kenya.

This uncertainty on whether EAC integration enhances FDI determinants and inadequate data/information on FDI flows due to lack of one coordinated National Investment Policy is a major reason for conducting this research.

1.5 Literature Review

This part of study examines some case studies conducted on the relationship between FDI and regional integration. The selected case study is of the FDI flows into Europe after the 2nd World War. The European Community has been considered as the most successful model of regional cooperation that other regions have tried to emulate. This will provide first hand understanding of whether the formation of the European Community had influence on the FDI flows to its member states.

This section in addition examines theories relevant to regional integration and Foreign Direct Investments (FDI). It also examines the relationship between the two concepts and how they explain the FDI flows and where they have been applied. The literature review highlights what FDI theories have been published and what could apply for this study.

In addition, the section reviews what scholars and UNCTAD have enumerated as the determinants of FDI flows. This provides information on what they considered as the major determinants of FDI to a regional economic block, such as EAC.

1.5.1 FDI and Regional Integration Concepts and Theories

The concepts and theories provide knowledge on what scholars explained as the relationship between FDI and regional integration. They include:

- **Concepts**

Foreign Direct Investment (FDI) Concept

FDI is defined as measure of foreign ownership of productive assets that includes factories, land and mines among others. FDI can be used as a measure of growing economic globalization. Most of the FDI flows are between the industrialized countries of America, North West Europe, China and Japan though flow to less developed countries is on the increase.

Developing countries view FDI as a means to leapfrog into more sophisticated areas of production, yet there is an argument that Transnational Companies (TNC) investing abroad allows only specific slices of their technology in their affiliate and utilizes the cheap labor abroad aiming at low cost production (Baldwin, 2011:21). Some TNC applies the strategy of *"technology lending"* ensures minimum transfer of technology and knowhow to host countries. The assumption therefore that FDI facilitates skills and technology transfer remains uncertain. Another major expectations from FDI inflows, is the creation of employment and income in the host country. Research shows this is not automatic but it's limited to the conditions and policies of the host country[9].

FDI are associated with the rapidly growing of developing countries such as China, which attracts large-scale FDI in the context of regional networks since early 1990. China strategy to host foreign enterprise was aimed at accelerating industrialization, employment creation and technology upgrading. China today is an economic giant whose presence is felt all over the world (*TDR 2006*: 186–189). The proponents of FDI argue foreign investment as neocolonialism in economic form and TNC as being exploitative.

FDI acquired prominence after the Second World War and has remained important both at national and international level. Several researches have been conducted on the motivations underlying FDI, with the main ones being developed by J. Dunning, S. Hymer and R. Vernon. FDI are important element of economic development of all countries[10] and contribute toward long term economic growth. It is especially important for its potential to transfer knowledge and technology, create jobs, boost overall productivity, enhance competitiveness and entrepreneurship, and ultimately eradicate poverty through economic growth and development. According to Caves (1996), countries improve their investment climate in an effort to attract FDI as FDI has potential to boost economic growth.

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[9]UNCTAD Secretariat, Trade & Development Report, UN 2012, pp.88-90.

[10]Denisia V, "FDI theories, "*An overview of the main FDI Theories*," European Journal of Interdisciplinary Studies, p.53.

Though its assumed that third world countries yearn for FDI to trigger economic growth, the opposite was witnessed during the 4th Ministerial Conference of the World Trade Organization (WTO) held in Doha in November 2001 where the Ministers of Trade of the African Union, least Developed Countries (LDC) and African Caribbean and Pacific (ACP) developing countries fought hard against *paragraph 20* of the Ministerial Declaration which sought to initiate negotiations on a multilateral framework for investment which meant formation of a free investment regime. This simply means there is possibility that FDI have negative impacts and states have to be conscious when admitting FDI into their territory.

Regional Integration concept

The contemporary world is faced with numerous challenges brought about by globalization. These challenges include among others economic, political, societal, security and environment. This has resulted into international regimes such as, international trade regime, environment regime, global politics and human rights regime that have automatically come in to coordinate and regulate international system through rules, norms and procedures.

With this realization, states have become interdependent and have joined to form integration blocks to increase their bargaining power[11] in the international arena or to solve a regional problem or for economic gain. Integration therefore could be referred to as a joint political process of policy

[11]Goldstein A & Njuguna N, *Regional Integration Experience in Eastern African Region*, Working Paper No. 171, OECD Development Centre, 2001, p7.

coordination that facilitates interdependence and management of external effects[12].

Integration is a multi-dimensional and leads to an integrated community with a sense of common identity. Most of the regional integrations are formed for collective benefits though in-depth analysis will show each country is interested in relative benefits or achievement of its national interests rather than mutual gains. Integration provides a country with the opportunity to achieve its goals through a negotiated position.

According to Ngeno, Nyangito and others[13], integration improves the welfare of the citizens of the member states through increased incomes as it's expected to result into trade creation and minimum trade diversion or trade created should exceed trade diversion[14] and improve investment climate of member states.

The broad objective of EAC is to develop policies and programs aimed at widening and deepening cooperation among the Partner States in economic, research and technology, political, security, legal and judicial affairs for the mutual benefits of all the East African citizens.

EAC Partner States established a Custom Union which came to force in 2007, a Common Market in 2010 followed by a Monetary Union which was signed in 2013 and has since been ratified by all the Partner States. It is to be noted that the implementation of the Custom Union has been characterized by further

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[12]Haggard S *Developing Nations and the Politics of Global integration,* Bookings Institution, 1995, Washington DC. p2.

[13]Nyangito, Ikiara & Others, *Regional integration Study of EA*: The case of Kenya*,* KIPPRA, 2003. p7.

[14] Ibid

harmonization of the customs and trade related instruments. The Common External Tariff (CET) has been reviewed to cater for imports to the region, making it more favorable to produce within East Africa and sell in the regional market under the certificate of "Rules of Origin" and zero internal tariffs. Foreign investors could find it suitable/profitable to produce in East Africa than export to the region to avoid paying import duties. A Custom Management Act (2004) is in place to guide the application of the tariffs.

The harmonization of the quality standards of goods within the region is ongoing. So far harmonization of standards for a total of 1200 products has been achieved.[15] The operationalization of the Custom Union and Common Market protocols has enabled the free movements of goods, services, capital, labour and persons, right of established and right of residence within the community has boosted trade and investment with the region.

- **Theories**

Theory of Economic Integration

Economic integration is one strategy that Africa and other regions have used to resolve global challenges and to achieve economic growth and development. Economic Integration according to neo-classical theory means expanding economic opportunities through economies of scale and specialization based on comparative advantage[16]. The theories purports that custom union is beneficial if there is trade creation otherwise it's harmful. Under economic

[15] EAC Secretariat, EAC Trade Report 2010, pp.1-2.

[16] Martin G, Regional Integration in W.Africa: *Role of ECOWAS*, in Hansen E., Africa; *perspective on the Peace & Development*, Regional Integration in W.Africa, Zed brooks ltd, 1987, pp172-173

integration, it's assumed that, countries take advantage of production under economies of scale as they produce for the regional markets. The theory visualizes economic integration as a gradual process that has several stages, progressing from the freeing of barriers to trade to achieve trade integration. It also ensures liberalization of movement of the factors of production. Progressively, members of the economic integration block harmonize the national economic policies or what is referred to as policy integration and finally total integration.

Opponents of the theory argue the theory cannot support quest for economic integration in Africa. They argue a Custom Union in the third world countries cause trade diversion rather than trade creation. They support their argument that a Custom Union force member states to shift their demand from low cost imports from developed countries to consume more expensive goods from high-cost producers in other member states.

Proponents of the theoretical approach argue states intending to form integration should be more concerned with the dynamics of economic growth. It's therefore imperative that countries should use the large markets created under economic integration as a favorable determinant to attract Foreign Direct Investment.

With the above in mind it's important that states in an economic integration should monitor and evaluate the gains of the integration. This study examines Kenya benefits from EAC integration in terms of FDI flows.

Theories of Foreign Direct Investment

Developing countries regard FDI as an important factor in causing economic development as it facilitates high productivity, employment generation, competitiveness and technology transfer. FDI enhances higher exports, access to international markets and foreign currency. Though this assumption is there, and several empirical studies carried to confirm the same; no theory can be said to have comprehensively explained this relationship[17]. Even David Ricardo theory of comparative advantage which is based on two countries, two products and perfect mobility of factors of production, has not successfully explained FDI flows. Scholars have classified FDI theories into the following four distinct categories;

Exchange Rates and Foreign Direct Investment

FDI provides TNC with control over foreign affiliate companies. This implies a lot funds is in circulation around the world and in 2005 FDI inflows in the world totaled to US$ 916 billion with more than half in developing countries[18]. One theory that can explain FDI flow is Exchange rate and FDI theory. *Exchange rates are defined as domestic price of the foreign currency that is; in terms of their levels and volatility*. Exchange rates to a certain degree determine the amount of FDI and the location of investment. The theory argues that a currency depreciates when its value declines relative to the value of another currency. The movement has implications on FDI as it reduces the production

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[17]Denisia V, FDI Theories: *An Overview of the Main FDI Theories,* European Journal of interdisciplinary studies, 2010.

[18]Linda S, *Exchange rates & FDI*, Princeton University –New York Press.

costs relative to the foreign counterparts, meaning the country experiences currency depreciation, becomes attractive for investment as it also improves the rate of return to investment for the foreign company.

The relation between trade and FDI can be used to explain the FDI flows. Its theorized that tariffs and non tariff barriers to trade triggers FDI as firms try to circumvent these barriers to export its products and sustain it share of its world trade. The option available for the firm to maintain its export is to invest abroad where the tariffs are less restrictive and cost of production comparatively low[19].

The Internalization Theory[20]

The theory was developed by Buckley and Casson in 1976 though first launched by Coase in 1937. Further development of the theory was by Hennart (1982) and benefits from addition works by Casson (1983). The theory explains the growth of TNC and their motivations. It demonstrates that TNC organizes their internal activities to achieve specific advantage and exploit them to enhance its competitiveness. According to Hymer (1976), the author of concept of firm-specific advantage, FDI will occur only when benefits of exploiting firm-specific advantage supersede the relative cost of investing abroad. In summary, he implies that FDI occur in imperfect markets and it's simply a firm level strategy decision rather than a capital- market financial decision.

Production Cycle Theory of Vernon

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19 Ibid.

20 Denisia V, "FDI Theories: *An Overview of the Main FDI Theories*," European Journal of interdisciplinary studies, 2010.

The theory developed by Vernon in 1966 was used to explain US FDI in the manufacturing sector in Western Europe after the Second World War. According to Vernon, the cycle has four stages; innovation, growth, maturity and decline. Simply the theory explains that after innovation, the firm experiences growth and seeks to satisfy local and export market. In the export, the product is copied or duplicated and later its demand is overtaken by new technology.

The US foreign direct investment in Europe after the 2nd World War could serve as a good example. In the first stage of the production cycle, the America TNC had advantage of technology on its European competitors. After stabilizing their production, other European companies replicated the American technology and with advanced technology their production became more efficient than the American TNC. The end effect was American control over production in Europe declined.

The Eclectic paradigm of Dunning

The eclectic theory also referred to as OLI paradigm, was developed by Professor Dunning and it's a mix of three different theories of FDI. He borrows partly from macroeconomic theory and trade, microeconomic theory and firm behavior. OLI simply means O-ownership advantage, L- localized advantage and I-internalization advantage. The tenets of the theory include: firm own specific capital advantage that is human capital, technology, patents, reputation among others that companies use to be competitive. Localized advantage means a firm has an added advantage if it locates it production next to its market, taking advantage of cheap inputs, trade barriers and saving transport costs. Internationalization advantage, a firm uses its internal capabilities to maintain its competitiveness in the market.

1.5.2 Determinants of FDI

FDI inflows are usually influenced by several factors which defer from country to country hence the disparity in the distribution of FDI. According Ann Wei (2004) the determinants of FDI are categorized into three groups, those related to objectives of the prospective investor, FDI policy framework for the host countries and the economic and business environment in the host countries.

The objective of the prospective investors includes the desire to exploit or take advantage of the expanded markets which are signified by size and growth rate of the host economies, availability of natural resources, agricultural raw materials and cheap labor. As for the policy frameworks, stable and transparent policies towards foreign firms or specifically applying open trade policies and treating domestic market oriented firms and export oriented firms equally is preferred rather than one that favors one through subsidies and tariffs creating unfair competition. The national treatment of investors is important to foreign investors.

Economic and business environment refers to a free market economy with no artificial incentives.[21].In addition investors seek for political and macroeconomic stability in host countries. The later does not hold a lot of water as FDI continues to flow into politically unstable countries such as

[21]Ann Wei Y & Balasubramanyam, Foreign Direct Investment, *six case Studies*, New Horizons in International Business, 2004.

Namibia, Nigeria, Democratic Republic of Congo (DRC) and Angola among others. Anna Wei (2004) argues investors are more interested in stable policies rather than unstable political regimes.

FDI inflow[22] to African dropped from US$ 60.2billions (2009) to US$ 55.0billions (2010), with EAC getting the least that is US $3.7billions while other regions received; North Africa US$ 16.9billions, West Africa US$ 12.7billions, South Africa US$ 20.0billions and Central Africa US$8.0billions. This can only mean that the investment climate of EAC is not as attractive as other regions. The regional policy makers have to understand the determinants of FDI and re-strategize and make the regional more attractive.

So, what are the determinants of FDI in Africa? According to Ngowi (2001), it difficult to determine the exact quality and quantity of FDI determinants necessary to attract a given level of FDI inflow but there is a critical minimum determinant that must be present for the FDI to Flow. These determinants range from size of market, quality of labor, infrastructure, institutions and availability of resources. The size of market is a major determinant as it allows the exploitation of economies of scale. Firms invest where there is a large population as it provides market. EAC combined population of 143.5million people (2014), provides a large market.

A low cost labor force is another preferred determinant, though investors are moving towards technologically intensive activities and qualified human capital (Pigato, 2001). Good infrastructure is also crucial in attracting FDI as it

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[22]UNCTAD Secretariat, World Investment Report 2011, UN-New York, 2011, pp.40-42.

increases the productivity of the investment and stimulates FDI flow as cost of production is reduced. The infrastructure is not limited to roads but includes communication services, financial services and energy (Alfaro, 2001).

The following paragraph examines in detail the major determinants of FDI identified by scholars in earlier studies conducted on FDI and explained as the major host country FDI determinants[23]. These are the same determinants that were used to test their applicability to FDI flows to Kenya.

Economic Determinants

The economic determinants of FDI inflows can be clustered into three categories where each category reflect what motives a foreign investor to invest in a foreign country. The categories include: market seeking, resource seeking and efficiency seeking. In this era of globalization, liberalization and dynamism of the FDI regulations, the impact of these determinants on FDI have changed with time.

The traditional economic determinants include natural resources, national markets and unskilled labor. In the 19th century, natural resource was one of the important host country determinants of FDI. Natural resources formed 60% of the world stock of FDI even before the Second World War with US, Japan and Europe moving to less developed countries in search of raw material and minerals for their industries[24]. This scenario has changed with time and by 1990 the sector share of the total outflows had declined to only 9% in Japan, UK, US and Germany. This phenomenon does not change the importance of

[23]UNCTAD Secretariat, World Investment Report, 2003, p.85.
[24]Dunning, 1993, p.57.

natural resource in attracting FDI, as major foreign investments in developing and less developed countries especially in sub-Sahara Africa, is the extraction and processing of the natural resources.

Access to national market is another traditional determinant of FDI. A Transnational Company opens an affiliate firm if it's satisfied that it will access new market both locally and abroad or increase its market share. It considers the market size and the income of the population or the purchasing power parity and market growth. Market factor drove the US investment in Europe during the post war period. Japan investments in the automobile industry in US in the mid 1980 was influenced by the access to US market (Dunning, 1998). Market is a major determinant when investing in service industry that requires physical presence. Trade in services has not grown due to restrictive FDI frameworks both in developing and developed countries.

Low-cost unskilled labor was an influential determinant in labor intensive enterprises, but today most countries have in place labor laws that don't allow exploitation of the labor force by setting minimum wages. Important also are relevant institutions, to facilitate enforcement of laws, integrity and existence of incentives.

Some host countries put in places policies that target foreign direct investment, providing tax incentives and creating Export Processing Zones (EPZ). Mauritius and Seychelles have benefited from such arrangements. EPZ firms in EAC will benefit from such an initiative when the EPZ incentives and exemptions are harmonized and laws and regulations put in place to guide the operationalization of EAC Special Economic Zones (SEZ). Today the EAC Custom Union provides for only EPZ and Free-ports. Such arrangement reduces the cost of doing business for the investors.

