UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

INVESTMENT POLICY REVIEW

UGANDA

UNITED NATIONS

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ABBREVIATIONS

AIG	America International Group
BOU	Bank of Uganda
CAA	Civil Aviation Authority
CCI	Cabinet Committee on Investment
c/kWh	(US) cents per kilowatt hour
CDC	Commonwealth Development Corporation
CEE	Central and Eastern Europe
COMESA	Common Market for Eastern and Southern Africa
CMA	Capital Markets Authority
EAC	East African Community
EDF	Electricité de France
FDI	Foreign direct investment
GDI	Gross domestic investment
GDP	Gross domestic product
ICSID	International Centre for the Settlement of Investment Disputes
IPP	Independent power project
km	kilometres
kWh	kilowatt hour
MFEZ	Multi-facility Economic Zone
MOWTC	Ministry of Works, Transport and Communications
MW	megawatts
NA	Not available
NWSC	National Water and Sewerage Corporation
Shs	Uganda shillings
TNCs	Transnational corporations
UEB	Uganda Electricity Board
UIA	Uganda Investment Authority
URC	Uganda Railways Corporation
USAID	United States Agency for International Development
USE	Uganda Stock Exchange
VIP	Vision Implementation Period

PREFACE

The UNCTAD Investment Policy Reviews are intended to familiarize Governments and the international private sector with an individual country's investment environment and policies. The reviews are presented at the UNCTAD Commission on Investment, Technology and Enterprise Development.

The Investment Policy Review of Uganda was initiated at the request of the Government of Uganda. The Uganda Investment Authority is the implementing agency and the Ministry of Finance and Planning, the cooperating agency. The project is financed jointly by the United Nations Development Programme and the Government of Switzerland.

The Review was carried out through a fact-finding mission in September 1998. Meetings were held with relevant government ministeries and statutory authorities, the private sector and the international community. The analysis and evaluation in this report draws on information gained during these interviews. Complementary activities were also carried out: a survey of foreign investors based in Uganda, 22 sectoral investment profiles, and a survey of investors in home countries.

The review was presented at a national workshop on 23 September 1999, and was considered by the UNCTAD Commission on Investment, Technology and Related Financial Matters on 5 October 1999. The recommendations of the Review have been endorsed by the Government and a follow-up programme is under way with the support of the United Nations Development Programme.

This report has benefited from the contribution of national and international experts. The national experts included Inter Africa Corporate Ltd and the Economic Policy Research Centre, while the Uganda Investment Authority commissioned 22 sector profiles. The international experts included Rory Allan, Mike Faber, Pierre Hostettler, Jagadeesan Jegathesan and Charles Yeterain. The UNCTAD staff include Lena Chia, Khalil Hamdani, and Prasada Reddy.

It is hoped that the analyses and recommendations emanating from this review will promote awareness of the investment environment, contribute to an improvement of policies and catalyse increased investment in Uganda.

INTRODUCTION

Over the past decade the Government of Uganda has reversed earlier policy and management failures that were so destructive of the economy and the investment climate. Economic fundamentals have been restored, the exiled business community has been invited back and State commercial misadventures are being corrected through privatization. The results are evident (see table 1): income per capita is rising in real terms, inflation is down from three digits in the late 1980s to less than 7 per cent for the last five years, and reserves are up from a week's cover of imports to 4.5 months. Uganda has also earned the right to be the first beneficiary of the World Bank/IMF initiative on debt relief for heavily indebted poor countries (HIPC Initiative).

Overall, these achievements have helped restore investor and donor confidence, and have established Uganda as a country of relative stability in the region – the pearl of Africa.[1]

The challenge for Uganda is now to go beyond recovery. The many positive developments since 1991 have been rewarded by a significant and very satisfying revival of domestic and foreign investment . The Government needs to take a number of actions to ensure that this revival is sustained and that Uganda realize its undoubted potential to attract much more FDI. The revival of investment and economic activity is partly a reflection of how fast the economy was previously destroying wealth – in Wall Street terms: «a dead cat bounce». Once the catch-up investments are made, investors will need to shift their sights to the development of new products and markets. There are ample opportunities for investment in new areas in which Uganda has potential competitive advantage, thanks to a diversified natural resource base and a growing regional market. But tapping these opportunities will require continuing public efforts to improve the microeconomic environment in which firms operate. Infrastructure and human resource development deserve priority attention, by the Government and the international donor community.

The need for Uganda to continue the momentum of recovery towards sustainable development is the central message of this report. Chapter I summarizes FDI trends and the improved economic and investment climate which have placed Uganda as one of the front runners in inward FDI in recent years. The inflows have helped to restore productive capacity and to diversify exports. Severe infrastructural constraints and the small market size inhibit the near- term realization of Uganda's full FDI potential, but there are opportunities to sustain new investment inflows. In the longer term, infrastructural constraints must be tackled in order to realize a vision of Uganda as a leading world producer of high quality agro-products.

Chapter I1 reviews the policy and operational framework for FDI. The Government has created a liberal climate conducive to business. Reforms of foreign exchange controls and taxation policies, in particular, have been implemented to high standards of international practice. Important but difficult reforms, such as land ownership, are being tackled. The quality of these reforms has overtaken the provisions of the Investment Code of 1991, which should be revamped in line with the liberal climate.

Chapter III considers opportunities for FDI in utilities, infrastructure and financial services. While these sectors do present some potential for FDI, including through privatization, they face two principal constraints. First, commercial opportunities are limited by the small domestic market. Second, the regulatory framework is not sufficiently developed to provide a clear structure for FDI. The small size of the economy means that Uganda must work exceptionally hard on its regulatory framework to attract substantial investment from major international investors.

Chapter IV provides an Eight-Point Action Plan on Investment Promotion. The strategy emphasizes a «Big Push» for a dramatic and sustained set of actions to overcome institutional and structural bottlenecks.

Chapter V draws the main conclusions and highlights priority actions to attract greater inflows of FDI.

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1 In characterizing Uganda as the pearl of Africa, Sir Winston Churchill said «My counsel is, concentrate upon Uganda! Nowhere else in Africa will a little money go so far. Nowhere else will the results be more brilliant, more substantial or more rapidly realized..It is the Pearl of Africa». Winston S. Churchill, «My African Journey» 1908.

Table 1. Indicators of macroeconomic performance, 1991-1997

KEY INDICA TOR	1991	1992	1993	1994	1995	1996	1997
Real GDP Growth (per cent)	5.4	3.2	8.3	6.1	11.2	9.4	5.3
GNP per capita ($)	260.0	200.0	190.0	190.0	250.0	300.0	330.0
GDI as a per cent of GDP	15.2	15.9	15.2	14.7	16.4	15.3	15.3
Private Investment as a per cent of GDP	7.8	8.5	8.5	9.2	10.1	10.1	10.4
Savings as a per cent of GDP	0.7	0.4	1.1	4.1	7.1	5.4	7.9
FDI inflows ($ millions)	1.0	3.0	55.0	88.0	121.0	121.0	250.0
FDI as a per cent of GDP	0	0	2.0	2.0	2.0	2.0	3.8
Import coverage ratio of reserves (months of import of goods and services)	1.0	2.0	2.0	4.0	4.0	4.0	4.5

Source: African Development Indicators 1998/99, World Bank Indicators 1997 and Ministry of Finance and Planning, Uganda.

I. FOREIGN DIRECT INVESTMENT IN UGANDA

Uganda is one of the fastest growing economies in Africa, averaging an annual rate of growth of 6.5 per cent in the 1990s. Domestic investment and FDI into Uganda have increased rapidly. Much of this investment and growth has been driven by the imperative to erase an earlier decade of self-destruction, and the economy has only now begun to recover to the levels of production that existed prior to the turbulent 1970s and early 1980s. As the recovery runs its course, the sources of economic growth will need to shift from rehabilitation to expansion. Investors will need to enlarge their focus from catch-up investment, to the development of new products and markets.

Policy makers will need to complement their success on the macroeconomic policy front with an equivalent effort at improving the microeconomic environment that governs enterprise and industry-level competitiveness. Firms in Uganda face high operating costs and low productivity due to structural constraints arising from weak utilities and transport networks; inadequate supply of inputs; and added transit costs from being in a landlocked country. An improvement in the business environment will require attention to problems ranging from infrastructure bottlenecks to shortage of technically trained manpower. The challenge for Uganda lies in upgrading the micro-environment to the high level of the macro-environment.

A. Recent investment trends

Uganda is a «front-runner» in Africa for inward FDI. Flows to Africa during 1993-1997 increased by about 54 per cent over the preceding five-year period, 1988-1992, of which Uganda has been one of the major beneficiaries (see table 2). Uganda is also the leading location for new FDI in the emerging regional market of the East African Community.

As recently as 1990, Uganda witnessed disinvestment to the order of $6 million. But since 1993, FDI inflows have grown rapidly. The average net annual inflow during 1993-1997 was around $112 million. In 1997, FDI inflows reached $250 million, double that of 1996.[1]

The accumulated FDI stock in Uganda reached $643 million in 1997, increasing from $4 million in 1990 (see chart 1). Government divestiture and increased remittances by non-resident Ugandans have generally contributed to the growth in capital flows. The latter is indicative of the new found confidence in the country's improved political economy.

[1] UNCTAD. *World Investment Report,* 1998.

Table 2. FDI inflows into African countries,[a] 1983-1997
(Annual average, millions of dollars)

Country/region	1983-1987	1988-1992	1993-1997
Côte d'Ivoire	49.3	-19.2	182.1
Ghana	3.8	15.5	156.9
Equatorial Guinea	2.5	12.0	116.5
Uganda	-0.8	0.2	112.0
Namibia	5.0	53.2	110.1
United Republic of Tanzania	-0.1	4.3	99.7
Zimbabwe	-5.0	-4.5	69.7
Zambia	39.5	107.8	60.6
Mali	0.3	-0.3	51.3
Mozambique	1.5	13.0	43.9
Total Africa[b]	1,966.0	3,183.5	4,900.9
Total developing countries[b]	17,858.6	36,846.3	112,845.6

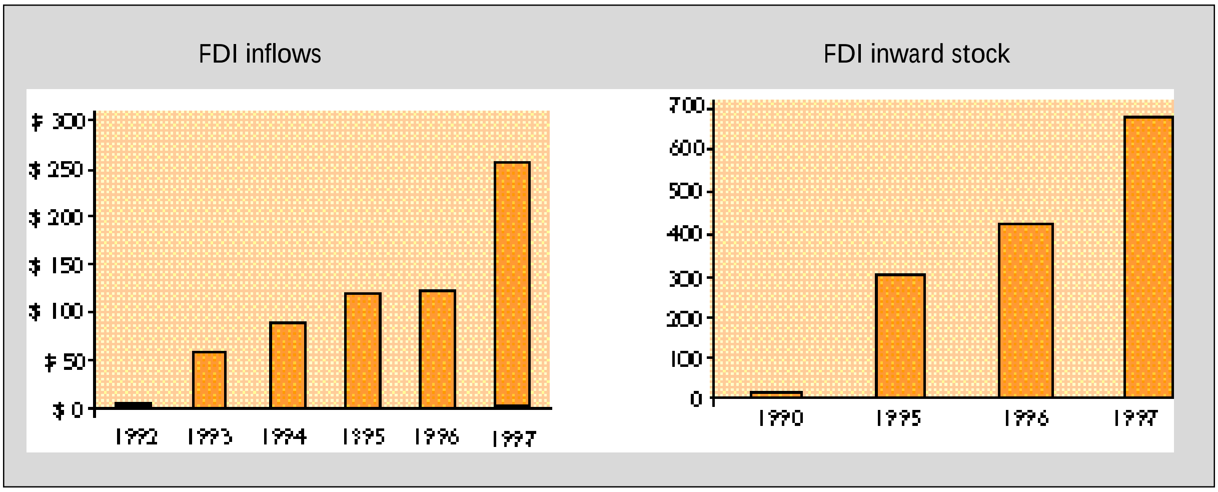
Source: UNCTAD FDI/TNC database.

a Countries are ranked by the size of their average annual inflows in 1993-1997, excluding oil-exporting economies and South Africa.
b Excludes South Africa.

During 1992-1996, the ratio of FDI inflows to gross fixed capital formation reached 10.3 per cent, surpassing not only the average for Africa but also the average performance of all developing countries.

The privatization programme, started in November 1992, has provided impetus to FDI in Uganda. It has progressed relatively rapidly, and by June 1998, about 70 per cent of the projects earmarked had been divested. These projects were mainly in the agri-business, manufacturing, tourism (e.g. hotels) and trade sectors. In August 1998 the programme was temporarily suspended over allegations of mismanagement and improprieties but has since resumed with the Government now disposed to apply the principles of best practice. An indication is the recent announcement that the Government intends to divest itself of its controlling share in Uganda Telecom Ltd. through an open competitive tender in which the financial adviser will be the International Finance Corporation, a member of the World Bank Group. The choice of such a financial adviser should assure confidence in the integrity of the process.

Chart 1. FDI inflows and inward stock *($ million)*



Source: UNCTAD, *World Investment Report* 1998.

The leading investors in Uganda are the United Kingdom, Kenya, India and Canada, which together account for more than half of the foreign-owned projects there (see table 3). Their leading position is largely derived from the welcome accorded by President Museveni to the exiled Ugandan Asian community who were forced to flee Uganda in 1972. Before their expulsion in 1972 there had been about 70,000 Asians in various sectors of business. They have since regained their properties and have injected capital into rehabilitating industries.

Table 3. Country of Origin of FDI

Capital Source	Foreign-owned projects (number)
United Kingdom	165
Kenya	117
India	62
Canada	47
United States of America	25
Sweden	22
Denmark	15
United Republic of Tanzania	14
South Africa	8
Republic of Korea	12
Others	142
Total	629
Of which, from African countries	165

Source: UIA Investor Survey Report, July 1991-December, 1996.

The Madhvani Group, the largest conglomerate in Uganda has since the mid-1980s, been rehabilitating its sugar, beer brewing, soaps and oil businesses. It has increased its beer production from the Nile Breweries to gain a 60 per cent share of the local market. It has also established a joint venture with South African Breweries that combines local knowledge with foreign management expertise. The group is also a partner in the Nile Independent Power consortium which plans to invest $400 million.

B. Investment and productive capacity

To sustain long term economic growth, it is estimated that private investment must rise from the present level of around 10 per cent to about 15-20 per cent of GDP.[2]

Such an increase is feasible with a more determined effort to realize planned investments. During 1991-1998, foreign investment proposals amounted to $2.4 billion, of which about 34 per cent were realized (see table 4). An additional $1.4 billion had been planned by domestic investors, of which about $624 million has actually been invested. The disparity between proposed and realized investments is attributed to factors such as difficulty faced by enterprises in obtaining land at appropriate sites and in securing utility connections.

Table 4. FDI by sector, 1991 to 1998

Sector	Investment in $ million Planned	Actual
Manufacturing	906.2	422.8
Real estate	343.3	56.7
Transport, communication and storage	291.2	70.3
Mining and quarrying	194.3	47.7
Tourism (hotels, casino)	132.3	52.0
Agriculture, forestry and fishing	112.5	57.2
Other business services	99.1	13.6
Water and energy	74.2	0
Trade	69.9	30.1
Financial services	67.4	31.2
Construction	55.4	18.1
Social services	51.9	12.1
TOTAL	2,397.6	812.0

Source: Uganda Investment Authority.

Uganda has a small manufacturing base accounting for only 6 per cent of GDP, but this sector has attracted the largest share of investment. A substantial part of the investment has been in the rehabilitation of old industries and not in the creation of new production capacity. Foreign investment is concentrated mainly in beverages/soft drinks and breweries for the local market. Other industries, such as sugar, textiles, cement, footwear, packaging, plastics and food processing, have also attracted some FDI. Overall, value-added in manufacturing appears limited as processing, in several cases, involves only repackaging (e.g. paints).

Manufacturing enterprises operate under difficult conditions. An erratic and irregular supply of electricity (power surges and widespread load shedding) interrupts operations and results in under capacity. Power breakdowns can last two to three hours, and can occur three times a week. Although factories have generators, they cannot support heavy operations such as manufactures in food processing industries, in which Uganda may otherwise have a comparative advantage, or glass manufactures for the beverage industry.

2 U.S. Agency for International Development (USAID). *Uganda Country Competitiveness Analysis*, 1998.

These industries are sensitive, in particular, to temperature variations in production. Another problem is the higher cost of fuel in Uganda compared with neighbouring countries. Additional constraints are the inadequacies of domestic transportation and logistics infrastructure (road system, storage and ancillary facilities), which tend to hamper the movement of high volume products at economical costs to markets. In general, land transportation is expensive and depends to some degree on seasonal weather factors.

FDI in the agriculture, forestry and fishing sector is predominantly in coffee, tea and cotton plantations. Otherwise, crop cultivation is dominated by smaller holdings with low input technology. Agricultural crops tend to suffer from high levels of wastage due to lack of appropriate storage facilities, and weak marketing and distribution systems. Partly for this reason, agro-industries depend on imports. For example, in the edible oil processing sector, the domestic supply of inputs (i.e. sunflower, simsim, cotton seed, soya beans, groundnuts, and some oil palm) meets only 20 to 25 per cent of the demand of the processing mills. Large oil millers bridge the gap between domestic supply and capacity demand by importing inputs and crude or semi-finished edible oil products. Improvement in the domestic supply of agricultural inputs would improve productivity in industry.

A few of the large projects that are expected to change the profile of foreign investment and productive capacity in Uganda, include the following:

- Capital intensive projects in power generation: 3 projects by international consortiums, presently under negotiations, are expected to mobilize investments amounting to a total of $1.07 billion. These are projects by Arabian International Construction Ltd., wholly-owned by the Egyptians with an investment of $600 million in the Kalagala Falls; the $400 million Nile Independent Power project, a joint venture between Madhavani Plc and AES International, a United States power producer with worldwide interests; and Norpak Power Ltd., a consortium involving Norwegian interests with a planned investment of $70 million.

