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“The Impact of Foreign Direct Investment on Development: Policy Challenges for Malawi”

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<td>ACP</td>
<td>African, Caribbean and Pacific</td>
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<td>AGOA</td>
<td>African Growth Opportunity Act</td>
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<td>CAMA</td>
<td>Consumer Association of Malawi</td>
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<td>COMESA</td>
<td>Common Market for Eastern and Southern Africa</td>
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<td>DDA</td>
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<td>EU</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>GATT</td>
<td>General Agreement on Trade and Tariffs</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>HIPC</td>
<td>Highly Indebted Poor Countries</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>JITAP</td>
<td>Joint Integrated Technical Assistance Programme</td>
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<td>LDCs</td>
<td>Least Developed Countries</td>
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<td>MCCCIC</td>
<td>Malawi Confederation of the Chambers of Commerce and Industry</td>
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<td>MIPA</td>
<td>Malawi Investment Promotion Agency</td>
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<td>MK</td>
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<td>NWGTP</td>
<td>National Working Group on Trade Policy</td>
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ABSTRACT

Foreign Direct Investment (FDI) is considered as a very important source of economic growth in developing countries. Malawi just like any other African country tries as much as possible to create a conducive environment for attracting investors. In order to do this it has tried to create a business friendly environment so as to promote local investment as well as foreign direct investment. Over recent years following the privatisation programme and other developments we have seen little commitment on investment. Most investors associate the country with political and economic instability and natural disasters e.g. floods.

This paper assesses some of the factors that deter investors from investing in the country, investigates the reasons why FDI in Malawi has not increased over the years and evaluates why Malawians are reluctant to invest in their own country? In order to make FDI work for development there is need to define and see how FDI fits in with our development objectives.
EXECUTIVE SUMMARY

The important role that investment, both foreign and domestic plays in the economy of the country is usually taken for granted. In recent times, the importance of Foreign Direct Investment (FDI) has been taken for granted. As a consequence, the debate amongst academics and policymakers has shifted from whether or not countries should attract FDI to how countries can attract and reap the full benefits that come with FDI. Before we can start analysing the benefits of FDI or how FDI is linked to development we have to ask ourselves this question “Why is FDI important to a country?” For a landlocked Least Developed Country (LDC) like Malawi, FDI is a source of capital and employment. This indicates that FDI is crucial to the country.

Most authors indicate that when it comes to Foreign Direct Investment in Africa what comes to mind is investment in natural resources, mainly investment in minerals and oils. This assumption means that FDI is basically determined by an uncontrollable factor and poor countries like Malawi, with deficient natural resources, will attract very little or no FDI regardless of the policies that the country pursues.

According to the “eclectic” theory of FDI, countries that have a “locational advantage” will attract more FDI\(^1\). Location-specific advantage embodies any characteristic (economic, institutional and political) that makes a country attractive for FDI. Where domestic resources to finance investment are limited, foreign capital inflows are necessary.

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\(^1\) Dunning (1988)
Malawi has suffered from internal and external economic shocks, which have resulted in limited economic growth. The country has taken a number of initiatives to create an investor friendly environment and attract more FDI.

The Malawi Investment Promotion Agency (MIPA) is the institution that promotes facilitates and encourages FDI. This operates as a one-stop investment center and was established under the Investment Promotion Act of 1991. Malawi has also put in place a generous incentive package for FDI. The country is a member of the International Convention for the Settlement of Investment Disputes and joined the Multilateral Investment Guarantee Agency in 1986.

Many investment opportunities are available in the country. The principal destination for foreign investment is Agriculture, notably Tobacco and sugar. In 2005, the main sector, which attracted investment, was the manufacturing sector with 19 companies out of 36 investing in it\(^2\). Investment in sugar is dominated by a South African owned firm (Illovo).

Developing countries or emerging economies acknowledge that investment could be a source of economic growth through development and modernisation. The link is positive, where countries actually enjoy the benefits arising from investments.