The presence of natural resources such as minerals, oil and other natural resources attracts 60% of FDI in Africa (UNCTAD, 1999). Namibia, Angola, Nigeria and Botswana attract large FDI because of their mineral potential. The recent increase of FDI in EAC is associated with mineral exploration and exploitation. An empirical study (Asedu,2003), on the factors affecting the flow of FDI in Africa, showed that FDI flows are mainly driven by availability of natural resources, large markets, good infrastructure and efficient legal frame work.

Macro economic instability, corruption, political instability and investments restrictions deter investment flows. This implies government could increase their FDI by streamlining their investment regulation frameworks, implementing policies that promote macroeconomic stability, infrastructure development and instilling integrity in the institutions. EAC should promote FDI that do not rely on the natural resource and those that targets regional and global markets. EAC has a high potential of developing the relevant determinants to maximize the FDI inflows into the region.

Some of these determinant especially availability of natural resources, cheap labour and market among other factors that could attract FDI into Africa; yet Africa registers low FDI. UNCTAD Report ((1999), suggests it could be the negative perception investors have on Africa that deter FDI flows into Africa.

Africa is associated with high instability and a continent riddled with disease and high levels of poverty. The report notes this scenario varies from country to country, explaining why some countries are doing well in attracting FDI while others barely receive any FDI.

FDI policy as an FDI determinant

As early as mid 1980, liberalization of FDI frameworks has been the dominant type of FDI policy used to create favorable conditions for FDI. The core of FDI policies include among others rules and regulations governing the entry and operations of foreign investors and the standard treatment accorded to them and the functioning of the market they operate in (UNCTAD 1996). FDI policy is an important determinant as no foreign investment can legally establish in a country unless it entry is allowed. Open policies are intended to attract FDI, though it's not absolute that the offer will yield positive returns. On the other hand restrictive policies such as nationalization can effectively block and keep foreign investors away.

For FDI policies to achieve intended purposes, other supplementary policies are put in place to influence the investors' decisions. Such supplementary policies include trade policy. Latin American countries are known to mix protectionist trade policies with policies allowing FDI in manufacturing as a way of attracting FDI. China and Hong Kong pursued laissez fair trade and FDI policies to encourage transnational companies to participate in the country's export-oriented economies. Japan, Taiwan and the Republic of Korea pursued broader industrial policies which selectively guided induced links between TNC and local firms to increase innovation and export capacities (UNCTAD, 1995).

Other supplementary policies related to FDI include privatization policies and policies determined by the international agreements a country has signed. Privatization policy broadens the scope of FDI if it welcomes the foreign investor to acquire state enterprises. It can also facilitate monopoly if the company acquired from the state had a near-natural monopoly (UNCTAD 1997). Existing international investment agreements provide an international dimension to national FDI polices. If the agreements are favorable then national policies will favor and facilitate FDI inflows. China is a good example where FDI liberalization as determinant has successfully influenced the performance of FDI, where FDI inflow rose from US $ 3bilion in 1985 to US$ 169 billion in 1997 (UNCTAD 1997). One province, Guangdong Province, which led in the liberalization policy in China had it FDI in the industrial sector grow from 8% (1990) to 33% (1993) (Lipsey, Blomstrom and Ramstetter, 1998).

FDI policies have not had a big impact in Africa though most of the African countries have open policies and are desperate for FDI. The FDI inflow to the continent remains very low.

The above argument confirms that policy liberalization is not sufficient to determine the performance of FDI though it's acceptable that liberal FDI policies complimented by liberal trade policies and other supplementary policies have contributed to a cohesive policy framework[25].

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[25]UNCTAD Secretariat, World Investment Report, *Trends & Determinants,* UN 1998, pp91-96.

Business facilitation as a Determinant

Countries have realized that natural resources and liberalization of FDI policies is not sufficient to attract FDI. Countries have therefore gone an extra mile to endear their locations by putting in place measures to improve the business climate or what is referred to as *business facilitation.* These efforts include reducing barriers for inward FDI, improving the standard of treatment of foreign investors and assuring them of a function market and overall facilitating a level playing ground for all investors.

Most countries have established Investment Promotion Agencies to market the country investment opportunities to potential investors. UNCTAD conducted a survey in mid 1990 which confirmed that eighty one (81) investments Promotion Agencies (IPA) had in place systems of identifying potential investors. An earlier study conducted in 1980 showed that IPA in both developed and developing countries, were concentrating on investment generation and not just image-building (Wells and Winter, 1990, p15).

Competition for FDI has led countries providing after-investment services as part of investment facilitation services. This is to endear investors to reinvest their investment returns which form a significant part of FDI. It also ensures investors are satisfied with the investment climate, which has also capacity to attractive to potential investors (Young and Hood, 1994, p54).

Political Stability

Political stability though not highlighted as determinant in most past studies and was not one of the factors identified in the World Investment Report (2003), is a major factor that affects the flow of FDI. Africa experiences low FDI inflow as it is characterized by political and macroeconomic uncertainty (Sachs and Sievers, 1998). The post election crisis (2007/8) in Kenya is one applicable phenomenon, where the economic growth rate went down and foreign investors considered the investment environment hostile and left the country, accounting for low FDI in Kenya during that period.

Unstable prices, currency instability, illegal currency markets and inflation due to civil unrests in Africa have adverse effects on the investment climate[26]. Other variables that explain low FDI especially in developing countries include corruption and judicial framework.

It can be summarized that the increase in FDI in the EAC is driven by the new resources recently discovered in the region, such oil in Kenya and Uganda and gas in Tanzania. The amount FDI in Tanzania alone just for the gas project is estimated to be US$ 1billion from China (EIU, 2011). Resource driven FDI could explain where DRC Congo receives high FDI flows though it's insecure and politically unstable.

1.5.3 FDI flows: Case study of the European Union

The paragraph examines some case studies conducted on the FDI flows in Europe to show the relationship between FDI and regional integration.

[26]Ajayi S, FDI in Sub-Sahara Africa, O*rigins, Targets, impact & Potential,* African Economic Research Consortium, 2006, pp.15-23.

According to Blomstrom and Kokko, in their working paper on regional integration & FDI (1997), referring to works of Yannopoulos (1990),[27] examined the extent to which the European Integration process influenced the investment decision of the US firms. The scholars confirmed that the formation of the European Community (EC), lead to increased investment activities in the community taking advantage of the EC common market. The upsurge of Japan's investment in the EC in 1992 (Thomsen and Nicoladies, 1991) was in response to the opportunities created by EC integration process.

Another research by Winters (1996), argues that its not obvious that integration boosts foreign direct investment in all member countries. A comparative study analyzing FDI flows to Spain, Portugal and Greece, all members of EC, showed, Portugal and Spain enjoyed high FDI flows while Greece did not, largely because Greece macroeconomic policies were not favorable to foreign investors.

This scenario portrays that enlarged market such as EU and EAC achieved through integration is not an adequate factor to attract FDI but an extent supports a conducive environment for attracting foreign investment.

1.6 Conceptual Framework

Due to the increasing importance of FDI, several studies have been conducted on the internalization process and corporate decisions to invest beyond the national borders. To this subject matter, most of the research has been based

[27]Blomstrom & Kokkoo, Regional Integration & FDI, *Working Paper Series in Economic & Finance* No.172, Stockholm School of Economics,1997, p.10

on the work of Stephen Hymer (Dunning 2003). Hymer in his doctorial dissertation (1960, published 1976), argued that indigenous companies have advantage over foreign corporations in the domestic market as they have a better knowledge of the local environment. In this regard, foreign companies must possess specific propriety and ownership qualities that compensate these disadvantages. Hymer concept of ownership advantage was further developed by Dunning (1977, 1980, and 2002). Dunning introduced a comprehensive framework built on specific advantage hypothesis with the aim of to explaining why companies become international. The framework developed by Dunning and referred to as Ownership-Location-International (OLI) or Eclectic paradigm, provides an understanding of the main economic mechanism behind the Multi-National Enterprises (MNEs) and clarifies the emergence of FDI. The OLI paradigm suggests that successful FDI are determined by the presence of three cumulative conditions, that is ownership advantages, localization advantage and internalization advantage.

Ownership advantage refers to those characteristics of a company that enables it to be competitive such as superior technology skills and patents. Localization advantage relates to institutional and production advantages associated with specific geographic environment[28] while internationalization refers to the ability to coordinate activities involving international transfer of tangible and intangible assets inside the organization.

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[28]Mattila L, Location-specific Determinants of Foreign Direct Investment: *Study of U.S. Direct Investment in Sweden*, Working Report, Swedish Institute for Growth Policy Studies,2005, pp.13-14

Literature review available confirms that there is no one theory that can explain the FDI flows and the nearest conceptual framework that have been used to explain FDI is the OLI paradigm, proposed by Dunning (1977)[29]. This study applied the OLI paradigm the location determinant as was the most applicable in a regional integration.

The OLI paradigm explains the conditions under which FDI occur. This paradigm was used to examine the performance of FDI in Kenya. It was applied to confirm what determinants influenced the decisions of foreign investors in Kenya. It was also be used to examine whether EAC integration contributed to making Kenya a favorable destination for FDI.

It's important to note that the ownership and internalization are firm specific determinants and host governments can only influence the localization determinant (UNCTAD, 1998). This study adopted the location-specific determinants model in the World Investment Report (WIR)[30] as the determinants are under control of the host country, in this case Kenya and by extension the EAC integration.

According to the World Investment Report (1998), location-specific determinants of FDI are categorized into:

i. Policy framework for FDI;

ii. Economic Determinants; and

iii. Business facilitation.

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[29] Ibid

[30] UNCTAD Secretariat, World Investment Report, *Trends and Determinants*, UNCTAD 1998, p.165.

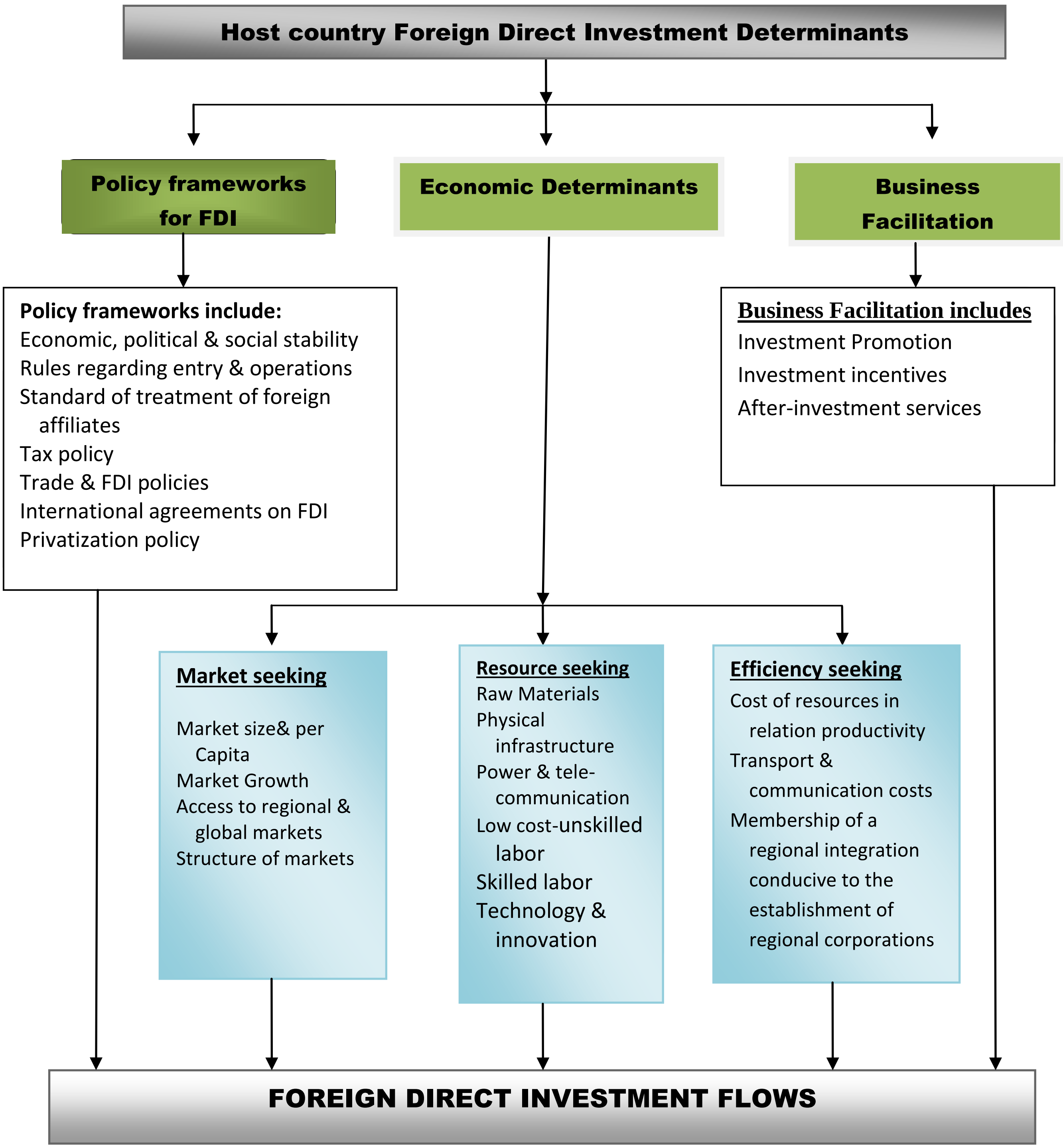
Policy framework refers to the national rules and regulations that govern the operations and market entry of foreign investors while economic determinants refer to what an investor will be seeking abroad. These include; market, resource and efficiency. Business facilitation on the other hand are promotion policies that aim at facilitating the business for the foreign investor by providing a level playing ground between the local and foreign investors.

Point to note is that these determinants apply to a particular country at a given time as their impact and influence on foreign investors change over time.

Below is location-specific model adopted from UNCTAD World Investment Report (1998)[31] and improved to suit the conceptual framework for this study, (See Figure 2, below).

[31] Ibid, p.166.

Figure: No.1: FDI CONCEPTUAL FRAMEWORK



Source: Adopted from World Investment Report 1998

1.7 Research Methodology

To achieve the objectives of this study several methods were used to collect, analysis and to correlate the information gathered so as make a conclusion on the findings. Onset, secondary data was examined through literature review of existing information. This brought out a better understanding of the relevant concepts such as Foreign Direct Investment, regional integration, existing FDI theories among other concepts. Secondary data also provided additional information on what already exists on the subject matter. Secondary data was collected from published material on FDI statistics at global level, EAC and Kenya. These publications included international reports such as World Investment Reports (WIR) by UNCTAD, World Bank Annual Reports and World Doing Business Reports; East African Community Secretariat publications and EAC Council reports; Kenya National Bureau of Statistics publications; reports from Kenya Investment Authority; Export Promotion Zones (EPZ); Export Promotion Council (EPC) and Central Bank of Kenya. Secondary data was correlated with primary data to establish the facts.

Secondary information was sought on Kenya FDI determinants and the same was correlated with information collected through primary data to ensure conformity and to enable the making of a generalized conclusion.

Primary data/information was collected through survey method. Questionnaires were used as data collection tools for gathering primary data. Two different questionnaires were administered to two different groups of respondents. The key informants were selected as respondents and direct interviews conducted through one on one interview. Questionnaires were mailed to the respondents who were not available for direct interviews. Follow up interviews were conducted through telephone conversion and probing method applied to capture information that was not clear during the interviews.

The first questionnaire targeted respondents who were foreign investors in Kenya. The aim of the questionnaire was to establish which determinants influenced the investors' decision to choose Kenya as their investment destination. The findings were a precursor to policy makers on what determinant to enhance to attract more FDI. This questionnaire also captured information on when the investor established his business in Kenya. The date enabled the interviewer to probe further whether the investors' decision was influenced by the fact that Kenya is member of EAC which provides for an opportunity to trade at zero duty in the larger EAC market. It also established whether the investor was planning to withdraw his investment from Kenya. This confirmed whether the determinant that influenced investor's decision was applicable or something else was impacting on the investor's decision. The questionnaire gave the foreign investor a chance to suggest what according to him needed to be done by the government which was responsible for location-specific determinants to improve Kenya's investment climate.

The second questionnaire targeted respondents who were policy makers and policy implementers. These included officials from government institutions such as: Kenya Investment Authority, Export Processing Zones (EPZ), Kenya

National Bureau of Statistics (KNBS); Export Promotion Council (EPC), Central Bank of Kenya, Ministry of Industrialization & Enterprise Development and Ministry of East African Affairs Commerce & Tourism. The questionnaire was be used to collect statistics of FDI flows in Kenya to correlate those generated through secondary data.

