Policy Paper

INVESTMENT PARTNERSHIPS FOR EMBEDDING FOREIGN DOMESTIC INVESTMENTS IN UGANDA

By

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Exective Summary

Many developing economies have successfully promoted Foreign Direct Investment (FDI) in order to facilitate economic growth and reduce poverty. However, attracting FDI without appropriate policy interventions for embedding these investments in the domestic economy inhibits the possible benefits expected to accrue to the host economy. This paper investigates the FDI inflows to Uganda, as well as the need to embed them in the economy through the creation of investment partnerships between the indigenous or local and foreign entrepreneurs.

The performance of FDI clearly demonstrates that FDI in Uganda is dominated by Asian and European Partners, with China, India and UK contributing the largest shares. On the other hand, joint ventures account for the smallest share of FDI flows. A number of constraints limiting the expansion of business ventures and partnerships through FDI in Uganda have been identified and include among others: limited capacity of local partners; inadequate infrastructure; information asymmetry; and limited access to credit, especially for long term investment. To promote partnerships by embedding FDI in Uganda, this study recommends that Government should: increase investments in infrastructure; implement measures that increase access to long term finance; improve the business regulatory framework and access to information; as well as spearhead local content development, especially in the key priority sectors of the economy.

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List of Acronyms

BOP Balance of Payments

FDI Foreign Direct Investment

ICT Information and Computing Technologies

NDP National Development Plan

PPP Public Private Partnership

IFAD International Fund for Agricultural Development

VODP Vegetable Oil Development Programme

TNC Transnational Corporations

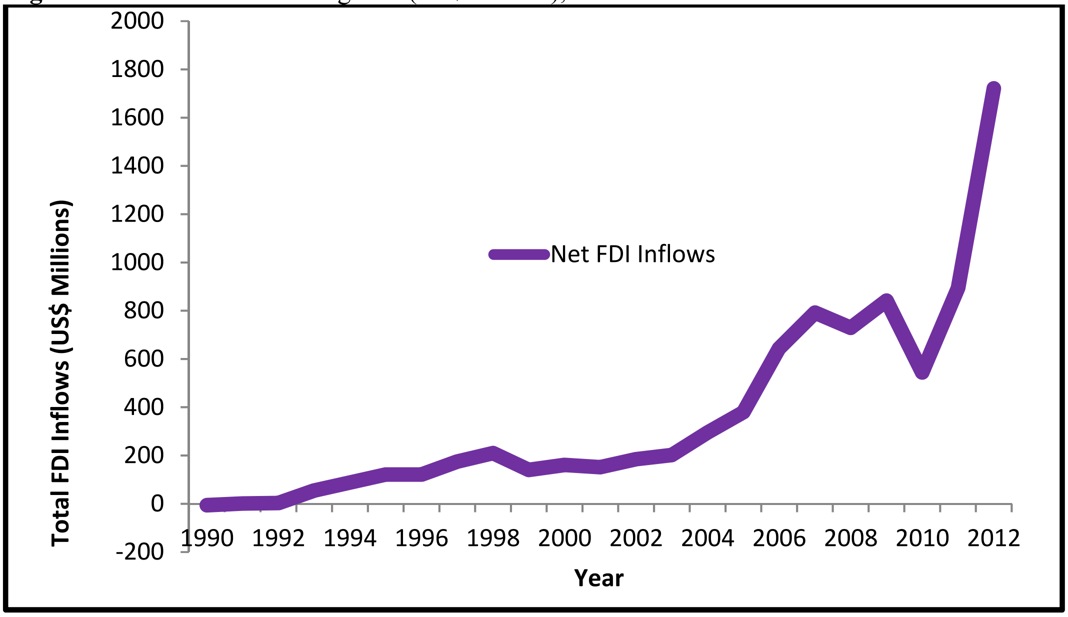
1.0 INTRODUCTION

Over the years, Government has maintained a good macro-economic framework and has spent significant resources for attracting foreign investors, through investment promotion activities, offering fiscal incentives and establishing industrial zones to mention a few. All these efforts were meant to catalyse the economy, unlock the latent potential in different sectors, to boost growth and create productive jobs. His Excellency the President has been in the vanguard, leading numerous efforts to attract investments at International and local fora. Many other senior public and private sector officials have joined him in this effort and Foreign missions are expected to take lead in promoting economic diplomacy abroad. While Uganda's economy has been growing, there is urgent need for the economy to be structurally transformed, to widen the potential for increased FDI and local investment, as well as job creation opportunities.

As a result of this marketing drive and other enabling factors, the country has seen an increase in Foreign Direct Investments (FDIs)[1]. According to the World Investment Report of 2013, there has been a remarkable progress in FDI flows, from a low of $151.1 million in 2001 to a high of $1.72 billion in 2012. However, since 2006, FDI flows have been increasing at a very fast rate (see figure 1), with a sharper upswing since 2011. The increase in FDI flows into the country is attributed to: a good political and general investment climate; stability in the macroeconomic policy; discovery of Oil and Gas; increase in the supply of energy and consistent marketing of the country as an important investment destination, among others.

[1] Foreign Direct Investment (FDI) refers to a direct investment into production or business in a country by an individual or company of another country, either by buying a company in the target country or by expanding operations of an existing business in that country. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments (BOP).

Figure 1 Net FDI Inflows in Uganda (US$ Million), 1990-2012



Source: World Bank Development Indicators, 2014.

The increase in FDIs in Uganda is associated with a host of benefits/returns including: employment creation; increased tax revenues; infrastructure development and transfer of knowledge and technology. Literature also shows that FDI can trigger technology spill overs, assist in human capital formation, contribute to international trade integration and enhance entrepreneurship and private enterprise development. Thus, FDI contributes to higher economic growth, which is a key tool for alleviating poverty[2]. In addition, studies show that as FDI for recipient economies increases, the proportion of people living below the poverty line in these economies decreases.

In order to maximise benefits from FDIs in the long-run, there is need to embed FDIs into the domestic economy. The literature has argued that FDIs attracted through marketing and investment incentives are many times associated with a 'financial leakages' and have relatively few benefits like: technology spin-offs; local purchasing or sales linkages; strategic collaborations and are relatively vulnerable to closure decisions made by headquarters overseas.

The embedment of FDIs through creation of partnerships[3] with local investors can create more benefits to the economy through the 'spill over' of technology and transfer of knowledge and skills (management, organisational practices and entrepreneurship) to local firms and workers. This is the only way that the benefits of FDIs can be sustained over the long-term and eventually lead to the country's socio- economic development and transformation. These spill overs are not

[2] OECD, 2002.

