The Foreign Direct Investment Environment in Africa

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Abstract

This paper discusses the legal, business and economic environment for Foreign Direct Investment (FDI) in Sub-Saharan Africa. It finds that despite recent improvements the FDI environment is still inadequate to attract high quality, efficiency-seeking, globalizing FDI; and that Africa is lagging behind in the development of its competitive factors of production. It suggests a way forward - which includes improving the competitiveness of the investment climate; attracting FDI into existing areas of comparative advantage, such as extractive and other natural resource activities; developing regional networks and integration; and accelerating privatization.

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The Foreign Direct Investment Environment in Africa

Introduction

Globalization - a worldwide trend towards integration of markets – is changing the strategies of multinational companies (MNCs) and the way developing countries compete for foreign direct investments (FDI). Faced with increased international competition, MNCs' global strategies seek to maximize their competitiveness by locating facilities in multiple locations around the world. In this 'globalizing' world, attracting FDI increasingly depends on the ability to provide a *favorable FDI regime* and *competitive factors of production*. The former requires a stable, efficient, and service-oriented environment that welcomes investors into most economic activities without discrimination. Modern legal and intellectual property rights, effective competition policies, a strong judiciary and minimum bureaucratic harassment are all important to attract foreign investors. The latter are the ultimate determinants of FDI. Competitive factors of production no longer mean just cheap raw labor and basic infrastructure. Today they require adaptable labor skills, sophisticated supplier networks and flexible institutions. Tax incentives can enhance a country's attractiveness, but, if other factors are unfavorable, they will be insufficient to significantly increase inflows of FDI.

This paper examines some aspects of the legal, business and economic environment for FDI in Sub-Saharan Africa (SSA) and asks the following questions:

- Is the FDI environment in SSA – incentive framework and competitive factors of production- adequate to attract FDI in a globalizing world?

- What should African countries do to improve the environment?

Summary

The FDI environment in Africa is still inadequate to attract high quality, efficiency-seeking, 'globalizing' FDI.

The general policy framework of FDI in the region has improved greatly in recent years, a trend that is continuing in many countries. However, the incentive framework continues to suffer from a number of deficiencies:

- *Barriers to entry still exist in many countries.* In some countries, certain sectors are reserved for domestic firms only. Almost everywhere registration requirements for foreign investors are burdensome thus raising transaction costs.
- *Generous and costly incentives for investment*. In recent years there has been a considerable effort to streamline incentives and harmonize them through the signing of regional agreements or Common Investment Charters. However, many countries still retain generous investment incentives (in particular,

costly tax holidays) and the authorities maintain considerable discretionary powers on the allocation of incentives.

- *The effectiveness of FDI promotion in SSA is generally low*. Most agencies are struggling with a difficult transition from a regulatory role to a promotional one. They often lack the authority to help investors cope with the myriad ministries, departments and agencies. They are often under-funded and there is insufficient private sector participation.

Africa is lagging behind in the development of its competitive factors of production.

Economic, rather than policy factors are likely to be bigger constraints to FDI in Africa. During the last 10 years educational, health and infrastructure indicators have worsened in many countries and are now below standards found in countries of other developing regions. Improving the competitiveness of Africa's investment climate is a major challenge in light of deteriorating education and health systems (at least in some countries), weak physical infrastructure and lack of back up services for enterprises. It is hoped that the additional resources freed up in the near future from the implementation of debt reduction initiatives will allow countries to spend more on raising social indicators and physical infrastructure and on rebuilding institutional capacity.

What then is the way forward for Africa?

- *First*, African countries should aspire, in the long run, to join the club of countries attracting significant amounts of high-quality, export-oriented FDI. To achieve this will require upgrading national laws and incentives to best international practices; lowering transactions costs (i.e. the costs related to setting up business, dealing with bureaucracy, paying taxes, exporting and importing, hiring and firing workers etc.); and improving the supply of skills, infrastructures legal and judicial systems and institutions. First priority should go to rationalizing tax rates and incentives. Incentives should be retained only if they are moderate and in line with development objectives.

- *Second*, African countries should aim to increase FDI inflows into existing areas of comparative advantage such as *extractive and other natural resource activities* and adopt appropriate policies to maximize their benefits. These sectors provide potentially high rents and do not require fiscal incentives to attract FDI. Rather, foreign investors place a premium on title security (for exploration and exploitation concessions), clear entry rules, guarantees against unreasonable government interference, a transparent fiscal regime, and guidelines on environmental and health standards. However, investment in natural resources sectors brings with it a number of drawbacks. First, mineral, energy and primary product prices have historically fluctuated widely thus exposing the countries to great vulnerability. Second, many natural resources are non-renewable unless very strictly managed. Third, natural resource investment can attract massive inflows of foreign currency that can lead to a continuous appreciation of the local currency. Finally, many MNCs operating in these sectors (e.g. minerals, oil, gas) are capital

intensive with standardized processes that require very little adaptation to local labor and technologies, thus generating only modest spontaneous positive spillovers and backward linkages to the local economy.

- *Finally*, *privatization* should be pursued. It may become a powerful instrument to attract foreign investors, provided they can count on fair and stable rules of the game. Privatization can result in net gains for both foreign investors and the country, though the interests may, at times, appear to diverge. Foreign investors are interested in access to market share of the enterprises that are being privatized, rather than in acquiring productive facilities (with the obligation to restructure and rehabilitate, and often with its consequent downsizing). They might require special deals or continuation of existing protection. By contrast, Governments objectives in privatization are to have better services for consumers, higher budget revenues and faster growth. The challenge for the Government is to protect both foreign investors and consumers, and make sure that the benefits from privatization are equally shared. To this aim, Governments should set clear rules regarding not just privatization rules but competition and pricing rules. Particular care should be taken in the privatization of infrastructure. Foreign investors are difficult to attract, as they face potentially large financial risks, because of sunk costs, as well as political risks associated with civil war, change of regimes and expropriation. Stable and peaceful countries, with a clear and transparent regulatory framework – including the rules governing entry conditions and market structures- have the best chance in attracting FDI. Governments must prevent undue market concentration and restrict mergers that would undermine competition; and introduce environmental, health and safety obligations of public services.

I. The new global environment

The old FDI paradigm

A firm undertook FDI in a foreign market if it possessed an 'ownership advantage' over local competitors (Caves, 1982, Dunning, 1992 and 1993). This advantage compensated for the greater costs incurred (due to lack of information about the legal system, bureaucracy etc.) relative to local firms. Ownership advantages include advanced technology, established brands, specialized skills and access to final markets. Under the old paradigm, MNCs invested in a developing country to exploit differentials in natural endowments and in factors of production. In this 'vertical'[1] or cost minimization strategy there were essentially two reasons for FDI: access to inputs for production (natural resources, low-cost labor etc.) and to markets for output. MNC would relocate

1 See Michalet (1997). Should be noticed that the bulk of FDI follows a horizontal strategy, within developed countries. The horizontal strategy involves establishing local branch plants in economies that are roughly at the same level of development, similar technology and consumer preferences. This strategy is followed by firms that operate in oligopolistic or monopolistic markets and that have specific competitive advantages over similar local firms that compensate for the costs of relocation and business in the foreign country.

production units based on differences in macroeconomic and political fundamentals, investment policies and economic competitiveness and attractiveness of host countries.

Host countries wishing to attract resource-based FDI attempted to lower location costs by raising the quality or lowering the costs of local inputs, or by offering foreign investors privileged access to local inputs. Countries with exploitable natural resources and a cheap and disciplined labor force had a clear advantage. The latter has been the engine of growth in export-oriented assembly activities around the world, both in low technology activities such as clothing as well for assembly operations in high-tech activities such as electronics. Countries with access to larger markets and quota availability in products such as textiles and clothing, under the MFA (e.g. Bangladesh) attracted export-oriented activities.

For countries with large and growing markets (such as Brazil or India) import protection represented the most powerful incentive for attracting foreign investors. While a powerful means of fostering industrial development, import substitution often created large inefficiencies, keeping alive infant industries that never matured. Most FDI was greenfield, in highly protected, high cost and low productivity activities, as it had to compete only with local firms with low standards of efficiency. Foreign investors rarely transferred up to date technology, managerial know-how or export marketing capacity, as these were not needed to compete. The limit on the volume of FDI was set by the saturation of the market. FDI was largely a substitute for trade.