- Mobile Telephone Network, owned by a South African company, has an investment commitment of $70 million. It has been given the second national operator's licence.

- Celtel, a cellular telecommunications operator, has an investment commitment of about $12 million involving the following: Mobile Systems International Plc, (43 per cent). Vodafone (37 per cent) and 10 per cent each by the Commonwealth Development Corporation and the International Finance Corporation.

- Kasese Cobalt is the biggest mining project with a total investment of $110 million. The project has attracted interests from Australia, France and Canada, and includes co-financing by among others, the International Finance Corporation, the European Investment Bank and Standard Bank of South Africa.

- Coca-Cola and Pepsi International have expanded investments to $33 and $20 million respectively, to strengthen their foothold in sub-Sahara Africa. Both companies have joint ventures with local enterprises. Century Bottling is the franchise holder for Coke; Pepsi International, through its South African subsidiary, has shareholdings in Crown Beverages Ltd, and it plans to take over the direct management of the local franchise.

C. Contribution of FDI to the economy

FDI has contributed substantially to the recovery of the Ugandan economy, especially in terms of additional private capital flows, employment creation, technology transfer and market development.

1. Capital formation

FDI has helped broaden the financial base of the Ugandan economy, which has been heavily dependent on official transfers. Table 1 shows the increasing importance of the FDI share in GDP since 1991. The FDI/GDP ratio was negative until 1990, the year when liberalization of FDI policies started, and by 1997 it had reached a share of 3.8 per cent to GDP, which is almost double that of the preceding year.

Apart from the direct equity participation, foreign companies add to capital formation through their ability to raise additional finance from international banks and other financial institutions. Given the country's low savings rates, FDI contributes to bridging the gap between savings and investment. Private investment has increased by an average of 13 per cent per annum in the past decade. Its share in GDP has increased from 6.5 per cent in 1990 to an average of 10 per cent in recent years.

To the extent that FDI is in existing and privatized projects, no new capacity is being added, but the effect is one of recovery with increased productivity. For future growth the levels of private investments that add new capacity must increase significantly.

2. Employment

The most visible aspect of FDI tends to be its contribution to job creation. The current investment projects, when fully implemented, are expected to generate about 95,000 jobs. Half of these would be in the manufacturing sector. Even allowing for the cancellation of some projects, the increase in employment opportunities, particularly in agro-based industries, is likely to be significant. In the agricultural sector, the rehabilitation of the coffee and tea estates, as well as rice and cotton, have done much to improve employment and farmers' incomes.

3. Technological capability-building

FDI offers host country firms the opportunity to learn through linkages and to accumulate technological capability through the transfer and diffusion of technology. In Uganda, there is evidence to suggest that FDI has contributed to the transfer of skills and technology.

In a survey conducted by UNCTAD (June 1998), domestic firms reported that linkages with foreign firms have benefited them in the areas of technology, management, export markets, equity capital and training. The benefits from technology acquisition received the highest rating of 3.95, out of a maximum weight of 5.00. For example, Century Bottling Company, a joint venture company has been able expand its local capacity by installing a new bottling line procured from Coca-Cola International. In the agricultural sector, the survey suggests that small-scale farmers have benefited from financing, technical inputs and an assured market at reasonable price resulting from activities generated by foreign investment in the country. Companies, through loan schemes to farmers have enabled farmers to acquire seeds, chemicals, fertilizers and pesticides, and directions on their uses. They are also given guidance on proper harvesting methods.

However, field visits also indicate that the level of technological capability in many of the sample firms is generally low, and production processes tend to rely on simple technologies. Machinery and equipment tend to be rather old largely due to many years of under-capacity utilization and lack of reinvestment during the turbulent years in the 1970s. There is also a significant shortage of educated and/or trained persons. While the primary school enrolment rate in Uganda (73 per cent enrolment) is almost at the level of comparator countries, such as Kenya and Ghana, education imbalances are severe at the secondary and tertiary levels – only 12 per cent of the school-going age population are enrolled at the secondary level, and 1.5 per cent at the tertiary level, of which only 13 per cent are enrolled in natural and applied sciences. In an attempt to improve this situation, the Government is currently developing new courses in accounting, business management and computer operations. The country's education policy also aims at achieving universal primary education.

The availability of technical and engineering skills are among the key requirements for industrial upgrading and the development of competitive enterprises as well as for attracting FDI. However, Uganda's comparative position in this respect is far from satisfactory as shown in table 5.

Table 5. Skill indices of selected sub-Saharan countries

Countries	Technical enrolment index	Engineering enrolment index	Years of schooling,1985 [a]
Ghana	1.16	0.76	3.22
Kenya	2.00	1.34	3.09
Mauritius	7.16	6.27	4.59
Namibia	8.98	7.36	
United Republic of Tanzania	1.03	0.88	2.29
South Africa	23.61	17.32	4.95
Uganda	2.06	1.78	1.92
Zimbabwe	8.41	7.07	2.63

Source: Lall, 1999.Calculated from UNESCO, World Bank and Barro and Lee,1996.

[a] Barro and Lee 1996

Notes: Technical enrolment index is tertiary total enrolment (times 1000) plus tertiary enrolment in technical subjects (times 5000), both as a percentage of the population. Engineering skills index is same as previous index, with tertiary enrolments in engineering instead of enrolments in all technical subjects

The dire state of technical skill supply in Uganda is confirmed by a survey of 121 firms carried out by the Uganda Investment Authority Technology Consult Survey, 1998. It shows that the 121 respondent firms employed only 115 engineers and 240 technicians (see table 6) suggesting that on average, the number of engineers and technicians per enterprise is roughly 1 and 2 respectively. In fact, the survey reveals that some of the enterprises in the sample, in particular those engaged in the production of tiles, paints, fabrication, footwear, plastics and timber, did not employ any qualified engineers or technicians.

Table 6. Technical Skills in a sample of 121 Ugandan Enterprises, 1998

Engineers/technicians	Numbers
Mechanical engineers	60
Electrical engineers	33
Civil engineers	5
Industrial engineers	15
Chemical engineers	2
Total engineers	115
Chemists	28
Food technologists	17
Mechanical technicians	120
Electrical technicians	72
Science technicians	48
Total technicians	240

Source: UIA-Technology Consult Survey, 1998

However, companies are taking measures to overcome the shortage in technical skills through firm-level training. UNCTAD's survey revealed that 48 per cent of the respondent firms had training programmes for their employees, and half of the firms participated in training programmes abroad. The firms offering training programmes reported that approximately 70 per cent of their training budget is spent on developing management and technical skills and 30 per cent on training their unskilled labour force. These firm-level efforts should be supported by government policies aimed at strengthening existing institutions of learning, such as the technical school at Nakawa and the Management Training and Advisory Centre, and fostering their linkages with domestic firms. In this respect, the concerted efforts by Makarere University, to establish stronger linkages with local enterprises is worth noting. The Faculty of Technology is working with small and medium-sized enterprises, through the initiatives of the Gatsby Trust Fund, to solve their immediate problems in the areas of technology adaptation and upgrading. In Uganda, research and development activities are coordinated by the National Council for Science and Technology (UNCST), but the Council lacks financial resources and its activities are restricted to academic research with limited use in industry.

In short, at present, the Ugandan science and technology system is poorly adapted to meeting the needs of local industries. In many cases, the linkages with local and foreign enterprises are still at an infancy stage. Most of the local science and technology institutions, with the exception of the strongly donor-supported National Agricultural Research Organization, are small, understaffed, poorly funded and are relatively new. There is, moreover, lack of coordination between the Government, technology-support institutions and the private sector. This is particularly true for the Ugandan Industrial Research Institute and the Uganda National Bureau of Standards. The latter is in charge of developing standards and providing metrology, laboratory testing and quality assurance services to industry. However, to date, only a small number of standards have been adopted, and most of these are not yet commonly applied by Ugandan enterprises.

The fragile state of the science and technology system in the country may impede the strategy to generate dynamic enterprises and create an environment conducive to a sustained inflow of FDI. The challenges are to:

- Design investment policies as integral parts of a strategy to build local technological capability.
- Generate the types of skills needed by local industry and in adequate numbers through policies that promote firm-level learning and that encourage interactions between educational institutions and the enterprise sector.
- Establish technology support institutions and ensure, through targeted policies and incentive scheme, linkages with the enterprise sector.

4. Export development

Before 1970, Uganda belonged to the then East African Community, and exported a variety of goods to the other members, Kenya and the United Republic of Tanzania. This regional market accounted for about 20 per cent of export receipts. The hiatus of the 1970s wiped out the broad export base, and in 1980 coffee became almost the only item of export, accounting for about 80-90 per cent of export receipts. By 1990, the recovery of Uganda's tradable sector still had some way to go, to make up for the poor performance of the 1970s (see table 7). Manufactures should have accounted for nearly 20 per cent of total exports in 1990, instead of 0.8 per cent (or the current 2 per cent). Agricultural exports should also be more diversified and include more processed products (such as fruit, for which there is sizeable long-term potential).

Table 7. Uganda's Export Composition in 1990
(Percentage)

Export categories	Actual	What it should have been
Static, unprocessed agricultural products	95.7	32
Dynamic, unprocessed agricultural products	3.1	40
Unprocessed minerals, metals, fuels	0.1	1
Static, processed agricultural products	0.1	5
Dynamic, processed agricultural products	0.1	1
Processed minerals, metals, fuels	0.1	1
Low-skill manufactures	0.3	17
High-skill manufactures	0.5	3
Total exports	100	100

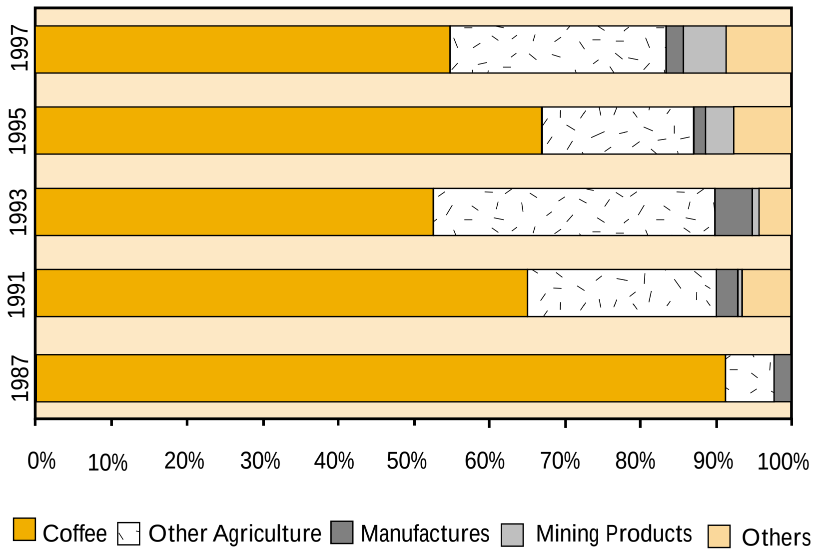
Source: Adrian Wood and Jörg Mayer, *Africa's Export Structure in a Comparative Perspective*, UNCTAD/GDS/MDPB/Misc.4. September 1998.

Notes:
Dynamic (static) products face rapidly (slowly) growing market potential identified on the basis of an income elasticity of demand which is greater (less) than unity. For example, dynamic products include meat, dairy, fish, fruit, vegetables, nuts, spices and vegetable oils. Low-skill manufactures include leather, rubber, cork, wood, paper, textiles, clothing, travel goods, footwear, iron and steel, fabricated metal products, sanitary and plumbing equipment and furniture.

Uganda's exports recovered from about $141 million in 1992 to $759 million in 1997. FDI in coffee, cotton and tea estates has contributed to restoring Uganda's past capacity in the production and export of these traditional exports. The export structure has also been diversifying, with non-traditional exports accounting for 40 per cent of recent export growth (see chart 2). FDI has also played an important role in the development of non-traditional exports, particularly of fish and cut flowers. Fish exports rose from $5.3 million in 1991 to $45 million in 1996. Export sales of cut flowers (roses) rose from $158,000 in 1993 (when first recorded) to $2.8 million in 1996. The growth in non-traditional exports can be expected to continue.

Uganda should also be exporting more manufactured products, particularly low-skill manufactures. Manufacturing exports are few and consist of low valued products, such as soap, footwear, plastic materials, hoes and hand tools, and textiles and yarn, exported to neighbouring countries. This product range should expand. Uganda may not have a comparative advantage in exporting manufactured products but the current share of manufactures in total exports is unexpectedly low.

Chart 2. Export structure, 1987 to 1997 (Percentage)



Source: Uganda Export Promotion Board.

The packaging industry, where half the firms are foreign, is important for the success of Ugandan exporters. With better backward linkages, the packaging industry could supply products which are currently imported, such as: kraft paper; tetrapak for dairy products; jute; high-and-low density polypropylene, PVC and polystyrene granules used in the production of styrofoam boxes for fish exports.

Transnational trading companies have played a crucial role in supporting the export of primary commodities by serving as buying agents on behalf of other firms or by exporting on their own account. The case of Kyagalanyi Coffee Ltd., a joint venture with a global coffee trading group, illustrates how linking up with a foreign company enabled it to expand its overseas markets (see box 1).

Box 1. Kyagalangi Coffee Ltd. underpins global operations of the Swiss-Volcafé Group

Kyagalangyi Coffee Ltd. is a joint venture between a Ugandan entrepreneur (20 per cent) and the Swiss-Volcafé Ltd., (80 per cent) which is the second biggest coffee trading group in the world. The Ugandan-based company is one of 18 export subsidiaries worldwide owned by the Volcafé Group, and is linked to Volcafés three import/trading houses of the Group, namely, Rothfos/Halsen of Bremen, Germany, Volcafé Ltd., Wintherthur, Switzerland, and Volcafé Ltd., Osaka, Japan.

The Ugandan operations are of vital importance to Volcafe's global operations. The Ugandan coffee, because of its high quality, is blended with other coffees. The global network of Volcafé enabled Kyagalangi to successfully enter some of the most competitive markets in the world. In 1995-1996, the company exported about $60 million worth of coffee. The linkages with Volcafe also helped Kyagalangi to acquire quality technologies, market intelligence and export market outlets.

Source: UNCTAD's survey of foreign firms in Uganda (company's profile), June 1998.

Likewise, the case of North Bukedi Cotton Co. Ltd. illustrates how a failing business was revived through a strategic alliance with a foreign partner. The company was established in 1995 as a joint venture between North Bukedi Co-operative Union and Africa Resources Ltd. of South Africa. The joint venture represents a strategic response to the challenges of cotton growing and marketing by local partners. While the co-operative union mobilizes peasant farmers and offers them extension services, the foreign partner provides an assured market through its global network. From an inefficient and inward-looking operation, the company has now become an exporter of quality products to sophisticated markets including the United States of America, the Middle East and Europe. Through its foreign partner, the company also gained access to modern technology and management techniques.

5. Linkages

According to UNCTAD's survey, foreign firms have reduced their use of imported inputs. In 1993, 76 per cent of the firms reported that they imported more than half of their intermediate inputs, whereas in 1997 the figure was 60 per cent. Among the firms that imported less inputs, 85 per cent linked the decline in importation to the purchase of local inputs, and 15 per cent to the production of such inputs within the firm. Thus, there appears to be an improvement in local supply capacity (see box 2).

Box 2. Britania Products Ltd. link with local suppliers in Uganda

Britania Products Ltd. wholly foreign-owned by the Dawda Group of India, was established in 1993. It is engaged in the manufacture and distribution of confectionery products. The company has increased its variety of biscuits from 2 in 1995 to 14 today. It has a total of 600 employees under direct employment and a well-established distribution network all over the country with 200 agents and over 600 retailers. The company also exports to Rwanda, Democratic Republic of Congo, southern Sudan, and to northern Tanzania.

The Company created forward and backward linkages with the local economy: it supports the agriculture, manufacturing and trading sectors; it also procures a number of inputs and materials from local suppliers, including corrugated carton boxes, polythene bags and labels, and periodically purchases cooking oil and sugar from local suppliers when their prices are more competitive than imports.

Source: UNCTAD's survey of foreign firms in Uganda, June 1998.

D. Potential for investment and development

1. Overall Assessment

Uganda has been fairly successful in building its economy to the level that existed prior to the civil war in the 1970s. The growth has gained momentum from the twin policies of economic liberalization and privatization. Uganda has also been making efforts to improve social conditions, especially in the areas of health and education. The challenge now is to go beyond the recovery phase and attain high growth rates on a sustainable basis. Uganda, according to foreign firms has good potential for FDI (UNCTAD's Survey of Potential Investors, October 1998, see annex), and this lies mainly in resource-seeking activities.

Uganda is located within both the east and central African regions. As a member of regional groupings, Uganda's access to trade and investment is enhanced. For example, it is a member of the Common Market for Eastern and Southern Africa (COMESA) which has a population of about 400 million persons, and in November 1999, it signed a treaty establishing the East African Community. The EAC market, comprising Kenya, the United Republic of Tanzania and Uganda has a total population of 74 million.

The National Vision 2025, envisages industrial development as the key to achieving increased value for the country's natural resources, the creation of inter-and intra-sectoral linkages and the creation of new markets with a view to raising national income.

For achieving this goal, Uganda must create operational conditions that are conducive for business growth. Firms in Uganda face very high operating costs and low productivity because of several weaknesses (see table 8 and box 3). The small size of the domestic market with low purchasing power is also a constraint.