[3] For this paper, partnerships include joint ventures between foreign investor and local private sector and/or public sector, and supplier relationship between foreign Investor and local suppliers.

guaranteed unless specific interventions by the host Governments are made. If no specific interventions are made to direct FDIs into priority areas, then FDI will operate as an enclave in an economy, as experienced in the case of Swaziland and Lesotho, countries which attract lots of FDIs from South Africa, but with few links to their own domestic economies. This calls for deliberate strategies to help local entrepreneurs master the art of creating partnerships with the Foreign Investors.

The Uganda Vision 2040 and the subsequent medium-term National Development Plans have identified potential areas for strategic investments, in order to revitalise the economy and these include: Infrastructure development (oil and gas infrastructure, energy, railways, and roads); Agriculture and agribusiness for value addition; and Tourism, ICT and Manufacturing. Maximizing benefits for Uganda, out of these key areas of prioritised investment, requires a lot of investment resources which cannot be generated locally and thus the need to attract more FDIs, for a subsequent embedment into the domestic economy.

The goal of this paper is to identify the key policy interventions that the country must undertake to embed FDI into the economy, so as to maximise the benefits associated with the spill-over effects of FDI flows.

1.1 Organization of the Paper

Section one provides the introduction and motivation of the paper while section two highlights the objective of the paper. Section three presents the analysis of FDI inflows in the country over the years, while section four presents international experiences in investment partnerships. Section five covers the different ways of embedding FDI in domestic economies. Section six identifies the challenges to the embedment of FDIs through creation of Partnerships. Section seven prescribes some policy options that Uganda can adopt to enhance investment partnership formations and Section 8 concludes the paper.

2.0 OBJECTIVES OF THE PAPER

This paper seeks to:

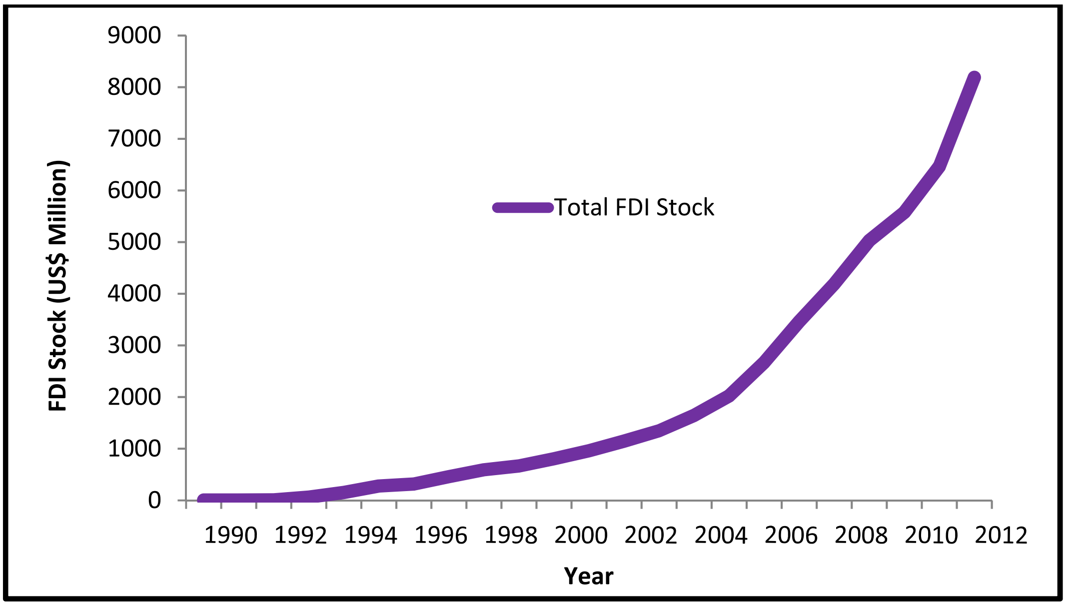
i) Analyse FDI flows in Uganda since 1990.
ii) Review experiences of embedding FDIs in different host economies and;
iii) Recommend policy interventions to facilitate local and foreign investment partnerships.

3.0 FOREIGN DDIRECT INVESTMENTS (FDIs) IN UGANDA

3.1 FDI Flows in Uganda

As already noted in the introduction of this paper, there has been an increasing trend of FDI in Uganda since the 1990's. As reported in the World Investment Report of 2013, the year 2008 had a marked rise of FDI flows in Uganda which amounted $799 million, which has continued to grow steadily, reaching a high of $1.72 billion in 2012. The 2012 released by the United Nations Conference on Trade and Development (UNCTAD) indicates that Uganda was the leading destination of FDI in East Africa during this period[4]. The report observes that the flow[5] of FDI in 2012 was driven partly by investments in Uganda's nascent oil and gas sector. For example, Uganda attracted investments worth $1.2 billion in 2012 compared to $0.180 billion in 2000, partly due to heavy investments by oil exploring companies from the UK, France and China. This represented a 25% increase in FDI flows during the same period. The global financial crisis is partly responsible for the decline in FDI flows in Uganda between 2007 and 2008 and between 2009 and 2010. In addition, the stocks[6] of FDI in Uganda have been growing each year between 2000 and 2012, peaking at US $8.19 billion in 2012 (Figure 2). The growth in stocks is a reflection of accumulation of capital.

Figure 2 Stocks of FDI in Uganda (US$ million), 2000-2012



Source: UNCTAD Data Bases.