Insufficient job opportunities are the result of inadequate levels of investment both foreign and local\(^3\). A key developmental spill over of FDI is local job creation. Given appropriate policies and basic levels of development, FDI can trigger benefits. Malawi has managed to attract FDI, which has brought along

\(^2\) Source: MIPA investment statistics

\(^3\) Low investment levels result in lower rates in job creation. (Jenkins)
local job creation. For instance, when a foreign firm invests in a country, it obviously employs the locals. Capital-intensive FDI may fail to create many jobs.

One of the significant barriers to foreign direct investment is high taxation. Tax rates are considered to be high in the country by most foreign investors. This being the case, taxation of foreign subsidiaries raises government revenues.

The macro-economic policies, which have been undertaken by the country in recent years, have led to the deflection of FDI flows into the country. Instability in macroeconomic variables such as inflation rates, exchange rates, and excessive budget deficits has limited the country to attract foreign investment. Recently the country reached the completion point under the Highly Indebted Poor Countries (HIPC) initiative. This development is expected to help in making the country more attractive to investors.

A small market size deters investors since most foreign investors have a local market focus and few are seeking to develop export capacity to markets outside the country. Lack of natural resources such as minerals also plays a part in deterring FDI into the country.

A country that is notorious for corruption cannot attract many investors effectively. This entails that a country with a higher rate of crime has no security, even for foreign investors. Malawi is a good investment destination since the crime rate in the country is not very high compared to other countries.

Finally if production costs are lower in some country, foreign investors are bound to flock to that particular country for that type of investment. This results in the country being regarded as a high-risk country by investors.
Globalization has led to an increase in competition for FDI among most African countries thereby making it even more difficult for Malawi to attract new investment flows.

Operations of any industry in a country are guided by policies formulated by the government. The Government needs to undertake initiatives to attract and retain FDI in the country. In order to contribute effectively to the promotion of FDI in the country, the Government needs to concentrate on tackling the domestic regulatory reforms, and the marketing of investment opportunities. Malawi should adopt a more targeted investment promotion strategy.

The way government policy on investment is formulated will also affect the performance of the sector. For example, investment policy for Malawi should have relaxed rules regarding market entry and foreign ownership, improved treatment standards of foreign firms. In other words, the Government policy on investment should promote the sector, as well as support its growth as much as possible.

FDI brings in international networks with other countries. A policy that allows for facilitation of business is a reliable tool for attracting investment. If promotion of investments and provision of incentives on investments are considered in the policy, the goal to promote investments will be achieved.

One of the development challenges facing Malawi is how to attract and retain FDI on a sustainable basis. Sound FDI policies for the country could be equivalent to policies for mobilizing domestic resources for productive investment, as domestic resources provide a foundation for self-sustaining development. In order to attract and retain foreign investors the government needs to lower the cost of doing business in the country as compared to its
neighbouring countries. It is generally expected that countries that offer a large domestic market and or natural resources can inevitably and ably attract FDI.

In the world Investment Report (2004) Malawi was classified as having a low FDI potential as well as being an under performer in its initiatives to attract FDI. In recent years Malawi has attempted to improve its business climate in an effort to attract foreign direct investment. Most of the foreign and domestic investors interviewed found the business environment conducive for investment and attributed most of this to the sound economic policies that are currently being implemented by the Government. This scenario has enabled Malawi to improve the sector to at least a better performance, as compared to previous performance in investment sector.

The key deterrents to investment in the country have been identified as high interest rates, lack of proper legal frameworks, macro-economic instability, poor infrastructure, corruption, lack of natural resources, high production costs, market size and political instability.
CHAPTER ONE

1.0 INTRODUCTION

The important role that investment, both foreign and domestic, plays in the economy of the country is usually taken for granted. It is envisaged that when investment takes place, the economy grows. Establishing an attractive business environment is a multidimensional effort. In order to attract investment on a sustainable basis there is need for a stable microeconomic environment for a prolonged period of time. Investment in the country is supposed to lead to accelerated economic growth, creation of wealth and employment opportunities in order to reduce poverty on sustained basis. This cannot be achieved by Government effort alone, the role of the private sector is critical in this.

