U.S. FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES: A CASE STUDY OF MALAYSIA, MEXICO AND SOUTH AFRICA

by

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(Under the Direction of GABRIEL WILNER)

ABSTRACT

There is an upsurge for foreign investment in developing countries. Developing countries that seek foreign investment actually prefer foreign direct investment. The issue of foreign direct investment has become a controversial issue among developing countries. Though this type of investment provides economic growth, employment, and infrastructure development, developing countries may also suffer legal and economic manipulation by the foreign investors at the expense of their countries' resources. The foreign investment policies of developing countries that seek such foreign direct investment ultimately determine the actions of foreign investors. In many developing countries, foreign investment policies and other investment regulation are catalysts to the desire for economic growth than proponents of such growth. This paper seeks to examine the concept of foreign direct investment in developing countries.

INDEX WORDS: Developing countries, Malaysia, Mexico, South Africa, Foreign investment, Foreign direct investment, Foreign investors, NAFTA agreement, Regulatory, Foreign investment policies, Manufacturing industries, Economic sustenance, Bilateral investment agreement, Privatization, Capital expenditure, Incentives, Bureaucratic tendencies, Performance requirements, License, Permits, Minimum wage, Industrial workers, Foreign workers, Liberalized investment regime, Economic liberalism, Nationalization, Import substituting industrialization, Restrictions on foreign investors, Economic sovereignty, Restricted zones, Apartheid, Sullivan principles, repatriation of investor profits.

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To my biggest fans, Kwabena and Nyamekye, for ALWAYS STANDING by me AND to my parents and Boakye for ALWAYS BELIEVING in me.

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CHAPTER 1

INTRODUCTION

Purpose of the study

Many developing countries seem to believe that economic growth cannot be solely obtained from dependence on their own assets. Hence foreign investment is the answer to many economic problems among developing countries. Any country with a Gross National Income (GNI) per capita of more than $6000 is a developed country. [1] A country with per capita GNI less than this is classified as "developing".[2] There is a general misconception that all developing countries are extremely poor. Though some countries may be classified as "developing" they all do not share the same or even similar economic ratings, some developing countries are more advanced than others.[3] FDI occurs when foreign investors establish businesses inside a foreign country.[4] There are three forms of FDI: (1) Greenfield investments, (2) cross-border merger and acquisition type of investment and (3) brownfield investments.[5.] Greenfield investments create new assets or facilities through new companies, new subsidiaries, or joint ventures where the foreign investor takes a controlling equity stake.[6] The cross-border merger and acquisition type of investment occurs when a foreign company acquires the assets of an existing foreign company or enters into a merger agreement with the country to form a new legal entity.[7] A brownfield investment occurs

[1] WORLD BANK GROUP, DATA AND STATISTICS (2002), *available at* http://www.worldbank.org
[2] *Id.*
[3] *Id.*
[4] *Id.*
[5] Brendan Vickers, *Foreign Direct Investment (FDI) Regime in the Republic of South Africa*. February 2002, *available at* http://cuts.org/ifd-Im-cr-safrica.doc.
[6] *Id.*
[7] *Id.*

when foreign investors acquire an existing local company and completely replace all plant and equipment of the former company.[8]

The popularity of FDI may be because it has the propensity to create other positive economic benefits by providing foreign exchange, employing citizens of the developing countries and stimulating general economic growth. A positive effect of FDI on developing countries is the international recognition gained as a result of their business interactions with developed countries. Evidence of this was seen when Mexico entered into the NAFTA agreement with the U.S. and Canada.[9]

This paper will analyze U.S. FDI in three developing countries: South Africa, Malaysia and Mexico. These countries were selected from three regions of the world: Africa, Latin America and Asia. The selection is based on the uniqueness of their foreign investment policies,[10] and the unique situations U.S. companies face in terms of FDI in these countries.[11] These three countries are representative of the quest for FDI by all developing countries. Foreign investment policies are designed to be unique documents that state the desire of a country to do business with foreign-owned businesses; foreign investment policies may afford investors the opportunity to discern all pertinent information and therefore must be drafted in ways that are comprehensible and accessible. To attract investors to a country, most countries, particularly developing

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[8] *Id*.
[9] North American Free Trade Agreement, drafted Aug. 12, 1992, revised Sept. 6, 1992, U.S.-Can.-Mex., 32 I.L.M. at 605 (entered into force Jan. 1, 1994) (*hereinafter* NAFTA Agreement).
[10] All three countries have achieved enviable success in attracting FDI, however their policy strategies have been very different. Malaysia's investment guide is still quite restrictive. Mexico's foreign investment law has certain facets from its 1917 Constitution. South Africa's investment guide has few restrictions. These issues will be addressed below. See p. 5, 25, and 53.
[11] Though U.S. FDI is sought after by many countries, it has also created some controversy. This is evident in Malaysia, Mexico and South Africa.

countries, offer all kinds of incentives to the investors.[12] Other countries, however, may have some very rigid foreign investment policies.[13] Though some rigidity in investment regulations is acceptable, investments can be forfeited in extreme cases. Economic, political, social, and legal situations of developing countries are key considerations for prospective U.S. investors. Currently, political tension has reduced FDI inflows to the developing parts of the Middle East.[14] However, some developing countries in the Middle East may still be able to attract foreign investors because of their oil and petroleum resources. Chapter 1 will form the beginning of individual country analysis. The first country to be discussed is Malaysia. Chapters 2 and 3 will focus respectively on FDI in Mexico and South Africa.

The analysis of U.S. FDI in each country will include a brief country profile as well as an analysis of the historical evolution of U.S. foreign direct investment in these nations. In the discussion on each country an analysis is made of factors that make each nation attractive to U.S. companies. The discussion also addresses restrictions on foreign investors in these nations, the effects of foreign direct investment on the citizens of these nations, and effects of foreign direct investment on the economies of these nations. Recommendations will be made in the concluding section of each individual country analysis.

Chapter 5 concludes with a general discussion of the regulatory problems affecting FDI among developing countries in Africa, Latin America, Asia, and other parts of the world. The discussion of FDI in certain regions includes other problems that may not be necessarily

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[12] Edward M. Graham, *Forward* to Louis T. Wells Jr ET AL., Using Tax Incentives to Compete for Foreign Investment. Are they worth the costs? at vii, (World Bank Publications) (2001). Incentives may be given through direct subsidies or indirect subsidies.

[13] Some foreign investment laws are restrictive on foreign investors and have no room for flexibility.

[14] *World Bank Anticipates Global Upturn, Urges Increased Help to Poor Countries; Growth in the Middle East Challenged by External Environment,* World Bank News No. 2002/225/MNA. FDI inflows to developing countries have been weak after the events of September 11th.

regulatory. Final comments and recommendations will be proposed on regulatory and other measures developing countries may adopt to reap maximum benefits from FDI.

CHAPTER 2

MALAYSIA

Though China actually gets the most FDI of any country in Asia,[15] Malaysia has increasingly become a unique example of how effective well-formulated investment policies and well-structured infrastructure can sustain the quest for FDI by developing countries.[16]

A. Historical Evolution of U.S. FDI in Malaysia.

Traditionally, Malaysia's source of economic growth was derived from public sector investment[17]. The Malaysian government focused on revenue from commodities like rubber, tin, and palm oil. Despite Malaysia's reliance on this public sector investment, Malaysian governments over the years exhibited their interest in extending investment to the private sector by enacting the following investment related laws: The Income Tax Act 1967,[18] The Free Trade Zone Act, No. 438 (1971),[19] the Industrial Coordination Act, No 156 (1975)[20] and the Promotions of Investments Act, No. 327 (1986). Between 1971 and 1973, a recession occurred in Malaysia because of a worldwide oil crisis.[21] This recession discouraged U.S. companies that wanted to set up businesses in Malaysia from doing so.[22] Between 1980 and 1981 the Malaysian

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[15] A. T. Kearney, *FDI Confidence Index*, vol. 5 BUSINESS POLICY COUNCIL. 2 (2002) According to the index report, China has also surpassed the U.S. to become the premier destination for foreign investment.
[16] *Id.*
[17] Terence P. Stewart, Png, L. H., *The Growth Triangle of Singapore, Malaysia and Indonesia*, GA. J. INT'L & COMP. L. Vol.23, 20 (1993).
[18] It contains tax regulation and other incentives for certain stated sectors
[19] It provides manufacturing investors with less customs control and bureaucracies in the export of raw materials, machinery and equipment, spare parts and finished goods.
[20] It provides coordination and organized investment for the activities of investors within the manufacturing industry.
[21] Ming-Yu Cheng, Sayed Hossain, *Malaysia and the Asian Turmoil*, 2 ASIAN-PAC. L. & POL'Y J. 5, 125 (2001)
[22] *Id.*

economy suffered again as a result of a commodity and second oil crisis.[23] In 1984, after the IMF imposed strict loan conditions on Malaysia, FDI became its perceived key to economic sustenance.[24] Malaysia's reliance on the agricultural sector was negatively affected when Palm oil, one of Malaysia's main exports, became unpopular.[25] Malaysia has been the leading producer of oil palm since 1988.[26] Malaysian export of palm oil to the U.S. grew from 1.7 in 1978 to 4.3% in 1986.[27] However, medical studies soon determined that palm could cause some heart conditions.[28] Therefore, between 1985 and 1992, Malaysia concentrated on developing a manufacturing industry for producing electrical gadgets.[29] This was soon affected by the worldwide electronic crisis of 1985 and 1986 causing little demand for electronic products.[30] The manufacturing industry in Malaysia therefore suffered when U.S. companies begun to lay workers.[31]

Political tensions between the majority Bumipatras and the minority Indians and Chinese affected the country's FDI attractiveness. This tension existed from colonial times when the Chinese were considered the wealthier of the local people and the Indians were considered the economic middleclass [32] while the majority Malays (Bumiputra's) were at the bottom of the economic wealth ladder, owning a miniscule equity from the country's resources.[33] Also, the Malaysian and U.S. relationship became strained when the Malaysian government refused to

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[23] *Id.*
[24] Kent Klaudt, *Hungary After the Revolution: Privatization, Economic Ideology and the False Promise of the Free Market*, 13 LAW & INEQ. J. 303, 307 (1995)
[25] Howard Shapiro, *Asian Economic Integration and the Growth Triangle*, 4 INT'L LEGAL PERSP. 1, 4 (1992)
[26] Stewart, *supra* note 17, at 21; *see also* report by STATISTICAL, ECONOMIC AND SOCIAL RESEARCH AND TRAINING CENTRE FOR ISLAMIC COUNTRIES (2002) *available at* http://www.sesrtcic.org/members/link.shtml
[27] *Id.*
[28] *Id.* This situation affected the growth of the Palm oil industry.
[29] Cheng, *supra* note 21, at 126.
[30] *Id.*
[31] *Id.*
[32] Charles Hirschman, *The Society and its Environment, in* MALAYSIA: A COUNTRY STUDY, 67, 109
[33] *Id.*

allow Vietnamese boat people into the country.[34] The strain was increased in 1990 when the U.S. government sanctioned Malaysia and prevented it from receiving International Military Assistance and Training funds.[35] Between 1992 and 1996, U.S. and Malaysian business dealings were not stable.[36] By 1993, foreign pledges in manufacturing declined and caused a loss of nearly $2.5 billion.[37]

By 1996, the manufacturing sector rebounded and pledged amounts reached $2 billion by the first quarter of 1996.[38] However, Malaysia's FDI setbacks were far from over. In 1998, Malaysia suffered its most devastating economic shutdown during the Asian economic crisis, The Asian economic crisis started when Thailand's currency, the Baht, floated internationally in July 1997[39]. As a result of the Asian crisis, Malaysia's GDP dramatically changed from 2.5 percent in the first quarter to 6.8 percent by the second quarter.[40] Panic-stricken investors started to pull out of short-term capital on a large scale.[41]

The crisis prompted a sharp FDI decline in the tourism and agricultural sectors between January 1997 and December 1998.[42] To worsen matters, in September 1998, Malaysia's Prime Minister, Mahathir Mohamad, introduced controversial new controls on currency trading.[43] The Malaysian Prime Minister introduced the new laws as a form of economic protectionism to prevent foreign countries from manipulating Malaysian resources in the wake of the Asian

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[34] Shapiro, *supra* note 25, at 5
[35] *Id.*
[36] INTERNATIONAL EXECUTIVE REPORTS, LTD., INVESTING IN MALAYSIA: CURRENT RULES, INCENTIVES, REQUIREMENTS 13 (1996) (hereinafter 18 NO. 7 E. ASIAN EXECUTIVE REP. 13)
[37] *Id.*
[38] *Id.*
[39] Cheng, *supra* note 21, at 127
[40] *Id.*
[41] *Id.*
[42] *Id*, at 130
[43] BBC News, *Malaysia Lifts Foreign Investment Controls* (May 2, 2001), *available at* http://news.bbc.co.uk/hi/English/business/newsid_1308000/1308240.stm.

crisis.[44] The new controls required foreign investors to keep their money in Malaysia for a year. The Malaysian government also demanded that all foreign holdings of the Malaysian currency be liquidated and repatriated to Malaysia within a month of receipt.[45] These factors made Malaysia unattractive for FDI.

