

**FOREIGN DIRECT INVESTMENT AND ECONOMIC GROWTH**

**IN UGANDA (2002-2011)**

**BY**

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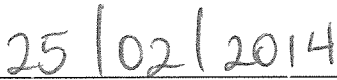
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**DECLARATION**

I **NAKAGGWA SYLVIA** registration number **BEC/34098/112/DU** do declare that this research report is my own working and it has never been submitted to any institution for any academic award.



Signature



Date

## APPROVAL

This research report has been submitted to the under graduate degrees committee for the award of a Bachelor of Arts in Economics of Kampala International University with my approval as a supervisor.

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## **DEDICATION**

This work is dedicated to my mother Mrs. Ajambo Ruth, whose sunny- natured cooperation helped me make this book possible.

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## **ACRONYMS**

2GM	Two-Gap Model
BoU	Bank of Uganda
ECRT	External Capital Requirement Theory
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IFS	International Financial Statistic
IMF	International Monetary finance
MNSES	multinational enterprises
MoFPED	Ministry of Finance Planning and Economic Development
UBOS	Uganda Bureau of Statistics
UIA	Uganda Investment Authority
USD	United States Dollar
WB	World Bank

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## ABSTRACT

The study is focused on Foreign Direct Investment and economic growth (measured by GDP) in Uganda (2002-2011), the study employed time series survey data since it examined data for a short time

Its objectives were; to establish the trend of Foreign Direct Investment in Uganda (2002-2011), to establish the trend of Economic growth of Uganda ((2002-2011), and to investigate the relationship between Foreign Direct Investment and Economic growth in Uganda (2002-2011).

The hypothesis of the study was there is no significant relationship between Foreign Direct Investment and Economic growth in Uganda. Time Series analysis such Correlation analysis, regression analysis mechanisms were used.

The trend of Foreign Direct Investment and Economic growth showed a general increase. Using the correlation, regression approach, there was a strong positive correlation between Foreign Direct Investment and Economic growth( $r=0.8202$ ) there was also significant relationship between Foreign Direct Investment and Economic growth at 0.05 level of significant.

In conclusion therefore both Foreign Direct Investment and Economic growth has a general increase, there is a positive relationship between Foreign Direct Investment and growth in Uganda which agreed with **Njimah et al (2009)**, **Makii et al (2004)** and **Borezstein (1999)** study on Foreign Direct Investment and Economic growth this has implied that Foreign Direct Investment play a very Important role in economic growth of Uganda.

The trend in Foreign Direct Investment implies that as the interest rate reduces, foreigners will be encouraged to set up industries and the reverse is true. The study was guided by the cost of capital theory (**Forgha 2009**), since developing country like Uganda cannot foster economic growth without Investment. Finally Uganda should embark much on the industrial set up since this employs a large number of people.

## CHAPTER ONE

### PROBLEM AND ITS SCOPE

#### 1.1 INTRODUCTION

Foreign direct investment is a phenomenon resulting from globalization, which involves the integration of the domestic economic system with global markets. It is accomplished through opening up of the local economic sector as well as domestic capital for foreign investors to establish business, within the economy. When there is a rise in capital movement within several countries, it results in to financial globalization. Domestic lenders and borrowers take part in the international market with the use of global financial intermediaries **(Macionis & Plummer, 2005)**. Financial globalization in developing countries is mainly favored by the availability of cheap labor and the fact that, return on capital is relatively high **(Obstfeld & Rogoff, 1996)**. In the recent years, there has been a rise in the amount of capital that has been flowing in to developing countries. Foreign companies investing in developing countries are significant in facilitating economic growth **(Feenstra, 2003)**.

On the global level, after a period of declining trends, global FDI inflow reached \$648 billion in 2004, increasing by 2% over its level in 2003, raising the stock of FDI in 2004 to an estimated level of \$9 trillion. Furthermore, there was a large increase in the share of developing countries in FDI inflow. Inflows to developing countries surged by 40%, to \$233 billion, while those to the group of developed countries declined by 14%. As a result, the share of developing countries in world FDI inflows has increased to 36% of global FDI, the highest level since 1997 **(UNCTAD, 2005)**. The observed uptrend in FDI was not evenly distributed among different countries of the developing world. While FDI flow into Africa remained stable at \$18 billion between 2003 and 2004, Asia and Oceania witnessed a significant upsurge during the same period. A similar significant uptrend in FDI inflow was recorded in Latin America and Southeast Europe, Global FDI inflows in 2010 were estimated at US\$ 1,244 billion which was a small increase from