The new FDI paradigm

The new paradigm emerged with the 'globalization of production' phenomenon, spurred in the 1980s by improvements in international transportation, the intensification of policy liberalization in both trade and investment flows and the information technology revolution (World Bank, 1998, 1999, UNCTAD 1999). Falling transport costs and the liberalization of trade and investment policies allows MNCs to move easily in and out of countries thus helping them to adopt integrated regional and global strategies. Policy liberalization reduces the role of trade policy (import protection, export performance clauses) in attracting FDI and minimizes the role of host governments in making investors externalize their intangible technological or marketing assets (selling or licensing them to local firms). Two aspects of policy liberalization have been key in attracting FDI to developing countries, particularly in Africa. They are: allowing foreign participation in privatization and in new infrastructure projects under a variety of contractual and ownership arrangements, and opening domestic capital markets to mergers and acquisition.

Falling communication costs allow parent companies to exercise much tighter control over affiliates and to integrate them more closely into their activities. MNCs allocate their activities and functions over host countries in line with their economic assets and competitive position. The rapid pace of technological change implies that host economies have to provide more skill and technology intensive inputs, and institutions and infrastructures that are needed for efficient production. Investors demand tighter

intellectual property protection and better enforcement of the relevant laws and rules. A significant part of global FDI is in mergers and acquisitions, rather than in greenfield activities. This is a better way for global enterprises to acquire the facilities they need (i.e., administration, research, accounting etc.) where and when they need them.

In a globalizing world, *trade and investment* tend to become complementary. Countries with open policies attract FDI in export activities, building on existing comparative advantages. Global investors need free trade and free foreign exchange regimes to maximize economies of scale generated by multi-country production centers. In this context, foreign investors are likely to support local policy makers in their efforts to further liberalize the economy as this improves their competitiveness in export markets. By contrast, foreign investors operating in and benefiting from a restrictive trade environment would more likely support a protectionist agenda.

New determinants of FDI

In a globalizing environment, many of the traditional determinants of FDI such as political and macroeconomic stability, availability of natural resources and a large and growing market remain important. However, there are new FDI determinants:

- *A favorable FDI environment*. This essentially means a transparent and non discriminatory regulatory environment, effective competition policies and an efficient judicial system. Low and stable tax rates are also important. Fiscal incentives may increase the attractiveness of a country but cannot substitute for the lack of a healthy FDI environment. Promotion activities may also help attract FDI but only when the basic framework is in place, including equal treatment of foreign and local investors and fast dispute settlement mechanisms.
- *Low transaction and business costs.* These cover investment, labor and trade regulations, entry and exit rules, location and environment regulations, and tax and legal systems. They depend not so much on the rules but on the way rules are implemented in practice and on the skills of the bureaucracy in dealing with the investors, as well as on the legal and judicial system.
- *Supplier networks and clusters.* Countries with dynamic local firms have an advantage in that they can attract better 'quality' FDI that subcontracts services and components of their production process to local firms.
- *Support institutions and technical services. E*ssential infrastructure facilities include effective quality assurance and testing bodies, metrology and calibration services, contract research and technical extension help for SMEs.
- *Human capital.* Low-cost, unskilled labor is becoming less important. There is a greater demand for qualified human capital with diverse modern skills that can cope with emerging technologies. Equally important are labor market flexibility including the use of expatriate personnel.
- *Low cost infrastructure,* in particular an efficient communications system as well as transportation links within and outside the country are essential to make a country attractive.

The benefits of FDI, however, do not come automatically to developing countries. MNCs and host governments have different objectives: the former aim to increase their profitability in an international context; the latter aim to foster development in their countries. In a globalizing world, where MNCs can enter and exit with relative ease, Government policies are more important than in the past. Host governments should develop policies that are both friendly to investors and that maximize the contribution of FDI to development (Moran, 1999).

Peripheral countries can still attract FDI

Few developing countries satisfy the requirements above. FIAS research suggests that only about a dozen developing countries can attract significant amounts of the new, globalizing FDI. This list includes countries such as Hungary that have no natural resources and relatively expensive labor, and Costa Rica, chosen by Intel for its high-technology chip assembly and testing plants, because of its good business environment despite its high wages. (FIAS 1997, Michalet, 1997).

Many developing countries lack some or all of the requirements outlined above and are thus becoming more peripheral to the considerations of MNCs. However, some of them can still attract FDI in a number of activities, on the basis of large and growing markets, low costs production conditions and natural resource sectors. For example, in China the investment climate is weak but the country has plenty of low-wage labor producing low-cost consumer goods for exports and this has proved highly attractive to foreign investors.

Low-cost and unskilled labor countries can attract "foot-loose investors" particularly when these endowments are coupled with fiscal incentives such as tax holidays (particularly in the textile and garment sector) and adequate basic infrastructure. These investors put a premium on the ability to move quickly from one country to another and are more interested in short-term financial gain, than in long-term economic profitability. Still, they provide benefits to host countries, in terms of employment and wages. In the past, despite generous investment incentives, and availability of cheap labor, African countries have not succeeded in attracting "foot-loose" investors. None of the export processing zones (excluding Mauritius) has been successful. The reasons are to be found in restrictive provisions, bureaucratic procedures and weak government bodies established to develop and operate the zones.

Resource-rich countries that offer attractive and stable conditions for exploration and development are also likely to continue to attract investors. This is the sector where most FDI to Africa went in the past and where it is most likely to go in the future. In fact, globalization is decreasing the overall risk for MNCs in this historically risky sector by spreading it across countries with different risk profiles. Thus, provided the projected cash flow is adequate, even countries with high political and country risk may attract FDI if the company can counterbalance this with low risk exposure in other countries. However, unless it can create the necessary skill and supplier bases, the host country may

not be able to use the benefits from FDI to move up the value chain and develop other sectors.

The example of Chile (see Box 1) is instructive. By promoting export-oriented growth through the development of its natural resources, Chile has managed to attract an increasing volume of FDI in natural resource based sectors and to become a leading world exporter of natural resource-based products. However, partly because of the "enclave" nature of these sectors with few spillover and linkages with the rest of the economy, the development of more skill-intensive industries with better prospects for longer-term competitiveness was discouraged. The country has not yet managed to use its resource-based export industries to lay a solid human capital foundation for industrial diversification and deepening.

Box 1: Chile: benefits and limitations of attracting FDI in natural resources sectors

Chile is a successful example of a country that has managed to attract massive inflows of FDI into natural resources and to gain increasingly high export shares. It managed to attract FDI into both traditional sectors – copper and copper based products, forestry agribusiness and fishing – as well as new ones - production of fresh fruit, cellulose, timber, fish-meal and fresh fish (Pietrobelli, 1998).

The shift towards resource-based industries during the 1980s and 1990s in the Chilean economy resulted in a major change in the country's export composition. The share of natural resources in total exports increased from about 50% in 1980 to almost 70% in 1995. Chilean affiliates of MNCs brought many benefits to the economy. For instance, the acquisition of state-of-the-art capital goods and foreign licenses resulted in high levels of productivity and boosted the country's international competitiveness in these sectors. Also, as inputs were predominantly procured from local suppliers and subcontractors many backward linkages emerged.

The reasons for Chile's success are manifold. First, there was macro economic and political stability. Second, since the mid-1970s the country had adopted an export-oriented strategy and market reforms. Third, Chile's FDI laws are considered fair and non-discriminatory. The Chilean FDI regulatory and tax regime [2] is simple, transparent and non-discretionary with all companies competing on equal terms. The only incentive for foreign investors is a VAT exemption on imported capital goods not produced in Chile. There are no limitations on foreign participation in investment projects and profit remittances are not subject to any restrictions. Finally, even though the State retains legal ownership of mining resources, concessions can be renewed indefinitely.

There are, however, some limitations to this experience that suggests that countries should not depend on a strategy almost exclusively based on natural resource-based exporting. While FDI in Chile has contributed to strengthening the country's static advantages, in sectors where exports could be expanded easily in the short term, the exports emanating from the natural resource sectors have remained low-skilled with a low R& D component. This despite the fact that many affiliates used 'state-of-the-art' technologies *within* their respective sectors; these technologies are relatively undemanding in terms of capabilities compared with those needed in other sectors of industry (e.g. electronics). And while MNC affiliates invested heavily (1.3% of sales) in training to develop human resources *internally*, spillovers from this training appear to have been fairly limited. In part this is because the companies are highly capital-intensive and generate relatively little direct employment. Finally, the recent collapse in the price of copper has exposed the fact that a country highly dependent on one traditional resource is vulnerable to fluctuating economic conditions in world markets.