[4] http://www.monitor.co.ug/Business/Uganda-top-investment-destination-in-East-Africa/-/688322/1903508/-/qy4r6n/-/index.html

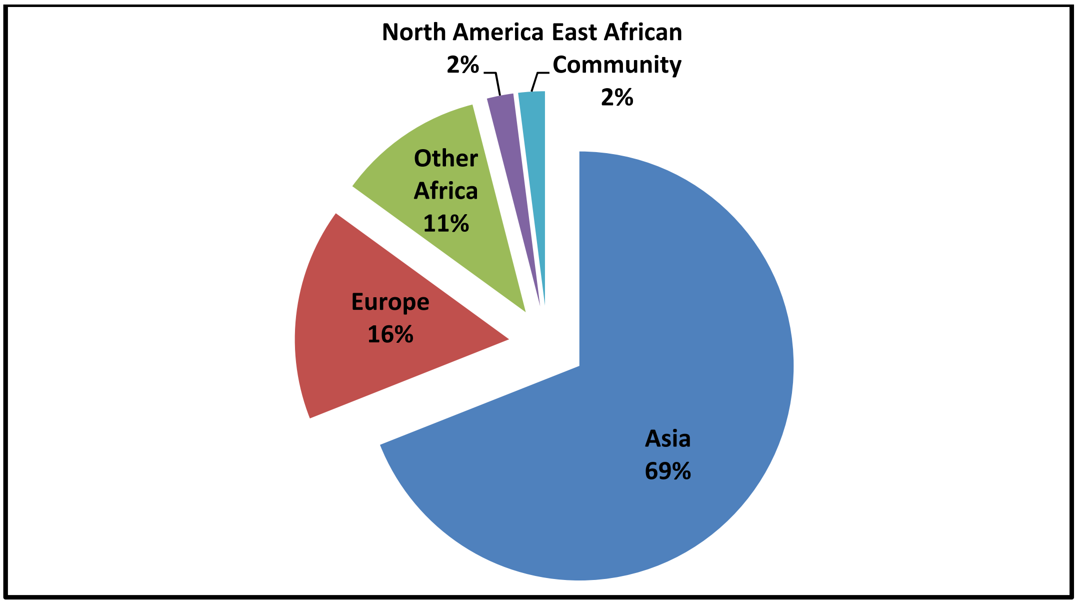
[5] A flow variable is measured over an interval of time. Therefore a flow would be measured per unit of time (say a year).

[6] stock of foreign direct investment refers to the cumulative number for a given period

3.2 Foreign Direct Investment in Uganda by Source Region

According to the Uganda Investment Authority Quarterly Investment Survey for 2013/2014, Asia remained the dominant FDI source by project number in the first quarter of 2013/14, accounting for 65 per cent of the total licensed projects, largely from India and China Asia was followed by Europe, which accounted for 16 per cent of the total projects licensed, Mostly from the United Kingdom. India, China and United Kingdom together attracted 75 per cent of the licensed FDI projects. The EAC region and North America accounted for 2 per cent of these projects as shown by Figure 3 below.

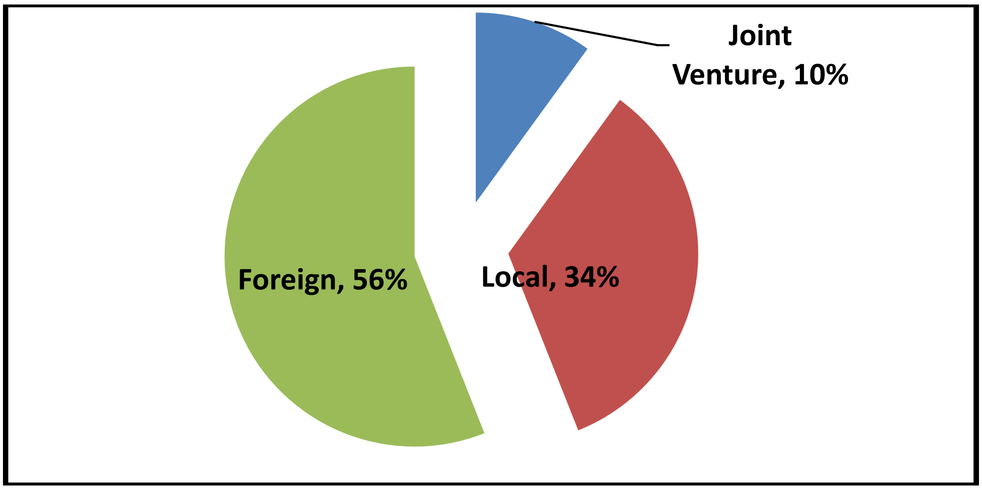
Figure 3 FDI Inflows in Uganda by Source Region



Source: UIA Quarterly Investment Survey, 2013/2014.

Foreign companies dominated the number of licensed projects in Uganda, accounting for 56 per cent of the total licensed projects in Q1 2013/2014 (Figure 4). The domestic or local companies accounted for 34 per cent, while joint ventures between foreign and domestic firms accounted for 10 per cent. Local firms do not always register their businesses and this can inhibit creation of partnerships with foreign firms. There is need to create incentives for registration of local firms in order to create a clear profile of local business enterprises and thus facilitate partnerships with foreign firms.

Figure 4: Project Ownership in Percentage Q1 2013/2014

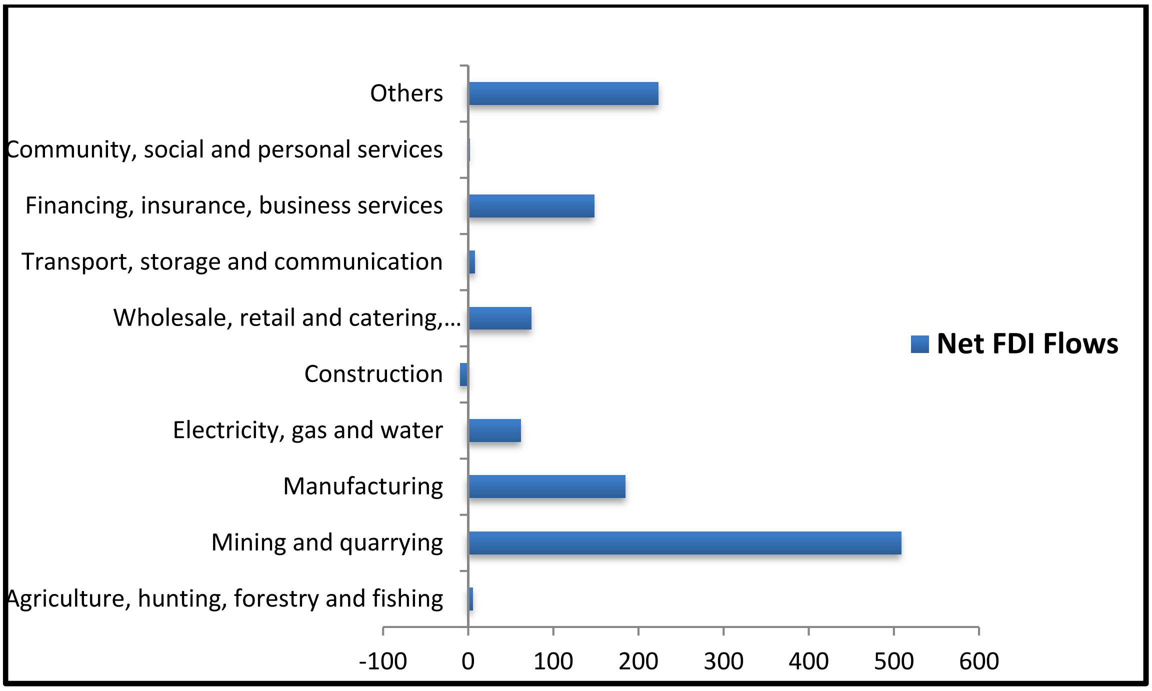


Source: UIA Quarterly Investment Report, October 2013.

