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FOREIGN DIRECT INVESTMENT AND DEVELOPMENT OBJECTIVES IN THE REPUBLIC OF UGANDA

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2007

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Foreign Direct Investment and Development Objectives in the Republic of Uganda

A Thesis Submitted
in partial fulfillment of the requirements for the degree of Master of Arts in Public Policy and Administration

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May 2007

The American University in Cairo

Foreign Direct Investment and Development Objectives in the Republic of Uganda

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CONTENTS

ACKNOWLEDGEMENT IV
LIST OF TABLES AND ILLUSTRATION V
ABBREVIATIONS VI
ABSTRACT IX
PREFACE: IX

INTRODUCTION

THE CONCEPTUAL FRAMEWORK 1
DEFINITION OF CONCEPTS: 1
CONSTRUCTS: 2
BACKGROUND TO THE STUDY: 5

CHAPTER ONE: METHODOLOGICAL BACKGROUND

1.1 PROBLEM STATEMENT: 7
1.2 RESEARCH QUESTION: 8
1.3 INVESTIGATIVE QUESTIONS: 8

CHAPTER TWO: FOREIGN DIRECT INVESTMENT AND DEVELOPMENT IN HOST ECONOMIES: THEORETICAL AND LITERATURE REVIEW

2.1 INTRODUCTION: 9
2.2 MACROECONOMIC AND INSTITUTIONAL REFORMS IN HOST ECONOMIES: 10
2.2.1: LIBERALIZATION AND PRIVATIZATION: 10
2.2.2 DETERMINANTS AND MOTIVATIONS OF FDI: 11
2.2.3 FISCAL INCENTIVES: 14
2.2.4 INVESTMENT PROMOTION AGENCIES (IPAs) AND EXPORT PROMOTION ZONES (EPZs): 16
2.2.6 PERFORMANCE REQUIREMENTS: 17
2.2.7 DECENTRALIZATION: 19

2.3 Basic Characteristics Foreign Direct Investment Enterprises in Host Economies: 21
2.3.1 Introduction: 21
2.3.2 Forms of FDI inflows: 21
2.3.2 Sectoral orientation of FDI: 22
2.3.3 Entry Modes of Foreign Direct Investment: 22

2.4 BENEFITS OF FOREIGN DIRECT INVESTMENT VIA SPILLOVERS IN HOST ECONOMIES: 26
2.4.1 INTRODUCTION: 26
2.4.2 FDI ROLE IN REDUCING POVERTY: 28
2.4.3 FDI AND EMPLOYMENT: 29
2.4.4 FDI AND TECHNOLOGY: 29
2.4.5 PRODUCTION LINKAGES: 31
2.4.6 COSTS OF FOREIGN DIRECT INVESTMENT: 31

2.5 POLICY OPTIONS FOR MANAGING FOREIGN DIRECT INVESTMENT DESIRABILITY IN HOST ECONOMIES: 33
2.5.1: INTRODUCTION: 33
2.5.2 FURTHER LIBERALIZATION AND PRIVATIZATION: 33
2.5.3 FOREIGN DIRECT INVESTMENT ROLE IN HOST INFRASTRUCTURE: 35
2.5.4 DIFFERENT INTERVENTION APPROACHES: 35
2.5.5 REGIONAL INTEGRATION: 36
2.5.6 GIVING FISCAL INCENTIVES: 37
2.5.7 THE ROLE OF INVESTMENT PROMOTION AGENCIES: 38
2.5.8 INTERNATIONAL EXPERIENCE: 38
2.5.9 SUMMARY OF THE DISCOURSE IN THE LITERATURE: 40

CHAPTER THREE: MACROECONOMIC AND INSTITUTIONAL INCENTIVES FOR FOREIGN DIRECT INVESTMENT IN UGANDA'S ECONOMY

3.1 Introduction 43
3.2 Macroeconomic policy reforms: 44
3.2.1 Fiscal policy 44
3.2.2 Monetary policy 47
3.2.3 Trade policy 48
3.2.4 Political stability and transparency in the institutions 49
3.3 The return of Asian investors: 52
3.4 The Privatization factor: 53

3.5 THE CREATION OF UGANDA INVESTMENT AUTHORITY: 56
3.6 THE MEDIUM TERM COMPETITIVE STRATEGY (MTCS): 60
3.7 THE "BIG PUSH" STRATEGY 62
3.8 REGIONAL INITIATIVES: 63
3.9 COMPARISONS OF CONSTRAINTS ON FOREIGN AND DOMESTIC MANUFACTURING FIRMS 65

CHAPTER FOUR: BASIC CHARACTERISTICS OF FOREIGN DIRECT INVESTMENT ENTERPRISES IN UGANDA'S ECONOMY

4.1 INTRODUCTION: 69
4.2 SECTORAL ORIENTATION OF FDI ENTERPRISES: 70
4.3 COUNTRY OF ORIGIN OF FDI ENTERPRISES IN UGANDA: 73
4.4 ENTRY MODE CHOICES: 76
4.5 REGIONAL DISTRIBUTION OF FDI ENTERPRISES: 80

CHAPTER FIVE: FOREIGN DIRECT INVESTMENT SPILLOVERS IN UGANDA'S ECONOMY

5.1 INTRODUCTION: 82
5.2 EXPORT DEVELOPMENT AND MARKET ACCESS: 82
5.3 HUMAN CAPITAL DEVELOPMENT: 85
5.4 BACKWARD AND FORWARD LINKAGES IN THE ECONOMY: 89
5.5 TECHNOLOGICAL SPILLOVERS: 94
5.6 ENTERPRISE DEVELOPMENT AND RESTRUCTURING: 96
5.7 COMPETITION: 98

CHAPTER SIX: STRATEGIC POLICIES FOR IMPROVING FDI DESIRABILITY IN UGANDA'S ECONOMY

6.1 INTRODUCTION: 102
6.2 THE STAKEHOLDERS' ANALYSIS 102
6.3 APPLYING SWOC ANALYSIS: 105
6.4. IDENTIFYING STRATEGIC ISSUES FACING UGANDA'S ECONOMY: 105
6.4.1 PRIORITIZING STRATEGIC ISSUES: 107
6.5 HOW CAN THE GOVERNMENT OF UGANDA FORMULATE AND ADOPT STRATEGIC FOR FDI ATTRACTION? 109
1. WHAT IS REQUIRED? 109
2. WHAT ACTION STEPS GOVERNMENT HAS TO PURSUE? 109

CHAPTER SEVEN: RECOMMENDATIONS AND CONCLUSION

7.1 INTRODUCTION AND MAJOR SUGGESTIONS: 115
7.2 LIMITATION OF THE STUDY: 117
7.3 RESEARCH AGENDA FOR THE FUTURE: 117

REFERENCES 119
APPENDICES 126

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List of tables and illustration

	Page
1. Table one	71
2. Table two	77
3. Table three	86
4. Table four	90
5. Table five	92
6. Table six	94
7. Table seven	95
8. Illustration one	4
9. Illustration two	103

Abbreviations

AGOA – African Growth and Opportunities Act

BOU – Bank of Uganda

COMESA – Common Market for Eastern and South Africa

EPZs – Export Promotional Zones

FDI – Foreign Direct Investment

GDP – Gross Domestic Product

HIPCs- Heavily Indebted Poor Countries

IPAs – Investment Promotion Agencies

M&As – Mergers and Acquisitions

MIGA – Multilateral Investment and General Agreement

MNCs – Multinational Corporations

MoFPED – Ministry of Finance, Planning and Economic Development

NEPAD – New Partnership for African Development

ODA – Official Development Assistance

OECD – Organization for Economic Cooperation and Development

PSFU – Private Sector Foundation Uganda

R&D – Research and Development

SSA – Sub-Saharan Africa

TNCs – Transnational Corporations

UBOS – Uganda Bureau of Statistics

UEPB – Uganda Export Promotion Board

UIA – Uganda Investment Authority

UMA – Uganda Manufacturers' Association

UNCTAD – United Nations Conference for Trade and Development

UN – United Nations

UNIDO – United Nations Industrial Development Organization

Ushs – Ugandan shillings

ABSTRACT

This study develops an analytical framework for investigating Government of Uganda's support for Foreign Direct Investment (FDI) development paradigm. It compares macroeconomic and institutional incentives in attracting FDI and institutional weaknesses. This study also discusses the nature of FDI, benefits of FDI in terms of its spillovers, and strategic issues and policies for managing stakeholders in the economy.

While Ugandan government maintains the view that improving on policy environment will attract FDI to address the country's development challenges, this study found out that, progress in policy environment (fiscal incentives, political stability, and good regulation) does not automatically lead to changes in the host's degree of attracting FDI unless it is aided by economic fundamentals like the availability of natural resources, market size and growth. Uganda has stagnated for the last 9 years with no improvement in terms of attracting more FDI. As shown in the finding, fiscal incentives influence FDI locational decisions in Uganda, but are not the most important factors however remain necessary evils to remedy poor microeconomic variables.

In spite of government's success on achieving macro reforms to attract FDI, institutional weaknesses undermine its efforts. Foreign investors pay bribes to access public sector provided utilities. FDI relatively concentrates in one region which is inconsistent with a balanced development thesis. A move towards defining property rights causes unpopularity of FDI. Government always relies on a crisis strategy rather than a deliberate strategy to manage the different groups of stakeholders and other constraints in the economy.

This study's conclusion is that FDI alone is not a necessary condition for economic development unless it is complemented by host policies to increase the absorptive capacity of its spillovers.

PREFACE

This study investigates government position on the importance of using FDI to address the country's development challenges. It is an exploratory and analytical study in which data and concepts were developed to explain the emerging issues and best-practiced policies. Analysis of documents and follow-up of business news on FDI constituted the qualitative methodology, though quantitative for macro and micro levels. Relevant data was collected from both internal and external sources. Internal sources were from Uganda Investment Authority, Ministry of Finance, Planning and Economic Development; Ministry of Tourism, Trade and Industry; Privatization Unit, Private Sector Foundation Uganda; and Bank of Uganda. External sources were from United Nations Conferences for Trade and Development, World Bank and United Nations Industrial Development Organization. All these organizations have great interests in FDI as an alternative development paradigm in developing host economies. Because the quality of the information varies across reports, this study utilizes data at disaggregate levels.

This Thesis is organized into seven chapters. Chapter one includes the Methodological Background that defines the problem statement, research question and investigative questions and study scope. Chapter two covers Theoretical and Literature Review on FDI and Development in Host Economies including theories explaining FDI, Macroeconomic and institutional incentives, basic characteristics of FDI enterprises, benefits from FDI spillovers, and policy options for managing FDI desirability in host economies.

Chapter three covers discussions on FDI in Uganda's economy. The theoretical underpinnings and research findings are discussed concurrently. It evaluates the importance of macroeconomic and institutional incentives in attracting FDI in Uganda. Macroeconomic reforms discussed include fiscal incentives, monetary and trade policies and political stability. While other factors discussed include the return of Asian investors, privatization programs, the creation of an Investment Promotion Agency, the medium term competitive strategy, the big push strategy and regional initiatives. Last in this chapter, are comparisons of constrains between foreign and domestic manufacturing firms in Uganda.

Chapter four covers basic characteristics of FDI enterprises in Uganda's economy with a special emphasis on sectoral orientation, country of origin, entry mode choices, and regional distribution of TNCs. Emphasis is focused on relating the characteristics to the need of the economy to overcome its development challenges.

Chapter five is based on FDI spillovers. These are export development and market access, linkages, technological spillovers, human capital development, enterprise development and restructuring, and inducing competition. Chapter six discusses urgent policy measures that Uganda has to address if they are to minimize the cost of doing business by TNCs and retain capital already attracted into the economy. Chapter seven gives recommendations and conclusion.

INTRODUCTION

THE CONCEPTUAL FRAMEWORK

Definition of Concepts:

1. *Foreign Direct Investment (FDI):* FDI is a foreign corporation or company having essential attributes of a corporation that is chartered under the laws of a state or government other than that in which it is doing the business (Webster's Third New International dictionary, p.889). FDI involves *control of a resident entity* in one economy by an enterprise resident in another economy (UNCTAD, 1996, p.20). It is entry through mergers and acquisitions (UNCTAD, 2000, p.101). The World Bank defines it as an investment made to *acquire lasting management* (usually at least 10 % of voting stock) in an enterprise operating in a country other than that of the host investors (Gillis et al, 2001, p.522).

2. *Transnational Corporations (TNCs):* TNCs are enterprises that produce in more than one country and consider overseas' operations to be central to its profitability (Gillis et al, 2001, p.524) while Moosa (2002, p.2) defines TNCS as firms that do cross border activities via subsidiaries, affiliates and join ventures.

3. Distinguishing between FDI and TNCs

Transnational corporations (TNCs) are parent enterprises or foreign affiliates, usually have some degree of equity stake; usually 10 percent needed for effective voice in management, While FDI refers to capital flows between parent and subsidiary enterprises.[1] The operational definition considers TNCs and FDI to mean the same.

[1]http://www.unctad.org/Templates/Page.asp?intItemID=3148&lang=1

Operational Definitions:

1. *Foreign direct Investment (FDI)*: This study refers to FDI and TNCs to mean the same in Uganda's economy, whether Joint Ventures, Mergers and Acquisitions or Greenfield, in which foreign investors have greatest share usually 10 percent of the equity stake and taking full management say and controls.
2. *Development Objectives:* Development objectives are specific to the generation of employment and improving household incomes, sustaining regional development, and technology spillovers, local capabilities in absorbing FDI benefits, building linkages for enterprise development, and competition in the private sector led economy.
3. *Host economy*: Host economy refers to the country in which the enterprises are operating rather than their home economy

Constructs:

Quality FDI attraction means attracting FDI to meet host's development objectives, especially in areas of resource capabilities, and location advantages.

Appropriate policy regimes are defined in terms of employing FDI policies which are relevant to the country's level of development and priority activities. These include opening up for FDI, active marketing targeting specific subsets of TNCs for industrial and export developments. *Appropriate FDI incentives* mean incentives which have great impact in the economy in terms of spillovers, such as in priority industries, regional development, exporting research and development. *Significant spillovers* mean human resource development, export promotion, technological transfers, linkages and enterprise development and restructuring. Spillovers depend on host's absorptive capacity, level of

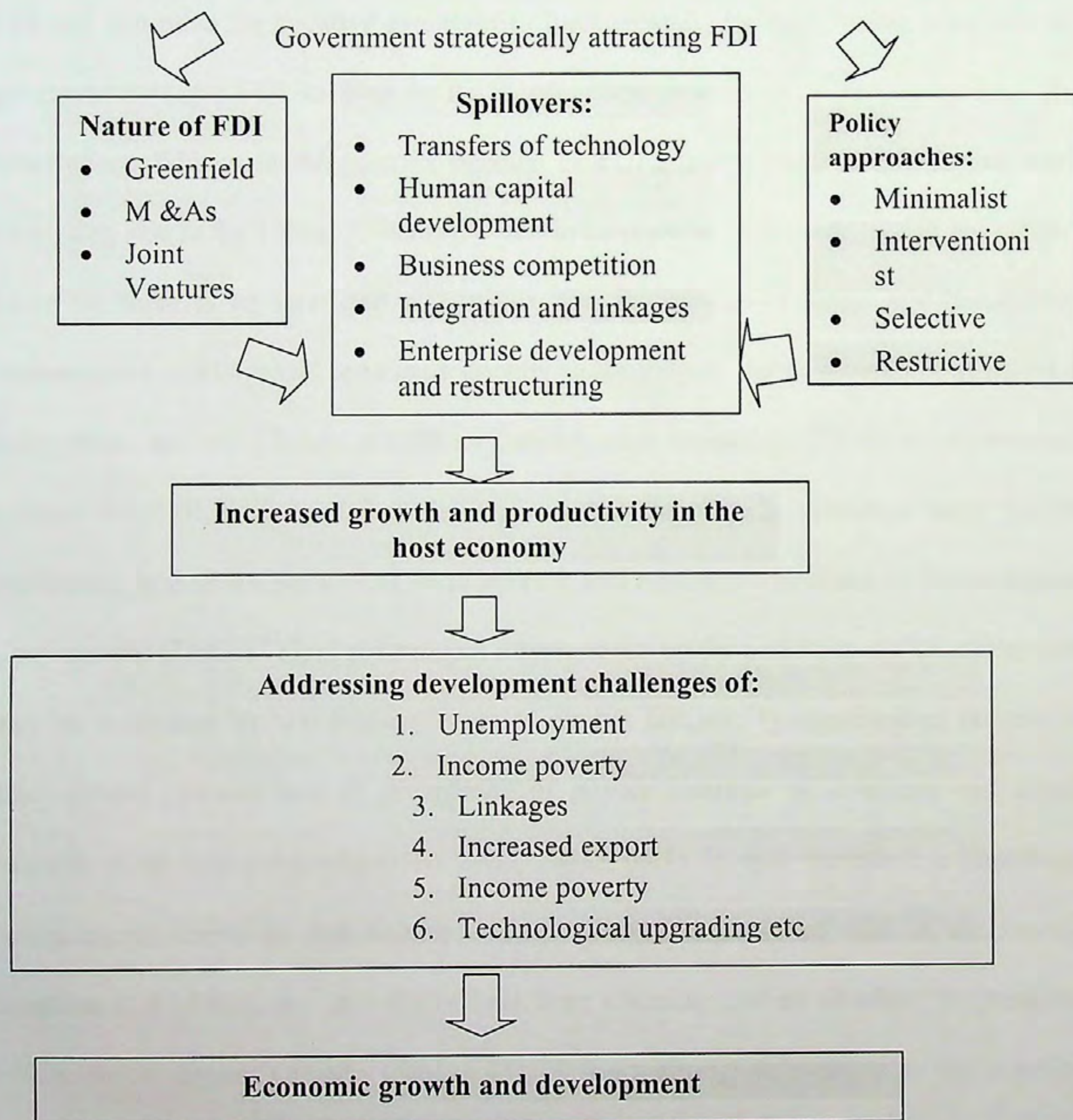
economic development, degree of education and extent of competition in the host country. Improving host capabilities to increase absorptive capacity occurs as a result of spillovers by offering quality education on top of the general education, human resource development in managerial skills and increased expenditures on infrastructure.

Technological competence depicts the ability of host's economy to acquire and use the technological knowledge to promote economic development. It should be relevant to the host's stage of development, and injecting competition through avoidance of cartel practices. The promotion of business linkages is likely to be successful if all systematic policy approaches to all factors influencing linkages are adopted and could lead to spillovers. Host country regulations promote domestic development priorities and linkages to protect public welfare from the negative impact of FDI. Quality of regulations and good governance improve investor's perceptions. Host country's capacity to influence and control TNCs determines the outcome of FDI.

Based on above concepts and constructs, a simple model is developed to guide a developing country in maximizing FDI spillovers. This is based on the following assumptions: first, that government is in a position to strategically attract quality FDI, and secondly, that government can discretionary apply various policy approaches that suit its development objectives. Since FDI enters into the host economy through various forms such greenfield (new investment), mergers and acquisitions, and joint ventures, government therefore, determines quality FDI to maximize its spillovers. The end result

is addressing host development challenges. Hence, economic growth and development will be achieved and sustained as illustrated below.

Illustration 1: A simple Model for a developing country using FDI as an alternative development paradigm:



Source: Author's contribution

Background to the study:

It is important to discuss the best-policy practices that work for development objectives of host economies. FDI plays a significant role in the development process of host economies because it acts as a catalyst for obtaining foreign technology and knowledge, managerial skills and capital. However, policies are required to maximize spillovers from FDI and minimize the negative externalities fundamentally by determining what role the government wants FDI to play in its development process as a host economy. The renewed confidence in the positive benefits of FDI has led many countries that were restricting FDI in the 1960s, 1970s and 1980s to be more open towards FDI in the 1990s.[2] More so, there is an increased recognition that the bundle of assets and capabilities encompassed in FDI could contribute directly to the growth and development of national economies,[3] declining levels of Official Development Assistance (ODA) have increased reliance on FDI, and least but not last, is that developing countries have gained confidence in their ability to maximize benefits and minimize liabilities of Transnational Corporations (TNCs).[4] Host government interventions on the activities of FDI enterprises may be motivated by two primary types of market failures: 1) coordination failures in development process; and 2) divergence of private interests of investors and social interests of the host economies (UNCTAD, 2003a, p.41). In spite the effort in improving policy environments in sub Saharan Africa (SSA), its share of FDI in developing countries is declining and its inflows have been characterized by absolute progress but with a relative decline (Asiedu, 2004, p.41). "It is not enough to improve on one's policy environment, but improvements need to be made in both absolute terms and relative terms". This signifies the complementary role of FDI to domestic investment as a means to an end and not the end itself.

Uganda demonstrated efforts to achieve economic development by instituting Uganda Industrial Act of 1963 to promote both private and local investors (Obwona, 2001, p.50; Obwona & Egesa, 2004, p.5-9) and Foreign Investment Act of 1964 provided for protection of investors against illegal state's expropriation. However, the "economic war" declared by President Amin's regime in 1972 led to the deterioration of investment climate in the economy, that was characterized by nationalization, hostility against foreign investors. This is because he wanted to empower local Ugandans in running the economy.

To re-build the confidence of foreign investors in the economy, Uganda Investment Authority (UIA) was created to link up investors into the economy via effective marketing, and also implemented the privatization program in 1992 (UCTAD, 2000a, p.3&4; Obwona, 2001, p.52; &MIGA, 2004, p.47) and it is now a model in Africa. This made Uganda to be ranked among the "forerunners" of FDI in Africa in 1998 (UNCTAD, 2000a, p.3&4). Even total flows of FDI went upwards from US$ 1 million in 1991 to US$256.4 in 2005.[5] Uganda's GDP (average annual growth) reached 5.6 per cent in 2005. Uganda is now among the newly market oriented economies that employs liberal policies for attracting FDI to solve the economy's development challenges.

---

[2] *FDI has the objective of obtaining a lasting interest by a resident entity in one economy in an entity resident in an economy other than that of the investors, with lasting usually defined as a 10 per cent in the entity (Te Velde, 2001, p.4).*

[3]*For a decade, economists became convinced that the key to rapid economic development lay not in a country's natural resources, physical or human capital, but rather in the set of economic policies that it pursued (Kobrin, 2001, p. 68)*

[4]*Te Velde (2001, p.29) recognized that local capabilities play a dual role of attracting FDI and absorbing positive spillovers associated with FDI.*

[5]IMF, Balance of payments CD ROM, August 2006 available at http://www.unctad.org/sections/dite_fdistat/docs/wid_cp_ug_en.pdf

CHAPTER ONE

METHODOLOGICAL BACKGROUND

1.1 Problem statement:

Of recent, public debates and criticisms are being directed to the Government of Uganda about the significance of achieving economic development by attracting FDI. While government maintains that improving policy environment will attract FDI to finance the economy without adding further indebtedness, critics justified their arguments based on the sense that FDI is being attracted into Uganda due to the availability of incentives (UNIDO, 2002, p.13) and have made little progress in creating economic benefits to ordinary Ugandans. FDI is oriented into export of traditional products that have limited linkages in the economy. Geographical position of Uganda constraints FDI ability to expand the economy through trade and take part in global specialization and Uganda has to depend on appropriate political and commercial relationships with Kenya and Tanzania (UNCTAD, 2003b, p.2&3) in order to access sea ports. Uganda has narrow resource base and domestic market even though it is ranked third in terms of progress in business environment and number eleven in Africa in terms of FDI attraction (UNCTAD, 1999, p.48&49). This study therefore, evaluates Government of Uganda's stand on the importance of using FDI to address the country's development challenges, based on a study of the best practiced outcomes related to FDI spillovers and then suggests policy options for such maximization. This study covers the period from 1990-2006 as a reflection of the beginning of liberalization and privatization. This range is sufficient for analyzing the best practiced outcomes related FDI spillovers.