Source : Lall (1998)

Privatization programs also present opportunities for attracting FDI. The first requirement for encouraging the participation of foreign investors is a set of clear rules regarding the privatization procedures as well as transparent and solid regulatory framework for the sectors that are being privatized. This includes preventing market concentration and setting up systems to ensure that the interests of the consumers and of the environment are protected. If this doe not happen, privatization will attract only foreign investors lured in by the possibility of huge rents in monopolistic (or protected) sectors. In Africa there have been successful examples of privatization, with a strong participation of foreign investors (e.g. in both Ghana and Uganda).

2 As far as the tax regime is concerned, foreign investors have the option of choosing from two schemes. Under the regular scheme, a 15 per cent corporate tax is paid when profits remain in the country and 35 per cent when profits are remitted abroad. Under the invariable tax regime, the firm pays 42 per cent for a maximum period of 20 years.

II The FDI environment in Africa

The incentive framework

The policy framework with respect to FDI has improved throughout much of Africa. First, most countries in the region have concluded bilateral treaties and have signed multilateral agreements with international organizations. Restrictions on external account transactions have been largely eliminated and many countries have shifted to market-based exchange rates. Simplification and reduction of tariffs has proceeded steadily. Annex I shows the participation of African countries in international, regional and bilateral agreements [3]dealing with FDI. Such participation is an important signal that a favorable policy environment is being created and that practices are being raised to the level of international standards and contribute to creating international recognition. The binding nature of a bilateral or international treaty contributes to securing a favorable climate for FDI.[4]

Second, the harmonization of investment laws and incentives has been intensifying during the last couple of years. For example, countries[5] in Eastern and Southern Africa that adhere to the Cross Border Initiative (CBI) have adopted a common Road Map for Investment Facilitation. By this initiative CBI countries have agreed to simplify and codify all regulatory provisions into a single published document that would be widely available. They also agreed to establish one-stop centers that will process all applications within 45-60 days and grant automatic approval in the absence of objections at the end of that period." (CBI, 1999).

Similarly, countries in various regional associations (the Central African Economic Community and Monetary Union, the West African Economic and Monetary Union (UEMOA) and the Southern African Development Community (SADC)) have either signed or are finalizing similar Investment Protocols. These documents are meant to set out common and general rules for the promotion of both local and foreign investment, transparent and non-discriminatory procedures for entry and operations of investments, a common fiscal regime, and the harmonization of fiscal incentives.

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3 Bilateral treaties aim at promoting investment between the two contracting parties; they normally refer to national laws for standards of treatment and protection in accord with international law - national treatment, MFN and fair and equal treatment of investments – and may accommodate specific country concerns. At the regional level the important issues are – liberalization of restrictions to entry and establishment of FDI, elimination of discriminatory conditions and a streamlining and harmonization of investment incentives.
4 For example, countries that are member of the WTO have to satisfy the performance requirements in TRIMS (Agreement on Trade-related Investment Measures). TRIMS contains a list of measures that are to be abolished, including local content, trade balancing (requiring that imports should be a certain proportion of exports), manufacturing requirement and limitations, foreign exchange balancing requirements, export performance requirements.
5 Countries participating in the cross Border Initiative (CBI) are: Burundi, Comoros, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe.

Investment liberalization and incentives

Notwithstanding recent improvements to streamline and remove obstacles to investment, the legal and fiscal framework for FDI in Africa presents several shortcomings. Table A2 in Annex I describes the main tax and incentive provisions in a number of African countries. Here are some summary considerations.

- There is considerable variation in FDI *entry procedures and requirements* across African countries. Certain sectors like tourism, petroleum and minerals are often placed under special approval regimes. For example, in Botswana, a prospective manufacturing investor has to obtain both an investment license as well as approvals from the land board and district councils. The investment has to satisfy criteria on capital adequacy, technical skills, and the interests of the economy. Incentives can be granted only to registered companies, which are only allowed one application per 12-month period and MNCs are not allowed in activities reserved for domestic SMEs. In Cameroon investment in SMEs must have 35% local equity. In the Republic of Congo, investors from outside the Central African Customs and Economic Union (UDEAC) region have to deposit 1% of invested capital. In Gambia, investors have to go through several government departments to get their applications approved. In Kenya, multiple licenses are needed before the investor can set up a business. Some of these, like land title transfer and registration, can take from six months to eight years. Special authority is needed for oil and mineral prospecting. Mozambique reserves several activities for the public sector and encourages local equity participation, even in EPZs. Nigeria requires approval from both the Ministry of Internal Affairs and the Ministry of Finance for new investments. In Uganda, potential investors have to establish that the project generates economic benefits like foreign exchange, employment, use of local raw materials, or technology transfer. Zambia requires a variety of different approvals by different agencies.

- The *granting of investment incentives* is variable, with some countries still operating on a discretionary, case-by-case basis that gives rise to delays and non-transparent procedures. The *nature of investment incentives* is also variable. Many countries grant tax holidays for 5-10 years. International experience (see Box 2) shows that tax holidays are biased against long-term investments and against equity financing and that they are very costly to governments. Only a few, like Ghana, have moved to a system of abolishing tax holidays in favor of low general tax rates. Many countries grant depreciation allowances on a straight-line basis, with differing rates for different items of capital. Relatively few, like South Africa, allow accelerated depreciation, though this appears to be the preferred tool in most modern tax regimes. The South African government grants several industry specific incentives (e.g. for textiles and automobiles) and activities (innovation, SMEs). Kenya also has industry specific incentives.

- *Tax systems.* Many countries are bringing tax rates in line with international norms, but tax systems still need to be rationalized and harmonized. Double taxation treaties have to be finalized by many countries, both within the region and elsewhere. The

tax treatment of such important items as R&D, training and new equipment purchase needs to be modernized. *Loss carry-forward provisions* vary, with some countries allowing 3-5 years and others giving indefinite periods. When short periods are given for carry-overs of losses firms may be subject to income tax, even though they have cumulative net losses (this discourages large scale investments with long gestation periods). *Withholding taxes* on royalties, fees, interest payments and dividends are similarly variable by country. South Africa and Zimbabwe (in EPZs) do not impose such taxes, while in others they are high (Kenya imposes 20% on royalties) and can vary by origin of investor (e.g. Uganda and Zambia). Withholding taxes on dividends received by non–residents affects companies financing decisions. If interest payments can be deducted from the taxable income, foreign investors will prefer to finance themselves through debt rather than equity. *Royalty and technical fee limits* have been removed in most countries, but some, like Nigeria, still impose limits on such fees. Some countries levy custom duties and other taxes on imported capital goods, thus increasing the cost of investment.

- *Work permit* regulations are highly variable, with many countries still making it difficult and cumbersome to obtain expatriate permits quickly and efficiently.

- *Export Processing Zones*. Many countries in Africa have created EPZs and maintain incentives for firms operating in them. However, with the exception of Mauritius, no other African EPZs can be regarded as successful in terms of attracting FDI or stimulating exports and employment. While investment incentives provided are often generous, restrictive provisions and bureaucratic procedures erode their effectiveness. The cornerstone of a successful free zone program is the transparency and comprehensiveness of the incentives offered and the quick response to their application, without the need for elaborate qualifying criteria. Other weaknesses include weak government bodies established to develop and operate zones, and regulate free zone activity. Regulatory authorities lack the basic power, autonomy and funding to function effectively. Some lack control over their budgets and have restrictive civil service limitations on remuneration and employment conditions.

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

Box 2: Are investment incentives effective in attracting FDI?

Investment incentives include *direct instruments* (grants or subsidies, tax holidays, investment tax credits, depreciation allowances etc.) to reduce the fixed costs of making an investment and *indirect* instruments, such as trade tariffs and quotas and foreign exchange restrictions, that affect the decision to invest. International research and experience (McLure, 1999, Shah, 1995, Dunning, 1993) suggest that incentives rarely attract additional investment, they have a high fiscal cost and create distortions in the allocation of resources. Why then do most developing countries continue to use incentives to attract foreign investors? Partial analysis suggests that some incentives, such as import protection in countries with a large internal market, have been very powerful in attracting investment. Cash and fiscal inducements to invest in particular industries or less developed regions have also been successful. But the analysis of the overall impact of the incentives suggest that the costs in terms of inefficiency, misallocation of resources, and revenue loss for the Government are significant and make these incentives a costly way to promote investment. In a study conducted in 1985 Guisinger reached the conclusions that cost reducing incentives tend to be effective when the investment decision is between similarly attractive locations for producing for exports to other markets; or similarly attractive parts of one large markets (such as Europe, the US, Brazil). This conclusion is confirmed by a number of studies which have analyzed the effect of different tax rates on location decisions of foreign investors in the US, a country where many states offer similar economic and political conditions (Siggle 1986, Coughlin *et al*. 1991, Hines 1993, and Coughlin 1995). Studies on how tax incentives influence location decisions of MNCs among countries give ambiguous results. Thus, Wheeler and Mody (1983) suggest that differential tax rates do not seem to have significant effect on location decisions of US direct investors. By contrast, Shah and Slemrod (1991) show that US direct investment to Mexico was sensitive to tax regimes.