3.3 Sectoral Distribution of FDI in Uganda

The sectoral allocation of FDI (Figure 5) suggests that Mining and Quarrying, Manufacturing, and Financial Services were the leading recipients of FDI in Uganda in 2012, while Construction, Agriculture and Utilities lagged behind during the same period.

Figure 5 Foreign Direct Investment Flows by Sector in Uganda, 2012



Source: Bank of Uganda Data.

The main outcomes of this analysis shows that: most of the FDIs are coming from Asia and this component is fast growing; the value of FDI going to the agriculture sector is very small and in the short to medium run FDI to the oil and gas sector will dominate the foreign direct investment flows. It is expected that investments in the oil and gas sector will increase substantially, once the field development plans are approved.

4.0 INTERNATIONAL EXPERIENCES IN INVESTMENT PARTNERSHIPS

4.1 Public-Private Partnerships

One practical way in which host economies maximise benefits from FDI is through facilitating increased linkages between local entrepreneurs and foreign investors, by adopting Public-Private Partnerships (PPPs)[7]. A global meeting of finance ministers, held in Lisbon in 2010, recommended: more FDI through PPPs in infrastructure- transport, communication and energy; increased vocational education in partnership with foreign enterprises; and reinforced capacity to negotiate with multilaterals. There are various case studies in the global economy that demonstrate how international investment partnerships between various players (governments, the private sector, local citizens and foreigners) have operated in host regional economies to bring about maximum benefits to the various communities.

Infrastructure Investments

PPPs have provided a principal vehicle for FDI into public utilities and infrastructure in developing countries, with OECD-based multinational enterprises participating in most of the largest PPPs in this area. There are three main modes of entry that private participation in infrastructure development has taken in various economies: Joint ventures, Greenfield projects and divesture or asset sale. In joint ventures, the public and private sectors jointly finance, own and operate a project to provide infrastructure. Greenfield projects involve new projects usually built and operated by the private sector, which takes on the commercial risk, although political and exchange rate risks are, sometimes, shared with the public sector. Such projects can take any form but the most common ones are- Build-Operate- Transfer (BOT) and Build-Own-Operate (BOO). Others are Build-Own-Operate-Transfer (BOOT), Design-Build-Finance-Operate (DBFO) and Build-Lease-Transfer (BLT). In the divestiture mode, State assets are privatised, either through direct sale or public offerings of shares in these assets.

a) India

The Government of India has carried out a number of infrastructure development programs through various modes of PPPs. One infrastructure project implemented in India under a PPP arrangement involved the construction of a major bridge across River Godavari that aimed at

[7] Broadly defined as collaborations between public sector and private entities who share costs, risks and benefits in order to jointly plan and implement activities towards common objectives.

reducing time of travel, lower travel costs and decongest traffic. The project was on a BOT[8] toll basis, with the developer being selected through competitive bidding process for a concession period of 25 years. The project was financed by a partial grant from the Indian government, equity raised by the selected developer and debt from foreign investors.

b) Bangladesh

In some cases, PPPs come with some technological innovation, in terms of service delivery, that results in more spin-offs to the entire community. The *Grameen Phone* programme is a joint-venture PPP initiative between a Norwegian operator (Telenor MC), a local microfinance company the *Grameen Bank* of Bangladesh and other investors (local and foreign) in the provision of mobile telephone services, in rural Bangaladesh, in a cost-effective manner. Telenor provided hardware, technology and management expertise, while the Grameen Bank offered its extensive local network, understanding of the economic requirements of the rural population and a local partner to negotiate effectively with the government. Bilateral and multilateral aid contributed to the installation of a number of base stations. What this programme achieved was the provision of infrastructure services to the rural poor through some kind of a PPP.

c) Lebanon

Further, the Lebanese government employed a PPP model of the BOT type to its telecommunication industry. Two foreign mobile telephone operators went into a joint venture with local private investors on the one hand and the Lebanese government on the other. In this partnership, the private sector players (local and foreign) were responsible for building and operating the network and the public sector took responsibility for regulation. The Lebanese government through this PPP managed to reinvigorate its telecommunications industry with the help of foreign players (FDI).

Agriculture

d) Ghana

One successful agro-based project that includes a number of stake holders in a PPP arrangement is the production of *Allanblackia* tree species and other by-products in Ghana. Under the Novella partnership, a corporate multi-country PPP was established, with strong development, extension

[8] This the most common form of PPP model used in India accounting for almost two- thirds of PPP projects in the country. The two major forms of BOT models are: User-fee-based BOT model used in medium-to-large scale PPPs for the energy and transport subsectors, and annuity-based BOT model commonly applied in sectors/projects not meant for cost recovery through user charges such as rural, urban, health and education sectors.

and conservation components, mainly aiming to develop domestication techniques, tree management practices, conservation strategies and a complete supply chain for *Allanblackia* species in Africa. Generally, this project involves a lot of integrated activities, namely; sensitising and encouraging farmers to domesticate *Allanblackia*; developing propagation methods and gene conservation; conducting research on ecology, abundance and sustainable harvesting; and integration of the specie into agro forestry farming systems. In addition, there is the facilitation and development of marketing networks and supply chain, as well as the development of poverty reduction options in the rural areas through the promotion of *Allanblackia*.

The activities within this PPP involve government, the private sector, development partners and farmer organisations in Ghana, working together to increase investment, productivity and sustainability in African agriculture. This project has had a positive impact on the livelihoods of the local communities in Ghana, which is mainly attributed to the nature of the partnership. This PPP benefits from policy support from the Ghanaian government, funding, product development and marketing by Unilever, supply chain, marketing, multiplication and distribution by Novel International; sustainable harvesting and biodiversity conservation by IUCN; and adoption of smallholder agro forestry systems by small holder Ghanaian farmers.