Box 3. Operational Conditions Faced by a Textile Manufacturing Company in Uganda

Pickfare Industries, a textile manufacturer in Rwanda, acquired Nytil, a textile manufacturing company in Uganda in 1996. In both domestic and export markets Nytil-Pickfare has to compete with textile exporters from India, Pakistan, China, Thailand and Indonesia. According to the company, raw material, utility and capital costs are generally higher in Uganda's textile industry than in the competitor countries. For instance, the cost of cotton is much lower in India and the costs of chemicals, which account for 10-14 per cent of production costs, are higher in Uganda as they have to be imported. Electricity charges are also higher when compared to Zimbabwe. The Bank interest rate on loans is over 20 per cent in Uganda, compared to 6 per cent in Pakistan and 12 per cent in India on local currency loans. While the nominal wages are lower in Uganda than in competing countries, the real wage costs tend to be higher because of lower productivity.

Source: UNIDO Assessment of the Impact of the Uruguay Round agreements on Manufacturing Industries in Selected African Countries – Country Report. Uganda 1996.

The most severe constraint for Uganda is its landlocked position, which imposes additional land transport costs. Uganda's imports and exports, apart from air cargo, presently pass through the port of Mombasa in Kenya. The single railway track to the port in Kenya is unreliable and inefficiently run. The cost of a container from Europe to Mombasa is about $180 per tonne and the inland transport cost from Mombasa to Kampala is $120 per tonne. This does not, moreover, take into account the costs associated with the delays in delivery. The decision by the Kenyan Port Authority and the National Shipping Company of Tanzania to open offices in Kampala is a small first step towards improving the situation.

Inadequate transport, electricity and telecommunications facilities stand out as prominent weak spots. The Government is making efforts to address these problems. However, because of the long implementation period required for infrastructure projects, it will take time to overcome these problems. The Government has set aside a plot of land near Kampala which will be developed into the Namanve Industrial Estate, providing serviced land for industrial projects. In addition, the World Bank and the European Development Fund are providing support to upgrade four sections of the road, which forms part of the East African road network.

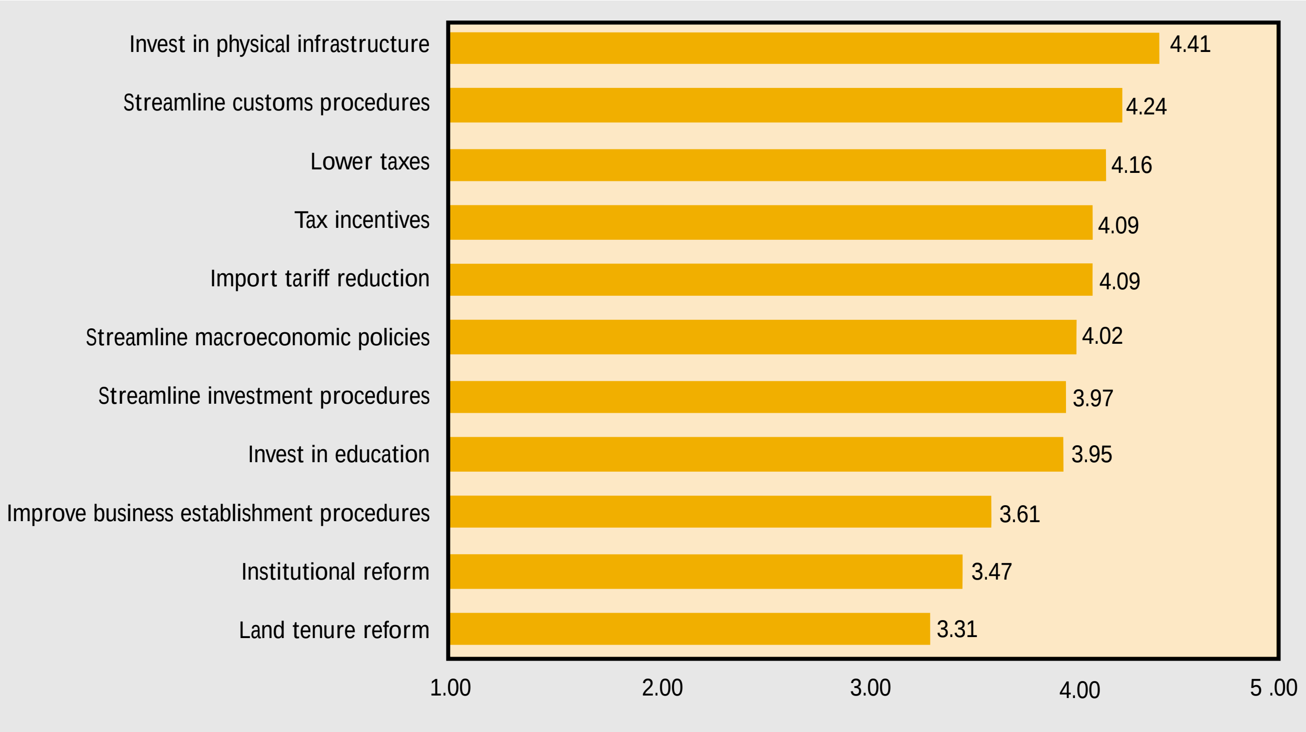
It is understood that red tape impediments and irritations persist, but these are being addressed by the Government. When asked what measures the Government should take to promote business and investment, the major areas identified by firms was investment in physical assets, with a high score of 4.41 out of a maximum of 5, followed by a need for streamlining of customs procedures, with a score of 4.24 (see chart 3).

Table 8. Factors of Uganda's competitiveness

Factors	Cur rent Standing of Uganda	
	Strengths	Weaknesses
Political environment	- Political stability - Private sector-led growth strategy - Openness to trade and foreign investments	- Regional conflict in the North
Economic environment	- High growth rates - Low inflationary rates - Liberalization of capital & current accounts - Strong donor support (first country to qualify for the HIPC initiative in 1998)	- High growth owed mainly to recovery phase - Low domestic savings - High debt/GDP ratio - Regulatory weaknesses in utilities sector
Market characteristics	- Emerging market - Enlarged market as member of regional groupings	- Low purchasing power in domestic market - Potential competition from East African sub-regional firms
Natural resources	- Fertile agriculture land (including plantations) - Fresh-water lakes - Forest resources - Minerals available in commercial quantities (e.g. cobalt and copper)	- Severe limits on availability of large-scale land parcels
Infrastructure	- Improved connections with the outside world following the opening of the telecommunications sector to private participation	- Landlocked country - Unreliable power supply & communications - Poor road network & high transportation costs
Human resources	- Large pools of literate labour force - Low wages	- Scarcity of skilled technical personnel
Financial system	- Uganda Securities Exchange and Stock Exchange established in 1997 - Formation of the East African Securities and Regulatory Authority in 1997	- Nascent capital market system

Source: UNCTAD assessment based on investor surveys and interviews.

Chart 3. Measures Government should take to promote business & investment



2. Potential areas for investment and development

The constraints imposed on Uganda strongly influence the industrial competitiveness profile that it currently presents for potential FDI. A determined effort is needed to invest in relieving infrastructure and energy constraints, and FDI can play some part in this. At least in the medium-term, Uganda will have to concentrate on industries for which raw materials and other inputs are readily available within the country. Although the small domestic market inhibits investment, opportunities should exist to tap regional and international markets in products and services where the transport constraints are less severe.

UNCTAD's work, including interviews with investors, indicates several promising areas for FDI. They fall into three categories:

- Investment in core infrastructure and services that provide amenities for consumers and a functional environment for business.

- Investment in activities where Uganda can competitively supply the domestic and regional market.

- Investment in activities where Uganda can competitively supply the world market.

The prospects for foreign investment in core infrastructure and services are reviewed in Chapter 3. As already mentioned, small market size is a key constraint in attracting aggressive and innovative foreign investors. Skilful project promotion, outstanding project structuring (including through privatization and concessionary schemes) and an excellent regulatory environment must be central to the Government's promotional strategy.

Opportunities that target both the domestic and regional market can overcome, to some extent, the constraints of small market size. They arise from Uganda's comparative regional strengths – its natural advantages (such as hydro-power resources), and its good macroeconomic and financial risk profile within the region. Potential opportunities of this kind, which were identified in contacts with investors, include:

- Power generation for domestic sale and export (refer also to Chapter 3).
- Expansion of edible oils production for local processing. Currently domestic production meets only 20-25 per cent of processors' needs.
- Other processed foods including bakery products and fruit juices.
- Packaging for the above products.
- Creation of a regional air transport hub.
- Secondary and technical level education services for a regional market.

Opportunities that target the world market overcome completely the market size constraint but must withstand or avoid land transport and other inefficiencies. Potential opportunities identified from investor contacts include:

- Traditional agricultural commodities – coffee, tea and cotton. FDI in these businesses is important because they are large employers and provide important linkages for technology, processing and marketing for smallholder growers. FDI in the rehabilitation of existing operations has run its course. New investment faces obstacles in poor transport services to ports and lack of large parcels of land under commercial title. It is not clear if exceptional fertility, high product quality and reputation can generate sufficient margins to overcome these obstacles.
- New farm products, such as cut flowers that overcome transport constraints. This industry is currently small but box 4 shows what can be done taking the example of the growth of this industry in Colombia.
- High value minerals, such as precious metals and specialist base metals. The recent revitalization of cobalt mining is an example.
- Niche products that depend on entrepreneurship plus the ability to access specialized markets by air and sell at premium prices. Box 5 gives an example of organic dried fruit processing. Such projects often start small, (and many fail), and can take root only if they are not excluded by over-zealous screening of applications from small-scale investors. Organic farming may be feasible on a larger scale as international markets grow for chemical-free products.

These activities are indicative of potential areas for FDI in the near term in which the handicaps of poor infrastructure and services are a fixed constraint. Clearly there are areas of potential around which the Government can construct its promotional strategy for new FDI beyond the privatization and restitution era. The key elements of a recommended promotional strategy are set out in Chapter 4.

In the longer term Uganda's focus must be on attracting FDI of a scale, kind and quality that will help to promote employment, living standards and small business. This can only come about if a concerted effort is made to restore efficient land transport and other services and to provide sufficient land for commercial development. Uganda must aim, in the long-term, to become a world-class producer of high quality agricultural products, both traditional and «new», which are grown, processed, packaged and marketed under distinctive branding to discerning world markets. Uganda's vision of an industrial future should therefore have agriculture and agri-processing at its core, and the creation of widespread employment with deep linkages to small growers and businesses as its key objective.

Box 4. Cut Flower Industry Clusters – Comparison of Uganda and Colombia

Uganda began exporting cut flowers in 1993 and has already seen some success in penetrating new markets. In 1996, export earnings from cut flowers reached $1.15 million. Exports consist mainly of roses to Europe, the market selection being determined by air transport costs. The Ugandan cut flower industry cluster includes 17 growers, with a relatively strong association, and a growing network of contacts and experts. However, the cluster is yet to become dynamic as training networks are still in their infancy and the capacity for research and development is very limited. The cluster is dependent on Europe, Israel and Kenya for technology and expertise. Cut flowers are a commodity type of export as the industry is dependent on intermediaries and on customer trends. However, some Ugandan companies have now started developing closer links to the end-users, going beyond the Dutch auction centres. Such links help in forward integration, as flowers need to be prepared in the form of bouquets and wrapped with cellophane to be sold directly in the supermarkets. Makerere University is now initiating a programme for training in technical and management areas relevant to the industry.

In comparison, the Colombian cut flower cluster began to take off in the 1980s. By 1995, about 4,500 hectares were being cultivated in greenhouses. There are about 500 companies involved in the cluster, exporting about $475 million worth of flowers annually, mainly to the United States. The cluster provides direct employment to 75,000 people and indirect employment to another 50,000. The market in the United States is controlled by Colombian companies registered in the United States, and these have links with Colombian growers. Cut flower production is supported by an active producers association, the Colombian Association of Flower Exporters. It is a non-profit association set up to protect exporters' position in the international markets and to help the cluster in all areas including market promotion, human resource development and technology development. A cut flower-specific research facility called the Centre for Agro-Industrial Research and Extension is created by the University of Bogota, in collaboration with the Catholic University of Louvain in Belgium. As a result of the creation of such a dynamic cluster, Colombia has become the second largest exporter of cut flowers in the world, after the Netherlands.

Sources: USAID, *Uganda Country Competitive Analysis*. UNCTAD. *The Science, Technology and Innovation Policy Review,* Colombia 1999.

Box 5. Suntrade's organic dried fruit processing project

This is a small-scale project with an initial investment of $ 20,000 started by a Swiss engineer utilizing self-developed solar energy technology for processing fruits and vegetables (organically grown pineapples, bananas, chillis, ginger, beans, mango and okra). The production of raw materials is organized through co-operatives/associates and could be expanded rapidly if demand increased. The investor currently sources from a 100 ha farm located in Didda, near Kampala, and plans to double the investment in the short term.

The farm associates are trained by the company owner in production and post-harvesting based on organic principles and practices. At present the company has 7 employees and owns 14 drying units. It uses a vacuum and gauging machine, the only one of its kind in Uganda. The organic quality is certified by the Institute for Market Ecology, Switzerland, which inspects the production area (soil inspection), harvesting, processing (drying and packaging) once a year.

The exports of fresh fruits started about half a year ago and amounted to about 1-2 tonnes per month. All dried fruits are presently sold through organic food shops in Switzerland. The owner considers Uganda's potential to be very high as farm labour is relatively cheap and it is endowed with excellent climate and soil conditions. The owner is interested in an expansion of operations (ideally a combination of fresh and processed fruits) and exports with the help of external financing with foreign partners who will market the products.

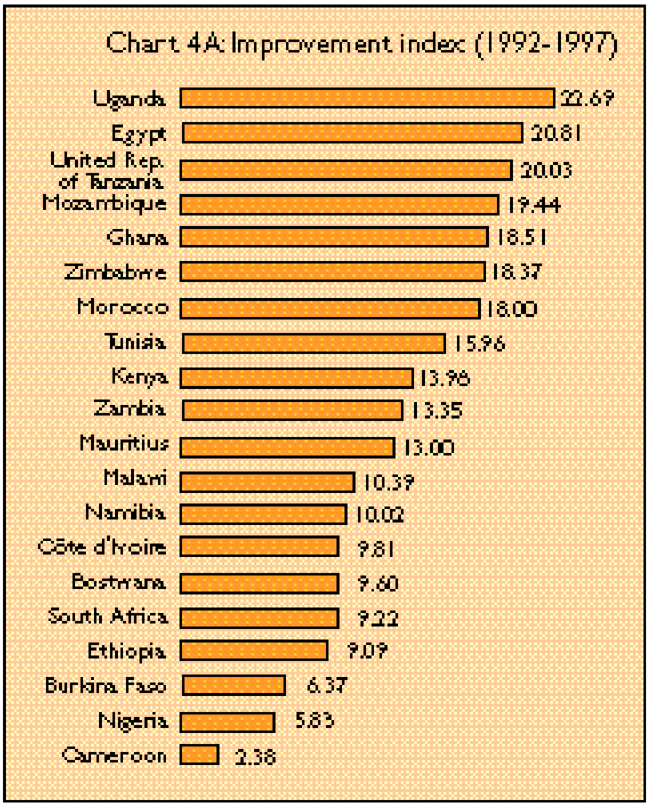
Source: Field interview by UNCTAD.

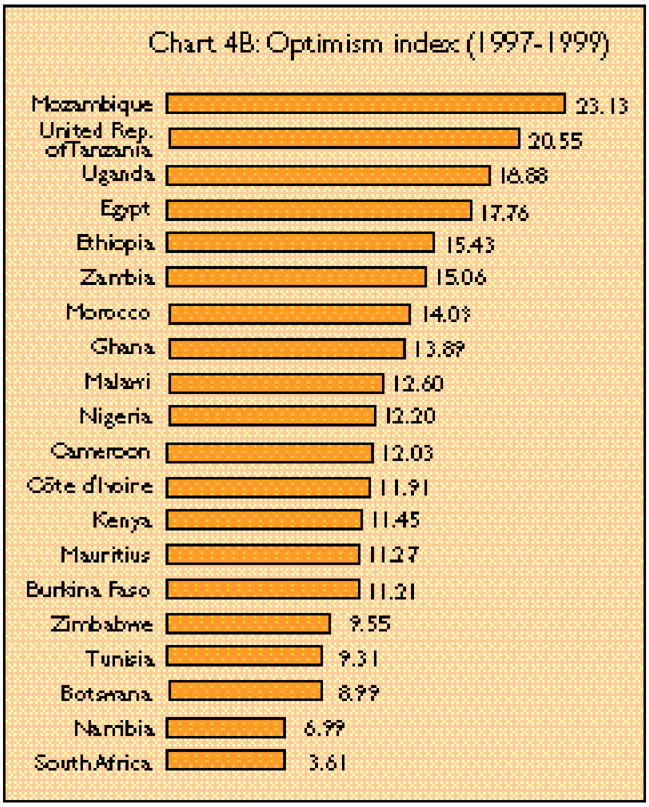
II. POLICY AND OPERATIONAL FRAMEWORK FOR FOREIGN DIRECT INVESTMENT

Uganda has made substantial progress in creating a hospitable investment climate. Much of the policy framework has been fashioned to exemplary standards. A recent business survey indicates high levels of optimism and a positive evaluation of recent policy improvements. In the improvement index (1992-1997) of 20 African respondent countries, Uganda tops the list, and in the optimism index (1997-1999) it ranks third after Mozambique and the United Republic of Tanzania (chart 4).

To continue to win investors' confidence, it is important to ensure that the high-level reforms permeate down into high standards of regulation and better administration of government functions. Against this objective, specific recommendations are provided on improving policy coherence and the fine tuning of foreign investment policies in line with the liberal policies of the Government.