Which incentive framework works best to attract FDI? UNCTAD (1997) found that the success of Latin American countries in attracting FDI was attributed to the following: (i) liberalizing investment (including the granting of de facto national treatment to foreign investors, the elimination or reduction of restrictions on profit remittance and other financial flows and the opening of sectors previously closed to FDI); (ii) establishing investor promotion agencies to stimulate foreign direct investment; (iii) entering into bilateral investment treaties with developed countries and among themselves; and (iv) implementation of new sub-regional arrangements to deal with FDI. Designing an efficient framework for investment that attracts FDI without losing considerable revenue is a difficult exercise. Textbook analysis shows that it should meet the criteria of efficiency (minimizing its impact on resource allocation); equity (similar taxpayers should be treated equally); and simplicity. The effectiveness of incentives depends on the type of investor, the degree of competition for the investment, and the response of other countries to changes in their competitors' incentive scheme. Start up firms prefer cash grants or other incentives that reduce initial expenses; firms with larger investments in fixed assets may prefer depreciation allowance. Tax holidays, an instrument used frequently by African countries, are attractive to the so-called foot-loose industries that utilize rapidly depreciating capital. But they are not useful for attracting investments that may not show profits in the initial years. They reduce the appeal of debt financing of capital investment by removing the benefits of interest deductibility. This funding bias is accentuated if dividends of tax-exempt firms are also exempt from personal income tax. Tax exemptions tend to benefit investments with a short-term time horizon. Longer-term projects that generate profits beyond the tax holiday period do not benefit, unless firms are permitted to accrue and defer asset depreciation deductions beyond the tax holiday period. Accelerated depreciation allowances and investment expenditure allowances encourage longer term investment and probably cost the government less than tax holidays. However, they discriminate in favor of machinery and capital and, if inflation is high, they are an inducement for companies to borrow rather than use equity.

Investment Promotion Agencies (IPAs)

In the original monograph "Marketing a country", which has become the standard description of what IPAs should do (see Box 3), L. Wells and A. Wint (1990) investigated the importance of promotion efforts in determining FDI. They found that promotion efforts were highly successful: every dollar spent generated benefits with a present value of almost four dollars. The most effective efforts were those directed to match up the needs of investors. Personal contacts had a larger impact than impersonal advertising. In reviewing the last 10 years of experience, L. Wells (1999) found that most of the original prescriptions are still valid. In addition, for African and transition economies the policy advocacy function (whereby the IPA becomes a champion for improvements in the investment climate, L.Wells, 1999), was also found to be crucial.

Box 3: Investment Promotion Agencies

Investment Promotion Agencies (IPAs) have a wide range of institutional structures. In general, they can be grouped into the following categories: i) *Government organizations*, usually staffed by civil servants seconded from line ministries; ii) *Quasi-government organizations*, typically financed by the Government (totally or in part) but autonomous in their decisions and operating outside civil service guidelines and salary structures; iii) *Private organizations*, run by firms operating under the private sector companies law. Outside Africa, the most common approach for IPAs is the quasi-government structure. Three successful examples are the Singapore Economic Development Board, the Malaysian Industrial Development Authority; and the Irish Development Authority. Purely private sector IPAs are common in Latin America, with notable examples in Costa Rica and the Dominican Republic. Private IPAs rarely undertake the investment regulation and incentives provision function.

In addition to variations in structure, IPAs vary in function (Wells and Wint, 1990). In the past, many IPAs would undertake *Investment approval and regulation* (e.g., screening and approving investments, monitoring compliance, and compiling statistics on investment impact). Currently, most IPAs concentrate on: i) *Investment facilitation* (e.g., "trouble shooting" investor problems and assisting in securing secondary licenses and permits); ii) *Research and development* (e.g., investment policy impact analyses, policy development and advocacy, publications); iii) *Investment promotion* (image building, investor services and investment generation.). There are three basic techniques utilized to attract investments. First, image building using advertising and other media relations to create or change the image of the investment location. Second, investment generation utilizing a variety of pro-active techniques to generate inward investment, and finally investor services designed to facilitate and realize an investment commitment and retain and facilitate the expansion of existing investors. Institutional effectiveness of IPAs appears to be linked to: (i) degree of managerial and financial flexibility; (ii) flexibility in hiring, compensating and firing staff without public sector restrictions; (iii) an independent Board with direct private sector participation; (iv) high level of power and autonomy in decision-making; and (v) simplified procedures and lack of bureaucracy. The effectiveness of an investment agency typically has as much to do with its implementation as with its structure.

One important factor for success is the *full commitment and backing from those at the highest level of the government*. Placing the agency directly under the authority of the office of the head of state is a good indication that this commitment exists. Or, following the example of Singapore, having a high-powered International Advisory Council to guide FDI strategy is another indication of the seriousness of the commitment. It also allows the IPA to have independent business advice to supplement guidance given by the government.

Many African IPAs are still *government agencies operating one-stop facilitator frameworks.* Some twenty-five African IPAs are currently members of the World Association of Investment Promotion Agencies (WAIPA). In recent years most IPAs in Africa have been struggling to transform from the old-style-setting regulations, granting licenses, - to the new-style IPAs - promoting and advertising FDI. In some instances this transition is encountering high resistance from administrative staff. In 1997 the Government of Tanzania enacted a new investment law (the Tanzania Investment Act) to unify and streamline all investment incentives. The old promotion agency, with its incentive granting role was converted into the Tanzania Investment Center (TIC), with the aim of promoting and facilitating investment. But the transformation has yet to take place because political resistance to change has been strong.

By contrast, in Mozambique the investment promotion agency has taken a major role in helping to reform the investment climate. For instance, by assisting with the negotiation and implementation of a large FDI project for smelting aluminum, it acquired experience and pointed out problems in company registration, registration procedures, customs clearance etc. It then played an active role with individual ministries and agencies to help reduce bureaucratic barriers.

National efforts by different African countries are *not coordinated* with each other, though there is a strong case for small economies and agencies to increase such coordination. Given the general image problem in the region, countries would benefit by cooperating in FDI promotion. This would involve consolidating investment codes and other regulatory provisions across countries and pooling advertising efforts. If accompanied by effective lowering of trade barriers, this would also exploit the larger market size available, overcoming one of the major handicaps of investing in Africa.

Economic factors

The ultimate determinant of FDI inflows is the expected long-term rate of return, which depends on economic factors. Besides macroeconomic management and stability, market size and growth, other determinants are the quality of physical infrastructure and the level of human development. Table 1 shows some indicators of health, education, power and communications in Africa and in other regions of the world. For most of these indicators Africa fares worse than any other region, a trend that has deteriorated in many countries since 1990. Thus, gross primary school enrollment rates have fallen in Botswana, Kenya, Madagascar, Mauritius, Tanzania and Zambia. Because of AIDS, life expectancy has become shorter in many countries. In Botswana, Namibia, Swaziland and Zimbabwe over one person in five between the ages of 15 and 49 is living with AIDS. AIDS is a development catastrophe in Africa, as it kills people in the prime of their working and productive lives. In Botswana, companies estimate that AIDS-related costs will increase from one to six percent of the wage bill in six years. In South Africa it is estimated that a worker with AIDS costs a company about $200 a year in lost productivity, benefits and replacement training.[6]

6 See UNAIDS (1998), Aids in Africa, Fact Sheet.

Energy and infrastructure costs, quality and availability indicators are difficult to compare across countries. Broad indicators such as power consumption per capita, phone subscribers, internet users place most countries in Africa, with the exception of South Africa and Mauritius, near the bottom of the pecking order in the developing world.