B. Reasons why Malaysia is Attractive for FDI.

After the recession, Malaysia's economy rebounded in 1999 growing 5.6 percent. Major factors for this growth were the low level of reserves, little foreign debt and the continuity of the manufacturing and export sector.[46] By this time, the focus changed to foreign export and foreign investment.[47] The manufacturing sector in Malaysia became the government's key asset in its quest for foreign investment.[48] FDI was promoted in export-oriented manufacturing and high-tech industries.[49] Some of the reasons that make Malaysia attractive are its undervalued currency, low cost of labor, and fairly low inflation rate.[50] Foreign investors have four options for investing in Malaysia: (1) Registering as a foreign company, (2) Incorporating as a separate company in Malaysia, (3) Forming a sole proprietorship or (4) A partnership or a joint venture company with a local company.[51] Technically any foreign company having a place of business or carrying on a business in Malaysia may register itself as a foreign company and directors meetings must be held in Malaysia.[52]

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[44] *Id.*
[45] *Id.* These measures received a lot of criticism worldwide because they did not correspond with orthodox financial and IMF trade practices. Ultimately the measures introduced by the Malaysian Prime Minister caused foreign investors to shun Malaysia.
[46] Mustapha Kamil, *Battle to Safeguard Independence,* NEW STRAIT TIMES, August 31, 1999, at A1
[47] *Id.*
[48] *Id.*
[49] U.S. DEPARTMENT OF COMMERCE, NATIONAL TRADE DATA BANK, September 3 (1999)
[50] Bently J. Anderson, *Venture Capital and Securities Market Development in Malaysia: The Search for a Functioning Exit Mechanism,* 12 WIS. INT'L L.J. 1, 12 (1993)
[51] Stewart, *supra* note 17, at 22.
[52] *Id.*

Though Malaysia's gets a lot of foreign investors from other Asian countries like Japan, the U.S. companies rank first in FDI in Malaysia.[53] Some of the U.S. investors are large multinationals like Boeing, General Electric, R.J Reynolds, and Bechtel. A positive effect of the influx of U.S. investors to Malaysians is that, customers have access to after-sales service and follow-up services and this is very much valued by Malaysians.[54]

Malaysia's FDI appeal also stems from Malaysia's National Economic Program (NERP).[55] Malaysia plans to become an industrialized nation by the year 2020; this quest is referred to as Malaysia's "Vision 2020".[56] The six objectives to promote economic growth under this plan are:[57] (1) Stabilizing the Ringgit (Malaysia's national currency), (2) Restoring market confidence, (3) Maintaining market stability, (4) Strengthening economic fundamentals, (5) Furthering the socio-economic agenda and (6) Reviving badly affected sectors. Though Malaysia is still facing tough economic situations, the idea of having a plan has been very appealing to foreign investors because Malaysia seems to be relentlessly pursuing the plan by producing equipment that is in high demand[58].

Malaysia is currently recognized as one of the world's largest exporter of integrated circuits and other semiconductor devices.[59] The multimedia super corridor (MSC) is Malaysia's blueprint for developing a high-technology information-based research and manufacturing region.[60] Investments approved for MSC status are exempt from currency exchange and

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[53] Dr Mahathir Mohamad, Address at the U.S.-ASEAN Business Council Dinner (May 14, 2002).
[54] *Id.*
[55] Cheng, *supra* note 21, at 133.
[56] NATIONAL ECONOMIC ACTION COUNCIL (NEAC), NATIONAL ECONOMIC RECOVERY PLAN (NERP) (August 1998) *available at* http://www.neac.gov
[57] *Id.*
[58] Stewart, *supra* note 17, at 21.
[59] *Id.*
[60] Chris Wong, *Malaysia's MSC and Intellectual Property Protection*, Jaring Internet Magazine, 1 (August 1999) *available at* http://www.mdc.com.my/

expatriate employment restrictions.[61] The Malaysian government is determined to develop the MSC to generate more export and investment opportunities for U.S. high-technology firms.[62] Foreign companies that are granted MSC status are also permitted 100% ownership of their companies.[63]

Like the U.S., Malaysia's legal system is founded on the common law system. This is the legal system the Malaysians inherited from the British. Since the U.S. has the same legal system, U.S. investors have a better understanding and appreciation for Malaysian laws and this is crucial to the handling of their business activities in the country. Fortunately for foreign investors, there are many professional legal firms in Malaysia and it is prudent for U.S. companies that wish to reside in Malaysia to secure the services of local lawyers.

Malaysia is also a signatory to the United Nations sponsored Convention on the Settlement of Investment Disputes.[64] Therefore foreign investment disputes are satisfactorily handled by existing dispute mechanisms.[65] Though many foreign firms may choose to include mandatory arbitration clauses in their contacts, foreign investment disputes are rare in Malaysia.[66] Malaysia has also instituted effective and enforceable laws within the legal system to assure foreign direct investors of the protection of their property.[67] Foreigners are freely permitted to own lands that are not considered agricultural land and residential property that is valued at less than $ 62,500.[68]

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[61] *Id.*
[62] *Id.*
[63] The Industrial Co-ordination Act, No. 156 (1975)
[64] 18 NO. 7 E.ASIAN EXECUTIVE REP, *supra* note 36, at 16
[65] *Id.*
[66] U.S. DEPARTMENT OF STATE, 2001 COUNTRY COMMERCIAL GUIDE: MALAYSIA (2001)
[67] *Id.*
[68] *Id*

Until the recent competition from China,[69] Malaysia had a strong information technology (I.T.) base. The Malaysian government instituted a very effective legal structure to protect intellectual property rights.[70] The Malaysian government has set up an Anti-Corruption Agency (ACA) to prevent corruption by officials and foreign businesses are asked to report any individuals who ask for payment in return for government services.[71] This is a positive action by the government to attract foreign investors.

U.S. business visitors to Malaysia do not require visas for a three-month entry unless they are in Malaysia for the purpose of employment. This gives potential U.S. foreign direct investors the chance to go to Malaysia for three months to explore possible business opportunities with no visa restrictions.[72]

The Malaysian government has eased political tension by promoting the holding of economic assets by the Bumiputra (ethnic Malays).[73] This move by the Malaysian government is a good political and social strategy because it resolves political unrest between the Bumiputra and the other Malays. Malaysia has also shown signs of its desire to evolve into a strong financial market within Asia by entering into agreements with neighboring countries; a prominent agreement is the "The growth Triangle" agreement, which was designed to facilitate economic growth and development in Singapore, Malaysia and Indonesia[74].

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[69] Kearney, *supra* note 15, at 21. After China joined the WTO, it has made great strides in obtaining FDI. More I.T. companies are setting up manufacturing bases in China and there seem to be more Chinese students in U.S. schools pursuing post-graduate degrees in I.T. related subjects.

[70] Trade Description Act, No. 291(1972), Patent Act of 1983, Patent Regulations Act, No. A648 (1986), Industrial Designs Act, No. 552 (1996), Copyright Act, No. 322 (1987), Intellectual Property Corporation of Malaysia Act (2002).

[71] *Id*

[72] MALAYSIAN INDUSTRIAL DEVELOPMENT AUTHORITY, *available at* http://www.mida.gov.my/

[73] The Industrial Co-ordination Act 1975, every foreign and domestic company must have a 30 percent Bumiputra workforce.

[74] Stewart, *supra* note 17, at 1, This idea of an economically unified partnership between Singapore, Malaysia and Indonesia was originally proposed by Singapore Deputy Prime Minister Goh Chok Tong in December 1989; a trilateral agreement was finally formed on the 17th December 1994, *available at* http://www.cmsb.com.my/

1. The Growth Triangle of Singapore, Malaysia and Indonesia.

This agreement is a strategic partnership among the three countries to complement each other's resources and potential while ensuring their individual growth.[75] Because the three countries have different but complementary stages of development, the "Growth Triangle" will also offer investors a chance to benefit from FDI derived from three countries at the same time. This is because sectors that are covered under the agreement could expand the geographical area for investor activity, creating huge FDI opportunities for investors.[76] Though the three governments try to coordinate their investment regimes and other economic policies to meet the requirements of the private sector, each country still maintains its own investment regime and laws.[77]

Malaysia has key contributions to the growth triangle.[78] One of Malaysia's cities, Labuan, was named the "International Offshore Financial Center" (IOFC)[79] because of its wealth in oil and gas. The city has literally become a tax haven for foreign investment because of its very relaxed tax laws.[80] Malaysia also has cheap labor, land and a good manufacturing industry to offer. Ultimately benefits accruing from Malaysia's involvement in the growth triangle may enhance the countries' attractiveness to U.S. investors.