Chart 4. Investors' optimism and improvement index for Africa





Source: The World Economic Forum. *Africa Competitiveness Report*, Geneva, Switzerland, 1998.

A. Policy framework

1. The permissive framework

Foreign direct investment in Uganda is governed by the Investment Code which was enacted in 1991. The Code is a restrictive and control-oriented regime for FDI, and if implemented to the letter or in an unsympathetic spirit, it could seriously deter FDI. In practice, Uganda has taken a much more welcoming stance towards foreign investors. Indeed, since 1991, there has been much improvement in the general legislative and policy climate for investment. There is now a debate about how best to modernize the Investment Code and to refocus the work of the Uganda Investment Authority. For now, the Investment Code of 1991 remains in force.

Under the Investment Code no foreign investor may undertake business in Uganda without a licence. Foreign investors are defined to include non-citizens of Uganda, any company more than 50 per cent of which is owned, or a partnership in which the majority of partners are non-citizens.

In order to obtain a licence a prospective foreign investor must submit, in effect, its business plan as well as corporate details including the identity and nationality of its owners. In deciding whether a licence is to be granted, the ability of proposed business to generate or save foreign exchange, to utilize locally-sourced inputs, to create employment, to introduce new technology, and to contribute to regional development are taken into account (the «objectives»). Following the repeal of tax holidays under the revised Income Tax Act of 1997, rigorous appraisal is no longer required and licensing has become more or less automatic.

Apart from these specific criteria the Investment Code provides that a licence may be declined if the investment is deemed to be «contrary to the interests of Uganda». Every applicant is required to declare that the intended investment does indeed meet this test. This provision could, of course, be used to block any or all new FDI if the Government were so inclined, but in practice, this provision has never been used to refuse a licence to a prospective foreign investor.

A foreign investment licence is issued for a minimum period of not less than five years. It may contain terms and conditions, the nature of which is not specified in the Investment Code. Presumably they might include obligations on the foreign investor in relation to the «objectives» (as noted above) against which the licence application is considered. There is no general requirement for a minimum size of investment in order to obtain a foreign investment licence although, in practice, a minimum of $100,000 has been applied.

The Investment Code does not automatically exclude foreign investors from any business activity except for farming. However, given that commercial agriculture is likely to be a mainstay of accelerated economic development in Uganda this exclusion is very significant. The Code allows some flexibility in that the Cabinet may permit an agri-processor to undertake farming in order to ensure a supply of raw materials. Further, there is at least one case where a foreign investor, the Commonwealth Development Corporation, has been able to acquire tea estates through privatization. In any reform of the Investment Code, it will be essential to uphold this flexibility for agri-processors to invest in related farming operations.

Sectoral legislation may also restrict private, including foreign, investment by mandating a predominant role for a State-owned enterprise. For example, the Electricity Act effectively enables the Uganda Electricity Board to decide how much competition it will impose on itself in the commercial generation and sale of electricity to third parties. However, the Government's privatization programme has broken down the barriers to private investment in a range of industries that were previously reserved for, or dominated by, the State. Completed privatizations have successfully attracted foreign investors in farming, hotels, crop marketing, banking and other industries.

2. Specific standards of treatment

(a) National treatment

The Investment Code gives no general assurances of «national treatment» to foreign investors and there are several instances, both in the Code and in sectoral legislation, in which they are provided with lesser entitlements than national investors, including the following:

(i) Foreign investors may be subject, as a condition of an investment licence, to a number of performance obligations which are not imposed on national investors. These obligations may include requirements as to minimum investment size, staff training and localization and, local procurement and environmental protection.

(ii) The Investment Code foreshadows limits, which may be placed by the Bank of Uganda on access by foreign investors to domestic credit. It is understood that no such restrictions have been applied in practice.

(iii) Foreign investors must invest the equivalent of at least $300,000 in order to qualify through the Investment Code for an entitlement to «externalize funds». The threshold for national investors is the equivalent of $50,000. This distinction has little practical relevance as the entitlement falls short of a guarantee of convertibility (see section 2.6 below).

(iv) Foreign-owned banks and insurance companies are subject to higher paid-up capital requirements than nationally-owned firms.

(v) Recently introduced land legislation permits foreign investors to hold leasehold but not freehold land title.

(b) Expropriation

The Investment Code provides that the interests of a licensed investor may not be expropriated, except in accordance with the Constitution of Uganda, and that compensation at fair market value should be paid within twelve months of any expropriation. The Constitution of 1995 provides for payment up front.

(c) Revocation of licence

A foreign investment may be revoked if an untrue statement is made in the application for a foreign investment licence, if the provisions of the Investment Code are breached, or for a breach of the terms and conditions of the licence. The UIA rarely revokes licences and relies instead on counselling to achieve corrective action.

(d) Dispute settlement

The Investment Code permits international arbitration in a form mutually agreed with the investor. In addition, Uganda has so far entered into investment treaties with the United Kingdom, Italy, Egypt and Mauritius, which provide an automatic right to the national of a treaty State to have recourse to international arbitration in the event of a dispute with the Uganda Government. For example, under the Uganda/United Kingdom treaty an investment dispute may be referred by a United Kingdom investor to the International Centre for the Settlement of Investment Disputes (ICSID). Uganda is a party to the ICSID convention and to the Convention of Recognition and Enforcement of Foreign Arbitration Awards. Investment treaty negotiations are under way with South Africa, Qatar, Canada, Belgium, the Netherlands and other countries.

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(b) T axation

In recent years Uganda has modernized the principal taxes which affect business. In 1995, a value-added tax («VAT») system replaced the sales tax, and in 1997, a new Income Tax Act was introduced. Care has been taken to reduce the burden of taxation during investment and start-up.

(i) Income Tax

The 1997 Income Tax Act sets a tax rate for companies of 30 per cent, except for mining companies, which have a band of between 25 per cent and 45 per cent depending on the ratio of chargeable income to turnover, (30 per cent is also the top marginal rate for individuals.) Branches are taxed at the company rate plus 15 per cent. Standard tax deductions are available.

Two elements are designed to favour new investment in a more direct way than the previous tax holiday approach which was originally adopted in the Investment Code. First, losses may be carried forward indefinitely. Secondly, depreciation allowances are generally favourable, especially the generous first year allowances of 50-75 per cent on plant and machinery. However, the allowance on industrial buildings of only 5 per cent per annum seems unduly low compared with the rates charged on associated capital assets

Whilst this approach to encouraging new investment is preferable to tax holidays the introduction of differential depreciation allowance rates by region and subsector should always be carefully evaluated to avoid fragmentation and selective benefits to aid special interest groups.[2]

The withholding tax rate on the gross amount of foreign payments for dividends, interest, royalty, management charges and service contracts is 15 per cent. By present international standards, some of these rates are high, perhaps especially the imposition on interest paid abroad. Uganda appears to be reluctant to give relief through double tax treaties with major home countries. Among these, only the treaty with South Africa provides for reduced rates on interest and dividends (10 per cent in each case).

(ii) Value-Added Tax

VAT can place a special burden on a new investor who is not able to offset input VAT against output VAT and is unable to obtain prompt refunds of excess VAT. Uganda has addressed this issue by exempting from input VAT all imports that are exempt from customs duty. In addition, a category of «investment trader» has been created which enables a new investor (without VAT able output)to defer the payment of input VAT until sales commence.

Relief from the burden of paying VAT up front on investment cost is a crucial factor for investors and it is vital that the refund system work reliably. The Government believes that it is now working well after some teething problems in the first year or two of the introduction of VAT. However, investors are not yet convinced that it can be completely relied upon.

2 Farming attracts the same depreciation allowances as other industries except horticulture, for which buildings and works attract 20 per cent depreciation with no initial allowance.

(iii) Import Duties

A wide range of capital items are exempt from import duties, including machinery. Certain Ugandan manufacturers have import tariff protection, which can include special import levies in certain cases.

(c) Land

Under the Constitution non-citizens cannot obtain freehold title to land. In 1998, a new Land Act was introduced to address customary and historic rights and to provide a basis for the creation of bankable title to more land. Non-citizens may now obtain leasehold title of up to 99 years. An important test for the new system is whether freehold titles issued prior to the introduction of the Constitution and now held by non-citizens will be smoothly transferred into leasehold titles of adequate duration (that is, for upwards of 99 years).

Land ownership and usage is an exceptionally complex and emotive topic and it remains to be seen whether the reforms will in fact lead to greater availability of land for use on a commercial scale. Certainly the Government is giving it high priority.

(d) Commercial laws

In keeping with the overall updating of the legal framework, the Uganda Law Reform Commission is spearheading a review of all significant commercial laws. The review process, which was carried out with consultations with the private sector as much as possible, found no major gaps in the current laws, just a need for fine-tuning them.

(e) Technical assistance and technology agreements

Under the Investment Code no agreement relating to technology transfer or the provision of technical services from abroad is «effective»[3] unless it is registered. For this, it must pass a number of criteria concerning its financial terms, training embodied, the continuity of access to know-how, and the avoidance of monpolistic practices.

These criteria may have worthy objectives but are too sweeping to be effectively enforced. In any event since FDI typically involves such agreements being made between related parties there can be little sanction involved in not registering them.

Uganda has a legitimate interest in ensuring that payments under such agreements do not lead to under-reporting of Ugandan taxable income. The anti-avoidance provisions in the tax legislation are a better means of implementing enforcement measures. However these problems can never be entirely eradicated by enforcement measures and it is important to create a climate that does not encourage under-reporting of income. This can be achieved by maintaining the present liberal taxation and foreign exchange regime.

Other issues, such as training and transfer of technology, need to be addressed by formulating general policies on these matters and then by providing a generally applicable regime of incentives, as well as sanctions to achieve the desired outcomes, if necessary.

3 *Investment Code 1991, Section 31.*

B. Administrative procedures and practices

1. The entry process

(a) Approvals for foreign investment, technology and expertise

The licensing of foreign investment and the registration of agreements on foreign technology and expertise is the responsibility of the UIA. Prima facie these approvals represent a very significant regulatory step in the entry process for a foreign investor. These requirements for licensing of foreign investments have been implemented in a prompt and flexible manner, and indeed, have now become routine. Nevertheless, the Board of the UIA, of its own volition, has decided not to license any foreign investment of less than $100,000. It is not known how many smaller foreign investments this ruling has deterred.

On the other hand, the requirement to register foreign technology and expertise agreements in order to make them «effective» is inoperative. Only one such agreement has been submitted and registered.

(b) Other business approvals and services

Securing regulatory approvals from the UIA is not an impediment in the entry process. Many more problems arise for the foreign investor in securing ordinary business permits and services, particularly in accessing services from State-owned utilities such as telecommunications, power and rail transport. These have suffered from State mismanagement and under-investment. The Government is now bringing private operators into these areas.

Additional delays and irritations can arise in the processing of permits required in the ordinary course of establishing a business. These problems have been reported on extensively by others (see below). The UIA endeavours to assist investors and prospective investors in obtaining permits; it believes that the processing of entry permits for personnel has improved since the Commissioner of Immigration joined the UIA Board.

It is beyond the scope of this report to analyse whether there is an unnecessary degree of regulation or poor administration. In either case the proposal to centralize the administration of entry level permits through a «one-stop» facility at the UIA is unlikely to be workable, as discussed later.

2. Administrative regulations

A 1996 report found that the initial effects of the major policy reforms are «muted somewhat by the perseverance of second-tier administrative constraints on investment, found throughout the complex regulatory structure governing the private sector».[4] UNCTAD's *Survey of Foreign Firms,* 1998 identified poor customs administration as an important obstacle to business. These problems are not, however, serious impediments to FDI, nor are they intended to be instruments for the de facto regulation of FDI.

The principal administrative weaknesses which disturb foreign investors are delays and corruption in customs' administration, some weaknesses in tax administration and a poor record by the courts in adjudicating fairly and promptly on commercial disputes. Remedial action is being taken, including the creation of a commercial court in the High Court, the setting up of a Tax Appeals Tribunal, the appointment of more High Court judges and the creation of arbitration centres.

The Government appears to be open about these problems (i.e. it is prepared to listen to criticism and advice), and it is working with significant assistance from international aid agencies to improve its procedures.

4 Foreign Investment Advisory Service. *Uganda, Administrative Barriers to Investment: the Red Tape Analysis Washington 1996.* Other reports include USAID-Presto. *Legal, Policy and Regulatory Constraints which Impede Private Sector Growth,* July 1997.

3. Investment promotion

The Government supports and funds foreign investment promotion through the UIA, which has been energetic in its general projection of Uganda as a good place to invest.

C. Policy coherence

1. Overview

There is no question that the evolution of major policy and primary legislation is towards an investment policy regime that is both internally consistent and in keeping with good international standards. With one surprising exception it is difficult to think of a single major law or policy that has not benefited from rigorous review. Many are already on the statute books.

That exception is the Investment Code itself, which has become a museum piece in the liberalized investment climate. The UIA is drafting a new Code but its spirit is not entirely consistent with the more liberal approach, as discussed in section 3 below.

There is also some evidence that policy towards industrial subsidy and import protection is not in keeping with the liberal reform process. Policy is occasionally ad hoc and sometimes subject to special interest lobbying which can result in significant levels of protection from imports.

The Government seems conscious of the importance of consulting the private sector on policy changes. No generalized complaints were made in interviews with established foreign investors about unpredictable or inconsistent policy changes, although one investor encountered an unforeseen volte face on a promised tariff regime. A current initiative to strengthen policy consultation with the private sector is discussed in section 2 below.

The next and perhaps more difficult challenge is to ensure that regulation and administration of the new laws and policies is in keeping with the high standards they set. It is much easier to write laws than to administer them consistently well at all levels of government. This constitutes the major test of coherence in Uganda. Certain problem areas have been identified in independent studies and some were highlighted in interviews with investors (see Administrative regulations above). While established foreign investors made no serious complaints, none volunteered that Uganda has administrative standards that are up to best practice elsewhere.

2. Investor Consultation

The National Forum, which is a mechanism for private-and public-sector dialogue, has proposed a mandatory process of notification and consultation with the private sector in relation to changes in regulation which affect business. A draft Regulation Participation Act (dated 13 February 1998) has been circulated for comment.

In summary, the draft Act calls for an annual «calendar» of proposed regulatory changes to be published; forbids the introduction of new regulations unless they are included in the calendar; requires a minimum period for public comment on proposals; and provides for a public/private sector committee process for arriving at a consensus.

A wise government will consult the private sector on regulatory changes. Our interviews did not elicit any strong complaints from the private sector about the conduct of the Government in this regard. Moreover, there are well-established industry associations, that are capable of expressing strong formal and informal views to the Government. It seems unnecessary to legislate on this matter, in fact legislation could even be counterproductive. It would introduce highly bureaucratic procedures that could cause delays at a time when the thrust of policy is positive. Rather, any weaknesses should be addressed by incorporating procedures for consultation into the working practices of the Government, cabinet and parliament.

3. Draft Investment Promotion Bill

As noted, the obvious inconsistency in the investment policy framework is the Investment Code itself. It has been clear for some time that the foreign exchange and fiscal incentives as set out in the Investment Code have been overtaken by general reforms. Indeed the fiscal incentives provision of the Code has been repealed. The Government should consider now whether continued screening of foreign investment is consistent with its liberal approach to business or whether its strongest thrust should be on investment promotion.

Amendments to the Investment Code in the form of an Investment Promotion Bill are being considered by the UIA. Should, the Bill provide for screening of foreign investments in order to protect smaller national businesses from competition from foreign-owned enterprises? These are sensitive national issues and indeed many other countries provide for some form of national investor protection. Nevertheless, such a measure would be more explicitly restrictive than the present Code. In considering its position, the Government of Uganda might wish to draw on the experience of other countries concerning some of the important practical and administrative issues involved. For example,

(a) There will be cases where existing national investors would welcome relatively small levels of co-investment from foreigners where this will bring risk funding, contacts, expertise and credibility to the business. Provision should be made for these cases, whatever regime is adopted.

(b) It is relatively easy for foreign investors to avoid legal restrictions (e.g. by the use of front companies) and correspondingly difficult to police credibly these restrictions. Moreover, widespread use of such techniques brings a taint of dubious practice to the investment scene.

(c) It is important to consider whether the scale of potential foreign investment in competition with small national businesses warrants the amount of administrative effort needed to police it compared with other priorities such as investment promotion.

(d) Another issue concerns the best form of protective measure to adopt (e.g. minimum size thresholds or reserved lists), and whether immigration procedures are a better vehicle to administer some form of restriction on small-scale owner-operators rather than universal licensing applied to all foreign investments.

Whether or not a licensing procedure is introduced to protect small national investors, the UIA believes that registration of all foreign investment should be mandatory so that entry can be facilitated by the UIA. However, there is a good policy reason for registration, making it mandatory seems an unnecessary bureacratic hurdle. A voluntary form of registration should be sufficient for those foreign investors seeking recognition and facilitation. The most sensitive area relates to foreign investment in farming; the present flexibility provided for agri-processors to invest in related farming operations should be retained in any newly formulated Investment Code.

4. Changing role of the UIA

Under the Investment Code the UIA has five principal functions:

(a) Regulation of foreign investment and the registration of agreements for foreign technology or expertise;

(b) Administration of incentives;

(c) Foreign investment promotion;

(d) Investor facilitation; and

(e) Policy advocacy.

Recently the UIA has been given the responsibility of promoting the development of the Namanve industrial park.

The first two functions provide «hard» activities for the UIA which guarantee its place on the investment scene. The remaining functions provide «soft» activities in which the UIA's influence will depend on its performance.