Table 1 Comparative Indicators

	Life expectancy at birth		**School enrollment**		**Electric power cons.**			**Cellular mobile subscribers per 100 inhabitants**		
	total (years)		primary (% gross)		(kWh per capita)				**Internet: users per 10000 inhabitants**	
	1990	**1998**	**1990**	**1999**	**1990**	**1997**	**1998**			**Estimated PCs per 100 inhab.**
East Asia & Pacific	67.38	68.92	120.15		465.38	770.59	World	5.65	260.77	6.11
Europe & Central Asia	69.32	68.90	98.58		3853.28	2691.94	Europe	13.14	529.12	13.90
Latin America & Caribbean	67.97	69.71	105.08		1131.29	1401.74	Asia	3.05	87.72	2.08
Middle East & North Africa	64.57	67.58	97.37		919.83	1158.01	Americas	13.96	913.98	19.53
South Asia	59.05	62.34	90.37		228.42	323.65	Oceania	24.75	1239.81	38.52
Sub-Saharan Africa	50.10	50.41	75.75	77	445.88	446.21	Africa	0.45	22.09	0.76
Angola	45.46	46.50	91.70		60.35	63.90		0.06	2.07	0.08
Benin	51.87	53.41	58.10		36.73	43.20		0.11	3.45	0.12
Botswana	56.76	46.09	113.20	108	..	..		1.46	63.69	2.55
Burundi	43.59	42.30	72.80		..	..		0.01	0.23	..
Cameroon	54.18	53.96	101.10		204.32	180.72		0.03	1.40	0.21
Congo, Dem. Rep.	51.55	50.82	70.30		121.81	120.43		0.02	0.04	..
Congo, Rep.	49.49	48.36	132.50		254.05	197.22		0.12	0.36	0.32
Cote d'Ivoire	49.80	46.14	67.10	71	157.97	181.34		0.64	7.00	0.45
Equatorial Guinea	47.16	50.32	..		..	..		0.07	10.90	0.23
Ethiopia	45.00	42.94	32.70		21.43	21.37		..	1.01	0.06
Gabon	51.88	52.52	..		806.25	752.24		0.83	17.14	0.86
Gambia, The	49.28	53.20	63.90	77	..	..		0.41	20.34	0.33
Ghana	57.16	60.02	75.30	76	300.54	275.85		0.12	3.13	0.21
Guinea	43.71	46.55	37.10	51	..	..		0.28	0.65	0.32
Kenya	57.11	51.02	95.00	89	114.68	126.70		0.02	5.17	0.34
Lesotho	57.58	55.49	111.80	108	..	..		0.48	0.97	..
Madagascar	54.66	57.76	102.90	72	..	..		0.08	1.94	0.16
Malawi	44.65	42.28	67.90	89	..	..		0.10	1.90	0.08
Mali	47.65	50.42	26.50	45	..	..		0.04	0.94	0.08
Mauritius	69.64	70.60	109.20	107	..	..		5.28	109.14	8.73
Mozambique	43.44	45.21	66.90	71	35.05	46.84		0.04	1.85	0.21
Namibia	57.52	54.46	129.30	131	..	..		1.17	30.12	2.41
Nigeria	49.48	53.45	91.40		77.07	84.03		0.02	0.38	0.61
Senegal	49.54	52.34	58.90	62	93.63	107.22		0.25	8.33	1.33
Seychelles	70.30	71.72	..		..	..		4.98	261.54	12.42
South Africa	61.93	63.36	121.60	131	3675.97	3800.17		6.14	310.95	5.16
Sudan	50.97	55.26	52.80		52.32	48.46		0.03	0.18	0.19
Swaziland	56.64	56.27	111.30	118	..	..		0.49	10.50	..
Tanzania	50.05	47.15	69.70	66	51.20	54.32		0.12	0.93	0.17
Togo	50.48	48.62	109.40	120	..	..		0.17	170.57	0.68
Uganda	46.75	41.83	74.50	91	..	..		0.15	7.30	0.19
Zambia	49.15	42.56	98.70	89	502.83	562.94		0.06	3.42	0.68
Zimbabwe	56.16	50.95	115.70	119	932.90	918.79		0.48	8.80	1.14
Source: World Bank							Source: ITU, Internet host data: Internet Software Consortium, RIPE			

Scattered evidence on enterprise training (Lall, ed., 1978, 1999) suggests that African enterprises provide very little training particularly when compared with comparable firms in Asian countries. Lall (1999) estimates that for 1995 the whole of SSA, including South Africa, enrolled only 12% of the absolute number of engineers enrolled in South Korea alone. Without South Africa's contribution, the total number of engineers enrolled in SSA, (approximately 50,000) is only 9% of Korean, or 22% of Philippine enrolment. Asia accounts for 86 percent of R&D scientists and engineers in the developing world compared with 0.3 percent for Sub-Saharan Africa.

Another indirect indicator of technological activity – particularly important for export dynamism – is the number of enterprises obtaining *ISO 9000 certification*. This certification is becoming an important competitive asset to manufacturing and other enterprises selling directly to world markets or to established MNCs within the economy (Kumar, 1998). Table 2 based on ISO (1999), shows the total number of certificates granted to enterprises in African countries through the end of 1998, along with a few comparators from other regions. There is a very low incidence of certification activity in most of Africa; South Africa is the outstanding exception, followed by Mauritius (in relation to its size). The African share (excluding South Africa) of world ISO 9000 certificates is a mere 0.1%.

These data support the impressionistic evidence (Biggs *et al*., 1994 and 1995, Lall, 1999) that technological activity and capabilities in African enterprises are extremely low even by developing world standards. One result is that the region attracts FDI only in very simple activities; its ability to draw in FDI in more complex and more dynamic activities is very limited. Another related outcome is that the ability of MNCs to increase local content and linkages is very constrained. Domestic firms simply do not have the ability to make the technological leap needed to meet international standards of quality, technology, cost and delivery.

Table 2 : ISO 9000 certificates at end 1998 in selected countries

Africa	No. certificates	Other countries	No. certificates
Botswana	4	Egypt	385
Cameroon	5	India	3344
Congo	2	Brazil	3712
Cote d'Ivoire	8	Mexico	978
Gabon	2	China	8245
Ghana	2	Hong Kong	1940
Kenya	41	Korea	7729
Malawi	1	Malaysia	1707
Mali	5	Singapore	3000
Mauritius	92	Thailand	1236
Mozambique	1	Taiwan	3173
Namibia	14		
Nigeria	20	**Total Africa**	**2439**
Senegal	1	**(exc. S. Africa)**	**273**
Seychelles	2		
South Africa	2166	**World total**	**271966**
Swaziland	6	**Africa Share**	**0.9%**
Zambia	4	**(exc. S. Africa)**	**0.1%**
Zimbabwe	60		

III Conclusions

As in the past, a welcoming FDI regime remains fundamental to attracting FDI. But today's globalizing investor has a wide choice of developing country locations and desires those that are capable of enforcing competition, providing stable and transparent rules for private business and, over time, improving the quality of their local productive factors. While there have been significant improvements in the policy regime for FDI in most African countries, they have not been significant enough to attract globalizing FDI. Disappointingly, the region continues to suffer from a poor image as an investment location despite efforts to promote and market the region. Most crucially, the economic disparities between Africa and other developing regions (with the exception of natural resource sector) remain considerable. Infrastructure, human capital, supplier networks, technological capabilities and support institutions are all relatively weak. In some countries they are stagnant and in others they are getting worse.

For Africa, therefore, the way forward is to continue to implement a competitive incentive framework, while simultaneously leveraging its comparative advantage in extractive and natural resource activities, and continuing to improve its supply of skills, infrastructure and institutions.