Tourism

e) Morocco

Globally, the absolute values of tourism-related FDI stocks remain low (UNCTAD, 2010). The Moroccan government, through its tourism strategy set up in 2001 and code named *Vision 2010,* sought to: (a) develop six beach resorts; (b) renovate and expand existing tourism destinations; and (c) develop new regional tourism products. The government sought participation by foreign investors and subsequently attracted several from Belgium, France, The Netherlands, South Africa and Spain. In the meantime, the Moroccan government played a role of investing in infrastructure at the sites, including provision of water, electricity and transport interconnectivity. In fact by 2010, 2 beach resorts that were a product of FDI-related PPPs were already in operation.

5.0 EMBEDDING FDI IN DOMESTIC ECONOMIES

5.1 Policy Intervention Experiences from Other Countries

Other than through PPPs, some governments, such as ***Jamaica, Costa Rica, Singapore, Malaysia, Czech Republic, Ireland, and the United Kingdom***, have developed strategies that promote linkages both amongst local firms and between local firms and foreign partners.

a) <u>Jamaica and Costa Rica</u>

Countries like Jamaica and Costa Rica developed strategies for directly increasing and strengthening economic linkages between the local enterprises and the foreign investors. Specifically, the governments established comprehensive linkage development programs, with the purpose of contributing to knowledge and technological transfers from Trans National Corporations TNCs, to feed into the development of vibrant domestic enterprises (Price, 2001). Specific actions undertaken included the following;

i) Provision of information and matchmaking,
ii) Encouraging foreign affiliates to participate in programmes aimed at upgrading domestic suppliers' technological capabilities;
iii) Establishing training programmes in partnership with foreign affiliates for the benefit of domestic suppliers; and
iv) Various schemes to enhance domestic suppliers' access to financing.

b) <u>Wales</u>

The Welsh Development Agency, in Wales, UK, using the *Source Wales* programme, focuses on integrating FDI with indigenous firms and stimulating networks so that both foreign and local firms can develop an interactive learning capacity. This programme has a two-pronged objective that aims at enabling large foreign firms to increase their purchase of local Welsh products, while at the same time increasing the capacity of the local Welsh firms to respond to large foreign firm demands. Specific interventions which this Agency undertakes include identifying potential local supply opportunities to foreign investors and providing development services to potential suppliers, in order to transform them into 'world class' suppliers. The Agency has also spearheaded the creation of Supplier Associations, to facilitate tutoring of the local suppliers by foreign investors.

The strengthening of linkages between foreign-owned and the indigenous sector in the Irish economy are handled under the Shannon Development Programme. This programme operates a major export zone (**the Shannon Free Zone**) and a technological park, which have helped attract major foreign investors. To increase linkages between foreign investors and local subcontracting firms, Shannon Development is sponsoring a number of initiatives such as: providing information (a profile) on the list of supplier companies so as to promote local sourcing; and providing a supply network website with information on network events and member contact details by company and sector listings. Further, the programme supports the creation of business clusters (company groupings so as to enable them subsidise one another in terms of common resource use).

c) The Czech Republic

The Czech Republic, runs the National Supplier Development Programme that supports the linkage between the country's local suppliers and foreign affiliates, through the country's foreign investment promotion agency, the *Czech Invest*. This programme involves: collection and distribution of information regarding the products and capabilities of potential Czech suppliers; match-making which involves organising events in which foreign investors and potential Czech suppliers interact; and seminars and exhibitions with and for Czech suppliers and foreign affiliates. Match-making also involves taking forward concrete proposals to foreign investors, besides indicating potential suppliers in the Czech Republic. Also, the programme has exerted effort towards upgrading selected Czech suppliers in chosen priority areas. The selected firms produce an upgrading plan, tailored to their individual capacities and requirements.

d) Ghana

The development of local content is seen as a viable option to support the development of local supply chains. Ghana recently passed the Petroleum Local Content and Local Participation Regulations, 2013. The following are key highlights from this law:

a) The Law requires new firms entering the oil and gas industry to have at least 10 percent local ownership. The target is to have an impressive 70-80 percent locally trained management and technical staff by 2023.

b) The law favours Ghanaian businesses and empowers them to provide up to 50% of goods and services to the oil and gas sector in five years' time and up to 90% within 10 years.

c) The law is also very clear regarding oil field licensing, award of oil lifting licenses, oil blocks and bid evaluation. The bid containing the highest percentage of Ghanaian content is favoured to be selected.

e) Brazil

Brazil's Experience has shown that you cannot boost local content unless the businesses are there to support it. In Brazil, Petrobras, the country's national oil company, has set up two funds to stimulate SMEs, of which there are now 14 million, accounting for 21 per cent of the country's GDP. To become a positive example in the African oil and gas sector, Uganda would benefit following the Brazil example.

The review of international experiences above shows that: other countries have developed a PPP model to promote investment; attracting FDIs into the agriculture sector has a big poverty reducing impact; and economies have successfully built institutional capacity to direct specific policy interventions to ensure increased FDI spill-overs into their economies.

5.2 PPPs, Joint Ventures and other Investment Partnerships in Uganda

5.2.1 Agriculture

Vegetable oil Development Programme (VODP)

One of the successful PPPs cited in Uganda's economy is the Vegetable Oil Development Project (VODP) whose objective was to produce and refine vegetable oil in Uganda. One component of the project is focusing on improving smallholder production of traditional vegetable oils, such as sunflower and the other was introducing oil palm cultivation in Uganda. The project works with farmers to help distribute better varieties, improve cultivation and quality control techniques, develop local processing, and link farmers to markets. Under the VODP, IFAD joined with the Government of Uganda in search for a private-sector partner and identified Oil Palm Uganda limited (OPUL) to bring technical expertise for plantation development and modern industrial refining methods that respect environmental safeguards and ensure a high-quality consumer product, in compliance with the country's food safety standards.

Oil Palm Uganda Limited (OPUL) is a consortium comprised of Wilmar, managers of the plantation and BIDCO. Farmers in Kalangala were mobilised and they formed an association called Kalangala Oil Palm Growers' Trust (KOPGT). OPUL and KOPGT developed a partnership that led to the development of 10,000 hectares of oil palm plantation. A third of that land is cultivated by small-scale producers and OPUL manages out-growers' schemes for farmers, clears the smallholder producers' land, provides seedlings and fertilizers and follows up with technical support.

The project employs over 1,400 Ugandans on its plantation, has built access roads to many remote households on the island and has attracted business to supply and service the growing development activities spurred by this oil palm investment.