In recent times, the importance of Foreign Direct Investment (FDI) has been taken for granted. As a consequence, the debate among academics and policymakers has shifted from whether or not countries should attract FDI to how countries can attract and reap the full benefits that come with FDI. The benefits of FDI include serving as a source of capital, employment creation, technology transfer, to mention a few. Before we can start analysing the benefits of Foreign Direct Investment (FDI) or how FDI is linked to development we have to ask ourselves this question “Why is FDI important to a country?” For a landlocked Least Developed Country (LDC) like Malawi, FDI is a source of capital and employment.
Over the past two decades many countries have implemented broad ranging economic reforms, including the liberalization of domestic markets and some privatization, which has had an effect on the flow and nature of foreign investment. However, Malawi has, on average, been relatively unsuccessful in attracting FDI in spite of very large increases in global flows.

Investing in Malawi is very tough at the moment, interest rates are very high, and infrastructure i.e. the reliability of water and power supply is still a problem that should be solved. The approval by the World Bank and International Monetary Fund (IMF) that Malawi has reached the completion point under the Highly Indebted Poor Countries (HIPC) initiative has led to the cancellation of almost all external debts to Multilateral Institutions. This has been seen by most Malawians as a major economic victory but the question is how this would translate into poverty reduction.

Malawi has a population of about 12.4 million people with about 50% of these people living in abject poverty. The Millennium Development Goal of reducing poverty rates by half is particularly important to Malawi. This situation indicates that FDI is crucial to the country.

In order to create a conducive environment for investment we need to start at the basic level. There is need to address the basic issues such as the supply side constraints. It is not about the change in policies only; there is also the need to change the mindset of Malawians through civic education. First of all encourage the local Malawians to invest in the country, and then focus on FDI. The local farmer, vendor etc should be ambitious enough to want to invest in the country. The purchasing power
of Malawians is very low and the saving itself is minimal. These need to be taken into consideration when developing policies on investment.

1.1 LITERATURE REVIEW

There has been very little literature on the impact of Foreign Direct Investment on development as regards the Malawian perspective. Most authors have concentrated more on literature on the impact on foreign direct investment to Africa\(^4\). This paper attempts to overcome this limitation. It emphasizes on identifying clearly what needs to be done at the national, regional, and international level in order to enhance FDI flows to Malawi.

Most authors indicate that when it comes to Foreign Direct Investment in Africa, what comes to mind is investment in natural resources, mainly investment in minerals and oils. This assumption means that FDI is basically determined by an uncontrollable factor and that poor countries with deficient natural resources like Malawi will attract very little or no FDI regardless of the policies that the country pursues.

According to the “eclectic” theory of FDI, countries that have a “locational advantage” will attract more FDI\(^5\). Location-specific advantage embodies any characteristic (economic, institutional and political) that makes a country attractive for FDI. This includes large domestic markets, availability of natural resources, an educated labor force, good infrastructure, low labor cost, good institutions, political stability, to


\(^5\) Dunning (1988)
mention a few. It is clear that international capital inflows are a fundamental element in economic performance. Poverty is almost invariably linked to unemployment, rural and urban. Investment is essential for creating new job opportunities in the formal economy, with indirect effects on the informal sector. Where domestic resources to finance investment are limited, foreign capital inflows are necessary.

CHAPTER TWO

2.0 MACROECONOMIC ENVIRONMENT

Malawi is a landlocked country in Southern East Africa bordered by Tanzania to the North East, Zambia to the West and Mozambique to the South. It covers an area of 118,485 square kilometres. It has a GDP per capita of around US$200 and ranks amongst the 10 poorest countries in the world. Its population is estimated at 12.4 million\(^6\). Agriculture is the predominant sector driving the economy. It employs about 85% of the labour force and accounts for over 80% of foreign exchange earnings. Tobacco is the largest export crop, followed by tea, sugar, coffee and cotton. The dependence on tobacco makes the country vulnerable to the growing antismoking lobby and creates further uncertainty regarding the future of the economy. The continual dependence on agriculture makes the country vulnerable to world commodity price fluctuations. There are investment opportunities in the agriculture sector such as livestock production, aquaculture, horticulture and processing and packaging of agricultural products.