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Annex

Table A1 The International Framework of FDI in Africa

Table A2 The Incentive Framework For Foreign Investment in Africa

Table A1: The International Framework of FDI in Africa[7]

		Angola	Botswana	Cameroon
1	Treaty Establishing the new East African Community (EAC) (1999)			
2	Southern African Development Community (SADC) signed a protocol on Investment policy, (1999)	✔	✔	
3	Adoption of a Road Map for Investment Facilitation by 14 countries in the Cross Border Initiative (1999)			
4	Adoption of a Community charter on Investment by the central African Economic community and Monetary Union (CEMAC) (1998)			✔
5	World Trade Organization (1994)	✔	✔	✔
6	Treaty on the Harmonization of Business law in Africa (OHADA) (1993)			✔
7	Treaty establishing the Common Market for Eastern and Southern Africa (COMESA) (1993)	✔		
8	Articles of Agreement of the Islamic Corporation for the Insurance of Investment and Export Credit (1992)			✔
9	Charter on a Regime of Multinational Industrial Enterprises in the preferential Trade Area of Eastern & South African States (1990)	✔		
10	Fourth ACP-EEC Convention (LOME IV) (1989)		✔	✔
11	Convention establishing the Multilateral Investment Guarantee (MIGA), (1985)	✔	✔	✔
12	Treaty for the Establishment of the Economic Community of Central African States (1983)	✔		✔
13	Paris Convention for Protection of Industrial Property (1983)		✔	✔
14	Agreement on Promotion, Protection and Guarantee of Investment among states of the Organization of the Islamic Conference (1981)			✔
15	The Multinational Companies Code in UDEAC (1975)			✔
16	Joint Convention on Freedom of Movement of persons and right of establishment in the UDEAC (1972).			✔
17	Convention on the Settlement of Investment Disputes between States and Nationals of other States (1965)		✔	✔
18	Common Convention on Investments in the States of the Customs and Economic Union of Central Africa (UDEAC), (1965)			✔
19	Convention on Recognition & Enforcement of Foreign Arbitral Awards (1958)		✔	✔
20	Bilateral Double Taxation Treaties		U.K, Mauritius, Swe, So Afr	Can, Fra, UDEAC countries
21	Bilateral treaty for promotion & Protection of FDI		US, Mal	Bel/LX, Ger, Neth, Rom, Swit U.S., UK

[7] Data collected by Bank Staff from various sources.

	Congo Democratic Republic	**Cote d'Ivoire**	**Gambia**	**Ghana**	**Lesotho**	**South Africa**	**Kenya**
1							✔
2						✔	✔
3							✔
4	✔						✔
5	✔	✔	✔	✔	✔	✔	
6	✔	✔					✔
7					✔		✔
8							✔
9					✔		Can, Den, Ger, Ind, Ita, Nor, Swe, UK, Zam
10	✔	✔		✔	✔		Neth.
11	✔	✔	✔	✔	✔	✔	**Kenya**
12	✔						✔
13	✔	✔		✔	✔	✔	
14							
15	✔						
16	✔						
17	✔	✔	✔	✔	✔		
18	✔						
19		✔			✔	✔	
20	France	Ger, Bel, Fra, Nor, Can, Ita, UK, Swi	Cote d', Nig, Sierra Leone, Nor, UK		UK, So Afr	35 countries	
21	Ger, Switz, U.K.	Den, Ger, Neth, Swe, Switz		UK	Ger, UK		

	Madagascar	**Mali**	**Mauritius**	**Mozambique**	**Namibia**	**Nigeria**	**Sao Tome**
1	✔	✔	✔	✔	✔	✔	
2	✔	✔	✔	✔	✔	✔	
3				✔			
4	✔		✔	✔	✔		✔
5							
6	✔	✔	✔	✔		✔	
7	✔	✔	✔	✔	✔	✔	✔
8	✔	✔	✔			✔	
9	France	France	19 countries[8]	Portugal	Rus, Rom, Ind, UK, So Afr	Fra, Neth, Pak, Phil, UK	
10	Den, Ger, Nor, Swe, Swi	Ger, Swi	Fra, Ger, UK		Germany	Fra, Ger, Neth, UK	
11	Den, Ger, Nor, Swe, Swi	Ger, Swi	Fra, Ger, UK		Germany	Fra, Ger, Neth, UK	
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							

[8] Botswana, PRC, France, Germany, India, Indonesia, Italy, Kuwait, Luxembourg, Madagascar, Malaysia, Oman, Pakistan, Singapore, South Africa, Swaziland, Sweden, the U.K. and Zimbabwe.

	Senegal	**South Africa**	**Seychelles**	**Tanzania**	**Togo**	**Uganda**	**Zambia**	**Zimbabwe**
1	✔		✔	✔	✔	✔	✔	✔
2	✔			✔	✔	✔	✔	✔
3				✔		✔	✔	✔
4				✔		✔	✔	✔
5								
6	✔		✔	✔	✔	✔	✔	✔
7	✔		✔	✔	✔	✔	✔	✔
8	✔			✔	✔	✔	✔	✔
9	Bel, Fra, Mauritania, Mali, Tun			✔	✔	UK		Bul, Can, Ger, Neth, Nor, So Afr UK
10	Ger, Neth, Rep of Kor, Rom, Swe, Swit, UK, US			Can, Den, Ind, Ita, Kor, Nor, Swe, So Kor, Zamb	France		19 Countries	Switz
11				Ger, Neth, Switz	Ger, Switz		Germany	
12	✔							
13								
14								
15								
16								
17	✔							
18								
19								
20								
21								

Table A2: The Incentive Framework For Foreign Investment in Africa [9]

Botswana	
Pre-conditions to obtain incentives	Apply for license; obtain approvals from land boards and district councils
Tax Holiday	Tax refunds of company tax on manufacturing projects approved for FAP. Refunds decrease from 100%in year 1 to 25% in year 5 in urban/per urban areas and 50% in year five in other areas
Corporate Tax Rate	Two tier system: Base rate tax for nonresident firms is 25%. Additional company tax (ACT) against which withholding tax on dividends is set off.
Capital Gains	For companies chargeable gains are included in taxable income.
Fixed Assets	Capital allowances according to straight line method: Furniture & fittings (10%), plant & equipment (15%), motor vehicles (25%)
Interest, Royalties, Management Fees	All subject to withholding tax
Taxes	
Net operating losses	carried forward for five years. Farming, mining and prospecting - no time limit
Withholding tax: dividends	15% of the gross dividend
Industry/Regional Incentives	Financial Assistance Policy (FAP) for productive activities in manufacturing (mining and cattle not eligible);/Allowance of P5,000 for each dwelling constructed for employee houses constructed by businesses other than mining
Training Grants	Training grants for approved manufacturing projects (deduction of 200% of approved training expenditure is allowed)
Free-trade zones	No
Other export incentives	No
Customs duty exemptions	No

[9] Data collected by Bank Staff from various sources.

Cameroon

Pre-conditions to obtain incentives	Simplified investment approval procedure. Incentives are identical for foreign and domestic investors. Cameroonian equity ownership required for SME scheme
Priority Industries/Areas	5 Special Investment regimes: 1)Basic; 2)SME; 3) Strategic Enterprise; 4)Reinvestment; 5) Free zone
Tax Holiday	Qualifying IFZ firms receive 10 year tax holiday and subject to only flat tax of 15% on corporate taxes beginning in 11th year
Corporate Tax Rate	35% plus 3.5% local council taxes. Finance law 1997/98 allows 50% reduction in company tax for companies in basic, SME or strategic enterprise regimes.
Capital Gains	Taxed at normal company tax rates
Fixed Assets	yes.
Interest, Royalties, Management Fees	Royalties paid to entities within UDEAC states are deductible if reasonable
Taxes	
Net operating losses	Carried forward for up to four years
Dividend Income (withholding tax)	
Industry/Regional Incentives	FAP for manufacturing, some agriculture, "linking" service industries and tourism
Training Grants	no
Free-trade zones	Industrial Free Zone. To qualify - 80% export bound
Other export incentives	no
Customs duty exemptions	Duty free imports on equipment

Congo	
Priority Industries/Areas	Research, professional training, rural areas. Specific codes for Oil, Mining, Tourist, Forestry, Informal sector and micro-enter
Tax Holiday	For infant industries up to 3 years, tax reduction up to 100% in Agro industries, electronic, telecommunication, chemistry, and pharmaceutical industries
Corporate Tax Rate	Tax credit for out of CEMAC exports
Capital Gains	Taxed on full rate
Fixed Assets	Building (20 Years), cars (5 years). Accelerated depreciation is possible for machinery used in a factory or agriculture if the value exceeds CFAF 10 mn
Interest, Royalties, Management Fees	patent and trade mark royalties paid to foreign parent companies are deductible; other interest limited
Taxes	Reduced import taxes for machinery and imported inputs
Net operating losses	Carried forward three years
Dividend Income (withholding tax)	dividends are subject to 20% withholding tax unless a different rate applies under an international tax treaty. Taxes on profits not deductible
Industry/Regional Incentives	Special tax treatment for companies doing business in oil, mining, tourist, forestry sectors, and in rural areas
Training Grants	Tax credit for training in CEMAC training centers
Free-trade zones	Tax advantages for Franc Zone
Other export incentives	Benefit tax credit for export oriented activities ranging from 25% to 50% and varying in proportion of export content of turnover.
Customs duty exemptions	Total exemption from customs duties and VAT for equipment and material imported for research Tax credit amounting to 25% of research contract concluded with CEMAC research centers. Tax credit up to 50% of training and professional development Free trade for intra-CEMAC trade