1.2 Research question:

To what extent the Government of Uganda supports FDI as an alternative development paradigm? What are possible strategies for maximizing FDI benefits to meet Ugandan development objectives?

1.3 Investigative questions:

1. How do macroeconomic and institutional incentives affect FDI in Uganda?
2. What are the basic characteristics of FDI enterprises in Uganda?
3. To what extent has Uganda as a host benefited from FDI spillovers?
4. What are some strategic policies that Uganda has to consider urgently for effective targeting of FDI?

1.5 Study Scope:

This study covers FDI in Uganda with regards to macroeconomic and institutional incentives, basic characteristics of investing enterprises, FDI benefits through spillovers rather than direct effects in countries of low domestic savings and weak financial intermediation, and looks at the policy options for managing FDI desirability. This study covers the period from 1990 to 2006 as a reflection of the beginning of liberalization and privatization policies in Uganda. It is from this time that Uganda started opening up its economy for private investors and Uganda Investment Authority was created in 1991 to facilitate investment marketing. This period is considered sufficient to realize results of FDI policies pursued.

CHAPTER TWO

FOREIGN DIRECT INVESTMENT AND DEVELOPMENT IN HOST ECONOMIES:

THEORETICAL AND LITERATURE REVIEW

2.1 Introduction:

This chapter covers the literature review on FDI in host economies. The various aspects of FDI discussed include: FDI theories, macroeconomic and institutional incentives, basic characteristics of FDI enterprises, FDI benefits, and policy options for managing FDI in host economies. The eclectic theory (OLI) developed by Dunning (1981, 1988, 1995,) provides a conceptual framework for explaining FDI in Host Economies. The paradigm states that FDI is a function of three variables: (1) existence of Ownership-Specific Advantages (O) that is based on firm's resources and capabilities; (2) host country's Location-Specific Advantages (L) comprised of both natural and created resources; and (3) is the Internalization (I) by which firms combine Ownership Advantages with Location Advantages to improve their competitiveness. Scholars see the theory as significance in explaining reasons for 'why', 'how', and 'where' of TNCs production, whereas others see the explanatory importance of constituting many variables as a source limitation. Kehal (2004, p.16) found that market size is the most popular factor influencing a country propensity to attract inward investment, and this was supported by subsequent empirical literature he reviewed to justify the market size hypothesis. In line with the above mentioned factors which attract FDI, availability of natural resources in host economies is the most fundamental factor. Others can include market size and growth rate, political factors and economic stabilization for poorly resourced economies. In fact, these factors depend on the nature of host economies.

2.2 Macroeconomic and Institutional Reforms in Host Economies:

This subsection discusses liberalization and privatization programs in host economies implemented to attract FDI, determinants and motivations of FDI, fiscal incentives, Investment Promotion Agencies and Export Promotion Zones, performance requirements, decentralization of FDI process.

2.2.1: Liberalization and privatization:

Official Development Assistance (ODA) declined by the beginning of 1990s (UNCTAD, 1998, p.13) and host economies resorted to different policies of attracting FDI. However, a low-waged country, even with liberal policies, needed various advantages such as natural resources and political stability for attracting FDI (Wood, 2001, p.18). African governments have put efforts in economic liberalization (UNCTAD, 1995, p.95), addressing investors concerns, privatizing and actively promoting investment (UNCTAD, 2003, p.36), making a total of 42 regulatory changes to favor FDI by 2005 (UNCTAD, 2006, p.46). But more are yet needed on improving political stability and privatization through political consensus of transparent policy (UNCTAD, 1995, p.90). However, political consensus is a nightmare in developing countries where power distribution is explained well by using elitist theory.

Privatization programs are common in African countries like Angola, Cape Verde, and among others (UNCTAD, 1998, p. 170). Privatization programs across Africa and African Growth and Opportunities Act have influenced strategic investors (UNCTAD,

2006, p.49). As for the African comparative advantages, the focus must be based on long term programs that attract FDI into vital sectors like natural resources that needed heavy investment. However, many with abundant natural resources have not even developed.

In addition, countries in Sub- Saharan Africa (SSA) such as Burkina Faso, Cameroon, Ethiopia, Ghana, and Madagascar among others have ongoing Integrated Industrial Development Programs that cover wide range of development issues including major components relating to FDI and capacity building of local intermediary institutions (UNIDO, 2002, p.2). Among the new schemes involving many countries include African Growth and Opportunities Act (AGOA) (UNCTAD, 2003, p.37) and New Partnership for African Development (NEPAD) that has prospect in infrastructure and energy investment development and among other priorities. For this case, NEPAD suits SSA as it needs more of development administration that has been neglected in economic development paradigm.

2.2.2 Determinants and Motivations of FDI:

Pull factors of FDI to developing countries are favored by growing markets, rising costs of factor production in home economies, host government policy frameworks, business facilitation.[1]

[1] Government policies include competition, incentives, transparent governance, investment in infrastructure and property rights and minimal foreign exchange regulations. Macroeconomic and political factors include uncertainty; strong currency, political stability and common monetary area (UNCTAD, 2006, p.157).

Similarly, UNCTAD (1999, p.91; 2003, p.85), grouped FDI determinants into host policy frameworks, economic and business facilitation while Wei and Balasurbramanyam (2004, p. 178) grouped them into: (1) those related to the objectives of the prospective investors; and (2) the policy framework of host countries. They argued that non-mineral countries in Africa would attract FDI through macroeconomic stability. But even the macroeconomic stability works well only for exploitation of the mineral resources rather than in non – minerals.

According to Kehal (2004, p.22), locational decisions by TNCs do not only depend on opening up an economy, but are primarily driven by economic fundamentals including natural resources, availability of markets and high growth rates. However, Moosa (2002, p.50) recognized other factors other than locational and market size. These are political risks and country risks; tax policies; trade barriers; and government regulations. Hence the importance of market size as a determinant of investment location has diminished; even a small country can now compete favorably for FDI, given that they can provide sufficiently attractive conditions for foreign investors.[2]

[2] *Until recently, there was a strong consensus in the literature that FDI is mainly attracted by strong economic fundamentals (UNCTAD, 2003a, 31). These are market size and income level, skills, infrastructure and other resources that facilitate efficient specialization of production, trade policies, and political and macroeconomic stability as other central determinants. Investment incentives were seen as relatively minor determinants of FDI decisions. Globalization has changed this picture and made incentives more important determinant of international investment decisions. More than 100 countries provided various FDI incentives already in the mid-1990s, and dozens more introduced such incentives since the few countries compete for FDI without any form of subsidies today.*

If the importance of market size has declined, then China case disapproves this proposition. In fact, market size and natural resource availability are the most important factors for FDI attraction in host economies. Other factors like subsidies and political stability are necessary conditions needed for exploitation of natural resources and production to supply goods and services.

According to UNCTAD (1998, p.106), TNCS are resource-seeking, market-seeking, efficiency-seeking and strategic asset seeking investment. Therefore, the different motives could have different impacts in host economies. FDI in SSA are resource seeking mainly, in fuel, oil and mineral resources. Such investments tend to be less sensitive to policy environments. For example, Angola, an oil rich country was ranked first in terms of FDI receipt in 1998 among African countries (UNCTAD, 1998, p.166; 1999, p.46). In addition to natural resources, FDI in Africa depends on economic infrastructure, and to lesser extent the size of domestic economy (UNCTAD, 1995, p.85; OECD, 2002, p.8).

In terms of rating; the degree of influence on profitability of investments was seen as the factor with the highest influence, followed by state physical infrastructure, political and economic outlook and last is regional markets (UNCTAD, 1999. p.47&50–52). Further more, the rate of return in Africa was more profitable than in any other developing countries though the share has been declining. While the returns on investment can be high in Africa (OECD, 2003, p.7), the effects are more counterbalanced by high taxes and significant risk of capital losses. Rising corporate profits and high commodity prices boosted FDI inflows in 2005 to a historical high of $31 billion from $17 in 2004 (UNCTAD, 2006, p.40–44). However, the region continues to exhibit weaknesses that

constraints its ability to attract quality FDI. For instance the continent has poor infrastructure, skills and technical based and general education enrollment.

2.2.3 Fiscal incentives:

a) Tax Incentives:

Tax incentives are more explicit than the implicit tax holidays, and are offered as investment allowances. There is overwhelming evidence that, relative to other factors, fiscal incentives are only a minor element in the locational decisions of TNCs (UNCTAD, 1995, p.298). However, the impact is not negligible: if one country offers and the other does not, ceteris peribus, foreign investors could be influenced in their location decisions between countries. Factors such as market size, skills level and economic stability and regulations remain the most important.

More so, TNC executives now readily admit the increasing importance of tax incentives in investment decisions (UNCTAD, 2003a, p.31) in the sense that they influence FDI inflows. It is possible that the competition between potential investment locations within countries will raise subsidy levels so much that most of the benefits are shifted from host countries to foreign investors.[3] OECD (2005, p.6) further pointed out that investors are more likely to be attracted to the locations when existing investors give positive advice.

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[3]In addition, costs of subsidization invite rent seeking FDI. For example, tax holidays and tax breaks may appear simple and innocuous forms of incentives, but are likely to lead to transfer pricing and other distortions as firms try to shift as many transactions as possible to activities with tax preferences, or set up new firms as the tax preferences of existing firms expire (UNCTAD, 2003a, p.33).

This puts the government in a situation of making already existing investors have positive perception of the host environments for doing businesses. However, tax incentives are used as politically ideology to appease people on government's commitment to promote development per se. However, tax incentives should be used to attract capital and technology for required purpose; spur industrial growth in particular geographical locations where infrastructure is inadequate among others. This is because investment incentives tend to benefit mostly foot loose industries which operate in short term basis. They are engaged in producing consumption goods and services, and their costs of relocation to neighboring countries are low, export oriented investment, in countries or regions that are similar to neighboring countries and in regions where the business conditions are favorable.

b) Tax Holiday:

Tax holidays are offered for a specific period of time, to particular types of investments, that government wants to promote. Investing enterprises pay no taxes specified in agreements until the grace period ends. Tax holidays are essential in quick capital recovery and maintain greater liquidity in early years (Seid, 2002, p.40). Thus reducing risks, provide large benefits as soon as companies begin earning income, and are more valuable than tax incentive (Bora, 2002, p.280). Tax holidays can further be counterproductive if they contribute to attracting more investors of the "wrong kind", which is certainly the case in countries where basic fundamentals are not yet in place. Even still, a firm at infantry level benefits less from tax holidays and a lengthy exemption is costly to the host country. However, they primarily benefit short-term investments,

which are often taken in so-called footloose industries. Further drawback is that, the cost of administering incentive regimes result in delays and uncertainty for investors. They have been also significant sources of corruption, screening out desirable investments, and detrimental to the process of developing competitive market and sound policy making.[4] Despite the negative situation, many poor African countries rely on tax holiday and import exemptions, while industrial countries allow investment allowances or accelerated depreciation. An incentive is correctly targeted if it is invested in capital because it encourages companies to take long-term planning.

2.2.4 Investment Promotion Agencies and Export Promotion Zones (EPZs):

Investment Promotion Agencies (IPAs) are more effective in a country with a good investment climate than only in a poor one, and is the obvious solution for SSA (OECD, 2005, p.6-7). Thus, IPAs role should be in image building under regional promotion since many prospective investors think regionally. Image building yields result in attracting FDI, but it is still less in policy advocacy and it is good for countries with good investment climate, hence, countries with poor investment should not spend too many resources on IPAs. In addition, Morriset (2003, p.14 quoted in OECD, 2005, p.5) finds that small agencies are not really effective in attracting FDI, and IPAs which spent more money on policies were more successful in attracting investors, possibly because of the role of such advocacy that leads to improvements on investment climate.

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[4] *The impact of tax policy may significantly depend on the tax instruments used by the host country. The effectiveness of tax policy and incentives is likely to vary depending on the MNC activities and on its motivation to invest abroad (Bora, 2002, p. 273 – 285)*

However, one-stop shop becomes more of a one stop, adding a red tape to investors. Decision-making is in a single authority within single organization and even line ministry resists ceding their regulatory to another agency.

Most economies have Export Promotion Zones (EPZs) supplied with improved infrastructure and special incentive packages (Sied, 2002, p.41), however (Hill, 1990, p.35-36 quoted in Bora, 2002, p.184) pointed out that EPZs though, have marginal impact on development and sometimes may not sometimes develop linkages within the economy especially to the new entrants. Foreign exporters have historically found it more profitable to establish production facilities within the tariff wall than to serve the market from an overseas location. For examples, the tax concessions to promote upgrading in R&D in Singapore and Ireland were based on performance requirements of export promotion, linkages and training schemes. OECD (2005, p.11-12) added that Ireland and Singapore had successful stories based on three lessons for other economies: a) programs of linkages are expensive; b) Irish Development Authority had strong powers within the government to shape and implement policy; c) both countries had large pool of skills and small investors necessary for linkages development. Hence, host economies seeking FDI need to develop the local capability needed for exploiting the opportunities brought in by FDI or else remain in enclaves of export promotion zones that have limited impact.

2.2.6 Performance requirements:

Developing countries have FDI restrictive policy of performance requirements (UNCTAD, 2003a, p.63), normally done by IPAs (Seid, 2002, p.38), such as purchases of local capital goods, raw materials, intermediate goods and services, recruitment,

employment and training practices, the proportion of output exported, trade balancing, technological transfer, information provided on intra-firm pricing practices, and types of production methods utilized. Host economies mainly use them to promote and protect local industries; provide information on intra-firm practices and prevent pricing abuses and tax evasion; foster transfer of technology; and also a means of serving national goals. But, such practices protect inefficient local firms and also exclude investors.

However, the right to regulate (UNCTAD, 2003d, p.216) FDI activities should be recognized in the interest of host/home countries, traders and investors and be compatible, though, it has been not as easy as it sounds. Among the measures that will certainly hurt, not only investors but also long-term interests of host countries are negative post-investment changes such as expropriation; and insufficient notice when a new regulation is implemented. Morisset and Neso (2002) examined administrative barriers to FDI in 32 developing countries. They demonstrated that the quality of investment climate plays a significant role in the location decision of many investors. The ultimate case would be where a country has abolished all controls and relies on market forces and competition to shape investment and prevent abuses (Stoever, 2002, p.50), but the scenario is neither possible nor desirable.

It is important to note that, performance requirements differ among countries depending on their level of development, endowments of natural and other resources, market size, development strategy, among other factors. Hence, the right to regulate in the current context involves (1) promoting domestic development priorities and linkages; and (2) protecting the public welfare from possible negative impacts. [5] Even many countries

which traditionally maintained an open policy towards FDI now impose restrictions on flows and activities of FDI, due to the rapid changes in FDI whereby those who used to be traditional exporters of FDI are increasingly becoming major importers of capital (Seid, 2002, p.34). This has become a threat to infant industry development and would reduce host economies to deepen their capacity to produce.

TNCs may want to invest in spite of performance requirements and other restrictions (UNCTAD, 2003a, p.71). For example, China and India have managed to attract a huge volume of FDI inflows despite stringent performance requirements enforced with respect to exports, ownership and local contents. This shows that high levels of economic freedom are not clearly correlated with high level of FDI. China is the leading destination of FDI, but ranks (112 out of 155) in the Index of Economic Freedom (World Bank, 2004). Similarly, the benefits accruing to the host country may greatly outweigh the adverse effects.

2.2.7 Decentralization:

Most countries have centralized process of dealing with investment process (Robinson, 1987, p.26–29). In a decentralized process, technical skills of departments are brought in for negotiations like for tax expert and finance, laws and labour issues. Agencies monitor their terms of agreements and administrators learn from the past. However, there is no evaluation of projects' benefits to the economy and individual ministries may give little attention to policy issues and also costly to investors.

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[5] *UNCTAD (2003a, p.216)* Trade and liberalization can only be achieved in the context of appropriate and effective domestic regulatory environments

In a centralized system like IPAs, negotiations are quick and there is high prediction of outcomes and further, consider the generally impact in the economy. The problem is that, there is separate negotiation and implementation that remain at the ministry level.

However, corruption arises when passive regulations exist and government officials have discretion in applying them. It becomes worst when regulations lack simplicity and transparency. Corruption, combined with administrative weakness, can both undermine policy reform and repel FDI as Asiedu (2004, p.46) suggests. Too much regulations lead to delays and add costs to firms. [6] The level of corruption or lack of good governance is expected to influence the administrative costs. Even the degree of political freedom, openness, and existing legal framework affects the capacity of bureaucrats or incumbent enterprises to exploit rents from administrative procedures.

In terms of negative influence; ranked orderly, extortion and bribery deter FDI most and others are high administrative cost of doing business and access to capital (UNCTAD, 1999. p.50–52). Corruption and poor governance appear to have more significant deterrent to FDI in Africa than elsewhere (Wei and Balasurbramanyam, 2004, p. 178). Therefore, combined with inhibiting factors, corruption makes African countries lag behind other developing countries in terms of attracting FDI.

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[6]In countries, some of the operational procedures can also be needed at the entry, such as import and foreign exchange licensing. However, because of trade and financial liberalization efforts, those are less and less frequent (UNCTAD, 2003a, p. 189-192, 211, 213, and 216).

In short, most host governments have liberalized and privatized their economies, created investment promotion agencies and export promotion zones to attract FDI. In addition, host economies further provided fiscal incentives to make their locations attractive. However, the determinants and motivations for FDI to invest in host economies depend on host characteristics like natural resource availability, market size and growth rates, not only on policy improvements. These are dilemmas to host economies on policies they would have to implement so as to attract FDI without waste.

2.3 Basic Characteristics of Foreign Direct Investment Enterprises in Host Economies:

2.3.1 Introduction:

This part gives the different forms of FDI inflows in host economies, the sectoral orientation in host economies, and entry through greenfield, M&As and joint ventures.

2.3.2 Forms of FDI inflows:

FDI inflows include equity capital, reinvested earnings and intra–company loans (UNCTAD, 1995, 1996, 1997, & Moosa, 2002, p.2). The equity capital is the foreign investors' purchases of share in an enterprise in a foreign country; reinvested earnings are injected funds on new projects in the host country; and intra-company loans include short or long term lending between the parent and its affiliates.[7]

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[5]Indeed, FDI in the host country can be import substituting (production of goods previously imported), export increasing FDI (seeking increase export of raw material and intermediary goods), Government initiated FDI (offer incentives to investors to eliminate B.O.T deficit), trade oriented (generating excess demand for imports and excess exports at the origin term of trade), expansionary FDI exploits firm specific competitive advantage in the host economy (sale growth both at home and abroad). Defensive FDI seeks labor in the host country with the aim of reducing cost of production (Moosa, 2002, p.2).

Indeed, different countries often have diverse conventions as to what constitutes the ownership of the company from both the management and assets point of view (Wood, 200, p.16). For instance, can be 10% or 20 % depending on host measurements of FDI. FDI intention therefore, relies on having a management voice in enterprises either in parent or subsidiary enterprises and such intentions is always demonstrated by taking the majority of the equity share of more than 10 per cent.

2.3.2 Sectoral orientation of FDI:

FDI has now moved mainly to services and technology from primary sector (UNCTAD, 1993, p.61–62) demonstrating the structural changes in economic activities and FDI itself as a conduit for economic integration. The most attractive industries for FDI were telecommunications, food and beverages, tourism, mining and quarrying, textiles and leather (UNCTAD, 1999, p.50). FDI in services is increasing particularly in telecommunications, electricity and management and trade (UNCTAD, 2004, p.45) due to the growing importance of services through privatization that has problems without regulations. This suggests that many African countries receive FDI in non–minerals.

2.3.3 Entry Modes of Foreign Direct Investment:

Entry mode choices of FDI enterprises occur through full equity control of greenfield (new investment), M&As, and Joint Venture (either greenfield or acquisition) (Bora, 2002, p.10, UNCTAD, 2006, p.110). However, FDI modes of entry between acquisitions and greenfield are affected by the production and transportation costs, government policies in the host countries with respect to trade barriers (like import substitution); the marketing factors to destined markets; and oligopolistic reactions that one firm induces

the others to follow suit (Moosa, 2002, p.58). M&As as modes of entry in services lead over greenfields (UNCTAD, 2005, p.111-113) with $716billion in 2005.

a) Greenfield:

Greenfield refers to the investment in projects that entail new production facilities such as offices, buildings, plants and factories and movement of intangible capital (UNCTAD, 2006, p.15) and always adds to the production capacity of the host–country through capital formation and employment, and valued added (Moosa, 2002, p.13). Therefore, greenfield is suitable for developing economies because it can be directed to specific sectoral priorities, even in promoting linkages among others.

b) Cross - border Mergers and Acquisitions (Mass):

Cross – border M&As involve a partial or full take over or merging of capital, assets and liabilities of existing enterprises in a country by TNCs from other countries (UNCTAD, 2006, p.16). Collective investment between private equity firms and the various financial institutions, involving mutual funds and hedge funds, has become a growing source of FDI through M&As, and are the popular mode of investment for firms wishing to protect, consolidate and advance their global competitive positions, by selling off divisions some parts of divisions that fall outside their scope of core competencies and acquiring strategic assets that enhance competitiveness (UNCTAD, 1996, p.7-15). They were rampant in the 1980s through sales and purchases of public enterprises that were loosing their comparative advantages. The motivations for M&As (UNCTAD, 1999, p. 101; 2000, p. 144 – 149) are due to the privatization of state owned enterprises; globalization; and economies of scale, as well as, Regional Trade Blocks (Dunning (1998, p.41) to

protect positions and market shares which previously come from exports. M&As are influenced by the speed and access to proprietary assets (UNCTAD, 2000, p.140) and can be fundamentally classified (UNCTAD, 2000, p.101) into: (a) horizontal – between firms in the same industry; (b) vertical involving client – supplier of buyer – seller relationships usually for reducing uncertainty and transaction costs, linkages and economies of scale; (c) conglomeration – usually between companies in unrelated activities to diversify risks and economies of scale.

M&As may yield significant economic benefits (Bora, 2002, p.10, UNCTAD, 2006, p.17) when investors make a long-term commitment to economic restructuring of firms - acquired, investors are likely to inherit local linkages that may have been established over a considerable period of time (Enderwick, 2005, p.98), rescuing ailing companies in the developing countries (UNCTAD, 2006, p. 17). Investors gaining access to markets (Mossa, 2002, p.13) but host countries prefer to retain local control on domestic markets. However, M&As can be dubious to development value (Bora, 2002, p.10) if they lead to changes in ownerships without changing or adding productive capacity, facilitating transfer pricing, rationalization, and also being practiced on the basis of anti competition in the host economy.