The economy is dominated by the production, processing and distribution of a limited number of agricultural crops, such as tobacco, tea, sugar,

\(^{6}\)National Statistical Office (NSO), 2005 estimates
coffee, cotton and maize, which is the main staple food. Manufacturing has remained stagnant and high interest rates; inflation and exchange rate movement have meant that returns on private sector activities are uncertain. The influx of cheap imported goods, which followed upon economic liberalization, has eroded the market share of consumer goods for domestic manufacturers.

Malawi has suffered from internal and external economic shocks, which have resulted in limited economic growth. The economic shocks include deterioration of terms of trade on the world market, oil price hikes, macroeconomic instability, and adverse weather conditions. The result has been inadequate economic growth (development) and a downward trend in savings and investment.

In order to address the above scenario, the Malawi Government, since 1985 started implementing policies for increasing the competitiveness of Malawian products in domestic and international markets, and enhancing public sector efficiency. These policy reforms were meant to create an enabling environment for accelerated and sustainable development of the real sector; import liberalization, privatization, enactment of an investment promotion legislation and the introduction of the Export Processing Zone programme.

2.1 INVESTMENT CLIMATE

For many years investing in Malawi has had its own setbacks. Potential investors have complained of lack of information on business environment. Malawi has taken a number of initiatives to create an investor friendly environment and attract more FDI. Apart from the repeal
of the Forfeiture Act of 1992, there are effective laws derived from the English Common Law to protect foreign investment. The Malawi Investment Promotion Agency (MIPA) is the institution that promotes, facilitates and encourages FDI. This operates as a one-stop investment centre and was established under the Investment Promotion Act of 1991. Currently, work is underway to review this Act so that the investment policy, incentives and investors guide reflect the current development thinking.

Malawi has also put in place a generous incentive package for FDI. This includes the corporate taxation policy and the special taxation for export-oriented manufacturers. Malawi signed double taxation treaties with eight countries: the United Kingdom, the Netherlands, France, Denmark, South Africa, Norway, Sweden and Switzerland. The country is a member of the International Convention for the Settlement of Investment Disputes and joined the Multilateral Investment Guarantee Agency in 1986.

Many investment opportunities are available in the country. For someone intending to do business in Malawi there are a number of challenges that they need to be aware of. Though the country has preferential access to regional and international markets through a number of agreements such as ACP/EU, AGOA, SADC, COMESA, it has a small domestic market and the purchasing power is very low thus hinders on its competitiveness in the global market.

Over the past two decades many countries have implemented broad ranging economic reforms, including the liberalization of domestic markets and some privatization, which has had an effect on the flow and nature of foreign investment. However, Malawi has, on average, been
relatively unsuccessful in attracting FDI in spite of very large increases in global flows. This can clearly be attributed to supply side constraints.

The principal destination for foreign investment is Agriculture, notably Tobacco and Sugar. In 2005, the main sector that attracted investment was the manufacturing sector with 19 companies out of 36 investing in it\(^7\). Investment in sugar is dominated by a South African owned firm (Illovo).

CHAPTER 3

DEVELOPMENTAL IMPACT OF FOREIGN DIRECT INVESTMENT

The likely impact of FDI on economic growth and development cannot be derived from the details of corporate strategy but must be viewed in the context of existing domestic economic structures, capacities and strategies. A high or low share of FDI in total capital inflows should not be taken as a positive or negative benchmark of a healthy economic policy. A more balanced framework for evaluating FDI needs to weigh up a series of accompanying costs and benefits. As a country, there is a need to realize that the inflow of capital from FDI may be a benefit but the subsequent outflow of profits earned on the investment may be so high as to make it a very substantial cost. The production of new foreign subsidiaries may be a benefit, but if it displaces existing production by local firms, this is an offsetting cost.

Developing countries or emerging economies acknowledge that investment could be a source of economic growth through development and modernisation. There is a direct link between FDI and development. This link can either be positive or negative. The link is positive, where

\(^7\) Source: MIPA investment statistics
countries actually enjoy the benefits arising from investments. Negative links between investment and development are bound to arise when there are shortcomings that occur due to having more investments. For instance, too much promotion of FDI can override protection of local industries, resulting to underperformance of local enterprises and no economic growth for the industry.

