SISERA

Working Paper Series

Determinants of Foreign Direct Investments and their Impact on Economic Growth in Uganda

Marios B. Obwona

Senior Research Fellow

(EPRC)

Les Cahiers du SISERA
1998/1

t d'Appui Institutionnel à la Recherche Economique en Afrique / Secretariat for Institutional Support for Economical Research in
CRDI/IDRC - BP 11007 cd Annexe - Dakar - Sénégal - tel(221) 824 09 20 - fax (221) 825 32 55 - Email dtandian@idrc.org.sn

Determinants of Foreign Direct Investments and their Impact on Economic Growth in Uganda

Marios B. Obwona

Senior Research Fellow

Economic Policy Research Centre
Makerere University Campus
51 Pool Road, P. O. Box 7841
Kampala, Uganda
Tel: 256-41-541023/4
Fax: 256-41-541022
Email: eprc@imul.com

Novembre 1998

Foreword

The mission of the Secretariat for Institutional Support for Economic Research in Africa (SISERA) is to provide technical and financial support to African research centres. One of SISERA's main objectives is to help improve upon the dissemination of research results of African centres.

This Working Paper Series was established in order to provide an outlet for the research output of SISERA's Partner Institutions, which are African research centres that have demonstrated a capacity to carry out policy-oriented research and to help enhance the policy debate in their respective countries or sub-regions.

The Series focuses on economic policy-making topics and provides a forum for discussions on issues of interest to African countries. It is widely circulated within Africa to policy-makers and research centres and abroad to institutions that work in the development field.

Manuscripts of Partner Institutions are published with their authorization.

For further information please contact:

Secretariat for Institutional Support for Economic Research in Africa (SISERA)
B.P. 11007 CD Annexe
Dakar, SENEGAL
Tel: (221) 824 09 20/ 824 42 31/ 824 39 31
Fax: (221) 825 32 55
e-mail: dtandian@idrc.org.sn

[M]ore than a trillion dollars roam the world every 24 hours, restlessly seeking the highest return......

..........[A]lthough private investment flows to developing countries increased between 1970 and 1994 from \$5 billion to \$173 billion, three-quarters of this went to just ten countries, mostly in East and South-East Asia and Latin America. Countries elsewhere, particularly in Sub-Saharan Africa, have been left behind. **Human Development Report, 1996**

I Introduction

Governments of developing countries are now giving new attention to the potential for private FDI in their economies. This is because many developing countries now desire to extend the market-price system and the private sector and to mitigate the external debt problem by attracting more private foreign investment.

When a country suffers a resource or savings gap, it will also confront a foreign exchange gap that will have to be filled with an inflow of foreign capital. In macroeconomic terms, when government expenditure plus private investment exceed government revenue and private savings (a resource gap), this internal imbalance will spill over into an external imbalance of imports greater than exports, and hence constitute foreign exchange gap. International financial intermediation is then required to fill the foreign exchange gap. This can be accomplished by loans from multilateral lending agencies and commercial banks, or by private foreign investment. While the former sources of foreign capital are flat or declining, FDI has considerable potential.

It is understandable why there is now a desire by developing countries to increase the equity/debt ratio on foreign capital: There are some relative advantages of FDI over foreign loans from the standpoint of balance of payments adjustment. Equity investment requires payments only when it earns a profit, but debt requires payments irrespective of the state of the economy. The host country can also control payments whereas the terms of the servicing of debt are set in international markets. In contrast to the need to service debt (amortization and interest), earnings from private foreign investment are frequently reinvested and only a part repatriated. With private foreign direct investment, both commercial risk and the exchange rate risk are passed on to the investor rather than having to be borne by the host government.

Uganda, in her attempt to accelerate growth and development, has always encouraged foreign direct investment through the introduction of incentive packages. This is based on the perception that domestic resource gap can partly be filled through foreign private investment. In other words, as a recipient of foreign savings, domestic resources are, therefore, supplemented. FDI makes available foreign exchange which should, all things being equal, increase the country's capacity to import. The other benefits of FDI include :

(a) the provision of managerial knowledge and skills including organizational competence and access to foreign markets ;
(b) enables the transfer of technology to occur from developed economies ; and
(c) provides an array of goods and services to residents in the recipient country.

There is no doubt that it is useful to encourage FDIs because the increase in real income resulting from the act of investment exceeds the resultant increase in the income of the investor. Once the value added to output by foreign capital is greater than the amount appropriated by the investor, social returns will exceed private returns. Given that foreign investment raises productivity and this increase is not completely appropriated by the investor, the greater product will be shared with others, and some other income groups will benefit directly. Domestic labour will benefit in the form of higher real wages; consumers by way of lower prices and government will receive higher tax revenue. These arguments do not suggest that there are no demerits to FDI. There are scholars who have argued that FDI leads to the domination of the domestic economy by foreigners; creates distortions in the domestic labour market by paying high wages, etc. Ake (1978).

Before the NRM government, the Uganda government theoretically encouraged FDI but in practice there were series of policies that served as disincentives to FDI. For example, a controlled interest rate and managed exchange rate regimes as well as restricted trade policy during the period provided wrong signals to potential investors.

The establishment of Uganda Investment Authority in 1991 with a series of packages and incentives was directed at wooing foreign investors to Uganda.

II Objectives of the study

What is the nature and character of FDI in Uganda ? What are the effects of government policy (economic and non-economic) on FDI ? What has been the contribution of FDI to growth and development in Uganda ?

Therefore, the objectives of the study are to :

(a) Identify the main factors that motivate foreign investors to come and invest in Uganda;
(b) Identify the salient features eg., ownership, market orientation, etc. of the investment initiatives being undertaken;
(c) Assess the role and effectiveness of investment incentives in the decision making of investors ;
(d) Examine the recent investment activities and future operational plans of the sampled investors ;
(e) Assess the investors' opinion about government regulations and agencies ;
(f) Establish the constraints investors face in operating business in Uganda ; and
(g) Derive policy framework based on the survey findings for promoting investments in Uganda

III Policy relevance

It is important that appropriate policies be put in place if FDI is to contribute to economic development. These policies must not only be dynamic but ought to include incentives taking into consideration the competitive global environment. To design appropriate policies and strategies, policy-makers must know the limitation and prospects of the existing policy on FDI. The study is to assist in this direction.

The study is to aid policy-makers to determine which sources or countries in which to target investors by designing specific incentives. In addition, the sectors in which to direct policies so as to attract the inflow of FDI will be useful to policy-makers. Invariably, Uganda must devise policies that will encourage a greater inflow of FDI and ensure that it makes the optimum contribution possible toward the achievement of the country's development goals.

In the context of development planning, the government ought to influence the performance of FDI; but in carrying out this task, government should be aware of the potential contribution of FDI and hence devise policies that will meet the mutual interests of private investor and the host country. It is in this respect that the study is policy relevant.

IV Review of the literature

The flow of foreign private investment or capital was the earliest type of resource transfer to developing economies and has been in existence before the post-war emergence of official development assistance (ODA) or most recent effort to transfer resources through preferences.

FDI has two major components: Portfolio investment and direct investment. Portfolio investment is in the form of equity capital, either share or bond holding, in ventures in developing countries. On the other hand, direct foreign investment enables the foreigner to own the physical productive assets which he operates directly. The flow of resources is essentially carried out by large multinational or transnational corporations with headquarters in the developed nations; flow of financial capital is by private international banks.

It is often argued that there is 'no unique established theory of foreign direct investment. Instead, there are various hypotheses emphasizing different macroeconomic and microeconomic factors that are likely to have an effect on foreign direct investment' (Khan, 1990, p. 282). Thus, there are several factors influencing foreign direct investment. Any effort to discuss conceptual issues on FDI must be aware of sweeping generalizations.

It should be noted that the interest here is not on overall private investment but the foreign capital component. Thus, it is assumed that various analysis inherent in investment theorizing, also influences FDI. In other words, factors determining investment in general are part and parcel of foreign investment as well. But more importantly, is how that investment can be attracted outside its borders.

There have been several studies on the relationship between government policy, private investment and growth in developing countries. It is important to discuss the results of some of these studies in relation to FDI. Monetary, fiscal, and exchange rate policies directed at correcting unsustainable macroeconomic imbalances do affect private investment. 'The standard macroeconomic package oriented towards improving the balance of payments and reducing inflation includes restrictive fiscal and monetary policies supplemented by real devaluation' (Serven and Solimano, 1992, p. 100).

The restrictive monetary and credit policies often found in stabilization packages affect investment in two ways: (i) They raise the real cost of bank credit; and (ii) by raising interest rates, they increase the opportunity costs on retained earnings. Both mechanisms raise the user cost of capital resulting in a reduction in investment. This effect has been confirmed by Green and Villanueva (1991). Other economists that found different results include: van Wijnbergen (1982), Blejer and Khan (1984), Lim (1987) and Dailami (1990). Their results show that in the repressed financial markets which characterizes most developing countries credit policy affects investment directly since credit is allocated to firms with access to preferential interest rate mechanism. However, van Wijnbergen (1983) results show that interest rates also affect firms that borrow in the unofficial money market. Consequently, the institutional structure of financial markets in developing economies is important in explaining the effect of monetary and credit policy on investment, and how such policy is transmitted (Montiel, 1994).

Regarding fiscal policy, high fiscal deficits increase interest rates or reduce the availability of credit to private sector, or both, hence crowding out private investment. It follows that the reduction of public deficit during macroeconomic adjustment should allow private investment to expand. However, the way fiscal deficit is rectified matters. The attempt to reduce the public deficit often involves reduction on public investment. Yet expenditures on infrastructure like roads, communication networks, etc. complement private investment. Hence, curtailment of public expenditures on infrastructure must be carried out carefully so that private investment is not adversely affected especially during the adjustment process. Blejer and Khan (1984) based on cross-country data found that government investment in infrastructure is complementary to private investment while other types of government investment are not. Green and Villanueva (1991) and Serven and Solimano (1991) arrived at similar results based on multi-country panel data. More recently, Ekpo (1994) and Asante (1994) have confirmed similar findings for Nigeria and Ghana using time series data.

The influence of other macroeconomic policy variables like exchange rate (profitability, devaluation, etc.), irreversibility, uncertainty and the role of credibility on private investment are well discussed in the literature. An excellent review is in Serven and Solimano (1992). However, these studies have stressed private investment although the concerns raised also affect FDI. If domestic private investment climate is not sound and conducive, it becomes difficult to attract a substantial inflow of FDI.

In economics of development, the issue of the benefits and costs of FDI causes so much controversy. Based on the neo-classical analysis of the determinants of economic growth, FDI is perceived as a way of filling in gaps between the domestically available supplies of savings, foreign exchange, government revenue, and management skills and the desired level of these resources needed to achieve growth and development targets.

Another role of FDI is that it fills the gap between targeted foreign exchange requirements and those obtained from net export earnings as well as net public foreign aid - the so called foreign exchange or trade gap. An inflow of FDI cannot only alleviate part or all of the deficit on the balance of payments current account but it can also serve to remove the deficit over time if the foreign-owned enterprise can generate a net positive flow of export earnings. However, in the case of import-substitution, the overall effect of allowing foreign investment behind protective tariff and quota walls is often a net worsening of both the current and capital account balances. Such deficits occur both from the importation of capital equipment and intermediate products and the outflow of foreign exchange in the form of repatriated profits, management fees, interest on private loans, etc.

The other gap filled by FDI is that between targeted government tax revenues and locally raised taxes. By taxing profits of established foreign companies and participating financially in their local operations, governments are in a better position to mobilize public financial resources for development projects. Finally, there is the gap in management, entrepreneurship, technology, and skills which are assumed to be partially or completely filled by the local operations of FDI.

The economic arguments against FDI include :

(a) FDI may lower domestic savings and investment rates by stifling competition through exclusive production agreements with host governments, failing to re-invest much of their profits, generating domestic incomes for those groups with lower saving propensities, inhibiting the expansion of indigenous firms that might supply intermediate products by instead importing such products from overseas, and imposing high interest costs on capital borrowed by host governments ;

(b) in the long-run, activities of established foreign investment may reduce foreign exchange earnings on both current and capital accounts. The current account may deteriorate due to large importation of intermediate products and capital goods while the capital account may worsen because of profit repatriation, interest, royalties, management fees, etc ;

(c) because of the usual liberal tax concessions, excessive investment allowances, disguised public subsidies, and tariff protection often provided to foreign companies by governments, their contribution to public revenue via corporate taxes may be quite less than anticipated ;

(d) the dominance of FDI may adversely influence the development of indigenous entrepreneurship ; and

(e) Environmental impact of FDI can be detrimental if not checked.
Capital inflows may generate problems for an economy. Calvo, et al. (1994) suggest that large capital inflows often result in inflationary pressures, real exchange rate appreciation, and a deterioration in the current account. According to them, the history of Latin America provides justification that massive capital inflows may contribute to stock market bubbles that could lead to an excessive expansion in domestic credit as well as shaking the stability of financial system.

There are other criticisms often levelled against the mechanism for concretizing FDI, that is, multinational corporations. These unfavourable arguments like charting an uneven development path in developing countries, producing inappropriate products, influencing host government policies, etc. are well examined in Todaro (1992, pp. 475-478).

Another interesting issue on FDI is that of incentives. Government policies which include incentives, tax holidays, and differential tax structures can change the level of and return on FDI. Most countries have in place some policy measures to boost expected profits for foreign investors.

Gubitz (1991) argues that distortions in source countries, like insurance on investment abroad could influence investors' decisions. Yet, the general investment climate and polices affecting particular sectors often rank above special incentives in influencing the allocation decisions of foreign investors. Some studies have suggested that investors for the most part ignore incentives particularly those that involve future benefits. Guisinger (1985) indicates that incentives play a minimal role in decisions on where to invest, with the attractiveness of the incentive scheme relative to those of other countries playing a more significant role. Invariably, countries find themselves in bidding wars that produce no change in a country's relative share of total capital inflows while increasing benefits to investors. The impact of incentives cannot be generalized; rather, empirical and country specific studies are needed.

Shapiro (1990) examines the case of the automobile industry in Brazil which was established due to government intervention and found that the action by government was successful. It should be noted that government intervention may include the establishment of export-processing zones (EPZs) with the desire of attracting foreign investment. Warr (1987) discovers that EPZs attract FDI but yield uncertain economic benefits to the host country.