2. Other Agreements.

Malaysia has bilateral investment guarantee agreements with 56 countries.[81] The first bilateral investment agreement was with the U.S. in 1959.[82] Malaysia also has a limited

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[75] *Id.*
[76] *Id.*
[77] *Id*, at 25.
[78] *Id.*
[79] *Id*, at 24
[80] *Id.*
[81] MINISTRY OF INTERNATIONAL TRADE AND INDUSTRY, MALAYSIA'S INDIVIDUAL ACTION PLAN, *available at* http://www.miti.gov.my
[82] U.S. DEPARTMENT OF STATE, *supra* note 66

investment guarantee agreement with the U.S. under the U.S. Overseas Private Investment Corporation (OPIC) program. Since 1959, Malaysia has qualified for the OPIC insurance programs. Due to the stable political system in the country and pro-foreign investor attitude, few investors have needed OPIC insurance in Malaysia.[83]

3. Promotions and Investments Act 1986.

Foreign investment in Malaysia has historically been safer than in other developing Asian countries. Malaysia's investment policy provides many incentives to foreign investors. The principle investment incentives are contained in the Promotion of Investments Act 1986 and the Income Tax Act 1967.[84] This act covers companies intending to undertake activities in manufacturing, agriculture, tourism, research and development and technical or vocational training. The tax incentives under this Act relating to direct foreign investment are: (1) Income tax exemption or investment tax allowance through Pioneer Status and (2) Double deduction for export expenses.[85] Pioneer status is a prime status for investors. Companies granted this status either enjoy full or partial exemption from income tax depending on the activities they undertake. Currently the income tax rate in Malaysia is 30%.[86] Therefore, companies qualifying for this status immediately increase the rate of return on their investments.[87]

High-tech companies engaged in promoted activities or in the production of promoted areas in new and emerging technologies are granted full tax exemption at the statutory income level for 5 years or a 60 percent tax allowance on qualifying capital expenditure incurred within

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[83] *Id.*
[84] n.18.
[85] Sec. A1
[86] INVESTORS' GUIDE, 1, extracted from The Economic Report 1995/96
[87] Sec. A1 (i), A company given pioneer status for producing promoted product or activity will be exempted on 70 percent of its statutory income. The grace period of tax exemption is 5 years beginning from the production day. Companies already located in promoted areas are granted 85 percent exemption where it will have to pay tax on 15 percent of their statutory income for 5 years

5 years.[88] Strategic projects of national importance involving heavy capital investments, high technology, the ability to generate extensive linkages and having a significant impact on the Malaysian economy are granted full income tax exemption for 10 years or an investment tax allowance of 100 percent on qualifying capital expenditure incurred within 5 years.[89] Subsidiary research and development services enjoy full exemption from payment of income tax for 5 years. Any incurred losses are added up and deferred to the post tax relief period. An alternative to this is a 100 percent tax allowance in respect of qualifying capital expenditure incurred within 10 years.[90] A final tax incentive attempts to offset export expenses by allowing tax deductions.[91] Some export expenses that are incurred by foreign investors in Malaysia on manufactured products and agricultural produce are eligible for double deduction.[92]

Malaysia has also encouraged FDI through privatization and generous limits on foreign equity ownership. Generally, foreign direct investors established in Malaysia are accorded national treatment in all but equity limits.[93] In addition Malaysia has temporarily eased equity restrictions on foreign ownership of licensed telecommunications companies.[94] Foreign ownership in local fund management companies has been raised to 70% for companies working with both institutional and unit trust funds and foreign ownership in stock-brokering companies was allowed to reach a maximum of 49% by June 30, 1998.[95] Malaysia has Free Zones in which

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[88] Sec. A1 (ii)
[89] Sec A1 (iii)
[90] Sec A1 (iv), These tax benefits create significant incentives for foreign companies to invest in Malaysia
[91] Sec. A2, by providing double deductions for these expenses, the Malaysian government shifts most of the export expenses of qualifying companies to itself.
[92] Sec. A2 (i) Overseas training, (ii) supply of free samples abroad, (iii) export market research, (iv) preparation of tenders for the supply of goods overseas, (vi) public relations work connected with exports, (vii) exhibits and/or participation in local or international trade or industrial exhibitions approved by the Minister of International Trade and Industry, (viii) employee fare expenses for overseas, (ix) expenditure by Malaysian businessmen overseas subject to RM200 a day, (x) cost of maintaining overseas sales office for the promotion of exports
[93] NATIONAL ECONOMIC ACTION COUNCIL, *supra* note 63, foreigners may own up to a maximum of 61% equity in telecommunications companies.
[94] *Id.*
[95] U.S. DEPARTMENT OF STATE, *supra* note 73

export-oriented manufacturing and warehousing facilities may be established. Raw materials and equipment may be imported duty-free into the zones with minimum custom formalities.[96] Companies that export not less than 80% of their output and depend on imported goods may be located in these zones.[97] The manifold ways in which Malaysia is attractive for FDI is seen through: (1) Its action to curb corruption, (2) A legal structure similar to the U.S., (3) An English-speaking business community, (4) Geographic alliances that attract capital, (5) Financial incentives through favorable tax treatment, (6) Encouraged foreign participation in privatizations and, (7) A more generous equity ownership.

C. Factors that Hinder FDI in Malaysia.

The Malaysian government retains considerable discretionary authority over individual investments.[98] Foreign investors who seek to invest in Malaysia must seek the approval of the Malaysian Investment Development Authority (MIDA).[99] Approval depends on several factors: (1) The size of the investment, (2) Percent of local equity participation, (3) The type of financing (both local and offshore) required, (4) Capital/labor ratio, (5) The ability of planned and existing infrastructure to support the effort and, (6) The existence of a local or foreign market for the output.[100]

Proposals for a manufacturing license, either foreign or local, are screened by the MIDA to determine whether they are consistent with the Second Industrial Master Plan and government

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[96] *Id.*
[97] *Id.*
[98] There are so many governmental agencies that are included in the FDI process. The Malaysian Securities Commission and the Foreign Investment Committee implement the regulations in the Malaysian code on Take-over and Mergers. The Foreign Investment Committee also formulates policy guidelines for foreign participation in the non-manufacturing sector. Foreign companies carrying on business within Malaysia need to register themselves as a foreign company in Malaysia. Approval to register must be given by the Ministry of Domestic Trade and Consumer Affairs.
[99] Malaysian Industrial Development Authority (Incorporation) Act, No. 397 (1986). *See also,* MALAYSIAN INDUSTRIAL DEVELOPMENT AUTHORITY, GUIDELINES ON FOREIGN INVESTMENT, (1992) (hereinafter *MIDA*)
[100] *Id.*

strategic and social policies.[101] The approval process is frustrating for potential investors. Investment is also restricted in the oil and gas industry. The oil and gas industry is under the supervision of the Petroleum National Board and this board has legal title to Malaysian crude oil and gas deposits.[102] The general investment policy limits foreign equity to a minority 30 percent share[103]. In certain cases, foreign firms selling their products to the domestic market have received licenses limited exactly to the 30 percent minority share.[104]

When the licenses of foreign firms expire, the Malaysian government requires these firms to demonstrate substantial progress towards meeting the foreign equity limits. These performance requirements are often written into the manufacturing license of both local and foreign investors.[105] A foreign company can lose any tax benefits it may have been awarded if it fails to meet the terms of its license.[106] According to the Foreign Investment Guideline of 1974, private entities both local and foreign can acquire, merge and take over businesses; however the acquisition or disposal of 5% or more of the interests in any local financial institution requires the prior approval of the Minister of Finance.[107]

It can be frustrating for foreign companies to obtain work permits for their employees. Though such permits are eventually obtained, the process can be time-consuming. Approval must first be obtained from the appropriate Ministries and then forwarded to the Immigration Department for issuance of the required documents.[108] Additionally, many foreign firms face

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[101] IMP2 (1996-2005)
[102] Petroleum Development Act, No. 144 (1974). The state petroleum company, Petronas, is the only proprietor of oil and gas reserves.
[103] MIDA, *supra* note 99.
[104] *Id.*
[105] 18 NO. 7 E. ASIAN EXECUTIVE REP, *supra* note 36, at 15.
[106] *Id.*
[107] FOREIGN INVESTMENT COMMITTEE, GUIDELINES FOR THE REGULATION OF ACQUISITION OF ASSETS, MERGERS AND TAKE-OVERS, (1990)
[108] 18 NO. 7 E. ASIAN EXECUTIVE REP, *supra* note 36, at 16

restrictions in the number of foreign workers they are allowed to employ.[109] This is to ensure that foreign companies employ Malaysian workers. In order to restrict foreign equity, The Malaysian government requires investors to hire up to 30% Bumiputra partners and have a workforce that reflects Malaysia's ethnic composition.[110] This forces foreign companies who prefer to have skilled workers from their countries to employ Malaysian nationals.

D. Negative Impact of FDI on Malaysia.

Malaysia has experienced some human right violations from U.S. investors in the manufacturing sector.[111] Malaysia's lack of a minimum wage for this sector[112] may be a contributory factor for these violations. This may be in violation of the International Labor Convention, which requires all cities to establish a minimum wage.[113] However, some U.S. investors took advantage of this problem causing certain Malaysians to suffer hardships and abuses from them.[114]

The Malaysian government has been criticized for failure to enforce workplace health or safety laws.[115] Workers employed by foreign-owned electronic companies sometimes work in deplorable conditions. Situations have been reported where huge electronic industries lacked proper ventilation and workers were subjected to various forms of health hazards.[116] In the early 1980s, many Malaysian women working in electronic factories began to experience hallucinations and seizures; this particularly happened after standing for long hours on the

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[109] *Id.*
[110] U.S. DEPARTMENT OF STATE, *supra* note 66
[111] Shruti Rana, *Fulfilling Technology's Promise: Enforcing the Rights of Women Caught in the Global High-Tech Underclass*, 15 BERKELEY WOMEN'S L.J. 272 (2000)
[112] MIDA, A GUIDE FOR INVESTORS, (October 31 1984)
[113] *Minimum Wage Fixing Convention No. 131*, INTERNATIONAL LABOUR ORGANIZATION (ILO) (1970) Malaysian citizens that work for foreign-owned businesses may be paid wages at the discretion of foreign investors; ironically, FDI does not bring always bring the economic relief that is expected by citizens of developing countries.
[114] Rana, *supra* note 111.
[115] Amii Larkin Barnard, *Labor Law in Malaysia: A Capitalist Device to Exploit Third World Workers*, LAW & POLICY, INT'L BUS., 279 (1992)
[116] *See id.* at 281.

assembly line in electronic industries.[117] In most developing countries, international labor standards are not really enforced and institutions set up to observe companies do not work efficiently.[118] American companies investing in Malaysia have been criticized as for being the worst violators of workers rights in Malaysia.[119] Some American electronic firms in the past banned union brochures and pamphlets from the work place.[120] In 1986, General Instrument Corporation warned the Malaysian Minister of Labor that if the local employees ever formed a union the corporation would sell its optic-electronic business and close down the Malaysian Plant.[121]

Ironically several American labor groups; protested against the Malaysian government's apathy, and pushed to have industrial workers form trade unions at their work places.[122] These groups complained that the limitation on workers to form unions was a violation of U.S. Generalized System of Preferences (GSP) requirements.[123]

E. Recommendation.

The Malaysian economy is somewhat vulnerable. FDI inflow is steadily decreasing annually because China is now posing as a serious competitor; it has a large domestic market, it is seriously liberalizing its FDI regime, it has wealth in skilled and unskilled manpower, it has

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[117] Rana, *supra* note 111, *see generally* AIHWA ONG, *Spirits of Resistance and Capitalist Discipline: Factory women in Malaysia,* 204 (1987) the factory bosses manipulated these women's religious beliefs and told them that their bodies were inhabited by demonic forces. This was a method devised to prevent the women from rioting against harsh work conditions.

[118] ILO regulations are constantly contravened in certain developing countries; the concept of international labor regulations are constantly flouted because they are not enforced by the regulatory bodies that are tasked to do so.

[119] Kimora Mai, *Malaysia's Workers – Jolting the Electronics Industry,* Vol. 10, No. 9, MULTINATIONAL MONITER, 11-12 (1989)

[120] *Id.*

[121] Russ Arensman, *Malaysia Heads for Showdown,* ELEC. BUS., Sept. 1990, at 45, 50.

[122] Shapiro, *supra* note 15, at 5. The AFL - CIO, the International Brotherhood of Electrical workers and the International Labor Rights Education and Research Fund

[123] *Id.* The GSP allows developing countries to export goods to the U.S. Effective 1985; only developing countries that adhere to workers rights would get the approval of GSP.

low labor costs compared to Malaysia.[124]There are certain drastic measures that Malaysia needs to take; some of the bureaucratic measures employed in the FDI process must be done away with. If such steps are taken and enforced, the hurdle investor's face will be cleared. Also, the Malaysian governments' ambitious stake of $10 billion for the development of the MSC program has not yielded much attraction to foreign investors[125]. $10 billion is an exorbitant sum of money that could have been used to enhance other areas that clearly attract foreign investors. The fact that Malaysia has gained world wide recognition for its high- tech industries does not mean the government should invest so heavily in the relatively new MSC project.