**FDI and job creation**

The most important factor of shifting poor people out of poverty is access to employment. Insufficient job opportunities are the result of inadequate levels of investment both foreign and local\(^8\). A key developmental spill over of FDI is local job creation. Given appropriate policies and basic levels of development, FDI can trigger benefits. Malawi has managed to attract FDI, which has brought along local job creation. For instance, when a foreign firm invests in a country, it obviously employs the locals. In this situation, the Government has created jobs for a number of people by allowing that firm to operate in Malawi.

Though this is the case, there is also concern that while FDI does succeed in creating employment, income inequality in the country may become more skewed. This would be the case where employment and training is given to more educated, typically wealthy elites. This situation may worsen the inequality between groups.

Capital-intensive FDI may fail to create many jobs. Foreign firms may adopt capital-intensive modes of production using technologies developed abroad thus not needing to employ any local people.

\(^8\) Low investment levels result in lower rates in job creation.(Jenkins and Knight 2002)
FDI and Tax Revenue

One of the significant barriers to foreign direct investment is high taxation. Tax rates are considered to be high in the country by most foreign investors. While incentive schemes have been developed in order to reduce the burden of taxation, these have been complex to administer and are lacking in transparency. Taxes are considered as the main source of revenue for the country. Revenue collection from taxes makes up almost a quarter of the annual budget. This being the case, taxation of foreign subsidiaries raises government revenues. This in turn can be used to fund various social development programmes.

FDI and technology transfer

FDI is generally associated with facilitating the transfer of newer, faster and more productive technology to host countries. Technological change may result in the acquisition of more efficient and productive capital. This
is an initiative that Malawi as a country can benefit from. The modern machinery that a foreign company would bring to Malawi with plans to manufacture textiles and garments would definitely be incomparable to the one that Mapeto Textile Manufacturers uses. This would definitely drive the local producers to obtain the same machinery in order to perform competitively.

Though this might be an advantageous situation for the country, it may still not be able to take advantage of the expected benefits that come along with foreign enterprises in the case of the technology that is very costly to maintain if left for local entrepreneurs in the long run.

**FDI and Competition**

FDI brings along a competitive environment that motivates local enterprises to perform to international standards set by foreign firms, as a survival strategy in the industry. In recent times, we have seen the emergence of a South African Supermarket chain known as Shoprite. At first we used to have the local Supermarket then known as Peoples Trading Centre. With the emergence of Shoprite, PTC was motivated to perform to international standards in order to be able to handle the competition brought by Shoprite.

The competitive environment could be detrimental to development in the country in national market. It is possible to have a competitive situation result into malpractice amongst national firms, as survival tactics, for example the production of counterfeit products. The tension in the environment could affect positive linkages between foreign and local firms, cutting off technology transfer and other benefits.
FDI and international integration

It has been observed that FDI contributes to international integration since many foreign firms are well connected globally in terms of access to financial markets, consumer outlets and transportation networks. In the case of Malawi, multinationals that have invested in the country have played a very big role in putting the country on the map and for being able to integrate internationally through trade. Such integration allows for trade networks through which trade relations are strengthened.

FDI and regional integration

Malawi is a member of two regional groupings of SADC and COMESA. Within any group of countries, there is the concern that the dominant member will attract FDI at the expense of its smaller neighbours. This is particularly relevant in the case of SADC, where smaller economies like Malawi are concerned by the possibility of increased domination of South African trade and investment, and of losing foreign investment to South Africa. This fear is not unreasonable, and it will become more of a problem with the formation of a regional free trade area. The benefits from regional trade integration (in terms of both trade volumes and new inward investment) tend to flow disproportionately to the larger partners to the agreement, and the emergence of a few poles of industrialization should be expected. There is need for some mechanisms to encourage reverse capital flows to be part of a free trade agreement in order to spread the gains from regional trade.