There can be little doubt that the current reforms have undercut the «hard» functions of the UIA. In relation to incentives this is quite clear. Concerning regulation it is open to question, as discussed above, whether continued licensing of all foreign investment is needed to keep whatever residual areas of protection are deemed necessary for national investors. And the function of registering agreements for foreign technology and expertise needs to be completely rethought.

On the other hand there is a need for a central unit to promote Uganda abroad, to lend some support and assistance to new investors and on occasion to promote the investor viewpoint within government and in the community at large. The aims and the limits of these activities need to be sharply defined so that they do not exceed the competence or the funding available to the UIA.

An option for a restructured UIA that is consistent with a liberal approach to FDI and confidence that the public interest is protected in general and sectoral legislation could be:

(a) Foreign investment promotion would be the core function of the UIA. Major promotional campaigns would be targeted by industry, based on well-developed industry policy, organized in conjunction with sectoral ministries, and have a clear follow-up and exit strategy for the UIA.

(b) Promotion of national investment by the UIA would be confined to helping national investors to establish links with foreign partners – passively in response to ad hoc enquiries and actively in relation to major promotional campaigns. There are many other agencies that assist national entrepreneurs.

(c) The UIA would not provide fee-for-service facilitation. Investors can consult private sector agents (and seek referrals from the UIA if required). The UIA should assist in removing bottlenecks where there are difficulties in obtaining government permits.

(d) Advocacy. The UIA would be an ad hoc adviser within government on formulation of general and sectoral policy likely to affect the investment climate. The UIA would also keep the public informed about achievements and issues connected with FDI.

(e) Selected project leadership. The UIA could execute projects such as the Namanve estate or a Uganda area at Mombasa port. The UIA should aim to participate as a project promoter provided the projects can be structured, and should seek to structure these projects so as to bring in private developers and operators.

III. INVESTMENT OPPORTUNITIES AND CONSTRAINTS: INFRASTRUCTURE, UTILITIES AND FINANCIAL SERVICES SECTORS

The utilities and infrastructure of Uganda suffer from such chronic under-investment, poor maintenance and poor service reliability that they now represent a severe obstacle to the conduct of business and the attraction of investment. To date these services have been provided under monopoly conditions by state enterprises, the majority of which have been poorly managed and are in disastrous financial condition. Most are now candidates for privatization, although this process still lacks strategic direction and adequate regulatory development to ensure that private ownership is properly introduced. FDI can play a significant role, although the relatively small size of Uganda's economy will make it difficult to introduce private investment in all areas.

Some progress has been made in regulatory development in financial services (especially in insurance and capital markets) and in privatization in banking. Yet the financial services market is small and will appear unappetizing to new foreign entrants unless opportunities are selectively and carefully promoted. The banking sector is simultaneously over-banked and under-competitive, and the apparent lack of firm regulation of this sector does not bode well for sustained firm regulation of the other sectors targeted for privatization.

The reform and reinvigoration of these sectors is the next great challenge facing the Government in order to reap the benefits of its excellent reforms of investment-related policies. So far, however, measures have not been put in place with sufficient drive and urgency to provide a platform for FDI to play its full part.

A. Utilities

1. Power

(a) Overview

The electricity sector of Uganda suffers from exceptionally poor state management. The country has abundant resources for hydropower generation and a ready export market and yet is reduced to a total commercial capacity of only 180MW with widespread load shedding. Meanwhile the state utility, the Uganda Electricity Board, reported a loss of Shs 13.2 billion ($12.7 million) in 1997 and is in default of its loans (see table 9). The UEB has had to reduce its previous contractual commitments to allocate 30MW to Kenya. New generation capacity through extension to the Owen Falls scheme is due to come onstream in the year 2000.

Table 9. Uganda Electricity Board financial indicators

Indicator ($m)*	1997	1996
Turnover	69.2	57.8
Profit/(Loss) after tax	(12.7)	(0.9)

Source: UEB accounts for the year ended 31/12/97.
* Shillings converted at mid-year exchange rate. Profit and loss figure excludes extraordinary items (grant aid).

Business finds the power supply to be a major irritation. There is a long waiting time by new customers for connection; there are power surges as well as load shedding; and it is expensive. The nominal rate is approximately 9.4c/kWh, which is broadly in line with power charges in developed countries. However, there is a minimum charge for business customers which, in view of the erratic nature of the supply, can make mains power supply very costly. Many businesses have installed their own generators.

The sector is governed by the Electricity Act. This Act mandates the generation, transmission and distribution of power exclusively to the UEB. Private commercial operations can be conducted only by agreement with the UEB.

Two initiatives are being planned to open up the sector to FDI:

- Independent power generation projects, and
- Privatization of elements of the UEB.

(b) Independent power projects

The Government is negotiating the terms of three major independent power generation and one smaller project as shown in table 10. All are hydro-projects.

Table 10. Proposed independent power projects

Project	Sponsors	Capacity (MW)	Earliest Commissioning Date
Bujagali	AES Nile Power*	290	2003
Kalagala	Arabian International Construction	450	NA
Karuma Falls	NORPAK**	100 Stage 1 100 Stage 2	2002 NA
Muzizi	CDC	Up to 13	NA

Source: Interviews; UIA Energy Sector Profile (March 1998)
* A consortium including AES Corporation and Madhvani International.
** A consortium including Interkraft, ABB, Kvaerner, Veidekke and Norplan.

Without question, the prospect of tapping foreign investment to relieve existing power constraints and to supply power for export is an important and welcome development. Any one of the major projects listed in table 8 would be Uganda's largest-ever foreign investment.

Foreign investors have taken the initiative in this sector. They have obtained certain project development options through negotiation rather than through a well-structured promotional and bidding exercise organized by the Government.

From the investors' standpoint they have spent time and money on project studies on the basis of limited contractual development rights and in the absence of a settled government policy towards independent power generation. They have received encouragement, in particular from the President's office, but little policy structure to work within. One consortium says that it has spent over two years «educating» the Government on «how independent power projects work». Indeed, even now amendments to the Electricity Act, which some believe are necessary to permit private generation for sale to third parties, have not been passed by Parliament.

From a government standpoint, foreign investment in IPPs is promising but also presents economic and risk issues that must be thoroughly considered if the introduction of FDI to this sector is ultimately to be judged as successful.* These include:

In the absence of a power market, how is the Government to obtain an optimal price for the power? It would be very damaging to Uganda's competitiveness to give a contract which on-sell power for up to 30 years at prices above opportunity cost.

In the event of significant devaluation of the shilling, will the Government be willing to have large price increases passed on to consumers (and will the market be inelastic enough to withstand large increases) and to ensure that the necessary foreign currency is available? A number of IPPs in Asia are in default for this reason.

Will the market absorb the volumes of new power capacity arising from the new projects, or will the Government be faced with unacceptable budgetary risk in underwriting the purchase of the power? The combined capacity of the proposed new projects, including the Owen Falls extension, represents a several-fold expansion of capacity. Demand forecasts published only in 1997 and now deemed too conservative are being reviewed.[1] This is being addressed through the update of demand forecasts now in preparation. However, it seems doubtful that three new IPPs can be accommodated in the next 10 years unless significant new demand from export markets or a major industrial user is found.

What are the macroeconomic implications of large-scale conversion of foreign currency to meet debt service and dividend payments? One project alone is calculated to require offshore payments equal to 25 per cent of Uganda's total export proceeds.

(c) Privatization in the power sector

The Government has decided to privatize the UEB and will seek a strategic investor. It intends currently to split the distribution, transmission and generation arms of UEB according to the «UK model» and to privatize each separately, although it is also possible that transmission will not be privatized at all.

The «UK model» is designed to promote a competitive market. It is not necessarily the best approach to adopt immediately in the restructuring of the power sector in a small emerging market. It is also important that a large strategic investor, which has the capacity to give credible power purchase undertakings and to undertake network development, be attracted to acquire the key utility. Sale of the distribution business alone may not achieve this because it is a very small business. It may be preferable to sell the entire business of UEB as a single entity.

* The commercial basis of IPPs is that they are typically strongly leveraged in order for the project sponsor to earn an acceptable return on equity with the debt being provided on a limited recourse basis. The project lenders are most concerned that once the sponsor's loan guarantees fall away on project completion there is a secure cash flow that is available in hard currency for debt service. To obtain debt finance the project sponsor will therefore need to execute long-term power purchase agreements, indexed to hard currency and inflation-protected, with creditworthy offtakers. Where the power purchaser is a state utility the sponsor will require that the utility's undertakings and the availability of hard currency are guaranteed by government. It may also require government assurances of foreign currency availability and tax stability.

1 Kennedy & Donkin Power Limited (1997), Hydropower Development Master Plan. November. EDF was requested to review the demand forecasts.

(d) Assessment and recommendations

(i) It is urgent that new generation capacity be brought onstream, and in that connection the interest of foreign investors in building IPPs is a very welcome development. The Government is being asked to underwrite market, exchange rate convertibility and performance risk. This risk allocation structure is consistent with arrangements for such projects elsewhere. The Government hopes that the privatization of UEB will relieve it of some of these risks (see below).

(ii) IPPs typically require very long-term power purchase undertakings in the absence of a competitive distribution market. It is clearly important for the economy that these undertakings do not lock Uganda into power offtake at non-competitive prices for up to 30 years. The fact that three projects are being worked up provides an opportunity to introduce competitive tension into project selection. This should be harnessed more effectively to ensure competitive power pricing. The aim should be for power purchase prices not to exceed the 5-6c/kWh range.

(iii) The IPP promoters are requesting the Government to give contractual guarantees of foreign exchange convertibility and tax stability. In the latter case adverse tax changes would trigger compensatory increases in the power purchase price. On balance, these assurances should be given but in a context where competitive pressure is exerted on power pricing, in line with the comments in (ii) above.

(iv) IPPs are highly vulnerable to sudden currency devaluation, as recent Asian experience shows. Governments have political difficulty in passing on fully the impact of devaluation to local-currency power charges to consumers. The result is default by government on the underlying agreements and damage to the investment climate. There is no reason to suppose that the Uganda shilling will avoid currency volatility.

The Government should explore ways to mitigate this exposure through encouraging export of power and promoting local-currency financing. Although local finance could supply only a modest amount of the large-scale funding required, a start could be made. The Ugandan commercial banks have no appetite because of the long-term nature of the liabilities. But efforts could be made to promote the issue of local-currency bonds that are capable of being traded on the Uganda Stock Exchange to provide liquidity.

(v) As mentioned above, the proposed sector restructuring in accordance with the «UK model» is not necessarily the optimal approach in a small emerging market to attracting FDI. Privatization of the small distribution arm alone will not attract strong interest. It may be better to offer at least the distribution and transmission assets as one parcel. This is an important issue as it will be vital for the Government to attract a strategic foreign investor to UEB that is large enough to relieve it of its power purchase guarantees. (In this context it might be possible to place the existing generation assets into the competitive structure suggested in (ii) above for new assets.)

(vi) The privatization of the UEB and the development of IPPs are intimately connected commercial matters. The correct sequencing of privatization vs closure of IPP contracts is a complex «chicken and egg» issue that must be resolved carefully in order to maximize the opportunity to attract FDI to the sector.

(vii) On the whole the Government has been reactive to FDI interest in this sector. It would assist prospective investors if the Government presented a firmer strategy and structure of private investment. Given the complexity of the commercial and financial issues, not least of which are the risk factors for government, the latter should appoint a financial adviser from among the international investment banks.

2. Water and sanitation services

(a) Overview

Water system coverage in urban areas is poor and services are expensive. Only 50 per cent of urban areas (20 per cent of households)[2] in Uganda have a piped water service and only 5 per cent have access to a piped sewerage system. Yet water resources for the main urban areas are abundant. In Kampala there is adequate capacity in the bulk supply system and there is underutilization of the sewerage treatment system

The sector is governed principally by the Water Statute of 1995, which is a modern legal framework for the management of water and sewerage. Under this statute it is possible for the responsible Minister to designate either a public or private operator to be a water authority or a sewerage authority and to permit such an authority to enter into concession or joint venture arrangements. These arrangements can cover the retail supply of water and sewerage services and/or the supply of bulk water. The responsible Minister regulates the price and other performance obligations of each authority.

The Water Statute clearly provides the necessary legal framework to accommodate private investment in this sector. With minor exceptions this has not occurred so far. Moreover, the necessary rules and capacity under the Water Statute to provide for the regulation of private operators have not been developed.

For many years the National Water and Sewerage Corporation, a statutory body,[3] has operated services in the eleven largest urban areas. It is expected to operate on a commercial basis. Local government councils operate services in areas not served by the NWSC.

The NWSC's charges for water are 740 shillings (the equivalent of $0.70) per cubic metre. The combined water and sewerage rate is $1.00, implying a very lucrative mark-up of sewerage services. There is no fee for bulk water; 95 per cent of customers are metered. The NWSC estimates that only about 42 per cent of water provided is billed, and collection is 75 per cent of billings.[4] Table 11 below sets out recent financial information on the NWSC.

Table 11. National Water and Sewerage Corporation financial indicators

Indicator	1997**	1996**
Corporation:		
Income	20.3	20.3
Expenditure	20.1	19.6
Surplus	0.2	0.7
Kampala only:		
Income	14.7	14.0
Expenditure*	7.6	8.4
Surplus*	7.1	5.6

Source: NWSC accounts for year ended 30/6/97
* Excludes allocation of headquarter overheads.
** $m at mid-year exchange rates.

2 Foreign Investment Advisory Service (1997). *Foreign Direct Investment in Infrastructure,* p. 22.
3 The governing statute is the National Water and Sewerage Corporation Statute, 1995.
4 However, the accounts to 30/6/97 show customer debtors, after provisions, equal to 67 per cent of turnover. The accounts do not show movement of debtors so it is not possible to confirm that recent performance is improving.

It would appear that the NWSC is barely profitable, and indeed, if more aggressive provision for bad debts and for depreciation were made it might well report losses. The dominance of Kampala is striking. It may well be profitable on a stand-alone basis, although it may carry a disproportionate share of bad debts, Kampala, Entebbe and Jinja are the only areas which record a surplus.

The thrust of NWSC investment in the 1980s was on rehabilitation, and the corporation is only now considering investment in new capacity. Funding for NWSC has been provided by international agencies. No private finance has been obtained either in the form of debt or of privately sponsored projects. Its present financial condition is such that the corporation is not likely to be able to obtain commercial sources of finance without a government guarantee. Prima facie there is a case for it to consider private finance initiatives in which financial risk and management responsibility are divested to private parties.

NWSC has conducted some limited experiments with contracted private management of operations in a Kampala suburb and in Jinja. The Ministry responsible for privatization has asked the corporation to defer consideration of other forms of private sector involvement, pending a sector study. It is understood that private finance initiatives are being considered as part of such a sector study.

Since the passage of the landmark Water Statute in 1995 there has been no development of commercial policy in the sector. Indeed, there is evidence of disarray:

(i) The Local Government Act of 1997 gives district councils (which include cities) the responsibility for water supply. This has thrown into doubt the functions of the NWSC and its ownership of existing water assets. However, the councils may contract out public services to the private sector.

(ii) Under current law the NWSC must remain 100 per cent State-owned. This arises from the Public Reform and Divestiture Statute of 1993. The provision relating to NWSC has not been repealed. On the other hand, this statute requires explicitly that the role of private, including foreign investment, be considered in the operations of all state enterprises.[4] Little appears to have been done in that regard apart from the limited initiatives undertaken by NWSC's management.

(b) Assessment and recommendations

(i) Since 1995 a legal framework has existed which would permit the introduction and regulation of private investment in the water and sanitation services sector. Despite apparent needs for service and incapacity of the public sector to provide for those needs there has been no serious attempt to introduce private investment or the associated regulatory capacity. It is a case where excellent primary legislation has not been followed up with detailed consideration of whether private investment, including a role for FDI, is desirable or feasible. Indeed, subsequent legislative developments have only added to the confusion.

(ii) The obvious place to start would be a private financing initiative for the Kampala system involving either the sale or the contribution of the Kampala business of NWSC to a new, privately managed and financed venture. A well-structured initiative, tendered on a competitive basis, could elicit terms (including in relation to price and development obligations) which would help to set benchmarks for private participation in other urban centres. This is not to deny the role for a proper strategic plan for the sector nationally. However, a Kampala carve-out, provided it is organized on a competent basis, would focus minds on the important regulatory and commercial issues and could bring forward investment much earlier.

4 Public Enterprises Reform and Divestiture Statute. 1993. Section 8.

3. Telecommunications

Telecommunications services in Uganda have an appalling record of low penetration rates, long waiting times for connection and poor quality. This is being vigorously addressed in a manner which should bring better access to service and improved technology whilst stimulating competition amongst providers. A second fixed-line operator has been licensed and the State-owned provider is undergoing privatization. Additional competition is also being introduced in mobile services.

FDI is playing a prominent role in these changes.

The transformation of Uganda telecommunications is well advanced and it has been agreed that the sector will not be assessed in this report.

B. Infrastructure*

1. Air transport

(a) Overview

Air transport is governed by the Civil Aviation Authority Statute of 1994. Under this statute the Civil Aviation Authority, a government authority, is responsible both for regulating civil aviation operations and for the ownership and operation of airports.

The statute does not expressly reserve ownership and operation of airports to the CAA. In principle, private investment may be possible.

The CAA currently owns and operates Uganda's sole international airport at Entebbe. Aircraft handling has been contracted out to Enhas, a private Ugandan company partly owned by Sabena, which leases facilities from the CAA. Enhas has invested $6 million in equipment and recently built an enlarged cool storage facility within a building leased from the CAA. At least one cargo airline, Das-Air, has exercised its right to handle its own cargo, and this company also leases facilities from the CAA.

Entebbe Airport activity volumes are still low but have expanded rapidly, as shown in table 12 below.

