Impact of Foreign Direct Investment in the Utilization of Natural Resources: Case Study from Kenya

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1. Introduction

Globalisation has shifted the economic paradigms from state-led economic growth strategies to more open market international regimes[1]. As a result, regional trade blocs have been lifted as well as laws harmonized to allow the proliferation of private investments flow into interested regions for the benefit of all. There is a surge on Foreign Direct Investment (FDI), especially in developing countries, unsurprisingly, foreign investment is higher in industrialized countries where the rate of return seems much higher and perceived risk to the investors is lower[2]. More than 70% of FDI flows to 10 recipients, all of which are middle income countries with China alone receiving 40% of these flows thereby attracting investors, on the other hand, low income countries only receive 6.5%[3].

2. Background to the study

Foreign Direct Investment (FDI) is the act of purchasing an asset and at the same time acquiring control of it. Control is understood as the acquisition of a significant degree of influence over the decision making of the direct investment entity[4]. The concept of control is further detailed as a determinant of FDI in the definitions found in the framework of the International Monetary

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[1] Nick Mabey and Richard McNally, '*Foreign Direct Investment and the Environment: From Pollution Havens to Sustainable Development*' *A WWF-UK Report*, August 1999, pg 11
[2] Ibid
[3] Ibid
[4] Organisation for Economic Co-operation and Development (OECD) 1996, Detailed Benchmark Definition of Foreign Direct Investment, 3(1), 7.

Fund (IMF) and the Organisation of Economic Co- operation for Development (OECD).[5] It has a long borne *modus operandi* on the reliance of the use and extraction of natural resources, particularly agriculture, minerals and fuel production by foreign investing companies in overseas subsidiaries or joint ventures. What therefore attracts FDI? Dunning (1993) emphasizes that the primal motive for FDI is resource or asset seeking, with reason that this type of FDI is born out of unavailability of resources such as raw materials or low cost labour. This triggers firms to be competitive in the existing and potential markets and it goes overseas if the case for investment is exportation, because the reduction of costs is an important factor and the firm's profits escalate and elevates their competitive level in the particular market of service. It is also important to state that this kind of FDI is attracted to natural resource rich countries as it is location-based and serves to exploit the region of interest.[6] Asiedu (2006) has portrayed the many influences of natural resources in directing FDI inflows to the region and the study suggests that African countries endowed with natural resources will attract more FDI.[7] Data shows that 95% of African FDI flows come from OECD countries which are usually resource seeking investment[8]. The impact expected from these investments are; technological spillover effects, facilitated access to global markets, knowledge and skills into domestic firms and stimulated economic growth by spurring competition, innovation and a country's export programmes.

China's FDI consists of many medium to short-term loans with a focus on extractive industries such as oil, mining, natural gas and natural resources.[9] Some loans are repaid with future exports from natural resources, especially

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[5] Ibid pg 9

[6] Dunning, J. 'Multinational Enterprises and the Global Economy,' [*Addison-Wesley Publishers ltd*,1993]

[7] Asiedu, E. 'Foreign Direct Investment in Africa- The Role of Natural Resources, Market Size, Government Policy, Institutions and Political Instability,' *United Nations/World Institute of Development Economics Research Conference*. Helsinki, 8th September 2006

[8] Nick Mabey and Richard McNally, '*Foreign Direct Investment and the Environment: From Pollution Havens to Sustainable Development*' *A WWF-UK Report*, August 1999,pg 26

[9] Wang J. Abdoulaye, B., "Africa's Burgeoning Ties with China", Finance and Development, 45 (2007)

in countries with poor credit ratings. Its recent investments in Africa have been driven by its state-driven strategy for providing infrastructure and in return acquiring natural resources from African nations. The link between infrastructure assistance and resources in resource rich countries is that often the most resource rich states are in dire need of infrastructure development and support.[10] Kenya and China have had a long term bilateral trade agreement to gain from each other, economic development and access to natural resources respectively In Kenyan case, China has invested in construction of major roads networks such as Thika Highway, as they receive exports from Kenya such as skins, sisal, fiber, coffee, tea, fishery products, horticultural products and scrap metals.[11]The Chinese firms are interested in coffee and manufacturing in Kenya because the returns are higher than in oil exploration. Kenya's national agenda is inclusive of liberalizing its trade by going global and embracing regional and international open trade, infrastructural investment deals will therefore gain first consideration to affect its economic scope. The World Bank provisioned from its data analysis on world development, that adequate supply of infrastructure is an essential ingredient for productivity and growth.[12]It also played a key role in helping reduce income inequality. The Chinese have established influence and control over the decision making process of investment processes in FDI. International observers have expressed their fear for how the Chinese run their investment business overseas by paying bribes and attaching no conditions, undermining local efforts to increase transparency and good governance. The Chinese also bring in migrated labour from their country to work in Africa and so there is no solution replacement for the unemployed. Finally, they have limited the competitive open market by the strategic corrupt ways they have used, such as lower costs in the