the estimated inflows of US\$1,185 billion during 2009. At regional level, FDI inflows to developed countries and transition economies shrunk during 2010 while inflows to developing economies recovered strongly. FDI inflows to developing economies rose by 12 per cent (to US\$574 billion) in 2010 on account of strong domestic demand and rising south-south flows. Subsequently, FDI inflows to developing countries and transition economies as a share of global FDI inflows exceeded the 50 per cent mark for the first time **(UBOS 2011)**.

The most profound effect has been seen in developing countries, where yearly foreign direct investment flows have increased from an average of less than \$10 billion in the 1970's to a yearly average of less than \$20 billion in the 1980's, to explode in the 1990s from \$26.7 billion in 1990 to \$179 billion in 1998 and \$208 billion in 1999 and now comprise a large portion internationalization of production in a range of industries, FDI into developed countries rose to \$636 billion, from \$481 billion in 2008 **(UNCTAD, 2008)**.

To reverse the downward trend in FDI inflows, the NRM government undertook steps to provide Uganda as an investment location. These efforts have included, at the macroeconomic level, wide ranging economic policy reforms such as foreign exchange rates reforms. Other measures have included the liberalization of existing frameworks, the simplification of administrative procedures applicable to investors, the conclusion of bilateral investment protection and promotion treaties and accession to various multilateral treaties facilitating FDI flows. **(African Development Bank 2001)**

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

A survey of actual and potential foreign investors shows that reform of regulatory and incentive environment has made Uganda more attractive to investors than many African

countries. The Heritage Foundation (a research center) of Washington DC in its December 1996 Report, 'Index of Economic Freedom', published in the Wall Street Journal, ranked Uganda as number 64 out of 150 countries.

Between 1993/94 and 1994/95, private sector investment increased from 5.6 per cent to 9.1 per cent of GDP. Actual investment figures are taken as 38 per cent of proposed Investment (**UIA 1993**). The sources of inward foreign investment coming into Uganda do not reflect the traditional domination of large Western multinational Corporations (MNCs).

### **Economic growth**

There are so many methods of measuring economic growth that is; Gross National Product, Gross Domestic Product, Net National Product among others but for this case the study adopted measuring economic growth in term of Gross Domestic Product since it is more reliable. **Gross Domestic Product** :According to **UBOS (2012)** Gross Domestic Product (GDP) as the total value of goods and services produced within the economic territory of the country, **Jeff Holt (2007)** defined Gross domestic product as the total market value of all final goods and services produced annually within the boundaries of the country whether by national or foreigner supplied resources. This was measured in billion US dollar.

### **Foreign Direct Investment**

Foreign Direct Investment (FDI) is composed of a flow of capital, expertise, and technology into the host country. Formally, it is defined as "an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor" (**IMF, 1993**), **UBOS (2000)** defined Foreign Direct Investment as the flow of technology for the developed country to the developing countries. This study adopted the IMF definition and it will be measured in billion of US dollar

## **1.2 Problem statement**

Policy makers believed that FDI produces positive effects on most economies; some of these benefits are in the form of externalities and the adoption of foreign technology. Externalities here can be in the form of licensing agreement, imitation, employee training and introduction of new processes by the foreign firms (**Alfaro, 2006**).

According to **Tang, Selvanathan (2008)**, multinational enterprises (MNEs) diffuse technology and management knows industries, economic rents are created accruing to old technologies and traditional management styles. The highly beneficial to the recipient country. In addition, FDI helps in bridging the capital shortage gap and complement domestic investment especially when resources are limited (**Noorzoy, 1979**)

From the above, it is obvious that there is a relationship between FDI and economic growth or development and FDI has positive effect on economic growth or development of most developing countries. Do these FDIs actually contribute to economic growth in Uganda; this becomes the reason for conducting this study so as to know the effect (positive or negative) of FDI on economic growth in Uganda.

## **1.3 Purpose of the Study**

The purpose of the study was to investigate the relationship between economic growth measured in term of Gross Domestic Product (GDP) and Foreign Direct Investment within a period of ten years (2002 to 2011).