In fact, the recent trends towards M&As reflect the strategic choice by TNCs and hosts' privatization programs across the continents during the 1990s. However, these are rather sellers, than buyers due to changes in national policies.

c) Joint Ventures:

Joint Venture (home country and other companies) provides technical knowledge and ability to raise finance and utilization of the other local knowledge of bureaucracy, regulations and the laws (Moosa, 2002, p.13). Joint venture has emerged as an alternative entry mode due to possession of complementary assets; opportunities for collusions; and barriers to full integration as well as a means of alleviating risks, especially the risks of take over (Moosa, 2002, p.58). Joint ventures can be useful to foreign investors due to diversification of risks, providing local partners to mediate with the governments, large pool of resources and technology and local entrepreneurial class will emerge through the acquisition of managerial and business skills (Seid, 2002, p.36). The basic motivations favoring joint ventures alternatively take the form of vertical, horizontal and diversification based joint venture (Robison, 1987, p.80 – 81). These can be an alternative strategy for developing countries seeking investment in infrastructure. It accommodates local development initiatives by governments such as energy development.

d) Implications:

The implications of the modes entry on development depend on the context in the host country, M&As and greenfield are rarely perfect substitute for each other (UNCTAD (2002, p.160). Therefore their degree of success depends on a number of host variables such as the level of economic development (high level of development favors M&A while developing countries are more likely to use greenfield); FDI policy of using greenfield; institutional factors of corporate governance and ownership; and financial crisis in the host country. Thus every mode of entry has mixed economic effects and TNC

characteristics and orientation relate to their impacts. Most developing countries prefer greenfields FDI over M&As (UNCTAD, 1999, p.102–103) because greenfield adds on capital investment, a pre–requisite for development, offers technology which local investors do not have, introduce innovation management and linkages with the local investors. However, M&As success depends on conditions under which they were created such as solving financial constraints of performing assets. The underlying argument for developing countries is that M&A is less beneficial than greenfield investments unless rescuing the ailing industries. FDI and employment creation (UNCTAD, 1994, p.166) depends on the types of initial investment (mode of entry) such as greenfield or M&As. Employment prospect can improve at a later stage as firms adapt to new competition and introduce new products.

In other words, FDI into host economies take the forms of greenfield, M&As and joint ventures. However, the recent entry modes favored M&As and mostly in services such as telecom and financial sector which are essential but the most important because developing countries could benefit more from FDI in terms of spillovers.

2.4 Benefits of Foreign Direct Investment via Spillovers in Host Economies:

2.4.1 Introduction:

This subsection emphasizes the benefits of FDI in Host Economies through spillovers rather than helping the host economy with low saving capacity and weak financial intermediation. These include the role of FDI in reducing poverty, creating employment,

promoting technological transfers, and promoting production linkages. In addition, costs of FDI are also discussed which occurred during the process of attracting FDI.

Evidence from the FDI related literature (Klein et al, 2001; OECD, 2002; Bende-Nabende, 2002; Bora, 2002; Asiedu, 2004; Kehal, 2004) demonstrates FDI role in economic development of host countries; mainly in terms of human development, technological transfers and capital formation, international trade, and competition and enterprise development. Effects of FDI in the host country are classified into economic, political and social effects (Moosa, 2002, p. 69-73) while Enderwick (2005, p.102) further categorizes the impact of FDI into primary effects by looking at aggregate benefits and costs that accrue to an economy and secondary impacts that related to the spillovers from foreign affiliates to local firms. These inflows of FDI into host economies have implications for economies seeking growth and development (Enderwick, 2005, p.94), including careful investment in assets and infrastructure, coordinated integration of policies, and the avoidance of expensive incentive to attract FDI. These can only be viable to host economies when they design policy that increases the absorptive capacity. According to OECD (2003, p.14) and Bende-Nabende (2002, p.124), the benefits of FDI are of two types: (1) saving countries of low domestic savings and weak financial intermediation, and (2) is spillovers. Spillovers therefore occur in five ways: transfers of technology, enterprise development and restructuring, integration, bolstering competition and supporting human capital formation. In this case, FDI policies need to discriminate between sectors or take certain wastes.

2.4.2 FDI role in Reducing Poverty:

While FDI may support development in an aggregate term, more attention should be focused on the distribution of gains from FDI. This is due to the fact that there is no direct link between FDI and poverty reduction (Klein et al, 2001. p.2-5; Sida, 2004), but there are some possible indirect links: (1) if FDI contributes to export growth, productivity and finances balance of payments; (2) if FDI increases employment it may move other people out of poverty; (3) foreign firms pay higher wages than local firms for workers of similar qualifications. Therefore, the evidence that FDI contributes to economic development is encouraging rather than compelling, because growth itself does not guarantee poverty reduction because of inequality in redistribution of resources. Te Velde (2001, p.6-7) added that FDI contributes in raising the tax base in the host countries, where increased domestic revenue may be used to build infrastructure and can also be spent on health, education and training. FDI remains one of the most effective tools in the fight against poverty because net debt flows have become less important (Klein et al, 2001, p.1-3).

But developing host economies rarely spend money in productive activities that would greatly reduce poverty instead security sector dominates public expenditures and ranks high in term of importance. More so, FDI can only benefit host economies if there are best practices of encouraging linkages since most people might not have the expert they need in the employment area. This can reduce income poverty.

2.4.3 FDI and Employment:

FDI has not had significant impact on employment, skill formation and growth in Africa as it has had in other areas such as East Asian countries with the exception of Botswana and Mauritius (Klein et al, 2004, p.9). Still in labor markets, TNCs have often been accused of "exploiting" labor in developing countries. However, it is generally accepted that FDI does not permanently change the level of unemployment, but can have a short run effect and result in permanent changes in real wages (Caves 1996, quoted in Bora, 2002, p.235). However, (Sida, 2004) noted that a great deal in manufacturing is likely to result in employment of highly skilled labor and thereby only indirect benefit to the poor. In short, developing host economies need to improve on their skills and general education so as to gain from TNCs presence in their economies.

2.4.4 FDI and Technology:

The level of technological competence affects firms' market share by producing product quality. Technology promotes economic development by increasing factor productivity, changing exports in favor of research intensive product with higher growth potential. However, importing and mastering technologies in developing countries is not as simple due to extensive coordination problems, externalities, missing markets and cumulative effects. In developing countries, technology transfers occur through TNC affiliates, joint ventures, franchising capital good sales, licensing, technical assistance, sub-contracting or original equipment manufacturer (Nabende-Bende, 2002, p.143). However, benefits from technology transfers by TNCs should not be taken for granted unless: they economize on the local scarce resources, directly or indirectly contributing to economic growth; have impact not only on GDP, but also on the livelihood and employment

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possibilities for the people; integrating the host government development planning process and strategies, and do not create 'technological enclaves' or regional imbalances' (quoted from Manson, 1994; in Bende-Nabende 2002, p.144).

A local firm may improve on its productivity by copying technology used by TNC affiliates operating in the local market. TNCs may also facilitate the transfer and diffusion of technology by signaling to local firms that certain products exist, that there is a market for them and how to produce them through the so-called 'demonstration effect'. The entry of TNCs may lead to technology spillovers through competition that TNCs may force local firms to search for and implement more efficient technology. TNCs may need to undertake research and development to adapt parent company technologies for products to suit the local market and be more readily adaptable to local conditions (Wong 1995 quoted in Bora, 2002, p.237). The importance of technology in developing countries have made OECD (Moosa, 2002, p.93) to issue guidelines urging TNCs to ensure that their activities are compatible with the technology plans of the host countries; adopt practices that allow the transfer and rapid diffusion of technology; address local market needs in an exercise pertaining technology; license technology on reasonable terms and conditions; and to develop ties with local university and research.

In sum, the role of governments is to arbitrate technology transfers by developing and promoting domestic capabilities. This ca de done by having good educational base, strengthen technological institutions, encourage firms in export sector to employ new technology that advances their competitiveness.

2.4.5 Production Linkages:

Production linkages are direct backward and forward linkages subsumed in economic development. FDI facilitates linkages between foreign affiliates and local firms, eases access to larger markets and resilience to shocks (UNCATAD, 1995, p.127). The impact of inward FDI adds capital stock that increase productivity and induces series of multiplier effects leading to expansion of indigenous firms (UNCTAD, 1995, p. 202 - 209). Linkages can be done with local suppliers, marketing intermediation and franchising and licensing. FDI influences growth by raising factor productivity in the host country mainly through: (1) linkages between FDI and trade flows and (2) spillovers and other externalities (OECD, 2002, p.8). Developing countries always have poor technology for the development of linkages. However, they can allow linkages to develop naturally (OECD, 2005, p.11). Hence backward linkages lead to spillovers while forward linkages are also seemed important for increasing necessary competition (UNCTAD, 2006b, p. 178). However, the benefits are accepted but the magnitude is less provable because of weak policies that hold back the benefits.

2.4.6 Costs of Foreign Direct Investment:

The effect of FDI can crowd-out or crowd-in investment by domestic firms (Bende-Nabende, 2002, p.150-153 &UNCTAD, 1999, p.212-214). Crowd-out may result from increase in the host country's interest rates when foreign firms borrow locally under conditions of scarcity and the use of superior assets thus justifying the need for protection of infant industry in developing economies. But, crowd-out on inefficient domestic firms may be desirable in the host country since FDI introduces dynamic competition and flexibility. However, crowding-in takes place when investment by foreign affiliates

stimulates new investment in the downstream or upstream production by other foreign or domestic producers or increases efficiency of financial intermediaries.

The analysis of economic and non economic costs of FDI have been discussed in the literature (Caves, 1996; Casey, 2003; Petras, 2005). FDI can substitute good jobs with bad ones; reduces real wages; facilitates high import propensity; causes deterioration in the host country's trade balance; transfers technology back home, compromising the host technology secrets; "crowding out" local capital and public initiative, and even local borrowing as well as creating 'boom and bust' in the economy; manipulates prices through intra-corporate transactions; erodes tax bases of other countries, and distorts trade and investment patterns and undermines the fairness, neutrality and broad social acceptance of tax system generally. Also, differences in environmental standards between countries may influence TNCs to invest in "dirty" industries in countries with low environmental standards exacerbating environmental degradation that may be already occurring (Bora, 2002, p.236). This suggests that the environmental policies among different countries are cost factors that can influence the location of TNC investments in dirty industries. Moosa (2002, p.73-77) acknowledged that TNCs can lower growth in developing country if; profits are repatriated rather than reinvested; and investment in manufacturing is detrimental to developing country's balance of payments because of high import contents as well as the mechanism of transfer pricing of TNCs. However, host policies are needed to minimize such practices.

In short, host developing economies can benefit well from FDI only if they have developed the absorptive capacity through training; linkages are needed in attracting specific kinds of projects. In addition, linkages need favorable conditions in the host country. These should be resulting from government policy especially in local contents of significance projects to host economies.

2.5 Policy Options for Managing Foreign Direct Investment Desirability in Host Economies:

2.5.1: Introduction:

This subsection examines policy options which host economies can use to make FDI work for the economy's development objectives. These include privatization and liberalization, promoting FDI role in infrastructural services, different policy interventions, regional integration, fiscal incentives, and the role of investment promotion agencies. Also, examples are drawn from the "emerging giants" and the South East Asian countries that have successfully managed to benefit from FDI.

2.5.2 Further liberalization and privatization:

The future of FDI policy depends on further liberalization of trade and investment policies. The state's role will be based on attracting the Headquarters of FDI (UNCTAD (1993, p.29&33). Especially in Africa that needs further diversification of the production structure towards manufacturing and services; ability to enlarge markets and foster high growth rates; improving on infrastructure including improvements from ODA; and ability of South Africa to become an investment pole for SSA. These policy factors include adopting macroeconomic reforms, including alleviating debt burdens, further

liberalization of FDI and related regimes, including those in primary and secondary sectors, introduction and expansion of privatization programs.

However, while pursuing the above, the "dos" in host economies (UNCTAD, 2003a, p.141) include a non-discriminatory, stable and predictable trade and investment environment; and a good competition policy. The "don'ts" include avoiding certain elements in policy approaches such as "subsidy race" being typically both discriminatory and expensive, lowering of domestic standards to attract investors is a bad solution for all, and host country rules or regulations that may be risky make investment less effective are also poor solutions. This is because even if the importance market size may have become less important as a determinant of FDI location, it remains a key factor. Therefore, policy implications for investment liberalization include: (1) liberalization of entry and operation to increase competition; (2) limiting market power inducements; (3) minimizing anti -competition cartels.

In other words, host economies need stable and predictable policy and macroeconomic environment. Further liberalization and liberalization should be based on factors determining FDI attraction in a particularly host economy and the investment opportunities. This can be in sector where governments have been able to exploit but are of strategic to the host's development goals.

2.5.3 Foreign Direct Investment Role in Host Infrastructure:

The role of FDI in infrastructure in developing countries can be channeled through greenfield. For instance, governments of Vietnam, China and Malaysia used build operate – transfer scheme (UNCATAD, 1996, p.22). This solves the infrastructure problems in developing countries. Host economies with a minimum necessary telecommunicating infrastructure can now leapfrog stages of development by adopting the new technologies like cellular telephones (Nabende-Bende, 2002, p.143). Host policies related to services should be used to promote universal access to telecommunications, through targeted incentives (UNCTAD, 2004, p.201). For landlocked developing countries, UNCTAD (2003b, p.7-8) pointed out the importance of attracting FDI that is not sensitive to distances. However, most developing host economies put restrictions on FDI in some infrastructure services. This is intended to safeguard the welfare of citizens; national security and price ceiling sometimes make such opportunities not being attractive.

2.5.4 Different Intervention Approaches:

UNCTD (2006b) defines four different intervention approaches: (1) passive open door policy involving limited policy interventions or no industrial policy; (2) open door policy involving selective interventions to improve on supply conditions; (3) strategic targeting of FDI; and (4) restrictive policy. However, Alternburg (2000, cited in UNCTAD, 2006b, p.8) argues that approaches 1&4 are not sufficient to exploit the opportunities from FDI. The optimum for many low-income countries will be near the second approach and only if local capabilities are developed. However, such assertions are disapproved by China,

which employed restrictive policy while Singapore and Malaysia targeted specific types of FDI to deepened linkages in manufacturing rather than only employing open door policy.

However, UNCTAD (2006b) called the first policy intervention as minimalist approach which focuses on the basic investment foundations and the second policy as an encouragement approach focusing slightly on a more of interventionism to solve market failures. The third is called, selective policies for specific firms or activities of strategic importance. Lastly, is the restrictive approach, which is a hard policy like market reservation for certain companies and mandatory local contents. Furthermore, domestic content is extremely useful to developing countries but question is how governments can apply is still an interesting point for the discussion. If domestic content is done for strengthening linkages, then government also needs to the market failure of imperfect information of the potential suppliers or cheap location (UNCTAD, 2001, p.164). In short, domestic firms and foreign affiliates should be brought together in the promotion of specific linkage programs. In fact, there is no single best-practiced strategy within which policies are framed, but depends partly on pre-conditions in host economies. The message is simple. FDI policies should be in line with development strategy being pursued in host economies.

2.5.5 Regional Integration:

Regional integration brings light to the market size (Sida, 2004). It can attract FDI due to the greater financial stability, better policy coordination, improved infrastructure and a

more favorable investment climate that usually accomplished it. Hence, governments' role is to demonstrate "political will" so as to coordinate regional policies in some areas and give up certain options for the benefit of regional integration (Bende–Nabende, 2002, p.187). In fact, regional integration has become a global phenomenon that any country joining benefit from the alternative it offers rather than relying only on tax incentives. Hence, regional integration is a catalyst for both industrialization and economic growth.

2.5.6 Giving Fiscal Incentives:

The policy challenge for developing host economies is to attract FDI without financial incentives, but through competition of providing fiscal incentives usually referred to as the "dowry chasing" (Robinson, 1987, p.79), the "race to zero" (UNCTAD, 1999, p.290). Other commentators see fiscal incentives to attract FDI be intended only for correcting the market failures (UNCTAD, 1995, p.290). Fiscal incentive schemes for TNCs appear to increase, both in terms of conditions attached to them and the variety of options they provide. The activities of FDI favored by fiscal incentives include: (1) priority industries; (2) regional development; (3) exporting; (4) innovation, research and development. For example, Malaysia used targeted incentive (UNCTAD, 2002, p.206); and setting EPZs provided with infrastructure, and removing the red tape confines within a limited areas.

But there is one element missing, interests of governments and TNCs are quite different. Governments provide fiscal incentives to development while TNCs use fiscal incentives to improve on their competitiveness since costs will be automatically reduced. Hence targeted incentives minimize the negative consequences of these different interests.

2.5.7 The role of Investment Promotion Agencies:

Majority of host economies have moved away from the first generation policy (opening up an economy to FDI) and second generation (government marketing the locations) to third generation policy that involves targeting investors (UNCTAD, 2002, p.221). Third generation policy helps in attracting FDI to host development objectives, makes it possible to attract export oriented FDI rather resource–seeking FDI and it is cost effectiveness compared to IPAs which attract many FDI of low quality. The targeting policy can still be directed to specific industries, activities and companies. Therefore, the need for an integrated approach to attract FDI in Africa involves improving on the national and international investment frame works, supporting national investment promotion efforts, promoting information dissemination and public–private dialogue and facilitating linkages (UNCTAD, 2003, 37&85). In a different perspective, most IPAs in Africa generally do investing marketing rather than targeted specific types of FDI that would change the economic structure, especially in countries with limited natural resources and small market size. This is because FDI in Africa in mainly attracted in countries with natural resources and oil deposits and hence the alternative for those without is only limited to the general marketing and improving on policy environments.

2.5.8 International Experience:

China benefited from FDI because of the rapid expansion of domestic market, gradual opening of the domestic market to FDI and improve relations with North Korea and Taiwan (UNCTAD, 1994, p.68 and Kehal, 2004, p.79). FDI policies had been designed to attract investors to act in the way that enhances the development impact by building local capacity using local suppliers and also upgrading local skills, technological

capabilities and infrastructure through mandatory requirements. Therefore, the vision of host economies can be drawn from past experiences and should be pursued as a broader policy to raise productivity.

Hong Kong used passive-open door policy to TNCs and the government did not intervene to promote industrial development (UNCTAD, 1994, p.72) While Thailand and Malaysia pursued active industrial policies and promoted local enterprises in certain activities, but also adopted effectively open door, non interventionist policies in some export oriented industries. Singapore sought heavy TNCs participation in manufacturing, but intervened selectively to guide investors in technological activity thought to be desirable for industrial upgrading through Export Promotion Zones to reduce the transaction costs of investment (Te Velde, 2001, p.42-47). Republic of Korea and Taiwan maximized reliance on FDI in the form of technological transfers in the context of comprehensive set of industrial policies to deepen the manufacturing sector, promoting linkages and increase local capabilities. Ireland focused on attracting quality FDI rather than upgrading existing FDI and later emphasized linkages (Te Velde, 2001, p.42-47). While, example Malaysia and India have educational policy to shape absorptive capacity and SMEs linkages, appropriate local incentives for local sourcing and give research institutions incentives for their findings (OECD, 2005, p.11-12 & UNCTAD, 2006b, p.10-13).

Hence, there are five broad categories of lessons which developing host economies can internalize from managing FDI in East Asia (Indonesia, Malaysia, Thailand and Philippine) (UNCTAD, 2005, p.57): (a) crowding in requires a proactive macroeconomic

environment; (b) liberalization should proceed from a point of strength and be done strategically; (c) industrial policies matter; (d) strong and capable states are needed to bargain effectively with the large firms; (e) think regionally. This implies that any policy to be applied should be subjected to social and cost benefit analysis. Interestingly, the above experience shows that host economies can benefit from FDI, if it is seen to supplement home efforts. Hence host success on FDI policy depends on how particular circumstances and priorities are integrated in host development objectives.

Hence, policy options to managing FDI benefits in host economies are numerous. Further privatization and liberation in host economies need to directed to areas which diversified the economic structures, which can shifting from agricultural production to the promotion on manufacturing and even liberalizing infrastructural services to foreign investors. More developing host economies need to use targeted policy of attracting FDI instead of relying only on the minimalist and interventionist policies. This has been proved by the strategy adopted by the South East Asian Countries.

2.5.9 Summary of the discourse in the literature:

Most of the literature reviewed confirms that the general directions for consensus on policy positions of most host economies are receptive to FDI. Developing Host Economies have adopted liberalization, privatized and continued to improve on the investment climate and others are searching for regional groupings. In addition, host economies are actively seeking a better understanding on the various elements of FDI including its determinants, impacts and policy implications. The relative significance of factors determining the host economy's propensity to attract foreign direct investment

continues to be highly contextual and depends upon the specific types of FDI, motives and host policies related to FDI. However, lots of uncertainties have been generated in the literature in developing host economies on the importance of FDI. The literature on FDI (Te Velde, 2001, Seid, 2002, Bende-Nadende, Kehal, 2004 and among others) has been concerned with the experience of advanced countries and economies in transitions, the "emerging giants" (china and India), and in addition to the experience of the East and South East Asian economies. Findings from these countries can not be applied simultaneously in all developing host economies, especially in Uganda which has got different socio-economic and political settings, a newly small emerging market-oriented economy that seeks to attract FDI. The available literature on FDI in SSA is scanty and not systematic enough in formulating a turn around strategy needed for Uganda to reap the potential benefits of FDI. Literature in Uganda (UNCTAD 2000a, Obwona, 2001, UNIDO, 2002, UN, 2004, Obwona and Egesa 2004) points out the important economic reforms conducted in the 1990s to attract foreign investors, general impacts of FDI and constraints in the economy. However, this literature concentrates mostly on the "Washington Consensus" that takes concern only at the macro policy. This study relates how the macro reforms have benefited Ugandans through FDI spillovers, and suggests policy options to be addressed. More so, some of the literature has been written for business organizations and portrays little evidence necessary for strategizing policy issues so as to answer questions regarding the achievement of quality and effectiveness in growth by using FDI as an alternative development paradigm to meet the national objectives. Moreover, the methodology used in some of the literature on FDI in Uganda was based more on surveys. However, this study analyzes documents so as to introject

out the best practiced issues emerging from investing enterprises in Uganda. Therefore, this study first analyzed to what extent Government of Uganda supports FDI, by looking at the macroeconomic and incentives for FDI and how institutional weaknesses undermine government's efforts. Secondly, this study looks at the basic characteristics of FDI enterprises in Uganda. Thirdly, analyzes the benefits of FDI only in terms of spillovers which have remained scarce in reviewed literature, and lastly, considers strategic issues which Government of Uganda has to improve on, so as to maximize the benefits from FDI.

CHAPTER THREE

MACROECONOMIC AND INSTITUTIONAL INCENTIVES FOR FOREIGN DIRECT INVESTMENT IN UGANDA'S ECONOMY

3.1 Introduction

This section evaluates the Government of Uganda's (GOU) efforts to attract Foreign Direct Investment (FDI) into the economy since the 1990s. This study looks at the importance of macroeconomic and institutional incentives in attracting FDI in Uganda, and compares how institutional weaknesses undermine government's efforts to use FDI as an alternative development paradigm. The investment code of 1991 provides pro-investment incentives and guarantees against state's expropriation. A turn around strategy was in 1997 and 2003 to provide generous incentives for capital investment.[1] Uganda's economic growth appears to be stabilized at a lower rate of 4.7 per cent of GDP by 2003 compared to the period between 1994-2002. Agricultural sector contributes to (34%) of GDP more than manufacturing (10% of GDP).[2] Given the total population of 28.8 million in 2005, [3] Uganda has been classified among the Heavily Indebted Poor Countries (HIPCs) by the World Bank.[4] Therefore, FDI is seen as a viable strategy by the current regime to obtain growth without adding further indebtedness, and this has been seen in the regime's commitment in adopting macroeconomic stabilization. Hence, inward inflows of FDI increased from US$ 1million in 1991 to US$ 256.4 in 2005 in Uganda (IMF, 2006, and details are in appendix C).