[10] Corkin, Lucy, Christopher Burke and Martyn Davies, 'China's Role in the Development of Africa's Infrastructure,' *SAIS Working Papers in African Studies* No. 04, 2008, The Johns Hopkins University

[11] Onjala, J., 'A scoping study on China-Africa Economic Relations: The Case of Kenya,' *Revised Final Report submitted to African Economic Research Consortium (AERC)*, Nairobi 5th March, 2008

[12] World Bank, 1994. World Development Report: Washington DC, The World Bank.

construction firms they own and thereby outbidding their western competitors and winning contracts for projects.[13]

Kenya performs poorly in attracting foreign direct investment (FDI) given the size of its economy. Corruption, poor infrastructure, poor investment and climate have affected foreign direct investment flows compared to pre 1980's[14]. In 2007, Kenya received US $729 million in FDI; unfortunately the flows were cut down to only US $96 million, this was after the controversial presidential election in 2008 that triggered intra-tribal hatred and violence that spread across the country and caused political instability which had a significant impact on the country's investment climate[15]. Kenya's savings rate is much lower than the average in Sub Saharan Africa of 20.4%. One reason for the low savings is Kenya's large scale infrastructure projects; the Standard Gauge Railway, Lamu berths, and Northern Corridor Integration Projects.[16]

The bulk of Chinese work in infrastructure is not investment but contracting. The SGR and the berths at Lamu are not investments but projects financed by China's EXIM bank: the bank will finance 90 percent of the SGR, making SGR a Kenyan investment[17]. Kenya has taken debts for many major construction projects and Chinese companies typically have no equity stake in the particular building, road or port[18]. The EXIM bank is responsible for promoting exports and investments of Chinese firms abroad, offering international guarantees, export buyers' credit, and export sellers' credit.[19]The

[13] Mugendi, F. K., 'Kenya –Sino Economic Relations: The Impact of Chinese Investment in Kenya's Transport Sector' *University of Nairobi Library*, November 2011.

[14] Sanghi A. & D. Johnson, 'Deal or No Deal: Strictly Business for China in Kenya?' *World Bank Group, Macroeconomics and Fiscal Management Global Practice Group,* March 2016 pg 18

[15] Ibid pg 18

[16] Ibid

[17] Sanghi A. & D. Johnson, 'Deal or No Deal: Strictly Business for China in Kenya?' *World Bank Group, Macroeconomics and Fiscal Management Global Practice Group*, March 2016 pg 23

[18] Ibid pg 23

[19] Moss, T and Rose S.," China Exim Bank and Africa: New Lending, New Challenges*" Center for Global Development,* 2006

EXIM bank only provides loans: Chinese firms worked on the Standard Gauge Railway and the Thika Superhighway, but the government of Kenya must pay back the debt.[20]

With the cold reality that the bulk of investment flowing into low income countries is mainly channeled into extractive sectors, it is safe to state that these sorts of investments do not provide the host country with similar benefits as the manufacturing spill over effectiveness is very little.[21]Furthermore, the detrimental effects on the environment are left for the weak government to deal with which can be overwhelming to these countries.[22] Rapid developments without adequate control can also cause irreversible social, cultural disruption, removing economic means of support to locals without providing substitutes. The proposal in this paper seeks to address the existence of natural resources and influx of FDI flowing in an economy which could potentially lead to economic growth and stability and inclusively proposes recommendations and solutions to some of the adverse effects of FDI in natural resources.