## **1.4 Research objectives**

1. To establish the trend of Foreign Direct Investment in Uganda (2002-2011)
2. To establish the trend of Economic growth in Uganda (2002-2011)
3. To investigate the relationship between Foreign Direct Investment and Economic growth in Uganda (2002-2011)

## **1.5 Research Questions**

1. What is the level of trend of Foreign Direct Investment in Uganda?
2. What is the level of trend of Economic growth in Uganda?
3. What is the relationship between Foreign Direct Investment and Economic growth in Uganda?

## **1.6 Hypothesis of the study**

Ho: There is no significant relationship between Foreign Direct Investment and Economic growth in Uganda (2002-2011)

## **1.7 Scope of the study**

### **1.7.1 Content scope**

The study focused on the establishment of the trend of Foreign Direct Investment in Uganda (2002-2011), the trend of Economic growths in Uganda (2002-2011) and on the relationship between Foreign Direct Investment and Economic growth in Uganda (2002-2011).

### **1.7.2 Geographical Scope**

The study was conducted in Uganda. Uganda is among the developing economies in the East African region. The country's population is estimated to be approximately 34,612,250 as of July 2011(**CIA, 2011**). It borders Southern Sudan to the north, Kenya to the East, Tanzania to the South-East, Rwanda to the South-West and the Democratic republic of Congo to the West. The country was a former British colony, but gained independence in 1962. Uganda has struggled with civil wars and political conflicts the last four decades since independence and this has had a negatively impact on the economy. Nevertheless, the country has experienced a relatively high economic growth in the last decade, but it is estimated that 35 % of the population live below the poverty line (**CIA, 2011**).

### **1.7.3 The theoretical scope**

The study was guided by the cost of capital theory (**Forgha 2009**), which states that some factors (rate of return on investment, higher productivity) that determine the inflow of foreign direct investment into developing countries.

### **1.7. 4 Time scope**

The study was conducted for five month ,three months was for proposal and the two months was for data analysis and discussion and it reviewed the ten-years time series data that is, from 2002-2011 in Uganda.

### **1.8 Significance of the Study**

This research is significant to the following stakeholders;

The government/policy makers; the government will base on the findings of the study to formulate and implement Foreign Direct Investment policies; this can be platform for the sustained economic growth and development.

The study will be useful to academia .Especially researchers who may be interested in carrying out empirical studies on Foreign Direct Investment and Economic growth in Uganda

The study is relevant to an individual because he/she will be in position to understand how foreign Direct Investment leads to economic growth



## **1.9 Operational definitions**

### **Economic growth**

Economic growth is the quantitative increase in the national income or increase in percapita income of a country from one period to another (i.e. increase in the volume of goods and services produced over the two periods). It also implies the persistent increase in the volume or quantity of goods and services produced by an economy and it was measured as billions of US dollar.

### **Foreign Direct Investment**

In a broad sense, Foreign Direct Investment (FDI) is composed of a flow of capital, expertise, and technology into the host country. Foreign Direct Investment can also be the flow of technology for the developed country to the developing countries. In other words; FDI are the enterprises set up by the foreign investors in the recipient country and the government has little influence on it, and it was measured in billions of US dollar

## CHAPTER TWO

### LITERATURE REVIEW

#### Concept, Ideas, Opinion from Authors/Expert

#### 2.1 Foreign Direct Investment

Foreign Direct Investment (FDI) is composed of a flow of capital, expertise, and technology into the host country. Formally, it is defined as "an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor" (IMF, 1993). Interested researchers, countries, and international organizations have increasingly recognized importance of foreign capital to growth. In our dynamic age of privatization, liberalization, and globalization, FDI has emerged as an important form of international capital flow. Recognizing the importance of investment with no borders, the World Bank has devoted its 2005 issue of "World Development Report" to the issue of trade and investment, discussing in detail the Importance of foreign capital flow to the economies of the host countries. According to the World Bank, "few countries have grown without being open to trade

#### 2.2 Economic growth

**Gross Domestic Product (GDP)** represents the total market value of the nation's annual final product, or output, produced per year by factors of production within national borders. Hence, it is the market value of final goods and services produced in an economy during a year. (Roger et al 2000). Gross domestic product is the market value of final goods and services produced by the resources located in one country regardless of who owns the resources, in that country (Jeff Holt 2007) GDP growth was measured in billion of US dollars.