Business Linkage Development Programme

Other than fostering investment partnerships involving a number of foreign and local stakeholders (), the Government of Uganda operates the **Business Linkage Promotion Programme** in partnership with development partners and the private sector. The Business Linkage Promotion Programme is being implemented by a Business Development Services Centre, Enterprise Uganda, as the lead facilitator, in collaboration with Uganda Investment Authority (UIA) and supported by UNDP, UNCTAD and the Government of Sweden (UNCTAD, 2006).

The main objective of the project is to promote the creation of durable and mutually beneficial partnerships between TNC affiliates and large local companies, on the one hand, and SMEs on the other, so as to enhance the productive capacity, efficiency, competitiveness and sustainability of their relationships. Since its inception in 2005, the project has achieved the following results:

i) Uganda Breweries was assisted in upgrading of the members of the barley growers' association in eastern Uganda, for the benefit of over 2,000 farmers; and Nile Breweries for benefit of over 4000 sorghum and barely farmers.
ii) In western Uganda, Kinyara Sugar Works Ltd, under Booker Tate, signed an agreement to strengthen its link with Kinyara Sugarcane Growers Ltd, thereby benefiting about 2,500 local farmers.

Other Business linkages

Furthermore, there are other significant linkages involving local and foreign stakeholders in investment partnerships in Uganda and these include: the Phenix Logistics Uganda Ltd; Shares Uganda Ltd; and Lango Cooperative Union (UNCTAD, 2010). Each player is involved in a different area of the cotton textiles supply chain, from farming activities in Northern Uganda to processing and exporting activities. The Lango Cooperative Union has a membership of 40,000 out-grower farmers; Shares Uganda Ltd is a farming company that is 80 percent foreign owned and 20 percent owned by Uganda farmers; and Phenix Logistics is a 50 percent foreign owned company that manufactures textiles and exports semi-processed organic cotton.

In order to gain access to a steady supply of raw materials, Phenix Logistics entered into a business linkage programme with the locally registered Shares Uganda Ltd, which has strong links with Bo Weevil, a Dutch Transnational Corporation (TNC), specializing in the production of organic clothing and textiles. With the assistance of the Lango Organic Project, an NGO that supplies organic cotton to local and foreign customers, Shares Uganda Ltd established a business linkage with 10,000 out-grower farmers from the Lango Cooperative Union. This network of out-grower farmers provides cotton that Shares Uganda Ltd processes, before consigning it to clients like Phenix Logistics.

5.3 FDI and Local Content Development Intervention

5.3.1 Local content in the Oil and Gas Sector

Before the discovery of oil and gas in Uganda, there was no specific legislation or deliberate policy drive to promote local content[9]. This is not unique to Uganda. Local content has therefore almost become synonymous with oil and gas, though it should be broader in coverage for it to be meaningful and create real in-country value for all stake-holders. The process of developing a policy framework for enhancing national participation in oil and gas sector is ongoing and is expected to be concluded in 2014.

Countries like Ghana and Nigeria now have standalone legislation on local content and Statutory Regulatory bodies that oversee and enforce the local content provisions. In Uganda, the process is still "on-going." The closest Uganda has come to legislating for local content is in the Petroleum (Exploration, Development and Production) Act No.3 of 2013. Section 125 (1) and (2) stipulate that, (1) "The licensee, its contractors and subcontractors shall give preference to goods which are produced or available in Uganda and services which are rendered by Ugandan citizens and companies."

The local content act above introduces - a 'slippery' concept of 'local content' - without defining what it is and what it is not. In addition, the law does not define what constitutes a "Ugandan company." The current provision makes the erroneous presumption that a company locally registered in Uganda is a "Ugandan company" rather than taking into account the nature of ownership and the degree of control of such a company and the actual degree of in-country value addition (i.e. how much of whatever such company inputs is strictly speaking, local) plus the

[9] Local content/national content refers to the competitive and gainful participation of citizens and private sector in an economic activity (Paul, 2005). It can be defined as the development of local skills, technology transfer, and the use of local manpower in an economy. Practically, local content is building a local in-country workforce that is skilled and building a competitive local supplier base

levels of participation (management, ownership and employment) by Ugandans. The local content clause in its current form obscures what is the objective of the local content provision in the law.

6.0 CHALLENGES TO EMBEDMENT OF FDIS THROUGH CREATION OF PARTNERSHIPS

6.1 Limited Capacity of Local Partners

One of the main challenges inhibiting formation of partnerships between local and foreign investors in Uganda is the limited capacity of local partners. There is low capacity to meet the partnership demands with the foreign investors, both in the form of equity contributions (capital) and input demands (supplier relationship). Local suppliers don't have the capacity to supply foreign establishments in terms of the quality and quantity required by large multilateral firms. Many of the local firms do not have the management expertise and capital to meet the demands of foreign investors. There are managerial expertise deficiencies leading to: failure to develop sound business proposals that would lead to sound partnerships and identification of sound investment projects.

In Uganda, there is also a big informal sector whose operations are a hindrance to partnering with the formal foreign investors. It is important, therefore, to make an effort to formalise the large informal sector. This may call for clustering of small and medium industries in well-defined industrial parks/production zones and deliberate programmes to improve skills. In Uganda, the large local businesses are reluctant to list on the stock exchange because they fear that the disclosure requirements could expose them to greater tax liabilities.

In addition, there is a mismatch in the skills possessed by the local labour market with what is required by the foreign firms e.g. the oil and gas industry is lacking local employees to partner with in form of the required skills base. Besides, the assimilation of the new knowledge by the locals is hard when the scientific base of the education system and the acquired skills are low, hence retention of new knowledge and therefore technology spill overs becomes very hard to achieve.

6.2 Information Asymmetry

Foreign investors seeking to operate and or bring investment opportunities to Uganda find challenges in reaching out to potential local partners. Conversely, Ugandan local business entities do not also have adequate information on credible foreign investors to partner with. Without full information and good assessment capacities, no viable partnerships can be established. The Uganda National Chamber of Commerce and Industry (UNCCI), whose mandate is to enhance business opportunities in Uganda, has assembled a list of various business opportunities that require the local enterprises to supply foreign markets with locally produced products and vice versa. By releasing such information on their website, the UNCCI[10] helps in minimising the information asymmetry gap.

However, there are issues arising from the approach being used in this 'match-making' task. The channel of communication (i.e. the internet) compared with the nature of development of our country is not sufficient in disseminating timely information to all stakeholders who are interested in investment partnerships. In addition, the information provided is scanty, as it does not detail out what is required from all parties. Besides, there is no public information indicating which particular deals have been concluded in terms of the duration taken for the local suppliers or foreign investors to respond, who exactly responded to what and such related issues.