Regarding tax treatment, several studies have stressed the importance of tax structure. Slemrod (1990) found that the influences of different tax regimes are not easy to quantify while Shah and Slemrod (1990) concluded that FDI flows to Mexico are sensitive to tax regimes. Tax treatment also affects decisions on investment, spending and type of financing. International differences in tax treatment affect initial foreign investment incentives as well as later decisions on research and development spending and product innovations. Tax laws can affect the kind of cross-border flows like decisions on debt-equity ratio for individual companies in a country in which the investment decision had already been made (Erunza and Senbert, 1981; Huizinga, 1991, 1992).

Another interesting variable in the FDI cum growth linkage is credibility. From a policy perspective, the incomplete credibility of policy reforms is an important source of uncertainty. Unless investors view the adjustment programme as internally consistent and are convinced that the government will carry out despite the implied social costs, the possibility of reversal will become a key determinant of the investment response (Serven and Solimno, 1992, p. 108). Governments can reverse reform policies but private investors cannot alter decisions about fixed capital. It follows that the value of waiting results from the losses that investors would incur if policies were reversed in the future.

The credibility factor is not a theoretical matter. In fact, many developing countries have had policy reversals especially during adjustment. Nigeria is a recent example when the present military regime reversed the policy on de-regulation and went back to a semi-controlled regime in November, 1993. Then from January, 1995, the regime embarked on what it labelled a 'guided de-regulation economy'. Such signals will not attract foreign investors because of the loss of confidence on how the economy is managed. Serven and Solimano (1992) have argued that a reversal of policy is an endogenous outcome because the private sector ultimately determines whether, for example, an adjustment programme can be sustained.

There is the need to stress the importance of institutional factors in influencing FDI. Inadequate administration of justice, deficient property rights, incessant political intrusion in private business, corruption, lack of transparency and accountability as well as excessive red tapism are serious constraints to FDI. The government must ensure that private contracts are enforced and the judiciary system functions properly. Pfefferman and Madarassy (1992) argue that the quality of institutions in developing countries can influence FDI; strongest responses occur when investors are convinced that improvements in institutions will endure. They further contend that positive responses by investors take place in countries with an open export-oriented economy, a convertible currency, a large-scale privatization programme, and emergence of strong trading blocs which will reduce the likelihood of policy reversals by governments.

More often, issues of credibility and policy reversals anchor on political system and its volatility especially in developing countries. There is the general notion that political instability will not only result in capital flight but will also discourage foreign private investment. However, the political variable is not easy to measure or capture. Edwards (1990) utilized the degree of political instability and the degree of political polarization and violence. A priori, an increase in both of these variables will tend to have negative effects on measures of FDI.

The above discussion suggests that FDI is determined by the size of the market, output, capacity utilization, fiscal deficits, inflation, exchange rate volatility, interest rate, wages, human capital, institutional and political factors.

A priori, it is expected that output, domestic interest rate,capacity utilization, credit to private sector, openness and public expenditures on infrastructure will have positive impact on FDI. On the other hand, large fiscal deficits, inflation and exchange rate distortions will discourage FDI.

Rising capacity utilization or growing output are indicators that demand conditions are buoyant and that there is a need to expand productive capacity. A low level of inflation and predictive rates will encourage investment. However, when the general price level rises rapidly and the inflation rate fluctuates over time then the environment becomes unstable. Invariably, the risks on the returns of investment increase. In addition, high inflation results in currency devaluations of uncertain magnitude - this will increase the cost of imported capital goods and other inputs.

There are not many studies on Uganda dealing with the relationship between government policy, FDI and growth. The present study is not only comprehensive but also timely given the dearth of the empirical work on the subject in Uganda. We now first examine some stylized facts on the investment performance in Uganda in order to better appreciate broadly the discussion on FDI.

V. An overview of FDI performance in Uganda

FDI in Uganda can be discussed under four regimes, namely, the post-independence upto 1970, the seventies, the 1980 to 1985 and 1986 to 1996. The initial period saw increasing FDI trend, the second and the third, a declining and near death of FDI and the fourth, a resurrection of the FDI.

The post independence period upto 1970

Before independence, financing of development projects in Uganda came mainly from the British government which was the colonial authority. When the country became independent in 1962, the government had to look for alternative sources of funding including FDI and aid for her development programmes. Government attitude towards FDI was clearly demonstrated in the Uganda Industrial Act 1963 which put emphasis on the promotion of both foreign and local investors.

Government strategy sought to promote industrialization at the expense of agriculture, viewing the former as having both backward and forward linkages, a potential to create market for the other sectors and creation of more employment. Government role in industrialization process of the country was enhanced by the Uganda Development Corporation (UDC) formed by the British in 1952. The state and a few Asian private investors like the Madhvani and Metha groups boosted the industrial growth of the country in the post independence era.

The legal protection for FDI against compulsory acquisition by the state and rights to repatriate capital, interest and dividends was provided under the Foreign Investment (Protection) Act 1964. However, this did not stop the government from slowly moving towards the nationalisation of foreign investment in subsequent years. Towards this end, the UDC which was meant to start investments with big capital outlays and then sell them to private investors was given a legal right to control 51 percent in some of the businesses it had started and this included such projects like Tororo Industrial Chemicals and Fertilizers (TICAF), Uganda Cement Industries (UCI) and Nyanza Textiles Industries Limited (NYTIL).

The biggest step towards nationalisation, however, came under the 1968 Common Man's Charter (CMC) which was viewed as a socialist stand. The economy was predominantly controlled by a few British-Asians who owned the commercial and industrial sectors of the country, a situation which government saw as unsustainable and therefore requiring change. The CMC was followed by the 1970 Nakivubo Pronouncement (NP) which spelt out strategies to implement the CMC. The NP increased government controlling interest from 51 percent to 60 percent in major private companies and manufacturing firms and excluded private enterprises from external trade. Foreign investors were not happy with this development. The business situation became tense and all indicators pointed towards political change. And indeed, in January 1971, the civilian government was overthrown by the army led by Idi Amin.

The Amin era: 1971 to 1979

This period was marked by the 'Economic War' of 1972, which resulted in the expulsion of the British-Asians, expropriation of the assets and businesses of foreign investors mostly Asians and eventual collapse of the industrial and commercial sectors.

Immediately after the coup, the military government under Idi Amin revoked the Nakivubo Pronouncement which provided for 60 percent share-holding and reverted to 49 percent in some industries. But this was followed by the Economic War which resulted into the nationalisation of industries and other businesses belonging to foreigners. Some businesses were given to Ugandans to manage while others were put under UDC and government ministries. That marked the beginning of more chaos to come.

The investment climate for foreigners in Uganda during this period was quite hostile. For instance the problems of political instability and insecurity, nationalization, the collapse of East African Community, were compounded by the requirement that a foreign investor be naturalised as a Ugandan to do business in the country!! Failure to meet the set rules was considered sabotage and was liable for severe punishment which ranged from executions to deportation. So in effect, FDI was outlawed! The Ugandans who took over lacked capital, expertise and connections to continue as had the foreign investors and the commercial and industrial sectors virtually collapsed.

There were shortages of almost everything which led to price hikes. The country lacked foreign exchange and creditworthiness. Subsequently even the military government began to realize the importance of FDI and tried to revive it through the 1977 Foreign Investment Decree which exempted a foreign investor from import duty, sales taxes on plant and machinery in investment in an approved enterprise. The exemptions were not retrospective and only applied if the investment exceeded US$ 571,000[1]. Investors were reluctant to risk their money at that time because Amin was always unpredictable and FDI continued to elude the country. The legacy of the military junta during this period continued to haunt the country for a long time, driving away potential foreign investors.

There was also the problem of overvalued currency with an unrealistic exchange rate that undermined investments by inflating the cost of imported inputs, equipment and spare parts. It had a negative impact on investors' capital structure that included foreign hard-currency obligations. In the circumstances, access to foreign exchange at the official rate was strictly rationed. Delays and/or failures to obtain official foreign exchange in sufficient quantities had serious cost implications on companies. In an attempt to resolve this problem, many firms resorted to purchasing foreign exchange on the parallel markets, where they paid a premium over the rate that would be effective if a more liberalized official exchange rate regime were in place.

---

1 1997 exchange rate was approximately US$ = 8Ug.Shs.

The period from 1980 to 1985

The military government was overthrown in 1979. Although an elected government came into power in 1980, FDI continued to elude the country, mostly on account of past expropriations of foreign investments. The ratio of FDI to gross fixed capital, which measures the importance of inward FDI to an economy, was negative 0.2 between 1981 and 1985 compared to LDCs (Africa) of 2.3 during the same period[2]. In order to correct this bad image, a bill was presented to and passed by the parliament to return the properties of the foreign investors. However, it was not implemented till 1990 by a new government under the National Resistance Movement (NRM).

The period from 1986 to 1996

To reverse the downward trend in FDI inflows, the NRM government undertook steps to provide Uganda as an investment location. These efforts have included, at the macroeconomic level, wide ranging economic policy reforms such as foreign exchange rates reforms. Other measures have included the liberalization of existing framework, the simplification of administrative procedures applicable to foreign investors, the conclusion of bilateral investment protection and promotion treaties and accession to various multilateral treaties facilitating FDI flows.

The Investment Code 1991 is the law governing investment in Uganda, which replaced earlier statutes relating to foreign investments, namely the Foreign Investment Decree 1977 and the Foreign Investment (Protection) Act 1964. However, privileges and property rights enjoyed under previous legislation by holders of licenses were to continue and were to be reviewed under the Code.

The Investment Code 1991 provided for the creation of the Uganda Investment Authority (UIA) to facilitate the procedures for those interested in investing in the economy. It is a one-stop-centre for investors.

The broad function of UIA is to promote, facilitate and supervise investments in Uganda. Specifically, among others, the functions of UIA include:

(a) to initiate and support measures which shall enhance the investment climate in Uganda for both Ugandan and non-Ugandan investors ;
(b) to promote investment in Uganda through effective promotional means ;
(c) granting approvals for the commencement of new businesses ;
(d) to provide and disseminate up-to-date information on incentives available to investors ;
(e) to assist incoming and existing investors by providing support services ; and
(f) to recommend to the government national policies and programmes designed to promote investment in Uganda.

In order to encourage foreign investors, a number of investment promotions have been organized abroad - the USA, Europe, India, Thailand, South Africa, etc. to explain the trade and investment opportunities available in Uganda, especially in agro-farming, fishing and forestry, minerals, power generation and tourism. Attractive incentives have been provided to prospective investors

[2] See World Financial and Statistical Tables 1995.

as well.

A survey of actual and potential foreign investors shows that reform of regulatory and incentive environment has made Uganda more attractive to investors than many African countries. The Heritage Foundation (a research centre) of Washington DC in its December 1996 Report, 'Index of Economic Freedom', published in the Wall Street Journal, ranked Uganda as number 64 out of 150 countries.[3] The ranking is based on the comparative analysis of economic freedom of a country in ten key areas, including: trade and taxation policy, wage and price controls, government consumption, monetary policy, capital flows and foreign investments, banking policy, property rights, regulations and the black markets.

Thus, although Africa's share of FDI flows to developing countries dropped from 11 percent in 1986-1990 to 6 percent in 1991-1993 and down to 4 percent in 1994, the upward trend of investment flow into Uganda is a promising indication of the newfound confidence in a greatly improved political economy.

Table 1, while failing to differentiate between local and foreign projects, exhibits the encouraging surge of investment emerging in Uganda. Between 1993/94 and 1994/95, private sector investment increased from 5.6 percent to 9.1 percent of GDP.

Table 1: Total investment (local and foreign) in Uganda, 1991-1995

	1991	1992	1993	1994	1995	Total
Licensed projects	12	232	351	571	554	1720
Planned investment (US$mil.)	66	505	628	563	750	2512
Actual investment (US$mil.)	25	192	239	214	285	955

Source: UIA database for July 1991-December 1995

Actual investment figures are taken as 38% of proposed investment. Various in-house UIA surveys taken in 1993, 1994 and 1995 all had proposed/actual conversion rates between 38 and 40%. Also, breaking down the investment into years is difficult as most of the inflow is incremental over years and hard to trace with the somewhat unsatisfactory techniques of the UIA surveys.

While the above trend is encouraging, it is essential to note the wide disparity between the licenses granted to proposed investments and the actual investment on ground. The UIA promotional literature and independent assessment of Uganda's investment climate only observe the planned investment figures without showing the reality of the situation on the ground. The average conversion rate of approximately 38% is very low in relation to other developing countries outside of the Sub-Saharan Africa.

---

3 Kenya and Tanzania were ranked 75th and 89th places, respectively.

Factors leading to this low conversion rate include the hesitancy of investors (value of waiting)[4], the difficulty in passing through the discouraging bureaucratic impediments before implementation can commerce, and the investors discovery of the difference in the rhetoric of the promotional agency and the reality of the business environment encountered after the initial license is obtained. Each perspective has validity.

The sources of inward foreign investment coming into Uganda do not reflect the traditional domination of large Western multinational corporations (MNCs). Among investors looking to invest in East Africa, a slim 15 percent are major MNCs.[5] Table 2 shows the sources of FDI into Uganda.

Table 2: Sources of licensed inward FDI into Uganda (as of June 1995)

Sources	Number of FDI	Percent of Total
UK	293	27
Kenya	193	18
India	123	11
Canada	123	11
South Africa	9	8
Others	332	31
Total of African countries	277	26

Source: UIA. Operating Summary, June 1995

The FDI coming from UK, Canada and Kenya can be misleading. Many of these investors are in fact Asians forced to flee Uganda in 1972. The Uganda business sector before 1972 was dominated by about 70,000 Asians, most of them fled to UK, Canada and Kenya. The vast majority of FDI flowing into Uganda comes from firms with previous experience in Uganda or East Africa.

Investment serves one of the three general purposes: to extend vertical integration, to export to the region, or serve the domestic market. Typically, FDI exploits the raw materials and cheap labour of developing countries and exports abroad. Investment flowing into Uganda with little exception targets the domestic market. However, this trend is slowly changing.

The main sectors which attracted more investments during the last five years or so are :

(a) Manufacturing (i) import substitution industries such as chemicals, cement, etc.; and (ii) agro processing, for example, food processing.

UIA Survey of 1995 shows that most of the post-1991 investment is reportedly going into

4 Foreign investors obtain licences yet continue to wait for further proof of stability before actual implementation takes place. They want to secure the incentive and the right to invest but want to gain more assurance about policy consistency before beginning.

5 Economist Associati 1994, Vol. I, p. 12.

the manufacturing sector, which is accounting for 70% of on-ground investment. Ugandan manufacturers are largely producing import substitutes. About 40% of manufacturing investment has been agro-based. Overall, during 1991-94, investment has not been directed at export oriented activities. Just about 8% of manufacturing output was exported to regional markets in 1995.