3. Problem analysis

Much as the Chinese are being portrayed as violators of domestic laws, corruption incidences are frequently being mentioned by the same Chinese companies as a hurdle to investing in Kenya.[23] Chinese firms are being seen as easy targets to rent seeking government officials for several reasons. First, there is a collective action problem for investors willing to "enforce" anti-corruption efforts.[24] Secondly, there are some Chinese companies that do not

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[20] Sanghi A. & D. Johnson, 'Deal or No Deal: Strictly Business for China in Kenya?' *World Bank Group, Macroeconomics and Fiscal Management Global Practice Group*, March 2016

[21] N. Mabey & R. McNally, 'Foreign Direct Investment and the Environment: From Pollution Havens to Sustainable Development' *A WWF-UK Report,* August 1999. P.27

[22] Ibid P.22

[23] SinoAfrica Centre of Excellence Foundation. *Business Perception Index Kenya 2014: Chinese companies' perception of doing business in Kenya 2014*. 2014

[24] Persson, A. et al, 'Why Anticorruption Reforms Fail- Systemic Corruption as a Collective Action Problem' 26(3) *Governance* 449(2013)

follow the rules and therefore, contribute to the reputation or perception of Chinese investors as violators of the law. Thirdly, many Chinese investors want to remain on good terms with the government consequently, paying bribes seems to be a better alternative to formal procedures.

In 2012, an important announcement that weighed heavy on Kenyans was made by the then Kenyan President, Mwai Kibaki. Oil had been discovered in the arid Turkana and which also meant a welcoming entrance into the petro-dollar billionaires' league[25]. However, there is a cloud of mystery going about the oil extraction project which was and is still being led by Tullow Oil Plc. a UK- based multinational Oil and Gas Production Company which also discovered the oil.[26] The Turkana region has then been experiencing both economic and social changes, a most prominent one is many of the region's oil drilling sites are located in areas that affect the local communities directly raising concerns about the economic, social and environmental impacts of production and the company had to halt its operation due to the numerous protests by the villagers. [27]The project has so far consumed 200 billion Kenyan shillings as total expenditure to the government's bill yet there is no evidence showing any progress to the oil extraction and it expresses its wish to stay despite not allocating any single cent to appraisal and exploration in the country in the year 2020.A case study done by the Food and Agriculture Organisation of the United Nations found that the major challenge confronting Turkana pastoralists in the context of extraction of oil and gas in the county is loss of land and lack of information regarding the development of their area. Another contentious issue arising from the same is that pastoralists have lost ownership, access and control of the basis of their pastoral livelihood and economic production and if not enough exclusion, they have not been included in the decision- making process regarding further development of the area.[28]As

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[25] Edwin Okombo, 'Kenya's fading oil cash dream' *Daily Nation* (Nairobi, March 17 2020) pg 32

[26] Ibid pg 33

[27] Horn International Institute for strategic studies, "The Negative Impacts of Oil Exploration and Discovery on the Turkana Community," *Horn Policy Brief* No.10, August 30 2018

[28] Food and Agricultural Organization of the United Nations, "Triggering the Voluntary Guidelines on the Responsible Governance of Tenure(VGGT) In the

such even though the climate has deprived and dispossessed pastoralists in the region from their daily livelihood, human activities have not only failed to solve the problem but rather exacerbated the situation.

What is unfolding in Kenya is referred to as the 'resource curse'. The resource curse states that natural resource exports harm growth prospects, even after controlling for the effects of initial income per capita, human capital, investments, trade openness and institutional quality on economic growth. Natural resources are often extracted by foreign multinationals that bring in capital and knowledge. However, resource FDI is very capital intensive and leads to fewer spill-over effects into the non-resource sectors of the host economy as it relies less on local subcontractors or suppliers.

Another separate case study is the large deposits of titanium discovered in the coastal strip which gave renewed impetus to campaigns supporting sustainable development in the mining sector.[29]The titanium deposits account for 40% of the world's known unexploited titanium reserves and are claimed to be worth trillions of US dollars on the world market[30]. The extraction of such a mineral had clear socio-economic benefits such as creation of jobs and urbanization through the multiplier effect of industrialization. The Kwale mining project located approximately 65km from Mombasa and 10km in land is located in an agricultural area with coconut and cashew nuts as the main crops[31]. When an Environmental Impact Assessment (EIA) for mining of titanium in Kwale district was carried out by Coastal and Environmental Services of South Africa on behalf of Tiomin Kenya Ltd, the local subsidiary of Tiomin Resources Inc., a Canadian multinational, failed to address adequately the impact of released toxic substances, including radioactive emissions from the mining operations on the coastal ecosystem, nor the need for continuous rehabilitation of the

Context of Oil Extraction in Kenya's Turkana County: A Case study" *Eastern and Southern African Pastoralists Development Network of Kenya-Turkana Chapter*, April 2018