The government institutions also provided information on: the most prominent FDI determinant in Kenya; what plans the government had to make the country more attractive for foreign investment and what it had in place to ensure the existing investors didn't withdraw their investment. The questionnaire also captured information on the respondents' views on how the EAC integration had impacted on the performance of FDI in Kenya.

The data collected was analyzed and depicted in graphs to show the FDI trends that informed the conclusion on the study hypothesis.

1.8 Chapter Outline

Chapter 1: The chapter gives the background of the research. It details the research problem statement, objectives of the study, the study assumption or the hypothesis, justification of conducting the study, the methodology used to conduct the study, the literature review which provided the meaning to definition of concepts such as regional integration and FDI and an in-depth examination of FDI and integration theories that explains how FDI occurs. The literature review also examines the FDI determinant as provided by the scholars and UNCTAD. The literature review also examines the performance of

FDI in the European Union after the formation of the European Community. The chapter finally provides the conceptual framework that was selected to guide this study to its final conclusion.

Chapter 2: The chapter examined the performance of global FDI flows with the aim of understanding the world FDI trends.

Chapter 3: This part of the study examined EAC FDI trends under the following sub-topics:

i. Geostrategic location of EAC to show the comparative advantage of due to its location and the infrastructural connectivity of EAC as an added advantage for the investors.

ii. Economic growth of EAC is evidence of purchasing power of the citizens. This is an assurance of market availability to potential investors. The section provides analysis of FDI trends in EAC in relationship employment and GDP. This analysis is crucial as it will bring out whether the objective of establishing EAC, which is to improve the welfare of its citizens, is being achieved through FDI flows. It also answers the assumption that FDI creates employment among other attributes. This section also covers the distribution of FDI by sector. This gives evidence on what determinant drives FDI in EAC, is it availability of resources or market access? Investment per sector brings out what sectors attract more investors. The section also analysis the major sources of FDI to EAC to understand Kenya share of FDI. Finally an examination of EAC trade performance as FDI has a direct relationship with trade especially investment that is market driven. Countries with good trade performance usually attract investors.

Chapter 4: The chapter examines FDI flows and the FDI determinants in Kenya with the aim of understanding the FDI trends in Kenya and determinants that influences the investors' decision to invest in Kenya. This brought out the relationship between EAC integration on FDI flows in Kenya.
This chapter also provides primary data through a summary of the findings from the survey and interviews conducted through the two questionnaires that were administered to foreign investors and government institutions.

Chapter 5: This part gives a summary of the research findings and a conclusion on the study hypothesis that is "*EAC integration enhanced the Foreign Direct Investment determinants leading to increased FDI inflows to EAC Partner States*". The chapter also provides the study recommendations and highlights gaps in assessing the benefits of EAC integration that could be treated as potential areas for research.

Annexes: Annex 1&2, Sample questionnaires;

CHAPTER TWO: GLOBAL FDI TRENDS

2.0 Introduction

This chapter examines the global FDI performance since the year 2005. This was for ease of comparison within the EAC region as this was the year the region signed the Custom Union Protocol. The chapter also examines what scholars and UNCTAD provided as the determinants that influence the flow of FDI.

2.1 Global FDI Performance

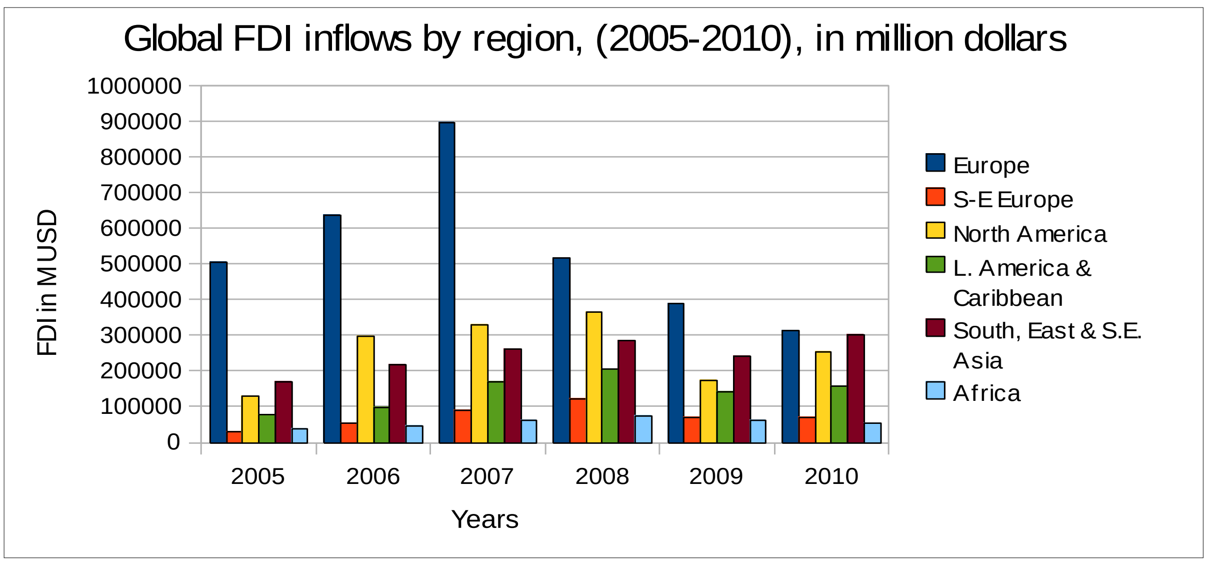
The high expectation and assumption that FDI causes economic development both in terms of wealthy and employment creation, skills development and transfer of technology is the reason that most develop, developing and least developed countries aggressively market their countries as favorable FDI destination. On the other hand it's the investor who makes the decision on where to invest. UNCTAD WIR reports shows low FDI flows to the developing and Least Developed countries even after enhancing the FDI determinants. The reports have also indicated that the Global FDI flows differ from region to region and it's on a declining trend *(World Investment Report 2011), (Table No. 1).*

Table No. 1. Global FDI inflows by region, (2005-2010), in million USD

Region	2005	2006	2007	2008	2009	2010
Europe	503,730	635832	895753	514,975	387,825	313,100
S-E Europe	31,116	54,516	91,090	120,986	71,618	68,197
North America	130,465	297,430	330,604	363,543	174,298	251,662
L. America & Caribbean	78,082	98,459	169,514	206,733	140,997	159,171
South, E.& S.E. Asia	171,337	216,351	261,041	284,100	241,534	299,653
Africa	38,160	46,256	63,132	73,413	60,167	55,040

Source: World Investment Report 2011

Figure 1: Global FDI inflows by region (2005-2010) M.USD



Source: World Investment Report 2011

The statistics above show there is disparity in the distribution of FDI flows across the world for the past years[32]. Europe was the greatest recipient of FDI, followed by North America while the inflows to Asia are fast growing and by passing the Americas. This was a reality as the economic growth of the Asian

[32] UNCTAD, World Investment Report, UN 2011, pp.187-190.

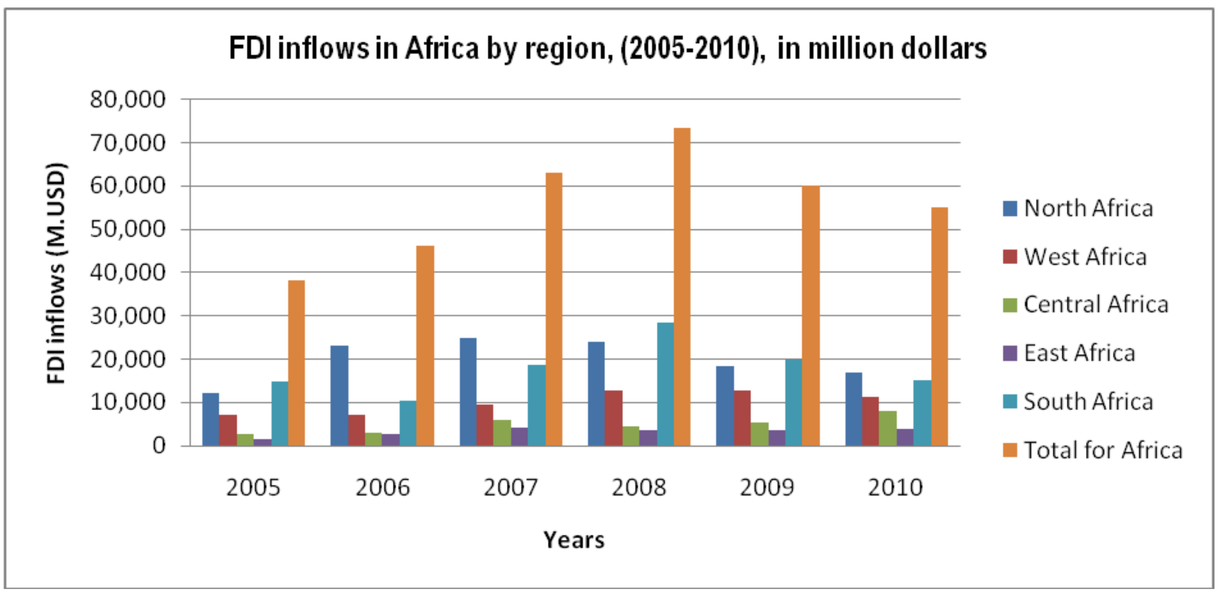
tigers is gaining popularity in the global economy. Europe though with the largest inflows has registered a decline while FDI inflows to Africa remain low though increasing insignificantly.

Table No. 2. FDI inflows in Africa by region, (2005-2010), in million USD

Region	2005	2006	2007	2008	2009	2010
North Africa	12,236	23,143	24,775	24,045	18,468	16,926
West Africa	7,126	6,976	9,522	12,718	12,662	11,323
Central Africa	2,675	3,051	5,985	4,395	5,400	7,959
East Africa	1,424	2,588	4,085	3,667	3,638	3,728
South Africa	14,699	10,501	18,764	28,588	19,999	15,105
Total for Africa	**38,160**	**46,256**	**63,132**	**73,413**	**60,167**	**55,040**

Source: World Investment Report 2011

Figure 3: FDI in flows in the African region (2005-2010),million USD



Source: World Investment Report 2011

There were fluctuations in the FDI inflows to Africa[33]. North Africa received the highest FDI; these could be investment from the rest of Maghreb. Southern Africa receives the second highest FDI inflows in Africa, this could be explained by the fact South Africa is a member of the BRICS and hence offers an attractive investment climate for foreign investors. Southern African States have vast resources such as large deposits of copper in Zambia and Namibia and oil in Angola.

East Africa has been receiving the lowest FDI though it is on the increase by small increments. Increased investment in East Africa could be associated to the integration process that has created a larger market and the finding of oil and gas reserves in the region.

33 Ibid

CHAPTER THREE: EAC REGIONAL FDI TRENDS

3.0 Introduction

This chapter examines the EAC FDI trends. The chapter first describes the geopolitical location of EAC as OLI paradigm is what was selected to explain the FDI in Kenya. The chapter also provides an analysis of the major sources of FDI in EAC, FDI distribution by sector and FDI impact on employment. Specifically this chapter reviews the performance of the economies of the EAC Partner States since the ratification of the Custom Union in 2005, in terms of Gross Domestic Product (GDP) and FDI Flows. The analysis gives an overview on the performance of FDI in the region and the source of FDI. The GDP statistics gives an indication on whether there has been improvement in economy that could have resulted into improved standard of living. This is one of the major goals of establishing the EAC.

3.1 The geostrategic location of EAC

The geostrategic position of East Africa and in particular Kenya is a key determinant of the international relations. The geographical location and infrastructural development are major factors that influence trade and FDI flows of any country. The geographical position and the distribution of the infrastructure will bring out a better understanding of the region and will give an insight on why it's suitable for the EAC members' states to operate as a single unit. The geopolitical location of East Africa refers to the region on the Eastern side of the African continent that comprise of five states, namely

Burundi, Kenya, Rwanda, Uganda and Tanzania. The region lies within latitude 5'30' N and 12'S and longitude 28'45'E and 41'50'. This geo-strategic location of EAC gives it an advantage as the gateway to the hinterland and hub of African trade. The region has total area of 1.82million sq km with a population of 143.5million (2014) and a combined GDP (current prices) of US dollars 110.3billion (2014) with an average GDP per capita of US dollars 769[34].

The major cities in each country are; Burundi-Bujumbura (capital city); Kenya-Nairobi (capital city), Kisumu and Mombasa; Uganda-Kampala (capital city), Rwanda-Kigali (capital city) and Tanzania- Dar el Salaam (Commercial capital city), Arusha and Dodoma. These cities are connected by air and major corridors facilitating transport. All the capital cities of the EAC Partner are served by an international airport providing faster means of transport. In 2010 there was 378 airports in the region, with 191 (51%) located in Kenya, 124 (33%) in Tanzania, 46 (12%) in Uganda while Rwanda and Burundi account for 4%.[35] The Port of Mombasa and Dar el Salaam gives outlet to the international waters[36].

The three countries, Kenya, Tanzania and Uganda are also linked by railway network and a railway master plan is place that will link all the EAC Partner States by railway line. It's notable that the road infrastructure has greatly been improved. Lake Victoria provides a shared inland waterway between Tanzania,

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[34]*EAC website- www.eac.int.org*

[35]Eyakuze A, Salim A & Hersi A, The State of East Africa 2012*, Deepening Integration, Intensifying Challenges*, Society for International Development (SID),2012, pp. 47-48

[36]ibid,pp.55-57

Uganda and Kenya and a large investment potential including fishing and tourism among others. This connectivity ensures access to the regional resource base areas as while as connecting the production to consumer markets that is local, regional and global markets.

Improved infrastructure leads to the reduction of transport cost, and it's expected the consumer prices would go down. It's evidence that Uganda, Burundi and Rwanda are landlocked and greatly rely on Tanzania and Kenya for port facilities. This means both Kenya and Tanzania have a favorable foreign policy with these land locked countries. The good infrastructural networks make a region attractive to foreign investors.

EAC has two transit corridors[37] that facilitate export and import business in the region. These include: the Northern Corridor which runs from Mombasa to Eastern DRC through Rwanda, and Burundi a distance of 1,700km. This corridor is part of the Trans- African Highway to Lagos. The Central Corridor which is 1,300km runs from Dar el Salaam to Eastern DRC through Rwanda, Zambia and Burundi. While the Cape- Cairo road transverses through Tuduma (Tanzania) to exit Kenya. These corridors facilitate trade across several states; increase the trading potential of EAC. It's important to note that the flow of trade highly depends on the level of infrastructure development. Overall EAC geopolitics favors Kenya. It's therefore expected that foreign investors considering infrastructure or interconnectivity within the EAC region and to the rest of the world as a determining factor to foreign investment destination,

[37] Ibid, pp. 53-54

would prefer to invest in Kenya rather than the other EAC Partner States that are land locked.

3.2 EAC Economic Growth

To achieve harmonized development in the region, it was imperative that EAC set goals that could drive the community towards the achievement of the region mutual interests and contribute to the achievement of individual state national interests. Towards this end, one of the objective of the establishment of the EAC regional integration was to facilitate overall economic development of the Partner States[38].

The EAC Partner States economies have registered remarkable economic growth over the recent years. The political leaders and policy makers have come up with development blue prints such as *Kenya Vision 2030*, with ambitious goals such as becoming middle- income and industrialized countries by the next decade[39]. The World Trade Report 2011 indicates that in the year 2010, Africa GDP growth rate stood at an average of 4.7%, while that of EAC was 5.9%. This shows the economies of African countries were growing at a faster rate than some of the developed countries such; USA (2.8%), European Union (1.9), and Middle East (3.8%) though Asia (6.3%), India (9.7%), and China (10.3%) are among other states that were doing better than Africa[40]. This implies that there is a driving force behind the economic growth in African

[38]EAC Secretariat, The Treaty on the establishment of East African Community, Article 5, EAC Publication, Amended 2007, p13

[39]MPND, Kenya Vision 2030, Government of Kenya,2008

[40]EAC Secretariat, EAC Trade Report 2010, EAC Publication 2012, pp.4-7

countries. There is an assumption as previously highlighted in this discourse, existence of a relationship between FDI and economic growth. This research will endeavor to study this relationship.

In EAC it's also assumed that the ratification of the Custom Union and the Common Market Protocols played a major role in boosting the economies of the region as they enhanced intra EAC trade and increase of both foreign and cross-border investment.

To gauge how the economies of the EAC Partner States performed for the period after the ratification of the Custom Union Protocol in 2005 and the signing of the Common Market Protocol (2010), analysis of the real GDP growth rates gives a broader picture of the economic growth. By examining the GDP per capital income it gives an indication as to whether the standard of living of the people have improved, though the GDP per capita is not an absolute measure of the standard of living as the indicator overlooks the distribution of wealth.