(b) Agriculture, forestry and fishing - dominated by coffee and rehabilitation of tea plantations; other nontraditional agricultural crop exports (in raw form or with minimal processing), fish products, floricultural and horticultural products, etc.

(c) Construction and services - construction and renovation of hotels mainly for tourism subsector grew by 18 percent per annum during 1995, earning about US$90 million from US$73 million in 1994. The banking and insurance industry also witnessed some improvement but based mainly in Kampala.

Of the above three sectors, FDIs are concentrated mainly in manufacturing because of the problem with the agriculture. An obsolete, over protective law preventing foreign ownership of land and limited acreage of land to leased prevents FDI from large-scale investment in Uganda.

In addition to manufacturing, much of the foreign investment can be linked to donor-related projects. Unfortunately, there is not much information on the foreign projects linked to donor subsidies. Donor supported investment has been in projects in infrastructure such as road building, non-traditional exports, etc.

VI Methodology

The study uses both primary and secondary sources of data. Direct questioning of the investors to obtain insights regarding their decisions and decision making processes were undertaken. For instance, to gauge the foreign investors' attitudes and experiences in Uganda's investment environment, loan accessibility and so forth. Structured questionnaire was used to obtain the desired information. The study is to add importantly to the understanding of motivation and behaviour of foreign investors in Uganda.

Annual time-series data for the variables of interest for the period 1975-1991 were collected from the following sources: World Bank, World Debt Tables (various issues); IMF, International Financial Statistics (various issues); Government of Uganda, Background to the Budget, and Key Economic Indicators (various issues); and Bank of Uganda, Annual Reports (various issues). Specifically, the secondary data are used for estimating the determinants and growth equations.

VII Discussion of the survey results

Scope of the survey

The survey covered both local and foreign investors operational in Uganda. The survey was exclusively concerned with productive activities, with the explicit exclusion of purely commercial and consulting activities. Sectors covered by the survey include : (i) agriculture and related processing activities; (ii) manufacturing; (iii) construction; (iv) service activities providing a direct and substantial support to productive activities (eg., transport, etc.); and tourism (hotels and lodges, but not restaurants and casinos).

The survey was conducted on the basis of face-to-face interview/discussion and a structured questionnaire covering the following subject matters: (i) sources of interest and first contact points in Uganda; (ii) attitude about investment incentives; (iii) Problems in operating business in Uganda; (iv) recent investment activities; (v) planned future operations; and (vi) investors' attitudes towards government regulations and agencies.

The questionnaires used were structured along the lines of the World Bank and UIA 1994 surveys. UIA provided a sampling frame of operational investments from which we took a random sample of 85 investors. Out of these, only 61 responded by providing most of the information required for the analysis.

Main survey findings[6]

Government efforts in attracting investors

- Provision of an enabling investment environment by maintaining political and macroeconomic stability.

- Establishment of policies and institutions which are conducive to project implementation and operation. The creation of investment vehicle - Uganda Investment Authority - and the 1991 UIA Investment Code offering security and incentives to investors in an attempt to offset the risk and increased cost of investing in Uganda (see Appendix B).

- Privatization programme which is creating new opportunities for both local and foreign investors thus stimulating investments. According to one survey, one-third of FDI flowing into Uganda is related to the purchasing of state enterprises.[7]

- Privatization programs act as a signal of the authority's commitment to private ownership. Moreover, the privatization programme with foreign participation acts as a vehicle to increase FDI flows with potential qualitative contributions to the economy over a longer period of time, since FDI flows can continue after the acquisition of an asset owing to post-privatization investment. Foreign investors also see it as a vehicle for fast entry into Uganda market and can provide profitable investment opportunities.

- The Asian repatriation factor is another catalyst for FDI inflows. Between 1991 and March 1996, 1,788 properties have been repossessed and returned to their original Asian owners.[8] The returning capital to build on repatriated property must be taken into account when evaluating the upward trend of FDI flowing into the country. Note that this portion

6 Details appear in Appendix C.

7 Economisti Associati, 1994, Vol. 1 p. 19, Vol. III p. 24.

8 Department of Departed Asian Custodian Board - Divestiture Notes on Properties, March 1996.

of investment is not likely to persist now that all the properties have been claimed by their previous owners.

- The dependence of PTA preferences on majority domestic ownership was revoked in 1992.

Perceived strengths and weaknesses of Uganda as an investment location

- The most widely perceived strength is the overall growth prospects buttressed with liberalized exchange rate and a fully convertible currency, low inflation and stringent fiscal management.

- However, the perception that Museveni is the key to Uganda's economic recovery and hence the perceived indispensability for the country's progress is viewed by foreign investors as a major weakness. They concede that if this is true then the future of Uganda will be highly uncertain if he were no longer in power.

- The main weaknesses are: its hostile and anti-FDI history,[9] landlocked position, poor infrastructure, high tax on fuel[10], slow and high cost of utility installation and low labour productivity; making Uganda a high cost country.

- The on-going conflicts especially in the North of the country erode investors' confidence and taint the image of the country.

- Uganda does not have a large domestic market (poor population of only 19 million). Moreover, Uganda lacks access to regional market because of the high degree of protectionism. Yet, open boarder trade could easily wipe out our entire manufacturing base (Tulyamuhika 1995 report on cross boarder trade)!!

- The banking system in Uganda is still underdeveloped, small and underdiversified handling essentially short term commercial transactions. Almost inaccessible sources of development finance for long term investments.

Policy unpredictability

- Although the macroeconomic policy - guided largely by the donor community - is predictable, the policies that have a direct impact on FDI remain erratic and thus constitute a serious impediment to investment facilitation. The root cause is the conflicting interests of the pressure groups: international donors, government agencies, foreign investors and politicians.

---

9 Uganda has a history of expropriation of foreign investment and discouraging regulations. The incentive system was biased in favour of domestic firms.

10 For example, the tax element of the fuel price in Uganda is equivalent to the pump price motorists pay in Kenya !

- One example of such policy unpredictability is the tax incentive policy since 1987. In 1987 duty payable on all industrial raw materials was suspended. The same duty was reintroduced in 1990 at the rate of 10 percent. The 1991 Investment Code abolished this duty for inputs used by new investors to minimize start-up costs. In 1992 after foreign firms negotiated agreements with the government over several tax rates, the Budget Speech[11] of 1993/94 ignored these agreements by revoking the duty exemptions on all industrial raw materials. In 1994, 10 percent duty was allowed for most raw materials not available locally. In addition, exemptions are added and revoked on an ad hoc basis by the Minister of Finance[12]. For investors to rely on erratic policies left to the discretion of an individual is inconceivable.

Tax holidays and exemptions

- There are no incentive schemes put in place specifically for local investors, rural sector (agricultural, in particular) and micro and small scale enterprises that form the bulk of producers and processors.

- Uganda's 1991 investment code offers tax holidays of up to 6 years from corporate profits taxes, dividends tax and withholding taxes on transfers to associated or parent companies abroad. The investment threshold for a local investor is $50,000 and for a foreigner-owned enterprises the minimum is $300,000. Although the thresholds differ, the holidays are widely perceived as benefitting mainly foreign investors.

- The decision to grant tax holidays rests with UIA which has the power to grant or refuse subject to the investment code. Companies with a generous holiday may have significant competitive advantage over companies which do not have a holiday. This results in gross inequality and unfair competition.

- Lack of transparency of this nature leads to abuse, corrupt tendencies such as favouritism towards firms with connections to people in places of authority.

- There is no discrimination in the allocation of these incentives in terms of project location in the country, employment creation, or market orientation (domestic or export).

- The tax holiday encourages enterprises which can establish and operate profitably very quickly. It is of limited value to a project which involves substantial investment and takes a long time to become profitable. Yet those are much more important from the economic development view point.

- It must be noted that when a tax holiday expires it is quite easy for an investor to wind up and leave country or to establish under a new name to qualify for a new tax holiday. Thus the existing tax incentives encourage mainly short term investment as investors are

---

11 Changes in policies are usually annouced during annual Budget speeches.

12 The Investment Code gives the Minister of Finance the powers to amend the incentive scheme in an annual Budget Speech (see Investment Code. Pqrt III. Section 11 (4).

aware that their tax obligations will change after the holiday.

- Tax holidays are insensitive to the value added a project brings to the economy. An enterprise which imports all its inputs (eg. bicycles, steel industry, etc.) gets the same benefits as one which uses primarily locally sourced inputs and therefore increases much more local value-added.

- Firms which commenced operations after January 1991 enjoy 100% exemptions while those already in business receive less than 100%. The problems with this is that it is possible to get firms in the same industry getting different degrees of exemption resulting in unfair competition among them.

- Tax policy appears to be ad hoc and subject to a lot of abuse. There is too much secrecy and apparently no objectivity in arriving at exemption tax rates which range from 0% to 100%. On top of that, the list of exemptions - that is, corporate tax, with-holding tax, tax on dividends and tax on imported intermediate inputs - differ from one investor to another. This is at the discretion of highly placed Ministry officials.

Investors' primary concern

- Foreign investors' are primarily concerned with fundamental factors, that is, a stable macroeconomic and political situation, together with credibility of policy reforms.

- A stable and sustainable macroeconomic environment boosts the confidence of private investors. Reductions in debt burden are also critical not only for sustaining both external and fiscal balance but also for engendering confidence to encourage private sector investment.

- However, the very scale of the achievement of President Museveni invites the question whether the reform process is more deeply rooted politically than the person of the president.

- Other factors that determine the location decision of investors are: market size (in terms of GDP per capita or size of the population) and market growth (GDP growth rates in constant prices). In addition, factors such as availability of natural resources, the quality of the infrastructure, and the cost, productivity and technology skills of labour are also taken into account.

Salient features of investments in Uganda

- Processing plants have been established without environmental impact assessment. Pollution (water, soil and air) and careless industrial waste disposal are reported to be rampant.

  According to NEMA, most of the plants would be closed if strict environmental standards were to be enforced. Key among these are fish processors, those producing batteries, foam mattresses, soap and detergents, paint, plastic products and oil products.

- Investment flowing into the country with little exception targets the domestic market - a local consumer demand produced by decades of negative growth.

- From a sectoral perspective, most FDI (about 75 percent) is going into manufacturing (including agro-processing).

- Tax incentives especially on imported intermediate goods have led to a bias towards `import-substituting' instead of export-oriented industries.

- High concentration in Kampala - about 75% of projects licensed since 1991. Kampala provides good market for the manufactured goods and services; relatively high levels of human capital; and has the utilities (water, power and telecommunications) which are relatively more reliable.

- Most investors come from UK, Canada, Kenya and India and have previous experience in Uganda. In fact, the majority are the returning Asians who were expelled from the country in 1972.

- This group of Asians has an informational advantage over other potential investors. The media coverage on good economic and political performance is often offset by media-worthy reports on Amin, fighting in the North and AIDS, wiping out Uganda from investors' shortlist.

- Actual value adding in manufacturing is limited and some investors just repack imported materials into new containers bearing new names for resale. This is more so with paints.

- Most investments are of high degree of vertical integration. Vertical integration occurs where a seller of a final product gains control over the production of various inputs that go towards making the product. For example, in tourism, a vertically integrated chain would involve a firm controlling the tour organization and marketing, ground transport and accommodation. Benefits include security of supply, greater control over prices and product quality.

- A number of investors are not creating the planned employment for Ugandans as stipulated in their investment plans.

- Although the investment code disallows importation of raw materials and construction materials available in Uganda, investors have gone ahead to import them (tax free) and quite often end up trading in them.

Investors' pre- and operational problems

- **No one-stop shop** [13]: There is a difference between stated purpose and actual function of the UIA as a one-stop shop.[14] There is wide discrepancy between the rhetoric in the Code and the reality of the application processes. A true one-stop shop does not exist in Uganda as UIA is not empowered to grant all licenses needed for operation and cannot guarantee access to serviced land for investors.

- While the powers of administration of foreign investments are vested in the UIA, at the same time many agencies still maintain the real decision-making capacity.

- The government is sincerely advocating for FDI as evidenced by the creation of the UIA under the Investment Code in addition to extensive measures promoting privatization, but these efforts are diluted as the initiatives trickle down through the reluctant institutional structures. There is an apparent gap between the pronouncements by government leaders on the need and desirability for foreign investment and the actual handling of applications and paperwork by lower level of bureaucrats. For example, UIA may license an investor for one incentive which is interpreted and implemented differently by the revenue collectors. Thus even after being certified for incentives the version which is received may be diluted significantly.

- **Business registration** : There is no publication of what steps an investor must follow to become operational. In addition, there is no time scale or itemization of the registration costs involved. In most cases one has to make several trips to different sections of the registration process - where more paperwork is added almost arbitrarily by bureaucrats.[15]

- **Serviced land** : The difficulty of obtaining land is often attributed to bureaucratic entanglements, legal constraints and scarcity of serviced land. Even when these problems are resolved and the land is located, more of theses are added. For instance, an investor then has to obtain land titles or official leasing certification which although critical for the security, can take years to obtain.

- **Trading licenses** : The anti-export bias inherent in Uganda's policy is compounded by the lack of transparency in getting a trading license. The Trade (Licensing) Act of 1969 grants the Minister excessive discretion to alter an already unclear process. The Minister has the power to declare, by Statutory Order, which goods cannot be traded by a non-citizen, reduce any fee payable or refuse to grant a trading license without reason.

---

13 See Figure 1.

14 In practice dealing with UIA is like playing snakes-and ladders in the dark.. Foreign investors supposedly can go straight back down into the up the ladder from the one-stop UIA. But a snake waits on the next square taking them straight back down into the bureaucracy. The UIA carries so little weight with other ministries that it is known not as a one-step shop but a 'toothless, yet another one-more-stop'. Bureaucratic institutions include NEMA, UNBS, Kampala City Council and the utility companies UPTC, UEB, NWSC and the Inspectorate of Factories.

15 A recent UIA study has confirmed that there are at least 12 decisions UIA to be visited before any business is operated in Uganda. This may explain why there is an enorme discrepancy between FDI licensed by the UIA and FDI actually implemented.

The cumbersome and frustrating method of obtaining a trading license is not published but must be found out incrementally as the investor goes from one agency to another.

- **Tax administration** : The changing status of tax incentives combined with the pressure applied by the international donors to boost revenue collection and the ambiguous delegation of powers leaves the URA free to exploit a muddled tax system.

  Because schedules of revenue collection are not clear, the URA uses this excuse to visit businesses at will to review accounts and look for loopholes to levy other taxes. The tax code is often open to abuse and misinterpretation without accounting for defunct tax laws which remain on books. There is no up todate coherent set of rules to protect investors from arbitrary collection by the URA. There is no one document listing the 30-plus taxes and investors can be ambushed by the tax authority with demands for back tax over several years.