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[1] *UEPB (2004, p.9, 11& 12)*
[2] *AfDB/OECD (2004, p.325-327)*
[3] *World Development Indicators, April 2006.*
[4] *Country analysis briefs at great lakes region country analysis brief.htm*

3.2 Macroeconomic policy reforms:

3.2.1 Fiscal policy

This study takes an analytical approach to fiscal incentives in attracting FDI in Uganda. Tax holidays of 1991 were intended to attract foreign investors into the economy, and a similar reform was initiated in 1997. [5] The new fiscal reform tends to favor new firms more explicitly than under the gone tax holidays, in which losses may be carried forward indefinitely and depreciation allowances are generally favourable. However, tax holidays benefit long term committed investors, and Uganda's inadequacy in resource fundamentals such as natural resources, large market size and growth means attracting mobile TNCs that tend to respond to market signals.

Fiscal incentives are among the groups of factors that have positively lured FDI into Uganda's economy, but are not the most important factors for attracting FDI. The Private Sector Survey of 2003 in Uganda has pointed out that fiscal incentives influence investment decisions by (51%), trailing behind other variables such as political stability (72%), domestic market size (65%), regional market (55%) and telecommunication (55%). [6] Hence, foreign investors in Uganda's economy are attracted most due to political stability and economic fundamentals such market size and market growth.

[5]Ritva (1999, p.5&7):Tax systems in Uganda; Initial allowances of 50-70% for investment in machinery and plants in the initial year, the abolition of tax holidays, 20% of annual depreciation allowances to farms works instead of 4% under the previous arrangement. The company income tax is 30 % and firms are allowed to carry their operating losses indefinitely, except those granted tax holidays. The 1997 Income Tax Act stipulates the initial investment allowances and the annual depreciation allowances available to all taxable firms. It never granted initial allowances for industrial buildings and annual depreciation rate is much smaller to 5 % than that of machinery.

[6]UBOS (2004, p.67) report on interviews of 46 % foreign and 54% domestic firms

However, the role of fiscal incentives should not be undermined because Uganda is comparatively poor in terms of natural resource endowments, and it has not yet developed fully the basic microeconomic variables necessary to reap the full benefits of fiscal incentives. For example, SAI and Xpressions flowers' firms have relocated to Ethiopia because it offers development funds, training and market research on top of land, long term loans with low interest rates, support grants, 10 years' tax holidays, basic infrastructure and subsidized air freight charges to investors.[7] At this point, critics have to acknowledge that fiscal incentives are necessary evils in Uganda's economy because they reduce the cost of doing business.

As noted earlier in the literature that fiscal incentives can lead to delays and corruption, findings from Uganda's economy justify the above hypothesis. Foreign investors face delays and additional costs while determining their eligibility for fiscal incentives from UIA in order to avoid troubles with the Uganda Revenue Authority (URA). According to The World Bank Group 2006 data base, the number of procedures needed for starting a business remained at 17 since 2004, and number of days has been reduced from 36 in 2004 to 30 in 2006. These procedures and days are higher when compared to 6.2 and 16 in OECD respectively. Even the newly introduced VAT created more constraints on investors by 49.9% and income tax (42.8%), corporate tax by 37.8%. [8] The issue is not only about fiscal reform, but the conduct of business with regards to tax collection, whereby investors are considered as customers. If tax incentives are poorly implemented, management will be failing the already existing foreign investors.

[7]The New Vision, Thursday 14th December, 2006
[8]The New Vision; Sunday, 21st May 2006: report on Private Capital Survey 2005.

Fiscal incentives are effective and necessary, but what matters is the behavioral culture of the implementing authorities to exhibit acceptable behaviors. For Example, URA which administers tax concessions was reported in the 1998 Survey as the least popular agency in tax and custom administration, and is neither improving nor changing in some of its tax administration because of the excessive bureaucracy, high tax rates, delays in clearance of document and goods.[9] With the recent power crisis in the economy, URA only managed to be displaced to second position from lists of agencies which negatively affect investment after UEDCL (22%) because of load shedding and URA (16%).[10] Is it because URA is given too much power? No, power is needed for the efficient tax collection, but URA should be checked by the ombudsman that reports work abuses without any compromise because delays and corruption undermine country's policy reform.

Similarly, Uganda pursues a relatively tight fiscal policy to promote private sector development and avoids crowd out effects. The fiscal deficit was reduced from 4.5 per cent of the GDP in the fiscal year 2001/02 to 3.3 per cent of the GDP in the fiscal year 2002/03, and tax revenue increased from 10.8 per cent of the GDP to 11.9 per cent of the GDP respectively. [11] This has crowded-in private opportunities in the economy. In fact, as a pro-Washington consensus, Uganda receives relatively an increased Official Development Assistance (ODA) to the buy tradables.

9Duanjie and Ritva (1999, p.12)
10 AfBD/OECD (2004, p.57)
11Basu & Srinivasan (2002, p.33)

Hence, stability is being registered at the macro level, which tends to take a long term approach to redress inequality in development. Moreover, the reduction in the fiscal expenditure has shown inadequate success in the social sector such as health and rural infrastructure. Even the private sector which is feared not be overcrowded does not adequately invest in these areas.

3.2.2 Monetary policy

The adoption of flexible exchange rate and the legalization of the black market in 1990 were intended to stabilize the value of Ushs. Also, current and capital accounts were liberalized to facilitate free flows of capital. Bank of Uganda (BOU) was boosted to formulate and implement monetary policy independently through "Bank of Uganda Act of 1993".[12] Significantly, the annual inflation rate was caped below 5 percent.[13] This led to the reduction of inflation rate from 7.5 per cent in 1996 to 2.5 per cent in 2002, and interest rate was reduced from 22% in 1996 to 17.5 % in 2002.[14]

However, Uganda is a price taker at the international market and is pruned to drought. According to the Foreign Private Capital Survey 2005 report, foreign exchange was the biggest hindrance with 56.4% because of its volatility, followed by corruption (55.4%), interest rates (54.8) and power (39.8%). [13] Hence, foreign exchange is the most constraining factor in the survey of 2005 with corruption taking the second position.

[12] *Abdalla and Egesa (2005, p. 10 &11)*
[13] AfDB/OECD (2006, p.510)
[14] UN (2004, p.13)
[15] The New Vision; Sunday, 21st May 2006.

Monetary policy has a little successful story in attracting FDI into Uganda's economy, especially those dealing in financial services, capital assets and export oriented FDI which makes their products very expensive and not competitive in foreign markets.

The initial success in controlling the exchange rate and inflation rate were due to increased ODA which reinforced the capacity of Uganda's economy to buy tradables. High interest rates limit credit availability and growth to foreign investors which are needed for the capital investment. More so, the inadequate collateral of private investors make only big companies to access financial assistance, leaving out SMEs, even though they are needed for the development of viable private sector led economy.

3.2.3 Trade policy

Uganda has removed bans on imports and eliminated export taxes. [16] Bank of Uganda provides medium and long term financing to potential export oriented investors, and is supported by external donors' agencies. These include Apex Private Sector Loan Schemes to SMEs, and Export Refinance Fund for working capital in non-traditional crops.[17]

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[16]MoFPED (2000, p.2)

[17]Abdalla & Egesa (2005, p.12 &16) discuss numerous categories of exports and guarantee schemes; exports and imports were liberalized apart from agro-chemical and pharmaceutical that needed clearance from National Drug Authority. Manufacturers and exporters of goods and services have access to a duty draw back to enable them compete in foreign markets without undue hardship arising from costs of imported inputs into the final export price (exporters drawback up to 100%). Exporters in manufacturing have a bound scheme that allow them seek custom licenses to hold and use imported raw materials intended for manufacturing for exports in secured places without payment of taxes.

While Uganda has registered success in liberalizing its trade policy, there are weaknesses in institutional capacity with regards to effective implementation. There are 12 documents needed when exporting and it takes 42 days while importing needs 19 documents and it takes 67 days. [18] In addition, Uganda's ranking in the 2006 Economic Freedom Index was very low compared to other FDI competitors in Africa. Uganda (60th) trailed behind some of the selected countries like Botswana (30th), and South Africa (50th). [19] This reflects the limited degree of freedom in conducting business by the private sector in the economy. Financial loans have been limited and benefited only big TNCs. They find it easier easy to get financial loans compared to domestic investors while at the same time incur high cost on transport, and delays in cross border trade when importing inputs, which can even be produced locally by SMEs if funding was at least given relatively to them.

3.2.4 Political stability and transparency in the institutions:

As a way to reduce political risks, the GOU have recognized the importance of democratic governance as a prerequisite for political stability. [20] This policy has positively affected inflows of FDI in the economy (political stability registered 72 % and availability of local market (65%), regional market and improvement in telecom had 55% respectively). [21] However, political factor alone is not a necessary condition for sustained inflows of FDI. Economy has to improve on other non-political factors such as infrastructural services which reduce the cost of utility.

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[18]The WB Group 2006: Economy Rankings - Doing Business - sub Saharan africa.htm
[19]The Heritage Foundation <Index of Economic Freedom 2006 – countries.htm
[20]AfDB/OECD (2004, p.335)
[21]UBOS (2004, p.67) based on the Private Sector Survey 2003

More so, the GOU has demonstrated commitment and political will by instituting the Leadership Code. The objective is to limit the incidence of corruption and promote public transparency, good conduct and leadership in public agencies. Uganda has got a good program in creating awareness on best regulatory practices. [22] Unfortunately, there is little or no value for money gained from this program. Creating awareness among foreign investors has got negligible impact on improving the locational advantage, even though it remains a viable option on enlightening foreign investors to resist illegal practices. UNIDO's survey of 2003 was replicated in 2005 and the result has shown that investment perception has slightly worsened more than in the survey of 2003 in Uganda.[23] Graft seems to be unchanging in hindering the operation of business. Uganda was ranked 93rd out of the 102 countries in the 2003 survey,[24] and has featured to number 105 in the global corruption index ranking of 2006.[25] The Private Sector Survey of 2005 ranked corruption as the second hindrance (55.4%) after foreign exchange volatility (56.4%).

The act of corruption has become a public good whereby investors have to pay bureaucrats before accessing public utilities such as electricity, water, and telecommunications among others which preceded actual implementation of projects. This explains why Uganda has got low actual investment rates when compared to planned investment rates because corruption frustrates implementation of TNCs' projects.

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[22]Klein (2004) compared 12 African countries by making analysis of public statements, institutions and actions. He rated at a maximum of 24 points. Uganda leads with 20 points beating Kenya that was rated at Kenya 18 points and Ghana 11 points. Others were Tanzania 8 points, Mozambique 8 points, south Africa 6 points, Botswana 4 points, Lesotho and Malawi 3 points, Namibia, Swaziland and Zambia had 2 points.
[23]UNIDO (2006, p.124)
[24]World Bank (2004, p.41)
[25]Transparency International.htm -Berlin, 10th July 2006

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To prove that this is not based on intuition, The World Bank Survey (2000) disapproves the success of the Leadership Code, in which more than 80% of business firms reported paying bribes during a typical business year and the amount of bribes does not correlates with the favors offered in return:

> Most firms reported paying more bribes than on necessities such as security; 70 % on corporate tax, and 50% reported larger payment on bribes than total investment. *Not paying bribes will continue to mean loss of business for smaller companies and big companies can resist such practices. In a similar study, Ugandan firms typically have to pay bribes when dealing with public officials whose actions directly affect firm's business operations. How much? The more a firm can, the more it has to pay.*[28]

In analysis, Ugandan small firms are affected most by graft than large firms which have got the power of neo-corporatism. This practice kills the economy because SMEs are needed for the development of absorptive capacity that later transfer employment to ordinary Ugandans, who can not easily be employed directly by the big TNCs because of low skills. By bureaucrats directly affecting firms' business operations, means deterrence of 'referred investors' who respond positively to investment opportunities when tipped by the already existing investors. More so, it can be argued that, it is not firms paying bureaucrats, but ordinary Ugandans who are consumers bear the actual incidence because corruption is included in the factor of production, and firms shift the cost to consumers who bear the real burdens.

Svensson further found that corruption has two adverse consequences: 1) discourages investment in sector S1 and shifts production to sector S2 and he called it "allocation effect"; 2) firms will tend to pick a more reversible (but possibly less efficient) capital stock, and he labeled it "technology effect." [26]

These shifts are market failures caused by egoistic bureaucrats who reduce competition, which affects the welfare of citizens because prices become high as the supply of such commodities becomes volatile to bribes. Even the adoption of less efficient technology is a market failure in facilitating technological transfers which the government has ever talked of through FDI

3.3 The return of Asian investors:

Amin's government gave an ultimatum of 90 days to all Asians to leave Uganda. Yet Asians were active in trade and agricultural-based industries like sugar production by the early 1970s. Historically, Asians were Indians coolies who came to build the East African Railway at the turn of the early 20th century, and they were about 25,000 to 70,000 strong communities at the time of independence in 1962. Most of them had British citizenship while a small number held Indian and Pakistani passports. Amin's "economic war" was applied indiscriminately to all Asians irrespective of citizenship or economic contribution. United Kingdom took 300,000 of them, Canada 15,000 and some returned to south Asia. The Expropriated Properties Act of 1982 was passed by Obote's regime to lure Asian investors back into the economy and this continued during Museveni's regime, that actively wooed the Asians and about 5,000 Asians investors have already returned, others have reclaimed their assets, rehabilitated industries while some have started new investments.

[26]Svensson (2002 1, 2 &41); he studied the causes and consequences of corruption in Uganda where he collected quantitative data on micro corruption on a cross- section of firms. His study was guided by a simple principal agent model and rested on the assumptions: 1) bureaucrats are profit maximizers; 2) existing firms can avoid bribes; 3) there are many bureaucrats, each being uncertain of remaining in a position to extract rents.

The Madhvani Group is among the Asians who have returned and controls significance enterprises like Kakira Sugar Works and Nile Breweries, and contributes to Government revenues at 80 billion Ugandan shillings per annum.[27]

The return of Asian investors is a practical example of a demonstrated political will to attract Asian investors back into the economy, and build confidence in them that the Ugandan economic nationalism of 1972 has been shelved by the current leadership. As a result, Indians in the last five years have created 115 project investments worth Ushs 170 billion plus 7,839 jobs. [28] They are currently actively involved in construction, agriculture, mining and the financial sector. Their expertise in wholesale and retail businesses has induced competition and prices have been driven down.

3.4 The Privatization factor:

Uganda implemented the privatization program due to the need to reduce fiscal burden, develop private sector, broaden ownership, increase economic efficiency, reduce administrative burden, and develop capital market.[29] This was conducted through the Public Enterprise Reform and Divestiture Statue of 1993, in which 117 enterprises have been divested and 39 liquidated/strike-offs (appendix A provides some of the remaining public enterprises not yet privatized). The divestiture started with small enterprises and the focus is currently on utility and large scale sector.

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[27] *UN (2004, p.17)*
[28] The New Vision, Sunday, 19th November, 2006 based on the report by UIA's executive director Dr. Maggie Kigozi.

The privatization program was successful since productive capacity of privatized enterprises has increased from 11% in 1993 to 51% in 1998. The pace of privatization process was faster in Uganda, and this facilitated rapid inflows of FDI in the economy. The divestiture has taken the form of direct sale of government shares, wholly or partly, in public enterprises, auction of debt/equity swap, joint ventures, and management contracts.[30] Public Enterprise Reform and Divestiture was amended in 2000 to facilitate privatization process, embedded with the commitment and transparency under the new Privatization and Utility Sector Reform Project (PUSRP) which was effected from 31st January 2001.[31]

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[29]Campell and Bhita, 1996, p. 11 & 22
Privatization means transfer of the operational control of an enterprise from the government to the private sector. The operational control to the private sector can be conducted through leases, concessions, or contract management. Controls are always secured through majority ownership. The definition includes ***equity dilutions*** -where the government has moved from a majority position to holding minority equity and **Joint ventures** – where a government holds no more than 50% of the equity and has ceded management to the private holders.
Divestiture means any transaction by which the government has transferred title or sold some or all assets or shares in an enterprise. This includes sales of government held shares, transfers of shares or assets, public enterprise mergers, official liquidations or sales of assets through other means. Divestiture is a process to the privatization, but does not mean equity dilutions, joint ventures, leases, concessions, and management contract. Although government has ceded ownership controls under these methods (i.e. sold or parted with, or transferred title to). **Transactions** mean "deals" reached whether in privatization or step towards eventual privatization. **Liquidation** relates the closure and winding up of an incorporated enterprise in accordance with procedures under insolvency –full divestiture when the enterprise is wound up. **Lease** – in return for an agree fee (rent), a private operator is given the custody for a specific period of time of some or all of these assets of a public enterprise to employ them a in productive manner. Ownership of the assets remains with the enterprise, and the ownership of the shares remain unchanged – temporary privatization of the business takes place and lasts as long as the lease arrangement.
Concession is a contractual arrangement whereby, in return for a negotiated fee, a selected private operator is awarded a license to provide specified services over a period of time. Ownership of the principal assets remains with the enterprise, and ownership of shares remains unchanged – temporary privatization of the service takes place and lasts for as long as the concession lasts. Concession is awarded on a competitive tendering.
[30] Basu and Srinivasan (2002, p.36)
[31]MoFPED (2003, p.1&2)

This study focused on how privatization process has positively influenced inflows of FDI in Uganda's economy. For example, in November 1999 GOU and UEB executed contracts with AES Nile Power for the development of 200MW Bujagali private sector hydropower project worth US$ 500m.[32] South African power Company, Eskom, was awarded 20 years concession to operate the Jinja stations in November 2002.[33] Umeme Ltd in 2004 took the distribution role of power for a concession of 20 years. These arrangements improved on the management of power sector. However, there are other things government do better than the private sector, especially in the energy development which has got high sunk cost, long gestation periods, plus heavy capital investment in which the cost of power, if rendered by the private sector, becomes very expensive for citizens.

The monopoly of Uganda Posts and Telecommunications Corporation was abolished. The Uganda Telecommunications Limited (UTL) was created to compete favorably with new foreign telecoms. These include MTN, Celtel, Mango, and the new Warid. MTN joined Ugandan market in 1998 and currently operates countrywide.[34]

MTN has successfully created a "public good," that is cell phones, which was characterized by market failures of coverage, imperfect competition and monopoly. This has built confidence in foreign investors because utility costs are driven down and businesses can be conducted smoothly.

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[32] MoFPED (2000, p.9)
[33] UN (2004, p.19)
[34] MoFPED (2000, p.14)

In the financial sector, Uganda Commercial Bank was privatized in 2002 and finally merged with the Stanbic Bank of South Africa. This contributed positively, especially in stabilizing the financial sector with multiple commercial banks spurring up the expansion of financial intermediation which increases confidence of foreign investors. The privatization program is the most important factor that facilitated inward FDI. Other cases include: Rwenzori Highland Tea Company Ltd bought by Finlays Group, British American Tobacco (BAT) sold to BAT, Blenders Uganda Ltd sold to Unilever, Kakira sugar works, Kibimba Rice Co. Ltd, Uganda Tea Corporation.[35] Details on Uganda's privatization programs are in appendix B.

3.5 The Creation of Uganda Investment Authority (UIA):

The 1991 investment code resulted into the creation of UIA that handles process of investment proposals, giving assistance and advice to potential investors.[36] UIA in 1999 changed its role from general marketing to targeting of FDI into priority sectors such as horticulture, food processing, tourism, textiles, packaging, livestock, and mining, where Uganda has a competitive advantage.[37] Marketing strategies have been via direct mails to potential investors, use of both Ugandan embassies and consulates abroad and foreign embassies accredited to Uganda and other agencies as key avenues.

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[35]ibid[9] *p.9-10*

[36] UNCTAD WID – Country Profile: Uganda Nov. 2006

[37]*UIA Annual Report (1999/2000, p.9), priorities countries were grouped into economic zones: Zone 1 constitutes South Africa, Kenya, and Mauritius. Zone 2 constitutes Egypt and the Gulf States. Zone 3 Constitutes United Kingdom and France. Zone 4 Constitutes India, China, USA and Italy. In Zones 1-3, UIA contracts International Investment Promotion Service providers to assist in targeting investors in the respective zone such as www.aaitpc.com supervised by UNIDO. UIA staff handles the investment promotion activities for countries in zones 4.*

The Mission to India and Malaysia in April 2000 was for palm oil growing, milling and refining in preparation for the implementation of Oil Palm in Kalangala. [38] This mission yielded a positive outcome. BIDCO Company currently runs a palm oil plantation project in Kalangala district.

In addition, UIA provides investment facilitation and "after care" by organizing meetings with investors to identify investors' problems and handle investors on case by case basis at different levels of authorities, and liaisons with relevant line agencies and ministries to provide services to all prospective and already existing investors.

After looking at the UIA as one of the means the GOU is supporting FDI as an alternative development paradigm, it is important to consider whether its role in promoting FDI has been adding value for money. A follow-up assessment of the UIA project activity concluded that $830 million was invested as a result of these components, amounting to $ 1,000 for every $ 1 spent. A detailed analysis confirmed that investors' projects are closely linked to the outward and inward missions. Up to 500 of 1800 existing investors contacted received "after care" through site visits.[39] In addition; the BIDCO Palm oil project in Kalangala has been as a result of outward mission to Malaysia in 2000. More so, over 710 (about 20%) investment projects licensed since 1991 have taken off according the report by UIA.[40]

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[38] UIA Annual Report (1999/2000, p. 10, 11, 14, 16 & 17)
[39]MIGA, 2004, p.53
[40]The New Vision, Tuesday, 16th January 2007

In critical perspectives however, UIA has registered great impact on the promotional role and its performance has been evaluated by TNCs at above 85 % in line with their expectations in the UNIDO's survey of 2003 (p.78). However, it has attracted more of 'quantity rather than quality' of foreign investors competing for domestic market especially in the production of non tradables. The UIA has also done little in directing investments in order to spur regional development because the greatest percentage of investments is in the central region.

In line with the above mentioned point, it is advisable for the UIA to focus currently on land as a factor of production, UIA has achieved less especially in securing land for commercial investment which can generate spillovers in the economy. Land in Uganda is leasehold land rather than freehold to foreign investors. [41] Hence, the role of UIA is still limited to stakeholders' management on land issues. Land is really scarce to potential investors in Uganda because of the political economy involved in it. For example, BIDCO is a greenfield palm oil project in Kalangala district, approved by the GOU in 2004 and started with $ 150m. The GOU is expected to provide 26,500 hectares of land, 25 years corporate tax holidays and VAT deferral for plantation projects. Only 5,500 hectares of land have been provided, and 3,500 hectares have been utilized for palm trees project. However, the project has got opposition from environmentalists and Members of Parliament because of the ecological consequences and fiscal losses.[42]

[41]Games (2004, p.71): In addition, lists of lands available to foreign investors in Uganda are Sembabule (4.5 square miles) lease hold, Kiryangdongo (9 square miles) freehold, Masindi (20 square miles) lease hold, Kasangati (20 acres) lease hold, Pain Upe (1700 square miles) untitled, Luzira (26 hectare miles) freehold, Nalumunye (137.5 hectares) mailo land, Pallisa (Un-surveyed), Bweyogere (35 acres) freehold (UIA Monthly Report for August 2004).