In recent times, Malaysia has steadily increased its labor cost; the country increased its levy on companies[126] that hire foreign workers causing some of those investors to leave. This labor costs were increased as a solution to the unemployment problem in the country and also the specific problem of unskilled professionals. Malaysia needs to reduce the high labor costs in order to compete with rival China. Malaysia's solution to unskilled was to refuse to renew the work permits of foreign investors; this is not a solution to the problem, rather it creates unattractiveness to foreign direct investors. Perhaps, Malaysia needs to embark on a more liberalized investment regime to come back into FDI picture. Ultimately foreign investors will not come back to Malaysia because of incentives that are no longer admirable, unless these primary problems are addressed.

Another measure that can be employed to increase technological shills among Malaysian workers is to provide special incentives for domestic companies that train their workers on modern technology. Malaysia needs to modify its investment incentives such that special

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[124] Kearney, *supra* note 20, at 31. Malaysia's problems are numerous. Its rival, China is not only presently ranked the number 1 destination for FDI, but Malaysia has lost its 22nd position and totally slipped out of the top 25 FDI destination list.
[125] Symonds, *supra* note 19.
[126] *Id.*

provision will be included to entire technological companies from industrialized countries to set up either manufacturing bases in the country or to form coalitions with Malaysian institutions to increase technological know-how. Instead of its direct dependency on FDI, Malaysia should concentrate on developing new industries for their individual growth and not solely for purposes of FDI inflow. If such a change in attitude is adopted, there would be a rapid industrial advancement in the country and this will ultimately lead to a growth in FDI.

CHAPTER 3

MEXICO.

Mexico rapidly seems to be emerging as an economic trailblazer for Latin American developing countries. Recent Mexican governments have encouraged growth in the private sector and reduced the number of state-owned enterprises in efforts to woo foreign investors into the country.[127] Though U.S. investors have presently set up businesses in Mexico, it is clear from Mexico's history that this was not always the case because U.S. FDI in Mexico was not always as stable as it seems today.

A. Historical Evolution of U.S. FDI in Mexico.

It was under the administration of President Porfirio Diaz, that FDI first gained prominence in Mexico.[128] President Diaz's foreign investment policies were structured around the exportation of primary goods.[129] Throughout his thirty-four year tenure in office, President Diaz and his ruling party called "Cientificos" established an economic liberalism similar to Mexico's present day free market economy.[130] This economic liberalism encouraged the free flow of foreign capital and FDI into Mexico.[131] U.S. and other foreign investors were investing in the mineral, commerce, real estate, banking, railroad construction and manufacturing industries of Mexico.[132] Unfortunately, the Diaz administration concentrated on putting up

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[127] U.S. DEPT. OF STATE, COMMERCIAL COUNTRY GUIDE: MEXICO (2000), The number of state-owned enterprises in Mexico have fallen from over 1,000 in 1982 to less than 200 in 2000.
[128] Gloria Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259 at 277 (1994). Diaz was president from 1876-1911.
[129] Michael W. Goldman, Michael C. McClintock, James J. Tallaksen, Richard J. Wolkowitz, *An Introduction to Direct Foreign Investment in Mexico*, 5 IND. INT'L & COMP. L. REV. 101 at 104 (1994).
[130] Sandrino, *supra* note 128, at 277.
[131] *Id.*
[132] *Id.*

special infrastructure for only foreign investors and not Mexican nationals. By the end of the Diaz administration, over half of Mexico's wealth was believed to be owned by foreign investors.[133] The Mexican people accused the Diaz government of selling off Mexico to foreign investors.[134] The unhappiness with the Diaz's administration and the realization that many businesses in Mexico were foreign-owned created social and political unrest.[135] U.S. FDI in Mexico also became unstable because President Diaz was having some political trouble with the U.S. government.[136] There remained widespread poverty and huge income disparity between the upper class and lower class Mexicans.[137] All of these factors contributed to the Mexican revolution of 1910.[138]

The Mexican revolutionaries[139] basically dismantled the role of the state prior to the revolution and set up a new state role.[140] The 1917 Mexican Constitution[141] clearly limited the wide powers of the state to make foreign investment policies that only benefited foreigners.[142] The new Constitution was very nationalistic in nature.[143]

FDI in Mexico suffered as a result of the 1910 Revolution. However, the petroleum industry still thrived mainly because most of the oil companies were located in parts of Mexico that suffered few effects of the revolution.[144] Due to the oil companies, U.S. FDI in Mexico increased from

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[133] *Id*. at 281.
[134] Goldman, *supra* note 129, at 105.
[135] Sandrino, *supra* note 128, at 327.
[136] *Id.* The U.S. engaged in an unsuccessful pursuit of the Mexican revolutionary Poncho Villa as a result of the feud.
[137] *Id.*
[138] The Mexican Revolution is an important phase in Mexican history, because it brought about the Mexican Constitution.
[139] The revolutionary party was called Partido Nacional Revolucionario.
[140] NORA HAMILTON, THE LIMITS OF STATE AUTONOMY: POST-REVOLUTIONARY MEXICO 3 (1982).
[141] CONSTITUTION POLITICA DE LOS ESTADOS MEXICANOS (1917).
[142] Sandrino, *supra* note 128, at 281.
[143] *Id.*
[144] *Id.* at 327

$616 million in 1911 to $683 million in 1929.[145] Prior to the 1917 Constitution, U.S. oil companies predominantly owned the petroleum industry in Mexico.[146] However, Article 27 of the 1917 Mexican Constitution vested all Mexican natural resources in its government,[147] therefore U.S. ownership of petroleum land was threatened.[148] U.S. oil companies therefore sought the help of the U.S. government and eventually reached an agreement with the Mexican government to protect foreign property and also ensure compensation for any foreign-owned land already confiscated.[149]

Victory for U.S. oil companies was short-lived when the new administration of President Lazaro Cardenas[150] nationalized the oil industry.[151] This generated a boycott of Mexican oil by U.S. petroleum companies.[152] Efforts by the U.S. government to get just compensation were refused.[153] Mexico was not very interested in FDI under the Cardenas administration. However, Mexico once again demonstrated its need for FDI under the administration of President Avila Camacho from 1940 through 1946.[154] This administration introduced the economic development model known as "import substituting industrialization" (ISI).[155] This model was used as a measure to encourage foreign investment in Mexican manufacturing and reduce Mexican

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[145] *Id.*
[146] PAUL E. SIGMUND, MULTINATIONALS IN LATIN AMERICA: THE POLITICS OF NATIONALIZATION 48 (1980).
[147] *Id.*
[148] *Id.*
[149] *Id.*
[150] *Id.* He was president from 1934 to 1938
[151] J. RICHARD POWELL, THE MEXICAN PETROLEUM INDUSTRY 1938-1950, 26 (1956)
[152] *Id.*
[153] Sandrino, *supra* note 128, at 290
[154] Lee Axelrad, *NAFTA in the Context of Mexican Economic Liberalization*, 11 INT'L TAX & BUS. LAW. 201, 203 (1993).
[155] *Id.* This model was the original idea of Argentine economist Raul Prebisch who created the ISI model with the view that manufactured goods earned a higher value on the market than raw materials.

dependence of the on foreign imports.[156] President Camacho also issued the Emergency Decree of 1944 that placed restrictions on the "creation, modification, liquidation and the transfer of Mexican stock". This Decree was a nationalistic effort aimed at maintaining control over Mexican assets.[157] Unfortunately for U.S. investors, local businessmen also felt threatened by the growth of FDI and lodged complaints with the government.[158] In response, the Mexican government discriminated against foreign investors in the award of business permits and contracts.[159] This problem continued from 1964 through 1970 during the administration of President Gustavo Diaz Ordaz.[160]

During the Ordaz administration, however, more U.S. companies invested in Mexico. Two restrictions on foreign investors eliminated:[161] (1) The requirement that sought to prevent foreign companies from investing in restricted industries through holding companies and, (2) The elimination of fertilizers, insecticides, food and chemical products from the "Mexicanization list" that was sent up by predecessor, President Lopes Mateos between 1958 and 1965.

1. The 1973 FIL and FDI in Mexico.

The Law to Promote the Mexican Investment and Regulate Foreign Investment (1973 FIL)[162] was enacted during the administration of President Luis Echeverria.[163] The 1973 FIL emphasized the economic sovereignty of Mexico and also set out broad powers of the

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[156] Sandrino, *supra* note 128, at 292. In a sense the ISI model was an indirect form of nationalism because foreign investors were given more leeway to invest in Mexican industries, whiles local businesses were assured of more jobs.
[157] *Id.* at 294, The decree stated that foreign capital was to be monitored by the Ministry of Foreign Affairs allowing the Ministry to authorize both majority Mexican ownership and majority Mexican control
[158] JORGE I. DOMINGUEZ, ECONOMIC ISSUES AND POLITICAL CONFLICT: U.S. LATIN AMERICAN RELATIONS p.20-21 (1982)
[159] *Id.* at 86
[160] 1964-1970
[161] Sandrino, *supra* note 128, at 296
[162] Reglamento de ley Inversion Extranjera y dela Registro Nacional de Inversiones Extranjeras.(L.I.E).
[163] Sandrino, *supra* note 128, at 302. He was president from 1970 to 1976.

government on foreign investment issues.[164] In effect, the 1973 FIL was a defensive measure that exhibited the growing mistrust of foreign investors in Mexico and the need to rebuild Mexican economic sovereignty.[165] Certain key provisions were incorporated into the 1973 FIL: (1) Cessation of foreign ownership by sector or region, (2) Foreign Investment to serve as a complement to Mexican investment ideals and, (3) The association of foreign investment with domestic capital on a minority basis.[166]

The National Commission of Foreign Investment (FIC) was set up to implement the 1973 FIL and supervise foreign investment.[167]The 1973 FIL established a regulatory scheme that required majority Mexican involvement in many economic activities and industries.[168]Foreign investment participation was also limited to forty-nine percent in new business that had not been regulated by the government.[169] The 1973 FIL also established a bureaucratic policy that required government approval if transfer of management was made to a foreign investor or foreign investments exceeded twenty-five percent of equity or more than forty-nine percent of the fixed assets of a company that already existed.[170]

Another provision in the 1973 FIL required all new businesses and existing foreign companies in Mexico to register with the National Registry of Foreign investment. (FIR)[171] While the FIR had the discretion to increase the maximum forty-nine percent foreign investment

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[164] *Id.* Art 4 provided that the state would exclusively handle oil and gas, basic petrochemicals, exploitation of radioactive minerals and the production of nuclear energy, electric power, telegraphic and radiotelegraphic communications, railroads, mining areas set out in the statutes and other activities and industries set out in the statutes.

[165] J. Hayden Kepner, Jr., *Mexico's New Foreign Investment Regulations: A Legal Analysis*, 18 SYRACUSE J. INT'L. & COM. 41 (1992).

[166] Reglamento de ley Inversion Extranjera y dela Registro Nacional de Inversiones Extranjeras.(L.I.E).

[167] Goldman, *supra* note 129, at 106. The commission was vested with discretionary powers as to whether to allow foreign investment and to what extent it would be allowed.

[168] Art 5 of the 1973 FIL restricted foreign investors to the exploration of mining, by-products of petrochemicals, the manufacture of automobile components and other activities that were set forth in specific instruments or by regulation published by the federal executive.

[169] *Id.*

[170] Sandrino, *supra* note 128, at 302.