- **Legal system** : According to a 1995 USAID study, the Ugandan administration of justice is `plagued with long delays, lack of publications and non-transparency, encouraging corruption and making business planning difficult'. Many foreign investors interviewed try to avoid the judicial system altogether and pursue private arbitration when absolutely necessary. In addition to inexplicable delays in judicial decision, the courts have been under public scrutiny for corruption.

- **Location** : Investors feel that Uganda is a difficult location for a business operation since it is landlocked (imported raw materials and fuel have to travel long distances compared to her regional partners, Kenya and Tanzania), the infrastructure is poor (therefore high transport costs), utility services are expensive and unreliable, labour market conditions are bad (labour productivity is low with high wage demand), access to export markets is difficult, etc.

Foreign investors[16] and the locals

- In an attempt to attract new investments through tax exemptions the Investment Code inequalities in the environment by making those older existing foreign and local businesses uncompetitive.

- Local firms complain that they are being squeezed out of business by foreign firms which use cheap offshore capital whereas the local firms have to borrow money at higher interest rates from local banks.

- While many of the tax incentives granted are legally non-discriminatory between local and foreign investors, in practice they sometimes have an inherent - though unintended - bias against local investors.

---

16 Foreign firm are MNC and non-MNCs. MNCs are defined as firms which have a parent firm in the home country and non-MNCs as those which do not have parent firms but are financed by investment of individuals or investment companies outside Uganda.

- In general, foreign firms pay much higher wages than domestic firms, which suggests that incoming foreign investment may help to raise living standards for a certain proportion of the population.

  Notwithstanding this, however, there is a feeling that there is widespread exploitation of unskilled labour, especially in small- and medium sized foreign owned firms. The terms and conditions of service are poor, for example, wages sometimes range from as low as 35,000 to 70,000 shillings per month and such workers have no appointment letters or identity cards. They can be fired without any warning and are denied the right to be unionized, thus contravening Trade Union Decree No. 22.

- Managerial positions in foreign firms are often filled by the `expatriates' some of whom have doubtful qualifications.

- Because of corrupt tendencies and other malpractices in the immigration department, work permits are often issued without serious scrutiny as to the suitability of such imported labour.

Difficulties of dealing with government agencies

- The URA has been singled out as the most difficult agency to deal with. This assessment arises out of the URA's arbitrary assessments, lengthy delays in clearance of documents and goods, and hostile attitudes of some revenue agents. Investors complain that URA has excessive discretion, lack clarity and many of its officers are corrupt.

- Many investors have complained of URA revoking incentives given by the UIA, especially with regard to tax holidays. With a defunct Tax Appeals Court, the only recourse businesses have in disputing a tax liability is through an appeal to Tax Commissioner, hardly a neutral arbitrator.

  UIA and URA are pushed towards goals by external forces that contradict each other over the same jurisdiction. The UIA with half of its funding from USAID, `exists to promote a liberal competitive code, ease investment constraints, and encourage inward investment through competitive tax incentives'. The degree of its success is measured by how much investment is attracted to Uganda. On the other hand, URA is under increasing pressure to collect more revenue. With substantial financial support from ODA, IMF and World Bank, URA's success is measured by the degree of revenue maximisation rather than by creating a good working relationship with tax payers.

  This URA/UIA contradiction is a serious problem which needs to be addressed to improve the investment environment.

  The UEB is very unpopular with those mainly in the manufacturing sector. The power supply is irregular and UEB tariffs are said to be higher than those in the neighbouring Kenya and Tanzania.

VIII. The impact of FDI on the Uganda economy

The impact of FDI on a country depends on many factors, such as the role of FDIs in the economy, the sector in which FDI is undertaken, the type of investment (eg. export-oriented or import-substituting), links of foreign affiliates with the host economy and on the conditions in the country.

Inadequate statistical data on FDI and the performance of MNCs in Uganda make it very difficult to assess their overall and specific impacts on the economy. What exists - some limited data on some aspects of FDI - allows only cautious assessment about the scope and the direction of possible impacts in a number of areas.

Output and employment (Table A1-2)

The most aggregate impact of foreign investors on the economy is their contribution to output and job creation, measured by their share in GDP and other economic aggregates (eg. employment).

Table A1 shows how the relative importance of FDI flows, based on annual averages in three periods, was changing relative to GDP between 1981 and 1993. The FDI/GDP ratio which has been negative until 1991, the year when liberalization of FDI policies started, became positive 0.07. This is still well below the African average of 0.89.

As to the sectoral dimension of the FDI impact, it has been in the domestic-market oriented, import-substituting type of investment in manufacturing, encouraged by trade protection and near monopoly positions. Its main contribution is to job creation and increased output of manufactured goods. Foreign investors in these industries co-exit with local firms, but in most cases they have not established linkages with the local economy and depend on imported inputs for their production. Their qualitative impact on the economy is therefore very limited. Although FDI is meant to be a relief for the balance of payments, they are increasingly seen as a burden because of imported inputs and transferred investment income[17].

Marketing and trading strategies

Trading firms have played a crucial role in supporting the export of primary commodities through joint ventures with local companies, by serving as buying agents on behalf of other firms, or by exporting on their own account. For example, in the coffee industry, crop finance which used to be a headache to the government is no more. According to Uganda Coffee Development Authority, foreign buyers with access to cheap offshore funds now provide over 90% of pre-financing.

The trading function is important because a comparative advantage in producing a good does not necessarily imply a comparative advantage in its marketing. The need for relatively high skills for international trading services suggests that Uganda could go through a period when they enjoy

---

[17] A full judgement about the impact of import-substituting FDI on the balance of payment would only be possible if a counter-factual situation could be constructed.

a comparative advantage in producing certain commodities but not marketing them. In such a case, the role of transnational trading companies can be a useful supplement to the country's exporting efforts. As examples of some developing countries in Asia show, with time, countries may not only successfully produce but also successfully market their commodities.

Domestic investment (Table A3)

The contribution to domestic investment is potentially important, especially in Uganda, where the level of domestic savings is extremely low and in fact has been negative during the 1980s and early 1990s (see Table 4).

Table 4: Investment ratios in Uganda

	1982-86	1987-93	1994	1995
Uganda				
Investment/GDP	8.5	13.9	15.2	17.3
Savings/GDP	-4.1	-3.8	-0.1	-0.05
Africa				
Investment/GDP	22.4	19.6	21.9	22.1
Savings/GDP	19.3	17.7	18.3	18.5

Source: World Economic Outlook

Table 3A in the Appendix reveals that the share of FDI in gross domestic investment which has been negative throughout the 1980s has increased to 0.80 during the period 1991-1993. Although this is well below the African average of 4.50 during the same period, it is by no means a remarkable achievement for Uganda. During the same period Kenya's figure was 0.71.

Balance of payments (Table A4)

The impact of foreign investments on the balance of payments is of special interest (see Table A4). Positive contributions include inflows of foreign capital to initiate and/or expand projects; export revenues if investors are export-oriented or contribute to exports indirectly; and savings of foreign exchange from import substitution. Burdens for the country's balance of payments include remittances of profits, fees and royalty payments to parent companies; imports of goods and services, and transfers of salaries by expatriate employees. The net foreign exchange effects depend on a number of factors that determine the size of foreign exchange credits and debits associated with each foreign affiliate over its entire existence. Indirect effects can be quite important among them; by supplying better and/or cheaper goods and services to local exporting firms, foreign affiliates can increase the competitiveness of the country's exports.

The overall impact of FDI on the balance of payments of Uganda cannot be ascertained with precision because the data on credits and debits needed for making such an assessment are not disaggregated by foreign versus domestic ownership of firms.
The problem is complicated by the way FDI is presented. FDI has been lumped together in the

balance of payments (BOP) totals of private transfers alongside unrecorded exports, remittances by Ugandans abroad, NGO transfers, etc. The liberalization of foreign exchange market, however, has made estimation of FDI difficult because some people bring hard currency into the country, exchange it at the various bureaus and start up business in the country.

However, export oriented FDIs have had a positive impact on the balance of payments. On the other hand, the impact of FDIs in import-substituting industries on the balance of payments is often negative inflows have frequently been offset by payments for related intermediate inputs and outflows of dividends and other forms of corporate payments.

However, direct investment should strengthen the balance of payments in the long run, as it adds to the productive capacity of the economy. When the investment is profitable, it generates profits which are payable overseas. This affects the balance of payments in two ways. First, the additional capacity increases the ability of the economy to finance payments overseas and second, it increases the amount which the economy must pay overseas. This applies whether the direct foreign investment is in import-substituting or export-creating industries. Investment in import-competing industries frees up foreign exchange which would otherwise be used to purchase imports, while investment in export industries increases the amount of foreign exchange available to finance the repatriation of profits. Of course, should the direct investment make losses in the long run, then there are no profits and therefore no balance-of-payments effects.

The growth generated in the economy by direct investment helps overcome so-called repayment problem. As long as there are growth opportunities in the host country, direct investment will continue to flow in. Furthermore, many of the overseas-owned companies will not leave the country as long as there are growth and profit opportunities. Over time the growth of wealth in the country will provide opportunities for Ugandans to acquire shares in the foreign-owned companies.

However, should the direct foreign investment occur behind high tariff barriers or other forms of protection, the outcome will be far less desirable. Overseas firms attracted to the country may make artificially high profits because of protection. The repatriation of such profits may then have a detrimental effect on the growth of the economy. There are a number of examples of foreign-owned firms in the Uganda manufacturing industry which have been ardent supporters of protection and have been content to inefficiently supply the small Ugandan market. These firms (which do not grow, do not achieve economies of scale and do not export) produce high-priced locally made goods, free from the positive effects of competition from imports. The opening up of the economy to competition can eliminate these undesirable consequences of the foreign investment.

Technology transfers and human resource development

Capital is one of the benefits of FDI for Uganda. Others include transfer of technology, the development of human resources those related to backward and forward linkages.

The question of technology transfer is difficult to assess. In the case of the many industrial and agro-business affiliates that were established through FDI in the 1960s, the pattern appears to have been one in which technologies have been operated with decreasing skill and precision over time. This was partly because, in many cases, there was either no continuing relationship with the former supplier or only a minimal one. This is different from the experience of countries in East Asia which sought to minimize equity investment from abroad during the 1960s and instead encouraged technology-sharing agreements.

As regards the development of human resources, a popular proxy measure in the literature has been the share of expatriates versus local personnel in managerial positions in foreign affiliates. In the case of Uganda, these ratios are generally high.

Another impact in the area of human resources concerns working conditions and salaries in foreign companies. There seem to be some important intersectoral differences illustrating a different impact of the services and manufacturing firms in Uganda. If wages are taken as a proxy for skills, FDI in services involve much higher skills than in manufacturing. Two factors account for this: the nontradability of services, and their reliance on human rather than physical capital. Both mean that a parent MNC in services establishing an affiliate in the country has to reproduce, in distinction from manufacturing firms, factor and skill proportions used at home. The impact on Uganda then depends on its labour market: if needed skills are abundant, the contribution of foreign affiliates will be to increase employment. If skills are scare, foreign affiliates may have to import them, divert them from local companies by higher pay or train them; under the last of these conditions, soft technology is transferred to the host country.

Tax revenues

Advocates of foreign investment point to its capacity to generate tax revenue. However, this does not necessarily suggest a net increase in tax revenue. If the activity is funded locally, a similar amount of tax revenue can also be collected. Only if it is shown that the investment would not have occurred without the foreign capital could it be argued that the increased tax revenue is attributable to the foreign investment. Furthermore, and perhaps most important, pricing policies of foreign-owned multinational firms may prevent taxation benefits from being realized. Foreign-owned firms sometimes engage in transfer pricing, whereby non-market prices are used to shift profits between subsidiaries operating in different countries so as to maximize profits where taxes are lowest. This practice could involve a substantial loss of tax revenue for the host country.

Fiscal burden of tax holidays

Uganda's tax/GDP ratio is low[18] at around 22 percent by 1995/96 Ministry of Finance estimates. This is well below the 42 percent for European Union.

The annual revenue loss arising out of the tax holidays alone provided to investors under the Code is estimated at US$7 million which adds up to about 19 percent of the corporate income revenues collected in 1994. According to the estimates by the Ministry of Finance foregone revenue from import duty and sales tax exemptions in 1994 were US$11.2 million and US$9.1 million, respectively.

---

18 The tax base too is narrow with percent coming from corporation tax, percent from PAYE and most of the remainder from duty (35 percent), exice duty (10 percent) and sales tax (30 percent).

This fiscal loss borne by the Government in its attempt to influence private investment behaviour could be reduced considerably if they are designed to take account of the inter-dependency between the tax laws of the capital exporting countries and the concessionary tax laws of the Government. Recognizing that, under the present practice of blanket provision of tax concessions, certain capital exporting countries give credit only for taxes actually paid abroad while taxing repatriated tax-free profits, there is a prima facie case that tax holidays may not serve as an incentive, and that capital importing countries like Uganda are sacrificing revenue unnecessarily. Some provision may very well be made whereby firms demonstrate proof that tax concessions can be utilized before receiving the concessions.

Estimation of the FDI and growth model

The decision by foreigners to invest in a given country depends on a wide range of factors in the host country. Among the major ones are: the availability and cost of natural and human resources; adequacy of infrastructure and support facilities; market size; trade policies and other policies that affect macroeconomic stability; economic growth and level of development; and political stability. The importance attached to each of these factors depends on the type of investment and the motivations or strategy of investors.

Relative costs influence location decisions, but low direct labour costs are not of as much importance as is commonly believed. In fact, the importance of low-cost unskilled labour in location decisions has declined in recent years and greater emphasis is now placed on skills and the 'trainability' of workers.
Moreover, in many industries, direct labour costs now account for only 10 to 15 percent of manufacturing costs, and the share is even smaller in some industries. In contrast, because of white collar and supervisory roles, labour costs have been rising in the more developed countries, it has become increasingly attractive to invest in countries that offer low-wage high technology skills pool of labour. As multinationals transfer ever more sophisticated production lines to developing countries, the availability and cost of skilled labour becomes of growing importance.

Market size is also significant in affecting location decisions. Larger economies have attracted the bulk of FDI. This is because of the potential for local sales. In small economies, FDI usually concentrates on production for export.

There is also somewhat of a 'herd effect' with potential investors following where others are already operating successfully. Further, as more firms invest in a country, synergies and linkages develop among them.