[42]The New Vision, Sunday, 24th September 2006

The Sugar Corporation of Uganda (SCOUL) has got land problem. SCOUL needs about 7,100 hectares of land for increasing the production of sugar in order to meet the national target. SCOUL also pays annually about Ushs13.3billion in taxes, employs 6,760 people, in addition to 1,000 out growers. [43] In Northern Uganda, the political risk is high for foreign investors because of continuous pronouncements of economic nationalism by area representatives:

> *I will spear to death any investor who dares to step in my constituency, I am warning the minister that we shall spear any investor who claims to be investing in our land or any body who dares to plough it because land is the only asset we are left with, said Aruu representative.[44] If the government tries to take our land, there will be more atrocities than those committed by the LRA rebels, said Acholi Parliamentary Group Chief.[45]*

These complicate the role of UIA which liaison between potential investors and land owners. Its role is constrained by the political economy in areas that are cynical of the land question, seeing government's efforts to acquire land for commercial investment as 'state alliance of neo-corporatism' to grab their land in the name of promoting development. Land has become a public good for politicians in Northern Uganda. It is supposed to be preserved for future generations and this necessitates its capitalization in the quest for a political alternative. People in Northern Uganda have low awareness on how they can benefit from foreign investors and UIA has also done little in creating awareness to an average communal person in the North. Hence, the issue is whether UIA decentralizes its land role and the local finalizes deals on land arrangements with the potential investors who shall be renting from the local community rather than being sold?

[43]The New Vision, Monday 16th October 2006: Metha wants 7,100 Hectares.
[44]The New Vision, Thursday, 16th November 2006: Otto warns investors
[45]The New Vision, Friday, 17th November 2006: Acholi MPs warned on land statements

3.6 The Medium Term Competitive Strategy (MTCS):

MTCS is a multi-sectoral government program which aims at improving the private sector competitiveness by increasing investment in basic infrastructure and improving institutional capacity of various ministries and line agencies. [46] It is based on the philosophy that strong economic growth would eradicate poverty, given the high level of private sector investment. However, the actual experience from relating findings shows that achieving MTCS is far from an easy task. The Private Investment Survey of 1998 revealed that on average, firms lose an estimated $90m of operating days a year due to power cut, which later translates into high cost of production. This therefore, reduces the competitiveness of private firms in Uganda, even though, 77 percent of large firms, 44 percent of medium-size firms, and 16 percent of small firms own power generators.[47]

The impact of MTCS is insufficient in attracting the heavy manufacturing FDI because existing TNCs operate below capacity. It was not surprising when the hydro electricity capacity of 380 mega watts on River Nile reduced in the financial year 2005/06 to 135 MW because of the extended regional drought. [48] Amidst power shortages, Electricity Regulatory Authority has approved new tariffs increment that took place on 1st November 2006 to 41% and 55% for commercial and large scale industries respectively. Hence, Uganda Manufacturers Association (UMA) boss had to respond to such policy:

[46]UEPB (2004, p.7): Annual Report
[47]MoFPED (2000, p.3): Medium Term Competitive Strategy for Private Sector 2000-005)
[48]The New Vision, Thursday, 4th May 2006:

The power tariff hike slapped on the industry, which is already overburdened with high production costs, is devastating. Many of the industries will close or relocate to the nearby countries[49]

Hiking the power tariff adds cost of doing business in Uganda. Heavy industry automatically reduces production and this affects consumption level in the economy. More so, prospective investors are deterred from entering Uganda's economy due to the high cost of utility. Especially, footloose industries relocate to other countries because they (foreign investors) tend to be more responsive to policy environment.

Being a landlocked country (Uganda), transport is expensive to manufacturing firms and its infrastructure suffers from negligence and poor management.[50] It is 1,200 km through the northern corridor to the port of Mombassa, in Kenya, or 1,600km through the central corridor to the port of Dar-es-Salaam in Tanzania. High transport costs are estimated at about 35 percent of the total value of exports.[51] The transport cost of raw material from Mombassa had gone up by more than 50 per cent, and the rail cost of 20ft container in November 2004 was US$ 1600, while in September 2006 rated at +$2500 and road transport has gone up from US$ 2400 to US$ 3500 per 20 fit FCL. It takes less than 12 days to 30 days by rail and there are no return journeys of the export trucks.[52]

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[49]*The New Vision, Wednesday, 1st November 2006:* Industries risk closer over high power tariffs
[50]AfDB/OECD (2006, p.513): African Economic Outlook. Paris
[51]Games (2004, p.70): The experience of South African firms in doing business in Africa. A preliminary survey and analysis
[52]PSF (2005, p.1): Cost of Doing Business in Uganda. Policy Advocacy Unit 2005

To export oriented foreign investors, MTCS has not yet made any differences and this explains why Uganda's economy has more domestic market-oriented FDI than regionally-oriented FDI which could generate significant impact in the economy. More so, even those already operating in the economy do not compete comparatively because of high cost of transport and the trends are changing towards merchandise businesses than in key production areas.

3.7 The "Big Push" Strategy

The Big Push Strategy aims to promote competition, improve efficiency, spur innovation, encourage inter-firm learning, establish forward and backward linkages in production, and subsequently improves quality for firms to become competitive.[53] It came to exist after the 1998 joint analysis by the GOU, UNCTAD and UNDP; where fundamental decisions were reached to embark on the major push for investment promotion.[54] Sectors selected included: agriculture/cotton, banking and insurance, air cargo and inland port, education, Multi-Facility Economic Zones (MFEZ), information/communication technology, medical facilities and printing and publishing.

This resulted into the creation of EPZs and Free Trade Zones in Entebbe. In addition, GOU is working on New Industrial Park at Namanve and Luzira .[55]

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[53] United Nations (2004, P.11): An Investment Guide to Uganda Opportunities and conditions, New York.
[54] *UIA Annual Report (1999/2000, p.15)*
[55] UIA News Letters April-June 2006 Quarterly reports

However, this program is just at an initial phase, involving planning and site construction. It has got little impact in attracting export oriented FDI that would generate exports, increase employment and facilitate domestic linkages, instead it has attracted FDI only in construction especially those from South Africa. Hence, the government's effort in promoting FDI through Multi-facility Economic Zones is far from its realization.

3.8 Regional Initiatives:

Uganda is a member of East Africa Community (EAC), African Union, NEPAD and COMESA. It is also a member of African, Caribbean and Pacific Countries partnership, Cotonou agreement for the renegotiation of the preferential trade and aid links with the EU and is eligible for "EU Everything But Arms initiative" and the "United State's market access initiative" for sub-Saharan Africa (AGOA). It is a member of the WTO and is a signatory to the International Center for the settlement of Investment Disputes and Multilateral Investment Guarantee Agency.[56] EAC is a custom union that would lead Common External Tariffs on imported goods. [57] It is moving along the continuum from custom union to full economic integration.[58]

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[56]UNCTAD WID – Country Profile: Uganda Nov. 2006

[57] United Nations (2005 p.513): An Investment Guide to the EAC: opportunities and conditions. New York

The EAC member countries are Kenya, Tanzania and Uganda as per the protocol for the establishment in March 2004 and effected from 1st Jan. 2005. Burundi and Rwanda joined later in 2006. The member countries of COMESA Include Angola, Burundi, Comoros, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Zambia and Zimbabwe

[58] *The Implementation of the customs Union Protocol in January 2005; creation of a single regional air space in August 2005; setting up of a regional Capital Markets Authority in December 2005; setting up of a Common Market in December 2007; adaptation of a single regional currency in September 2009; swearing-in of the President of a transitional Federation of East Africa in January 2010; drawing up of regional constituencies and swearing-in of a transitional Federation Parliament in 2010-2012; and Elections for an East African President and Government in March 2013 (United Nations, 2004, p.9)*

The regional and international market access has had positive effect on location of FDI in Uganda, that is, 39 per cent on foreign investors and 33 per cent on domestic investors.[59] This is an important opportunity for Uganda to justify the promotional role to attract regionally oriented FDI in order to reduce its expenses on transport cost in accessing markets in the EU and other western countries.

In the project of AGOA, GOU pays up to Ushs 800m per year for its operations. These include: transport, training of girls, office rent, officer's allowances, travels, and fuel and vehicle maintenance. Apparels Tri-Star is the Uganda's company exporting garments to the US market under the project of AGOA since Dec. 2000. [60]

The case of AGOA is almost the new strategy of financial subsidies GOU has started offering to the Apparels Tri-Star company. Legislatures disagreed with the GOU on this position because GOU is going too far with the allocation of money to private proprietors. However, strategically, GOU is right to offer financial assistance. The project has good impact on the economy, employing unemployed young girls countrywide, by exporting textiles to the USA means linkages with rural farmers in cotton production. Hence, the problem of financial management was at the company's level, not the responsibility of the Government of Uganda.

[59]UBOS (2004, p.53): Private Sector Investment and Investment Perception in Uganda Report 2003
[60]The New Vision: Friday 3rd November 2006: Now MPs want TriStar's Kananathan arrested

3.9 Comparisons of constraints on foreign and domestic manufacturing firms

Can we say that foreign investors are doing better because they are foreigners and have special offers compared to domestic investors? The response is no, they bear more burdens than domestic firms in Uganda as illustrated in table one below.

Table 1: The percentage of respondents evaluating constraints as major or very severe.[61]

Constraint	Full sample	Foreign firms	Domestic firms	Exporters	Non-exporters
Cost of finance (interest rate)	60.3	54.1	62.0	62.5	60.2
Tax rates	48.3	43.3	49.6	48.9	48.4
Macroeconomic instability	45.4	**57.6**	**41.3**	**64.3**	**41.7**
Access to finance (collateral requirements)	45.0	**36.5**	**47.7**	37.2	46.6
Electricity	44.5	48.5	43.1	52.4	42.9
Corruption	38.2	**55.0**	**33.3**	**56.4**	**35.0**
Tax administration	36.1	42.2	34.5	42.9	35.1
Anticompetitive or informal practices	31.1	34.4	30.2	**41.5**	**29.4**
Skills and education of available workers	30.8	25.4	32.0	36.6	30.0
Regulatory policy uncertainty	27.6	**38.1**	**23.7**	**42.9**	**24.6**
Custom and trade regulations	27.4	**38.1**	**23.2**	33.3	26.3
Crime, theft, and disorder	26.9	**37.3**	**23.5**	**36.4**	**25.3**
Transport	22.9	28.8	20.9	**36.4**	**20.2**
Access to land	17.4	24.6	15.6	17.1	17.4
Labor regulations	10.8	12.3	10.4	14.6	10.1
Business licensing and operating permits	10.1	13.4	9.2	8.9	10.4
Telecommunications	5.2	6.2	4.9	7.0	4.5

*Differences of more than 10% between different categories are bolded

Source: World Bank Investment Climate for Uganda 2004 report p.38

Foreign firms bear more burdens due to macroeconomic instability, corruption, regulatory uncertainty, custom and trade regulations and crime, theft and disorder by margins of 10 per cent. The macroeconomic instability burden reflects the dominant role of FDI in financial services which are affected by unstable value of Ushs against foreign currencies. Uganda is a price taker at the international level and is affected by changes in world oil prices, in addition to drought that has destabilized the economy.

[61] *The World Bank 2002/03 survey was conducted to 392 firms in Uganda*

Local firms are mainly dominant SMEs in agriculture, whole sales, and construction and services, hence, scoring low in the comparison. Corruption is high among foreign firms because they are foreigners, financially loaded, and they have low level of awareness business procedures when accessing public utilities. They become the prime target of bureaucrats unless they want to receive the utility of 'come tomorrow' which is tactical. Customs and trade regulations having severe constraints on foreign investors reflect the traditional dominant role of FDI in the economy in production of raw materials to supply their home countries. The existence of regional export oriented FDI, long procedures and number of days for importers and exporters, and also reflect the high number of TNCs in Uganda which outsourced inputs from outside the economy.

However, foreign investors have fewer constraints in accessing finance compared to local investors. This reflects the big size of TNC investments in the economy, which makes it easier for banks to grant foreign investors loans compared to local investors which have small size investment, making interest rates on borrowed loans very high because of high risk of paying back. Exporters face high degree of constraints on macroeconomic instability, corruption, informal practices, regulatory policy uncertainty, transport and crime, theft and disorder by margins of 10 per cent compared to the non-exporters. Ugandan products become expensive at the international market because inflation pushes up prices of factor of production. Corruption is high during the clearance to avoid delays, while informal practices such as smugglings reduce firms' revenues and competitiveness due to the availability of cheap good and services. Transport cost is high to the sea while

non-exporters only concentrate on the domestic market, thus reducing their degree of exposure to such practices.

To sum up this chapter, the Government of Uganda has employed various macro policies to support FDI in the economy, including fiscal incentives, liberalized both exchange and capital markets, privatized most of its public enterprises, created promotional agency and recalled back the economic engineers chased during Amin's regime. Uganda is currently moving towards micro policies to reduce the cost of doing business. These can be seen in the adoption of MTCS and the Big Push strategy.

Fiscal incentives positively affect FDI location decisions in Uganda, but are not the most important factors compared to political stability and economic fundamentals such as domestic market and regional market. The provision of fiscal incentives by state authorities adds delays and costs to firms due to the ineffectiveness in administering, and has given bureaucrats the opportunity to do corruption.

The monetary policy has performed poorly in Uganda's economy. The exchange rate volatility and high interest rates negatively affect FDI when it comes to capital loans. Uganda has liberalized trade, but non-tariff barriers remain active in frustrating foreign investors in the export sector. Uganda's role in building transparent business operations, which is free from corruption, has remained unchanged in spite the adequate awareness.

The privatization program has positively affected inflows of FDI. The productivity of privatized enterprises has increased by a difference of 40 percent (an increment from 11% in 1991 to 51% in 1998). Any discussion beyond this role is exogenous to the thesis argument. Calling back historical investors into the economy has been one of the significant reforms. Asians have rehabilitated their former enterprises which were nationalized and others have opened new ones.

The role of UIA has been very effective in general marketing to attract FDI, but not much in targeting specific types of FDI which could turn around the economy and in managing land owners who leased land to foreign investors. Uganda's economy has stagnated for the last 9 years with no improvement in terms of attracting FDI. Uganda was ranked in the 11th position in 1998 in terms of attracting FDI (UNCTAD, 1999, p.49) in Africa. The recent ranking by the World Bank 2006 is still in the 11th position. The FDI tends to respond to economic fundamentals (natural resources and market size and growth) more than the general improvement in policy (fiscal incentives, political stability, and good regulation).

CHAPTER FOUR
BASIC CHARACTERISTICS OF FOREIGN DIRECT INVESTMENT ENTERPRISES IN UGANDA'S ECONOMY

4.1 Introduction:

This section discusses the basic characteristics of FDI enterprises in Uganda's economy. It looks at the sectoral orientation of FDI enterprises, the country of origin, entry mode choices, and the regional distribution of FDI enterprises. Emphasis is taken in relating characteristics to the need of the host economy. Bank of Uganda defined FDI as reflecting the objective of a lasting interest by a resident entity in one economy (direct investor) in an entity resident in another economy (direct entity). FDI comprises of three components: new equity investment, re-invested earnings and inter-company loans.[1] FDI flows to Uganda's economy increased from US$1 million in 1991 to US$ 258.5 million in 2005. Equity investment increased from US$1 million in 1991 to US$155.9 in 2005 (details in appendix C). These are due to changes in national policies such as privatization via M&As, and purchases of the existing projects which later helped in restoring the economy at the macro level, especially in agriculture, mineral, finance and real estate development.

FDI enterprises have reinvested their earnings in Uganda. Reinvestment in earnings increased from US$5.0 million in 1993 to US$70.7million in 2005. This is a good-practiced issue emerging from FDI because of re-investment in new projects within the host economy, which is a precondition for achieving economic development and building linkages within the economy. On top of this, reinvested earnings in the host economy is a

way of paying back to the economy because of its multiplier effects compared to profit repatriations and transfer pricing. Reinvesting in earnings also builds the national confidence in the performance of foreign firms which would act as an incentive for policy reform on equal treatment with local enterprises. However, reinvesting in earnings does not automatically mean benefits to the host economy unless it is in line with its economic interests and development strategy, and directed to sector of national priorities other than only in corporatists' interests.

As often emphasized, FDI can deepen the absorptive capability of SMEs by assisting them through financial obligations. Uganda's economy has got good examples in which inter-company loans transfer increased from US$22.1 million in 1997 to US$31.8 in 2005. Inter-company loans are given to local affiliates, but more financial loans should be given to local suppliers of inputs plus local distributors of TNC products. This can alternatively be a development point, where good local entrepreneurs are able to access real financing from financial intermediaries.

4.2 Sectoral Orientation of FDI Enterprises:

A survey by UBOS in 2003 shows that foreign enterprises' activities in Uganda are concentrated mainly in manufacturing (29.1 per cent), wholesales and catering and accommodation (20.6 per cent), and finance services (16.8 per cent).

[1]UNCTAD WID – Country Profile: Uganda p.4 Nov. 2006

Table 2: The principal private enterprises' activities in Uganda.[2]

Sector	Domestic		Foreign		Total	
	No	%	No	%	No	%
Agriculture, hunting, forestry and fishing	42	10.2	30	8.5	72	9.4
Mining and quarrying	1	0.2	5	1.4	6	0.8
Manufacturing	135	32.9	103	29.1	238	31.1
Electricity, Gas and water	4	1.0	3	0.9	7	0.9
Construction	15	3.7	26	7.3	41	5.4
Wholesale/retail, catering/accommodation	88	21.5	73	20.6	161	21.5
Transport, storage and communication	31	7.6	24	6.8	55	7.2
Financing/insurance, real estate/services	49	12.0	58	16.8	107	14.0
Community, social and personal services	14	3.3	10	2.8	24	3.1
Activities not covered in the above	31	7.6	23	6.5	54	7.1
Total	410	100.0	355	100.0	765	100.0

Source: Private Sector investment and Investment Perception in Uganda report 2003, published by UBOS 2004, p.16

The recent growth in manufacturing, wholesale, catering and accommodation plus finance sector shows investment opportunities in the economy because Uganda mainly depends on traditional crops (coffee, tea, cotton and tobacco) mostly from European investors. Manufacturing sector is the highest because of the new strategic market available in the Eastern Democratic Republic of Congo, Rwanda and Burundi as well as the new market in Southern Sudan where the factor of production had been non-operational for the last two decades due to wars. Also, when we look at the data from the manufacturing sector and finance, both foreign investors and private domestic investors have high levels of involvement. By implication, these necessitate opportunities for forward and backward linkages, learning from foreign affiliates' technology and management skills, and even setting up research and development center for product development and innovation, which will enhance products' quality and competitiveness on top of deepening the absorptive capacity of the economy.

[2]UBOS (2004) reports on the surveyed 765 investing enterprises in Uganda in 2003

To illustrate further, the financial sector leads in the actual investment with an investment of US$339.7 (23.5%), followed by manufacturing US$335.3 (23.2%), electricity US$20.6 (1.4%) and mining is the least with US$6.2 (0.4%). [3] In the financial and real estate services, privatization program has opened entry into the economy to rescue the ailing companies which were controlled by the government through M&As and Joint Ventures. More so, Uganda has inadequate, poor financial and real estate developers prompting foreign investors to exploit lucrative opportunities. Furthermore, the trend towards services is not sensitive to distance, and it is needed for the economic integration.

Uganda is experiencing high growth of FDI in financial services and real estate development, but manufacturing sector continues to dominate. It deems fit for the government to reinforce the recent development in services. These are non-tradables meant for domestic demands. Deepening the key productivity using the 'best-practiced policy' of targeted subsidy to promote production oriented firms in a particular industry is needed on top of relying on the general subsidy which has got little incidence, by attracting FDI in non-tradables.

Investors' participation in utility sector has been minimal since the 1990s. Private investments in energy increased from US$18 million in 2003 to US$124 million in 2005, and investment in telecom increased from US$4 million in 1994 to US$77 million in 2005. Hence, totaling to 10 projects; 5 in electricity, telecom 3, water and sewage 2.[4]

[3]UBOS (2004, p.22): Private Sector Investment and Investment Perception in Uganda Report 2003

[4]The World Bank Group 2006: Private Participation in Infrastructure Projects Database

However, investment in the energy sector should not only be seen as a response to the current drought in the economy which has reduced the power production capacity of the Owen Falls Dam, but should be seen as a strategic point of entry into the economy given the available resources for energy development including solar, biomass, and Fall sites. Such best-practiced policy would be to the interest of the GOU that is eagerly promoting the rural electrification, but it is constrained by limited resources. Private developers can complement government's production rather than being only consumers of energy. Foreign investors have recently invested in the energy sector to avoid load shedding which affects firms' productivity and competitiveness. The recent development in telecom is due to the liberalization and removal of antitrust law that inhibits new entrants in the sector because of the agreement signed between MTN and Uganda Telecom in 1998. This has helped in creating a public good (information and communication) across the country, unlike before under the monopoly of Uganda Post and Telecommunication Limited, which had been characterized by limited coverage, and lack of competition.

4.3 Country of Origin of FDI Enterprises in Uganda:

United Kingdom invests in Uganda more than any other country with a total of 287 licensed projects; U.S.A came second with 50 licensed projects (high capital value of investment), Kenya in the third position with a total of 219 licensed projects. Others countries are Canada with 82 licensed projects, South Africa had 31 projects, India had 178 projects, Egypt had 11 projects, Japan had 34 projects, Norway had 1 project, and Singapore had 5 projects. [5]

[5] United Nations (2004, p.15) listed the top ten investing countries in Uganda covering the period between 1999 -2002.

European investors are mainly found in agriculture, basic chemicals, pharmaceuticals, nonmetallic mineral products and financial intermediation, and they are absent in the wearing- apparel sector. African investors are strongly present in textile, wearing apparel, metallic products and manufacturing sector. Asian investors are particularly strong in wearing-apparel sector.[6] Uganda is mostly dominated by the small, recently established foreign enterprises from the south with a strong concentration in the service sector having the highest density.[7]

Europeans' dominancy in the agricultural sector has a lot of implications. One is due to the need for raw materials in home countries, which is cognizant with the locational advantage theory. Secondly, the market access granted under the "Everything But Arms" in the European Union and AGOA reflects the behavior of legislatures in opening up markets for their investors operating overseas as the primary objective, serving the interests of organized corporatism. This is because access is made for goods which are not produced in home countries and mostly intermediate agricultural inputs instead of manufactured products. Their roles in chemicals and pharmaceuticals reflect the high expertise and capitals that are needed, and African investors have limited access to capitals. Therefore, Uganda can even improve on by attracting FDI from the South rather relying only on Northern investors.

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[6] UNIDO (2003, p.13): African Investment Survey: Motivations, operations and future; Implications for investment promotion, Vienna.
[7] UNIDO (2006, p.20): African Investment Survey 2005; Understanding the contributions of different categories to development implications for targeting strategies, Vienna.