Table 12. Entebbe Airport activity

Year	Aircraft movements	Cargo (tonnes)		Passengers	
		Exports	Imports	International	Domestic
1993	9,556	3,065	6,535	148,502	6,560
1994	11,122	4,748	10,386	191,706	9,905
1995	12,600	8,462	11,318	254,335	14,746
1996	15,624	14,627	12,383	296,778	27,958
1997	15,057	12,740	14,186	326,265	30,280

Source: Civil Aviation Authority

* The Ministry responsible for transport was unavailable for an interview, and information obtained in this section relies on interviews with industry and other government agencies.

The CAA believes that Entebbe Airport would not be a suitable candidate for privatization on the grounds that it is required to perform non-commercial functions and that its charging structure is deliberately concessional in order to stimulate more activity. The CAA believes that there is adequate scope for private operators within a concession system such as the Enhas arrangement.

Opinion within the private sector is that Entebbe is underperforming its potential due to public sector restraints on initiative and capital for investment. There is a view that private ownership would lead to Entebbe being promoted much more formidably as a regional hub to attract new operators and to draw market share from Nairobi. Currently Entebbe handles less than a quarter of the volume of its Nairobi counterpart. Specific investment initiatives mentioned by the private such include:

- Significant investment in increased cold storage to keep pace with expanding exports of perishable goods, including fish and flowers;
- Development of an industrial estate on the Kampala-Entebbe corridor; and
- Increased aircraft parking space to handle peak traffic.

Activity at lower-tier Ugandan airports is far too low to consider them as candidates for any form of FDI. A potential initiative, but a longer-term one, would be to attract FDI to second-tier airport operations in the context of an integrated tourism development, possibly in conjunction with private management of wildlife areas. This is a specialized subject beyond the scope of this report.

(b) Assessment and recommendations

(i) Entebbe Airport is underutilized despite rapid growth in business volumes in recent years. There is evidence that the «catch-up» increases of recent years are levelling off.

(ii) International airport operations are attractive to foreign investors because they generate hard-currency fee revenue.

(iii) Further consideration, in close consultation with the private sector, should be given to bringing an international investor/operator into Entebbe. These considerations should include:

- Whether current small volumes would attract interest from specialized international operators (and indeed competition in the bidding for operatorship rights);
- How to structure an offer to private investors--possibly a long-term lease structure with build/operate rights in which bidding focused on fee proposals with due weight to business plans to build volume;
- The appropriate regulatory system, taking into account the strategic role of Entebbe and the interests of users. Depending on the structure of a tender to international operators this could be relatively light-handed regulation of commercial matters.

Above all it would be important to attract an operator with the entrepreneurial capacity and financial resources to invest in building volume growth through backwards linkages into the regional economy. Equally it would be important to avoid a simple fee-based management contract which incentivized the operator to «sweat» assets rather than to build on them.

2. Railways

(a) Operations

Ugandan railways are at a very low ebb. The rail system, comprising 1,250 km of track, was built 50 years ago and has not been adequately maintained. There is a shortage of operable rolling stock. The key overseas link to/from Mombasa, a distance of around 750 miles, averages 21 days and at worse can take 60 days due principally to delays in Kenya. Once Ugandan rolling stock crosses into Kenya it is handled by Kenyan railways, which makes many stops en route and may leave Ugandan wagons behind.

Rail operations are beset by poor utilization of wagons, a situation exacerbated by lack of coordination with rail operations within Kenya and Tanzania.

Rail freight charges for the Kampala-Mombasa section are the equivalent of $ 66/tonne compared with $120/tonne by road. These charges are prohibitive for the development of any low value-to-weight agricultural or mineral export industry.

Less than 10 per cent of domestic freight and 30 per cent of external trade freight is carried by rail.[5] Other things being equal, business would prefer to use rail rather than road for export and import through Mombasa as there is less pilferage. However, the railway is too unreliable, especially for exporters. Rail arrivals in Mombasa are so uncertain that it is difficult to book ships. Imports are (relatively) easier, and Mombasa port will not charge for storage of imports booked for carriage by Kenyan railways.

A number of rail investment projects were identified in interviews, although it was difficult to obtain firm information on their status and cost.[6] Table 13 sets out the information obtained from the interviews:

Table 13. Uganda Railways investment proposals

Project	Cost ($m)	Status
Kampala-Kassese line rehabilitation	15	Feasibility study completed
Kampala-Malaba line upgrade	35	Not known
Kampala container terminal	NA	Stalled
Wagon refurbishment	9	325 in customer-financed programme

Source: Interviews.

It was suggested in the interviews that the total capital cost of rehabilitating the track and rolling stock would be in the order of $100-150 million (including the projects identified in table I3).

A privately financed transshipment facility has been mooted at Kidatu in south-west Tanzania to establish a rail link from Johannesburg to Kampala. The facility would augment the existing link to Dar-es-Salaam from Kampala and would provide Uganda with access to South African ports. The project is a joint venture which includes Spoornet of South Africa and Transerb of Belgium.

5 MOWTC. *The Ten Year Road Sector Development Programme,* October 1996.
6 It is understood that a railways study is under way but it was not possible to obtain a copy of the draft report.

(b) Uganda Railways Corporation

The railway is owned and operated by the Uganda Railways Corporation, a state corporation. The URC has an honorable history but has been in financial difficulties for some time. It lives «hand to mouth» and sometimes finds it difficult to pay wages on time. The most recent available accounts (unaudited) relate to 1996. The financial performance of URC is shown in table 14 below. It shows for that period:

- Declining turnover: in 1988 turnover may fall further to only $10-15 million for the year;[7]
- Increasing losses, including an operating loss in 1996;
- Low and declining capital expenditure; and
- Inadequate expenditure on maintenance.

Table 14. Uganda Railways Corporation financial performance

Indicator	1996*	1995*
Turnover	18.9	28.8
(of which freight)	(14.8)	(21.8)
Operating profit/(loss)	(1.7)	2.0
Profit/(loss) after tax	(9.9)	(6.9)
Capital expenditure	0.5	2.0
Maintenance	1.1	NA

Source: Draft accounts for the year ended 31/12/96; Financial statements for the year ended 31/12/95.
*Values are expressed in $ million at mid-year exchange rates.

URC has outsourced the repair of locomotives through the formation of a joint venture with a German company. It has also introduced a scheme for wagon repair and refurbishment in which customers pay for the work in exchange for discounted freight. So far there are 325 wagons in the scheme at an average refurbishment cost of $ 3,000 each.

URC no longer has the financial and overall management capacity in its present form to run an effective railroad. Nevertheless, it remains listed in the Public Enterprises Reform and Divestiture Statute as an enterprise to be kept 100 per cent State-owned.

(c) Assessment and recommendations

(i) The railroad is in decline and, coupled with the lack of coordination with railway operators in Kenya and Tanzania, has lost credibility with the business sector.

(ii) Given its economic importance, insufficient attention has been paid to creating opportunities for private investment, including FDI.

7 Interview with URC.

(iii) In the absence of information from a market study, including estimates of new business that could be induced by a credible operator, it is not possible to say whether URC would be an attractive proposition for private acquisition. A private investor may need to invest up to $150 million to bring long-neglected track and rolling stock up to acceptable standard, and it is not known whether an acceptable return on investment (and an adequate stream of foreign exchange receipts) could be earned. The need for and merits of a public subsidy should also be examined.

(iv) It seems unlikely that private investment can be attracted to discrete projects within the system (such as those listed in table 13 above) until a competent and creditworthy operator is introduced to the system as a whole and a bankable structure is introduced to include the railways of Kenya and Tanzania. Until then FDI opportunities will be confined to marginal activities such as maintenance.

(v) The firm view of the private sector is that a common operatorship structure should govern the railroads of Uganda, Kenya and Tanzania (as in the days of the East African Community). There is hope that it will be addressed in the negotiations under way for a new community treaty.[8] Yet the draft railroad provisions of the treaty imply continued national operatorship amid platitudes about cooperation which could not be relied upon by a private investor.

The Government, working in conjunction with the Governments of Kenya and Tanzania, must give greater priority and leadership to addressing the above points in order to provide the subregional framework within which opportunities for FDI in the railway sector may be created.

3. Roads [9]

(a) Network investment plans

The Uganda road network of 30,000 km carries over 90 per cent of Uganda's passenger and freight traffic. Road maintenance was badly neglected from 1975-1984, and most expenditure in the following decade was devoted to maintenance rather than development. Generally road conditions remain poor. Only 10 per cent of the network is paved.

A 10-year road sector development programme was begun in 1996. It calls for expenditure of $1.5 billion, of which almost two thirds will be capital investment in network improvement, concentrated on the upgrading and paving of existing roads.

The programme does not propose any private investment initiatives directly. All the capital expenditure is expected to be publicly financed, including over 90 per cent from donor aid. Attention is given to stimulating private involvement in construction and maintenance contracting, and a budget has been set aside to support «capacity-building» among local firms.

The Ministry of Finance and Planning believes that traffic volumes are too small to support private finance initiatives through toll road structures. It believes that public investment can be recouped more effectively by fuel taxes than by toll systems. Given the small size of the economy and the relatively small number of vehicles on the road (126,000 in 1996 [10]), this is likely to be the correct view. In the long term there may be opportunities for private investment if the present explosive growth of traffic continues; the number of vehicles on the road is doubling every four years.

8 Article 105. Draft East African Community Treaty, undated but believed to be 1998.
9 Data in this section are derived from MOWTC. *The Ten-Year Road Sector Development Programme*, October, 1996.
10 BOU. *Quarterly Economic Report*, July-September 1997.

(b) Assessment and recommendations

(i) There is no apparent scope for private investment in new construction or upgrading of roads in which the market risk is assumed by the private investor through a toll concession.

(ii) There may well be scope for FDI in the contracting industry given the projected levels of road expenditure but, if so, this will be a natural outgrowth of international procurement procedures for the larger, aid-funded, projects.

(iii) Given (i) and (ii) above there is no reason to take a proactive approach to promoting FDI in this industry.

4. Mombasa Port

(a) Port services

The private sector believes that port services in Mombasa are very inefficient, cause losses of cargo and may give low priority to handling of goods originating in or bound to Uganda. Under present circumstances Ugandan business loses control of its goods whilst they are over the border.

The private sector would like to have a «Uganda area» set aside at Mombasa Port under dedicated management. Exports would travel down in trust having been customs-cleared, but not bonded, at the border, and consolidated in the Uganda area. Imports would be offloaded and consolidated there as well. In both cases the operator of the Uganda area would handle deliveries. This would provide greater security and efficiency in the handling of Ugandan goods.

There is sufficient warehouse space at the port that could be leased for this purpose. Investment would be required in cargo handling equipment. The Uganda Clearing and Forwarding Agents Association supports this proposal.

(b) Assessment and recommendation

The UIA should support this practical initiative. The UIA could encourage and support negotiations with the Kenyan government agencies. The UIA could also investigate playing a direct part by taking a long head lease on the proposed Uganda area. It could then tender a lease/invest/operate deal for bids by private operators.

C. Financial services

1. Commercial banking

(a) The banking market

Uganda has 20 commercial banks that have between them total assets equivalent to $ 890 million.[11] It is immediately apparent that the banking market is both very small and spread over an extraordinarily large number of institutions.

The Government appears to have three principal objectives in the commercial banking sector. It would like to see a lower cost of credit. a spread of banking services out from Kampala and the introduction of new products and services. Additionally the Government believes that there is a sufficient number of banks. There has been a moratorium in place for two years on the admission of new banks and the present intention is to extend this. An exception is made if a prospective new entrant can demonstrate that it will introduce new products and services to the market.

The large number of banks does not seem to have created competitive pressures on loan spreads or in the aggregate supply of credit to the domestic private sector. In September 1997 average spreads were in the order of 16 per cent [*]. Loans outstanding to Ugandan customers were only 50 per cent of deposits. Business complains about the high cost of credit but, on the face of it, has considerable bargaining power. It is possible that foreign exchange business is more competitive.

According to the BOU, aggregate return on assets of the commercial banks in 1997 was 1.9 per cent. This suggests that on average the sector is reasonably profitable. But it is unlikely that 20 banks in such a small market can all be profitable. It is probable that the largest banks (with the exception of the Uganda Commercial Bank, which until recently was 100 per cent Government-owned) may have quite exceptionally good cost and profitability ratios. The Standard Chartered Bank, for example, has a cost-to-income ratio of 35 per cent [12] (a ratio of 55-60 per cent would be considered excellent in most banks) and in 1997 a return on equity of 58 per cent.[13]

These statistics might suggest that there is scope for new foreign investment in the commercial banking sector. This could appear to be confirmed by the partial privatization of the loss-making Uganda Commercial Bank, which resulted in the acquisition of 49 per cent of the State's interest by Westmount Holdings, a Malaysian finance company. Also Citibank recently acquired a commercial banking licence.

However, the key issue for the larger foreign banking groups may not be the relative returns but the low absolute levels of profit that are currently generated by the sector due to its small size. This is a deterrent to foreign investors because they invest not just capital but also name and reputation and must devote valuable management time and resources to staffing and overseeing the operation.

For these reasons the Ugandan banking market is not an attractive target, in any direct sense, for new foreign investment. There are two less direct scenarios under which new foreign investment could be forthcoming:

(i) Opportunistic investment: the opportunity of acquiring cheap banking assets on a one-off basis. This may have attracted Westmount Holdings. Generally, however, this kind of acquisition does not appeal to major international banking groups.

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[11] BOU. ibid, as at September 1997. Shs are converted to $ at the official mid rate at the end of the applicable period.

* Weighted average deposit rates compared with indicated lending rates. Prime customers may be able to borrow at spreads of 9 per cent.

[12] Interview with management.

[13] Standard Chartered Bank Uganda Limited. Accounts for the year ended 31 December 1997.

(ii) Strategic investment: a handful of major international banks aim to become truly global banks. Those banks whose global ambitions include retail banking are Citibank, HSBC, and to a slightly lesser extent ABN-Amro and ING. They can take positions in such emerging markets as Uganda based on population size and long-term economic potential. Such investors will stake out a position in markets but will not necessarily, in the early days, aim to be competitive or innovative forces in everyday domestic banking business. By the same token there are other banks (for example some of the British clearing banks) which are undertaking strategic divestment from smaller emerging markets.

In short, the attractions of the Ugandan banking market for any new investor are either cheap assets or a long-term position, and each attracts a different kind of foreign investor. Unfortunately for Uganda, both such conditions now present themselves in many larger economies in Asia, Latin America and Central and Eastern Europe. Attractive banking acquisitions have been available recently in Latin America (especially Brazil). Now, the Asian financial crisis will almost certainly present sizeable and inexpensive acquisition opportunities in important strategic markets for the global banks.

(b) Assessment and recommendations

These considerations lead to the following conclusions and suggestions:

(i) The qualified moratorium on the entry of new banks may be a way of preventing the entry of yet more poorly capitalized nationally owned institutions. Although it is a curious instrument (in contrast to more straightforward capital and experience criteria) it has probably succeeded in that respect. Certainly, the sector appears to be vastly over-banked, and any serious pressure on spreads and margins – which itself would be a welcome step – must cause financial stress to a number of smaller banks.

(ii) The moratorium tends to undercut any proactive strategy of seeking new banks to provide more competition in the bread-and-butter aspects of banking, including corporate and project lending. This must be of at least equal priority to the introduction of new products and services.

(iii) Given the small size of its financial market, Uganda has already done well in attracting or retaining large foreign investors, including Standard Chartered, Barclays and recently Citibank. Also HSBC has established a presence through a small merchant banking operation. Accordingly there is limited scope for major new entrants. The most obvious missing element is a major continental European bank that has a global banking strategy and is not averse to branch banking in emerging markets. Examples are such banks as ABN-Amro and ING, which apart from their global reach, have expertise in running branch operations in emerging markets. (More such banks could bring a package of allied financial services, as discussed in Section B below.)

(iv) However, the small absolute size of the Ugandan banking market remains a constraint to new foreign investment and to the secondment of first-class management to operations in Uganda. Ugandan commercial banking will have an «outpost» reputation in group head offices. This can be overcome if the Uganda leadership at a very high level can form relationships with key officers of the multinational banks at group level. If carefully targeted this can break down the barriers to new investment and innovative management.

2. Capital markets and merchant banking

(a) Activity

The Government has enacted primary securities legislation through the Capital Markets Authority Statute of 1996 and subsidiary regulations concerning the licensing of broker/dealers and of stock exchanges, prospectus requirements, and securities issue and trading rules. Draft legislation has been prepared to regulate collective investment schemes.

The securities regulator is the recently established Capital Markets Authority. Separately, it has also been recommended as the principal regulator of corporate affairs as part of proposed reforms to the Companies Law.

The CMA has encouraged the commercial banks to apply for broker/dealer licences through subsidiary companies, as it is keen that market participants are of substance. Eleven broker/dealers have been licensed, eight of whom are founder members of the fledgling Uganda Stock Exchange.

The USE is currently trading only government securities and bonds issued by the East Africa Development Bank. No equities have yet been listed. Existing major companies (including subsidiaries of major foreign investors) and the privatization programme will be targeted as the foundation for a supply of tradeable equities. Also, Uganda has developed its securities regulations in harmony with those of other countries in the region in order to promote a regional market. It is expected that securities listed in such countries will gain virtually automatic dual listing in Uganda.

The volume of domestic institutional funds available for investment in listed securities is small (no estimate is available) and poorly structured. Very little life insurance is sold in Uganda and there is a precise monopoly of statutory retirement funds. There have been a few relatively small domestic public issues, and corporate finance advisory business is too small to attract major investment banks. There may in due course be some scope for the development of corporate finance boutiques that are part foreign-owned but rely on strong local institutional or industrial shareholders.