The overall economic performance of Uganda as measured by Gross Domestic Product (GDP) for the fiscal year 2011/12 reflects a lower growth rate compared to 2010/11. In the fiscal year 2011/12, the preliminary real GDP at market price grew by 3.2 percent compared to the 6.7 percent growth registered in 2010/11. This, therefore, indicates a

slow down growth of 3.5 percentage points of the economy between the two fiscal years. Nominal Per Capita GDP increased by 21.3 percent from 1,206,866 Uganda Shillings in 2010/11 to 1,463,961 Uganda Shillings in 2011/12(**UBOS 2012**).

Uganda has experienced strong economic growth over the past decade. Real GDP at market prices has averaged 6.7 percent per annum since 1990/1991. Recently concern have been raised that growth has slowed slightly over five years, as the average growth rate between 1998/99 and 2002/03 was 6.1 percent per annum, as compared to 6.8 percent between 1997/98 was boosted by three years exceptionally strong growth in the early 1990s, which was driven by reforms implemented in the first half of 1990s and coffee boom (**MoFPED 2004**). The determinants of growth in Uganda during the 1990s have been identified as improved security ,the restoration of macroeconomic stability, the removal of economic distortions and the improvement in the terms of trade, as a result of the mid-nineties coffee price boom. Growth productivity, meaning the efficiency with capital and labor are used, made a significance contribution to GDP growth during the 1990s, reflecting the scale of rehabilitation of production processes after the restoration of peace to most of the country (**MoFPED 2004**).

### **2.3 The relationship between Foreign Direct Investment and Economic Growth.**

According to the proponents of Foreign Direct Investment, the higher amount of foreign investment a country can attract the bigger portion it can take from global production and income, therefore; its national wealth can increase (**Gürak, s.2003**).

The neoclassical growth model, Foreign Direct Investments causes medium-term temporary increases in economic growth in the countries where investments are made through increasing the amount of investment and its efficiency. On the other hand, new endogenous growth theories focus on the long-term growth as a function of technological processes. Therefore; they claim that Foreign Direct Investments can

continuously increase growth rate through technology transfer and spillover effects. **Nair-Reichert and Weinhold, (200, pp.154).**

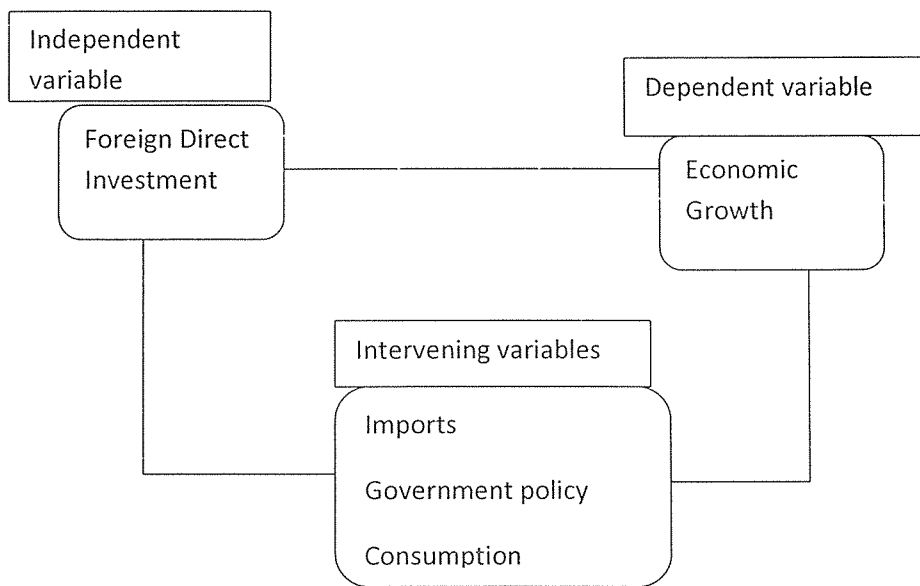
Foreign direct investment (FDI) and trade are often seen as important catalysts for economic growth in the developing countries. FDI is an important vehicle of technology transfer from developed countries to developing countries. FDI also stimulates domestic investment and facilitates improvements in human capital and institutions in the host countries. International trade is also known to be an instrument of economic growth **(Frankel and Romer)**. Trade facilitates more efficient production of goods and services by shifting production to countries that have comparative advantage in producing them.