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CHAPTER 4

FACTORS THAT DETER INVESTMENT INTO THE COUNTRY

It is assumed that a rapid pace of opening up (liberalization) is key to attracting the right type of FDI on a desired and sustainable scale. Government through policies and other factors can be able to attract FDI into the country but there are instances where such efforts do not yield the expected results. This has been the case for Malawi, which has seen low levels of FDI inflows in recent years. (Insert Table 2)

Table 2 : Source: UNCTAD, Country Profile Report

Macroeconomic instability

A stable macroeconomic environment is fundamental for any economy's growth. The macro-economic policies, which have been undertaken by the
country in recent years, have led to the deflection of FDI flows into the country. Instability in macroeconomic variables such as inflation rates, exchange rates, excessive budget deficits has limited the country to attract foreign investment. Most of the fiscal and monetary policies that have been undertaken have generated unsustainable budget deficits and inflationary pressure thus raising local production costs, generating exchange rate instability and making the country a risky location for long term investment. Rapid depreciation of local currencies erodes the foreign currency value of both profits and equity. Recently, the country reached the completion point under the Highly Indebted Poor Countries (HIPC) initiative. This has led to the cancellation of almost all external debts to Multilateral Institutions. This development is expected to help in making the country more attractive to investors.

**Lack of Proper Regulatory Frameworks**

Restrictive regulatory frameworks for investments are a turn off for foreign investors. In the past, domestic investment policies—for instance—on profit repatriation as well as on entry into some sectors of the economy e.g. mining was not conducive to the attraction of FDI. Most of the foreign investors in the country feel that the existing frameworks do not allow for liberal operations for them.

**Market size and GDP growth**

The growth rate of real per capita output is very low in the country and the market is very small. Not only is the domestic market very small but also the purchasing power of the people is very low taking into consideration that almost half of the population live in abject poverty. This definitely deters investors since most foreign investors have a local market
focus and few are seeking to develop export capacity to markets outside the country.

From the survey conducted it was noted that, the market for financial services has expanded due to its market size and potential for growth. The per capita income in this sector is quite good and this has led to quite a number of multinationals investing in this industry\(^\text{10}\).

**Lack of Natural Resources**

Malawi is a landlocked country, which is lacking in natural resources like minerals. Recently, mineral deposits were discovered in the Northern and Central region of the country and foreign investors are showing interest on the matter. Though this is an initiative that has to be taken advantage of, we are yet to see the project take off.

**Corruption**

A country that is notorious for corruption cannot attract many investors effectively. Corporate governance with sleazy practices, whether in the public or private sector, is one factor that allows for demerits as a potential country for FDI inflows. The zero tolerance policy on corruption that has been introduced by the Government is an initiative, which is expected to attract investment, as contribution to the improvement in the macroeconomic stability of the country.

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\(^\text{10}\) Commercial Bank has turned into Stanbic Bank through investment from Standard Bank
**Political Instability**

A political environment that is not stable has the capacity of scaring away investors. For example, a number of investors highlighted that Malawi’s political environment is constantly stable except during the elections period. In 2004, investors were uncertain of the political situation, as voters reacted to the outcome of the elections violently. This entails that a country with a higher rate of crime has no security, even for foreign investors.

Investors are concerned about the security of their assets and financial resources. Malawi is a good investment destination since the crime rate in the country is not very high compared to other countries.

**Poor Infrastructure**

The absence of supporting infrastructure such as telecommunication, transport, power and water supply and skilled labour discourage foreign investors since it increases transaction costs. Investment comes along with the need to communicate with clients at ease, operate efficiently under reliable utilities. Such factors include proper infrastructure and utilities that would make investing in Malawi a pleasure with no hassles. The constant cuts in power and water supply make it hard for international businesses to manufacture and produce efficiently. The cost of transport is very high in the country. Better road networks enable investors to transport and supply products at a lower costs.
High Production costs

Finally if production costs are lower in some country, foreign investors are bound to flock to that particular country for that type of investment. Production of carbonated drinks is quite a challenge in the country and that is why there is one efficient, monopolistic multinational that is able to supply these drinks throughout the country.

Malawi relies on the export of a few primary commodities such as tobacco, tea, sugar etc for foreign exchange earnings. The prices of these commodities are highly volatile thus making the country vulnerable to terms of trade shocks. This results in the country being regarded as a high-risk country by investors.

Globalization has led to an increase in competition for FDI among most African countries thereby making it even more difficult for Malawi to attract new investment flows.