Costs are also affected by adequacy of infrastructural facilities and the supply of utilities. Unreliable transport and telecommunication services and insufficient power or water supply create operational bottlenecks which could be very costly. In addition, the existence of efficient financial and other support facilities which can cater to the diversified needs of investors is also necessary.

The host country's policies with respect to restricting or welcoming FDI will obviously also affect the magnitude and character of FDI. Not only will the policies have direct effect on FDI, but they will also affect whether the foreign firm wishes to export or license instead of having a direct production investment in the foreign country.

Finally, the importance of political stability in creating a climate of confidence for investors cannot be underestimated. Political instability, whether perceived or real, constitutes a serious deterrent for FDI as it creates uncertainties and increases risks and hence costs.

There is no doubt that in order to determine quantitative and perhaps more precise relationship(s) between the above factors and FDI in Uganda, it is necessary to specify and estimate a model linking them.

Based on the Ugandan situation and availability of consistent data series, the following model is specified and estimated:

FDI determinants equation

(1) FDI = a11 + a12GDPGR + a13GDP + a14TB + a15INF + a16PPEGDP + a17DSR + a18EDSGDP + e1

Growth equation

(2) GDPGR = a21 + a22FDI + a23GDS + a24OCF + a25EXGR + a26AID + e2

where

FDI	= Foreign Direct Investment,
GDP	= Gross domestic product,
GDPGR	= Annual growth rate of GDP,
TB	= Trade account balance,
INF	= inflation rate
PPEGDP	= proportion of public expenditure to GDP,
DSR	= Domestic savings rate,
EDSGDP	= external debt service as a proportion of GDP.
GDS	= gross domestic savings as proportion of GDP,
EXGR	= rate of growth of real exports,
AID	= net current transfers to government plus official long-term borrowing,
OCF	= other capital inflows,
e1, e2	= stochastic disturbance terms.

Superficially, the model just puts together two single equations which are rather familiar in the literature of FDI. The economic implications are, however, quite different from those of single equation models. In the simultaneous equation model, both GDPGR and FDI are endogenous variables. GDPGR can affect FDI via equation (1), but FDI can in turn affect GDPGR via equation (2). The interdependence of FDI and GDPGR does not exist in a single equation model where either FDI of GDPGR is treated as exogenous. Neglecting the interdependence may result in biased and inconsistent estimates. Accordingly, the model consisting of (1) and (2) is more appropriate in capturing the underlying relationship among variables from the point of view of both economic theory and statistical investigation.

The independent variables capture some structural characteristics of the economy and are related to economic policy which can be adjusted by policy makers in order to make FDI more attractive. Rate of inflation is preferred to exchange rate because the cost of the latter in Uganda fuels inflation. The inflation rate is also a proxy of some measures of macroeconomic stability. The high debt service EDSGDP overhang describes both the structure of the economy and political effects.
Government's behaviour is also important. Thus the share of government consumption in GDP is included to capture the size of government.

The FDI determinants equation

Equation (1) includes most of the frequently mentioned quantifiable
demand side determinants of FDI..[19] The variables GDP and GDPGR stand respectively for the market size hypothesis and the growth hypothesis. The market size stresses the necessity of large market size for efficient utilization of resources and the exploitation of economies of scale. As the market size grows to some critical value, the hypothesis asserts that FDI will start and increase thereafter with the expansion of the market size (Scaperlanda and Mauer, 1969; Torrisi, 1985). Moreover, GDP can be used to capture the influence of proven economic performance. The higher the value of GDP implies, in addition to greater domestic market, better infrastructure and hence provides greater incentive for FDI. The growth hypothesis postulates a positive relationship between FDI, GDPGR, PPEGDP and DSR.

According to the theories of FDI, developed nations will tend to invest in poorer countries that have a higher rate of return. In Uganda, the capital market is not well developed hence the return on capital is being proxied with GDPGR. The argument is that a rapidly growing economy provides relatively better opportunities for making profits than the ones growing slowly or not at all (Lim, 1983). Thus an impressive rate of economic growth will be taken as a favorable signal by international investors when making investment decisions.

The relationship between trade balance (TB) and FDI is rather complex and there are diverse predictions about this relationship (see, for example, Torrisi, 1985; Tsai, 1994). Following Fry's (1983) view, along with the argument of the two-gap model that foreign exchange is one of the key constraints on economic growth in developing countries, it is not difficult to understand the relation between trade balance and FDI. When a country faces growing trade deficits, it is expected to adopt more favorable policies to facilitate inflow of FDI.

The growth equation

The growth equation is derived from a neoclassical aggregate production function comprising exports (see, for example, Gupta and Islam, 1983; Ram, 1985). There are reasons to include the export variable in the growth equation. It is well documented that trade, especially exports, may increase competition, permit the realization of comparative advantage, enable countries to

---

[19] Admittedly, there are noneconomic, qualitative factors such as political stability and incentive policies that are of vital importance in determining FDI.. The difficulties and controversies in defing and quantifying these variables prevent the study from including them in the analysis. Although Root and Ahmed (1979) suggested the use of discriminant analysis to avoid problems in regression analysis, there is still a problem of assigning categorical index to each qualitative variable.

purchase goods from abroad, and provide opportunities to gain access to new technology as well as managerial skills (Voivodas, 1973; Tyler, 1981; Ram, 1985; Rana and Dowling, 1988; Otani and Villanueva, 1989).

The impact of FDI on economic growth is one of the most controversial topics in development economics. According to the modernization hypothesis, FDI promotes economic growth by providing external capital and through growth, spreads the benefits throughout the economy. It is the presence, rather than the origin of investment that is considered to be important. Moreover, FDI usually brings with it advanced technology, and better management and organization. FDI, is, in fact, the other 'engine' of growth in developing countries. Contrary to this modernization hypothesis, the dependency hypothesis, while admitting a possible short-term positive impact of the flow of FDI on economic growth, insists that there is deleterious long-term impact of FDI on economic growth
as reflected in the negative correlation between the stock of FDI and growth rate. In the short-run, any increase in FDI enables higher investment and consumption and thus creates directly and immediately to economic growth. However, as FDI accumulates and foreign projects take hold, there will be adverse effects on the rest of the economy that reduce economic growth. This is due to the intervening mechanisms of dependency, in particular, 'decapitalization' and 'disarticulation' (lack of linkages) (Stoneman, 1975; Bornschier, 1980; O'hearn, 1990).

Some economists have argued that political, social and cultural factors play crucial roles in determining the growth performance of a country. Others have argued that the impact of FDI on economic growth might vary across countries because of different stages of development.

From the preceding discussions, the expected signs for the coefficients of GDPGR and GDP are positive, whereas that of TB is negative. In the growth equation, the coefficient of FDI denotes the impact of FDI on economic growth. According to modernization hypothesis, it should be positive. But dependency hypothesis would expect the coefficient FDI to be uncertain. Finally, the variable GDS is so standard in a production function that it is unnecessary to repeat the rationale of including it. As usual, the coefficient of GDS is expected to be positive.

Empirical results

Beacuse of the likely simultaneity between FDI and growth, a two-stage least squares (2SLS) estimation method has been used. The period covered is from 1981 to 1995. Note that the R2 defined for the 2SLS does not have the usual interpretation for R2 as the proportion of variance explained by the regression.

Table 5 : FDI determinants and growth equation

Explanatory variables	FDI determinants	Growth equation
Constant	-9.564** (-4.021)	3.910 (1.697)
GDPGR	0.098** (2.187)	

GDP	0.005** (1.987)	
TB	-0.102** (-2.401)	
INF	-0.053 (-1.873)	
EDSGDP	-0.042 (-1.724)	
PPEDGDP	0.098** (2.145)	
DSR	0.019 (1.408)	
GDSGDP	0.961 (1.166)	
EXGR	0.726** (2.049)	
AID	0.256** (4.895)	
OCF	0.193** (2.118)	
FDI	0.172 (1.104)	
R2	80	35

Note : The numbers in parentheses are asymptotic t-statistics ;
** indicates significantly different from zero at 5% level.

All sources of funds have a positive impact on the growth rate, with flows to the public sector having the strongest effect. Table 5 reveals a number of interesting observations, for example,

(a) The overall performance of the FDI determinants equation are quite satisfactory with a computed F-value of 21.09 which far exceeded the critical F-value at 5% significance level. All the coefficients are correctly signed and three of them are statistically different from zero. The fact that the coefficient of GDPGR is statistically significant confirms the existence of simultaneity problem. Both the market size and the growth hypotheses are supported by the study. The significant negative correlation between FDI and TB indicates that a deterioration of the trade balance does, as expected, lead a country to adopting more liberal policies toward FDI.

High and unpredictable inflation, a proxy for macroeconomic instability, distorts the information content of the market prices and the incentive structure. As the results above, this impacted negatively on FDI.

(b) As expected, FDI impacts on growth positively though the coefficient is insignificant. The importance of the export variable reaffirms the findings of most researchers (see, for example, Ram, 1985).

(c) The estimation results suggest that foreign AID and other capital inflows (OCF) significantly influenced growth through public sector investment in Uganda over the period 1981-1995. For, example, foreign aid resulted in an increase growth by approximately 25.6% which was statistically significant (with t-value of 4.895).

In conclusion, it can be argued that foreign aid has promoted FDI through its effects on public sector investment between 1981-1995. These results are consistent with what is being observed on the ground with a number of foreign firms springing up in and around major towns especially Kampala, Jinja and Mbarara.

While thes empirical results based on a small sample suggest that foreign AID and other capital inflows have had a positive effect on FDI through their effects on public sector investment in the short-run, a developing country like Uganda must also be concerned with the long-run sustainability of the macroeconomic stability and external debt.

IX Policy considerations

Policies that are conducive to sustained growth and macro-economic stability are essential elements of an enabling investment environment. They are as important to foreign investors as they are to domestic ones, as they determine risks and profitability of investment. During the last decade, Uganda pursued more liberal policies on trade and investment and other market-oriented reforms in the context of structural adjustment programmes. Although the full impact of these measures may take time to materialize, they would eventually lead to increased competitiveness and efficiency.

No doubt, foreign investors can and have a major role to play in the country's economic development. They should therefore be encouraged and facilitated.

The general message from our survey and empirical findings is that, from the view point of attracting investment, the macroeconomic and political stability and policy consistency are much more important than the level of the incentives themselves. This view has important consequences for the macroeconomic policy-making and for the design of reform programs to promote investment.

From the macroeconomic viewpoint, the key policy implication is that to encourage the investment response to incentive schemes, macroeconomic stability and investor confidence in the sustainability of the policy framework are essential. Thus, the government must correct the unsustainable macroeconomic imbalances - such as large public deficits - because they are a primary cause of macroeconomic instability and uncertainty about future policies. Institutional reforms to ensure policy predictability, effective property rights, and stability of the basic 'rules of the game' can contribute significantly to the investment response.

Uganda's courageous and sustained policy changes have allowed considerable progress toward macroeconomic balance and a market-based incentive structure. While private investment has recovered dramatically over the last five years, it has concentrated in the manufacturing and service sectors. The private investment response in agriculture has so far been disappointing and poses a great challenge. The World Bank has been instrumental in identifying and addressing key constraints to private sector activities, as well as a large lending program of financial support and technical assistance.

Uganda's stabilization effort was embodied in an economic recovery program that induced liberalization of the foreign exchange market, dismantling of price and distribution controls, and fiscal policy reform eliminating subsidies, improving tax collection, and redirecting spending to improve operations and maintenance and privatization of public enterprises.

The establishment of UIA addresses, in particular: (i) business establishment and investment licensing procedures; (ii) commercial legal framework; (iii) Technology transfers and investment promotion; and (iv) improvements in access to crucial economic information.

Efficient private sector-led growth requires some combination of increased private investment, enhanced productivity of private firms, and competition. The presence of a thriving business community creates a supportive environment for FDI and provides an efficient network of local suppliers and service firms. It cold also be a source for potential partners in joint ventures, which could facilitate access to local administration and supporting services. Joint ventures are an efficient mechanism for effecting technology and skill transfers and for developing stronger linkages with the domestic economy.

The setting up of the Private Sector Foundation in 1996 is a welcome development. The objectives of the Foundation are: (i) help improve the business and investment environment by decreasing policy constraints to private sector development; (ii) strengthen institutional support to the private sector; (iii) enhance dialogue between the private sector and the Government on policies and regulations which affect private investment; and (iv) alleviate problems associated with inadequate know-how and the weak financial system.

In order to create an environment that is more conducive to increased flows of FDI, government has to continue the efforts aimed at policy liberalization and introduce new measures and mechanisms to attract and accelerate the flow of FDI. We suggest below policy options, which may be additional to measures already in place, that merit special considerations by policy makers in government.

All policy recommendations must be aimed at fulfilling a balance between investment promotion, administrative simplicity and revenue generation. Each pressure group has different intentions. For example, as was pointed out earlier, some international donors and URA tend focus on revenue generation without considering the ramifications on the investment facilitation. The key is to filter the good intentions of each group and propose a reform package that is based on the limited capacity of the government, the desperate need for optimizing revenue generation and yet still fulfill the ultimate goal of increasing FDI flows.

General policies for enhancing an enabling investment environment and increasing FDI inflows

PO1 : Change in general attitudes towards work ethics and debureaucratization

There is an urgent need to reorient the attitude of workers especially government officials to the new and changing environment. Their role should be to facilitate and to nurture private investment.

The politicians, civil servants, custom officers, opposition politicians, and people generally in the country must encourage foreign investors. There should be no bias causing anti-foreign attitudes resulting into locals hating or fearing investors.

Government and donors should organize seminars to educate civil servants on their new role. Further, for civil servants to serve the investors better, steps must be taken to improve their terms of service. Present terms make civil servants susceptible to corruption. Therefore, rationalization of these terms will not only help reduce or stem corruption, but will also improve their productivity.

To encounter the red tape issue, government should vigorously continue the efforts aimed at the deregulation and debureaucratization in the licensing and approval process, customs, clearing offices, etc. to reduce unnecessarily high costs to the economy.

PO2 : Government to improve the risk rating

By 1992, not only Africa was rated as the most risky region, but Uganda was rated as the riskiest of the 25 African countries covered by Institutional Investor.

However for the past three years (1994-96), Uganda's risk rating has improved by 2.5 points per annum (Collier, 1996). Even with this recovery, Uganda's risk rating places it near the bottom despite its reforms and its growth rate which place it at the top of the African league table.

