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Good Governance and Foreign Direct Investment: A Legal Contribution to a Balanced Economic Development in the East African Community (EAC)

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The developing world is experiencing a paradigmatic shift from official development aid (ODA) to foreign direct investment (FDI) as the main source of external financing for its economic development. The recent exponential increase of FDI inflow to Africa has led observers to predict that the amount of foreign investment in Africa would soon surpass that of foreign aid. Accordingly the attraction of FDI has become the spearhead of the most African countries' economic development policies. Besides, in order to be more efficient in their quest for constantly increased FDI, African countries are resorting to regional integration initiatives primarily as a tool to mitigate the adverse consequence of their small and fragmented national markets.

This is typically the case of the East African Community (EAC) whose main treaty objective is the promotion of a more balanced and harmonious economic development of its Partner States: Burundi, Kenya, Rwanda, Tanzania, and Uganda. According to the treaty of Arusha establishing the EAC, one of the privileged ways to reach this economic development is the attraction of investment, especially FDI. However, despite the establishment of a common market in 2010 in which the free movement of persons, goods, services and capital are in principle guaranteed, each EAC Partner State individually conceives, defines, and implements its own policies and rules related to investment with the purpose of attracting more FDI than the others.

Yet, the Rambo theory, an unfolding theory on regional integration between developing countries, poses that the increase of FDI inflow in one of the member states of a common market implies a correlative loss of the same type of FDI for the other members as foreign investment is a common pool resource with the characteristics of rivalry, but non-excludability of consumption. In this kind of common market, foreign investors rarely establish multiple production units in the territories of the Partner States because they are ensured to have unrestricted access to the markets of all the Partner States by simply locating their investment in the territory of just one of them. In the EAC, this state of affairs definitely fosters intra-EAC competition for FDI, whereby each Partner State is doing its utmost to advertise itself as the most suitable investment destination in the region. Nevertheless, such a competition is generally foreseeable regarding FDI made in a domain which is sensitive to the common market, especially FDI in the manufacturing sector (production of goods and services) contrarily to location-specific investment like in the extractive industry (oil and mining).

Anyway, considering huge asymmetries between EAC Partner States' endowment in terms of key FDI determinants such as economic productivity, human capital, infrastructure, and regulatory framework (observance of good governance principles), engaging in this kind of competition would be a losing battle for some of the Partner States as it is anticipated that only one or two Partner States presenting the best combination of these FDI determinants would attract disproportionately higher amount of FDI than the others. This assertion is supported and supplemented by a well-tested economic theory, known as the agglomeration theory, which postulates that in a common market where free movement of factors is enhanced, industries (FDI) tend to flow into the region or the territory of the member states who have already achieved a certain level of industrial development in a similar area. According to this theory, this tendency ends up by creating a core-periphery division between the members of the common market whereby the core represents countries that attract higher FDI inflow while the periphery is constituted of the 'losers'. As a consequence of this inequitable attraction of FDI, the Rambo theory posits that the frustrated member states would be tempted to defect from the regional integration initiative, which – depending on the number and the power of the defector - would seriously undermine the regional integration process.

Based on the history of the EAC, this thesis takes this threat seriously. A retrospective look at the history of the EAC informs us that FDI in the manufacturing sector has always been the bone of contention between the Partner States. Two examples can be given as evidence. The first concerns the East African Common Services Organization (EACSO), EAC's ancestor inherited from the colonial power, which collapsed in 1965 amidst disputes about trade imbalances between its Partner States – Kenya, Tanzania and Uganda – caused by the fact that major manufacturing companies were located in Kenya following massive European and Indian investments in Nairobi region in early 1900s. Tanzania and Uganda alleged that higher external tariffs established under the EACSO's customs union were mainly benefiting the Kenyan economy as they had to import most of their manufactured products from Kenya, which created unacceptable trade imbalances between them. The agreement reached in Kampala in 1964 instituting the redistribution of industries and export quotas between the Partner States proved inefficient.

The second example concerns the collapse of the former EAC in 1977. Although the immediate cause for this collapse was more political than economic, due to the failure of the EAC Heads of State to meet in order to approve the community's budget following political disagreements specifically caused by advent of Idi Amin to power in Uganda, industrial imbalances reflecting inequitable distribution of FDI in the manufacturing sector continued to be an underlying crux which was not adequately addressed by the East African Development Bank (EADB) and the Transfer Tax system introduced by the treaty of Kampala in 1967. This is subtly confirmed by the preamble to the 1999 treaty of Arusha establishing the current EAC where the 'continued disproportionate sharing of the benefits of the Community among the Partner States due to their differences in their levels of development' is basically deplored as one of the main reasons that contributed to the collapse of the former EAC.

These two illustrations demonstrate how the fragility of the EAC cohesion before the attraction of FDI in the domain of goods and services production is more than hypothetical. But, it is noteworthy that as much as the preamble to the treaty of Arusha acknowledges that the continued disproportionate attraction of FDI is due to structural and conjectural differences between Partner States' economic endowments, it emphasizes the adverse consequence of the lack of adequate policies to address these differences. In other words, the treaty concedes that regardless of the nature of the concerned differences between the Partner States, choosing, making and implementing appropriate policies would drastically mitigate the adverse impact of those differences on the Partner States' economic development. Yet about fifteen years after the adoption of this treaty, it is astonishing to notice that although the treaty-makers clearly pinpoint the lack of adequate policy as the catalyst of the continued inequitable distribution of FDI among them, the Partner States have been too reluctant to take appropriate steps to avoid history repeating itself. Indeed, a Common Investment Area Protocol inspired by the COMESA model was once mentioned in the Joint Investment Promotion Strategy (2006-2010) as one of the ways to promote EAC as a single investment territory. But leave alone the inadequacy of such an instrument due to the advanced stage of the implementation of the EAC common market freedoms, this suggestion never came to fruition. It was again renewed in the 4th East African Community Development Strategy (EAC-DS) with a specific deadline to be adopted by December 2016. As things stand now, there are good reasons to believe that this deadline may not be met. If it does, there is strong risk of not adopting the appropriate remedy, especially that the EAC-DS vaguely advocate the need 'to develop a mechanism for equitable sharing of benefits and costs of EAC integration' which is reminiscent of ineffective measures successively adopted by the Partner States through the Kampala Agreement in 1964 and the Treaty of Kampala in 1967.