Even though past studies show that FDI and trade have a positive impact on economic Growth, the size of such impact may vary across countries depending on the level of human capital, domestic investment, infrastructure, macroeconomic stability, and trade policies.

## 2.4 Conceptual Frame Work

The conceptual framework depicts the model of Foreign Direct Investment and Gross Domestic Product (GDP) growth.

**Figure 1: The conceptual framework of Foreign Direct Investment and real GDP growth**



**Source: Researcher (2014)**

The conceptual frame works indicate the contribution of Foreign Direct Investment to Economic growth. It also portrays others factors apart from Foreign Direct Investment which promote economics growths and these, are government policy, Foreign Direct Investment, consumption among others.

## 2.5 Theoretical Literature

In an attempt to capture the true insight of the place of FDI in Uganda's economic performance, it is pertinent and critical to look at some of the theories associated with FDI. These theories of Capital Theory, Theory of the Firm, Product Cycle Theory, External Capital Requirement Theory (ECRT), and Two-Gap Model (2GM).

Capital Arbitrage or the Cost of Capital Theory is linked to international trade. If foreign investors move their capital resources in response to changes in rates of returns on investment. By this, capital is expected to flow from a capital surplus to a capital deficit country in response to a higher productive of capital until the rates of returns are equalized. This theory also sees the existence of foreign direct investment from the ground that investing enterprise has management skill or technological advantage, which it can exploit in the foreign economies (**Forgha, 2009**). This theory states some of the factors (rates of return on investment, higher productivity) that determine the inflow of foreign direct investment into developing countries.

The second theory under consideration is the Theory of the Firm. It assumes perfect market condition and also postulates that transactional corporations invest abroad when their investments at home have reached an optimal level whereby further investments are likely to suffer from diminishing returns to scale. Here, I expected that the desire to add to the existing plants would expand output as long as there exists a profitable future market for the products. Therefore, FDI is a function of market factors and marginal efficiency of capital (**Forgha, 2009**). Therefore, this theory makes it clear that foreign entrepreneurs invest in developing countries in order to expand their scale of production and to enjoy economies of scale and huge profit.

Next is the Product Cycle Theory. This theory propounded by **Raymond and Vernon (1966)**, **Hirsch (1967)** explains that the early life of a product, innovations tend to be centered in a richer industrialized country and later extends to other countries. **Vernon (1966)**, further argued that once a product has evolved in a standard form competing

products have been developed, the firm might decide to expand its production frontiers overseas. The resulting expansion tends to capture lower cost locations and new markets in form of exports. This theory also sees investment innovation in three phases. Phase one, called the innovative stage. Here, firms are located in the most advanced industrial countries. Phase two; called the maturing or process development stage where manufacturing process keeps improving. Here, similar firms arise producing the same product in other industrially advanced economies due to increase foreign demand for such product. The third phase called the mature or standardization phase allows for the installation of plant and machineries for production in LDCs. Therefore, based on the above, the product cycle theory provides a useful point of departure for the causes of international investment in the form of foreign direct investment (FDI).

The fourth theory is the External Capital Requirement Theory (ECRT). This theory the extent to which foreign direct investment can be substituted for other forms of capital inflow differs amongst countries. These differences could be accounted for by variations in their economic structure, which comprises attractiveness to foreign investors as well as diversity in the existing macroeconomic causes of the need for these capital inflows. That is to say, larger countries that are better endowed in resources and possess a dynamic industrial sector have the privilege to substitute foreign borrowing from international financial market for FDI. FDI is also attracted into countries having existing international corporations affiliate; the theory further explains that countries having small internal market, relatively under potentials may have difficulties in attracting FDI in substantial magnitude into their economies irrespective of any existing incentive schemes.

The Two-Gap Model (2GM) is the fifth theory. This model expands out of the adaptation of Harrod-Domar growth hypothesis to the open economy by planners, is interested in exports, Foreign Direct Investment, savings, investment and foreign aid. This two-gap comprises of the foreign exchange gap and the domestic saving. **Hollis (1968)** occur that domestic savings and foreign exchange gaps are separate and have independent

constraints towards achieving growth in the LDCs. To fill these gaps, **Chenery (1966)** sees its expedients to source for foreign aid in order to achieve the economy's target growth rate.