Their concentration in textiles, apparel, metal products and manufacturing sector relieves the economy of transport costs, reinforces backward linkages with local entrepreneurs, diversifying export development necessary for economic integration, plus creating more jobs in more dynamic sense rather than in a static sense that is evident in agriculture products.

This concurs with the view presented in UNCTAD (1994, p.33), that South Africa has a critical success factor for the investment pole in Sub-Saharan Africa. Cases from Uganda justify the proposition. UIA has a joint venture with South African companies including JHI Real Estate, iProp, engineering Companies BKS Global and ADS developers at Kampala Industrial in the construction of Business Park at Namanve.[8] South Africa invested $17 million in Uganda and has become among the top ten countries in Uganda, established 32 companies mainly in tourism, mining, energy, construction, agriculture, trade, and services. Its total planned of investment in Uganda has reached US$222.79, and has created 3, 583 jobs. Fifteen Companies are wholly foreign to Uganda, while 17 are Joint Ventures. South Africa dominates in the infrastructure sector in Uganda. For examples, Umeme and Eskom are in the power sector and MTN in telecom. MTN is the most powerful investment which begun in 1998 and holds 67% of the Mobile and 57% of the overall telecommunication markets including 207,000 lines in the 34 districts.[9] In fact, Uganda has benefited from the commitment of South African investors in the provision of "public goods" especially utility services which European investors have neglected.

[8]Games (2004, p.17, 66, 68&69): The Experience of South African firms in doing business in Africa, The South African Institute of International Affairs.
[9]The New Vision, 3rd May, 2006: South Africa companies dominate infrastructure sector

This has helped the economy in reducing utility costs, improved productivity, employment and leapfrogging technology of cellular phones, affordable by an average Ugandans. More so, many telephone outlets are operating countryside and local entrepreneurs act as agents to MTN showing the good-practiced policy.

4.4 Entry Mode Choices:

As noted earlier in the literature, FDI enters into the host economy through greenfield, M&As and joint ventures. UNIDO's survey of 2003 found out that Joint Venture enterprises are 20%, new greenfiled enterprises are 67% and M&As are 13 %.[10] Similarly, the Private Sector Survey report 2003 shows that 521 enterprises (68.1%) in Uganda are greenfield investments, 81 (10.6%) are due the expansion of existing projects, 31 (4.1%) are purchased through privatization and 49 (6.4) are purchased of existing project, 53 (6.9%) are others and 30 (3.9%) are not indicated.[11]

Uganda receives high number of FDI in greenfield as stated in the 2 surveys, and these have positive implications in the economy in terms of adding investment capital, offering new technology, introducing innovation management and linkages with the economy. However, high number of greenfield investments does not guarantee high employment and values added unless the government has high bargaining powers in inducing the behavioral and corporate strategy of TNCs in supporting linkages with domestic investors.

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[10]UNIDO (2003, p.32)
[11]UBOS (2004, p.17)
[12]The New Vision: Wednesday 15th November, 2006

For example, BIDCO is a greenfield in palm oil project in Kalangala district. It currently employs 1,500 people who work for eight hours a day for 2000 Ushs (appro.US$1).[12] However, this kind of greenfield increases the quantity of employment, but not the quality because of the poor working environment which is characterized by exploitation of rural people. How can someone work (physical work) for eight hours at a rate Ushs 2000 (approximately US$1)? This has got nothing to do with employment apart from giving free labor to foreign investors because the government wants to show people that they are creating employment. Such kind of employment is just subsidizing foreign investors by the poor on top tax concessions granted to foreign investors.

Uganda has registered significance numbers of Cross-Border M&As through sales and purchases of public enterprises between 1996 and up to date. Entry through sales worth US$55.4 million in 1996, 29 million in 1997, 11 million in 1998 and 32 million in 2000. Entry through Purchases was registered in 1999 worth US$ 406.1 million.[13] Among the largest M&As in the industrial section include Uganda Breweries from Kenya employing 16,000, Nile Breweries from UK employing 634, BAT from UK employing 600, Uganda Grain Milling from Kenya employing 500, Hima Cement from France employing 350, monitor publications from Kenya employing 300, Unilever Uganda from UK employing 160. In the finance sector include: Standard Chartered Bank Uganda from South Africa employing 113, Stanbic Bank Uganda Limited from South Africa employing 99, Barclays Bank of Uganda from UK employing 146, Bank of Baroda India employs 180, and DFCU from Germany employing 95.[14]

[13]UNCTAD (2002, p.106)
[14]ibid[1] p.13

In fact, the philosophy beyond M&As in Uganda was facilitated by privatization, globalization, and regional blocks for the strategic oriented investors. For example, industries such as Hima Cement, Nile Breweries, Stanbic Bank among others have improved on their performance. However, as noted earlier in the literature that M&As are undesirable if they are accompanied by rationalization. The case of "Nile Breweries" laying off 28 permanent employees as part of the second internal restructuring is part of the bad practices.[15] It followed the laying off 15 staff by the "Uganda Breweries" to cut the cost of doing business. However, given the fact that restructuring is inevitable, Nile Breweries had the best practiced policy in which the first restructuring staff laid off underwent training in entrepreneurship. This however, mostly depends on the motivation of TNCs towards training of employees, and not all TNCs do it.

For joint ventures, as pointed out earlier in the literature, are driven by the need for technical knowledge, raise finance, utilize local knowledge of bureaucracy and alleviate risks. Madhvani has a joint venture in Nile Independent Power Consortium with the initial investment plans of $400m. Also, Arabian International Construction Ltd., wholly owned by Egyptians has got $600 million in the "Kalangala Falls project".[16] Madhvani Group Crown Corks has entered a 50/50 joint venture with Coleus Packaging of South Africa to become the biggest Corks Company in the region. [17] "Made In Africa Exploration" has a joint venture with "Kilembe Mines Limited" worth US$20 million.[18]

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[15]Daily monitor Wednesday, May 3, 2006

[16] (UNCTAD, 2000a, p.5&7)

[17]The New Vision, Wednesday, 25th October, 2005

As for the above scenarios, joint ventures in energy and mineral exploration can be regarded as positive moves in Uganda because they are meant to reduce risks and costs in the energy sector, acquire technology and managerial skills, local partnership and entrepreneurial class within local firms. This reinforces the capacity to produce additional power needed for the production process. However, the limited entry in the utility sector shows risks borne by the private sector's participation in energy, including risks in heavy capital investment and sunk costs, government caps on prices and the political economy embedded in it.

The 50/50 joint venture between the Madhvani Group and Coleus Packaging of South Africa to become the biggest Corks Company in the economy is a bad-practiced issue emerging from FDI. This is an oligopolistic reaction meant to reduce competition which is associated with market failure. Similarly, the recent development in the financial sector is worst from the host's perspective because of it is more of the corporate governance and ownership. For example, Crane Bank has taken over Stanhope and Nile Bank, and Allied Bank International buyout by Bank of Africa-Kenya, AUREOS East Africa Fund LLC and Central Holdings. This reduces the development of financial intermediaries that would drive interest rates down, which in turn increase credit accessibility to SMEs that would steer a dynamic economy.

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[18]Daily Monitor, Saturday 6th May 2006

4.5 Regional Distribution of FDI Enterprises:

The distribution of FDI enterprises has economic impact in the host economy. Table 3 below illustrates the regional distribution of FDI enterprises in Uganda.

Table 3: Distribution of enterprises by region, actual investment and employment

Region	Location of number of enterprises				Actual investment		Actual employment	
	Domestic	Foreign	Total	%	Amount US $ m	%	Number	%
Central	281	315	596	77.7	1,032.8	71.4	61,890	73.8
East	63	31	94	12.5	272.2	18.8	12,601	15.0
West	57	8	65	8.5	136.0	9.4	8,836	10.5
North	9	1	10	1.3	5.1	0.4%	570	0.7
Total	**410**	**355**	**765**	**100.0**	**1,446.1**	**100.0**		**100.0**

Source: Private Sector Investment Survey Report 2003 published by UBOS 2004, p.14

Actual investments are concentrated in the central region (71.4%) as illustrated in table 3 above. The rest of the regions have got little investments even though government invested in regions before liberalization. These scenarios have implications on economy in terms of regional imbalances because the government uses corporatist strategy in resource allocations to improve on utility and infrastructural services where foreign investors dominate in order to beat off competition from its counterparts. The central location and heavy investment of FDI enterprises are pull factors, which negatively affects the long term development planning proposed in PEAP framework, which provides for the private sector's participation in poverty reduction strategies of increasing household incomes. For instance, 73.8 % of enterprise employment in the central region means a lot in terms of improving income poverty, and also, high possibility of being employed than the 0.7 percent in the North. More so, these regions with less investments are supply points for industrial inputs in the central region, and firms incur high cost in transporting raw materials.

To call off this chapter short, there are good-practiced issues from FDI in Uganda, including re-investment of earnings into new projects within the economy, which is a precondition for achieving the economic development. There is a sign towards the development of manufacturing sector which has the highest concentration of TNC activities in the economy, though agriculture traditionally dominates. However, the financial sector leads in actual investments than manufacturing. Investors' participation in utility sector has been minimal, and if so then it has been motivated by the energy crisis in the economy, not a deliberate participation. European countries (UK, USA and Canada) top investment lists in the economy, while African countries including Kenya and South Africa are also increasing their market shares. South Africa has a long term interest in the economy. Its involvement in the infrastructure sector has been of significance in reducing the cost of utility in the economy.

As a developing country, this study found out that Uganda receives the highest number of TNCs in greenfield more than through M&As and Joint Ventures which is consonant with its level of development. However, the regional distribution of FDI in the economy is uneven, and is associated with the mass urbanizing region (central) which is contrary to the government's position of promoting FDI to solve the economy's development challenges. The Government will fail to address the development goal of improving household incomes as they might have projected.

CHAPTER FIVE

FOREIGN DIRECT INVESTMENT SPILLOVERS IN UGANDA'S ECONOMY

5.1 Introduction:

Spillovers are defined as benefits of FDI that occur through positive externalities such as transfers of technology, enterprise development and restructuring, integration, bolstering of business competition and supporting human capital formation. This subsection emphasizes only benefits of FDI through its spillovers in Uganda's economy.

5.2 Export Development and Market Access:

Agricultural exports stood at 68 per cent of the total exports in 2004, manufactured exports showed positive growth of 23 per cent, and minerals contributed 9 percent of the total exports.[1] The number of exporting companies in Traditional exports increased from 89 in 2004 to 127 in 2005 while exporting companies engaged in non-traditional sectors, excluding manufactures increased from 354 in 2004 to 414 in 2005.[2]

Traditional exports as share of total exports continued to decrease for the last five consecutive years since 2001 because of the increase in the number of investing companies in non traditional crops as seen in table 4 below.

[1]UEPB annual report (2004 p.19)
[2]Traditional exports in Uganda include coffee, cotton, tea, and tobacco. The Non Traditional exports include fish and fish products, floriculture, cereals and products, horticulture (fruits and vegetables), cocoa and products, spices, mining, gold, animals and products.

Table 4: The recovery of non traditional exports over traditional exports in per cent

Year	1998 (%)	1999 (%)	2000 (%)	2001 (%)	2002 (%)	2003 (%)	2004 (%)
Non Traditional Exports	34	29	47	62	61	61	62
Traditional Exports	66	71	53	38	39	38	38
Total	100	100	100	100	100	100	1000

Source: UEPB Annual report 2004, p.4 and UEPB Aug 2004 p.14, increasing growth through exports.

Non Traditional Exports since 2001 have surpassed traditional exports, contributing to 62 per cent of the total export earnings. Floriculture is one of the leading non traditional exports and the average annual growth from 1998-2002 was valued at 28 percent, and Uganda is ranked number 28th among the world exporters.

More companies in non-traditional crops disapproved critics' view that FDI in Uganda is attracted fundamentally in traditional export oriented products. Also, the non-traditional performance justifies the need for 'performance incentives' to reduce the cost of operation and make TNCs competitive. Especially, to flowers' companies (including Pearl Flowers in Ntungamo district among others) which are exploiting demands in the EU and other western countries. This is because non-traditional sector rescues the economy by utilizing alternative means of marketing like air transport.

Large companies in Uganda account for 18 per cent of the export enterprises and contribute to 89% of the total export earnings; medium companies take 21% of the exporting enterprises and contribute to 8% of the total export earnings. Small companies account for 50 % but contribute only to 3% of the total export earnings. [3] Hence, large companies benefit more from export earnings than medium and small enterprises.

This reflects the background of the economy that is agricultural based in coffee, tea, tobacco and cotton. Also, big enterprises are well established and resilience to economic vulnerabilities compared to medium and small enterprises that are more affected by the microeconomic variables such as non tariff barriers, inadequate governance, red tape, energy crisis, low standard labor and capital. The increasing numbers of foreign companies in non traditional crops have made Uganda's economy to benefits from the market access in the regional blocks than ever before as illustrated in table five below.

Table 5: Uganda exports by regions in per cent

Regions	2002 (%)	2003 (%)	2004 (%)	2005 (%)
COMESA	24	28	26	31
Other Africa	8	8	6	5
EU	35	28	27	31
Other Europe	18	16	17	10
North America	2	3	3	2
Middle East	2	3	6	11
Asia	8	8	3	8
South America	0	0	0	0
Rest of the world	3	7	0	0

Source: UEPB 2004, p.8 and UEPB 2006: Export Performance Analysis 2005

European Union leads on average as the market destination for Ugandan exporters since 2002 because of the free market access under the Everything But Arms initiative. AGOA initiative in USA offers duty free market to 1830 products, textiles and apparels. Fish exports to USA in 2003 were valued at US$3.5 Million. Cut flower exports grew from US$1.4 to US$3.8 million in 2003.[4] Generalized System Preference to Uganda is offered by countries like Canada, Japan, China, Switzerland, Russia, Turkey, Morocco and Norway. Ugandan exporters started accessing the market duty and quota free in EAC with the effect from 1st January 2005, and 80 % tariff reduction in COMESA.

[3]UEPB (Aug. 2003, p.28)

Uganda has signed multiple agreements with many countries such as South Africa, Libya, Iran, China and Pakistan. Other countries on the list include: Rwanda, Sudan, Kenya, Tanzania, Burundi and Egypt.[5]

EU averagely leads as the export destination of Uganda's export not only because of the availability of EBA initiative plus other bilateral agreements, but as a reflection of the dominant numbers of foreign investors in the economy that hail from the region. They are engaged in traditional crops to supply their home countries, though others are engaged in non traditional crops. Also, sanitary and phytosanitary requirements limit Uganda's exports to the EU, especially in non traditional crops not only because of hygienic factor, but due to the need of protecting domestic firms.

5.3 Human Capital Development:

Investing firms in Uganda play outstanding role in the development of human capital. The percentages of firms offering formal training are 29.67 percent, to permanent skilled workers are 25.69 per cent and employment growth over the last 3 years is 12.22 per cent.[6] Trainings offered by firms should be seen not only in terms of the interest of corporatists, but most fundamentally in the development of local managerial skills that is needed for the local entrepreneurship.

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[4]UEBP (Aug. 2004, p.16)
[5]UEPB (Sep. 2004, p.10)
[6]The World Bank Group 2006: Economy Rankings - Doing Business - sub saharan africa.htm>

In addition, training is one of the ways of deepening the root of TNCs into the economy because new entrants find skilled man power trained already by the other TNCs and could be the benchmark for coordination in activities that they offer, hence the good outstanding practice.

Employment growth over the last three years has been at 12.2 percent. However, this is not adequate enough for the fight against income poverty that has gained momentum at 38 percent of the GDP. Moreover, the employment growth is shown in gross percentage which does not signify how many Ugandans benefit from the increase.

With respect to the sectoral employment; manufacturing employs 26,875 workers accounting for 33 per cent of the employment; agriculture employs 16,076 workers (19%), financing employs 12,101 workers (14%), electricity has 402 (0.2%), construction has 10 per cent, wholesale 11 percent, transport and community both at 4 per cent, and others had 4 per cent.[7]

Although manufacturing sector leads in employment, report on the size and capacity of TNCs engaged in the sector is not economically viable though it is a good start for the economy like Uganda which had been dominated by the agricultural sector. Most of the manufacturing firms are small and medium size enterprises from the South with limited scope of employment especially to the best talent available. They also operate below optimality to champion development in export sector.

[7]UBOS, 2004, p.21

The total numbers of planned employment between the year 1991 to 2002 reached 189,727 and 97,877 jobs were actually realized at the rate of 52 per cent as shown in Table 6 below.

Table 6: FDI Employment in Uganda between the year 1991-2002

Year	Investment (US $ millions)			Employment (No. of jobs)		
	Planned	Actual	Realization rate (%)	planned	Actual	Realization rate (%)
1991	16.03	16.43	102.5	514	514	57.0
1992	374.43	331.55	88.5	11,480	13,953	121.5
1993	581.62	741.83	127.5	23,967	26,957	112.5
1994	399.57	273.61	68.5	30,783	13,201	42.9
1995	642.07	451.25	70.3	24,380	11,197	45.9
1996	680.80	350.68	51.5	25,368	9,666	38.1
1997	533.93	453.61	85.0	17,271	8,440	48.9
1998	361.15	271.42	75.2	8,715	4,661	53.5
1999	625.30	98.88	15.5	6,371	2,933	46.0
2000	296.70	7.20	2.4	9,158	5,565	60.8
2001	273.69	18.49	6.8	16,650	n/a	n/a
2002	916.67	3.96	0.4	15,070	1,011	6.7
Total	**916.67**	**3,016.91**	**53.0**	**189,727**	**97,877**	**52.0**

Source: MIGA 2004 p.66: Investing in Developing Series. Washington D.C

The highest actual realization rates of employment were only recorded between 1992 and 1993 of 121.5% and 112.5% respectively because of high inflows of FDI at the beginning of liberalization with more greenfield investments that were labor intensive. The recent trends towards services reduce realization rates because services are more capital intensive. Through M&As, TNCs demand for highly skilled workers to fill in the technical and few clerical positions. These are also accompanied by restructuring and rationalization to maximize productivity.

There is an outstanding issue pertaining 'workforce diversity' practiced by TNCs in Uganda. Table 7 below represents different job categories offered by investing enterprises in the economy.

Table 7: Employment by sex, nationality job category by 2001

Nature of employment	Local		Foreign		Total
	Male	Female	Male	Female	
Administration	3,865	1,754	310	38	5,967
Managerial	2,690	807	1,097	91	4,685
Skilled/technical	16,527	4,505	577	64	21,673
Unskilled	40,064	11,484	23	1	51,572
Total	**63,146**	**18,550**	**2,007**	**194**	**83,897**

Source: Private Sector Investment and Investment Perception in Uganda report 2003, published by UBOS, 2004, p.22

Foreign investors employ more Ugandans in all the four different classes of jobs than the foreign experts. Ugandan women are comparatively employed in administrative positions, reflecting the good practice of recognizing diversity at workplace. Ugandans have also gained more from managerial skills and experience necessary for the development of local entrepreneurship.

At this point, it can be argued that performance requirements of local employment are not necessarily the most important as shown in economy, in which more Ugandan are employed than foreigners. Uganda has a liberal policy of employment which is done at the discretion of foreign firms. Even unskilled Ugandans are more employed than skilled ones but, the question remains how much they get from foreign employers and labor standards and conditions of their jobs? Lugazi-based SCOUL employs over 7,000 permanent and casual workers.[8] However, worker's welfare is fundamentally not favorable, especially for unskilled workers. SCOUL's workers in December 2006 had strike over non payments and poor working conditions, and even the payment is too low at Ushs 50,000 a month, and there is lack of proper medical facilities.

[8] The New Vision: Sunday, 30th April 2006: SCOUL staff stage strike

Uganda continues to receive spillovers of FDI through employment. The former victims of economic war are creating value for money in promotional efforts as reported by the UIA's executive director: "Indians have created 7,839 jobs in the last five years through 115 project investments amounting to Uganda shilling 170 billion".[9] In addition, "73,000 people are employed in tourism sector with hospitality sub-sector employs about 57,000 people and transport accounting for 16,000 jobs", according the PSFU.[10] The telecom sector has created 290,000 jobs directly or indirectly, [11] SMEs comprise 90% of private sector in Uganda and employ 1.9 million people.[12]

However, 1.9 million employments are inadequate as many Ugandans are unemployed. The private capacity to employ Ugandans is still low as many graduates are unemployed, thus necessitating attracting FDI through targeting. These figures are only stated at macro levels without references to who are those employed, regional locations, and more so, are just for building public confidence in FDI as a development alternative amidst smart state's withdrawal from economic activities, even in areas that Uganda has good competitive edge and could complement the private employment.

5.4 Backward and Forward linkages in the economy:

As noted earlier in the literature that linkages depend on how TNCs obtain inputs, transfer technology, train, share information and provide financial support. This study analyses whether such good practices have been developed in Uganda's economy.

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[9] The New Vision, Sunday, 30th April, 2006: Indians create 7,800 jobs
[10] The New Vision, Sunday, 7th May, 2006: 73,000 employed in tourism
[11] The New Vision, Wednesday, 27th December 2006: Telecom sector creates 290,000 jobs
[12] The New Vision, Sunday, 19th November, 2006: Small, Medium enterprises employ 1.5m

Small-scale farmers in Uganda have benefited from financing, technical inputs and assured market at some reasonable prices from activities generated by TNCs. TNCs give loans to farmers to enable them acquire seeds, chemicals, fertilizers and pesticides and guidance on proper harvesting methods. [13] These are key milestones because farmers have no collaterals needed to obtain business loans. In addition, guidance on proper harvest complements government's efforts in the Plan for Modernization of Agriculture.

TNC serves as buying agency of primary commodity in Uganda. Kyagalangi Coffee Ltd is a joint venture between a Ugandan entrepreneur (20%) and a Swiss Volcafe Ltd (80%), which is the second biggest coffee trading company in the world. Kyagalangi is one of the 18 export subsidiaries under Volcafe Group, and it is linked to other Volcafe importing/trading companies such as Rothfos/Halsen of Bremen, Geramny; Volcafe Ltd., Winterthur, Switzerland and Volcafe Ltd, Osaka, Japan. Kyagalangi enters into the most competitive market in the world and exported about $60million worth of coffee between 1995/1996.[14]

Volcafe Ltd. has therefore, integrated a local company (Kyagalangi) into the global economy through sharing skills and utilizing quality technologies, market intelligence and market outlets necessary for forward linkages with coffee farmers within the economy.

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[13]UNCTAD, 2000a, p.8
[14]ibid[13] p.13

A related example is that of North Bukedi Cotton Co., that was rescued through a strategic alliance of joint venture between the local North Bukedi Co-operative Union and foreign African Resources Ltd of South Africa to minimize challenges in cotton growing and marketing. The Co-operative Union mobilizes farmers and other extension services while foreign partner provides assured market through their global networks. The company currently exports to USA, Middle East and Europe.[15]

The alliance is of great importance to the new company because it involves sharing technical knowledge in marketing which had been an obstacle to the former North Bukedi Co. Ltd. In addition, African Resource Ltd has also benefited from the local knowledge in mobilizing farmers that would not have worked well if it was to be taken by The African Resource Limited due to differences in cultures, that might require local modes of communication to farmers.