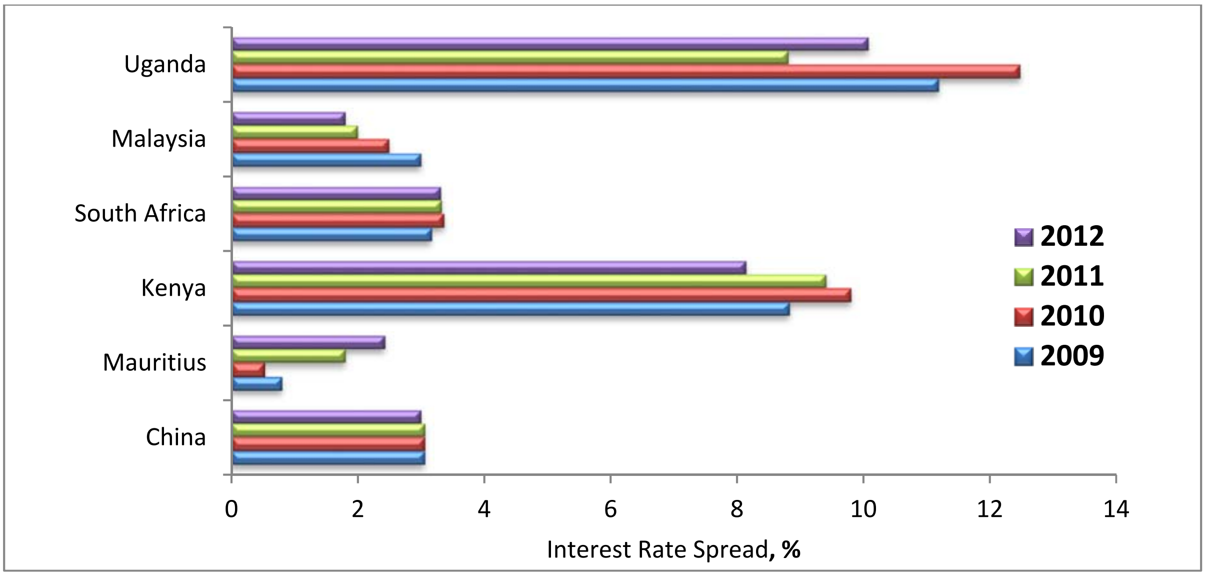
6.3 Limited Access to Credit

Where personal finances are inadequate, local investors are likely to seek bank credit as an alternative source of investment financing. However, in Uganda limited access to credit is one of the most significant factors affecting the growth and expansion of investors' businesses (UIA Investor's Survey, 2012). For instance, according to The Uganda Vision 2040, only 28 per cent of the population had access to formal financial services. The limited access to credit is partly attributed to high cost of capital, largely explained by the high interest rates charged by banking institutions. Figure 6 based on data from the World Bank shows that between 2009 and 2012, the interest rate spread[11] was much higher in Uganda and Kenya compared to countries such as China, Malaysia, Mauritius, and South Africa. Other factors that limit access to credit in Uganda include: lack of market information and managerial skills; long-term development finance; bureaucratic banking processes; corruption (red tape); and under-developed capital markets.

[10] www.chamberuganda.com/?q=Investment-Opportunities

[11] Interest rate spread is the difference between lending rate and deposit rate.

Figure 6 Interest Spread (%) in Selected Countries, 2009-2012



Source: World Bank Development Indicators, 2014.

6.4 Poor Infrastructure

Poor infrastructure especially for transport and energy is a big inhibitor for local investors to supply big foreign investors, as it increases the total cost of doing business. A separate Presidential Economic Council paper on infrastructure has been produced and an action plan developed fo handle this constraint. In this paper, therefore, we will not detail the actions required to address the gaps in infrastructure.

6.5 Coordination of the Scattered Local Suppliers

Foreign firms involved in agribusiness and agro processing have a challenge of connecting with local or smallholder farmers, who are scattered in different places. For example, Uganda Breweries experienced problems in dealing with the local farmers that were to supply it with equatorial barely, until it got an intermediary called Kapchorwa Commercial Farmers' Association. However, this intermediary also lacked enough capacity to coordinate all the farmers. Similarly challenges were encountered in the Kinyara Sugar Works partnership with the local sugar farmers that were scattered in different localities. Besides, there are quantity and quality issues that out-growers fail to adhere to and which act as a big challenge in such partnerships. However, the local out-growers also complain about their inability to bargain for favorable prices between them and the firms to whom they are supplying inputs, which derails them to other options.

6.6 Bureaucracy in Formalizing the FDIs

Another challenge cited in hindering the smooth operation of joint ventures and other investment partnerships in Uganda is the bureaucracy involved in obtaining work permits and business licenses. Such burdens currently faced in Uganda emanate from the multiplicity and overlap of business licenses, levies, fees and permits at national and sub-national government levels. There is duplication in terms of information obligations required for license applications and other regulatory submissions to the various government agencies, in view of these overlaps. In addition, the lack of coordination between government agencies and the insufficient ICT solutions to integrate and streamline administrative processes are a great hindrance to efficient regulation of business.

Licensing processes involve too many unnecessary administrative steps and often require multiple interfaces with government officials, which could have the potential of encouraging corruption and rent seeking behaviour. This is further exacerbated by the general lack of information for the investors about licensing requirements and procedures.

7.0 POLICY OPTIONS FOR PROMOTING INVESTMENT PARTNERSHIPS

The following policies are recommended to promote investment in Uganda, thereby promoting local and foreign partnerships in economic activities.

a) To strengthen the Capacity of Local Investors:

There is need to fast track the **Private Public Partnership law**, strengthen the flow of capital and strengthen partnerships between the foreign investors and the public sector. The public sector must play a key role, especially in the key strategic investment areas like infrastructure (Transport, energy and ICT), where local capacity to invest is limited, given the huge capital requirements.

b) To address the problem of business licensing:

i) Licensing should be used to serve legitimate regulatory and not revenue generating purposes such as: protection of the environment; public safety and security; consumer protection and competition; and fair trade. For this purpose it would be more efficient to raise revenues through fiscal policy rather than through licensing.