[29] Abuodha, J. O. Z. 'Environmental impact assessment of the proposed titanium mining project in Kwale District, Kenya.'. [*Marine Geo-resources and Geo-technology*, 20, 2002] 199-207

[30] Ibid pg 202

[31] Ibid 205

mining area.[32] The people settling in the region are already experiencing limited water, energy and land resources and the onset of this project will cause additional deprivation to the related resources, related infrastructure and new settlement. The project revealed conflict of national laws and need for effective implementation of up-to-date laws. This has to seek consideration of harmonization with the Kenya Environmental Management and Coordination Act (EMCA) and the World Bank Standards on trade.[33]

Many adverse effects from specialization of natural resources are irreversible, causing permanent and harmful environment of the host country. Environmental degradation leads to an economy's inability to produce goods over a period of time which reduces the value of the land, due to depletion of resources like soil fertility.

4. Conclusion

The Mining Act of Kenya,[34] emphasizes matters of occupational health and safety, but lacks clear provisions on environmental management. This omission is countered for by the enactment of the National Environmental and Coordination Act,[35] for the following purposes;

1) To provide a framework for sound environmental management in Kenya;
2) To provide a framework for improved legal and administrative coordination of the diverse sectoral initiatives for the management of the environment.
3) To be the principal instrument of Government in implementation of all policies relating to the environment.

The Act embodies the principles of sustainable development and also stipulates that all EIA procedures should engender the management tools

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[32] T.C. Davies & O. Osano 'Sustainable mineral development: case study from Kenya' *Geological society London Special Publications*, (2005)P.93

[33] Ibid

[34] The Mining Act of Kenya (Cap 306) ,1904

[35] National Environmental and Coordination Act, 2000.

inherent in section 58 to 67 of this Act. The Environmental Management C-ordination (Amendment) Act, 2015 was enacted to make provisions to align the Environmental Management and Coordination Act, with the Constitution of Kenya, 2010. It takes into account the devolved system of government, rationalizing of state resources, sound environmental practices, structures for dispute resolution and principles such as transparency, accountability and participatory environment management. The Act however, is not comprehensive enough to show how the public participation will be carried out. The implication being that the proposed public participation will be done through less meaningful ways.

Devolution can be used efficiently to facilitate effective natural resources management that is people-centered and one that benefits the people of Kenya. Its framework can prove its worth by overcoming the challenges associated with state-centric approaches to natural resources management such as inequitable benefit sharing, exclusion of the poor and marginalized in the decision making system, indiscriminate environmental degradation, effectively promoting efficiency, equality among citizens, economic growth and stability in the countries.[36] To ensure the success of the devolution of natural resources management, there is a need for management frameworks that encourage the engagement of multiple actors across the two levels of government and affected communities. The Central government can oversee the county government resource management in a system of counter-checks and balances amongst the 47 county governments and the national government. The involvement of independent organizations and Non-Governmental Organisations (NGO's) will also go a long way in ensuring that the appropriate standards in natural resource management are maintained, educating the locals on the benefits that accrue and from sustainable utilization of the resources around them.[37]

[36] Kariuki M. "Devolution and Natural Resource Management in Kenya" [2018]

[37] See generally, 'Final Report of the Taskforce on Devolved Government,' Office of the Deputy Prime Minister and Ministry of Local Government, Vol.1, (Government Printer, Nairobi, 2011).

Kenya can also learn from its neighbouring African countries and emulate their economic management frameworks. Rwanda for example, has been experiencing significant economic growth amidst increase in Foreign Direct Investment[38]. It has been able to achieve this steady discourse through the following means:[39]

- The Rwanda government has put up measures to promote FDI and to reduce poverty with limited empirical studies;
- Rwanda Development Board (RDB) has been created to bring together all government agencies in charge of investment under it to manage and oversee their activities. This structure assists foreign and local investors to obtain the certificate of incorporation, tax identification number and other documents necessary[40].

Other proposed recommendations are; first, countries endowed with natural resources should pursue policies targeted at full deregulation (privatization) of their natural resources sector to better utilize the abundance of their natural resources and henceforth attract additional FDI. Second, more investment in the agricultural and industrial sectors which will make the growth of the economy branch out and spread across other sectors.

[38] Ruranga C. "Foreign Direct Investment and economic Growth in Rwanda: A Time Series Analysis," *Journal of Business Management and Corporate Affairs*, 2013,Vol. 2, Issue 1, pp 11

[39] Ibid

[40] Ibid pg 11- 18

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