To effectively address the recurrent issue of inequitable FDI distribution in the EAC, the striking (and probably the growing) discrepancies between Partner States' FDI determinants must be acknowledged without complaisance. At the same time, it must be highlighted that Partner States' individual actions and policies related to investment could just contribute to worsening the situation by fueling an unhealthy competition. Therefore, the selected mechanism should focus on the elimination of any intra-EAC fratricidal competition for the attraction of FDI while remaining economically sustainable for foreign investors and politically acceptable for the Partner States in short and long run.

This thesis suggests that the adoption of a good governance-imbued regional common investment policy is the necessary prerequisite for the establishment of any lasting mechanism to ensure equitable distribution of FDI in the EAC. Good governance as an overriding principle enshrined in articles 6(d) and 7(2) of the Treaty of Arusha should be put into contribution for the strengthening of regional institutions and the making of adequate common investment policy with the immediate purpose of mitigating the adverse consequences of the existing asymmetries between the Partner States.

The first step towards such a common policy would consist of transferring competence on inward investment in the manufacturing (production of goods and services) sector to the EAC as a supranational entity. The principle of subsidiarity contained in article 7(1)(d) of the Treaty of Arusha provides a legal basis for this kind of competence transfer. Accordingly, the EAC Secretariat should be entrusted with the responsibility of carrying out basic investment functions which are currently under the jurisdiction of national Investment Promotion Authorities (IPA), such as image-building, investment generation, investor services, and policy advocacy. It is important to reiterate that this transfer of partial competence on investment does not advocate the disappearance of national IPAs, instead the latter should be converted into decentralized offices of the regional investment authority with the main responsibility of collecting data, identifying investment priority areas at the national level, and providing on-ground customized support to foreign investors especially during investment implementation and post-investment phases. The adoption of this regional common investment policy would speed up the harmonization of national investment laws and regulations, and consequently present the EAC as an enhanced legal single market to foreign investors.

Additionally, to thwart any leaning to intra-EAC competition and to ensure that each Partner State receives proportional FDI, the regional investment policy should be accompanied by a revolutionary investment strategy. The present researcher suggests that there should be a shift from the investor-choice strategy to host-oriented strategy. The current investor-choice strategy, which gives to foreign investors full discretion to choose the Partner State where they want to make their investment whereas their products or services are intended for the whole common market, cannot help the EAC reach its objective of a more balanced and harmonious economic development of the Partner States. This *laisser-faire* strategy has failed in the past and would end up diverting the EAC from its cardinal objective as long as asymmetries between the Partner States will be as blatant as it is now. On the contrary, the host-oriented strategy according to which a central regional investment authority should be given power to channel foreign investors in the Partner States where such investments are more needed pursuant to a pre-established regional investment strategic plan could be more salutary in terms of addressing in a sustainable way the century-old enigma of inequitable industrial distribution in the EAC.

The advocated host-oriented strategy may be criticized because of its ‘backward interventionist character’ and may be resisted by conservative policy-makers and/or opposed by foreign investors as it will certainly jostle the existing foreign investment landscape in the EAC. But whatever could be the case, the suggested adoption of a regional common investment policy and its operational strategy are meant to ensure economic stability in the region while focusing on the attainment of the EAC’s treaty objective of promoting a more balanced and harmonious development of the Partner States; failure of which has nurtured distrust in any deep-seated regional integration in the EAC all along the history and, consequently, has been the cause of collapse of previous regional integration initiatives in the region. As rightly put by Mary Norton Gordon, “In order to accept change and the suffering it brings, we need to find meaning in it”. It is the primary responsibility of decision- and policy-makers in EAC Partner States to find meaning in the policy change suggested by this thesis.

MAIN RECOMMENDATIONS

- Good governance in terms of better policies, better regulations, and better institutions assessed against the treaty objectives should be the overriding principle in the decision-making in the EAC both at the national and at the regional level with the constant aim of building every day a better EAC, especially in relation with the promotion and the protection of investments.

- The EAC Partner States should urgently adopt a regional common investment policy within which good governance-oriented regulations, procedures and institutions should be developed in order to avoid the occurrence of harsh intra-EAC competition for the attraction of FDI.
- The EAC Partner States should adopt a non-complaisant and revolutionary host-oriented regional strategy whereby, instead of foreign investors being allowed to freely choose the location for their investments within the common market (as is the case currently), a centrally organized regional institution should rather channel foreign investors in the territories of the Partner States where such investments would be much more needed according to a pre-agreed regional investment strategic plan.
- The EAC Secretariat should proactively play the role vested upon it by the Treaty for an effective integration in EAC, especially in triggering the transfer of competence on foreign investment in the manufacturing sector from the Partner States to the EAC as a supranational entity.
- The East African Court of Justice should continue its pro-integration interpretation of the EAC Treaty and its protocols in order to make sure that actions and policies of both the Partner States and EAC institutions converge on the achievement of the Treaty objectives.