However, it should be noted that although some foreign investors are discouraged with such an environment for investment, there are some who have found it quite conducive for their operations. Therefore, improvement of such deterring factors would enable Malawi to attract a good number of foreign investors but not excessively.
CHAPTER 5

THE ROLE OF GOVERNMENT IN PROMOTING AND ATTRACTING FDI

It is clear that good governance is fundamental to the social economic well-being of every nation. Most of the time, policymakers are interested in the performance of the economy relative to its potential. Operations of any industry in a country are guided by policies formulated by the government. It is quite obvious that not only the government has a role in policy formulation. The private sector, as a main drive of the economy is also considered as a contributor to policy formulation and monitoring as well as partners with the government.

The vision of turning the country from an importing nation into a producing and exporting one can be achieved through the promotion of FDI inflows. The Government needs to undertake initiatives to attract and retain FDI in the country. For instance, attracting FDI in the textile industry will help in increasing exports and low skill job creation. Though this is the case, without further policy intervention this can only be sustained in the short run. In the long run this is unlikely to lead to significant growth in the economy.

In order to contribute effectively to the promotion of FDI in the country, Government needs to concentrate on tackling the domestic regulatory reforms, and the marketing of investment opportunities. Improving the current image of the country is key to reversing the dismal FDI inflows. This will require an increase in political stability and macro-economic stability. This can be done through the following ways:
Support to existing investors

The Government of Malawi needs to make all efforts in supporting the existing investors through improvement of the investment climate, infrastructure development; provision of services and changes in the regulatory framework. The laws on profit repatriation need to be relaxed. This will encourage existing investors to increase their investments and also attract new investors. In the case of domestic investors, an improvement in the investment climate will also encourage them to keep their wealth in the country and reduce capital flight.

Marketing investment opportunities

The Government should facilitate the creation of awareness of investment opportunities through the use of existing investors and information, communication technologies such as the Internet. Malawi should adopt a more targeted investment promotion strategy. In other words, this strategy should identify sectors where the country has comparative and competitive advantages and then promote FDI into those sectors. This would make investment promotion less costly and more effective.

Privatization

The privatization of inefficient state-owned enterprises which was undertaken in 1996 was expected to boost foreign investment. The privatization programmes was aimed at fostering increased efficiency in the economy, increased competition and promote the participation by the Malawian public enterprises. This saw the privatization of 66 State Owned Enterprises (SOEs), 44 of which went into the hands of Malawian
entrepreneurs\textsuperscript{11}. FDI attracted by privatization of SOEs may enhance efficiency but does not guarantee affordability of services for all without proper regulation or competition policy. Malawi at the moment has a competition policy, which is helping in tackling problems that arise due to uncompetitive behavior.

A significant share of privatization-led FDI has been concentrated on the telecommunication sector.\textsuperscript{12}

The zero tolerance policy on corruption that has been introduced by the Government is an initiative, which is expected to attract investment as well as improve the macroeconomic stability of the country. It should be clearly noted that FDI is not a solution to all development problems.

The way government policy on investment is formulated will also affect the performance of the sector. For instance, a regulatory framework that is liberal would enable investors, whether foreign or local to operate efficiently and effectively with fewer restrictions. This implies that policies should have restrictions that are placed tactfully for the benefit of the country meanwhile attracting investors, not scaring them away. For example, investment policy for Malawi should have relaxed rules regarding market entry and foreign ownership, improved treatment standards of foreign firms. In other words, the Government policy on investment should promote the sector, as well as support its growth as much as possible.

FDI brings in international networks with other countries. This is always effective if the government policy also allows for participation in the

\textsuperscript{11} Trade and Investors Magazine Vol. 2. No.1
\textsuperscript{12} Privatization of Malawi Telecommunication Limited with 60% acquired shares by foreigners
global trade. For Malawi, such networks and trade networks have been established at multilateral, regional and bilateral levels through membership in the WTO, SADC and COMESA, including trade relations with other states like South Africa and European Union (EU) to mention a few.

A policy that allows for facilitation of business is a reliable tool for attracting investment\textsuperscript{13}. If promotion of investments and provision of incentives on investments are considered in the policy, the goal to promote investments will be achieved. Incorporating after investment services, measures that reduce high costs of doing business in the policy would at least ensure that entrepreneurs whether foreign or domestic are some burdens that they are likely to face off their shoulders.