(b) Assessment and recommendations

(i) The Government has taken the correct steps to establish the securities market on a properly regulated basis, to give attention to custody and settlement issues and to review the Companies Act to fine-tune the provisions for disclosure and minority shareholders' rights. This preparatory work is up to a good standard. It is an essential prerequisite for attracting foreign institutional investment.

(ii) No mainstream foreign-owned market participant – whether a broker/dealer, capital markets' professional, or fund manager – is likely to base itself at present in Uganda on a stand-alone operation. The supply of stock, the trading volumes and the availability of domestic institutional funds now and in the medium term are far too small. The Government's strategy should focus on development of preconditions, packages and presence, as outlined below:

(iii) Preconditions: an active market needs a supply of securities and a diversified fund base to provide liquidity and new capital. The key sources of supply of securities are:

- Privatizations;
- Listings of the larger Ugandan companies (often foreign-owned); and
- Dual listing of companies domiciled in other countries of the region.

Concerning privatizations, it is undoubtedly correct strategy first to introduce strategic investors, as the state enterprises are too badly managed to be offered direct to financial investors. However, there should be an agreed plan to offer additional interests on the USE to financial investors and closer cooperation between the relevant authorities on this matter.

The larger Ugandan companies usually have little incentive to list locally, as they do not depend on the local capital market for financing and they regard it as an extra management burden to deal with public shareholders and additional compliance requirements. They will be accommodating if there is strong political support delivered from a high level. A political message should be delivered but not before the Government itself has shown the way with offerings of securities of newly privatized companies. Otherwise it will not be credible.

Somewhat similar considerations apply to dual listings. Will a typical company that is listed elsewhere have any incentive to list also in Uganda, no matter how seamless the Uganda listing requirements are with those of its home exchange? Not in present circumstances. It has been suggested that there be tax incentives to encourage foreign portfolio investors to invest through Uganda in dual-listed companies. A number of powerful incentives could be readily devised but these would almost certainly invite retaliation from neighbouring countries if foreign business is lost to Uganda.

The domestic institutional industry is barely developed and poorly structured. It is well understood that the key to development of this industry will be the privatization of pension provision or at least of the private management of statutory pension and other funds and the development of life insurance. A strategy should be put in place to promote both developments. It is understood that reforms to the pension industry are being considered with the support of the World Bank. It seems likely that institutional demand for Ugandan securities will come primarily from foreign sources in the medium term.

(iv) Packages: In the absence of viable stand-alone opportunities the best prospects for attracting greater foreign participation are by creating packages of services. Potential examples are:

- To give consideration in the entry of new commercial banks to those which have active securities offering, trading or fund management arms; and
- To combine domestic pension management opportunities with some degree of commitment to offer life insurance.

Such arrangements have to be very carefully devised so that the correct priorities are maintained.

(v) Presence: The assessment here is that the sector is still at the early preparatory stage of creating the conditions and opportunities which are needed to attract FDI. The focus meanwhile should be on encouraging interest and occasional presence in Uganda of foreign firms. For example, some preference in appointing global coordinators of international offerings of Ugandan securities (e.g. in telecommmunications operators) could be given to firms which undertake to maintain longer-term research coverage.

3. Insurance

(a) The insurance market

The Ugandan insurance market is small and overcrowded. Total life and non-life premiums in 1997 were the equivalent of only $ 28.5 million, divided among 26 firms of which five have a degree of foreign ownership.

Key activity statistics are shown in table 15 below:

Table 15. Uganda insurance market

Total premium income	1997*	1996*
Non-life	26.0	25.4
Life	2.5	3.3
Total	28.5	28.7

Source: Uganda Insurance Commission
* Values are $m at mid-year exchange rate.

The non-life underwriting business is dominated by a few firms. In 1996 the top five firms had 73 per cent of the market, which left only $ 7 million of business to be shared by the remaining 21 firms. (At the time of writing the firms may have been reduced to 18.) The largest firm is the State-owned National Insurance Corporation. The firms with foreign ownership include the American International Group, one of the world's largest insurers.

The life market is exceptionally undeveloped. It appears that only three firms offer life cover, of which the State-owned National Insurance Corporation is by far the largest. It is understood that the AIDS epidemic has undercut the development of life insurance.

A new Insurance Statute was enacted in 1996 to provide for the regulation of the insurance business. Foreign-owned insurers and reinsurers have a higher paid-up capital requirement than nationally owned companies but these are not set at prohibitive levels.

(b) Assessment and recommendations

(i) Consolidation in the underwriting sector is inevitable and is starting with the non-renewal of licences of some smaller firms. Acquisition of small firms is not likely to provide tempting opportunities for new foreign investors.

(ii) Privatization of the National Insurance Corporation would provide an opportunity for FDI. However, it is a small business in international terms and its divestment may result in sale to an existing participant. If it is privatized, consideration should be given to embodying some preference to an acquirer willing to be innovative in the life market and also able to contribute expertise to the emerging capital market (e.g. in relation to fund management services).

(iii) Development of life business should be the key thrust of search for greater foreign participation. Innovation will be needed given the AIDS-related risks of premature death The opportunity should be taken by Ugandan government leadership at a very high level to establish contact with senior group management of existing foreign insurers (such as AIG) and potential new entrants with expertise in life products. Cultivation of the right contacts will attra ct attention to Uganda among foreign investors disproportionate to the market size.

D. Conclusion

Within the constraints of a small market there are potential FDI opportunities in the utilities, infrastructure and financial services sectors, although some are medium-to long-term prospects. These opportunities, however, need excellent preparation and careful promotion to be realized on mutually satisfactory terms. A good general investment climate is a necessary but not sufficient condition to attract such investment.The UIA can assist with some of the more practical and business-sensitive aspects of attracting foreign investment to these sectors, especially those that are opening for the first time to investment from abroad.

The UIA has a diminished regulatory role in the present climate whatever the final shape of a revised Investment Code. The key future contribution of the UIA would seem to lie in creative promotion of selective opportunities for new FDI, in close cooperation with the sectoral ministries. This is not an easy role in the regulated industries such as those covered by this report. It must include pointing out in constructive terms to sectoral ministries where there is inadequate preparation to attract strong FDI interest or to attract it on the best terms for Uganda. Inadequate preparation can take the form of substandard development of regulatory rules and institutions or poorly structured investment terms. Lapses of these kind happen very frequently in cross-border business. In the absence of good preparation the entry process for FDI will be confusing and frustrating. At best this will lead to less competitive terms being offered by foreign investors. At worst it will lead to such frustrations at the entry level that the overall investment climate will be damaged. The recent power generation initiatives (and these are the only major FDI initiatives in the last few years) have exposed poor preparation by government and show all these propensities. As the mandated foreign investment agency the UIA has both a right and a duty to add its voice and contribution on these matters in the regulated industries.

This point can be made from another perspective. Uganda has introduced excellent financial policies for business and is committed to divestment of state ownership in favour of private investment. But in the regulated industries, will Uganda manage the job of regulating private activity any better than it managed its ownership in these sectors. The commercial banking system does not seem to have been especially well regulated, for example. Many of the same pressures for disastrous performance exist. The existence of these pressures makes good project preparation and promotion doubly important. Offers to investors should if at all possible be organized so that important regulatory matters (e.g. price, coverage and service obligations) are settled at the outset, including through the intelligent use of investment tender procedures. The terms should be structured and the deals promoted so as to obtain the greatest possible competitive interest amongst qualified foreign investors. Every potential FDI opportunity identified in this report would benefit from detailed attention of this kind.

IV. INVESTMENT PROMOTION STRATEGY

Uganda's investment promotion strategy should start from the recognition that several domestic weaknesses militate against any successful investment promotion. These constraints — partly structural, partly institutional — include:

(a) Government bureaucracy and red tape, including the lack of close cooperation between government department/agencies involved in the economic planning process and the investment thrust of Uganda;

(b) Major infrastructural bottlenecks;

(c) The relative absence of secondary education facilities (especially technical education); and

(d) Limited links with critical capital-and technology-exporting countries. These links, such as banking, financial and air travel links, can serve as important conduits for the flow of information, people, project ideas and, eventually, investment.

Institutional weaknesses can be alleviated by government action alone, although not always quickly or easily. The structural weaknesses will diminish only after sustained, long-term development efforts. Both types of weaknesses will need to be addressed.

It must be emphasized that the prerequisite for success is a «Big Push»: a dramatic and sustained set of actions that can bring about results on the ground. Minor adjustments «here and there» and failure to «bite the bullet» will generate only mediocre success. Uganda needs to mobilize the political will that exists at the highest levels of government and translate it into a vision for a big push that can make the difference.

A. A comprehensive investment promotion strategy: Eight-point action plan

Uganda has the potential to be a model success story of economic development in Sub-Saharan Africa. But there are challenges to be overcome, and an Eight-point action plan is recommended:

Point 1: Set up a Cabinet Committee on Investment chaired by the President. The CCI will coordinate all inter-ministry efforts, remove bottlenecks, give the direction for the «Big Push», and ensure that all critical entities move in the same direction and with the same urgency. The Uganda Investment Authority should be the secretariat for the CCI (if necessary, jointly with officials from the President's Office).

The CCI, which initially should meet once a month or once every two months (later, the frequency can be reduced), will undertake to:

(a) Receive, approve and guide the investment strategy/vision for Uganda's development;

(b) Meet with captains of industry, senior ministers/government officials and representatives of the National Forum–a body established by the Government to discuss policy issues–to understand problems affecting industry and remove all bottlenecks to investment;

(c) Receive regular reports/briefings of progress on development efforts and ensure approvals are given where necessary;

(d) Take all necessary measures to ensure that the sustained «Big Push» is not in any way affected by inertia or acts of commission by any government departments; and

(e) Ensure that Uganda creates an ideal investment environment for private sector growth and profit.

The CCI should not become another level of FDI screening. Its function would be to promote, not approve foreign investment.

Point 2: Move away from the concept of the traditional Free Trade Zone as a model and set up a bold new concept for a Multi-facility Economic Zone.

This zone will provide facilities for all targeted industrial projects, be they 100 per cent export - or local market - oriented.

The concept embraces the identification and development of maximum facilities for the zones which will be the «centres of excellence» in Uganda for industrial development. It will be impossible in the short to medium term to create the high-quality infrastructure that is required for modern industry in multiple locations within Uganda. However, it should be possible to focus the best infrastructure within one or two targeted areas until sufficient momentum of growth and wealth is created to expand these facilities to other areas. This could begin with the Government's proposal to earmark prime land at Namanve Industrial Estate for development into fully serviced land.

The MFEZ will come under the direct supervision of the CCI and the UIA. Within the limited MFEZ area, special facilitation schemes should be designed to create a haven for investors by removing administrative bottlenecks and should become a model of what could constitute an «ideal investment environment».

Each MFEZ will be an «Engine of Growth» geographic area and will also operate as a virtual zone for targeted MFEZ projects that are not located within the physical MFEZ zones. An example could be a major textile operation that wishes to locate in close proximity to cotton-growing areas: it would be designated an «MFEZ project» and given all privileges due such projects.

The Ugandan Government should announce a type of «Magna Carta» of guaranteed privileges for all MFEZ projects. These could include guarantees on unrestricted expatriate employment, fast track approvals from project initiation to implementation on the ground, high-quality customs administration, and guarantees on foreign exchange and tax arrangements and the like. The special privileges should be given to companies in one Special Certificate, authorized by the President and the CCI and issued by the UIA.

Point 3: Specific industries with potential for success should be identified and «packaged» for promotion efforts. In effect, this means that once an industry/sector is «targeted» (and this should be two or three at the most), the special environment required to attract investment in these sectors should be created and then specific promotion campaigns launched to attract targeted investors.

Expert studies should identify target sectors and these must be pre-tested with leading industry investors before launch. Preliminary recommendations are made for three target sectors:

(a) As Uganda is rich in agricultural resources, with large parts of the population in the rural areas, the creation of a modern, dynamic agricultural sector is a priority. If Uganda wishes to attract FDI to this sector, then it is not sufficient just to declare to the world that Uganda welcomes agricultural and agro-based industries. Many countries have done this, but their investment promotion efforts have not been sufficiently targeted. The measures recommended are as follows:

(i) The Government should identify tracts of land available for cultivation, which would be wholly leased to foreign investors or as joint venture with domestic investors;
(ii) The agronomic nature of the land should be presented in a short report – what crops can be grown, soil and irrigation, rainfall conditions, etc.;
(iii) The report should also include the types of incentives and privileges the Government is prepared to offer investors in this activity; and
(iv) With this report, targeted agriculture-based industrialists in capital/technology-exporting countries should be approached and invited to investigate the potential for investments.

(b) As cotton is an abundant cultivated natural resource of Uganda, can attempts be made to turn the country into the textile centre of East Africa? In order to create the ideal environment for that, it is necessary to talk to potential investors (i.e. existing textile manufacturers in capital-and technology-exporting countries), inform them of the resource availability and ascertain what preconditions should be created to get them to locate in Uganda. It must be kept in mind that there are other cotton-growing countries in Africa and elsewhere that are also competing for these investments.

c) Education is another area that Uganda can target as an economic growth sector. The UIA sectoral profile on education services indicates that in 1996, there were over 2,700,000 enrolments of students in the primary education sector, as compared to only 345,290 in the combined sectors of secondary, teachers' training colleges and tertiary institutions. This is a great shortfall by any standards, and this problem represents both a challenge and an opportunity (see box 6).

The sectoral profile on education services quite rightly proposes that the secondary education sector be private-sector driven, and a number of rights and incentives have been proposed. If these measures succeed in attracting private investors to the education sector, the problem will be overcome. However, if this area remains a potential problem, the lack of technically trained Ugandan youths could slow down Uganda's Big Push, and then a special promotion effort must be launched to attract investors to the sector.

An attempt can also be made for Uganda to become a centre for technology training education for the East African nations and beyond. The key effort here is to get a number of reputable, international colleges and universities that offer technology training to establish themselves in Uganda. Once a few institutions have come and are successful, they will attract others to set up similar institutions.

This concept can draw upon the success of the former East African Community, when Makerere University in Uganda had specialized in medicine, the University in Tanzania in law and the University in Kenya in engineering. It worked well then, as each centre commanded the best resources.

Since technically trained workers are a valuable resource for Uganda's investment drive, a special promotional deal should be considered for offering to the first five major institutions that are established. The package of privileges must be carefully designed but could include:

(i) Subsidized land and buildings for a start-up period;

(ii) A long-term lease management contract for an existing educational institution, which would be the nucleus of a new technology centre;and

(iii) Tailored incentives for investors and staff that are especially attractive for the «early bird» entrants.

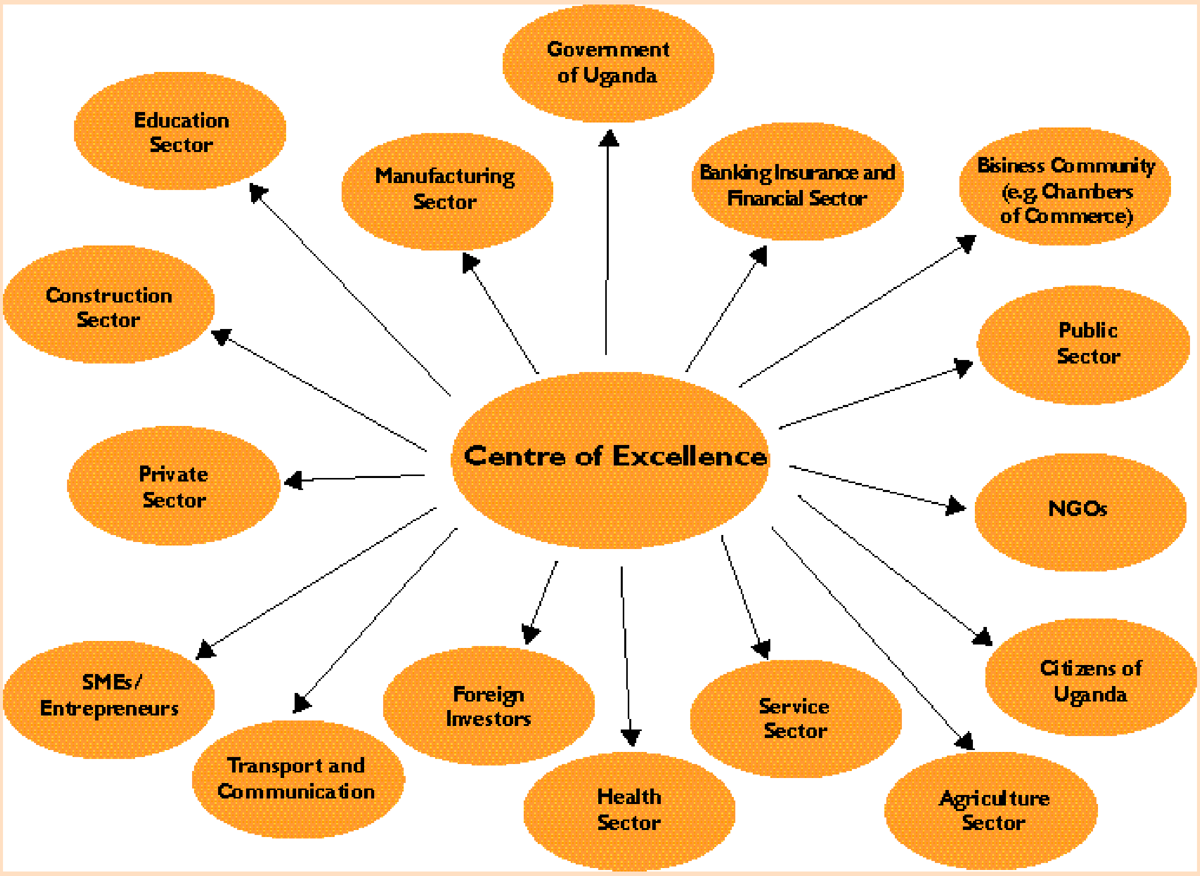
The above three – agriculture, cotton and education – are examples of potential sectors. In each case their inherent attractiveness to investors must be established, the investment conditions and incentives must be properly structured and the promotional effort must be targeted to specific pre-identified investors.