The data below gives the trend of real Gross Domestic Product (GDP) growth rate and GDP per capita of all the five EAC Partner States for the period between the years 2005 to 2012[41]. Data for 2000 could be used as base year for comparison purposes as it was the year the Treaty establishing the current EAC with was ratified but data is not available for Burundi and Rwanda who joined EAC in 2008.

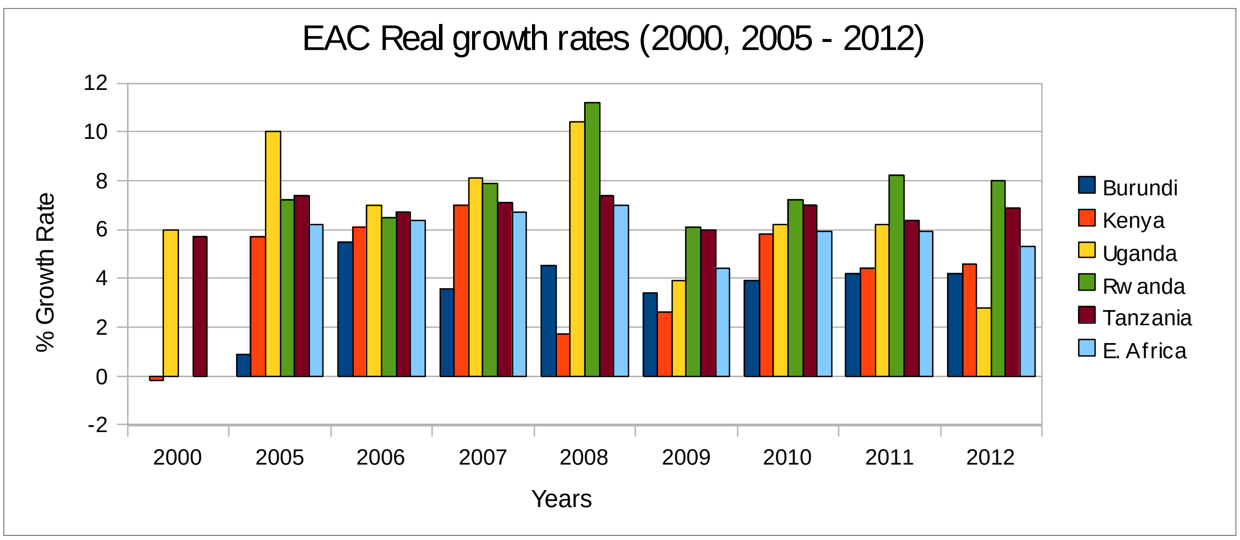
[41]EAC secretariat, East African Community Facts & Figures-2013,EAC Annual Publication, July 2013,pp.33

Table No. 3. EAC Real GDP growth rates (2000, 2005-2012)

State	2000	2005	2006	2007	2008	2009	2010	2011	2012
Burundi	N/A	0.9	5.5	3.6	4.5	3.4	3.9	4.2	4.2
Kenya	-0.16	5.7	6.1	7.0	1.7	2.6	5.8	4.4	4.6
Uganda	6	10.0	7.0	8.1	10.4	3.9	6.2	6.2	2.8
Rwanda	N/A	7.2	6.5	7.9	11.2	6.1	7.2	8.2	8.0
Tanzania	5.69	7.4	6.7	7.1	7.4	6.0	7.0	6.4	6.9
E. Africa	**N/A**	**6.2**	**6.4**	**6.7**	**7.0**	**4.4**	**5.9**	**5.9**	**5.3**

Source: EAC Facts & Figures 2013

Figure4: EAC Real Growth rates, %



Source: EAC Trade Report 2010 / EAC Facts & Figures 2013

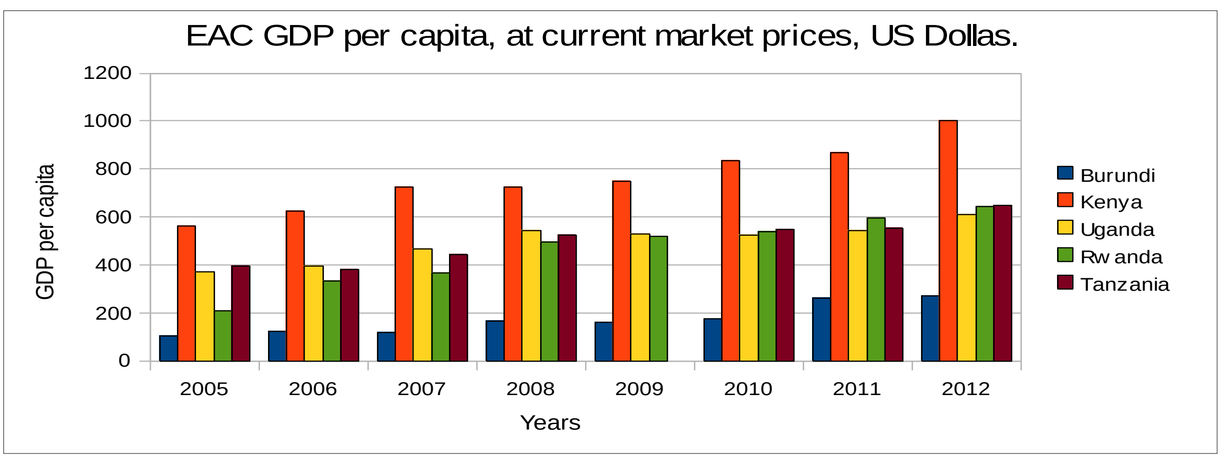
The above statistics show the growth rate has been fluctuating in all the Partner States but of importance is that all Partner States have gained the growth momentum. The average GDP growth for the region ranged from lowest 4.4% (2009) to 5.3% (2012), Kenya post election crisis of 2007/8 could be the reason of the drop in the economic growth in the region as Kenya provides a large export market especially for Tanzania and Uganda. Also due to its geostrategic location, Kenya provides access for imports and exports for the landlocked countries of Rwanda, Uganda and Burundi. Overall the economic performance of the all the Partner States have improved. It's therefore right to assume that EAC integration has had positive impact on the performance of the economies of the Partner States.

Table No. 4. EAC GDP per capital, at current market prices, US dollars[42]

State	2005	2006	2007	2008	2009	2010	2011	2012
Burundi	104.7	124.5	118.5	163.5	161.4	173	259.0	271.0
Kenya	560.8	622.7	726	724.9	746.8	833.4	869.1	999.9
Uganda	372.9	396.0	465.9	543.7	529.2	525.9	543.4	611.4
Rwanda	207.1	331.0	365.0	493.6	520.3	540	595.0	644.0
Tanzania	392.9	381.9	443.8	524.8	525..2	546.7	553.1	650.1

Source: EAC Trade Report 2010 / EAC Facts & Figures 2013

Figure 5: EAC GDP per capital, at current market prices



Source: EAC Trade Report 2010 / EAC Facts & Figures 2013

42 Ibid, p29

The statistics shows GDP per capita is on the upward trend. This means the EAC regional integration objective of improving the welfare of all citizens in the community is being achieved. This is an indication that all the Partner States are benefiting from the integration.

3.3 Foreign Direct Investment in EAC

Eastern African region has been dependent on Overseas Development Assistant (ODA) as a form of external finance but in recent years the region has increasing though not in large amounts attracted FDI. Foreign Direct Investment serve as a source of capital, generates employment, facilitates access to foreign markets, generates and transfers technology and efficiency spillovers to local firms and eventually integrate the host country into the global market and foster economic growth.

Investors in EAC region enjoys expanded market to other African markets under COMESA and SADC. EAC is in the process of negotiating a Tripartite Free Trade Area (FTA) between EAC, COMESA and SADC member states. The Tripartite Free Trade Area will provide a market access to a population of over 600million which will be an added advantage to investors in EAC. Foreign Investors in EAC will also access international markets through preferential treatment offered to Africa such as AGOA just by operating enterprises in EAC.

In all the five Partner States, coordination, promotion and facilitation of investment activities is performed by respective Investment Promotion Agencies, namely, Burundi Investment Promotion Authority, Kenya Investment Authority, Rwanda Development Board, Tanzania Investment Centre, Zanzibar

Investment Promotion Authority and Uganda Investment Authority. These institutions were set up by Acts of Parliament. In general, the basic requirements for approval of investment are the same in all the countries. These include filling in an application form, attaching a business proposal, Certificate of Company Registration and Memorandum and Articles of Association.

However, there is a variation on the minimum threshold requirement among the Partner States. In Burundi the minimum threshold is US$77,000 for both foreign and domestic investors. In Kenya the minimum threshold is US$ 100,000 for foreign investors and US$ 15,000 for domestic investors. In Rwanda the minimum threshold is US$200,000 for foreign investors and US$100,000 for domestic investors. In Tanzania the minimum threshold is US$ 300,000 for foreign investors and US$ 100,000 for domestic investors. In Uganda the minimum threshold is US$ 100,000 for foreign investors and US$ 50,000 for domestic investors. However, under Chapter Twelve, *"Co-operation in Investment and Industrial Development",* Article 80 of the Treaty establishing the East African Community[43], the Partner States agreed to harmonize and rationalize investment incentives with the view of promoting the Community as a single investment destination. The region is in the process of harmonizing the investments incentives to make all the states equally attractive to foreign investors[44].

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[43] EAC Secretariat, Treaty Establishing EAC*, Article 80*, EAC Publication, p.57

[44]EAC secretariat, *Experts report on harmonization of incentives in EAC*,2012

Table No. 5. Foreign Direct investment inflows to EAC, US$ million

State	Source	2006	2007	2008	2009	2010	2011	2012
Burundi	Kenya	0	0	0	0	3.15	7.15	0
	Uganda	0	0	0	0	0	0	0
	Tanzania	0	0	0	0	0	6.09	0.72
	Rwanda	0	0	0	0	1.58	0	1.6
	Total EAC	0	0	0	0	4.73	13.24	2.32
	Rest of world	0	0	0	0	144.54	124.7	81.4
	Total	**0**	**0**	**0**	**0**	**149.27**	**137.94**	**83.72**
Kenya	Burundi	0	0	0	0	0	0	0
	Uganda	1.43	4.285	0.571	0	0	0	6.4
	Rwanda	0	0	0	0	0	0	0
	Tanzania	0.31	8.571	1.429	0.94	0.52	0.6	25.1
	Total EAC	1.74	12.856	2.0	0.94	0.52	0.6	31.5
	Rest of world	1235.26	2044.144	4555.142	1246.86	591.64	840.7	549.6
	Total	**1237**	**2057.142**	**4557.142**	**1247.8**	**592.16**	**841.3**	**581.1**
Uganda	Burundi	0	6	0	0	0	0	3.5
	Kenya	148.05	30.88	133.48	194.46	62.81	88.1	7.8
	Rwanda	0	0	0	0	3	11.7	0
	Tanzania	2.17	3.99	9	7.15	9.6	1.4	1.3
	Total EAC	150.22	34.87	142.48	202	75.41	101.2	12.6
	Rest of world	487.99	519.8	1111.71	958.8	677.36	349.8	725.0
	Total	**638.21**	**560.67**	**1254.19**	**1160.41**	**752.76**	**451**	**737.6**

Rwanda	Burundi	0	0	0	0	0	1.4	0
	Kenya	12.94	33.9	17.56	9.79	14.31	17.5	6.6
	Uganda	0	0.9	0	0	11.57	0	1.0
	Tanzania	0	0.36	0	20.59	15.5	36.0	0.6
	Total EAC	12.94	35.16	17.56	30.37	41.38	54.9	8.2
	Rest of world	106.8	195.3	311.96	499.35	157.69	344.0	466.8
	Total	**119.74**	**230.46**	**329.52**	**529.72**	**199.07**	**398.9**	**475**
Tanzania	Burundi	1.56	0.58	0.54	0	4.62	0	3.5
	Kenya	35.3	45.80	366.34	49.49	67.23	50.2	82.2
	Uganda	2.3	2.8	2.27	33.73	0.17	0	10.9
	Rwanda	1.8	1.7	1.03	0.48	1.64	0	3.7
	Total EAC	37.6	48.64	368,61	83.7	73.66	50.2	100.3
	Rest of World	5836.3	5664.7	2858.98	2201.5	4992.5	7124.6	1889.4
	Total	**5877.26**	**5715.58**	**3229.16**	**2285.2**	**5066.16**	**7174.8**	**1989.7**

Source: EAC Trade Report 2013

Table No.6: Total FDI inflows to EAC by Partner States, US million dollars

Recipient Country	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Burundi	0	0	0	0	144.54	137.94	83.72
Kenya	1237	2057.142	4557.142	1247.8	592.16	841.3	581.1
Uganda	638.21	560.67	1254.19	1160.41	752.76	451	737.6
Rwanda	119.74	230.46	329.52	529.72	199.07	398.9	475
Tanzania	5877.26	5715.58	3229.16	2285.2	5066.16	7174.8	1989.7

Source: EAC Trade Report 2013

The statistics shows the EAC region receives most of it FDI from outside the region, with Tanzania receiving the majority share. Its evidence that there is intra- EAC investment flows. Kenya has remained the major source of intra-EAC investment flows, mostly in the service industry. Decline on the inflows from the rest of the world could be associated to the financial crisis that was experienced in the USA and EU and the increase is credited to investments by China and India. China investment to EAC reached US$ 750million (2011) and projected to raise US$1,500billion (2013)[45].

3.4 Impact of FDI on Employment in EAC

One major objective of EAC regional integration, Article 5 of the Treaty establishing the East African Community, is to strengthen and consolidate cooperation to enhance economic development which would in turn raise the standard of living of the population. As earlier discussed in this thesis, FDI theory purports that FDI inflows brings about economic growth and creates employment. EAC Partner States have individually and jointly made efforts to create a favorable investment climate to attract FDI to the region. It can be assumed that increased FDI inflows were brought about by these integrated actions. It's therefore expected that, there were gains in employment creation.

The table below shows statistics on job creation per EAC Partner State.

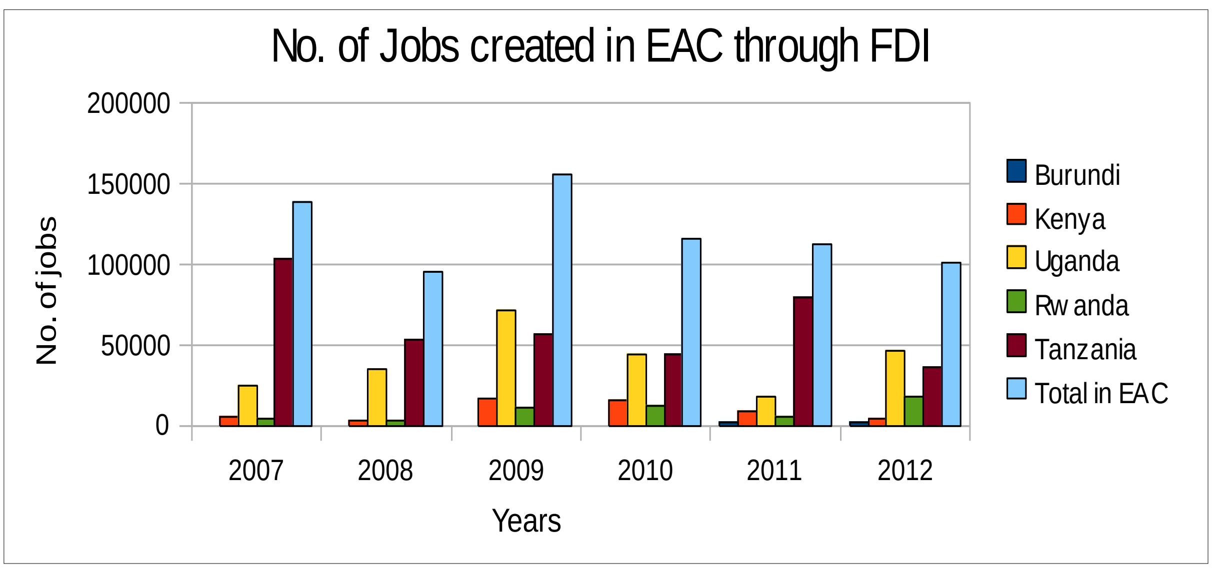
[45]UNECA, Tracking Progress on Macroeconomic & Social Development in the E.A. Region "*Sustaining Economic Growth & Development in Turbulent Times".* Economic commission of Africa-2012, pp.38-43

Table No. 7: No. of Jobs created through FDI in EAC

State	2007	2008	2009	2010	2011	2012
Burundi	0	0	0	0	2,118	2,245
Kenya	5,257	3,474	17,154	15,265	8,241	3,898
Uganda	25,264	35,374	71,451	44,152	17,664	46,285
Rwanda	4,144	3,436	10,734	12,529	5,553	17,311
Tanzania	103,956	52,942	56,615	43,640	79,101	35,879
Total in EAC	**138,621**	**95,226**	**155,954**	**115,586**	**112,677**	**101,618**

Source: EAC Trade Report 2013

Figure 6: No. of Jobs created through FDI in EAC



Source: EAC Trade Report 2010

The data show the number of jobs created in EAC slightly decreased in the year 2012 from 2011 by 9.8% and overall the Kenya and Tanzania lost employment opportunities while Rwanda, Burundi and Uganda gained with Uganda creating most employment opportunities registering a growth of 162% followed by Rwanda. This was expected after Uganda made major investment with the discovery of oil reserves and as for Rwanda after the World Bank, “Doing Business Report 2010”[46] indicated Rwanda was in position 9 in the world as a country where it took the shortest time register and start a business. This could be the reason why foreign investors preferred investing in Rwanda as compared to other Partner States. The statistics also shows FDI created more employment opportunities in Tanzania and Uganda over the years. EAC Partner States are characterized by high levels of unemployment and it can be concluded that FDI inflows contributes to the creation of employment opportunities though in significant compared to the value of FDI during the same period.