[171] Arts. 4,5,8,12 of the 1973 FIL

limitation if the investment area was important to Mexico, the exception was rarely granted.[172] These provisions in the 1973 FIL all affected the inflow of FDI into Mexico.[173]

2. Mexico's Brief Economic Boom and Subsequent Crisis.

President Jose Lopez Portillo[174] was the successor to President Echeverria. During his administration, Mexico became a major petroleum-producer. Large petroleum deposits were found in the Tabasco and Chiapas provinces and in the Gulf of Mexico in the late 1970s.[175] These petroleum discoveries were so significant that production from petroleum tripled and income from petroleum sales increased from $500 million in 1976 to $6 billion in 1980.[176] Petroleum sales, controlled by PEMEX, the state-owned oil company, were expected to provide domestic funds for investment and relieve the economy from the need for foreign investment.[177]

Mexico did not allow much FDI during this period because the domestic economy was faring well without the help of investment by foreign companies.[178] The only FDI that continued during this period was in the Maquiladoras assembly, an export assembly plant with foreign ownership exempted from the requirement of FIC approval.[179] External debts and rising oil prices created an economic crisis for Mexico in 1982. This economic crisis caused U.S. and other foreign investors in Mexico to withdraw their money from Mexican banks.[180]

In response to the gradual depletion of its foreign reserves, President Portillo put a freeze on all foreign reserves and converted them to devalued pesos.[181] This move destroyed investor

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[172] Arts. 1 & 5.
[173] Sandrino, *supra* note 128, at 307.
[174] *Id.* Jose Lopez Portillo was president of Mexico from 1976 to 1982. He had been Foreign Minister under the Echeverria administration.
[175] Axelrad, *supra* note 154, at 206.
[176] *Id.* at 207.
[177] NORA LUSTIG, MEXICO: THE REMAKING OF AN ECONOMY 20 (Brookings, 1992).
[178] Kepner, *supra* note 165, at 45.
[179] *Id.*
[180] *Id.* at 25.
[181] Axelrad, *supra* note 154, at 207.

confidence and caused massive removal of capital from Mexico.[182] Because of this problem, FDI in Mexico was quite minimal by the time President de la Madrid took office in 1982.[183]

In 1984 the Mexican government issued foreign investment guidelines.[184] Because the guidelines were not substantive law, foreign investors remained skeptical until the enactment of the 1989 Foreign Investment Regulation [185] that U.S. foreign direct investors regained their confidence to invest in Mexico once again.

3. 1989 Foreign Investment Regulation (1989 FIR).

Mexico's present foreign investment policies predominantly evolved from administrative declarations rather than from the enactment of new legislations.[186] The 1989 FIR was enacted by virtue of the powers given to President Carlos Salinas de Gortari[187] under Article 89 of the Mexican Constitution.[188] The 1989 foreign investment regulation modified the restrictive policies of the 1973 FIL but not the entire act.[189] In a broad sense the 1989 regulations govern the following: (1) Foreign investment activity in opening new businesses, (2) Acquiring companies that already exist in Mexico, (3) Expanding the scope of existing foreign investment, (4) Clarify and liberalize rules on foreign investment within restricted zones.[190] All of these provisions were designed to encourage foreign investment.

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[182] *Id*.at 208.
[183] Sandrino, *supra* note 128, at 307. He was president from 1982 to 1988.
[184] Kepner, *supra* note 165, at 46. The guidelines were clearly no longer defensive and also the discretionary powers of the FIC were limited to restrict the high level of bureaucracy that crippled foreign investment. U.S. direct foreign investors like Hewlett-Parkard and IBM were allowed to have 100 percent ownership of their companies.
[185] Reglamento de la Ley para promover la Inversion Mexicana y Regular la Inversion Extranjera. *See also,* Goldman, *supra* note 129, at 108. The 1989 FIR was set up in an attempt to woo back foreign investors, and with less stringent investment policies.
[186] Hope H. Camp, Jr., Jaime Alvarez Garibay, C. Lee Cusenbary, Jr., *Foreign Investment in Mexico from the Perspective of the Foreign Investor*, 24 ST. MARY'S L. J. 775 at 784 (1993).
[187] Sandrino, *supra* note 128. He was President from 1988 to 1994.
[188] The president is granted the power to "promulgate and execute the laws enacted by the Congress of the union, providing for their administrative sphere."
[189] Sandrino, *supra* note 128, at 302.
[190] Kepner, *supra* note 165, at 46.

Initial foreign investment response to the 1989 regulation was slow because of uncertainty over the constitutionality of the regulations.[191] Gradually U.S. investors gained confidence in the regulations; between late 1979 and early 1990, FDI from U.S. industrial companies was $11.6 billion.[192]. Both countries clearly enjoyed the advantages provided by FDI during this period and this caused more U.S. investors to be more interested in Mexico. Mexico definitely has the propensity to attract more U.S. investors to the country.

B. Reasons why Mexico is Attractive for FDI.

In spite of Mexico's infamous FDI history, U.S. companies continue to do business in Mexico; as of April 16, 2002, there were approximately 2,600 American companies with operations in Mexico.[193] Although Mexico receives average foreign investment on a global level, the country is one of the largest recipients of general FDI outflow among developing countries.[194]

U.S. investors are centrally located in the manufacturing and financial sectors.[195] Mexico's long-standing Maquiladora industry was set up by U.S. investors in 1965,[196] also major U.S. telecom businesses like AT& T, SBC, COFETEL and MCI are active in Mexico. The NAFTA agreement, 1993 FIL, 1998 FIL and other considerations of infrastructure are the reasons for persistent U.S. foreign direct investment in Mexico.

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[191] *Id.* Article 89 forbids the President from issuing regulations that exceed the scope of the law that the regulations can enforce. The regulations exceeded the scope of the law in terms of the FIC and the decision of the President to invoke Art 89 without the support of Congress may have been unconstitutional.

[192] Stuart Auerbach, Edward Cody, *Boom over the border: U.S. firms go to Mexico*, WASH. POST, May 17,1992, at A1.

[193] Alan P. Larson, Under Secretary for Economics, Business and Agricultural affairs, Testimony Before the Senate Foreign Relations Committee (April 16, 2002).

[194] According to a report by Oxford University, World Economic Research Monthly Review for February 2002, Mexico received double FDI inflows compared to other leading Latin American countries like Brazil and Argentina in 2001.

[195] Embassy of Mexico in U.S., *NAFTA Works, available at* http://www.naftaworks.org/, U.S. companies are willing to expand their investment to include information technology, energy and agribusiness as soon as facilities for this become possible. U.S. FDI in Mexico increased from $8.9 in 2000 to $20.9 billion in 2001.

[196] Brandon W. Freeman, *An Overview of Foreign Direct Investment in Mexico*, 3 L. & BUS. REV. AM. 123, 142 (1997).

1. **The NAFTA agreement.**

On December 17, 1992, the United States, Mexico and Canada entered into a trade agreement known as the North American Free Trade Agreement (NAFTA).[197] NAFTA is aimed at eliminating trade barriers to the flow of North American goods and services and investment; encouraging enforcement of intellectual property rights; and setting up dispute resolution procedures.[198] Chapter eleven of the NAFTA agreement specifically relates to foreign investment.[199] Although U.S. companies have always engaged in FDI in Mexico, the NAFTA agreement is unique to Mexico in that Mexico, a developing country, was able to enter into an important trade agreement with two developed countries. Since 1994, the majority of Mexico's FDI has originated from U.S. investors.[200] NAFTA permits U.S. automotive manufacturers in Mexico to import U.S. produced parts for use in their Mexican factories.[201] NAFTA also led to an increase in U.S. food processing companies in Mexico.[202] NAFTA creates significant employment opportunities for the Mexican people.[203] One of the important provisions in the NAFTA agreement is that foreign investors will be treated without any discrimination.[204]

As a goodwill measure, President Salinas modified Article 27 of the Mexican Constitution to protect foreign investors against government expropriation of land and provided for compensation to foreign investors who had been dispossessed of their property.[205] NAFTA

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[197] U.S. President Bush, Mexican President Salinas and Canadian Prime Minister Mulroney signed the NAFTA agreement. The agreement went into effect on January 1994**.**

[198] Axelrad, *supra* note 154, at 202.

[199] NAFTA Agreement, *supra* note 9.

[200] Embassy of Mexico, *supra* note 195.

[201] Prior to the agreement U.S. manufacturers had to use Mexican parts

[202] Embassy of Mexico, *supra* note 195. In 1998, the largest investments were by the Coca-Cola Company. Other food processing companies in Mexico is Corn Products Inc, Smithfield foods, Campbell-Soup, General Mills, Ralston Purina and PepsiCo.

[203] Embassy of Mexico, *supra* note 195. From 1994 to 2000, Some 2.7 million jobs were created in Mexico as a result of the NAFTA agreement.

[204] NAFTA Agreement, *supra* note 9. During periods of its nationalist foreign investment phase, Mexican officials discriminated against foreign investors and awarded contacts to domestic businesses.

[205] Sandrino, *supra* note 128, at 306.

eliminated performance requirements and the reservation of minimum equity and top management positions for only Mexican nationals.[206] NAFTA also provides a mechanism for the settlement of investment disputes in subchapter B of Chapter 11.[207] Although investment disputes are not common in Mexico, the NAFTA agreement seeks to provide grounds for the amicable settlement of investment disputes.[208] The idea that industrialized countries like Canada and the U.S. are willing to enter into an investment agreement (NAFTA) with Mexico may cause investors from other industrialized countries to also consider investing in Mexico.

2. The 1993 Foreign Investment Law.[209]

Regulations that were made by the Salinas administration in 1989 were codified into the 1993 FIL and this law was structured to match the provisions of the NAFTA agreement.[210] The Salinas government used the 1993 FIL to cure the controversy that stemmed from the 1989 regulations and the anti-friendly foreign investment policies of the 1973 FIL.[211] The 1993 FIL provided a broad scope for foreign investment and simplified the processes of registering foreign companies.[212] The 1993 FIL was instrumental in attracting more U.S. investors because it addressed foreign investor concerns. First, it repealed a provision of the 1973 FIL that limited foreign investment ownership to a minority position in the capital stock of Mexican companies.[213] Second, the performance requirements contained in the 1973 FIL[214] were limited

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[206] Axelrad, *supra* note 154, at 203.
[207] NAFTA Agreement, *supra* note 9, vestment arbitration will be in accordance with either the International Centre for the Settlement of Disputes Convention, UNCITRAL Arbitration Rules or at a court selected by the parties.
[208] Sandrino, *supra* note 128, at 319.
[209] Ley de Inversion Extranjera. Foreign Investment Law, Dario Oficial (D.O.), Dec. 27, 1993.
[210] Sandrino, *supra* note 128, at 319.
[211] Goldman, *supra* note 129, at 114. President Salinas said this new law was established to provide 'legal clarity to foreign investment in Mexico".
[212] Chiang-feng Lin, *Investment in Mexico: A Springboard Toward the NAFTA Market – An Asian Perspective,* 22 N.C. J. INT'L L. & COM. REG. 73 at 99 (1996).
[213] *Id.* Art. 5, 1973 F.I.L. (Mex), The 1993 FIL allowed foreign investors to control up to 100 percent of a Mexican company subject to certain limitations.
[214] *Id.* Foreign investors had to perform numerous requirements to the satisfaction of the FIC before their projects were approved.