ii) Government should establish an official e-registry, which houses all information on approved business licenses. This information would minimise duplication of submission of information and excessive licensing. The e-registry would serve as the definitive repository of information on licensing requirements and delineate legally required licenses in all sectors of the economy, thus increasing transparency and the likelihood of compliance by the private sector. Subsequently, it would be enhanced to serve as a virtual transactional platform for all business licenses through which a license shall be issued and renewed;

iii) There is a need to ease the processes associated with business formalization by: establishing business entry One Stop Shop; and integrating business incorporation with other business registration processes such as tax, licensing and social security registration. This will reduce the time and costs associated with starting and running a business. The One Stop Shop should employ ICT tools, to facilitate sharing of critical information on businesses, in order to avoid duplication of submissions by businesses.

iv) Government should adopt a Regulatory Impact Analysis (RIA) mechanism as a tool to promote efficient regulatory policy through an assessment of the potential economic impacts, including likely benefits, costs and effects of new or existing regulation. Given the business licensing reform, the implementation of RIA would be a logical next step to improve the quality of the flow of legislation. The introduction of mandatory RIA in the legislative process would prevent the re-introduction of unnecessary and complicated regulations, including licenses.

c) Addressing supply rigidities

i) Local supplies can be mobilised through groups i.e. farmers groups, cooperatives where these can be provided with inputs, market information, quality control information, small scale irrigation information and equipment provided at subsidised rates. In other words, production would be strengthened and access to the wide range of services, assets, information on productive inputs and market status would be provided. This will improve on the consistency of supplies to the foreign investor and it will improve partnerships/linkages between the local suppliers and foreign direct investments coming to the country.

ii) There is urgent need to develop the capital markets to mobilise financing for development projects.

d) To address the information asymmetry:

i) The Uganda Investment Authority (UIA) together with other relevant institutions such as Uganda National Chamber of Commerce, Uganda Manufacturers Association, Private Sector Foundation etc. should develop a detailed data base of Local entrepreneurs giving their detailed business profiles including: areas of investment interests; their legal status; and contact information among others. This information should be accessed on different web portals and should be disseminated through different fora and updated regularly. The directory should also include suppliers.

ii) UIA, the One Stop Investment Centre should also capture information on foreign investors requiring partnership with local information and share it broadly on a number of portals and directly with the relevant stakeholders listed above. It should also provide regular analysis of foreign investors, the actual investment ancd associated jobs on the ground and the major areas of investments.

iii) Hold regular investment fora/symposiums for local and foreign investors and develop a framework for continuous discussions.

e) To address the challenge of limited access to capital

i) Government could ensure increased access to credit by putting in place measures that reduce the cost of doing business. These include: strengthening collateral registration and the credit rating bureau system; individual identification by establishing a national identification; vigilant supervision to minimize collusion in the financial sector; and promotion of public-private partnerships in favour of rural financial transformation. Furthermore, international experience has shown that specialized financial institutions can increase access to finance by providing adequate credit to sector specific projects. This model has been successful in Malaysia where Bank Pertanian Malaysia, a development financial institution, was set up to arrange, provide, supervise and co-ordinate credit for agricultural purposes in Malaysia[12]. Other examples include: the Agriculture Bank of China, National Bank for Agriculture and Rural Development in India, among others.

ii) Increase availability of long-term development finance by implementing reforms in the pension sector; Government could strengthen the capacity of Uganda Development Bank (i.e. by increasing its capital base and human capacity) to increase access to finance by local investors;

iii) Increase credibility of the financial systems in the country by strengthening Anti-money Laundering institutions and building capacity in the sector to adhere to acceptable international financial governance standards, including enhanced financial sector supervision;

iv) Promote Capital Markets development in the country by enhancing the capacity of institutions regulating and participating in activities of the sector. Capital Markets can provide an important alternative source of long-term finance for long-term productive investments. This helps in diffusing stress on the banking system by matching long-term investments with long-term capital. In addition, capital markets provide, which provide equity capital and infrastructure development capital that produces strong socio-economic benefits (i.e. roads, water and sewer systems, housing, energy, telecommunications, public transport, etc.) are ideal for financing such investments, through long dated bonds and asset backed securities. Capital markets are also critical in increasing domestic savings and investment ratios that are essential for rapid industrialization.

v) Strengthen regulatory mechanisms for efficient and fair functioning of the financial sector.

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f) Enhancing Local Content Development in Uganda

A badly enforced local content policy may be detrimental to Uganda's social economic transformation, as envisaged in the NDP and Vision 2040. To fully benefit from local content development in Uganda, government should:

(i) Have a Clear Local Content Law in Place

The law should clearly explain among other things, the nature of ownership and the degree of control and definition of a foreign company and the actual degree of in-country value addition (i.e. how much of whatever such company inputs is strictly speaking, local) plus the levels of participation (management, ownership and employment) by Ugandans.

(ii) **Invest in Infrastructure:** Poor infrastructure (roads, energy, and electricity) is a major constraint limiting growth of firms in Uganda and could therefore be a major setback to the realization of the potential for local content development in Uganda.

(iii) **Training and skills development:** An effective local content program usually features training and skills development elements to help local populations achieve the minimum standards required by the company—either in terms of general education or specialist skills. Such training can be an in-house initiative or the company can look to local institutions to provide the necessary training. In either case, the program should be based on a detailed analysis of local capabilities and a schedule of the skills requirements over the life of the asset.

(iv) **Foster the Development of SMEs:** It is difficult to boost local content unless the businesses are there to support it. In Brazil, Petrobras set up two funds to stimulate SMEs, of which there are now 14 million, accounting for 21 per cent of the country's gross domestic product.

8.0 CONCLUDING REMARKS

Uganda is endowed with a variety of natural resources such as oil and gas, forests and minerals. These are the major motivators for foreign and local investors. The government has made tremendous progress to attract FDI in the country, with the hope of facilitating economic growth and development. Good foreign relations with trade partners and regional neighbours have boosted FDI inflows, making Uganda the leading destination of FDI in the East African region. Despite this achievement, there is limited partnership between local and foreign investors which has negatively impacted the performance of FDI in key sectors of the economy i.e. infrastructure (roads, energy, ICT) and Tourism. This dampens the poverty reducing impact of FDI on growth. A number of constraints limiting the expansion of business ventures and partnerships through FDI in Uganda have been identified and include among others: inadequate infrastructure; information asymmetry; and limited access to credit.

To promote partnerships and embed FDI in Uganda, this study recommends that government should create and sustain an enabling environment for local and foreign investors, aimed at promoting investments in key sectors of the economy, by learning from other countries with successful partnerships. Specifically, the Ugandan government should: increase investment in infrastructure; implement measures that increase access to finance; improve the business regulatory framework and access to information.

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