Therefore, either unilaterally or through bilateral treaties, the government need to offer some assurances designed to reduce the likelihood of expropriation or impairment of investors' rights and to insure investors adequate recourse if such impairments should occur. Along with guarantees against risk and measures for the arbitration of investment disputes, such as by the World Bank's International Centre for Settlement of Investment Disputes, and the Multilateral Investment Guarantee Agency, considerable attention should be given to compensation for any loss suffered from other than normal business causes. This will help to minimize the investors' risk and give some advance assurance of a reliable safety margin. Typically, some capital-supplying nations have provided insurance coverage such as the United States' Overseas Private Investment Corporation (OPIC). OPIC can offer up to 90 percent coverage for three types of risk: inconvertibility of assets; war, revolution, or insurrection; and expropriation.

PO3 : Government policy credibility: clear policy guidelines, consistency and transparency

Several studies indicate the importance of a stable macroeconomic environment for investment. An update of the Adjustment in Africa study by the World Bank (1995) shows that two thirds of the countries that improved their macro policies (fiscal, monetary and exchange rate policies) also experienced an improvement in domestic investment performance, while in the group of countries that experienced a deterioration in macro performance, only one of the countries experienced an increase in investment.

So far the government macroeconomic policy has been consistent. Fiscal discipline, heeding the advice of the international donors, and implementation of major reforms have been instituted consistently and have been predictable. Proof of this is the low and stable inflation rate, market-based exchange rate and the on-going privatisation exercise.

Despite the macroeconomic policy predictability[20], which is also guided by international donors, micro regulatory policies affecting FDI directly are of a 'stop-go' type and remain a serious impediment to investments in the country.

What the government must know is that such 'stop-go' inconsistent and unpredictable policies are harmful and tend to undermine the credibility of the government and taints the overall policy environment. The establishment of clear, accountable rules which are implemented consistently is fundamental in attracting FDI as well as minimizing government corruption.

Inconsistency of micro policies in Uganda stems from influences on decision-making processes of the various pressure and/or interest groups such as international donors, government agencies (eg. UIA, URA, etc.), private sector (eg. UMA, PSF, Importers and Exporters association), foreign investors and politicians. These groups have different and sometimes contradicting interests. For example, URA is funded to increase revenue while UIA is to promote investment through tax incentives.
Finally, the other important item of a functional positive policy environment is transparency. Land allocation, license acquisition, tax payments and related activities are all riddled with superfluous complexities. These difficulties can be minimized through a simple measure of publicising the necessary procedures and regulations. Establishing clear, accountable rules which are implemented consistently are fundamental in attracting FDI as well as minimising bureaucratic red tape and accompanying administrative costs. More importantly, the simplification of the procedures will eliminate many of the opportunities for corruption arising out of a policy environment where the rules are vaguely established and interpreted.

PO4 : Infrastructure and local capacity building

The incentives available to investors are mainly of a fiscal nature and are short in the areas of financial and other infrastructural services incentives where many other developing countries are

---

[20] Predictability should not be confused with conservation and unwillingness to change. Rather, the point is that frequent changes in the 'rules of the game' are inimical to individual risk-taking and innovations. New initiatives flourish best when public performance is not to volatile.

doing much better. This skewed position in favour of fiscal incentives cause the scheme to appear to possess a foreign and urban bias.

In view of the competing priorities which include social expenditure and maintenance of existing infrastructure, government is increasingly recognizing the role and potential of the private sector in providing infrastructural services as opposed to the traditional approach where the public sector has been largely responsible.[21] For example, among the countries that have tried to attract private investors to finance and operate infrastructure facilities are the Philippines and India.

Reforms to improve the efficiency and provision of infrastructure can include privatization or contracting out which reduce both excessive government involvement in production and weak infrastructural support. The burden of poorly functioning infrastructure - and thus the benefit of reform - falls unevenly across different types of investors depending on their financial ability to undertake remedial capital expenditure.[22]
Utility providers especially the Uganda Electricity Board (UEB) should organize their internal operations to reduce service installation time and costs and improve on the quality of their services.

Besides modern infrastructure, an increasingly important factor in attracting FDI is the availability of low-wage but good technical and skills base.

The ability to compete internationally in the new global economy requires a level of productivity and managerial and technical skills that is presently lacking in Uganda. A policy to build human capital should also aim to develop a broad array of technical, managerial, and scientific skills needed to sustain rapid growth.

There is therefore a great need for mid-level technical and supervisory skills in Uganda. Government should consider removing constraints on the employment of expatriates where such constraints reduce the overall capacity of investors to operate efficiently. This may involve a greater willingness to grant work permits to foreigners where it is clear that no appropriately qualified Ugandans are available for particular positions, and the introduction of incentive measures to attract highly skilled foreigners. At the same time, more business training centres should be established to improve local capacity and create practical skills in areas such as manufacturing, industry and banking.

Finally, the skills and capital of overseas Ugandans and capital held abroad by resident citizens are an important resource that should be considered in efforts to build local skills and technology

---

21 See the Workshop Proceedings on 'Policy aspects of promoting and implementing FDI in infrastructure in Eastern and Southern Africa' organized by the Foreign Investment Advisory Services, a joint service of International Finance Corporation and the World Bank. The Workshop was held on 28 March 1996 at Windsor Lake Victoria Hotel, Entebbe.

22 The provision of power through the public, centralized grid is so inefficient that private firms are forced to turn to the second-best solution of providing power in-house. All large investors surveyed had its own stand-by electric generator. The average cost of power production for these investors are much higher than in countries where it is efficiently supplied, but the cost is unevenly distributed, and the unit cost of power generated is much higher for the smaller investors. In fact, for some very small firms, the cost of inhouse power generation is prohibitive and their operations suffer accordingly.

capability. Ugandans who live and/or have funds abroad are able to make comparative assessments of the investment climate in Uganda and overseas. Unless pure sentiment drives their economic decisions, skilled Ugandans or their capital will not return in numbers unless government implement the kinds of measures that makes the investment climate attractive for all investors, including foreign investors. The return of flight capital would be fostered, for example, by permitting local banks to offer foreign currency-deposit facilities to nationals.

PO5 : Government must foster institutional building for private business activity

Building a sound financial system, a fair legal system and well-equipped money and capital markets are very important.

Financial institutions have not put in place specific credit schemes to address the financial requirements of investors. Most commercial banks have funds for short-term lending which is beneficial for traders and businesses which require funds for working capital. Moreover, the high interest rates charged by banks discourage investors from using borrowed capital.

The passing of the 1991 investment code was meant to signal in clearer terms than those of the existing law that private individuals or companies are welcome to invest in Uganda, to provide them with assurance about their treatment and to indicate the current priorities of the government with respect to investment issues. However, this is not sufficient. What is required is an overall legal infrastructure for private business activity - for local and foreign investors alike - consisting of laws providing for the formation of business activities, enforcement of contracts, private ownership and transfer of property, technology and industrial property protection, the assessment and payment of taxes, foreign exchange dealings and so on.

The provision of a strong framework of laws defining property rights, regulating the enforcement of contracts, assuring effective competition, establishing bankruptcy procedures, and building an independent judicial system for the fair and timely adjudication of claims. The establishment of Tax **Appeals Court** would provide a means of neutral arbitration and thus help alleviate the fear investors have developed under an unaccountable tax administration.

Specific policies related to investment incentives

Fiscal, financial and other incentives remain an important part of Uganda's investment promotion packages. While their effects on stimulating new investments are difficult to measure, they nevertheless represent important costs to the domestic economy.

PO6 : Harmonize policies on investments by enlarging the membership of and empowering UIA to become a true `one-stop shop'

Government needs to harmonize and institutionalize the decision making process and relieve the over-dependency on the President or the Finance Minister.

In this respect, UIA should be made a true 'one-stop shop' and should include other relevant bodies like URA, National Bureau of Standards (NBS), National Environmental Management

Authority (NEMA), line ministries in a streamlined institutional decision-making body for investment approvals.

Unless this is done, the new investment code concerning foreign investors can be contradicted or undermined by other existing laws, for example, tax regulations, labour laws, environmental protection, etc. Often, the implementation of the investment code is vested in the Uganda Investment Authority, while the implementation of other laws remains vested in the traditional ministries. The result is that the extent to which a foreign investor stays under the purview of the investment code and is 'excused' from otherwise applicable but conflicting legislation, largely depends on how powerful each individual agency or ministry is perceived to be in the national decision-making process of the day and whether the most powerful agencies are in favour of the proposed investment.

As a result, many investors develop an impression that the arrangements for investments are less than transparent and that some form of 'extra effort' is required if projects are to be finalized. Where such efforts can be construed as illicit payments, many foreign investors would be deterred from investing so as not to transgress anti-corruption laws in their own countries. In US, for example, illicit payments are illegal under the Foreign Corrupt Practices Act, passed in 1978, and companies can be fined up to $2 million for transgressing the Act.

PO7: Provision of after-investment services to established investors

Government can benefit from a positive image given by investors already established in Uganda. They are the natural candidates to play a key role as a source of FDI for Uganda, including through reinvested earnings, and to provide positive demonstration effect for potential new investors. At the moment, they are, however, frequently those that have benefitted least from the new investment regimes. Incentives are often targeted only at new investors. Such policies need to be reviewed. In this respect, consideration should also be given to the provision of various after-investment services aimed at reducing the 'hassle costs of doing business' to established investors, analogous to the marketing concept of 'after-sales service'.

PO8: "Front-loaded" tax holidays be abolished altogether

Tax holidays or reduced rates on taxable income are effective, of course, only when the investment yields substantial taxable profits. Moreover, the foreign investor in a newly developing country is less interested in receiving an exemption after a profit is made than he is in being sure of a profit in the first instance. Measures that enable a company to earn a profit are more encouraging than the granting of exemptions after a profit is made.

The current over-generous, untargeted incentives represent unnecessarily lost revenue, distortions in the domestic economy and are not proven to be effective in attracting FDI.

Kibikyo's (1996) survey of 32 firms benefitting from tax incentives in Uganda showed that tax incentives are ineffective and inefficient way of attracting FDI24. Only 6 firms believed that the incentives are of some use, the rest think otherwise. See also other studies such as Dixson, 1967; Billerbeck and Yasugi, 1974; Anwar and Shariff, 1974; Bond, 1981.

Moreover, the result of tax competition among developing countries is that all offer essentially the same package. Hence, the main impact of these incentive schemes is a loss in government revenues.

Besides the tax revenue foregone as a result of exemptions may afterall be taxed away by the investor's home country - that is, a transfer of tax revenue from Uganda to those countries as shown in Table 6.25

Table 6: Overall effective tax rates (in percentages) for institutional investors : Selected OECD countries

Country	Domestic Investment	Investment Abroad	Foreign Investment
Australia	11.8	27.0	33.9
Canada	19.3	33.3	40.5
France	8.2	24.2	36.7
Germany	9.9	36.7	21.9
Italy	14.8	41.9	30.6
Japan	21.5	37.5	38.3
UK	15.6	25.4	25.6
USA	13.9	29.6	33.3
OECD average	**15.3**	**33.3**	**33.3**

Source: OECD database

Moreover, among the sectors receiving incentives, services and trade which contribute much lower revenue than manufacturing has the greatest share. This has negative effect on the manufacturing sectors - competition over the markets with imported goods.

Furthermore, a recent 1995 USAID report evaluating investment attraction programmes in developing countries concluded that tax exemptions have a negligible impact on investments targeting the domestic market but are essential for export-oriented FDI. These findings tend to explain the fact that virtually all the foreign investors operating in Uganda are targeting the domestic market and do not find the incentive scheme to be critical.

We therefore recommend that tax exemptions should be abolished and instead replace them with a uniform but low tax rates. Lower uniform tax rates will also eliminate the arbitrary tax exemptions by UIA to different companies leading to favouritism and corruption in the scheme.

PO9: Consider promoting `back-loaded' incentive system where only willing and successful investors are rewarded

Sometimes obligations are imposed on investors concerning their operations after establishment of the business. Foreign investors may, for example, be required to create and maintain a certain number and type of jobs or to achieve export targets. A common requirement concerns limitation on the employment of foreign managerial and technical personnel. Such requirements are often linked to the grant of incentives at the time of the investment approval.

X Concluding remarks

Uganda has undertaken many efforts during the past few years to increase its attractiveness to investors and thus enhance its own growth prospects. These efforts have included, at the macroeconomic level, wide-reaching domestic economic policy reforms and, at the level of the FDI regulatory framework, the liberalization of existing frameworks or the adoption of new ones, creating investment vehicle (UIA), the simplification of administrative procedures applicable to foreign investors, the conclusion of bilateral investment protection and promotion treaties and accession to various multilateral treaties facilitating FDI flows.

All these efforts have led to a recognizable improvement of investment conditions in Uganda, although more can and needs to be done to exploit the investment opportunities that exist in Uganda. In this respect government can do this, for instance by,

- Creating a climate favourable to investment which requires establishing a partnership between the government and the private sector on the basis of greater transparency in public administration and strong intermediate organizations such as chambers of commerce, business councils, professionals and associations. that can engage the state in a regular dialogue. The state has a critical role to play; but government need to encourage, stimulate, regulate, and complement the private sector, rather than compete with it or attempt to displace, discourage, and exploit it.

- Maintaining economic and political stability, as a general precondition for increased FDI, and to intensify regional cooperation. With greater regional integration, each individual country would have an increased market for particular goods.

- Recognizing that Uganda's medium to long-term investment potential and its comparative advantage is not in its modest manufacturing sector but in food production, agro processing, tourism and power supplies.

What we have to realize is that there is no pool of investors with Uganda in mind just waiting to be lured into the country. There is Eastern Europe, Asia, Latin America and other African countries also competing for the same investors.

We also have to bear in mind that foreign investment cannot entirely be the engine of growth, and cannot be the solution to our country's shortfall in capital needed for investment. It will only contribute but other sources must also be tapped. It cannot substitute the need for domestic savings. Singapore, with the largest amount of FDI in Asia (as a percentage of total capital), also has one of the highest saving rates in the world.

Overall, Uganda has done a remarkable job in attracting FDI given the obstacles of history, context and inherent impediments. A continued process of foreign investment liberalisation is thus necessary to realize the full potential of foreign investment and allow foreign investment to complement local effort in accelerating the country's development. The hope is a promising one as the restoration continues.

XI. Areas of further research

One line of research can look at whether or not foreign firms have any 'spillovers' such as promoting technology transfers; improving productivity through joint ventureship with local counterparts; whether foreign firms push up wages for local workers; whether foreign firms act as export catalysts by helping domestic firms to break into export markets; etc. Furthermore, to assess the validity of the 'pollution haven hypothesis', that is, that foreign investors flock to developing countries like Uganda to take advantage of lax environmental standards.