to just a few by the 1993 FIL.[215] These are: (1) How the investment was going to impact the employment sector and how much training would be given to the employees of the foreign business; (2) How the project impacted technology in Mexico; (3) The project satisfied environmental laws set by ecological ordinances; (4) The project basically conformed to Mexico's goals of economic advancement. The 1993 FIL removed restrictions on foreign exchange that were imposed to exercise governmental control under the Portillo administration.[216] Finally, the 1993 FIL also lessened the restricted zone limitation on real estate acquisition by foreign investors.[217] U.S. investors can also seek permission from the Ministry of Foreign Relation to acquire residential property through the aid of a Mexican trust.[218]

3. The 1998 Foreign Investment Regulations.[219]

In 1998, Mexico once again improved on its foreign investment laws by enacting new the 1998 regulations. The 1998 regulations supplemented the 1993 Foreign Investment Act [220] by expanding, clarifying and matching the substance of the 1993 FIL.[221] The1998 FIR relaxed the restriction on the acquisition of real estate by foreign investors and allowed them to own property along land that was reserved by the Mexican government for national purposes.[222] The provisions of the 1998 regulation also serve as legal backing for the administration of the

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[215] Art 29, 1973 FIL (Mex).
[216] Chiang-Fen, *supra* note 212, at 100.
[217] *Id.* Article 10 states that U.S. foreign investors may be able to acquire Mexican real estate.
[218] *Id.* at 101.
[219] Diario official, (D.O), Sept 8, 1998.
[220] Jorge A. Vargas, *Acquiring Real Estate in Mexico,* INTERNATIONAL LAWYERS' NEWSLETTER Vol. XXI, No. 4, July/August 1999, *available at* http://www.mexlaw.com The regulations were published on September 8, 1998 and became effective on October 6, 1998. *Id.*
[221] *Id.*
[222] *Id.* Art 10, 1998 F.I.R. (Mex) Under previous foreign investment laws of Mexico, foreign investors were prevented from directly owning property along a strip of land known as the "restricted zone". *Id.*

National Commission of Foreign Investments, The National Registry of Foreign Investments and the formation and incorporation of Mexican corporations.[223]

4. Other Factors Attracting U.S. FDI in Mexico.

Foreign investors have the option of entering into general or limited partnerships.[224] Foreign investors can also enter into joint venture contracts with domestic partners.[225] Joint venture contracts allow foreign investors to have better interaction with labor unions; this removes any concerns of labor exploitation.[226] Most U.S. foreign investors are enticed by Mexico's cheap labor market.[227] To the advantage of foreign investors, Mexican governments allegedly form alliances with trade unions to suit foreign direct investor needs.[228] U.S. investors are particularly enthralled with the location advantages of being next door to Mexico. It is easy for U.S. companies to set up offices or relocate to Mexico. The enactment of the 1991 Law for the Promotion and Protection of Industrial Property and amendment in the copyright law[229] is a sign that the Mexico sees the need for technological growth and this is attractive to foreign investors. [230]

The political situation in Mexico is fairly stable and political violence and uprisings in Mexico fairly limited because activities of the Zapatista National Liberation Army, The Popular Revolutionary Army and the Revolutionary Army of the People's Insurgency are mainly confined to the southern states of Mexico and not prime FDI areas like Mexico City, Guadalajara

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[223] Vargas, *supra* note 220.
[224] Freeman, *supra* note 196, at 138.
[225] *Id.* at 139, Joint venture contracts give foreign investors the opportunity to satisfy ownership requirements.
[226] *Id.*
[227] HARRY K. WRIGHT, FOREIGN ENTERPRISES IN MEXICO 285, UNIV. OF N.C. PRESS (1971)
[228] Freeman, *supra* note 196, at 143.
[229] Chiang-Fen, *supra* note 212, at 95.
[230] Camila Castellanos, *Foreign Interest, available at* http://www.mexconnect.com, Samuel Araiza, the Corporate Communications Director of Hewlett Packard attested to the fact that Mexico is very technologically advanced. Hewlett Packard has operations that amount to $1.6 billion in Mexico.

and Monterrey.[231] The Mexican government has also instituted measures to combat corruption.[232] Besides NAFTA, Mexico has a bilateral investment agreement with seventeen other countries.[233] Mexico has entered into free trade agreements with thirty-two countries including the European Union.

C. Factors that Hinder FDI in Mexico.

Articles 27 and 28 of the 1917 Constitution have remained giving power to the government to regulate foreign investment in Mexico.[234] Article 27[235] sets out three restrictions to foreign direct investors in Mexico: (1) National sovereignty over national resources, [236] (2) The "Calvo Clause"[237] requiring foreign investors to agree to be bound by Mexican law, not to appeal to their own governments for foreign protection, and to forfeit property if agreements are abrogated [238] and (3) The "restricted Zone" clause limiting land ownership.[239] Mexico's energy industry is Constitutionally reserved for the state because PEMEX continues to monopolize the exploration and production of gas and oil.[240] This prevents U.S. petroleum companies from owning oil companies in Mexico as they did during the administration of President Diaz.[241]

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[231] U.S. DEPT. OF STATE, COMMERCIAL COUNTRY GUIDE: MEXICO (2001).
[232] *Id.*
[233] *Id.*
[234] MEX. CONST., ch. 1
[235] *Id.*
[236] *Id.* "The nation shall at all times have…the right to regulate the utilization of natural resources…in order to conserve them and to ensure that there is a more equitable distribution of public wealth."
[237] *Id.* "The state may grant the same right to foreigners to acquire ownership of lands, waters, and their appurtenances, provided they agree to consider themselves as nationals in respect to such property, and bind themselves not to invoke the protection of their governments in matters relating thereto under penalty, in case of noncompliance with this agreement, of forfeiture of the property acquired to the nation."
[238] Goldman, *supra* note 129, at 105.
[239] MEX. CONST., ch. 1." Under no circumstances may foreigners acquire direct ownership of lands or waters within a zone of one hundred kilometers along the frontiers and of fifty kilometers along the shores of the country." *Id.*
[240] U.S. DEPARTMENT OF STATE, *supra* note 236.
[241] PAUL E. SIGMUND, MULTINATIONALS IN LATIN AMERICA: THE POLITICS OF NATIONALIZATION, n.171 (1980).

The Mexican legal system is based on civil law and therefore strictly based on enacted codes, unlike the U.S. legal system that is based on common law and based on enacted codes and the principle of precedents. [242] Under Mexican law when damages cannot be quantified in terms of money, injunctive relief is unavailable. In the U.S. an injunctive relief is very common in commercial disputes.[243] The Mexican civil code allows limited damages in civil cases, while U.S. law allows unlimited civil damages and jurisdictional issues are also very different.[244] U.S. foreign investors need to retain Mexican lawyers so they can be briefed on these differences before they set up in Mexico.

There still remains a great deal of bureaucracy in Mexico; the National Foreign Investment Commission must determine within forty-five days whether investments within restricted areas should be allowed.[245] All businesses with foreign ownership must register with the Secretariat of Commerce and Industrial Development within 40 days after being set up, even if its operations do not require formal authorization.[246] Before the business commences, tax registration must be done with the Registro Federal de Contribuyentes.[247] The Secretariat of Foreign Relations has the duty of issuing permits to foreign investors to establish or change the nature of already existing Mexican companies.[248] Foreign investors must first seek authorization from the Ministry of Foreign Affairs to incorporate a business in Mexico.[249] U.S. foreign investors can also establish branches or subsidiaries of a company by complying with certain

[242] *Id.* Mexico fully embraced the Civil law system after the cessation of civil wars and during the ascent of the 1917 Constitution as part of the new system that was developed by the revolutionaries.
[243] Camp, *supra* note 191, at 778.
[244] *Id.*
[245] *Id.*
[246] U.S. DEPARTMENT OF COMMERCE, COUNTRY REPORT: MEXICO (2002)
[247] *Id.*
[248] *Id.*
[249] Freeman, *supra* note 201, at 138

procedures including seeking authorization from the Foreign Investment Commission.[250] These factors hinder FDI attractiveness in Mexico.

D. Effect of FDI on Mexico.

Due to Mexico's inclusion in the NAFTA agreement, trade with the U.S. and other countries have greatly increased over the years.[251] Unfortunately, Mexico seems to rely a lot on its trade with U.S. investors and sometimes overlooks the needs of its local investors. If this continues, local investors may call for nationalistic policies such as those introduced in the past.

E. Recommendation.

Mexico needs to assure investors that in times of economic crisis, it will not resort to making the same impulsive laws and decisions that historically affected its FDI inflow. Since [252]Mexico enjoys a steady flow of U.S. FDI, it needs to consider lowering labor costs like China has done. Educational standards should be raised to produce more skilled workers. The Mexican government needs to address its immigration problems because if people continue to migrate from Mexico into the U.S., there will be a problem of limited manpower. This could cause Mexico to lose some potential investors to other countries with large workforces.

Mexico needs to consider reducing the number of governmental agencies that handle the initial aspects of setting up a foreign business in the country. While it is necessary to have a system to ensure that foreign-owned businesses are properly established, it is tedious and unattractive for direct foreign investors to seek approval for every specific action from different agencies. The Mexican government and the trade unions also need to address the problem of labor laws being abused by foreign investors. Regulations and penalties should be enacted and

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[250] *Id.*

[251] *Id.* On a global scale, Mexico gained a lot of respect and recognition after the NAFTA agreement because developing countries started looking up to Mexico and other developed countries wanted to do business with Mexico

enforced on to prevent the abuse of labor laws. If Mexico effectively addresses some of its prevalent problems, its desire for economic growth through FDI will certainly be realized.

CHAPTER 4

SOUTH AFRICA

South Africa is rich in many natural resources;[253] South Africa has the highest inflows of FDI to Africa.[254] Although South Africa has a middle-income economy, the country is still classified as a developing country.[255]A lot of multinational and transnational businesses have subsidiaries or branch offices located in South Africa.[256]

A. Historical Evolution of U.S. FDI in South Africa.

Though South Africa presently enjoys a good and stable trade relationship with the U.S. Historically the trade relationship between the countries was quite difficult at times. There has always been an influx of U.S. foreign direct investors into South Africa.[257] Because of the vast development of South Africa's manufacturing base during World War II, the country generated a lot of interest from U.S investors.[258] At that time, the focus of U.S. investors was most evident in high-tech electronics and military equipment.[259] In 1969, U.S. returns from South Africa averaged 9.5 percent when the return from all countries averaged 4.9 percent.[260] This situation continued over the years and by 1981, U.S. direct investment in South Africa had escalated to

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[253] C.I.A. FACTBOOK, (2002). Diamonds were discovered in South Africa in1867 and Gold was discovered in 1884.
[254] *Id.* Since 1994, South Africa has been able to maintain an FDI average inflow of $1 billion; this amount is relatively large compared to the inflow of other African countries. According to a 2002 CIA Fact book report, the country's GDP is the highest in all of Africa.
[255] THE WORLD BANK GROUP, DATA & STATISTICS (2002).
[256] C.I.A. FACTBOOK, *supra,* 252. Since apartheid ended, many African nationals have themselves migrated to South Africa in search of better job and livelihood opportunities.
[257] D.J. VENTER, SOUTH AFRICAN SANCTIONS AND THE MULTINATIONALS, 144 (1989).
[258] *Id.*
[259] Scott E. Siverson, *Where Tax Disadvantage Looms Large: Interest Expense and the American Corporate Return to South Africa,* 6 PACE INT'L L. REV. 353 at 400 (1994).
[260] Lynn Berat, *Undoing and Redoing Business in South Africa; The Lifting of the Comprehensive Anti-Apartheid Act of 1986 and the Continuing Validity of State and Local Anti-Apartheid Legislation,* 6 CONN. J. INT'L L. 7 (1990).