Britania Products Ltd from India is linked with the local suppliers in Uganda. It engages in manufacturing and distribution of confectionary products. It has 14 product brands, employs 600 people, and it has got 200 agents countrywide and over 600 retailers. It gets inputs from local suppliers. It also exports to the DRC, Rwanda, Southern Sudan and Northern Tanzania.[16]

[15] UNCTAD (2000a, p.13)
[16] UNCTAD (2000a, p.14)

While its role is prominent in creating employment, forward linkages, diversified products, networking with local agents and retail traders, and promoting exports, the company can still relieves itself from the distribution role through outsourcing local transporters and then concentrate on increasing its production capacity.

Amfri Farm Ltd is involved in the growing and exports of organic fruits and vegetables. It started in 1990 with 25 individual out growers and cooperative farms by a Swiss engineer with an initial investment of $20,000, using self-developed energy technology for processing fruits and vegetables. The company now has got 82 out-growers. Major developments have been in the certification by the Swiss Institute for Market Ecology (IMO) to process and market organic products in compliance with the EU Regulation (EEC) No. 2092/91; advising and supporting out grower farmers with techniques in organic and sustainable farming; development of company-owned farm in organic production and a pack house facility; development of continuous improvement of solar driers to increase efficiency; certification (in May 2003) by USDA AMT CFR part 205, National Organic Program.

The company handles a wide range of products, both fresh (pineapples, apple bananas, ginger, passion fruit, baby aubergines, okra, matoke and hot pepper) and dried (pineapples, apple bananas, papaya, and mangoes). It owns a farm of 1,500 acres in Luwero, 450 acres of which are certified as organic. At the moment, 90% of the produce comes from the out growers but future plans are to increase company farm production so that 40% of the export produce come from the farm. The company has 25 permanent and

75 casual workers and owns 50 drying units. The project uses a vacuum gauging machine, the only of its kind in Uganda. Exports of 1-2 tons of fresh fruit started in 2000 but by the end of 2002, over 282 tons of fresh and dried fruits and vegetables were realized, earning $35,000 for the company. In the past, the main market was Switzerland, but now the market has expanded to include Canada, Norway, Germany, and the United States.[17]

In fact, targeted incentives should be given to Quality Company like this because of its innovativeness in the use of alternative source of energy, research and development, acquiring 90% of its produce from out growers and expanding market in EU. Such outstanding practices promote export competitiveness, diversify products and improve on the income level of the poor employed in small and medium farming via forward linkages.

Backward and forward linkages have only developed naturally in Uganda's economy, and are in the best interest to the economy because of creating competitive environment for local firms and integration into the world economy, and creating employment within local enterprises. However, small and medium enterprises needed for the linkage development are still small and weak; there is a slow response rate because of lack of technical and financial capacity to implement urgently the required changes in their managerial systems and technological base needed for the development of local absorptive capacity.

[17]UN (2004, p.34)

SMEs account for 90 % of non-farm employment and local enterprises own around 38% of investment projects licensed by the UIA between 1991 and 2000. [18] It is importance to note that TNCs are motivated by profits that take into consideration the capacity of local enterprises to deliver quality inputs so as to minimize the cost of doing business.

5.5 Technological spillovers:

The role of FDI in telecom sector has been highly recognized in solving the country's technology problems. MTN Uganda Ltd joined business in Uganda since 1998 through a concession of 20 years for the provision of telecom services. It is now the leading mobile industry in the economy with over 70% of 350,000 lines. In addition, Celtel Uganda has got 60,000 lines, Uganda Telecom has a network of 140,000 lines, and 40,000 lines rest in the hand Mango telecom–Uganda.[19]

Leapfrogging in the telephone industry has filled in the information gap, Ugandans have ever longed for via greenfield investments from MTN, Celtel, Uganda Telecom and new entrant Warid Telecom from Abu Dhabi. Leapfrogging has got multiplier effects of attracting prospective investors because competition drives the cost of utility down and improves on TNC competitiveness. Uganda's economy has benefited more from the technology transfer in telecom sector, and has helped in building the confidence in foreign investors.

[18]UN (2005, p.29)
[19] www.ugandainvest.com

Ugandan firms have benefited from technology transfers and received the highest rating of 3.95, out of a maximum weight of 5.00 in 1998 UNCTAD's survey. However, field visits revealed low level of technology. Machinery tends to be old and lacks reinvestment. Technology upgrading requires technical and engineering skills.

Uganda's satisfaction is far from the comparative position. Uganda's technical enrollment index is 2.06 and engineering enrollment index is 1.78 compared Mauritius with 7.16 technical index enrollment and 6.8 engineering index. South Africa has got technical enrollment index of 23.61 and engineering enrollment of 17.32 that is necessary for technological competency.

However, the low enrollment index in Uganda is not a guarantee that foreign firms employ all the technically qualified people. Uganda's firms prefer employment few technical people and use unskilled ones because they pay low wages. Enrollment in technical education sometime is not only about government's policy towards it, but the marginal return to trainees motivates others to join the industry. For example, a survey of 121 firms carried out by UIA Technology Consultant Survey in 1998 showed that, out of 121 firms surveyed; only 115 engineers and 240 technicians were employed.[20] Suggesting that firms would employ one to two respectively, and this shows how firms minimize costs on trained employees, but employed more unskilled people to work in tiles, paints, fabrication, footwear, plastics and timber, did not employ qualified engineers or technicians.

[20]UNCTAD (2000a, p.9)

The argument is that it depends on the kind of corporate interests and the type of TNCs government attracts in the sector, but not only on the high technical enrollment rates. In addition, linkages between foreign and local enterprises in Uganda are still at the infant phase that limits technological spillovers. However, training of employees by TNCs enhances the possibility of acquiring technological skills.

A survey by UNIDO in 2006 shows that out of 48 enterprises that were interviewed in Uganda, 30 enterprises (62.5%) provided training and only 18 enterprises (37.5) had no training for their employees.[21] Training develops the absorptive capacity in the host economy and strengthens host's capabilities to adopt the technological competency.

5.6 Enterprise Development and Restructuring:

Uganda has registered successful stories of enterprise development and restructuring. Hima Cement was privatized in December 1994 and was incorporated into a new company called Hima Cement (1994) Uganda Limited, and later taken by Bamburi Cement. Bamburi Cement, a subsidiary of Lafarge together with Lafarge itself acquired 100% shares from the previous owners.[22] The company was renamed Hima Cement Ltd and now owned by Bamburi Cement and eventually Lafarge which is the world biggest building materials company.

Under Hima Cement Ltd, production had increased to 170,000 tons per annum because of improved efficiency by 1999. New investors (Lafarge) have increased the plant's production capacity to 305, 000 tons per annum. Investment since May 1999 reached US$ 13 million in plant modernization, quality, safety and training programs reflecting

market growth internally and in the neighboring countries. Hima Cement currently employs 393 staff (329 permanent + 64). In terms revenues to the government, Hima Cement paid annually Ushs 4.1 billion in direct taxes (corporate tax) and Ugandan shillings 8.6 billion in indirect taxes (excise, VAT, duties).

In building its image in the economy, Hima supports corporate social responsibility principles in the community in the areas like health, education, shelter and the environment. Hima's support include: Universal Primary Education (constructed Hima Primary School in Kasese); constrction of pit latrines in schools and reforestation in Kasese.

Hima commits US$ 50,000 every year for Corporate Social Responsibility and US$ 40, 000 is spent annually on women and men sports. Hima plans to invest US$95m for its expansion in factory, mining project at Dura and construction of grinder at the Kampala Business Park in the year 2007. Also, Hima recognizes government's policy of levying Ushs 500 on each bag of cement for infrastructure.[23]

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[21] *UNIDO (2006, p.92)*
[22] *Privatization and Utility sector Reform Project –Uganda at http://www.perds.go.ug/*
[23] The New Vision, Sunday, 5th November 2006

Hima has the "best practiced outcome" from foreign investors by engaging in contract services with local firms in Uganda such as in transportation, maintenance, and security provision among others. Even in implementing the principles of corporate social responsibility, Hima is acting as a good example for the prospective of implementing the Global Compact in Uganda.

Another case in enterprise development is Rwenzori Highland Tea Company Limited. Government sold its remaining 6.8 percent shares in Rwenzori Highland Tea Company Limited at Ugandan shillings 1.48 billion with additional Ushs 250 million fee for settlement of outstanding dividends. RHTCL is owned by Finlays Group, which in turn owned by the Swire Group UK and since its establishment in 1994, the company is now Uganda's single largest producer of black tea, accounting for quarter of country's tea exports. The company invested US$ 45 million since 1994 and tea estates have been rehabilitated, factory upgraded, machines replaced and Ugandan managers trained. [24] In a similar way, the company added value by investing in capital and training employees.

5.7 Competition:

The investment code of 1991 allows foreigners to invest in all activities, except those related to national security or requiring ownership of land. Uganda imposes no limit on equity ownership, and foreign ownership can be 100%. Foreign investors are free to bring in and take out capital.[25] As a result; there is productive competition in the financial sector, manufacturing and the telecom sector.

[24] UNCTAD (2000a, p.7)
[25] UNCTAD (2000a, p.51)

Standard Chartered Bank of Uganda, Stanbic Bank Uganda, Barclays, Bank of Baroda, DFCU Bank and Aon Bank are the biggest competitors in the financial sector.

Uganda has a liberal (open) competition policy and prices are determined by market forces. There are few state monopolies remaining and most of them have started outsourcing managerial functions to steer competition, including the Electricity Company. There are numbers of independent power generating firms after liberalization of the energy sector. These include: Vital Peaks from Malaysia and China Shan Sheng industry among others, which can reduce the monopoly of Umeme Company Ltd that has a concession of 20 years in power distribution.

Competition in telecom services is of beneficial to the economy. In December 2006, Uganda Telecom Commission has awarded the local arm of Adu Dhabi based Warid Telecom a license to operate phone services; [26] becoming the forth mobile network operator in Uganda after MTN, Celtel and Uganda Telecom. This is meant to allow market forces play the role in pricing. According to ICT minister; "Private investment in the sector since January 2004 December 2006 was about US$180m compared to US$ 15m between 1999 and 2000". "Since 2004, there has been tremendous development in the sector. The tele-density (number of phones per 100 people both mobile and fixed lines) has improved from 2.4 % in 2004 to 6.5 % in 2006". "The network coverage is in 745 sub-counties of the 926 sub counties, which amounts to 80% of geographical coverage and 10,000 public pay phones installed".

[26] The New Vision, Friday, 8th Decemder, 2006:

However, there are currently no laws governing competition between firms. The recent takeovers by big companies are aimed at reducing the number of companies. For example, in financial sector, Barclays Bank of Uganda Buys out Nile Banks and Crane Bank takes over Standhope, these moves reduce competition in the financial sector. This is because there are no anti-trust laws regulating investment environment.

To sum up this chapter, Uganda has benefited more from FDI spillovers. In export development and market access, the total share of Traditional Exports continues to decrease consecutively since 2001 because of the increase in the number of investing companies in non traditional crops, and Uganda is able to access markets in the regional blocks than ever before.

In paving the way for human capital development, findings show that TNCs offer both formal and on job training and employment growth is more than 10 per cent over every three years. However, high actual employment rates were only recorded in two peaks of 1992 and 1993 during the initial period of liberalization, and have dramatically been reduced because of the recent growth of FDI through Mass, and trends towards services.

Even without performance requirements, TNCs recognized work force diversity. Women are employed in administrative positions, and more Ugandans are employed in managerial positions compared to foreign counterparts. However, unskilled laborers benefit from FDI, but have poor job context and low motivation.

Linkages have developed naturally between TNCs and SMEs without performance requirements in Uganda. There are some registered outstanding cases that are beneficial to the economy: Kyagalangi Coffee Ltd. buys coffee (forward linkages) from Ugandan farmers and has integrated the economy into the global economy, North Bukedi Cotton. Ltd markets Ugandan cotton in North America, Middle East and Europe. Britania Products Ltd is linked up with the local suppliers in Uganda while Amfri Farm Ltd is known for promoting out growers and using alternative source of energy. In spite of these, linkages are still at the infant phase in Uganda.

Creating public value in telecommunication sector has been the most significant benefits from TNCs in Uganda. Leapfrogging in telephone industry has filled in information gaps by companies like MTN Uganda, Celtel Uganda and the new entrant Warid telecom from Abu Dhabi, a move from a monopolistic market to oligopolistic market. With regards to enterprise development and restructuring, the economy has benefited most in terms of improving performance of enterprises after privatization. Hima Cement Ltd production capacity has doubled after restructuring; its market has expanded at the regional level. Similarly, Rwenzori Highland Tea Company has been rehabilitated, and currently is the single biggest producer and exporter of black tea. Hence, productive competition has been generating by TNCs in the economy including the financial, manufacturing and telecom, but the recent development in the financial sector in terms of take over is intended to avoid competition; moreover, Uganda has no anti-trust laws regulating investment environments.

CHAPTER SIX

STRATEGIC POLICIES FOR IMPROVING FOREGIN DIRECT INVESTMENT DESIRABILITY IN UGANDA'S ECONOMY

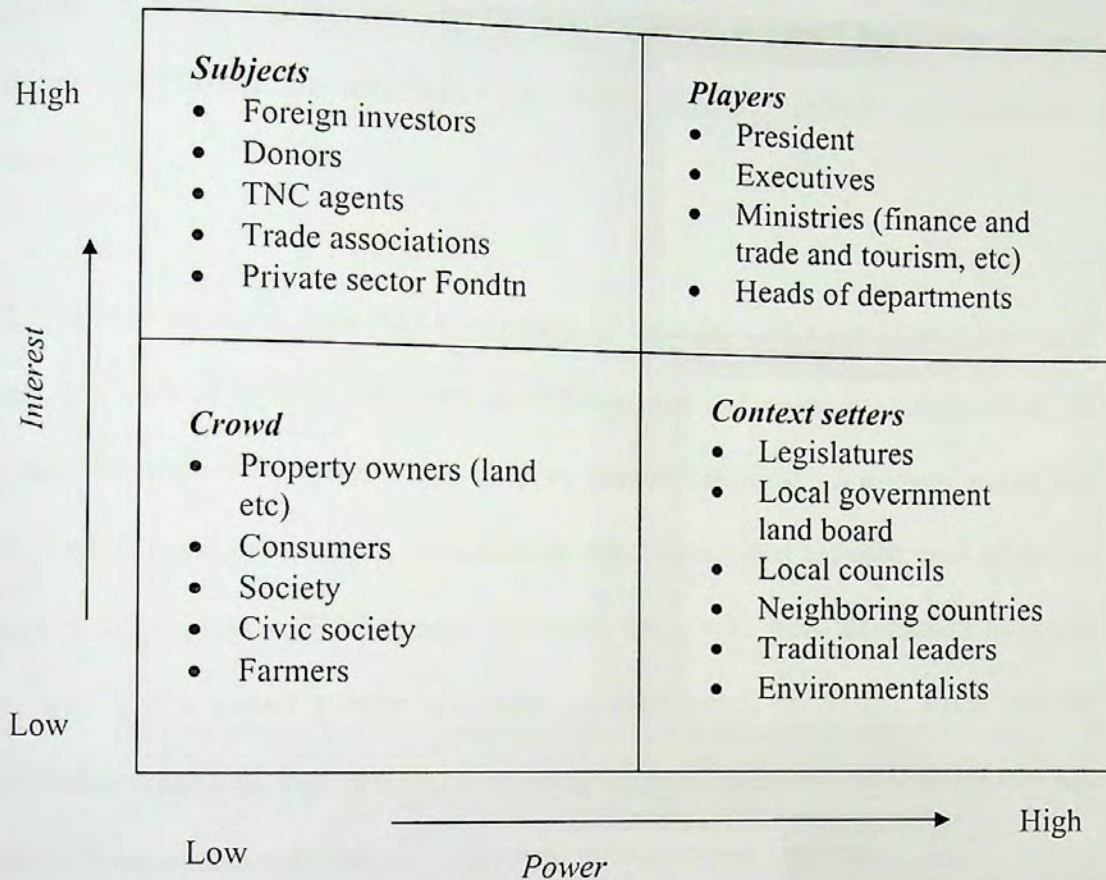
6.1 Introduction:

This section discusses possible strategies for maximizing benefits of FDI in Uganda's economy. For the government to succeed in achieving its development objectives through FDI, it has to consider different stakeholders' groups, and their interests and expectations. International experiences are also internalized into the discussion. Strategic issues facing the economy are identified; why they are strategic? What are the consequences of not addressing the issues? This study answers the question of why the Government of Uganda is facing opposition now when it tends to adopt micro policies, than ever before when it implemented macro policies. This study ends by discussing alternative strategies to be pursued by the Government of Uganda.

6.2 The stakeholders' Analysis:

Developing strategic issues needs understanding of stakeholders that affected or are affected by FDI policies, criteria they use to assess the performance of FDI and how well the Government of Uganda performs against those criteria. In analyzing how various stakeholders influence FDI in Uganda, this study uses Power versus Interest grid analysis. This analysis accommodates political issues at hand, and stakeholders that affect FDI in the future. Four categories of stakeholders are identified: 1) players are those who have significant interest and power, 2) subjects are those who have power but little interest, 3) context setters are those that have power but little direct interest, and 4) members of the 'crowd' are those with little interest and little power as done in illustration 2 below.

Illustration 2: Power versus Interest Grid Analysis



Source: Eden and Ackermann, 1998.p.122, adapted in Bryson 2004 p.338. Strategic Planning in Public and Non-for Profit Organizations, Jossy –Bass Publication.

Hence, this analysis identified key players in the economy, those people whose power must be taken into consideration, the need for collaboration in creating strategic issues. This study looks at what the Government of Uganda needs from each group. In the section of players, which include the president, executive and heads of department, they are supposed to be initiators and champions in instilling the spirit of developing alternative strategies in order to maximize benefits from FDI. These include pushing for a breakthrough into the creation of regional integration (East African Community), maintaining good political relations with Kenya and Tanzania, seeking funding from

NEPAD and Donors to upgrade railways and road networks to the sea. Internally, they are supposed to work together with traditional leaders, communal land owners, and political parties. Players are satisfied when TNCs promote growth and economic development.

Subjects also need attention from the Government of Uganda. TNCs need cheap transport to the sea, low cost of utilities, domestic confidence, and not economic nationalism, as well as land for large scale production. Donors would like to see a private sector led economy, less corrupt government, reduction in regulations, and reduced cost of doing businesses in the economy. TNC agents, including those who have developed linkages naturally with TNCs expect greater utilization of their inputs by TNCs. Trade unions want good labor standards, and safe working environments. Importers and exporters want the number of procedures reduced, and improved infrastructural services.

Context setters are really very important for developing collaboration strategy. Legislatures from Northern Uganda want to maintain the communal property right ownership of land to their constituencies, and ready to go for war if players proceed to allocating land to foreign investors. Environmentalists want preservation of natural forests and forest reserves, which the Government of Uganda is giving to foreign investors to be withheld.

The crowd including land owners wants to keep land for future generations. Society expects corporate social responsibility from TNCS, while civil society emphasizes TNCs'

fair business practices, respecting the country's cultural values and redistribution. Farmers expect TNCs to buy their products.

This study prioritizes stakeholders that have to be involved in strategic planning if Uganda's economy is to benefit from FDI. These include all the major players listed above, TNCs and donors, legislatures, local councils and environmentalists, land owners and civil society organizations.

6.3 Applying SWOC Analysis:

The acronym SWOC means strengths and weaknesses which are related to internal environment, opportunities and challenges relate to the external environment. SWOC analysis of Uganda's economy is presented in appendix D, provides benchmark for identifying strategic issues. Although, Uganda's economy has achieved strong macroeconomic stability that is needed for exploiting numerous opportunities that exist in the economy, these are static benefits at macro levels. Translating benefits to nearly all the population would allow the economy, not only to win the confidence of foreign investors, but also domestic confidence, which is a dynamic approach that corrects weaknesses and challenges in the economy.

6.4. Identifying strategic issues facing Uganda's Economy:

This study focuses on what the Government of Uganda is expected to do, but not what government should do. What government should do is usually based on intended objective of changing the way government runs FDI related activities (set of criteria which the economy must meet), but what government is expected to do only brings in

ideas that might be useful for exploiting benefits from FDI if other things are improved on. This study also internalizes the international experience of countries that have strategically succeeded in adopting FDI policies to answer some of policy questions:

1. *How can Government of Uganda address the energy crisis in the economy?*

There is a natural barrier in this sector that creates monopoly, which is characterized by heavy capital investment and sunk costs. This makes entry into the sector limited. Even if it is opened to private developers, the marginal cost of providing it to additional consumers is low, and this leads to under consumption. There is always political economy of regulation through price ceiling.

2. *How can Government of Uganda improve on its cheap transport to the sea?*

There are long delivery periods and delays to Uganda's exporters that reduce the competitiveness of manufacturing enterprises, coupled by the persistent high cost of transport to the sea.

3. *How can land be made available to foreign investors?*

The constitution of Uganda does not allow investors to own land, unless it is organized through joint ventures with local investors, yet the acquisition of land is a key milestone to the implementation of any planned project.

4. *How can Government of Uganda support and deepen linkages between foreign and domestic enterprises?*

Linkages have only developed naturally between few TNCs and SMEs. There is poor development of local enterprises to benefit from spillovers in terms of employment, local skills, technological coping from TNCs, and solving limited market for their products.

5. *How can uneven regional distribution of FDI be minimized?*

There is regional concentration of TNCs in the central. Also, there is poor infrastructural development in regions with few or inadequate FDI.

6. *How can Government of Uganda tackle persistent corruption?*

Foreign firms in Uganda pay bribes when seeking public utilities and this has affected their operations.

7. *How can Government of Uganda improve on low purchasing power in domestic* market? There is high income poverty in Uganda which affects the market-oriented foreign investors due to low demand.

6.4.1 Prioritizing strategic issues:

This study subjects the above seven strategic issues to litmus test. [1] The following issues are prioritized accordingly:

1. Addressing the energy crisis in the economy comes first because it determines productivity and competitiveness in the manufacturing sector. The high cost of production affects locational decisions of already existing and prospective TNCs. In addition, there is under productivity of non tradables because the economy can not meet production targets.
2. Improving on access to the sea comes second. This is needed to ease exporters' accessibility to regional markets, and reduce costs and delays to the sea. It involves political negotiations and compromises to finalize the materialization of East African Community, plus donor's assistance in funding infrastructural projects.

3. Land availability to foreign investors comes third reflecting the recent lead trend in entry mode through greenfield that are needed in commercial agriculture, and increasing production capacity of essential investments like sugar industry. Also, foreign investors will be driven more towards services which tend to be market oriented, rather than in the primary sector where most of the poor are employed. Failures to manage politicians and communal land ownership means continuity in the subsistence production with no linkages to the supply resourced-oriented FDI.
4. Supporting and deepening linkages between domestic and foreign enterprises comes fourth. Linkages are needed in building a dynamic private sector led economy, which is characterized by positive externalities capable of achieving development objectives of reduced poverty, sustained employment, business competition among others.
5. Tackling persistent corruption comes fifth. It will allow the SMEs grow, and investors will also respond positively to investment opportunities in Uganda's economy.
6. Last is the regional distribution of FDI enterprises which are needed for the balanced development in underdeveloped regions.