Gambia	
Pre-conditions to obtain incentives	Application for Certificate of Special Investment (CSI) with one-stop shop, the Investment Promotion Agency. CSI issued by Departments in charge of trade and industry and that in charge of sector where investment is located. Three requirements: (i) be a company or partnership, (ii) invest at least US $ 10,000 of fixed assets, and (iii) meet the priority industry list (see below)
Priority Industries/Areas	Agriculture, fisheries, tourism, manufacturing, energy, mining, skills development, and selected services
Tax Holiday	With CSI, exemptions are: 2/3 of company tax for first 3 years, 1/3 during 4-6 years, and full payment after the 6th year.
Corporate Tax Rate	Normal company tax rate is 35% or 2% of turnover, whichever is higher
Capital Gains	Guarantees to transfer after-tax profits. Capital gains tax of 25% for companies and 15 % for individuals. Capital losses can be offset against capital gains in same year of assessment.
Fixed Assets	Proposals to allow accelerated capital allowances on buildings (10 %), all other (20%)
Interest, Royalties, Management Fees	Guarantees to transfer royalties.
Taxes	Exemption from customs duties, sales tax, and turnover tax for capital equipment and intermediary inputs. Plans to reduce the maximum duty rate to 20%.
Dividend Income (withholding tax)	Can be credited against the shareholder's income tax liability
Industry/Regional Incentives	Divestiture and regulatory strategy under study to open up energy, telecom, port, hotel, and transport sectors.
Training Grants	None
Free-trade zones	Reexport and export processing zones under study (Gateway project). Arrangements proposed for joint ventures; proposed higher flexibility in labor legislation in the port of Banjul
Other export incentives	No
Customs duty exemptions	With CSI, eligibility for total waiver of customs duty on approved capital equipment, etc.

Ghana	
Pre-conditions to obtain incentives	Foreigners allowed 100% ownership provided they meet certain requirements. Prior approval not needed, except in mining and petroleum
Priority Industries/Areas	
Tax Holiday	Real estate (5 years); rural banks (10 years); agriculture and agro-industry (5 years); air and sea transport
Corporate Tax Rate	Tax rate in all sectors is 35%, except non-traditional exports (8%) and hotels (25%)
Capital Gains	Flat rate of 5%
Fixed Assets	Straight line method used - no details
Interest, Royalties, Management Fees	deductible
Taxes	Not deductible for tax purposes
Net operating losses	Carried forward by mining companies indefinitely; all others 5 years
Dividend Income (withholding tax)	Subject to 10% withholding tax
Industry/Regional Incentives	Tax incentives for agriculture and agro-industry; Tax rebate (25%) to manufacturing firms locating in regional capitals other than Accra and Tema. Rebate of 50% when locating outside regional capitals.
Training Grants	None
Free-trade zones	No
Other export incentives	No
Customs duty exemptions	Plant machinery and equipment are zero rated

Kenya

Pre-conditions to obtain incentives	Certificate of general authority required from Ministry of Finance. No industry specific approval required, except for reasons of environmental policy, banking and security.
Priority Industries/Areas	Food and horticultural exports encouraged through removal of duties. No generalized incentive scheme, but negotiated on a case-by-case basis
Tax Holiday	Export processing zone allows for 10 years tax holiday
Corporate Tax Rate	Foreign controlled companies taxed at same rate as domestic ones.
Capital Gains	No capital gains tax
Fixed Assets	37.5% for combine harvesters, tractors etc.; 30% for computers, calculators; 35% for motor vehicles and aircraft; 12.5% for other assets; Buildings - annual allowance of 4% for hotels; 2.5% for factories, docks, etc.
Interest, Royalties, Management Fees	Contingencies in place
Taxes	
Net operating losses	May be carried forward indefinitely
Dividend Income (withholding tax)	Withholding tax on dividends payable to non-resident shareholders is 10%, while for Kenya residents is only 5%
Industry/Regional Incentives	No regional/rural incentives
Training Grants	None
Free-trade zones	5 Export processing zones: Mombasa and Athi (Government owned) Nairobi, Della Rue and Nakuru (privately owned)
Other export incentives	Duty/VAT Remission Scheme available on raw inputs for transformation and export. 100 percent allowance on plant machinery and equipment for manufacturing exports.
Customs duty exemptions	Reduced for small scale industries in rural areas; agricultural inputs are zero rated; other duty free schemes available on case by case basis

Lesotho	
Pre-conditions to obtain incentives	Investors are screened but may own 100% of equity
Priority Industries/Areas	Pioneer Industries (manufacturing and related sectors)
Tax Holiday	No
Corporate Tax Rate	Basic rate of 35% for all sectors except manufacturing which is 15%
Interest, Royalties, Management Fees	Normal operating costs are deductible
Taxes	
Net operating losses	Carry forward of 5 years for approved manufacturing (pioneer industries)
Withholding tax: dividends **Royalties:**	25% for all industries, except manufacturing which is exempt 15% for non-manufacturing
Industry/Regional Incentives	Pioneer industries may opt for 10 year exemption from income tax. Concessional loan finance available
Training Grants	Training grants available
Free-trade zones	No
Other export incentives	Comprehensive export credit facility
Customs duty exemptions	No

Mali

Priority Industries/Areas	
Tax Holiday	5 year tax holiday available from start of production
Corporate Tax Rate	35% following devaluation of CFA in January 1994
Capital Gains	Partnerships and individual enterprises 15% Craftsmen 10%
Dividend Income (withholding tax)	Standard rate 18%; Reduced rate 9%; Dividends may be repatriated
Industry/Regional Incentives	
Training Grants	None
Other export incentives	Mineral products may be freely exported and are exempt from all indirect internal taxation
Customs duty exemptions	Ad valorem duties ate rates of zero or 5%. Productive capital goods, agricultural inputs, etc. exempt; Import of mining equipment and machinery is duty free as long as re-exported

Mauritius	
Pre-conditions to obtain incentives	Foreign investments are approved by the ministry that manages the particular scheme under which the investment is entering the country. Upon approval, the office of the Prime Minister grants final authorization for an individual to invest in Mauritius.
Priority Industries/Areas	Manufacturing, application of new technologies, technology services, export oriented service companies, offshore businesses, freeport.
Tax Holiday	Exemption from payment of income tax on dividends up to 20 years.
Corporate Tax Rate	Corporate tax at 15% (except for Freeport & EPZ - tax exempt). As from 2000/01 EPZ companies will be subject to same 15%
Capital Gains	Depends on scheme
Fixed Assets	Depends on scheme
Interest, Royalties, Management Fees	No provisions
Taxes	No deductions allowed for corporate income tax, capital gains tax, land transfer tax, etc.
Net operating losses	Carried forward for maximum of three years.
Dividend Income (withholding tax)	Wholly exempt
Industry/Regional Incentives	Incentives for Export Enterprises include: no customs duty, corporate tax, tax on dividend, capital gains, etc.; Pioneer schemes for technology transfer include incentives: no customs duty, 15% corporate tax, no tax on dividends, etc.; SME schemes include no customs duty and 15% corporate tax
Training Grants	None
Free-trade zones	Yes (Export Processing Zones-manufacturing).
Other export incentives	In manufacturing: Pioneer Status Enterprises, Modernization and Expansion, Small and Medium Enterprises, Industrial Building Scheme, and Strategic Local Enterprise. In services: Export Processing Zones –export oriented services companies, Offshore Business, and Freeport.
Customs duty exemptions	Waiver of customs duty is dependent on scheme