$2.6 billion.[261] Despite widespread criticism of the Apartheid system, the U.S. adopted a neutral policy known as constructive engagement.[262] The essence of this policy was to impose limited economic restrictions on South Africa while U.S. investors continued to do business with the Apartheid government.[263] In 1943, prior to the Apartheid era, U.S. direct investment in South Africa was $50 million but after the inception of Apartheid and the constructive engagement policy, this figure increased by 4000 percent to $2 billion in 1978.[264] The U.S. government was criticized and accused of maintaining South Africa as an ally despite its Apartheid policy.[265]

The U.S. government defended the constructive engagement policy and merely implored U.S. investors in South Africa to adhere to the Sullivan Principles.[266] Few U.S. investors adhered to the Sullivan Principles; out of the three hundred U.S. companies in South Africa, only one hundred and thirty-five were signatories to the Sullivan Principles after ten years.[267] Eventually, from the late 1970's through the early 1980's, some U.S. investors disinvested their businesses from South Africa because of widespread criticism by the international community.[268] U.S. investors were also pressured to disinvest by student protestors and legislature passed by some state and local governments.[269] The Comprehensive Anti-Apartheid Act of 1986[270] also affected

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[261] Siverson, *supra* note 258, at 402.
[262] Eric Taylor, *The History of Foreign Investment and Labor Law in South Africa and the Impact on Investment of the Labor Relations Act 66 of 1995*, 9 TRANSNAT'L LAW, 611 at 614, (1996). This policy was adopted under the administration of former U.S. President Reagan.
[263] Jennifer Frankel, *The Legal and Regulatory Climate for Investment in Post-Apartheid South Africa: An Historical Overview*, 6 CARDOZO J. INT'L & COMP. L. 183, (1998).
[264] Taylor, *supra* note 261, at 649.
[265] Frankel, *supra* note 262, at 187.
[266] Berat, *supra* note 259, at 15. The Sullivan Principles, propounded by Rev. Leon Sullivan, was a voluntary civil rights code that advocated for desegregation in work places and other fair labor policies.
[267] *Id.*
[268] Siverson, *supra* note 258, at 433. In 1986, General Motors disinvested its business in South Africa after a sixty-year stay in South Africa. U.S. companies like Coca-Cola and Ford also disinvested and relocated to Swaziland.
[269] Taylor, *supra* note 261, at 619.
[270] 22 USC 5113 (b) (c)

the financial activities of U.S. investors in South Africa.[271] This Act was passed by the U.S. Congress and overrode weaker sanctions that were proposed by President Reagan.[272] This caused U.S. nationals who had invested their pension funds with U.S. investors in South Africa to withdraw their investments.[273]

By February 1990, South African President De Klerk lifted all bans on anti-apartheid groups.[274] Two weeks later, the imprisoned leader of the opposition African National Congress (A.N.C.), Nelson Mandela, was released.[275] In 1991, all Apartheid laws were finally abolished and the country's first non-racial elections were held on May 10, 1994.[276] Since the abolition of Apartheid, several U.S. companies use South Africa as their foundation to extend their businesses to other African countries.[277]

B. Factors that Attract U.S. Investors to South Africa.

South Africa's attractiveness to U.S. investors is due to many factors. A 1999 report by the Investor Responsibility Research Center of Washington D.C. stated that many U.S. companies doing business in South Africa rated it as one of the best in terms of its infra-structure, legal system, abundance of raw materials and macroeconomic management.[278] South Africa's investment guide[279] provides many incentives to investors. There are no capital gains

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[271] *Id.* This Act required all U.S. businesses with over twenty-five employees to adhere to the Sullivan Principles, effectively precluding companies from having South African subsidiaries.
[272] *Id.*
[273] Frankel, *supra* note 262, at 192.
[274] SOUTH AFRICA *available at* http://www.worldstats.org/world/South_Africa.shtml
[275] *Id.* http://www.worldstats.org
[276] *Id.* http://www.worldstats.org
[277] Siverson, *supra* note 258, at 433. PepsiCo's joint venture with Groovy Beverages of South Africa was for South Africa to serve as a foundation for future business with other African countries.
[278] *See generally* Weld Royal, *Back to South Africa,* Oct. 19, 1998, *available at* http://www. IndustryWeek.com
[279] GUIDE TO FOREIGN INVESTORS, *available at* http://www.satcis.co.za

taxes in South Africa.[280] Another advantage for FDI in South Africa is that as the company increases, so does the percentage of permissible borrowing.[281]

Foreign direct investors also enjoy the following incentives: (1) almost all business sectors are open to investors in South Africa,[282] (2) foreign investors do not necessarily need government approval for an investment project though precise FDI procedures are provided for foreign direct investors,[283] (3) foreign direct investors are exempt from VAT being imposed on their exports of foods and services,[284] (4) foreign direct investors can import capital goods without paying any duty and, [285] (5) foreign investors may be given tax allowances of either 50 or 100 percent when the investment project is approved [286] and, (6) several governmental agencies exist to assist foreign investors in areas of finance, information, marketing and finding business premises.[287]

Foreign direct investors have quick access to obtaining licenses and permits. There are no restrictions on the number of foreign employees on a company's payroll. Foreign employees are also subject to the same employment as local residents to prevent bias.[288] To enable South Africa to offer many investment incentives to foreign investors, each South African region has created agencies that offer investment incentives.[289]

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[280] *Id.*
[281] *Id.*
[282] Taylor, *supra* note 261, at 649. There are very few restrictions on the extent or form of FDI in South Africa.
[283] *Id.* Government approval may however be sought where a new or expanded industry is involved importing technology, equipment or raw materials because approval needs to be obtained from a subcommittee of the Department of Industries and Commerce.
[284] SOUTH AFRICA DEPT. OF TRADE & INDUSTRY (2002). Import tariffs have also been lifted to encourage foreign investors to manufacture in South Africa
[285] *Id.*
[286] *Id.*
[287] The Industrial Development Corporation of South Africa (IDC), The Small Business Development Corporation (SBDC), and The Small and Medium Manufacturing Development Program were all agencies set up for this purpose.
[288] *Id.*
[289] *Id.*

Though South Africa is not a member of the International Center for the Settlement of Disputes, all of the country's bilateral agreements provide that in situations where disputes cannot be settled amicably, the foreign investor may choose the dispute mechanism.[290] This provision is a courtesy extended to investors and may be sufficient to boost investor confidence.

The South African government has formed an International Task Force to provide information technology.[291] This task force may help the country become more technologically advanced which will eventually boost the FDI appeal of South Africa. South Africa has very developed financial institutions; The Johannesburg Stock Exchange (JSE) is one of the ten largest stock exchanges in the world.[292] There are a plethora of banks in South Africa, quite a number of them are foreign-owned or subsidiary companies of foreign investors.[293]

U.S investors also feel welcome to invest in South Africa because it entered into a bilateral tax treaty with the country on January 1, 1998.[294] Foreign direct investors find the automobile industry appealing because automobile components like aluminum and steel are locally produced in South Africa.[295] Aluminum is power-intensive and since South Africa has one of the cheapest electricity markets in the world,[296] it is easier to produce automobiles in the country.[297]

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[290] Brendan Vickers, *Foreign Direct Investment (FDI) Regime in the Republic of South Africa.* February 2002, *available at* http://cuts.org/ifd-Im-cr-safrica.doc
[291] SOUTH AFRICA CHAMBER OF COMMERCE (2002), this task force has prestigious members like Carly Fiorina, President and CEO of Hewlett Packard, Larry Ellison, CEO and founder of Oracle Corporation, and Jorma Ollila, CEO of Nokia.
[292] Stephanie R. Nicholas, *Privatizing South Africa's Industries and the Law and Economics of a New Socialist Utopia*, 30 LAW & POL'Y INT'L BUS. 721, 757 (1999).
[293] *Id.*
[294] U.S. DEPT. OF STATE, BUREAU OF AFRICA AFFAIRS, April 2002.
[295] DEPT. OF TRADE & INDUSTRY, *supra* note 283.
[296] *Id.*
[297] *Id.*

C. Factors that Hinder U.S. FDI in South Africa.

Though U.S investors remain the largest investors in South Africa, their dominance in South Africa FDI started diminishing in 1999.[298] By 1994, there was more outbound FDI from South Africa than inbound FDI to the country[299] Potential U.S. foreign direct investors are cautious about investing in South Africa because local investors do not seem interested in investing in their own country, despite the country's plethora of natural resources and manpower.[300]

There is a problem of economic uncertainty in South Africa.[301] Though FDI accounted for 27.5 percent of South Africa's GDP in 1981, by 2000 it accounted for only 14.9 percent of the GDP. The Rand lost 6.5 percent of its' value against the dollar during the first eight months of 2001. After the events of September 11th, the Rand further depreciated by 10 percent against the leading world currencies.[302] Limitations are imposed on lending to corporations, partnerships, and joint ventures if those entities have foreign ownership in excess of 25 percent.[303] Foreign investors in South Africa are also required to hire resident South African auditors and resident South Africans for the duty of service of process.[304]

Some of the multinational companies that want to invest in South Africa are uncomfortable with the political situation between the ANC and other parties[305] over the Kwa

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[298] Vickers, *supra* note 289.
[299] Samuel C. Thompson, *South African Perspectives: Its Prospects and its Income Tax System,* 1 CHI. J. INT'L L. 443 at 446 (2000), South African investors have statistically been shown to be more interested in investing in offshore interests than in the resources of the country.
[300] *Id.*
[301] *Id.* at 447, The country has such high interest rates that the cost of capital for investing in South Africa is also high
[302] CIA FACTBOOK, 2001.
[303] Wallace L. Ford, *Doing Business in South Africa-A Primer for Practice,* NBA Magazine, February 19, 1995, at 17.
[304] *Id.*
[305] *Id.*

Zulu Natal province and prefer to invest in areas with stable political environments[306] There are few skilled workers in South Africa to suit investor needs. For example the Ford Company had to train most of its assembly workers in acquiring reading and math skills. Ford hired twelve tutors because 80 percent of its workforce was not adept in those two subjects.[307] Microsoft Corporation spent over $200,000 to set up two digital villages to educate people on the uses of the Internet. Ironically Microsoft now suffers form intellectual property theft because half of the software on South African markets is pirated.[308]

D. The Negative Impact of FDI on South Africa.

Some U.S. investors have taken advantage of South Africa's liberal labor laws.[309] Because South African investment laws do not require foreign investment companies to hire a specified percentage of its citizens, there is no regulation that can force these companies to hire South African nationals.[310] As a result, FDI is not necessarily alleviating the unemployment problem in South Africa.[311]Some South African companies are suffering because their businesses compete with foreign-owned companies.[312] This competition is prevalent in the pharmaceutical, steel, dairy and electronic industries.[313] Civil activists in South Africa are also concerned about the inflow of FDI in South Africa.[314] These activists are concerned that foreign ownership of South African media houses may compromise the journalistic and editorial integrity of those media houses. Because sixty percent of South Africa's FDI is in the form of mergers and

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[306] Siverson, *supra* note 258, at 356. Because of South Africa's previous political history and the fact that foreign direct investors ultimately suffered because of the Apartheid system, it is understandable that U.S. investors would be hesitant to invest in a country with lingering political problems.
[307] *Id.*
[308] *Id.*
[309] *Id.* Rockwell Automation, a U.S. investor, prefers to use electronic equipment to control machines rather than to hire workers.
[310] *Id.*
[311] *Id.*
[312] Vickers, *supra* note 289.
[313] *Id.*
[314] *Id.*

acquisitions between foreign investors and local companies, most FDI activities are geared towards already established sectors and not new sectors. [315]

E. Recommendation.

South Africa still has more room for improvement. Though privatization may be a good way of attracting investors into South Africa, the government should not rush into privatizing too many state-owned businesses. Because of the previous Apartheid situation, privatization may be very touchy for South Africans and could lead to resentment of foreign investors by its nationals. This situation may lead to major political problems and drive away foreign investors. The South African government should encourage investors to establish new businesses rather than just engaging in mergers and acquisitions. Though the latter still profits the country, more growth will be seen when new businesses are established. Such a situation would also cause more investors to be attracted to South Africa.