3.5 Distribution of FDI in EAC by sector

To enhance FDI incentives it imperative to affirm which sectors attracts more foreign investment and why. The table below gives a comparative analysis of FDI by sector by country. It’s evidence that investors to different countries were attracted to different sectors.

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46 World Bank, *Doing Business Report, 2010*, P

Table No. 8: Distribution of FDI in EAC by sector, value in million (USD)

State	Sector	2009		2010		2011	
		Value	Employment	Value	Employment	Value	Employment
Burundi	Agriculture, fishing, forestry & hunting					15	105
	Construction					4	337
	Manufacturing					83	626
	Utilities (water & energy)					-	-
	Transport, Storage & Communication					2	97
Kenya	Agriculture, fishing, forestry & hunting	320	5,350	61	2,020	558	7
	Construction	522	4,138	1,559	4,129	45	-
	Manufacturing	93	2,379	91	3,725	4,194	309
	Utilities (water & energy)	102	80	175	370	1,435	691
	Transport, & Storage Communication	12	1,311	13	2,330	614	78
Uganda	Agriculture, fishing, forestry & hunting	205	27,950	300	14,883	5,505	161.7
	Construction	175	3,625	146	6,452	1,466	35.7
	Manufacturing	728	20,944	335	15,457	4,596	78.2
	Utilities (water & energy)	92	2,655	378	255	567	70.7
	Transport, Storage & Communication	127	1,765	50	1429	554	7.3
Rwanda	Agriculture, fishing, forestry & hunting	41	387	-	4,053	2,701	136
	Construction	38	1,849	11	432	594	19
	Manufacturing	67	3,258	13	263	1,731	44
	Utilities (water & energy)	92	2,655	378	255	171	86
	Transport, Storage & Communication	127	1,765	50	1429	188	110

Tanzania	Agriculture, fishing, forestry & hunting	51	15,202	477	5,269	9,281	671.52
	Construction	772	4,855	1,379	5,100	16,493	976.55
	Manufacturing	503	14,143	504	14,327	19,779	706.94
	Utilities (water & energy)	59	240	1627	45	120	374.81
	Transport, Storage & Communication	296	6,797	612	8,232	19772	3,495.75

Source: EAC Trade Report 2011

In Tanzania, increased investment was registered in the utility sector but very few employment opportunities were created as the sector is high capital intensive. The manufacturing sector in the same country with low investment created the largest number of jobs. In Rwanda there was increased investment in the utility sector, though the service sector created the most jobs at a low cost. The construction and manufacturing sectors in Kenya and Uganda provided the highest employment opportunities. It's to be noted that Agriculture and services (transport, communication and storage) in all the states received relatively low investment yet they created more employment opportunities. This means increased investment in these two sectors will create the most needed employment in the region.

China the recent major investor in the region has diversified its investment in the region to include not just in natural resources and infrastructure development but also other sectors such as textiles, shoes, pharmaceutical, industrial machinery, electronics and ICT. Chinese company Chery Automobiles has alone invested US50million in a plant in Nairobi to serve the East African Market and TATA the largest automobile company of India plans to invest US$20 million in Nairobi targeting also the EAC market (Brand Kenya 2011)[47].

The decline of FDI inflows to EAC could be associated with inadequate infrastructural development especially the roads and the high cost of energy which translates into high cost of production. This will certainly change with the discovery of oil and gas in the region. The high cost of doing business in the region, due to corruption and lengthy bureaucratic administrative government procedures discourages foreign investors[48].

3.6 Major sources of FDI in EAC

The region receives FDI from all over the world as well as from within the region. Among the Partner States, Kenya is the major investor in cross-border investment. Tanzania receives FDI from China, India, USA, UK and Kenya among others, with India and China targeting the construction and manufacturing sector. Major investors in Uganda include India, UK, China, Netherlands and Kenya, while major foreign investors into Rwanda include investors from China, Mauritius and Tanzania. Kenya attracted the least investment inflows from the EAC Partner States but major inflow was received from China and UK.[49]

3.7 EAC Trade Performance

The major exports from the region were minerals and agricultural products while the imports were finished goods, vehicles and petroleum. The main

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[47] Brand Kenya website, *http://ww.brandkenya.co.ke/index*

[48] World Bank, *The World Doing business report 2010*, World Bank Publication, 2010

[49] UNCTAD, *World Investment Report 2011*, UN-New York,2011, Pp40-42

export market for EAC products includes; EU, COMESA, SADC and USA which accounted for 20.1%, 17.2%, 11.9% and 3.3% respectively.

This is evidence that the region is deepening integration with the global economy. The intra-EAC trade has gradually grown and is expected to accelerate with the ratification of the EAC Monetary Union. The growth of exports from EAC to the rest of the world is evidence that region products are increasing their competitiveness in the global market or the world is changing its attitude towards the products from the region hence making the region more attractive as an investment destination.

FDI directly relate to trade, as investments are geared towards increased production/productivity whose returns are felt through profited business transactions. The growth in trade therefore will to a certain degree reflect increase in investment though not necessarily from FDI. It's imperative therefore to examine the trend of EAC trade as an outcome of increased investment.

EAC trade has been on an upward trend, increasing from US $ 8.8 billion dollars (2000) to US $ 37billion (2010), which accounted for 47% of the EAC GDP from 28% (2000). In 2010, Kenya contributed 47% of the EAC exports and 44% of the imports while Tanzania accounted for 36% Exports and 29% of the imports[50]. The EAC trade performance has maintained a positive growth as the EAC total trade with the rest of the world increased from US$ 43,740.5 million in 2012 to US$ 47,365.4 million in 2013 while the value of intra-EAC trade grew by 6.1% from US$ 5,470.7 million in 2012 to US$ 5,805.6 million in

[50]Eyakuze A.& Salim A, *The State of East Africa 2012*, SID, 2012, pp.70-72

2013. In 2013, Tanzania, Rwanda and Burundi recorded an increase in their shares of the total intra EAC trade while that of Kenya and Uganda declined. Despite the decline of the share, Kenya continued to dominate, accounting for about 31 percent of total intra-EAC trade.

CHAPTER FOUR: FDI PERFOMANCE IN KENYA

4.0 Introduction

To analysis the FDI performance in Kenya, the study applied the FDI Conceptual Framework discussed in chapter one of this thesis that applies the host country FDI determinants. These determinants include FDI policy framework, economic determinants and business facilitation.

4.1 Determinants of FDI in Kenya

According to the World Investment Report (1998) which collaborates the Ownership-Location-International (OLI) paradigm or the eclectic paradigm that was developed by Dunning (1997, 1980, 2000), that was informed by works of Hymer (1969), FDI determinants are of three categories. Those related to ownership advantage which refers to characteristics of a company that includes high technical skills and copy rights that applies to an individual company. Another is specific location advantage of the host country and internationalization advantage which also depends on the company as its the company that makes the decision to invest abroad. Analyzing these determinants, these scholars and UNCTAD (1998), were in agreement that the host country can only control the location-specific determinant, to influence the decision of the foreign Investors.

The location- specific determinant or host country determinant are classified into three categories that is; FDI policy framework, Economic determinant and business facilitation. The economic determinants are further classified as

Trans-National Corporation (TNC) motives; these are market seeking, resource /asset seeking and efficiency seeking.

This part of the thesis examined the determinants of FDI in Kenya. Having confirmed from previous studies and UNCTAD reports, that location-specific determinant is what a country can use to create a favorable investment climate[51] that is attractive for foreign investment. This chapter examined the applicability of these determinants on the performance of FDI in Kenya. In summary the chapter made analysis on how much EAC integration has impacted on these determinants.

FDI policy framework

What investors want to see is a stable macroeconomic environment and a politically stable country that ensures their investments are profitable and secure. According to UNCTAD report (2005)[52], countries enhance their ability to attract FDI by adopting policies that improve their investment climate. In this regard Kenya has formulated favorable FDI policies such as the privatization and liberalization policies. Of important, Kenya enacted a Foreign Investor Protection Act of 1964, which among other provisions allows investors to repatriate 100% of their profits. In addition Kenya constitution provides security to all persons and their property, be they local or foreign as long as they are within the territory of Kenya. There is no discrimination but a national

[51]Mattila L, *Location-specific Determinants of Foreign Direct Investment,* Study of U.S. Direct Investment in Sweden, Working Report, Swedish Institute for Growth Policy Studies,2005, pp.13-14

[52]UN, *World Investment Report 2005, Transnational Corporation & the Internationalization of R & D*, UNCTAD,2005, pp. 192, 233

treatment for both foreign and local investors. In terms of tax policy, unless an investor is operating under a special program such as in the EPZ, he is liable to payment of taxes like any other investor, though corporate tax holiday is used as an incentive to entice foreign investors.

To make the country attractive for foreign investors, Kenya has put in place policy frameworks such as establishment of the Export Promotion Zones (EPZ), Export Promotion Council (EPC) and Kenya Investment Authority (KENINVEST) that promote investment and provide business facilitation. Evidence that foreign investors enjoy the same treatment with local investors is seen in treatment of exports under AGOA, where foreign firms in Kenya EPZ, doing textiles and apparel are now taking advantage of the preferential market access to the United States of America, under AGOA program just like any other Kenyan firm. The same with foreign companies producing for the EAC Market and outside the EPZ have a 100% market access under EAC Rules of Origin as any locally owned enterprise.

Favorable policies alone will not entice foreign investors as according to the findings through interviews, it was established some investors at the EPZ though privileged with a lot of incentives are closed shop, as other factors have made business less profitable. Kenya like many African States practices open/liberal investment policies and provides fair national treatment to foreign investors yet she receives limited FDI. This means favorable policies alone will not endear investors.

So how then have EAC integration policies implicated on the FDI flows into Kenya? On one hand the provisions of the Common Market and Custom Union

Protocols have enhanced free trade in the region, having removed import duties and internal tariffs hence creating a large market for investors operating outside the EPZs. On the other hand EAC Custom Union Protocol Article 25 (3) limits the market access for the EPZ firms to 20% of their annual production in the EAC Custom territory. This limitation of market access has caused 16 EPZ firms[53] who established their business before the ratification of the EAC Custom Union Protocol and those that had their target market as other EAC Partner States to withdraw their investment from Kenya. This negative impact is in the process of being corrected with the formulation of EAC Special Economic Zones Policy that is under formulation.

Business facilitation

Business facilitation is the promotion policies that aim at facilitating the business for a foreign investor by providing a level playing ground between the local and foreign investors. This facilitation includes among others investment promotion; investment incentives and after-investment services.

Kenya has established institutions that promote investment on behalf of the government. KENINVEST markets Kenya abroad plus it has a data bank of investments opportunities in Kenya. Through KENINVEST foreign investors are provided with post and after investment services. Kenya has policies in place that provide foreign investors with financial and non financial incentives. For example, investors operating in the EPZ enjoy incentives including corporate tax holiday and suitable infrastructure among other incentives as highlighted

[53]EAC Secretariat, *Impact Study of the Custom Union on EPZ Firms in EAC, 2013*, p. 43

in the EPZ ACT, Cap 517 Export processing Zones (Rev.1993). Kenya is also in the process developing a Special Economic Zones (SEZ) policy to guide on how to establish other economic zones beyond the EPZ and free ports that are already approved by the EAC Custom Union.

KENIVEST, KEPSA, CHAMBER of Commerce, Kenya Tourism Board, Export Promotion Council in collaboration with the Ministry of East African Affairs, Commerce & Tourism have been all over the world marketing and promoting Kenya as a favorable investment destination yet the number of foreign investors coming in are very few compared to the vigorous campaigns by the relevant stakeholders. The value of FDI in the oil and gas exploration and the standard railway gauge is so large that the onetime investment might mislead that Kenya is gaining in terms of FDI inflows.

Business facilitation alone or jointly with favorable FDI policy will not entice investors into Kenya. There is need to enhance other efforts such conducting joint promotion with the other EAC Partner States. Marketing the region as one investment destination and that the investors enjoys the economies of scale while exploiting the opportunities of the larger EAC Market.

EAC Investment conferences were one forum where the Partner States could have promoted the region as one investment destination but the EAC Council of Ministers directed that the conferences be suspended until an impact assessment study on the previous conferences was conducted and results tabled at a Council meeting. In conclusion we can't attach a major effort by EAC to facilitate FDI in Kenya though the East African Business Council (EABC) is purported to be providing some business facilitation.

Economic determinant

Economic determinant influences the investment decision for those investors who invest abroad in search of a market, efficiency so as to produce at a low cost or establish a business at the source of raw material to avoid the cost transporting the raw material.

How then has this determinant influenced FDI flows into Kenya and how has EAC integration enhanced this determinant?

Market seeking motives:

It's generally assumed that EAC regional integration enhances the attractiveness of the region to those investors who wish to enjoy the economies of scale in their production as the region provides a large common market[54] of a population 143.5million people.

Trans National Corporations (TNC) seeking for market for their products has an opportunity to invest in EAC where there is a ready market. The middle class in the region is on the raise and the GDP per capita for the region is on the increase, standing at US 635 dollar,[55] with Kenya having the highest; US 999.9 dollars[56]. This means increased purchasing power of the people in the region. A foreign investor in Kenya therefore is assured of Kenya domestic market and EAC regional market. EAC Common Market Protocol provides for four freedoms and two rights. The freedoms include; free movements of goods, services, persons and capital, while the rights include right of residence and

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[54]Blomstrom M & Kokko A, Regional Integration & Foreign Direct Investment, *Working Paper series in Economic & Finance No. 172*, Stockholm School of Economics, 1997, p.7.

[55]EAC secretariat, EAC Facts and Figures 2011, EAC publication, 2012, pp.28.

[56]KNBS, Economic Survey 2012, Kenya Government Publication, 2012, pp.16-27.

establishment. This means a foreign investor whose products are produced within the EAC Partner States will have access to the regional market under the EAC Rules of Origin criteria (RO) and to global markets under preferential treatment such as under WTO, GATTS, AGOA and to EU markets. Kenya has the largest economy in the region and a population of over 38mllion people *(Kenya Census 2009)* and market seeking investors should be attracted more to Kenya as compared to other Partner States.

Resource seeking:

Search for raw materials and minerals for their industries has been one major attraction that leads investors to less developed countries as compared to other FDI destination such to the BRICKS and the Asian countries, where the major attraction is advanced technology and abundance skilled labor.

It's to be noted that FDI inflows to Kenya, which has been the lowest in the EAC has just risen since the discovery of oil in Turkana County and the discovery of minerals such coal at Mui Basin and Titanium and other minerals at the Coast. The cheap semi-skilled labor as resource is one factor that drives investors to Kenya EPZs especially the textile and apparel factories, though they are also taking advantage of the US market under AGOA.

Additional resources that investors to Kenya considered before investing in Kenya were: the fact that Kenya is the hub of Africa, with international airports connecting to all over the world; excellent telecommunication services; accessible roads especially the motor able Northern Corridor from Mombasa to Malaba; rail and road connectivity to the rest of the East African, Africa and the rest of the world. Good infrastructure is crucial for attracting FDI as it reduces the cost of production and hence stimulating FDI inflow.

EAC is committed to the improvement of the infrastructure with the construction of the standard railway gauge and the implementation of the railway master plan and the energy master plan that will see to the reduction of the cost of doing business in the region, making the region attractive for investment. Otherwise majority of the FDI inflows in the oil and gas exploration and the extractive industries are barely influenced by the EAC integration as they are limited to territories of individual Partner States. So it's not conclusive that the EAC integration played any role in the recent increased FDI inflows in Kenya in the oil, gas and mineral extractive sector.