Namibia	
Pre-conditions to obtain incentives	To qualify for incentives must register with Ministry of Trade and Industry and Ministry of Finance
Priority Industries/Areas	
Tax Holiday	50% abatement on taxable income derived from manufacturing for a period of five years to be phased out over 10 years
Corporate Tax Rate	Non-mining: 40% on taxable income derived within Namibia. Taxable income derived from exports of locally manufactured goods is further reduced by 80% making the effective corporate tax rate 3.5% for the first five years, rising to 7% thereafter. Worldwide sourcing rules apply only to interest and dividend income
Capital Gains	Mining: formula: y=65-480/x Diamonds: 50% of taxable income plus 10% surcharge
Fixed Assets	Buildings (20% first year, 4% thereafter); Mining exploration expenditure is deductible in full
Interest, Royalties, Management Fees	Deductible as a finance cost; payment to foreign affiliates subject to Reserve Bank approval
Taxes	General sales tax, additional sales levy and transfer duty are treated as capital expenditure qualifying for depreciation allowances
Net operating losses	Assessed tax losses may be carried forward indefinitely
Dividend Income (withholding tax)	10%
Industry/Regional Incentives	For manufacturing, an accelerated building allowance is available (20% in the first year and 8% over the next 10 years)
Training Grants	Training expenses and production wages have a 25% deduction.
Free-trade zones	The port of Walvis Bay is the first full scale export processing zone. Enterprises here qualify for total relief from general sales tax, additional sales levy, customs duties, excise duties, stamp taxes, et.
Other export incentives	Taxable income from exports is reduced (see corporate tax section);Export expenditure on a wide range of activities is deductible in the range of 25-75% depending on export turnover
Customs duty exemptions	Exempt in EPZ

Senegal	
Pre-conditions to obtain incentives	For Industrial Free Zone of Dakar, eligible firms should export 60% of their production. Authorization obtained from inter-ministerial committee
Priority Industries/Areas	
Tax Holiday	Foreign investors in IFZ who establish labor intensive industries can be exempt from all taxes on income, transactions, etc.
Corporate Tax Rate	0 in IFZ; 15% in FEC; 30% outside
Capital Gains	
Fixed Assets	Depreciation rates: buildings (3-5%); office furniture (10%); machinery (10-15%); cars 20-33%
Interest, Royalties, Management Fees	Reasonable royalties, interest and management service paid to foreign parent companies are tax deductible
Taxes	Some investments exempt from the following taxes: turnover, transfer, franchise, employee contributions, minimum profits, etc.
Net operating losses	Carry forward of 3 years is permitted
Dividend Income (withholding tax)	withholding tax at rate of 16% is deductible from corporate tax
Industry/Regional Incentives	Many industrial activities are eligible for exemptions and incentives
Training Grants	None
Free-trade zones	Industrial Free Zone of Dakar: Duration of the benefits to zone operation vary depending on location from 5 to 12 years
Other export incentives	No export tax is levied on export sales
Customs duty exemptions	Import taxes and custom duties on plant and machinery exempt for 5 years for SME

	South Africa
Priority Industries/Areas	There are numerous regional incentives and industry specific incentives
Tax Holiday	Tax holiday from 2-6 years depending on region, industry and human resource component
Capital Gains	Proposal to levy tax on realized capital gains from investments effective from April 2001. Rates of taxation will be subject to consultation
Fixed Assets	
Interest, Royalties, Management Fees	Accelerated depreciation allowance are applicable to all sectors other than banking, finance, commerce, insurance, mining and petroleum: plant expenditure (50% per annum for two years);building expenditure (20% p.a. for five years)…etc.
Net operating losses	carried forward for 5 year
Dividend Income (withholding tax)	No withholding taxes for resident corporations and individuals; tax is withheld from certain payments to foreign corporations for nonresident corporations and individuals
Industry/Regional Incentives	Industrial Innovation grants for new products; Manufacturing development for SMEs; regional incentives in 10 corridors. Loans for new investment . Venture capital for high-tech development. Medium term loans for manufacturing
Training Grants	None
Other export incentives	Export marketing and Investment Assistance schemes; special low interest loans for plant & equipment to expand export manufacturing operations; Export finance guarantee scheme
Customs duty exemptions	Duty Credit Certification Scheme For clothing and textiles allows firms to use 30% of the value of exports to import textiles

Tanzania

Pre-conditions to obtain incentives	Certificate from Tanzania Investment Center available to foreign investors with US$300,000 and local investors with more than US$100,000
Priority Industries/Areas	Agriculture, Air Aviation, Commercial buildings, commercial, development and micro-finance banks, export oriented projects, human resources, manufacturing, natural resources including fisheries, tourism, radio and television broadcasting, rehabilitation and expansion.
Tax Holiday	Companies with a Certificate have 100% deduction on investment
Corporate Tax Rate	Corporation tax is 30% in most priority sectors, except 'Expansion Tourism' where it is 35%
Capital Gains	10%
Loss carry forward	Companies with a Certificate have unlimited loss carry forward (otherwise losses sustained in one year can be carried forward and offset against taxable profits arising in the succeeding five years).
Payroll Levy	4%
Dividend Income (withholding tax)	Withholding taxes for priority sectors are 0% for interest on loans and 10% for dividends;
Industry/Regional Incentives	Mining sector
Training Grants	No.
Free-trade zones	No
Customs duty exemptions	Companies with a certificate pay are exempt from import duties on all capital equipment

Uganda

Pre-conditions to obtain incentives	Minimum threshold of $100,000 and application submitted to Uganda Investment Authority
Priority Industries/Areas	
Tax Holiday	No new Tax Holidays since 1997. Firms with current tax holidays can choose to retain them until they expire
Corporate Tax Rate	30%
Fixed Assets	Capital allowances vary by location and type; For these and annual depreciation allowances, see page 67
Interest, Royalties, Management Fees	
Taxes	A presumptive tax (1%) on small business was introduced in 1997
Net operating losses	forwarded indefinitely
Withholding Tax (Dividend Income)	15%
(Interest income)	15%
Industry/Regional Incentives	
Training Grants	None
Free-trade zones	No

Zambia	
Pre-conditions to obtain incentives	Compliance with Companies Act and application to Investment Center for investment license. Depending on sector, other licenses may be required
Priority Industries/Areas	Exporters on non-traditional products (defined as anything other than metallic minerals), mining, tourism and agriculture
Tax Holiday	Small scale enterprises exempt from tax for first three years in urban areas and 5 years in rural areas
Corporate Tax Rate	• Standard corporate income tax rate 35% • Companies listed on Lusaka Stock Exchange 30% • Non-traditional exporters and agricultural sector 15% • ZCCM private successor mining companies 25% (with carry forward of losses up to 20 years; and 100% capital expenditure tax credit)
Fixed Assets	Capital allowances vary from 5% for industrial buildings to 50% for manufacturing industries, to 100% for farm works and improvements
Interest, Royalties, Management Fees	Yes (for ZCCM successor mining companies, these are exempt from income tax)

Taxes	• Corporate tax rate 35%
	• Tax exemptions for ZCCM successor mining companies:
	  • Duty on imported consumables up to 4 years
	  • Excise duty on electricity consumed

Net operating losses	Carry forward indefinitely
Dividend Income (withholding tax)	Right of repatriation
Industry/Regional Incentives	Special incentives for investment in: tourism, non-traditional products, privatization of ZCCM.
Training Grants	None (but technical training, R&D expenditures are tax credited)
Free-trade zones	No
Other export incentives	Duty Drawback Scheme, Manufacturing under Bond, no exchange controls, legal guarantee from appropriation by the state
Customs duty exemptions	Duty exemptions on imported mining equipment; petroleum, agricultural inputs and machinery, tires and tubes, some manufacturing equipment, e.g. extruders, brewery equipment, agro-processing equipment; other manufacturing equipment attract only 5% duty. .

Zimbabwe	
Tax Holiday	5 year tax holiday followed by 15% corporate tax rate for EPZ firms
Corporate Tax Rate	Basic tax rate: 35 % (taxable income of manufacturing company derived from increased exports = 25%)
Capital Gains	Flat rate of 20% for gains exceeding Z$5,000
Interest, Royalties, Management Fees Taxes	Yes
Net operating losses	Carry forward for six years for some sectors and indefinitely for mining
Dividend Income (withholding tax)	Exemption from Non Resident Shareholder Tax for EPZ firms
Industry/Regional Incentives	Profits from approved new manufacturing operations in designated areas taxable at 10% for first five years
Training Grants	50% deduction on expenditure related to erections/additions of trade training buildings, equipment, etc.
Free-trade zones	Existing firms in EPZ exporting 50% or more taxed at 8 percentage points below prevailing corporate rate; New firms in EPZ taxed at 10 percentage points below;
Other export incentives	Manufacturing firms that increase their export by 20% or more have their taxes reduced 10 percentage points
Customs duty exemptions	Duty free on capital equipment; for EPZs raw materials and capital goods