Besides establishing traditional educational institutions, vocational institutions also need to be established. Vocational institutions provide specialization for people who desire more specific skills. South African schools should be equipped with adequate materials for technological education. If this is done, the country will attain more recognition for its advancement among developing countries and this will cause more foreign direct investors to be interested in South Africa. South Africa's government may also increase employment opportunities by including a provision in its investment guide that requires foreign investors to hire a certain percentage of the South African nationals as is done in Malaysia.

Despite appalling economic conditions, corruption is rife in many African countries and this is internationally known. Most of the time the victims of corruption are foreign investors because the culprits are high-ranking individuals for government agencies. Investors sometimes

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[315] *Id.*

have to pay exorbitant sums of money to have their businesses approved and registered. South Africa needs to establish an efficient anti-corruption campaign to assure investor confidence.

CHAPTER 5

CONCLUSION

The initial idea for this topic was to determine the legal factors that hindered African nations in their quest to attract foreign direct investment. However, it is almost impossible to discuss this problem without considering the belief of developing countries that FDI is the sole solution to their economic problems.

To discuss FDI in developing countries would be too broad, hence the idea to select three developing countries from three regions of the world and compare the FDI triumphs and failures. Once again, it would be too broad to discuss the activities of all foreign investors in these three countries; therefore a case study of U.S. investors was selected for this paper. Many investments worldwide are carried on by U.S. businesses. Malaysia, Mexico and South Africa were not only selected because they have many foreign investors, but also because they have unique foreign investment regimes and policies. The FDI uniqueness of each country ranged from restrictive nationalistic policies to rather liberal investment policies.

The growth of U.S. FDI is not equal in the three countries. They have different economic capabilities, and as developing countries some of them are more developed than others. In this discussion, Malaysia, Mexico, and South Africa generally represent all aspects of developing countries.

A. Recommendations for Regulatory and Other Reform.

Generally, developing countries around the world appear to share similar FDI ideals and problems. Some of the ideals are increased employment, higher economic development and the

availability of foreign exchange. The more pervasive problems are, limited and underdeveloped infrastructure, limited educational status of workforce and stunted economic growth. Interestingly, they all have very unique approaches to attracting FDI and the key factor to this uniqueness is in the contents of their foreign investment policies and the regulations that ensure their enforcement.

1. Africa.

Some developing countries have embarked on deregulating and liberalizing their restrictive investment laws. Unfortunately many African countries continue to make unrealistic investment policies. Though there are numerous factors that determine why Africa receives the least FDI worldwide, the two prominent issues facing FDI on the continent stem from restrictive foreign investment policies and the misconception that excessive incentives would be most attractive to foreign direct investors. Examples of restrictive investment policies are seen where countries require high capital amount for FDI while others require foreign direct investors to employ a high and fixed percentage of their nationals.

Though investment capital is very necessary, high investment costs need to be reduced and the percentage for hiring citizens should be reasonable. In light of the poor perception of Africa, foreign investors may be coaxed into Africa if the investment policies are made less restrictive.

African countries should be cautious about giving generous tax incentives to investors at the expense of their economies. The cost of providing too many incentives is that it is a one-sided benefit for the investor while the countries suffers economically. African countries need to consider whether they can afford to ‘survive’ without certain resources before they offer them as incentives to foreign investors. They also need to consider the idea of replacing tax incentives

with a system that abolishes exchange controls and provides for the repatriation of the investor profits and free trade zones. These are the types of incentives that foreign investors may find to be truly attractive.

Foreign investment policies must be transparent and comprehensible. Even the legal language in some investment policies is unattractive to foreign investors because it is difficult for foreign investors to easily understand the contents of the policies and regulations. African countries that have conservative and archaic foreign investment policies are less attractive to foreign investors. African countries should not only make investment regulations more transparent to ensure investor confidence, but also consider the introduction of neo-liberalism in their investment policies. African countries need to realize the importance of membership in internationally recognized arbitration groups and how such membership may attract foreign investors.

Also, African countries need to realize the need for foreign investment consultants and tax lawyers to address FDI issues. These professionals are assets to the concept of FDI because they possess adequate information on many FDI issues. The cost of training and retaining such specialists should not prevent African countries from realizing potential benefits of such professional advice.

Many African countries lack effective financial institutions. To worsen this existing problem, African economies are so small that few African markets have access to international capital markets. This affects foreign investment attractiveness. Though South Africa is recognized for having one of the best financial institutions worldwide, the rest of Africa is lagging behind. There creation of well-organized and effective financial institutions would make more African countries attractive for FDI.

In addition to forming organizations like the African Union, African countries need to form economic coalitions among themselves; in Asia, they have ASEAN and in Latin America they have the Southern Common Market (MECOSUR). The importance of these coalitions is that they are more effective in attracting foreign investors because each member country may contribute a unique resource for FDI. Such coalitions also tend to be well organized.

In terms of technology and communication, Africa is lagging behind the rest of the world. Except for countries in the southern part of Africa and a few countries in North Africa, there is little technological growth in Africa. In most sub-Saharan African countries, basic computer training is not part of the educational systems. The average African student has little familiarity with the use of computers. Internet café's are common in many African cities; however, because of the high cost of using computers and frequent power outages, individuals are unable to educate themselves technologically. As a result, foreign investors spend huge sums of money in training local personnel on how to use computers.

A major impediment to Africa's FDI attractiveness is the foreign media. For decades, the continent has been portrayed as very backward. Pictures in foreign newspapers and television rarely show the developed side of Africa. The tendency of foreign media to negatively stereotype all African countries is affecting the quest for FDI by individual countries. African leaders need to advocate for a change in this situation. African countries need to individually and collectively make efforts through advertising and other promotional resources to emphasize their FDI potential.

Bureaucracy is a big problem in Africa's quest for FDI. There are so many government agencies that must be negotiated with in individual countries. Bureaucratic tendencies and political wrangling also affect FDI inflow. Foreign direct investors are subject to unnecessary

and lengthy approval procedures before being granted permission to commence business. Sometimes the officials in government agencies that deal with FDI do not possess the skill for their jobs and this makes the process more frustrating to foreign investors. Government agencies that handle FDI should be limited to a few and countries need a total revamp of such agencies. In many African countries, local investors do not seem to receive the same encouragement given to foreign investors. If the same emphasis placed on attracting FDI were placed on encouraging domestic privatization or local investment, there would be a definite growth in African economies. This growth would also make Africa more attractive for FDI.

2. Latin America.

Latin American countries appear to have more attractive foreign investment policies and regulations than most countries within Africa. Unlike Africa, many countries in the region receive a fair amount of FDI inflow. Latin American countries have modified and enacted laws that are more realistic and responsive to their goals of attracting FDI. Because of their efforts to create liberal trade regimes, most Latin American countries do not have restrictive foreign investment policies. However, there are a few Latin American countries like Nicaragua, Uruguay and Costa Rico maintain harsh capital inflow policies that affect their FDI inflow. These countries need to do away with restrictive laws that would deter foreign direct investors.

Regulatory uncertainty is also an FDI concern in Latin America. When countries suddenly modify tax laws, it affects the activities of foreign investors. Foreign direct investors need to be provided with adequate time to adjust when tax laws are changed. If this were done, more investors would become more interested in the region.

Investment policies need to be consistent with the development strategies of the individual Latin American countries. Latin American countries need to implement policies and

labor laws to discourage mass migration to foreign countries. This would ensure wealth in manpower for FDI purposes. Latin American countries may need to consider forming a union like the EU of Europe. The formation of such a union may encourage FDI exchange among member countries as well as fostering stability and attracting investment from outside the union.

3. Asia (Excluding Middle East).

FDI has been a key source of growth for some developing countries within in Asia. One of the factors affecting FDI flow in Asia is restrictive national foreign investment policy. Asian countries that screen foreign direct investors through screening agencies or Boards of Investment need to make the process more efficient. Though screening is not a bad idea, the process sometimes becomes political and time-consuming. Screening agencies will be most effective if they are independent of government interference. Ownership restriction is also an FDI concern among developing countries in Asia. Instead of total restriction on land ownership, Asian countries should consider assigning or leasing lands to foreign investors for specific periods, allowing the government to claim the land the land back after expiration of the agreement. This would be fair to investors who genuinely need the land for production.

Some Asian countries also need to revamp their legal framework to achieve FDI attractiveness. If Asian countries truly want to liberalize trade with investors, reliable and transparent laws must be enacted to replace old laws. Transparency will be hard to achieve as long as government interference remains. Investment regulations should be fair and investors assured of legal protection where necessary. Though Asian countries like Indonesia, China and Malaysia are making efforts to deregulate and liberalize some of their investment and trade policies, these efforts need to prevail in all developing parts of Asia to maintain sustained economic growth.

4. Other Developing Parts of the World.

The quest by developing countries for FDI has not been restricted to Africa, Asia and Latin America. Developing countries in Europe, the Middle East and the Caribbean are also interested in FDI inflow to their countries.

a. The Middle East.

FDI in the Middle East is affected by the political tension in the region. Wealth in oil and petroleum makes the region quite attractive for FDI. Privatization may be the key to FDI growth in the Middle East. Because of the ongoing strife in the region, it may be easier to convince investors to merge with existing businesses than to create new ones.

b. The Caribbean.

Most Caribbean countries enjoy a fairly modest inflow of foreign direct investment. FDI flow into the region mainly stems from privatization. Labor is cheap in most Caribbean countries; however, their small size affects FDI in terms of insufficient manpower and natural resources to establish large manufacturing companies. Caribbean countries need to make their labor laws more flexible and provide incentives that prevent harsh treatment of foreign investors during periods of internal economic crises. Countries within the Caribbean also need to embark on more liberalization of their trade policies.

c. Europe.

Some Balkan countries cause their own FDI demise through poor legal frameworks. Balkan countries with archaic and conservative investment policies need to modernize them. This will make policies more transparent and easier for foreign direct investors to appreciate their foreign investment policies. Balkan countries also need more independent agencies and legal mechanisms to ensure the effectiveness of investment laws.

B. Final Remarks.

There is a positive increase in regulation change affecting FDI;[316] in 1991 there were only 80 regulation changes, this number increased to 194 in 2001. This indicates that more countries are becoming aware of policy change on FDI. In 2001, developing countries suffered a 59 percent decrease in worldwide flows of FDI, while developed countries saw a 14 percent increase.[317] Though total FDI worldwide was $735 billion, $503 went to developed countries and only $205 went to developing countries.[318] Developing countries need more FDI inflow than developed countries; however, this report shows that foreign investors are more interested in investing in developed countries. Developing countries need to stop providing costly incentives to foreign investors. Though numerous factors contribute to the attainment of FDI growth, developing countries should not overlook the importance of having effective regulations and strong legal frameworks as a major requirement for FDI attractiveness. If developing countries ignore this factor, they will continue to receive minimal FDI inflows. Without strong legal frameworks, enforceable legal institutions, transparency and predictability, foreign investors will continue to flock to developed countries where these factors abound.

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[316] UNCTAD, *"World Investment Report 2002, Transnational Corporations and Export Competitiveness"*, (2002), *available at* http://www.unctad.org
[317] *Id.*
[318] *Id.*

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