CHAPTER 6

POLICY CHALLENGES AND IMPLICATIONS

One of the development challenges facing Malawi is how to attract and retain FDI on a sustainable basis. A number of efforts have been made in the past to boost FDI flows to the country but they have not had any significant impact. Sound FDI policies for the country could be equivalent to policies for mobilizing domestic resources for productive investment, as domestic resources provide a foundation for self-sustaining development. If there is an enabling domestic business environment, then domestic resources could be mobilised but it could also be used to attract and effectively use international investment.

\textsuperscript{13} Caves R.E (1996)
The policy approaches towards FDI have been driven by conditionalities attached to multilateral lending. These have helped introduce a degree of policy coordination at the multilateral level. However, this has been coherence in policy means, which has come at the expense of coherence in policy ends leading to an excessive pace of reform and an unhelpful narrowing of the policy agenda\textsuperscript{14}.

In order to attract and retain foreign investors the government needs to lower the cost of doing business in the country as compared to its neighbouring countries. There is need to prioritize reducing budget deficits, interest rates and inflation in order to make economic growth more stable.

The Government of Malawi should encourage investment into productive sectors such as agriculture and manufacturing by creating incentives. As tourism is one of the priority areas in the Malawi Growth and Development strategy, there is need to encourage investment in this sector. There is need to put Malawi on the radar screen of most potential investors.

Malawi has already liberalized its market thus making it already an attractive destination for FDI. There is need for Government to facilitate in the market access for most of the export products. The country can develop a few priority projects that would have a multiplier effect on other investment projects.

The benefits of the privatization programme are yet to be seen. The developmental impact of the privatization process is yet to be admired. For instance when Malawi Railways Ltd was privatized, most of the

\textsuperscript{14} Stiglitz (2002)
employees were laid off thus increasing unemployment in the country. There is need for government to help in the awareness campaign on the benefits of investment or success stories of companies that have been privatized so as to attract FDI in the other State owned enterprises that are yet to be privatized. The privatization process needs to be more attractive and this can only be done with government involvement and support.

There is need to ensure that sufficient policy space remains in order to secure Malawi’s economic future. It should be noted that the Government of Malawi has made it possible to make available an Act that is being reviewed, which promotes both domestic and foreign investment. Every policy is bound to have a number of setbacks, as a result of overlooked factors that have not been well addressed. Policy makers should strive for greatest possible macroeconomic stability and an institutional framework that is predictable.

Though no empirical evidence or link has been established it is generally assumed that FDI may help in addressing social concerns by acting as a tool to alleviate poverty. In this case the Government should ensure a balanced distribution of investment by developing rural infrastructure. This might lead to new and existing industries to move to the disadvantaged areas.

CHAPTER 7

CONCLUSION

It is generally expected that countries that offer a large domestic market and or natural resources can inevitably and ably attract FDI. In the world Investment Report (2004) Malawi was classified as having a low FDI
potential as well as being an under performer in its initiatives to attract FDI.

In recent years Malawi has attempted to improve its business climate in an effort to attract FDI. Establishing a competitive business climate is a difficult task since it takes time; not only to implement the policies but also to convince potential investors. Malawi has not been able to attract as many investors, whether local or foreign per expectations and as entailed in the findings of the report.

Most of the foreign and domestic investors interviewed found the business environment conducive for investment and attributed most of this to the sound economic policies that are currently being implemented by the Government. The Government should put in some efforts to exert a pull on such investors through policies and involvement of the private sector. This scenario has enabled Malawi to improve the sector, at least to a better performance, as compared to previous performance in investment sector.

Government can play an important role in promoting investments in the country. In the long run, government can increase the FDI inflows by streamlining the investment regulatory framework, implementing policies that promote macroeconomic stability and improving physical infrastructure.

The key deterrents to investment in the country have been identified as high interest rates, lack of proper legal frameworks, macro-economic instability, poor infrastructure, corruption, lack of natural resources, high production costs, market size and political instability.
REFERENCES