## 2.6 Related studies.

**Baharumshah and Thanoon (2006)** used a dynamic panel model to examine the link between FDI and growth in East Asian economies. They demonstrated that FDI positively contributes in the process of growth in studied countries. In other words, this study has argued that countries that are successful in attracting FDI can grow faster than those that deter FDI.

**Nair-Reichert and Weinhold, (200, pp.154).** In their study, **Borenzstein et al. (1998)** has made a regression analysis which includes 69 developing countries and the data covering 1970-1979 fiscal years. The study in which endogenous growth model is used shows that technological development is very Foreign Direct Investment for the economic growth of developing countries and Foreign Direct Investment affects economic growth positively.

**Borenzstein, De Gregorio and Lee,(1998, pp.115-135).** **De Mello**, in his study conducted in 1999 through time-series analysis and panel data analysis, predicted the effects of Foreign Direct Investment on Muharrem AFŞAR capital accumulation and the increase in the amount of GDP in taking countries.

Ericsson and Irandoust calculated the cause and effect relationships between FDI and economic growth by using the data collected from four OECD countries (Denmark, Finland, Norway and Sweden) in 2001. The researchers failed to find a causality relationship for Denmark and Finland and they claimed that the reason for this was the unique dynamics and nature of FDI in these countries. **Ericsson, J. and Irandoust,( 2001, s.122-132).**

Regarding the relationship between FDI and GDP, Chakraborty and Basu conducted a study in which they calculated the causality between FDI and the increase in production. The results of the study, which is based on annual data between 1974 and

1996 fiscal years, showed the presence of causality from FDI to GDP rather than from GDP to FDI. **Chakraborty and Basu, (2002, pp.1065).**

Liu, Burridge, and Sinclair, in 2002, predicted a longitudinal relationship between FDI, trade and the economic growth in China. By using the data for 1981-1997 fiscal years, they found a two-way relationship between FDI, economic growth and Foreign Direct Investment. **Liu, Burridge and Sinclair, (2002, pp.1431-1440)** Similarly, Wang tried to explore which types of FDIs contribute economic growth considerably. Within the context of the study, he used the data between 1987-1997 fiscal years from 12 Asian countries and suggested that manufacturing FDIs have positive effect on economic growth and this positive effect is due to spillover effect of FDIs **Wang (2002).**

**Makki and Somwaru** in their study used the data from 66 countries classified in three decades (1971-80, 1981-90, and 1991-2000). This study was an extended replication of **Borenzstein's (1998)** analysis in a way to include 1990s as well. The results showed no significant differences between these two empirical studies. It has been found that FDIs affect economic growth to a large extent together with foreign trade, human capital and domestic capital and, finally, FDI has direct or indirect positive effects on economic growth.

**Makki and Somwaru, (2004, pp.795-801).** **Frenkel, Funke and Stadtmann, (2004, pp.281-300)** examined the mutual effects of pushing and pulling factors in developed countries with FDI outflows and developing countries with FDI inflows. 22 countries and 1990-2002 fiscal year data was used in this study and it was found that as the GDP increase rate is getting higher in developing countries with FDI inflows, FDI volume is also increasing.

The empirical evidence showing the causality between FDI and economic growth does not seem to be invalid for some countries. One of the studies on this issue was conducted by Joseph Magnus Frimpong and Eric FosuOteng- Abayie in 2006, who examined the causality between FDI and economic growth in Ghana based on the data

covering 1970-2002 fiscal years. Causality test done for two different periods (1970-1983 and 1984-2002) produced conflicting results for the periods mentioned.

**Frimpong and Oteng-Abayie (2006)**

**Rodriguez and Rodrik (2001) and Rodrik, Subramnian, and Trebbi (2002)**

show that omitted institutional variables may have exaggerated trade's strong showing in many empirical growth regressions. Nevertheless, the wide range of empirical studies that find a positive correlation between trade and growth, combined with the lack of any evidence that would suggest that trade hinders economic growth, has led most economists to accept that, *ceteris paribus*, international trade is good for growth.

**Romer (1993)** emphasized FDI's role in diffusing technology and its relationship to economic growth: "...for the poorest developing nations, letting multinational firms profit from the international transmission of ideas is the quickest and most reliable way to reduce the idea gaps that keep them poor."<sup>2</sup> More fundamentally, FDI's potential role in the growth process as a diffuser of technology is supported by Solow's (1956) growth model and Easterly and Levine (2001) and Caselli's (2004) empirical evidence, which show that long term economic growth is driven by technological progress and not just factor accumulation.