Another line of research is the relationship between FDI and local private investment. How do different elements of the local business community feel about foreign investment? Does FDI act as a catalyst for the local private investment or is it the other way round ? What are the linkages, if any, between FDI and local private investment and how do they work ?

These questions are important in the Ugandan case since the government tends to be more enthusiastic and attentive to foreign investors than to local investors. Answers to these questions can help government in formulating policies that will enhance the linkages between local and foreign firms.

A third line of research can assess the effectiveness of the microeconomic policies specifically designed to promote private investment, both local and foreign. Alternative investment policies have different consequences that can be analysed in terms of an 'allocation effect', a 'distribution effect', and a 'balance of payments effect'. For example, Fry (1983) finds that policies designed to deliberately stimulate FDI may simply encourage round-trip capital flows from the host country thus reducing national savings. In a survey of the incentive systems in nine Asian countries, Chen (1994) finds that competition for FDI through special incentive schemes may actually be more harmful than beneficial. For example, one study of Thailand shows that 70 percent of all projects that received fiscal incentives such as tax holidays would have proceeded without the tax incentives. Moreover, the result of tax competition among these nine countries is that all offer essentially the same package. Hence, the main impact of these incentive schemes is a loss in government revenues.

In a series of studies by the OECD, it was found that investment incentives play little role in determining whether or not to undertake the investment, or the timing and form of such an investment but did play a role in choosing the location of the investment.

Appendix A

Table A1: FDI inflows, value and as percentage of GDP, by host country, 1981-1985, 1986-1990 and 1991-1993

Host country	Value, millions of dollars			Percentage of GDP		
	1981-1985	1986-1990	1991-1993	1981-1985	1986-1990	1991-1993
Africa	1697.2	2828.20	3005.30	0.53	0.89	0.89
Least developed countries of Africa	231.6	507.50	665.70	0.36	0.71	0.95
Côte d'Ivoire	33.7	52.00	62.80	0.46	0.53	0.65
Chad	12.6	11.30	2.80	1.99	1.17	0.22
Liberia	2.8	238.70	9.30	1.90	20.56	0.78
Namibia	3.3	7.00	75.80	0.20	0.37	3.10
Botswana	49.8	60.90	39.90	4.52	2.77	1.05
Ethiopia	1	0.40	4.30	-0.02	0.0	0.09
Gambia	-0.1	3.10	7.30	-0.03	1.14	2.32
Ghana	8.5	8.80	20.50	0.20	0.16	0.31
Nigeria	400.3	723.30	780.40	0.50	2.16	2.35
Rwanda	15.9	15.90	3.90	1.05	0.72	0.25
Burundi	3.3	1.20	0.70	0.32	0.11	0.06
Sudan	5.9	-3.30	-0.20	0.7	0.03	0.00
Uganda	**-0.4**	**-0.60**	**2.50**	**-0.02**	**-0.02**	**0.07**
Kenya	15.9	39.00	8.90	0.25	0.48	0.12
Tanzania	8.7	-0.30	11.60	0.15	-0.01	0.44
Zambia	19.2	11.50	97.20	0.59	36.5	2.99
Malawi	8.6	14.40	7.90	0.72	1.01	0.39
Zimbabwe	0.2	-12.70	15.30	-	-0.2	0.26

Table A2: Determinants of FDI, by host country, 1991-1993

Host country	Total GDP (bill. $) Annual average 1991-1993	GDP per capita (dollar) 1993	GDP growth rates percent Annual average 1991-1993	Share of commodities in total exports early 1990	FDI (dollars) annual average 1991-1993
Average for Africa	6.7	523.0	0.8	72.0	8.9
Côte d'Ivoire	9.6	698.3	-0.6	32.9	6.5
Chad	1.3	199.2	1.2	46.2	2.2
Liberia	1.2	419.7	-	65.2	7.8
Namibia	2.4	1,716.6	3.8	-	31.0
Botswana	3.8	2,865.8	4.6	-	10.5
Ethiopia	4.9	64.8	-1.1	19.7	0.9

Host country	Total GDP (bill. $) Annual average 1991-1993	GDP per capita (dollar) 1993	GDP growth rates percent Annual average 1991-1993	Share of commodities in total exports early 1990	FDI (dollars) annual average 1991-1993
Gambia	0.3	245.7	2.6	0.5	23.2
Ghana	6.7	369.9	4.5	35.6	3.1
Nigeria	33.2	331.8	4.1	95.7	23.5
Rwanda	1.6	205.4	1.3	11.5	2.5
Burundi	1.1	94.5	2.3	42.4	0.6
Sudan	6.4	224.8	4.9	56.3	0.0
Uganda	**3.3**	**202.0**	**4.2**	**9.1**	**0.7**
Kenya	7.2	211.0	0.5	23.3	1.2
Zambia	3.6	356.1	0.7	84.9	29.9
Malawi	2.0	192.7	1.1	3.1	3.9
Zimbabwe	5.9	518.4	-1.3	21.3	2.6

Table A3: Share of FDI in gross domestic investment, by host country, 1981-1985, 1986-1990, 1991-1993

Country	1981-1985	1986-1990	1991-1993
Africa	2.33	3.50	4.50
Least developed countries of Africa	2.48	4.47	5.78
Côte d'Ivoire	2.31	4.84	6.31
Chad	23.95	10.64	2.28
Liberia	10.89	220.62	9.41
Namibia	1.98	2.50	27.69
Botswana	16.07	10.60	2.98
Ethipia	0.17	0.05	0.78
Gambia	-0.15	72.29	12.19
Ghana	2.42	1.43	2.31
Nigeria	3.64	23.73	19.89
Rwanda	6.67	4.93	1.58
Burundi	1.97	0.68	0.33
Sudan	5.1	-0.25	-0.02
Uganda	**-0.19**	**-0.18**	**0.80**
Kenya	10.6	2.42	0.71
Tanzania	2.54	-0.08	2.55
Zambia	3.59	39.14	30.97
Malawi	3.4	6.78	2.67
Zimbabwe	0.02	-1.22	1.19

Table 4A: **External financial flows related to FDI, by host country, 1981-1985, 1986-1990, 1991-1993 (Annual averages, millions of dollars)**

Country	1981-1985	1986-1990	1991-1993
Africa			
A FDI inflows	1679.5	2810.6	2782.8
B. Profit remittances	-3157.0	-2146.3	-1722.6
C. Net transfers	-1477.5	664.4	1060.2
Least developed countries of Africa			
A. FDI inflows			
B. Profit remittances	215.2	489.2	572.6
C. Net transfer	-215.5	-320.7	-423.2
	-0.3	168.5	149.4
Côte d'Ivoire			
A. FDI inflows	215.2	489.2	572.6
B. Profit remittances	215.5	-320.7	-423.2
C. Net transfers	-0.3	168.5	149.4
Liberia			
A. FDI inflows	20.8	238.7	9.2
B. Profit remittances	-0.3	--	--
C. Net transfers	20.5	--	--
Namibia			
A FDI inflows	--	7.0	80.6
B. Profit remittances	--	--	-56.0
C. Net transfers	--	--	24.6
Botswana			
A FDI inflows	49.8	60.9	39.7
B. Profit remittances	-137.2	-248.2	--
C. Net transfers	-87.4	-187.3	--
Ghana			
A FDI inflows	8.5	8.8	21.3
B. Profit remittances	-1.7	-5.8	-8.5
C. Net transfers	6.8	3.0	12.8
Nigeria			
A FDI inflows	400.3	723.3	804.5
B. Profit remittances	-542.4	-308.0	-151.0
C. Net transfers	-142.1	415.3	653.5
Rwanda			
A FDI inflows	15.9	15.9	4.6
B. Profit remittances	-1.7	-1.7	-1.8
C. Net transfers	14.2	14.2	2.8
Uganda			
A FDI inflows	--	--	--
B. Profit remittances	--	--	--
C. Net transfers	--	--	--
Kenya			
A FDI inflows	15.9	39.0	9.1
B. Profit remittances	-71.5	-50.3	-94.2
C. Net transfers	-55.6	-11.2	-85.1
Tanzania			
A FDI inflows	8.8	-0.3	11.6
B. Profit remittances	--	-23.1	--
C. Net transfers	--	-23.1	--
Zambia			
A FDI inflows	19.2	112.5	34.3
B. Profit remittances	-18.2	-17.8	-8.0
C. Net transfers	1.0	94.7	26.3

Country	1981-1985	1986-1990	1991-1993
Malawi			
A FDI inflows	7.6	13.1	7.8
B. Profit remittances	-13.7	-6.1	--
C. Net transfers	-6.0	7.0	--
Zimbabwe			
A FDI inflows	0.2	12.7	15.3
B. Profit remittances	-69.1	-68.6	-68.6
C. Net transfers	-69.1	-81.3	-53.3

Sources : *UNCTAD Division on Transnational Corporations and Investment, based on International Monetary Fund : estimates of the Organization for Economic Cooperation and Development; national sources, and UNCTAD databank.*

Notes : Least developed countries of Africa include: Angola, Benin, Burkina Faso, Burundi, Cape Verde, Central African Republic, Chad, Comoros, Djibouti, Equatorial Guinea, Eritea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Uganda, Zaire and Zambia.

Appendix B

Table IB: Comparison of investment incentives for selected Eastern and Southern African countries

	Uganda	kenya	Mauritius	Zambia	Zimbabwe	S.Africa	Remarks on Uganda
Exemption Import Duty & Sales Tax	Machinery & Equipement		Machinery	Imported Machinery	Imported Machinery	Low rates Appx. 5%	Zero rated
Exemption Corporate tax & withholding	3-6 years			Low rate 15% farming exports on non traditional products			A low rate saw 10% for 10-15 years preferable.
Depreciation allowance	100% outside k'la, Jinja-Entebbe						Accelerate depreciation
Capital allowance		85% outside Nrb-Mbs 100% EPZ		10-20%		20% p.a. for machinery	
Training grant/allowance				Tax deductible	Training for employees deductible	levels	At priority sub-sector
Factory bldgs. & Serviced land			Available			Available	Specific incentives and promotional techniques
Export incentive scheme						14% FOB value product exported	Require refinement and Action Programme
Export Marketing Assistance					Exhibition and market research costs	Feasibility be considered	

	Uganda	Kenya	Mauritius	Zambia	Zimbabwe	S. Africa	Remarks on Uganda
Export Loan Programme					Soft loans offered Low rates for SME's on capital items	Loans at 9%	At priority Sub-sector levels
Establishment						Expansion of existing cap. 10.5% cost of operational assets 50% of stocks (2 month's sales)	At priority Sub-sector level
Export of Capital Good						Allowed write-off for tax 100% of outstanding debts	
Relocation allowance						R.1 million transport costs	Policy required
Depreciation allowance						Exp. of capital nature deductible over 4 yrs	Area of immediate focus
Research & Development				Available			
Duty Drawback Scheme	Imported raw materials				Imported raw materials		Operationalise scheme

	Uganda	Kenya	Mauritius	Zambia	Zimbabwe	S. Africa	Remarks on Uganda
					50% of cost on bldgs. & equipement deductible		Areas of study
Growth point areas					-Mining districts companies taxed 10% for 5 yrs. -15% cost of bldgs & equipment not taxed. -Sale tax on capital goods refunded.		Need be identified as part of setting priorities
Export Processing Zones		-No Corporate tax for 10 yrs then at 25% -No withholding tax -Exempt custom duties, VAT on plant, machinery & raw materials	Available		-5yr tax holiday and then 15% -Exemption from withholding taxes -Raw materials/capital goods imported duty free		Concept to operationalised looking at serviced land, estates, rural production zones.
Export retention scheme	100%				100%		

Source : UIA - A background paper prepared for the taskforce for the formulation of private sector national strategy and programme of action.

Appendix C

Table C1

	Frequency	Percent
Kampala	41	67.3
Masindi	1	1.6
Mpigi	2	3.2
Toroto	3	4.9
Jinja	4	6.6
Iganga	1	1.6
Kasese	2	3.2
Mbarara	7	11.5
Total	61	100.0

Table C2 : Country of origin of investor

	Frequency	Percent
Africa	29	47.5
Britain	14	23.0
Other european country	5	8.2
Other countries	3	4.9
Not applicable	10	16.4
Total	61	100.0

Table C3 : Point of first contact

	Frequency	Percent
Local business people	5	8.0
Foreign investors in Uganda	2	3.4
Well establisèd persons	7	11.5
Presidential mission abroad	5	8.0
UIA	7	11.5
Not applicable	35	57.4
Total	61	100.0

Table C4 : Do you benefit from any UIA incentives ?

	Frequency	Percent
Yes	54	88.5
No	7	11.5
Total	61	100.0

Table C5: Main market of your product(s)

	Frequency	Percent
Domestic	54	8.8
East Africa	2	3.3
Europe	3	4.9
Others	2	3.3
Total	61	100.0

Table C6: Do you have problems in securing raw materials/inputs ?

	Frequency	Percent
Yes	27	44.4
no	24	39.3
non response	10	16.3
Total	61	100.0

Table C7: What do think of future economic outlook ?

	Frequency	Percent
Development	53	86.8
Decline	6	9.9
Uncertain	2	3.3
Total	61	100.0

Table C8: Which government agencies causes greatest difficulties ?

	Frequency	Percent
URA	34	56.0
Customs department	5	8.2
UEB	10	16.4
UPTC	6	9.8
Ministry of trade an	2	3.3
Ministry of lands	2	3.3
non response	2	3.3
Total	61	100

Table C9: Main motivating factor for coming to invest in Uganda

	RANK		
Enabling environment, that is, generally favourable economic conditions and political climate	25	41.0	1
Availability of specific resources	6	9.8	4
Promotion/incentives offered by the Uganda government	10	16.4	2
Promotion/incentives offered by the home country	1	1.6	8
Previous trad relations with Uganda	7	11.5	3
Long established personal/family relations	3	4.9	6
Favourable information from press/other investors	2	3.2	7
My competitors made similar move first	0	0.0	9
Cost of labour	4	6.6	5
Size of market	4		

Table C10: Most important incentive

MOST IMPORTANT INCENTIVE	FREQUENCY	PERCENTAGE	RANK
Duty exemption/rebate on plant, machinery and construction materials	19	31.1	1
Duty exemption/rebate on industrial inputs	11	18.0	2
Tariff protection	7	11.5	3
Corporate tax holidays	19	31.1	1
Ease of remittances of dividends and profits	4	6.6	4
Privileged access to local credit	1	1.6	5

Table C11: Main sector of activity

SECTOR	FREQUENCY	PERCENTAGE	RANK
Agriculture and forestr	7	11.5	3
Fishing	2	3.3	4
Manufacturing	42	68.9	1
Construction	2	3.3	4
Trade and restaurants	8	13.	