Efficiency seeking

Another major factor that influences the decision of Transnational Companies to establish branches in a country is if they enjoy efficiency that reduces the cost of resources, transport and communication costs resulting to increased productivity. Regional integration could also increase efficiency as a company utilizes economies of scale and gain from production of large volumes for a larger market.

Efficiency seeking companies that have established in Kenya, include among others include, British African Tobbacco (BAT) *(cheap raw material and reduced transport cost)*; Delmonte Juice factory in Thika *(raw material bulky),* while motor vehicle Industry in Kenya could efficiently produce for the region and be based in Kenya due to its geo-strategic location. That is near the Port of

Mombasa for importing materials for the industry and good road network to the other EAC Partner States.

4.2 Performance of FDI in Kenya

Like any other developing country, Kenya appreciates FDI as contributor to its economic growth specifically towards wealthy and employment creation as a solution towards poverty reduction. There is expectation that the FDI contributes to the GDP, creates employment, facilities skills and technology transfer. FDI are also associated with high quality and cheaper products as TNC produce large volumes as they exploit the principle of economies of scale. In the long run FDI promote the standard of living of the citizens.

This section of the discourse examined the FDI flows in Kenya in relation to the GDP and GDP per Capital as indicator to its impact on the Kenyan economy. It also examined the relationship between FDI and employment creation as the FDI theory purports that FDI inflow stimulates creation employment opportunities. The section also examined the relationship between FDI and sectors of the economy. This would give guidance to the policy makers which sector requires to be enhanced to attract more investors. The section highlights what factors drive investors to these types of investments. Efforts was made to evaluate whether the same factors could be enhanced and applied to other potential investment enterprises to make them attractive to foreign investors.

The section also examined the determinants of FDI, keeping in mind the relevance to EAC integration. The section apart from looking at statistics showing Kenya FDI trends, examined how Custom Union and Common Market

Protocols, some of the ratified stages of EAC integration have impacted on performance of FDI.

First, it's important to note Kenya has potential for both market seeking FDI flows and non - market-seeking FDI flows. Market-seeking FDI is assured for an EAC market of over 143.5 million people as Kenya is member of EAC. Foreign investors in Kenya enjoy the provisions under the Custom Union and Common Market Protocols, just like any other local investor. Non- market seeking FDI will reap the benefits of the Kenya strategic location and take advantage that Kenya is a business hub in Africa and has international connection to all over the world by air and access to sea transport through the port of Mombasa.

FDI has potential to enhance growth of local firms through complementary production and productivity spillovers (Philips et al.2001) and hence stimulate domestic investment, though on the other hand FDI especially large MNC may kill local industries through unfair competition. This is also possible as FDI enjoys government incentives such investment allowances, tariff protection and liberal tax concessions resulting to low cost of production for the foreign firms. For example Kenya EPZ, as part of incentives offers all foreign firms at the EPZ, a ten-tax holiday and no restrictions in repatriation of profits[57]. It's important to note that EAC is in the process of harmonizing foreign investment incentives so that the incentives are not an issue when an investor is choosing where to

[57]Investment Promotion Centre, *website, www.ipckenya.org*

locate his investment in the region. Incentives should be a regional determinant[58].

4.3 Kenya FDI in relation to its GDP

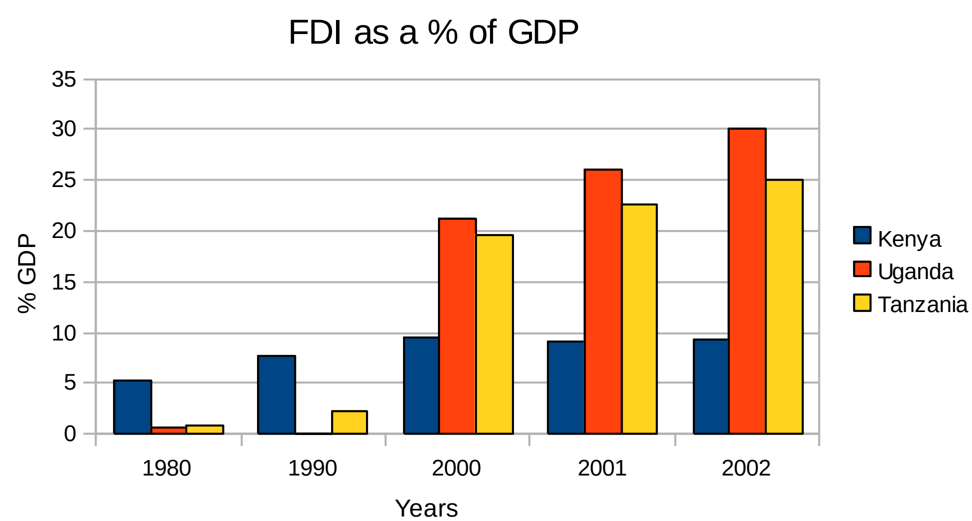
Increase in the percentage or the ratio between the FDI to GDP implies that the domestic saving and investment are very low and the host countries largely relies on external finance to sponsor its investments.

Table No. 9: FDI as Percentage of GDP (1980-2002)

Country	**1980**	**1990**	**2000**	**2001**	**2002**
Kenya	5.3	7.8	9.5	9.2	9.3
Uganda	0.7	0.1	21.3	26.1	30.0
Tanzania	0.9	2.2	19.6	22.6	25.0

Source; UNCTAD Report 2012

Figure 7: EAC FDI as % of GDP



Source: UNCTAD Report 2012

The above table shows that after ratifying the EAC treaty in 2000, FDI in flows gained momentum in Uganda and Tanzania.

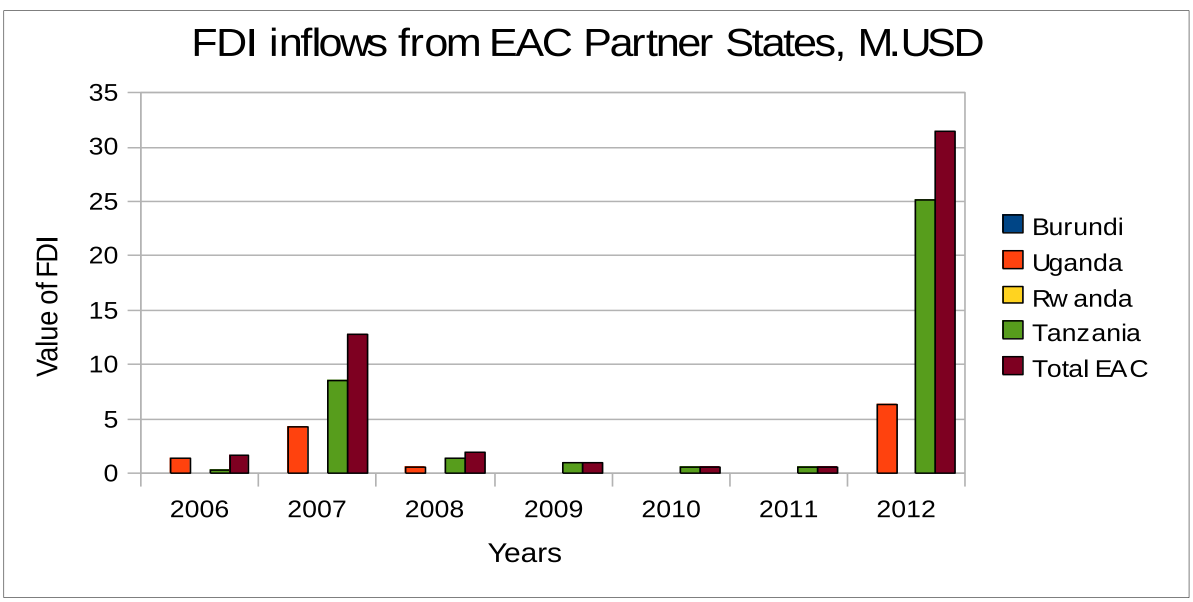
[58]EAC Secretariat, *EPZ incentive harmonizing Report*.

Table No.10: Foreign Direct investment inflows to Kenya, US$ million

Source	2006	2007	2008	2009	2010	2011	2012
Burundi	0	0	0	0	0	0	0
Uganda	1.43	4.285	0.571	0	0	0	6.4
Rwanda	0	0	0	0	0	0	0
Tanzania	0.31	8.571	1.429	0.94	0.52	0.6	25.1
Total EAC	1.74	12.856	2.0	0.94	0.52	0.6	31.5
Rest of world	1235.26	2044.144	4555.142	1246.86	591.64	841.3	581.2

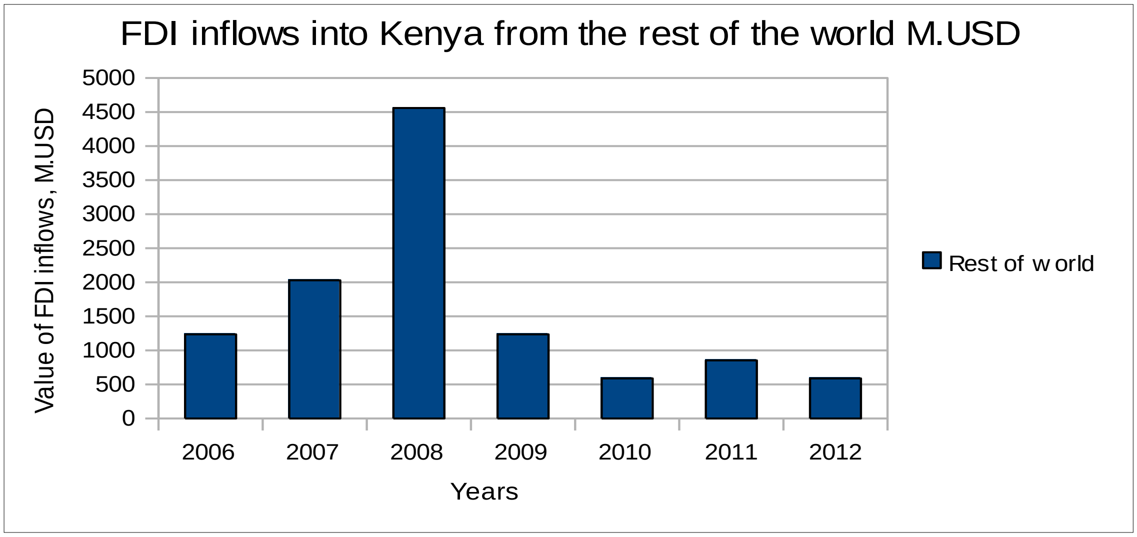
Source: EAC Trade Report 2013

Figure 8: Foreign Direct investment inflows to Kenya, US$ million



Source: EAC Trade Report 2013

Figure 9: Kenya FDI inflows



Source: EAC Trade Report 2013

The graph shows foreign investment into Kenya rose shapely in 2008, and the then fell drastically. The increase of FDI inflows in 2008 could be attributed to the EAC integration as this was just after signing of the EAC Common Market Protocol. Foreign investors flocked to take advantage of the provisions under the EAC Common Market, which provided market access to all the EAC Partner States. Investors wanted to take advantage of trading under the Rules of Origin Criteria and the removal of internal tariffs as provided for under the EAC Custom Union. The decline there after could be associated with the political instability after the national elections in 2007.

It's evidence that from the EAC Partner States; Kenya receives the highest FDI from Tanzania followed by Uganda. Though not shown in the graph, Kenya FDI outflows to the EAC Partner States are the highest in the region, *(see Table No.5).*

4.4 FDI and employment creation in Kenya

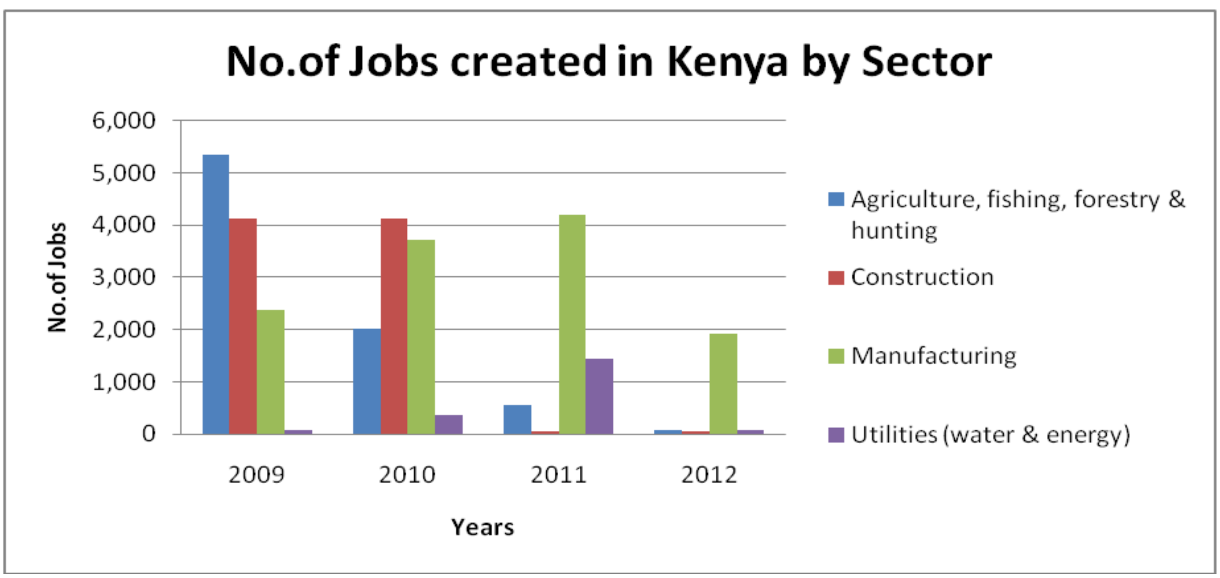
One of the expectations of the recipients of FDI especially in developing countries is that it creates the most needed employment for it bulging youthful population. The statistics below examines the number of employment opportunities created by sector in Kenya.

Table No. 11: Value of FDI and No. of employment opportunities created in Kenya by Sector (US. m)

Sector	2009		2010		2011		2012	
	Value	Employment	Value	Employment	Value	Employment	Value	Employment
Agriculture, fishing, forestry & hunting	320	5,350	61	2,020	10	558	1	65
Construction	522	4138	1559	4129	2	45	13	40
Manufacturing	93	2379	91	3725	35	4,194	75	1,925
Utilities (water & energy)	102	80	175	370	7	1,435	6	78

Source: EAC Trade Report 2013

Figure10: No. of created through FDI by Sector in Kenya



Source: EAC Trade Report 2013

The figure above shows agriculture sector created the largest number jobs though it was on declining trend in 2010. The jobs were generally in the horticulture and flower sectors. Construction was next and this was associated with the investment from China in the infrastructural sector especially in road projects and investments in the real estates.

FDI creates the most needed employment and the region has to amend the Custom Union (CU) Protocol Article 25 (3), to increase the market access threshold to the EAC Market, to enable the EPZ firms to sell more than 20% of their annual production and create employment, failure to, EAC will continue exporting jobs by allowing products from the COMESA EPZs under preferential treatment and those from the rest of the world by simply paying a common external tariff (CET) which Kenya EPZ firms are willing to pay plus a surcharge. The continued application of this limiting provision, CU Article 25 (3), which is disincentive, discourages re-investment of profits and closing shop by existing EPZ firms.

4.5 Analysis of findings from the primary data

The following section gives a summary of findings on the primary data collected by use of questionnaires. One administered to the respondents in government institutions and the second to foreign investors. The analysis will be question in the questionnaire and answers provided by respondents.

The primary data collection was hampered by non availability of foreign investors in person for direct interviews. This caused the delay in the completion and submission of this dissertation.

4.5.1 Performance of FDI and FDI determinants according to government institutions

Respondent: Officials from government institutions

Aim: Facts on the FDI performance and FDI determinants in Kenya

Determinants of FDI in Kenya

The World Investment Report 2011 shows that FDI is diversely distribution across the world, with some regions of the world attracting a lot of FDI while others almost nothing. This means there are specific determinants that drive foreign investors to those regions. According to UNCTAD (1998) there are four host country determinants that influence the investor's decision on where to invest. These are:

1. ***Economic determinants***: which include market seeking, resource seeking and efficiency seeking;
2. ***Policy framework for FDI:*** include rules and regulations governing the entry and operations of foreign investors, the standard treatment accorded to them and the functioning of the market they operate in;
3. ***Business facilitation***: include improved business climate e.g. reducing barriers for FDI and assuring foreign investors of a function market and a level playing ground for all investors;
4. ***Political Stability***: politically stable government.