Not all empirical evidence supports the hypothesis that FDI plays a positive role in diffusing technology and stimulating economic growth, however. **Haddad and Harrison (1993)** studied Morocco, **Aitken and Harrison (1999)** studied Venezuela, **Djankov and Hoekman (2000)** analyzed data for the Czech Republic, and **Konings (2001)** examined Poland and Bulgaria, and all these studies failed to find technology spillovers from FDI. **Rodrik (1999)** wrote that: "today's policy literature is filled with extravagant claims about positive spillovers from FDI but the evidence is sobering."

Human capital is not the only determinant of countries' varying capacities for absorbing technology. **Balasubramanyam, Salisu, and Sapsford (1996)** found that the size of FDI's technology spillovers depends critically on whether domestic firms are protected from Foreign Direct Investment competition. **Pattillo, Poirson, and Ricci (2002)** found that macroeconomic stability is critical to attracting FDI. **Smarzynska (2000)** presented evidence suggesting that firms with leading technologies prefer wholly-owned overseas subsidiaries to joint ventures; she therefore concluded that regulations on foreign ownership shares affect technology transfers.

Studies conducted by **Njimah (2009)** and **Adeolu (2007)** have shown a positive relationship between foreign direct investment and economic growth. **Chenery and Strout (1966)** observed that most countries before 1966 were able to achieve economic transformation by clamoring for foreign aid and foreign debt. To them, to achieve accelerated growth, countries must improve in the areas of skills, domestic savings and foreign exchange earnings. However, since in most developing countries the savings rate is low, to overcome poor growth and development, they see foreign aid as the only source of their economic transformation. **Hans (1948), Nurske (1953), Olaniyi (1995)** and **Singer (1949)**, identified capital insufficiency as one of the causes of Less Developed Countries (LDCs) low income. To them, the LDCs suffer from vicious cycle of low production and insufficient tools and equipment among other things, which helps to accelerate their low productivity. The resulting situation as argued by singer (1994) is mass poverty

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Research Design.**

A time series analysis was adopted, and the use of quantitative techniques to analyze secondary data scientifically to critically conclude the research objectives, secondary data was collected from different ministries, some quantification will be necessary because of the need to tabulate data and use of statistical techniques to arrive at a dependable conclusion. Also inferences were drawn by fitting the regression model and testing for its significance using the t-statistics. The researcher also correlated the two variables and tested for significance of the Pearson's correlation coefficient of determination on Foreign Direct Investment and Economic growth in Uganda for thirteen years (2002-2011).

#### **3.2 Research Population**

The researcher took ten years time series of study that is, from 2002-2011, the population became ten

#### **3.3 Sampling Technique**

The sampling technique was judgment sampling for data collection for ten years (2002-2011). The choice of the period of reference is significant because Foreign Direct Investment constitutes the matter of serious policy consideration; this period encompasses the major landmarks in our economy.

#### **3.4 Research Instrument.**

The Record sheet was used to enter the yearly data on Foreign Direct Investment and Economic growth in Uganda for thirteen years that is from 2002-2011.

#### **3.5 Data Gathering Procedure and Source**

After the proposal was approved, the researcher got an introductory letter from the Department of Economic and Applied Statistics of Kampala International University, which introduced her to the respective ministries and they were informed by the

researcher on area of interest of data to be collected. Data collection was done by skilled research assistants under close supervision of the researcher to ensure that all the information required are collected.

The domestic sources are the annual and quarterly bulletin of the Bank of Uganda, Uganda Bureau of Statistic, the Ministry of Finance Planning and Economic Development, IMF's, International Financial Statistics, World Bank and United Bank of Africa . The data was entered into the record sheet and compiled; this was used to analyze the relationship Foreign Direct Investment and Economic growth with the help of computer -statistical package

### 3.6 Time Series Data Analysis

This was analyzed with the help of Ms. excel and , STATA packages was used to derive descriptive statistics and accompanying table, diagrams and graphs were also relevant for the study prior to the estimation of the regression line ,descriptive analysis was also conducted to describe the behaviors of the individual variable over the duration of the study by plotting each variable against time ,it included testing for significant correlation coefficient between the dependence and independence variables.