Table C12: Main factor considered in making investment decisions

MAIN FACTOR CONSIDERED	FREQUENCY	PERCENT	RANK
Profitability in the sector of operation	35	57.4	1
Incentives packages offered by government	13	21.3	3
Access and reliability to basic utilities, e.g. water, electricity, phones, etc.	9	14.8	4
Local contribution to the project	6	9.8	4
Intellectual property protection	4	6.6	5
Returns to your investments	13	21.3	3
Ease of remittance of dividends and profits	4	6.6	5
Cheap labour	1	1.6	6
Political stability and enabling economic environment	14	23.0	2

Table C13: Main contribution of your investment to Uganda

MAIN CONTRIBUTIONS	FREQUENCY	PERCENTAGE	RANK
Taxes/fees paid to the treasury	23	37.7	1
Providing employment to Ugandans	16	26.2	2
Net increase in investment (Capital formation)	6	9.8	4
Net increase in exports (foreign currency savings)	2	3.3	6
Import substitution ability (foreign currency savings)	10	16.4	3
Transfer of new technology and managerial skills	4	6.6	5

Table C14: Main problems in operating business

PROBLEM	FREQUENCY	PERCENTAGE	RANK
Problems with basic infrastructure e.g. water,electricity, telephone, etc.	13	21.3	1
Availability and/or cost of raw materials and other inputs	8	13.1	3
Problems with financing	9	14.8	2
Problems with distribution network(transport)	5	8.2	6
Restrictive government regulations	4	6.6	6
Cost and/or quality of labour	3	4.9	7
Market conditions (level of demand, competition)	5	8.2	5
Problems to get land/industrial space	3	4.9	7
Taxes on raw materials finished products	2	3.3	9
Competition from imported similar products	6	9.8	4
Intellectual property protection is too weak	3	4.9	8

Table C15: Main problem relating to recruitment/management of labour

LABOUR RECRUITMENT MANAGEMENT PROBLEMS	FREQUENCY	PERCENTAGE	RANK
Lack of middle management/technicians	19	31.1	2
Lack of skilled labour	13	21.3	3
High wage demand coupled with poor work culture leading to low productivity	21	34.4	1
Can't lay off or fire workers	3	4.9	4
Trade union restrictions	2	3.3	5
Regulations governing expatriate personnel	3	4.9	4

Table C16: Main recent investment initiative

MAIN RECENT INVESTMENT INITIATIVE	FREQUENCY	PERCENTAGE	RANK
Launch of new activity/product	22	36.1	1
Expansion of existing operations	17	27.9	2
Improvement of the effectiveness of existing operations	15	24.6	3
Simple replacement of existing equipment with minor improvements	7	11.5	4

Table C17: Sources of finances

SOURCES OF FINANCING	FREQUENCY	PERCENTAGE	RANK
New equity from foreign parent company	12	19.7	2
New equity from Ugandan private/public company	7	11.5	3
Loan from foreign parent company	12	19.7	2
Loan from Ugandan banks	13	21.3	1
Loan from foreign banks	7	11.5	3
Supplier credit	5	8.2	4
Others	5	8.2	4

Table C18: Main problem in securing raw materials/inputs

IF YES, MAIN PROBLEMS	FREQUENCY	PERCENTAGE	RANK
Poor quality	11	18.0	3
Prices are not competitive	9	14.8	4
Supply is not reliable	18	29.5	1
Local suppliers are too few or non existent	15	24.6	2
others	8	13.1	5

Table C19: Perception of sources of non-commercial risks

PERCEPTION OF SOURCES OF NON - COMMERCIAL RISKS	FREQUENCY	PERCENTAGE	RANK
Expropriation	3	4.9	5
War or civil disturbance	11	18.0	2
Unpredictable political climate	4	6.6	4
Failure to respect contractual obligations by government	10	16.4	3
Reversal of policies/incentives granted by government	33	54.1	1

Table C20 Main future plan of operation

FUTURE PLAN OF OPERATIONS	FREQUENCY	PERCENTAGE	RANK
Maintain operation at current level	5	8.2	5
Expand operation	44	72.1	1
Introduce a new product	18	29.5	2
Invest in new equipment	15	24.6	3
Improve workers' technical training	15	24.6	3
Improve management skills	9	14.8	4

Table C21: main problem in dealing with government agencies

PROBLEM IN DEALING WITH GOVERNMENT AGENCIES	FREQUENCY	PERCENTAGE	RANK
Failure to respect contractual obligations	5	8.2	5
Legislative insecurity, including increases in taxation after a project has been implemented	18	29.5	2
Corruption resulting from red tape and a multitude of authorizations required to do business	26	42.6	1
Excessive legalism and lack of precision in legal texts	3	4.9	6
slow and arbitrary decision taking	18	29.5	2
incompetent/rude officials	14	23.0	4
Others	2	3.3	6

Table C22: Main problem related to government regulations

PROBLEM RELATED TO GOVERNMENT REGULATIONS	FREQUENCY	PERCENTAGE	RANK
Import and export regulations	16	26.2	2
Tax related regulations	27	44.3	1
Licensing requirements and processing	2	3.3	5
Restrictions on employment of expatriate staff	6	9.8	3
Requirements to use local inputs o poor quality	3	4.9	4
ownership of land	6	9.8	3
The proportion of ownership open to foreign firms	1	1.6	6

Table C23: Current work force

LEVEL	UGANDANS FEMALE	UGANDANS MALE	NON UGANDANS FEMALE	NON UGANDANS MALE	TOTAL FEMALE	TOTAL MALE
MANAGEMENT	30	45	10	39	40	84
TECHNICAL	23	31	6	52	29	83
UNSKILLED	42	152	3	6	45	158
TOTAL	**95**	**128**	**23**	**87**	**211**	**325**

References

Agarwal, J. P. (1980) Determinants of foreign direct investment: *A survey, Weltwirtschaftliches Archiv*, Vol. 116, No. 4.

Ake, C. (1978) Revolutionary Pressures in Africa, London, Zed Press.

Anwar, S. and Slemrod, J. (1992) Taxation and foreign direct investment, in J. Khalilzadet-Shirazi and S. Anwar (eds.), *Tax Policy in Developing Countries*, World Bank, Washington, D.C.

Asante, Y. (1994) Industrial development co-ordinating committee (IDCC) and foreign private investment in Nigeria, Economic and Financial Review, Central Bank of Nigeria, Vol. 29, pp. 327-340.

Bernanke, B. (1983) Irreversibility, uncertainty and cyclical investment, *Quarterly Journal Of Economics*, Vol. 98, pp. 85-106.

Billberbeck, K and Yasugi, Y. (1979) Foreign Direct Investment in Developing Countries, World Bank Working Papers, Number 348.

Blejer, M. and Khan, M. (1984) Government policy and private investment in developing countries, IMF Staff Papers, Vol. 31, pp. 379-403.

Blomstrom, M. and Persson, H. (1983) Foreign investment and spillover efficiency in an underdeveloped economy: Evidence from the Mexican manufacturing industry, *World Development*, Vol. 11, 493-501.

Bond, E. (1981) Tax holidays and industry behaviour, *Economic and Statistical Review*, Vol. 63, Number 1, February.

Bond, E. and Larry, S. (1986) Tax holidays as signals, *American Economic Review*, Vol. 76, pp. 820-26.

Bornschier, V. (1980) Multinational corporations and economic growth: A cross national test of the decapitalization thesis, *Journal of Development Economics*, Vol. 7.

Calvo, G. A., Leiderman, L. and Reinhart, C. M. (1994) The capital inflows problem: Concepts and issues, Contemporary Economic Policy, Vol. 12, pp. 54-66.

Caves, R. (1982) *Multinational Enterprise and Economic Analysis*, Cambridge, Cambridge University Press.

Claessens, S. and Diwan I. (1990) Investment incentives: New money, debt relief and the critical role of conditionality in the debt crisis, *World Bank Economic Review*, Vol. 4, pp. 21-42.

Claessens, S. (1993) Alternative forms of external finance: A survey, *World bank Economic Review*, Vol. 8, pp. 91-117.

Cockcroft, L. and Riddel R. (1991) Foreign direct investment in Sub-Saharan Africa, Working Paper 619, International Economics Department, World Bank, Washington, DC.

Collier, P. (1996) A commentary on the Ugandan economy: July 1996. A paper prepared for the European Commission. Centre for the Study of African Economies, Oxford.

Dailami, M. (1990) Financial policy and corporate investment in imperfect capital markets: The case of Korea. Working Paper 248, The World bank, Country Economics Department, Washington, DC.

Dixon, S. R. (1967) Economic inducements to private foreign investment in Africa, *Journal of Development Studies*, Vol. 4, pp. 109-137.

Dunning, J. H. (1973) The determinants of international production, *Oxford Economic Papers*, Vol. 25.

Dunning, J. H. (ed.) (1980) *International Production and the Multinational Enterprises*, Oxford University Press, Oxford.

Edwards, S. (1990) Capital flows, foreign direct investment and debt equity swaps in developing countries.

Ekpo, A. H. (1994) Public expenditure and economic growth in Nigeria, 1960-1992, Final Report, AERC, Nairobi, Kenya.

Erunza, V. and Senbert, L. (1981) The effects of international operations on the market value of the firm, *Journal of Finance*, Vol. 26, pp. 410-17.

Fry, E. H. (1983) *The Politics of International Investment*, McGraw-Hill Book Company.

Green, J. and Villanueva, D. (1991) Private investment in developing countries: An empirical analysis, *IMF Staff Papers*, 38, pp. 33-58.

Gubitz, A. (1991) Impact of investment policies on German direct investment in developing countries: An empirical investigation, World Bank.

Guisinger, S. (1985) *Investment Incentives and Performance Requirements*, New York, Praeger.

Guisinger, S. (1986) Host country policies to attract and control foreign investment, in T. Moran (ed.), Investing in Development: *New Roles for Private* Capital, New Brunswick, Transaction Books.

Haddad, M. and Harrison, A. (1991) Are there dynamic externalities from direct foreign investment? Evidence of Morocco, Industry and Energy Department Working Paper, Industry Series Paper No. 48, The Work Bank, Washington, DC.

Hartley, P. (1986) Portfolio theory and foreign investment: The role of non-marketed assets, *Economic Record*, Vol. 62, No. 178.

Huizinger, H. (1991) National tax policies toward product-innovating multinational enterprises, *Journal of Public Economics*, Vol. 44, pp. 1-14.

Huizinger, H. (1992) The tax treatment of R&D expenditures of multinational enterprises, Journal of Public Economics, Vol. 17, pp. 343-59.

Khan, M. and Reinhart, C. (1990) Private investment and economic growth in developing countries, World Development, Vol. 18, pp. 19-27.

Killick, T. (1973) The benefits of foreign direct investment and its alternatives: An empirical exploration, *Journal of Development Studies*, Vol. 9, No. 2.

Lim, D. (1983) Fiscal incentives and direct foreign investment in less developed countries, Journal of Development Studies, Vol. 19, No. 2.

Lim, J. (1987) The new structuralist critique of the monetarist theory of inflation, *Journal of Development Economics*, Vol. 25, pp. 45-62.

Montiel, P. (1994) Financial policies and economic growth: Theory, evidence and country-specific experience from Sub-Saharan Africa, AERC, Plenary Session, Nairobi, Kenya.

O'hearn, D. (1990) TNCs, intervening mechanisms and economic growth in Ireland: A longitudinal test and extension of Bornschier model, *World Development*, March.

Otani, I. and Villanueva, D. (1989) Major determinants of long-term growth in LDCs, *Finance and Development*, Vol. 28, No. 3.

Pfeffermann, G. and Madarassy, A. (1992) *Trends in Private Investment in Developing Countries* 1993, IFC, World Bank, Washington, DC.

Ragazzi, G. (1973) Theories of determinants of direct foreign investment, *IMF Staff Papers, Vol. 20.*

Ram, R. (1985) Exports and economic growth: Some additional evidence, *Economic Development and Cultural Change*, Vol. 33, No. 1.

Rana, P. B. and Dowling, J. M. (1988) The impact of foreign capital in growth: Evidences from Asian developing countries, *The Developing Economies*, Vol. 26.

Rhee, Y. and Belot, T. (1990) Export catalysts in low-income countries: A review of eleven success stories, *World Bank Discussion Papers*, No. 72, The World Bank, Washington, DC.

Riedel, J. (1987) *Myths and Reality of External Constraints on Development*, Thames Essay, 47, Trade Policy Research Centre, London.

Rodrik, D. (1991) Policy uncertainty and private investment in developing countries, *Journal of Development Economies*, Vol. 36.

Root, F. and Ahmed, A. A. (1979) Empirical determinants of manufacturing direct foreign investment in developing countries, *Economic Development and Cultural Change*, Vol. 27.

Scaperlanda, A. E. and Mauer, L. (1969) The determinants of US direct investment in the EEC, American Economic Review, Vol. 59.

Serven, L. and Solimano, A. (1991) Economic adjustment and investment performance in developing countries: The experience of the 1980s. Paper presented at the Conference on private investment and macroeconomic adjustment, March 21-22, World Bank, Washington, DC.

Serven, L. and Solimano, A. (1992) Private investment and macroeconomic adjustment: A survey, *World Bank Research Observer*, Vol. 7, pp. 95-114.

Shah, A. and Slemrod, J. (1990) Tax sensitivity of foreign direct investment: An empirical assessment, WPS 434, World Bank, Country Economics Department, Washington, Dc.

Stoneman, C. (1975) Foreign capital and economic growth, *World Development*, Vol. 3, No. 1.

Torrisi, C. R. (1985) The determinants of direct foreign investment in a small LDC, *Journal of Economic Development*, Vol. 10, No. 1.

Todaro, M. (1992) *Economic Development in the Third World*, New York, Longman.

Tsai, P. L. (1994) Determinants of foreign direct investment and its impact on economic growth, Journal of Economic Development, Vol. 19. 137-163.

Tyler, W. G. (1981) Growth and export expansion in developing countries: Some empirical evidence, *Journal of Development Economics*, Vol. 9.

Van Wijnbergen, S. (1983) Interest rate management in LDCs, *Journal of Monetary Economics, Vol. 12, pp. 433-52.*

Voivodas, C. S. (1973) Exports, foreign capital and economic growth, *Journal of International Economics*, Vol. 3, No. 4.

Warr, P. (1989) Export processing zones: The economics of enclave manufacturing, *World Bank Research Observer*, Vol. 4, pp. 65-88.