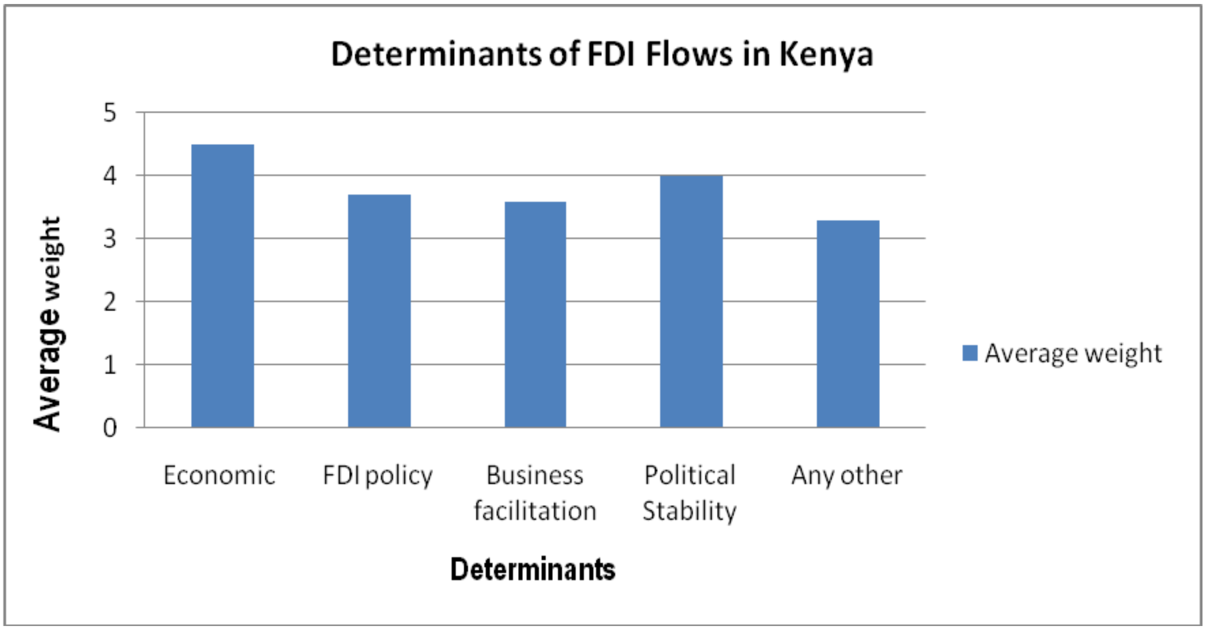
1. *In your view which determinant influences FDI in Kenya? Rate the determinants in a scale of five (5), with 5 being the highest weight and 1 the lowest.*

   The respondents who were selected for the interview were those directly interact with foreign investors or are custodian of information on foreign investment flows. These include: Ministry of East African Affairs Commerce & Tourism. (MEAAC&T), Ministry of Industrialization & Enterprise Development (MOIED), Export Promotion Council (EPC), Kenya Investment Authority (KENIVEST), Central Bank of Kenya (CBK) and Export Promotion Zones Authority (EPZA). The results were as below:

Table12. Weighting of FDI determinants in Kenya by Institutions

No.	Determinant	MEAAC&T	MIED	EPC	Keninvest	CBK	EPZA	Total	Average
		weight	*weight*	*weight*	*weight*	*weight*	*Weight*	*weight*	*weight*
1	Economic determinants	*5*	*5*	*4*	*4*	*5*	*4*	*27*	*4.5*
2	FDI policy	*3*	*4*	*3*	*3*	*5*	*5*	*23*	*3.7*
3	Business facilitation	*3*	*3*	*3*	*4*	*4*	*5*	*22*	*3.6*
4	Political Stability	*4*	*4*	*5*	*3*	*4*	*4*	*24*	*4*
5	Any other	*4*	*4*	*4*	*4*	*1*	*3*	*20*	*3.3*

Figure11: Weight of the Determinants of FDI in Kenya



The above data shows that all the government of Kenya Institutions who filled the questionnaire almost concurred that all four determinants considered influenced foreign investor's decision to invest in Kenya at almost to the same degree. The Economic determinant has slightly greater influence with an average weight of 4.5 out of 5 compared to the FDI policy, business facilitation and political stability whose weight is above 3, meaning they also play a role in influencing investors decision. The research shows that the determinants identified in the World Investment Report (1998) were not the only determinant that influenced the FDI flows in Kenya, as shown by an average weight of 3.3, for any other determinant.

Its evidence that economic determinant, which includes resource seeking, efficient seeking and market seeking was key determinant in influencing investors decision to investing in Kenya. This is true considering that in Kenya major investors are resource seekers investing in extractive sector that is in oil, gas and mineral exploration. Others such as the vehicle assembly companies, iron and steel rolling industries established targeting to exploitation the EAC market. The last scenario could be quoted as an impact of EAC integration process on FDI flows.

2. *If you gave a weight of more than one (1) in the determinant "any other" above; list your additional determinants and give brief description of how/why you think it influences FDI flows in Kenya.*

   Other factors or determinants that influenced investor's decision to invest in Kenya identified as "any other" include:

   i. **Strategic location**

      Kenya is strategically located as a gateway to East and Central African region. It borders the Indian Ocean and has a relatively well developed interconnecting infrastructure *(air-transport, road connectivity through the Northern corridor and Trans-African Highway and a railway line network).* Kenya is well suited as a production and distribution base to serve Africa, Europe, the Middle East, South Asia and other Indian Ocean Islands. This geostrategic location of Kenya therefore is a major factor that most investors consider as important before investing in the country as they are able to move their cargo to any destination of the world. The geostrategic location has made Kenya the hub of Africa.

ii. Globalism/culture

Culture and global orientation of the population determines how fast the foreign investor adopts to the local conditions and acceptability as part of the economic system of the host country. Kenya multi-cultural society presents a situation where foreigners are easily integrated into the society. There is that national treatment for law abiding foreigners. This makes Kenya a suitable investment destination, attracting rich individual investors hence the large presence of foreigners in the country, such as the Indian billionaire Mukesh Ambani's Delta Corporation East Africa, Nigerian billionaire Aliko Dangote, Cement manufacturing, Robert Bosch, automotive components, Royal Philips, manufacture of electronics consumers goods and Bill Gates among others.

iii. Cost of doing business

The high cost of production associated with especially unreliable, unavailable and high cost of energy, have discouraged investors as the overhead expenditure impact negatively on the profitability of a business.

iv. Incentives

Some of the investors at the Kenya Export Promotion Zones (EPZ), established their business in Kenya as they were attracted by the favorable incentives offered such as fiscal, regulatory, procedural incentives, business facilitation and suitable infrastructure offered by the EPZ Authority *(EPZA acts as the intermediary between Investors and Government)*.

3. *Are you aware of any foreign investors who have withdrawn their investment from Kenya since year 2000?* **Yes**.

   The year 2000 is the year the EAC Treaty for establishing the East African Community came into force. This question was supposed to gauge whether the coming together of the East African Partner States into one community was a discouraging or an encouraging factor. The finding was some companies closed shop in EPZ and moved to different parts of the world, Most of those who moved out left after 2007 after coming to force of the fully fledged EAC Custom Union Protocol, which established an EAC single custom territory limiting market access for the EPZ firms to only 20% of their annual production to all the EAC Partner States.

4. *For the respondents who had, **Yes**, as an answer in 3 above*, the reason given as to why companies withdrew their investment from Kenya included:

   i. Economic environment and Intellectual property issues;

   ii. Increased cost of production due to increase in prices of overhead compared to other countries especially the cost of power;

   iii. Unfair competition from cheap imports from China and other developed countries;

   iv. Elapsing of the 10 year tax holiday for EPZs. These are investors not willing to contribute financial wise to the host country. Frequently such investors either transfer ownership or re-locate to other Partner States to gain a fresh similar benefit especially the fiscal incentives.

v. Companies in the EPZ that established their business targeting the other EAC Partner States as their export market, suffered loss of market access after coming into force of the EAC Custom Union(2007) which established EAC as a local market and the firms were expected to get export market out the EAC Custom territory. Some of the EPZ firms[59] that wind up includes: Norbrool Africa EPZ Ltd, Alliance EPZ Ltd, Plastex EPZ Ltd, and Plastic Compounders EPZ Ltd. In the year 2010 alone Kenya EPZ lost Kshs. 11.8billion worth of investment and 10,305 jobs as result of closure of some firms who had lost the EAC market after coming to force of the EAC Custom Union.

   This Protocol had failed during its formulation to consider the plight of the EPZ firms who had EAC as its export market. The protocol could have increased the threshold to the local market considering products from other EPZs such from the COMESA access the some of the EAC market under preferential treatment and from the rest of the world they only pay Common External Tariff (CET); and

vi. The uncertainty of extension of AGOA initiative beyond 2015, *(AGOA was to come to an end in 2015 but has since been re-authorized up to 2025),* caused some investors to hold on additional investment especially those dealing with apparel and textile products.

[59]EAC Secretariat, *Impact Study of the Custom Union on EPZ Firms in EAC, 2013*, pg 43

5. *Where did these investors relocate to?*

The investors relocated their investment to:

i. Other EAC Partner States for example Kenap EPZ dealing with textiles relocated to Uganda;
ii. Rest of Africa; and
iii. Rest of the World

This implies there are other investment destinations with a better investment climate than Kenya. Kenya needs to conduct a research on how to improve it investment climate to make the country more attractive to investors and also reorganize its investment policy to sustain and retain the investors.

6. *For majority of the incoming investors (since 2000) into Kenya, what would you say attracted them to investing in Kenya?*

The question was to capture whether investors saw/considered the establishment of the East African Community as a potential/ opportunity for investment. So what attracted the investors?

i. Domestic market growth potential; some saw the EAC population of over 143.5million people as market for their products;
ii. Proximity to regional markets preferential market access, as Custom Union with no internal tariffs and trading under Rules of Origin, was an opportunity to access other Partner States with less harassment and no duties;
iii. Political stability and supportive legal environment; political instability may cause investors to hold into their investment capital, but some

foreign investors plan with returns in mind rather than diplomatic rows. This is evidence in that since the Jubilee government took over the leadership there have been increased FDI inflows with billion worthy of deals with the China and Asian countries, against the warning of "*choices have consequences*" and travel warning by the US and some countries in Europe.

iv. Availability of highly skilled human resource and a Strong entrepreneurial and innovative environment;

v. Improved infrastructure, that is roads and railway transport and good communication network

vi. Liberalized and strong economy in the region;

vii. Strong private sector foundation; investors are free to join private sector groups such as the Kenya Private Sector Alliance (KEPSA) that ensures their issues are articulated collectively; and

viii. The government general pro-business stance; the government through its agencies such as KENIVEST and Export Promotion Council (EPC) provide satisfactory business facilitation and after care service to investors. There is political goodwill from the government evidence by the Head of State openly marketing Kenya and EAC as an investment destination while in his foreign missions and holding regular private sector round table.

7. *What according to you is one factor that discourages foreign investment in Kenya?*

The question was to capture what the government needs to look into improve the investment climate and also to gauge whether the EAC Integration discourages foreign investments. According to most responds some of the things that discourage FDI include:

i. High cost of production due to unreliable, unavailable and high cost of energy;
ii. Limited market access for the EPZ firms to EAC Custom territory. The EAC Custom Union provides that EPZ firms to offload only 20% of their annual production in the EAC market. This limitation of sales affected the profitability of the firms due to loss market.
iii. Delay in the implementation of the Special Economic Zone (SEZ) program;
iv. Uncertainty in the extension of the AGOA initiative beyond 2015; and
v. Negative publicity portrayed by international media especially with regards to activities related to terrorism and perceived lack of adequate security.

8. *What kind of impact do you think EAC integration has had on the performance of FDI flows in Kenya and why?*

   i. The EAC Custom Union limits the sale of good from EPZ firms to only 20% of their annual production. This has lead to the closure of at least 16 firms established before the said Protocol was ratified after losing the EAC market after the enforcement of this restriction;

ii. EAC integration has the potential to boost FDI inflows as integration creates a larger market thus increasing opportunities for potential investors;
iii. EAC is attractive in terms of the growing population which provides a large market and has strong aspects and commonalities for integration;
iv. EAC integration provides preferential market treatment to investors as application of Rules of Origin allows free movements of goods within the region at no internal tariff.

9. *Are you aware of any Cross- Border Investment (CBI) by Kenyan investors to the other EAC countries? Yes.*

The question was gauging impact of integration on CBI. Kenya has the largest presence in terms of cross-border investments[60] in EAC. There has been cross-border investment by at least seventeen companies (17)[61] in the following sectors:

i. Manufacturing, 2 companies;
ii. Banking and other financial services, 10 companies;
iii. Wholesale & Retail, 3 companies;
iv. Transport, 1 company; and
v. Media 1 company.

[60]EAC Secretariat, EAC *Cross Border Private Investment among the Partner States study*,2013, pp.21

[61]KENIVEST, *Direct interview*, 2014.

10. *What specific areas of intervention would you recommend that Kenya policy makers should enhance to improve investment climate in the country so as to attract FDI?*

To improve the Kenya investment climate, the respondents proposes that the policy makers have to:

i. Speed up the integration process by implementing the provisions of the Custom Union, Common Market and Monetary Union Protocols in order to achieve the objectives of the of Treaty establishing the EAC;

ii. Develop a national investment policy to guide investment promotion;

iii. Establishment of one stop shop for investment promotion to ease bureaucracy and cumbersome procedures to register, starting up and operationalize a business in Kenya; and

iv. Provide security for both persons and investments as provided for in the Kenya Constitution.

4.5.2 Performance of FDI and FDI determinants according to foreign investors in Kenya

Respondent: Foreign Investors in Kenya

Aim of the questionnaire: Gauge what determinant influenced foreign investors' decision to invest in Kenya.

1. *Name of company interviewed*: Botanical Extracts Ltd, INSTA products and New Wide Garments Ltd.

2. *Location of the headquarters operations*: Apart from New Wide Garments EPZ Ltd, the others had their headquarters in Kenya and no branches in other Partner States.
3. *Which year did you start operations in Kenya?* Apart from the Garments Company the others were established before the coming into force of a fully fledged EAC Custom Union in 2007.
4. *How many employees do you have in your enterprises*?

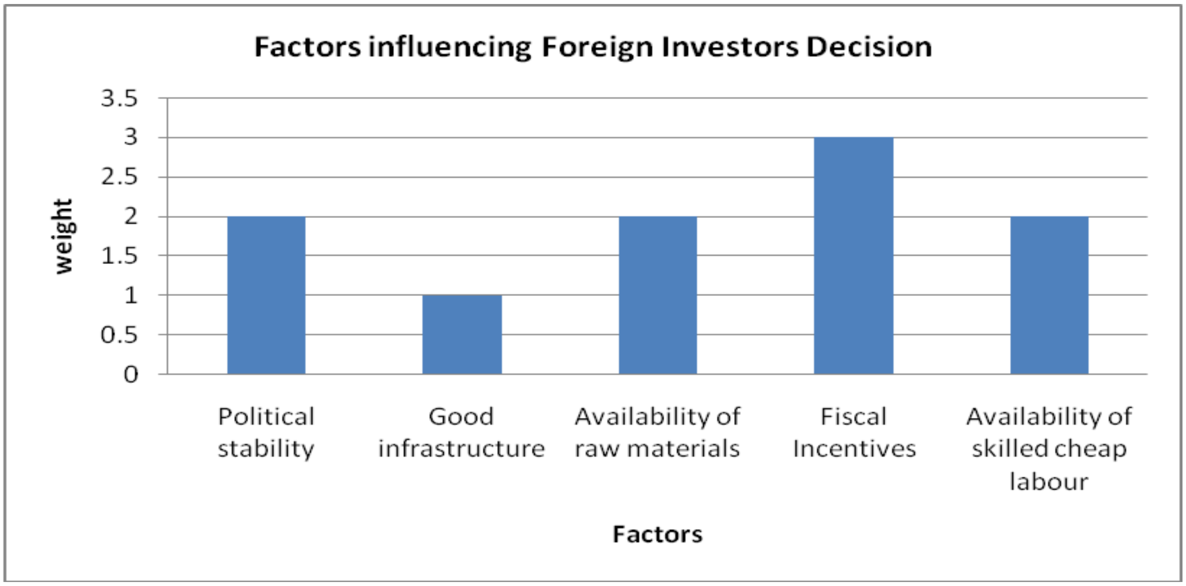
   Three (3) companies that provided this data employed a total of 7025 workers out of which 6807 were local this means 99.1% of the workers were Kenyans.
5. *What influenced your decision to invest in Kenya?*

   Some of the reasons given include: Availability of cheap skilled labor, availability of raw materials, provision of fiscal incentives, good infrastructure *(roads and communication)* and political stability.

