UDN ARTICLES

Foreign Direct Investment (FDI) in Uganda

Attracting and Keeping Quality Foreign Direct Investment in Uganda

Foreign Direct Investment (FDI) is crucial for any economy. Uganda is one of the countries that attracts the most FDI in East Africa. FDI flows to Uganda accounted for USD 700 million in 2017, an increase from USD 626 million in 2016. FDI stock also grew to USD 11.893 billion in 2017 according to the World Investment Report, 2018. How Uganda can attract and keep the right kind of investment from global companies is key for its economic growth and competitiveness. Note that majority of emerging economies such as China, Brazil, Vietnam and India have built their growth on foreign direct investment flows. But we need to keep in mind that foreign direct in- vestment is often preferred to exporting. This is majorly because while exports merely involve moving goods from one country to another, foreign direct investment actually involves an investor establish- ing foreign business operations or acquiring foreign business assets. However, the trick is to attract "quality/right foreign direct investment" that links foreign investors into the local Ugandan economy. The International Growth Centre, a British-funded research centre that aims to promote sustainable growth in developing countries, characterizes "quality foreign direct investment" as contributing to: i) decent and value-adding jobs and enhancing the skill base of host economies; ii)transfer of technology, knowledge and know- how; and iii) boosting competitiveness of domestic firms and enabling their access to markets. So the question would be what can Uganda do to attract and keep the right foreign direct in- vestment that promotes economic growth, creates more employment opportunities and boosts

competiveness in Uganda products? There are a few things Uganda can do to boost foreign direct investment. One; it must play fair such that foreign and domestic businesses are treated equally. They should be open, transparent and dependable conditions for all kinds of firms. Second; infrastructure development is key to attracting foreign direct investment because businesses need an easy and reliable transport network, adequate and reliable supply of energy and relative certainty that the country will be good to invest in. Third; Government should strive to encouragepartnerships between foreign and local business- es. Although foreign firms might be familiar with global good business practices, the local firms are much more familiar with the indigenous

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Context of Uganda therefore, this synergy could be very beneficial. Fourth; there's need to strengthen backward linkages from FDI into the local economy to allow for multiple forms of direct assistance from foreign to domestic firms, i.e. in the form of trainings, encouraging spillovers from FDI into the local economy such as gaining knowledge on new technologies, skills and marketing techniques. Furthermore, Government should: ensure that all investors coming into the country have long term strategic plans on what sectors or activities to tar get; make certain that foreign business create local solutions or a diversified portfolio that meet needs of ordinary Ugandans. The huge diaspora should also be tapped because there are many Ugandans living outside the country who understand Uganda's challenges and thus they should be encouraged to help, or asked to work with their networks to invest in the country. The main takeaway for both foreign investors and Government is that it would be prudent for all parties to act locally but think globally.

Use of Incentives in Attracting Foreign Direct Investment

Foreign direct investment (FDI) is an integral part of an open and effective international economic system and a major catalyst to development. Yet, the benefits of FDI do not accrue automatically and evenly across countries, sectors and local communities. Developing countries, emerging economies and countries in transition including Uganda have come increasingly to see FDI as a source of economic development and modernization, in- come growth and employment. Thus, countries have liberalized their FDI regimes and pursued policies and offered various incentives to attract quality FDI which promotes economic development, creates employment opportunities, provides technological trans- fer and financing. Majority of such countries have also established investment promotion agencies and enacted policies to incentivize FDI. These normally include incentives of a fiscal or financial nature. The former are designed to reduce tax burden and include tax concessions in the form of a reduced corporate income tax rate, tax holidays, exemption from import duties and duty drawbacks on exports. The latter consist of direct contributions to an investor's firm from the government and includes grants, subsidized loans, loan guarantees, the participation of publicly funded venture capital in investments involving high commercial risks and government insurance at preferential rates. Note that empirical research shows that international FDI incentives play only a limited role in determining the international pattern of foreign direct investment. Factors like market characteristics, relative production costs and resource availability explain most of the cross-country variation in FDI inflows. Nevertheless, it is clear that FDI incentives might play a role for investor decisions on

the margin. For instance, if an investor has two more or less similar location alter- natives for an investment, incentives can tilt the investment decision. This is particularly the case for financial incentives like tax holidays and other subsidies, since they reduce the initial costs of the investment and lower the risk of the FDI project. However, the question is whether the host country's costs for providing the incentives in terms tax holidays, subsidies, and other expenses is the best practice. To answer this, a hypothetical situation would be whether incentives offered for FDI are likely to yield benefits that are at least as large as the costs. Keep in mind that incentives offered for FDI can only be justified if the foreign investors firms differ from local firms such that they possess some firm specific tangible assets with spill overs to local firms/ economies. Whereas it is understandable that incentives are a global reality offered to compete and attract quality FDI, the best practice should be creating an attractive and enabling environment that takes into account; country efforts to modernize its infrastructure, research and development, raise the level of education and labor skills and improve the overall business climate as part of the investment promotion policy. In any case, incentives are still a good strategy but this should be followed with strict performance measurements for investors while also that ensuring that they are provided on equal terms to all investors irrespective of industry or nationality. Furthermore, although incentives are good, they are not sufficient determinants/ factors an investor will base on to make his/her investment decision. Therefore, incentives especially tax holidays or exemption should be given to facilitate business continuity not at commencement of operations. This implies that they should be awarded to investors up to at least five years. This would determine the investment's eligibility for a given incentive. However, the provision for incentives should also include a consultative process involving relevant stakeholders. This should also include a criteria for granting incentives which is realigned to minimize revenue loss the country continues incurring through offering incentives On the other side, to guard against FDI incentive arrangement, countries should develop an incentive strategy that prohibits investors from investing in any sector of the economy but specific areas or critical areas of the economy that promote spill-overs into local economies i.e. technology and skills trans- fer. This ensures that incentives are not given at the expense of local entrepreneurs while also protecting local entrepreneurs/ firms from unfair competition and significant losses. This should go together with strengthening capacity of local firms to absorb foreign technology and skills The incentive strategy should also ensure that investors are conditioned to use 30% of the locally produced materials rather than importing everything. To avoid losses due to providing incentives especially tax holidays or exemption, the same strategy should also consider only awarding a reasonable incentive period i.e. rather than giving tax holidays up to 10 years, it should be maximum 5 years after the investment has been operating. Hence, prior to award of an incentive, the investment should be subjected to an appraisal for tax incentives to determine if it has, for example, been tax compliant, employed/ procured from locals, or whether it has facilitated skills and technology transfer among others.

Eventually what all countries should expect from FDI incentive arrangements is equalized social and private returns to investment. Therefore, incentives should not be of an ex ante type that is granted prior to the investment, but they should instead promote investments that create a potential for spillovers, economic growth and development of the local industry which is after all, the ultimate goal why countries offer them. In particular, these include education, training, and R&D activities, as well as linkages between foreign and

local firms. Given their broad scope, incentives should also be considered part of the economy's innovation and growth policies rather than a policy area that is only of relevance for foreign investors. Moreover, countries can still attract quality FDI without offering incentives i.e. guaranteeing market access for example Uganda is part of number of regional free trade arrangements i.e. East African Community, Common Market for Eastern and Southern Africa and more recently the African Continental Free Trade Area which create a basis for marketing the country to potential investors.

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