Box 6. Centre of Excellence for Education

A centre of excellence for education could provide a strategic response to the country's critical needs for trained manpower and improved productivity. Besides strengthening education capabilities by re-tooling existing teachers and training new recruits to the teaching profession, the centre can contribute to transferring knowledge and technology to build consulting capacity in each of these institutions, so that institutional strengthening could support organizational effectiveness.

The experience of other developing countries, as depicted in the chart below, suggests that a successful centre of excellence should involve all major stakeholders, including beneficiaries as participants and contributors. It should be a collaboration between the public and private sectors and be governed by a board of directors made up of representatives of the private sector and of State-appointed members. One possible model is the Institute of Business of the University of West Indies, which has operated since 1989 along similar lines.

The centre can create an impact on the vital economic sectors in Uganda by working with industries and government to develop a competent cadre of managers in various functional areas, human resource specialists, general managers, entrepreneurs and leaders to support the development effort in both the private and public sectors in a sustainable manner. The centre should essentially be driven by the market and respond to the needs of the private, public and education sectors. Competitiveness requires a dynamic, properly managed, constantly improving, constantly innovating private business sector. Such a private sector requires public sector understanding and support to facilitate competitiveness. Both private and public sector workers need to improve their skills, competencies and capacities through education.



Point 4: Promote actions which create confidence among investors including the signing of investment guarantee agreements and double taxation agreements with capital-and technology-exporting countries. More agreements should be initiated. The media publicity and upsurge of interest that normally accompanied the high-profile signing of such agreements can have promotional value.

Point 5: The overseas reach of Uganda's investment promotion efforts should be maximized by engaging Ugandan embassies and High Commissions located in capital-and technology-exporting countries to make investment promotion the top priority in their work programmes. Should ambassadors, High Commissioners and senior staff be used for investment work, special intensive briefing sessions should be arranged for them. This can be done by recalling senior staff of all targeted embassies/High Commissions to Uganda for such briefings when necessary, or by sending investment experts to brief them in their overseas locations. Their efforts at investment promotion should become one of the measurable criteria for Ugandan overseas representatives.

Point 6: Intensify investment promotion efforts through the following means:

(a) Create a «Friends of Uganda» club among existing foreign investors in Uganda; and

(b) Request the banks/companies to organize roundtable meetings in their home countries, making use of their conference rooms/premises to meet selected «friends» of these investors who may have prima-facie interest in hearing about opportunities that the Ugandan Big Push Programme offers. Companies will have no problems doing this, and it is a cost-effective means of promotion.

A prerequisite to the above is of course that these existing investors are happy with their operations in Uganda and have a good story to tell their «friends.»

It is critical at this stage of Uganda's investment drive to avoid «big show» seminars in expensive hotels. The costs and benefits of roundtable meetings with 10 to 15 interested investors will be much greater than major, expensive seminars with untargeted participants.

Point 7: The Cabinet Committee on Investment must ensure speedy implementation of approved projects as a priority task. All government institutions connected with project implementation should report through the UIA on project implementation efforts.

Every economic ministry/government department must be requested to create a «Client's Charter». This charter will have them identify their «clients» (that is, who they serve), and each government department should inform the CCI of the time it will take to issue approvals or provide services within its authority. This time period will be posted in the department in public view and become the benchmark by which the department and the public measure its success.

Point 8: The Government should announce a Ugandan «Vision Implementation Period» in tandem with the launch of the MFEZ. This is the period of the «Big Push»! The Magna Carta and any other special privileges should be reviewed in the year 2005. All projects approved within the VIP will continue to enjoy the special privileges even after that year. If the momentum for growth has been generated by 2005, then some of the special privileges created can be reviewed and, if necessary, modified or withdrawn. Thus, this five-year VIP is the period of the «Big Push» for Uganda.

In terms of public relations and promotion efforts, the years 2000 and 2003 should be targeted as the years when extra efforts and expenses will be incurred to create a «Ugandan fever» overseas. Such an intense promotional initiative cannot be sustained for a long period, thus the choice of the years 2000 and 2003 — the period of challenge for Uganda.

During these two years, all aspects of Uganda, e.g. manufacturing, tourism, agriculture, etc., should be the subject of a well-coordinated and orchestrated promotional and public relations effort with full cooperation from the private sector.

B. Special infrastructure efforts: challenges and opportunities

Two additional areas could receive careful consideration, as they would also help to overcome the disadvantages faced by a landlocked nation. Besides posing as challenges they could also create opportunities for Uganda. They are:

- Given that Uganda does not have its own seaport, could it have the vision to see itself as a major air-cargo logistics centre for Africa? Could Entebbe airport be made a cost-effective and efficient air-cargo centre, which could become a base for international cargoes coming into Africa with deconsolidation and transshipment to other landlocked African nations and even to those which have both air and seaports? International cargo traffic will seek the most efficient and cost-effective platform. If this initiative succeeds, the multiplier effect will bring new growth opportunities for Uganda.

- To offset the «hassle factor» for manufacturers in Uganda using seaports in neighbouring countries, could Uganda create an efficient internal dry port for use as the gateway for their products coming into and going out of the country? Malaysia has successfully implemented such ports although it already has efficient seaports. Success in Uganda will require effective implementation of existing transit agreements and genuine cooperation at the subregional levels, particularly with customs clearance. This is in addition to the possibility of creating a Ugandan area at Mombasa Port (see Chapter III).

The CCI should be the leadership and oversight body to tackle Uganda's urgent infrastructure and services handicaps identified in Chapter III of this report.

V. MAIN CONCLUSIONS

In recent years Uganda has made great strides in improving economic conditions and the investment climate. The reward has been a revival of inward FDI flows, led by restitution and privatization programmes, which have been among the highest in Africa. This is cause for satisfaction. But challenges remain if recent FDI flows are to be sustained let alone accelerated.

FDI complements domestic investment, and is only one component of the development strategy of any least developed landlocked country. But in the case of Uganda it is a key component. Uganda has the core industrial potential to transform itself from one of the world's poorest economies into a renowned world-class producer of high-quality traditional and new agri-products with widespread impact on general living standards. FDI can bring to bear the capital, technology, management and market access which Uganda needs to realize this potential. Key findings are:

The legal and policy framework for investment is generally sound. The challenges are to:

- Develop and administer excellent regulatory systems for the private operation of utilities and infrastructure;
- Modernize the Investment Code and re-orient the UIA firmly towards FDI promotion;and
- Bring administrative practices up to standard by requiring all agencies to adopt a «Clients Charter of Excellence».

The lamentable state of infrastructure and utilities is a severe constraint on new investment. The challenges are to:

- Drive forward the restructuring and privatization of these sectors;
- Address with greater commitment and urgency the road, rail and port bottlenecks, which frustrate investment in the «heavy» commodities; and
- Expedite cargo transit through much better cooperation from neighbouring countries.

An aggressive «Big Push» strategy for investment promotion is needed. The gist of the strategy should be to :

- Lead from the top – the President and a special cabinet committee;
- Carve out model zones and centres of excellence;
- Target investment prospects with attractive packages of land, facilities and terms; immediate opportunities should be available despite small market size and poor infrastructure;and
- Co-opt departments, embassies, current investors and all friends of Uganda in a coordinated promotion drive.

ANNEX

Abstract : survey of potential investors

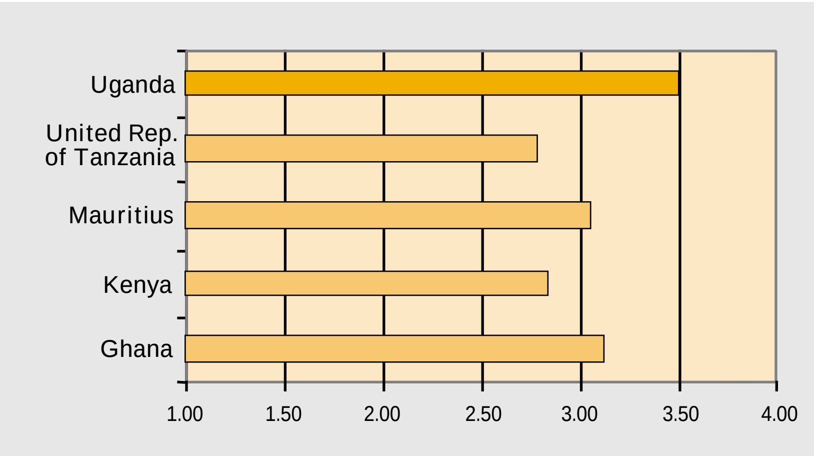
UNCTAD's survey of potential investors from home countries, carried out by Novus Management & Consulting SA., Geneva in October 1998, provided some insights as to how corporate headquarters of international companies view the Africa region, and specifically Uganda, in their development and expansion programme in the continent.

Questionnaires were sent by mail and fax to 750 companies in ten economic sectors in Denmark, France, Germany, Ireland, Japan, Kuwait, Malaysia, South Africa, Sweden, Switzerland, United Kingdom and United States. The mailing list was drawn from the UNCTAD database on TNCs, participants at the Uganda Investment Forum in London, April 1998, and the Crans Montana Forum, Switzerland, June 1998 as well as visiting overseas delegations to Uganda. Follow-up telephone interviews conducted with some respondents. The analysis of the responses is based on 55 completed questionnaires.

The key findings of the survey are:

Uganda obtains the highest ranking as an investment prospect among five countries in the region.

Question: *«Are any of the following countries in Africa on your target list of host countries for investment outside your company's home base? If yes, rate the investment prospect for each country on a scale from 1 (poor) to 5 (excellent).»*

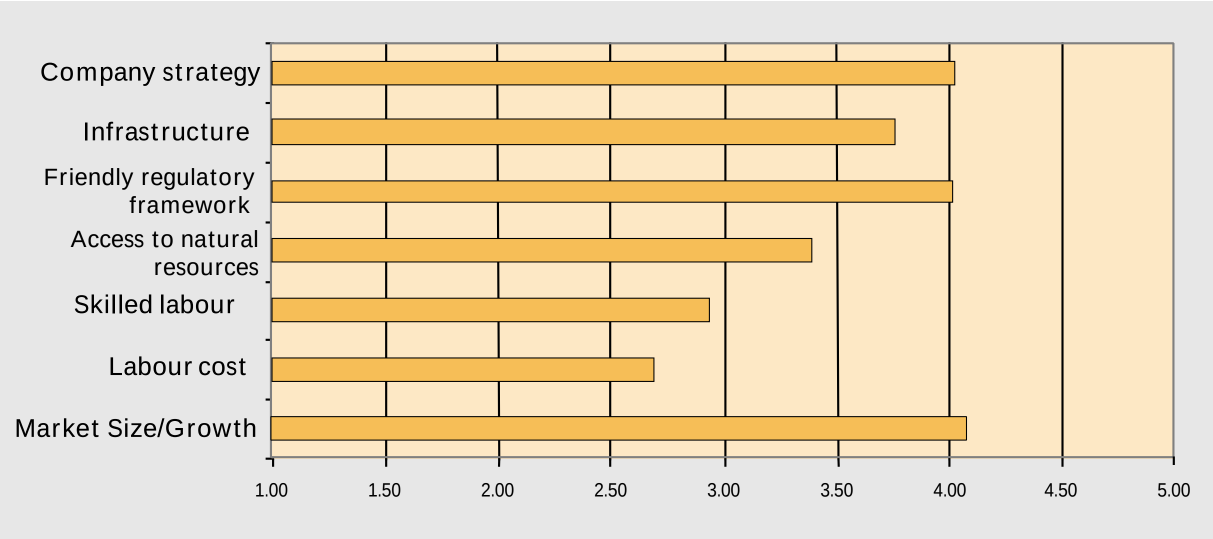


Source: UNCTAD's survey of potential investors, October 1998.

Compared to four other locations in Africa – Ghana, Kenya, Mauritius and United Republic of Tanzania – Uganda is recognized as a country with considerable resources to be explored and exploited. Uganda's image is very favourable. Over one third of the respondents, however, replied that they were not interested in investing in Africa or that they currently had adequate coverage.

Among the main determinants influencing FDI in Uganda, market size/growth, company strategy, and friendly regulatory framework are cited most frequently, followed closely by infrastructure.

Question: *«In your company's view, what are the main determinants influencing FDI in Uganda?»*



Source: UNCTAD's survey of potential investors, October 1998.

The most important single factor is market size and the prospects for market growth, with purchasing power as a constant qualification. One severe deterrent at present arises from the hidden costs of poor infrastructures and unreliable utility services, which were described as more than offsetting the savings realized from low labour costs. Only in particular subsectors like special-interest tourism was it generally felt that access to natural resources outweighed such disadvantages.

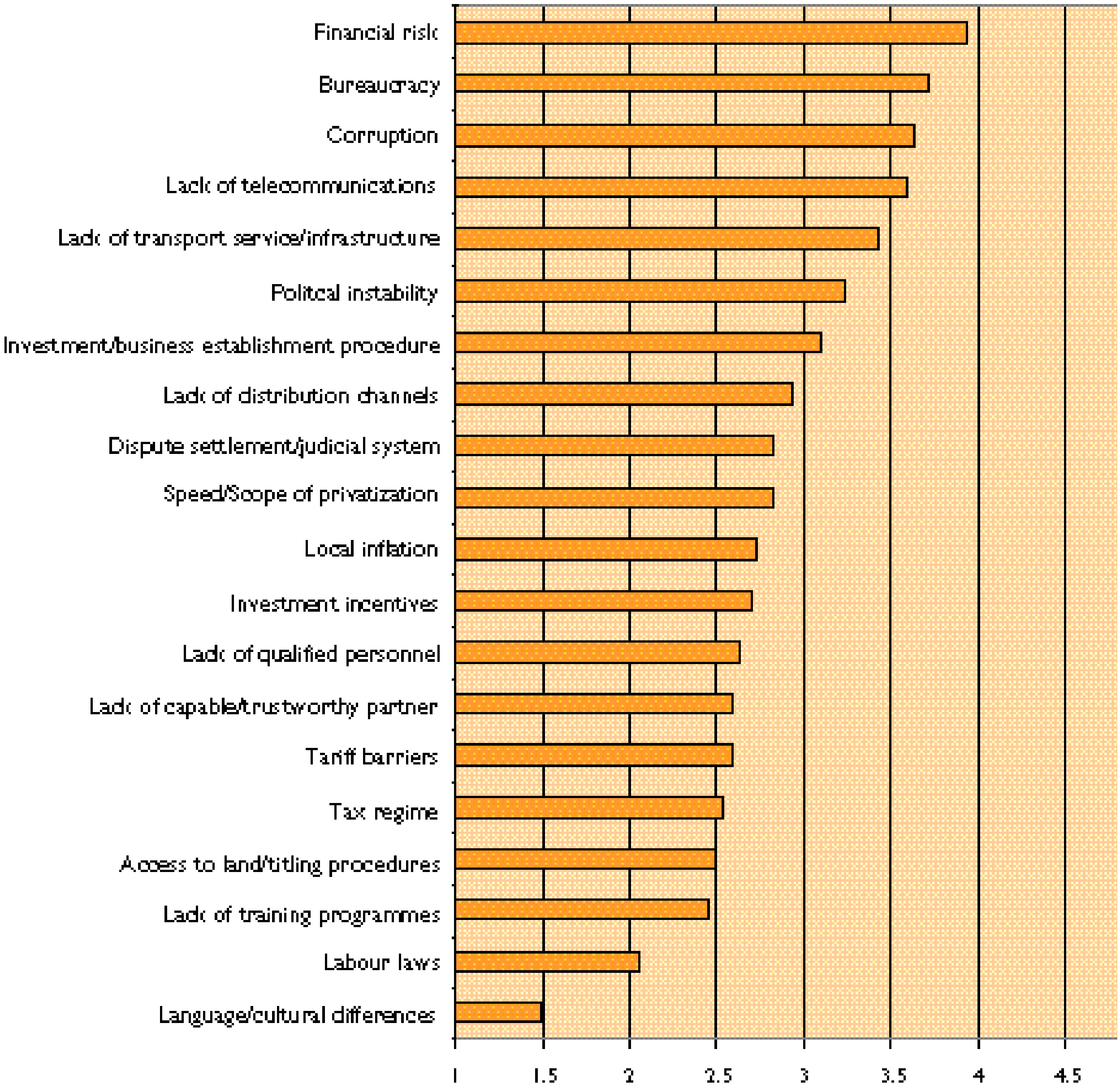
Among 20 obstacles to business operations in Uganda presented to investors, the four most frequently cited were financial risk, bureaucracy, corruption and lack of telecommunications.

While many of the twenty obstacles would also apply to other developing countries, these are the four most frequently cited in the case of Uganda.

Question: «*What are the main obstacles to business operations in Uganda?*»

Obstacles to business operations in Uganda

Range from 1 (not important) to 5 (very important)



Source: UNCTAD's survey of potential investors, October 1998.

Overall, many respondents indicated that whilst there is a sense of renewed confidence in the Ugandan economy and its prospects, the country remains a landlocked market with difficult and expensive access (road, rail and air) for goods, both imports and exports, stifling the chances of being competitive in a free market environment.

In spite of government efforts to improve the infrastrucure (power generation and telecommunications), potential investors are generally unaware of the achievements or of the Government's plans and timetable for future improvements.

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