Table13. Weighting of FDI investment decisions, foreign investors opinion

Company/ Factor	Insta Products Ltd	New Wide Garments Ltd	Botanical Extracts Ltd	Total weight
Political stability	1	1	0	2
Good infrastructure	0	0	1	1
Availability of raw materials	1	0	1	2
Fiscal Incentives	1	1	1	3
Availability of skilled cheap labor	0	1	1	2

Figure 12: Weight of factors influencing the foreign investors' decision



From the graph above it shows foreign investors target fiscal incentives especially the ones in the EPZ while majority others are interested in taking advantage of cheap skilled labor and availability of raw materials more than good infrastructure. This is especially true with investors in extraction industries.

6. *Has EAC integration impacted on your business?* If yes, how?

Some companies were affected while others were not. Companies affected were the ones in EPZ who had established business before coming to force of the EAC Custom Union and had established targeting the EAC market. Those outside the EPZ increased business as they access a larger market duty free.

7. *If you were making your decision today to invest in East Africa, would you still choose to establish your business operation in Kenya? If No, which coutry would be your best option and why?*

Yes; most investors are satisfied with Kenya as their choice of an investment destination.

8. *If you were given an opportunity to advice Kenya policy makers on what to do to attract and sustain foreigner investors in Kenya, what specific areas would you request them to enhance?*

   Most foreign investors would appreciate if policy makers put in place policies that encourage large scale production, so as to enjoy economies of scale and create more employment and in this regard lower power tariffs to especially industries that are labor intensive; and to ensure that border Custom officer operate on 24/7 schedule to avoid unnecessary delays.

CHAPTER FIVE: CONCLUSION

5.0 Introduction

This chapter gives an overview of the findings in relation to the study objectives and the hypothesis or the assumption on the research topic and gives a conclusion on the actual position.

The goal[62] of EAC is to improve the standard of living for it citizens through increased competiveness, value added production, trade creation and increased investment. EAC targets to boost the Partners States economic growth through promotion of trade, investments and industrial development[63] by exploiting it vast resources.

To enhance trade and investment EAC Partner States signed and ratified Custom Union Protocol (2005), Common Market Protocol (2010) and the Monetary Union protocol (2013) and are in the process laying down the foundations of the Political Federation. These initiatives are expected to facilitate market enlargement which in turn would enhance trade creation and create a favorable investment climate that would attract foreign direct investment (FDI) from within and outside the region.

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[62] EAC Secretariat, *The Treaty for the establishment of EAC, Article 79,* EAC Publication, revised version 2007,p. 58.

[62] Ibid

[63]UNCTAD Secretariat, World Investment Report 2011

The EAC integration is therefore expected to enhance the FDI determinants and as a result boost the flow of FDI. Global statistics show there has been an increase Foreign Direct Investment (FDI) flows to developing countries[64].

Has EAC integration enhanced Kenya's attractiveness to get a share of the global FDI?

5.1 Conclusion on the study findings

The research assumption was that "*EAC integration enhanced the FDI determinants leading to increased FDI inflows to EAC Partner States*".

This research examined the implications of EAC integration on the performance of foreign direct investments (FDI) in Kenya by answering the following questions: *What are the determinants of the FDI flows in Kenya? How has EAC integration process impacted on the performance the FDI flows in Kenya?* The findings could be used to improve FDI policies and to enhance FDI determinants.

This research conceptual framework was host country FDI determinants as identified in the World Investment Report (1998), these are: Policy framework for FDI; Economic Determinants and Business facilitation.

The study confirmed that several determinants influenced investors' decision to invest in Kenya. Economic determinants especially the market size and search for raw materials had the highest impact. The market size was attributed to the provisions of the EAC Common Market Protocol and an EAC market size of 143.5million people.

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Economic determinants:

The Economic determinants which include market seeking, resource seeking and efficiency seeking have slightly greater influence compared to the FDI policy, business facilitation and political stability. This is true considering that in Kenya major investors are resource seekers investing in extractive sector that is in oil, gas and mineral exploration. Others such vehicle assembly companies, iron and steel industries established targeting to exploitation the EAC market. Proximity to regional markets, preferential market access, in a Custom Union with no internal tariffs and trading under Rules of Origin, provides an opportunity to access other Partner States market with less harassment and no duties.

The research also found out some companies' closed shop in EPZ and moved to different parts of the world. Most of those who moved out left after 2007 after coming to force of the fully fledged EAC Custom Union Protocol, which established an EAC single custom territory limiting the market access for the EPZ firms to only 20% of their annual production to all the EAC Partner States. Some of the EPZ firms[65] that shut down includes: Norbrool Africa EPZ Ltd, Alliance EPZ Ltd, Plastex EPZ Ltd, and Plastic Compounders EPZ Ltd. In the year 2010 alone, Kenya EPZ lost Kshs. 11.8billion worth of investment and 10,305 jobs as result of closure of some firms who had lost the EAC market after coming to force of the EAC Custom Union Protocol. This Protocol had failed during its formulation to consider the plight of the EPZ firms who had

[65]EAC Secretariat, *Impact Study of the Custom Union on EPZ Firms in EAC, 2013*, p. 43

EAC as its export market. The protocol could have increased the threshold to the local EAC market considering products from other EPZs such from the COMESA access the some of the EAC countries under preferential treatment and from the rest of the world they only pay Common External Tariff (CET).The last scenario could be quoted as a negative impact of EAC integration on FDI flows.

Business facilitation:

The government through its agencies such as KENIVEST and EPC provide satisfactory business facilitation and after care services to investors. There is political goodwill from the government evidence by the Head of State openly marketing Kenya and EAC as an investment destination while in his foreign missions and holding regular private sector round table.

Political instability:

Political instability may cause investors to hold into their investment capital, but some foreign investors plan with returns in mind rather than diplomatic rows. This is evidence in that since the Jubilee government took over the leadership there have been increased FDI inflows with billion worthy of deals with the China and Asian countries, against the warning of "*choices have consequences"* and travel warning by the US and some countries in Europe.

The research shows that the determinants identified in the World Investment Report (1998) were not the only determinant that influenced the FDI flows in Kenya, as shown by a weight of 3.3 out of 5, for any other determinant (*Table 12. Weight of FDI determinants in Kenya by institutions).*

Other factors or determinants that positively influenced investor's decision to invest in Kenya includes: Kenya geo-strategic location, globalism and incentives while the cost of doing business and uncertainty of extension of AGOA initiative beyond 2015 were among other factors that discouraged investment.

Geo-strategic location:

Kenya is strategically located as a gateway to East and Central African region and investors consider this as important factor as they are able to move their cargo to any destination of the world from Kenya.

Globalism/culture: Kenya multi-cultural society presents a situation where foreigners are easily integrated into the society. There is national treatment for law abiding foreigners. This makes Kenya a suitable investment destination, attracting rich individual investors.

Incentives:

Some of the investors at the EPZ established their business in Kenya as they were attracted by the fiscal, regulatory and procedural incentives plus good business facilitation and suitable infrastructure offered by the EPZ Authority. This was supported by the fact that some investors transfer ownership or re-locate to other Partner States to gain fresh similar benefits especially the fiscal incentives after the elapsing of the 10 year tax holiday.

Cost of doing business:

The high cost of production associated with especially unreliable, unavailable and high cost of energy, have discouraged investors as the overhead expenditure impact negatively on the profitability of a business. There is need to reduce power tariffs to especially industries that are labor intensive.

Unfair competition from cheap imports from China and other developed countries is another factor not related to integration process that discourages investors coming to Kenya.

Uncertainty of extension of AGOA initiative beyond 2015: The AGOA programme was to come to an end on September 2015, this caused some investors to hold on additional investment especially those dealing with apparel and textile products but now that it was reauthorized to 2025, its expected there will increased investment in the production of AGOA eligible products.

Negative publicity portrayed by international media especially with regards to activities related to terrorism and perceived lack of adequate security discouraged investors. Case example is slow investment in the tourism industry that highly relies on the country's image abroad. Our marketing strategies are also wanting compared to other EAC Partner States. Case example Kenya investment promotion slogan, "*Brand Kenya"*, or "*unlocking Kenya investment opportunities*" compared to Rwanda, "*untapped global investment destination*".

Lack of a national investment policy to guide investment promotion and lack of well-developed one stop shop to ease bureaucracy and cumbersome procedures in registering startup businesses in Kenya keep investors away. The region should develop an e-registry where investors could register companies on line.

Though Kenya has the largest economy in the region, with a GDP per capita of USD 999.9 (2012), which translates to high purchasing power parity she has been attracting the least FDI in the region but has the highest FDI outflows to the other Partner States. Signs of recovery were noted in Kenya as from 2010 after the discovery of oil, coal and other minerals. The majority of the major FDI inflows were from China and UK. [66]

5.2 Conclusion on the study hypothesis

That, *"EAC integration enhanced the FDI determinants leading to increased FDI inflows to EAC Partner States".*

The study has confirmed that to ascertain extent EAC integration enhanced the FDI determinants but other factors / determinants that are not directly related to EAC integration played a major role in enhancing the investment climate in Kenya. To some extent EAC Custom Union discouraged investment in the EPZ.

The study therefore established that EAC integration had both positive and negative impact on the FDI flows in Kenya. Though the EAC market size of 143.5million people was available for the investors, the share of Kenya FDI remained low meaning other investment destinations have better investment climate than Kenya.

Therefore in conclusion EAC integration so far has not been the major driver of FDI flows into Kenya.

[66] *Investment report 2011*

5.3 Recommendations

Major FDI determinants in Kenya identified in this study include: economic determinants *(resource seeking and market seeking investors),* FDI policies, fiscal incentives and political goodwill.

EAC integration process provides preferential market treatment to investors as the provisions of EAC Rules of Origin allows free movements of goods within the region at no internal tariff. To maximize the exploitation of this opportunity Kenya has:

1. Conduct a research on the global best practices on how to improve her investment climate to make the country more attractive to foreign investors and also reorganize her investment policies to sustain and retain the existing investors.

2. To be in the forefront supporting and implementing the EAC Council of Ministers decisions and encouraging the other Partner States during the regional forums to implement the provisions of the Custom Union, Common Market and Monetary Union Protocols and remove all the restrictions on the free movement capital, goods, labor and services.

3. Kenya needs to urge other Partner States in accepting the amendment of the EAC Custom Union Protocol Article 25 (3) that limits market access for EPZ firms to 20% of their annual production. Yet the provision allows products from the rest of the world including Chinese products to access EAC market by just paying Common External Tariff (CET) or under COMESA preferential treatment. For Kenya to retain the investors who

established their business targeting the EAC Partner States as their market and were in place way before the EAC Custom Union was ratified, EAC has to amend this article and increase the EPZ firms' market access threshold to the EAC market. This will reduce the flight of investments from the EPZ firms that were established before the ratification of the Custom Union Protocol, and those who established business targeting the EAC Partner States as their export market.

4. Kenya to fast track the development of national investment policy to guide investment promotion.

5. Establish a one stop investment shop for registering start up businesses and ease bureaucracy and cumbersome procedures. It should aslo support the region to develop and operationalize a regional e-registry.

6. Kenya Investment Authority to urge the other Investment Promotion Agencies (IPA) through EAC Secretariat to conduct joint global investment promotion and market the region as one investment destination. The investors might see the sense of economies of scale while exploiting the larger EAC market.

7. Reduce the cost of doing business by investing in reliable and renewable cheap energy. Kenya to consider reduction of power tariffs for industries that have large annual production and those that are labor intensive to encourage employment creation.

8. Kenya must go an extra mile to eliminate the other negative factors highlighted in the World Doing Business Reports that discourage investment.

5.4 Areas of further Research

The gap that exists today that could call for further research includes:

1. *The level of implementation of the regional policies in all the Partner States?* This could be the factor hindering flow of FDI, as without being integrated through implementation of regional policies EAC will always be seen as individual sovereign states rather than a region which enjoys economies of scale.
2. *What is the status of social integration?* Are we one EAC citizen enjoying all the provisions of the EAC Common Market Protocol?

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7.0 RESEARCH GUIDE

PREAMBLE

The goal of East African Community is to improve the standard of living for it citizens through increased competiveness, value added production, trade creation and increased investment among other initiatives. EAC has competitive and attractive investment opportunities such as in agro-processing, mining, manufacturing, services, tourism and energy as identified in the EAC Industrial Policy and Strategy 2012-32.

The year 2015 is the 15th year of the current EAC integration; it's time Kenya evaluated the implication of EAC integration has had on its economy. This research targets specifically to evaluate the impact of EAC integration on the performance of Kenya Foreign Direct Investment (FDI) to give the policy makers facts on which to base the future decisions on FDI.

The research tools are two different questionnaires, one targeting the foreign investors with the aim of establishing the determinants that influenced their basing their investment in Kenya. The second questionnaire whose target respondents are government policy makers, who include among others, Kenya Investment Authority, Export Promotion Zone Authority, Export Promotion Council, Kenya National Bureau of Statistics, State Department of East African Affairs and Vision 2030 secretariat. These institutions will provide actual FDI statistics, current FDI determinants and future plans to improve the investment climate in Kenya.

7.1 ANNEX 1: *Questionnaire No. 1*

Respondent: Foreign Investors in Kenya

Aim of the questionnaire: Gauge what determinant influenced their decision to invest in Kenya

1. Name of company: ………………………………………………………
2. Location of the main/headquarters operations: County: ……………..; Do you have any other branches within East Africa ……….. if yes; in which country ……………
3. Which year did you start operations in Kenya? …………………..
4. How many employees do you have in your enterprises? …………; how many are Kenyan citizens? ………………
5. What influenced your decision to invest in Kenya?
6. Has EAC integration impacted on your business? ………………….

   If yes, how? ………………………………………………………
7. If you were making your decision today to invest in East Africa, would you still choose to establish your business operation in Kenya? If No, which country would be your best option and why?…………………..
8. If you were given an opportunity to advice Kenya policy makers on what to do to attract and sustain foreigner investors in Kenya, what specific areas would you request them to enhance? ……………………

7.2 ANNEX2: *Questionnaire No. 2*

Respondent: Government institutions

Name of Institution: ……………………………………

Respondent Designation: ……………………………………

Aim: Facts on the FDI performance and FDI determinants in Kenya

Determinants of FDI in Kenya

The World Investment Report 2011 shows that FDI is diversely distribution across the world, with some regions of the world attracting a lot of FDI while others almost nothing. This means there are specific determinants that drive foreign investors to those regions. According to UNCTAD (1998) there four host country determinants that influence the investor's decision on where to invest. These are:

i. ***Economic determinants***: which include market seeking, resource seeking and efficiency seeking;

ii. ***Policy framework for FDI:*** include rules and regulations governing the entry and operations of foreign investors, the standard treatment accorded to them and the functioning of the market they operate in.

iii. ***Business facilitation***: include improved business climate e.g. reducing barriers for FDI and assuring foreign investors of a function market and a level playing ground for all investors.

iv. ***Political Stability***: politically stable government.

1. In your view which determinant influences FDI in Kenya? Rate the determinants in a scale of five (5), with 5 being the highest weight.

Weighting scale of 1 to 5

No.	***Determinant***	***Weight***
1	Economic determinants	
2	FDI policy	
3	Business facilitation	
4	Political Stability	
5	Any other	

2. If you gave a weight of more than one (1) in the determinant "any other" above; list your additional determinants and give brief description of how/why you think it influences FDI flows in Kenya.

   ……………………………………………………………………………

3. Are you aware of any foreign investors who have withdrawn their investment from Kenya since year 2000? …………….

4. If yes; what was the reason they left?

   ………………………………………………………………………………………

5. Where did they relocate to? Fill in the No. that relocated to each area:

   i. ☐ East Africa,

If within East Africa to which country: ☐ Burundi; ☐ Uganda; ☐ Rwanda; ☐ Tanzania

ii. ☐ Rest of Africa

iii. ☐ Rest of the World

iv. ☐ Don't Know

6. For majority of the incoming investors (since 2000) into Kenya, what would you say attracted them to investing in Kenya?

   …………………………………………………………………………………………………

7. What according to you is one factor that discourages foreign investment in Kenya?

   ………………………………………………………………………………………………

8. What kind of impact do think EAC integration has had on the performance of FDI flows in Kenya and why?

   ………………………………………………………………………………………………….

9. Are you aware of any cross- border investment by Kenyan investors to the other EAC countries? .... If yes approximate how many? ………………………..

   (Where possible give No. of Investors per sector)

   ……………………………………………………………………………………………

10. What specific areas of intervention would you recommend that Kenya policy makers should enhance to improve investment climate in the country so as to attract FDI? …………………………………………………………………………………………………