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[1]Litmus test identifies and frames strategic issues, categorizes whether the issue is operational or strategic.
Issues which require significant policy board involvement; very challenging that needed different stakeholders than a single party; requiring changes in objectives, development of new program and funding plus long effects on the economy are strategic
While issues which do not require significant policy board involvement; not very challenging in management of stakeholders a single party; do not require changing objectives, and do not need the development of new program and funding plus long no effects on the economy are operational (Bryson2004, p.95: strategic planning in public organizations, Jossey-Bass Publication).

6.5 How Can the Government of Uganda Formulate and adopt strategic plan for FDI attraction?

1. What is required?

The plan the government of Uganda can pursue is the *grand strategy,* especially in the energy development, improving access to the sea, land development, linkages and regional distribution of foreign investors. In this strategic plan, the Government of Uganda always responds to the environment in a crisis planning rather than a deliberate plan. While the deliberate strategy in energy development, cheap access to sea, land development, deepening linkages and regional distribution remains fundamentally essential, things don't always work as planned, crisis planning should be maintained on energy sector that depends on nature (volume of water in Lake Victoria) characterized by period of drought as well as improving access to sea, and involves political compromise in policy development and implementation of agreements between Uganda, Kenya and Tanzania.

2. What action steps government has to pursue?

a) In the energy sector: TNCs operate below capacity due to inadequate power and load shedding. Hence, further liberalization and privatization is expected to encourage private investments in dams through greenfield and joint ventures. Also, it has to maximize the window opportunity of donor's support to the private sector led economy to finance energy development, plus the NEPAD's support in energy development. Government of Uganda can use the system of build-transfer-operate scheme as practiced in China, Vietnam, and Malaysia. [3] This transfer system of power production to private sector

minimizes management costs; reduces corruption that is rampant during utility connections.

Furthermore, doing it the south-south way is very important. Government of Uganda has to target South African investors because of their long term commitment in the energy sector. With the already existing investors such as Eskom and Umeme companies Ltd, targeted incentives can be used to exploit the opportunity rather than relying only donor funded projects, through Joint ventures and franchise rights. Also, a more operational goal is to use energy saving bulbs and solar panels.

b) On easing access to the sea: Uganda is a landlocked country, and its infrastructure suffers poor maintenance and negligence. Government of Uganda is expected to promote FDI in infrastructure development, through joint development funds for infrastructure upgrading between Kenya and The Republic of Tanzania. Illustrative case can be seen in Kazakhstan's role in overcoming the "tyranny of geography." [4] It is 2000 Km from the sea, but received $2.6 billion of FDI in 2002, the highest among all landlocked developing countries. Its uniqueness is that major investors do not originate from neighboring countries, but from USA that leads, followed by UK, Canada and Italy. However, comparatively, Uganda is only 1,200 Km to the sea, though it is not that rich in natural resources like oil deposits and natural gas, but can internalize the *collaboration strategy* with foreign companies, that have been the central resource development in Kazakhstan, especially, in the pipeline, distribution of power, gas and water, characterized companies' role in easing the cost of doing. Hence, it is possible to overcome geographical constraints when supported by policy makers in any host

economy. GOU has to improve on *the utilization capacity of ODA in infrastructural development and upgrading of road and railways*. This is evident from the experience of the fastest- growing economies (Malaysia, South Korea, Hong Kong and Taiwan) before financial crises of 1990s. It is important to invest in capital rather consumption.

More importantly is the continuous maintenance of political support and acknowledging the significance of political compromises in regional initiatives. For example, China benefited much from FDI by improving its relations with North Korea and Taiwan. Bolivia and Paraguay are good examples of landlocked developing countries that have enhanced their ability to overcome geographical limitations via *regional integration*. Bolivia belongs to Latin American Integration Association (LAIA) and the Andean Community, and has a free trade agreement with MERCOSUR (The Southern Common Market). Paraguay is a member of MENSOCUR, and has a special status with Adean Community. Moreover, these regional blocks have some negotiating power with other trading blocks, including Free Trade Areas of America (FTAA).

In a similar line of thinking, the inland location of Uganda provides an easy access to East African Countries that have become the *hub of regional activities to serve the entire region,* thus it is an opportunity because neighboring countries have become trading partners, and this opens up the gate for Uganda to *attract the Headquarters of TNCs*. In further respond to FDI and geography, creating competitiveness in areas that are less sensitive to transport costs, development of needed skills and technology are viable

strategies. Uzbekistan success in attracting FDI in its telecommunications industry provides an example that accounted for 1/3 of FDI stocks in 1997.

c) Addressing land question: The constitution of Uganda does not allow investors to own land; instead land belongs to the community. Hence, there is need for political compromise and transparent land policy of the affected community. Hence, transition from communal ownership to private ownership takes time as peasantry gets absorbed in the capitalist world. For instance, most of the countries that emerged out of feudalism to private ownership did it through political strategy of concessions rather than for the sake of market oriented economy. In Uganda, where most of the land ownership is defined by the customary arrangements, no force is necessary because Uganda is a signatory of United Nations (equal access to property rights is the fundamental right of humankind). Stakeholders should be involved in the strategic investment planning to facilitate land accessibility to prospective investors. Even districts should avail lists of lands available to investors, including those for sales and leasing through concessions. Private investors should deal with land owners directly to facilitate land leasing. These arrangements reduce the problem of relying only on UIA for land acquisition.

d) On supporting and deepening TNC-SME linkages. There is poor development of local enterprises to benefit from spillovers. Hence, TNCs are expected to outsource local firms in construction, professional services, and non core services such as cleaning. Giving SMEs the distributional role of their products remains a viable option. More loans to manufacturers are needed because they dominate FDI activities, plus an integrated

funding to SMEs from development banks. UIA is expected to target specific subsets of TNCs, on top of providing information on new suppliers. For example, Malaysia used targeted incentives for specific subsets of TNCs.[5] TNCs then transferred technology to local firms, training suppliers and agents, sharing information and financial support.

The role UIA is to focus on skills enhancement, which is needed to shape the absorptive capacity, in addition to attracting lead firms for future specialization. The promotion of business linkages is likely to be successful, only if a systematic policy approach is adopted for all factors influencing linkages, and can lead to spillovers. We can learn from the examples of Thailand, Ireland, Singapore and Taiwan.[6] Ireland focused on attracting quality FDI rather than upgrading existing FDI, and then later emphasized on linkages. Similarly, Singapore had been having industrial strategy in promotional-seeking of FDI through EPZs to reduce transaction costs to foreign investors, and employed relevant skills upgrading on top of industrial policies, macroeconomic and infrastructure support.

As noted earlier on that the country's capability to maximize FDI spillovers depends on the absorptive capacity in the host economy, Malaysia and India have good educational policy to shape absorptive capacity and SMEs linkages, appropriate local incentives for local sourcing and give research institutions incentives for their findings. Malaysia is one of those countries with a relatively clear policy focus, with FDI explicitly playing a prominent role within its industrialization strategy.[7] Malaysia and Thailand pursued active industrial policies and promote local enterprises in certain activities, but adopted effectively open door, non interventionist policies in some export oriented industry.

Singapore sought heavy TNCs participation in deepening manufacturing, promoting linkages and increasing local capabilities, based on strong selective aspects to practically all interventions. These are wealth of experiences that can be internalized according to development needs of the economy like Uganda that needs to deepen SMEs linkages.

e) *Tackling persistent corruption:* Government of Uganda is expected to tackle corruption seriously. The Sector Survey of 2005 ranked corruption as the second most hindrance after volatile exchange rate. Foreign firms in Uganda pay bribes when seeking public utilities and this has affected their operations. Government of Uganda needs to institute ombudsman that is powerful, to check on the unethical behaviors of bureaucrats. They should be given the authority to report independently, propose dismissals of public officials caught in the act. More so, an independent court should be instituted for trying those who are involved, especially in the commercial courts of justice.

e) *On uneven regional development*: Uganda's government is facing opposition from communal land owners, because land belongs to the community not government. Government of Uganda is expected to provide incentives for regional development so as to correct the market failure in allocation, and up country incentive rate should be increased from 75% to 100% to spur industrial growth in the regions where infrastructure is inadequate to influence locational decisions of TNCs. In addition, UIA should be targeting specific activities to exploit regional advantages.

[3]UNCTAD (1996, p.22)
[4]UNCTAD (2003b, p.4-5, 8&11)
[5]UNCTAD (2002, p.206)
6Te Velde (2001, p.29 &42-47)
[7]OECD (2005, p.11-12) & UNCTAD (2006b, p.10-13)

CHAPTER SEVEN

RECOMMENDATIONS AND CONCLUSIONS

7.1 Introduction and Major Suggestions:

This section highlights recommendations to identified strategic issues, conclusions, limitation of the study, and the future research agenda. Government of Uganda needs to liberalize the energy sector, not only by allowing TNCs rely on their self-provided generators. Opening up the energy sector will provide alternative sources of energy, in which private developers can have joint ventures with government and other development partners to develop dams. This relieves the economy's reliance on Owen Falls Dam as the only main source of power. Hence, establishing low-cost operating environment, including power development and employing the latest technology reduces risks in the economy of relying on hydro as the only source of power.

Easing access to the sea needs provision of political risk incentives to targeted investors. Political risk incentives will encourage private developers to inject money in transport development that tends to be characterized by oligolispolistic conditions. This results from heavy capital investment, high risk of political interferences and sunk costs. This study recommends the need to use ODA in capital investment for upgrading railways lines and roads to the sea, in addition to maintaining good political relations with Kenya and Tanzania.

Encouraging Corporate Social Responsibility in social and infrastructural services reduces poor perception on FDI role as a development alternative. This improves on the

domestic confidence, and communal land ownership can lease their land to TNCs. Ease restrictions on land ownership by managing stakeholders.

Enhancing FDI spillovers remains the sole role the GOU has to pursue, through targeting specific industries of potential success is needed for promoting development of TNC-SME linkages, which have only evolved naturally in Uganda. Cases from Malaysia, Singapore and Ireland have shown that deliberate linkages have greater impact on host economies; hence developing economy like Uganda needs to target specific industries. Furthermore, policies for long term financing are viable options for strengthening SMEs in export development. The approach to Multi-Facility Economic zones need to be speeded up, in order to realize increased exports and linkage developments. Quality government information is also useful for developing good TNC-SME linkages, especially, on area of technological transfers and sourcing. This information shows the need for particular types of technology that is relevant to the host's capabilities and development. Hence, training is expected to be extended to SMEs for strengthening their capability, and more so to particular areas where spillovers effects from TNCs.

In addition, Government of Uganda's role in minimizing uneven regional distribution of TNC activities is very essential in realizing the Poverty Reduction Action Plan of increasing household incomes. Hence, government can target specific sets of FDI to invest in different regions in the economy by using of targeted subsidies.

In conclusions, fiscal incentives are necessary evils for Uganda's economy which has not yet evolved truly in laying the basic foundations for a viable private sector led economy. Third generation policy helps in attracting FDI to host development objectives, makes it possible to attract export oriented FDI rather resource–seeking FDI. The role of UIA has been very effective in general marketing to attract FDI, but not much in targeting specific types of FDI which could turn around the economy, where direct marketing works well rather than using embassies for distributing investment materials, and managing land owners who leased land to foreign investors. FDI alone is not a necessary condition for economic development unless it is complemented by the host policies in increasing the absorptive capacity for its spillovers. Hence, deliberate strategy avoids pursuance of isolationism in national development objectives. This is because FDI benefits are not automatic, and sometimes it tends to benefits few individuals and TNCs, hence deliberate policy will direct host's interest.

7.2 Limitation of the study:

This study only evaluated Government of Uganda's efforts to use FDI as an alternative development paradigm, based on benefits of FDI through spillovers, and policy options for maximization. Taking empirical perspectives of foreign direct investors would be a future gap to be filled.

7.3 Research Agenda for the future:

Based on the findings of the current thesis, the researcher was able to identify several areas for potential future research as follows:

- A thematic analysis of the role of President Museveni in making policy with regards to FDI as an alternative development paradigm in Uganda's Economy.
- How regionalism impact on FDI into Uganda.
- The role of FDI in reducing poverty in Uganda.
- FDI and Official Development Aid, which does what and to what extent?
- The Political Economy of land and FDI in Uganda.
- Examining causes and the nature of corruption on TNCs in Uganda.

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APPENDICES

A. Lists of public enterprises not yet privatized - Uganda

1. Diary Corporation Ltd
2. Kinyara sugar works Ltd
3. Uganda seeds Ltd
4. Housing Finance Company of Uganda
5. National Social Security Fund
6. Post Bank Uganda Ltd
7. Uganda Development Bank
8. National Insurance Corporation (Privatization quite advanced)
9. Kilembe Mines Ltd
10. Uganda Development Corporation (Lake Katwe Project)
11. Uganda Posts Ltd
12. New Vision Printing and Publishing Corporation
13. National Housing and Construction Corporation
14. Mandela National Stadium
15. Uganda Railway Corporation
16. National Water and Sewage Corporation

United Nations (2005, p. 96): An Investment Guide to the EAC: Opportunities and Conditions. New York and Geneva, July 2005

B. List of completed privatization Transactions in Uganda as per 1st December 2002

No.	Enterprise	Buyer	Date	Participant	Method	Amount (Ushs)
1	Acholi Inn	MS Laoo Ltd	May 1995	Ugandan	Sale of assets	235 m
2	African Ceramic Co.	Muhindo Enterprise Ltd	May 1996	Ugandan	Sale of assets	0.270 bn
3	African Textile Mills	P/S Patel	May 1996	Uganda	Share sale	1.4 bn
4	Agip (U) Ltd	Agip Petrol International	May 1996	Foreign	Share sale	1.675 bn
5.	Agricultural Enterprises Ltd	Common Development Corp	Oct 1993	Foreign	Join Venture	US$12.7m*
6	Apollo Hotel Corporation Ltd	MIDROC Ethiopia p/c	March 2001	Foreign	Sale of share	US$18 m*
7	Bank of Baroda	Bank of Baroda (India)	June 1999	Foreign	Shares/pre-emptive rights	2.5 bn
8	Barclays Bank of Uganda Ltd	Barclays P/c	Oct 1998	Foreign	Shares/pre-emptive rights	5 bn
9	BAT	BAT Investments Ltd	Sep 1999	Foreign	Shares/pre-emptive rights	US$ 7m
10	BAT	Various	June 2000	Ugandan	Initial public offering -USE	Shs 1,000 per share
11	Blenders (U) Ltd	Unilever Overseas Holding BVC	Aug 1994	Foreign	Share sale	US$531,586
12	Comrade Cycles (U) Ltd	Uganda Motors Ltd	Jan 1997	Ugandan	Share sale	n/a
13	East African Distilleries	International distillers and vintners	Nov 1992	Foreign	Share sale	US$ 600,000
14	Government Central Purchasing Corp.	Management and employees	July 2000	Ugandan	Management buyout	1.09bn
15	Hilltop Hotel	Three Links Ltd	May 1995	Ugandan	Sale of assets	35 m
16	Hotel Margherita	Reco Industries Ltd	Aug 1994	Ugandan	Sale of assets	US$ 400,000
17	ITV sales	ROKO construction	Dec 1996	Foreign	Sale of assets	0.32bn
18	Kakira Sugar Works	East African Holdings Ltd	July 2000	Foreign	Shares/pre-emptive rights	3.5bn
19	Kampala Auto Centre(Gomba Motors Ltd)	Management	Nov 1995	Ugandan	Auction	0.110bn
20	Kibimba Rice Co. Ltd	Tilda holdings	Sep 1996	Foreign	Share sale	1.607bn
21	Lake Victoria bottling Co. Ltd	Crown Bottlers (U) Ltd	Feb 1993	Ugandan	Share sale	6.46 bn
22	Lake Victoria Hotel	Windsor Ltd	Aug 1995	Foreign	Share sale	3.06 bn
23	Lango Dev. Co	Sunset International Ltd	May 1998	Ugandan	Share sale	0.1bn
24	Lira Hotel	Showa trade Com. Ltd	Jan 1995	Ugandan	Sale of assets	250m
25	Masindi Hotel	Ottoman Engineering	Feb 2000	Ugandan	Sale of assets	US$500,000
26	Motorcraft and sale Ltd	Andami Works Ltd	Sep 1996	Ugandan	Share sale	0.200bn
27	Mt Elgon Hotel	Busigu Cooperative Union	May 1995	Ugandan	Sale of assets	650m
28	Mt. Moroto Hotel	Kodet International	Nov 1995	Ugandan	Sale of assets	40m

29	Mweya Safari Lodge	Madhani Group	Aug 1995	Ugandan	concession	1.821bn
30	NEC Pharmaceuticals Ltd	Haupt Groupe	Dec 1999	Foreign	Joint venture	US$1.5 m
31	Printpak (U) Ltd	New Printpak (U) Ltd	May 1996	Uganda	Management buyout	0.9bn
32	Republic motors	Rafiki trading com.	Dec 1995	Ugandan	Auction	0.395bn
33	Rock Hotel	Swisa Industries Ltd	Nov 1994	Ugandan	Sale of assets	300m
34	SAIMMCO	Still Rolling Mills Ltd	Sep 1999	Ugandan	Share sale	202m
35	Second National Operator	MTN	March 1998	Foreign	concession	US$5m
36	Shell (U) Ltd	Shell Petroleum Co. Ltd	Dec 1992	Foreign	Debt/equity swap	12.79bn
37	Soroti Hotel	Speedbird Aviation services Ltd	Jan 1995	Ugandan	Sale of assets	150m
38	Stanbic Bank (U) Ltd	SBIC Africa Holdings Ltd	Dec 1996	Foreign	Share sale	6.75bn +150m
39	Steel Corporation of Africa Ltd (SCEA)	Muljibhai Madhvani and Co. Ltd	Jul 2000	Foreign	Shares/preemp tive rights	0.32bn
40	Total (U) Ltd	Total Outre Mer	March 1996	Foreign	Share sale	5.7bn
41	Transocen 1998 (U) Ltd	Coin Ltd	Jul 2001	Ugandan	Share sale	361m
42	TUMPECO	GM Company Ltd	Aug 1994	Ugandan	Share sale	US$700 ,000+U shs 429m
43	Uganda American Insurance Company	American Life Insurance Company	Nov 1992	Foreign	Repossession	n/a
44	Uganda Cement Industry- Hima	Rawals Group of Industries	Dec 1994	Foreign	Sale of assets	US$20. 5m
45	Uganda Cement Industry – Tororo	Corrugated sheets Ltd	Oct 1995	Foreign	Sale of assets	5.75bn
46	Uganda Clays Ltd	Various	Oct 1999	Ugandan	Initial Public Offering -USE	Ushs 4,000/ share
47	Uganda Fisheries Ltd	Nordic-African Fisheries Co. Ltd	May 1995	Foreign	Share sale	US$1.1 m
49	Uganda Garment Industries Ltd	Phoenix Logistics (U) Ltd	Aug 2000	Ugandan	Sale of assets	US$0.5 m
50	Uganda Grain Milling Co.	Calebs International	Dec 1996	Ugandan	Share sale	5.3bn
51	Uganda Hardwares Ltd	Management	Oct 1995	Ugandan	Management buyout	0.298bn
52	Uganda Hire Purchse Co.	Tadeo Kisseka	Nov 1999	Ugandan	Auction	0.00024 bn
52	Uganda Industrial Machinery Ltd	F.B Lukoma	May 1997	Ugandan	Share sale	7m
53	Uganda Leather and Training Industry(ULTI)	IPS (U) Ltd	Jul 1995	Ugandan	Sale of assets	1.71bn
54	Uganda Meat Packers Ltd (Kampala Plant)	Uganda meat Industries Ltd	Aug 1995	Ugandan	Sale of assets	0.7bn
55	Uganda Meat Packers – Soroti	Teso Agricultural Industrial Co. Ltd	Nov 1997	Ugandan	Sale of assets	0.3bn
56	Uganda motors Ltd	Management	Nov 1995	Uganda	Management	0.803bn

					buyout	
57	Uganda Pharmaceuticals Ltd	Vivi Holdings	Jul 1996	Foreign	Share sale	1.501bn
58	Uganda Securiko Ltd	Securiko (U) Ltd	Aug 1993	Foreign	repossession	n/a
59	Uganda Tea Corporation	Mehta Group	May 1994	Ugandan	Repossession	n/a
60	Uganda Telecom	Detecom	Jul 2000	Foreign	Share sale	US$33.5-*
61	White Horse Inn	Kabale Dev.Co.Ltd	Aug 1994	Ugandan	Sale of assets	600m
62	White Rhino Hotel	Dolma Associates Ltd	May 1995	Ugandan	Sale of assets	200m
63	EUGCL	Eskom Enterprises	Nov 2002	Foreign	Concession	
64	Rwenzori Highland Tea Company Ltd	Finlays Group	May 2002	Foreign	Share sale/preemptive rights	1.45bn
65	Kiryara Ranch	Ziwwa Ranchers	May 2002	Loca	concession	0.800bn

Source: UNCTAD Data Base –Uganda

C. FDI flows, to Uganda by type of investment 1990-2005 (millions of dollars)

Year	Inward Investment			
	Equity	Re-invested earnings	Inter-company loans	Total
1990	--	--	--	-5.9
1991	1.0	--	--	1.0
1992	3.0	--	--	3.0
1993	49.6	5.0	0.01	54.6
1994	78.2	10.0	--	88.2
1995	89.5	35.0	--	124.5
1996	30.0	10.0	--	40.0
1997	110.8	8.6	22.1	141.5
1998	68.0	15.8	48.8	132.6
1999	71.9	16.7	51.6	140.2
2000	105.1	16.6	59.2	180.8
2001	86.5	42.1	22.9	151.5
2002	99.6	42.1	42.9	184.6
2003	102.1	51.9	48.2	202.2
2004	126.5	60.2	35.4	222.1
2005	155.9	70.7	31.8	258.5

Source: UNCTAD, FDI/TNC database country profile – Uganda p.4 November 2006

D. SWOC Model Application in Uganda's Economy

Table 2: Strengths, Weaknesses and Opportunities and Challenges in Uganda's economy

Strengths	Weaknesses
• Strong and stable government commitment to private sector led growth • Average growth rate of 6 % over the past five • Trainable low cost labour • Good climate agricultural production and tourism • Location in EAC with 93 million consumers, COMESA (385 million) and SADC (215 million) and preferential access to EU (EBA) and USA markets (AGOA) • Relatively large and low-cost pool of workers, some with high engineering skilled and enterprising • Uganda is gifted by nature for agricultural production and tourism • Low inflationary rate • Strong donor support (HIPC) • Improved telecommunication services	• Inadequate physical infrastructure • Shortage of technical and managerial skilled • Persistent though declining corruption • High cost of doing business • regulatory weaknesses in utility sector • low purchasing power in domestic market • land ownership systems limit on the availability of large scale land • Landlocked country • unreliable power supply and communication • poor road network and high transport costs • uneven regional distribution of FDI enterprises in the economy
Opportunities	**Challenges**
• Commercial agriculture and agro-processing • Tourism and mining and oil exploration • Telecommunication, education and health services • Infrastructure development • Further Privatization	• Regional and internal conflict (north) • HIV/AIDS impact labor resources and productivity • Potential completion from regional countries

Source: Based on the information gathered from UNCTAD (2000a, p.16) *Uganda Investment Policy Review*, New York and Geneva; United Nations (2004, p.9); and United Nations (2005 p.31).

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