The following formulae and computational formula were used.

The correlation is given by

$$r = \frac{n \sum xy - \sum x \sum y}{\sqrt{(n \sum x^2 - (\sum x)^2)((n \sum y^2 - (\sum y)^2))}}$$

The  $t_c$  compute will be

$$t_c = \frac{r\sqrt{n-2}}{\sqrt{1-r^2}}$$

Reject  $H_0$  if  $t_c \geq t_{\alpha}$  at 0.05 level of significance

### **The Simple Linear Regression Model.**

Economic growth =  $\alpha + \beta_0$  (Foreign Direct Investment) +  $e_i$

$$Y = \alpha + \beta_0 X_0 + e_i$$

Where y: Economic growth

$\alpha$ : The Economic growth without Foreign Direct Investment

$\beta_0$ : The rate of change Economic growth to Foreign Direct Investment

$x_0$ : Foreign Direct Investment

### **3.7 Limitations of the Study**

In Uganda, evaluating the quality of data, there is no adequate, consistent data in domestic sources. For example, there is a discrepancy of Economic growth data reported by IFS yearbook and the current Ministry of Finance and Economic Planning. One of problems in data collection is that different sources use different calendar year. Since it is difficult to compare different calendar year data, effort was made to convert data from different calendar years into the same calendar year.

The limitations of model used here are that it assumes the volume of Foreign Direct Investment was determined by an explicit optimization problem. Furthermore, it assumes that the long run level of international reserves is positively related to the long run Foreign Direct Investment level; it also assumes that the current level of foreign exchange receipts is a proxy for the long run level. Therefore, the data collected will be representative enough to enable the researcher to draw general conclusions.

## CHAPTER FOUR

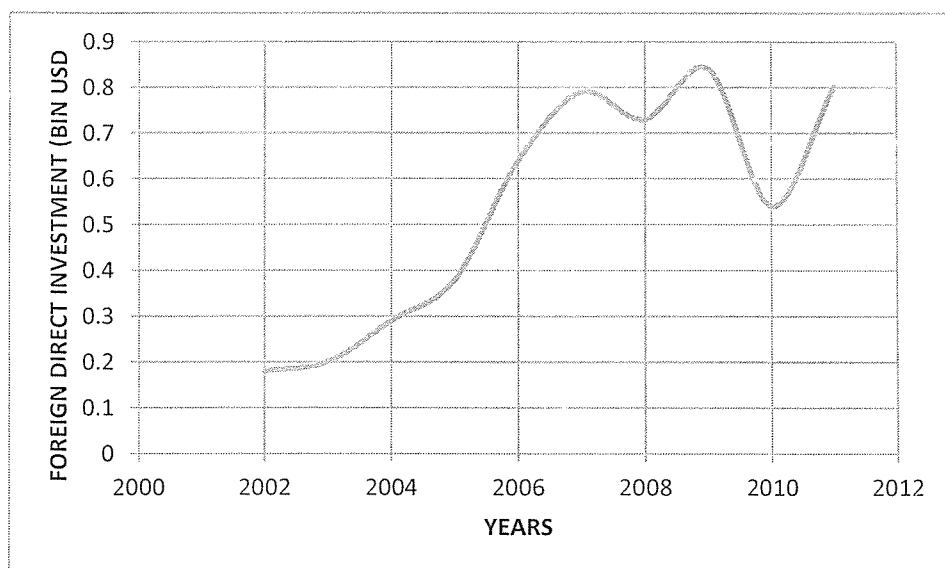
### PRESENTATION, ANALYSIS AND INTERPRETATION OF DATA

Data was presented using figure, graphs based on the research objectives and the corresponding research questions, testing the hypothesis and for implication of the findings. (i) To establish the trend of Foreign Direct Investment in Uganda (2002-2011), (ii) To establish the trend of Economic Growth in Uganda (2002-2011), (iii) To investigate the relationship between Foreign Direct Investment and GDP growth in Uganda (2002-2011).

#### 4.1 The Trend of the Foreign Direct Investment of Uganda (1995-2011)

Objective one was to show the trend of Foreign Direct Investment in Uganda (2002-2011). Under this; the researcher used the line graph as can be seen below.

**Figure 2: Trend of the Foreign Direct Investment of Uganda (2002-2011)**



**Source: Researcher (2014)**



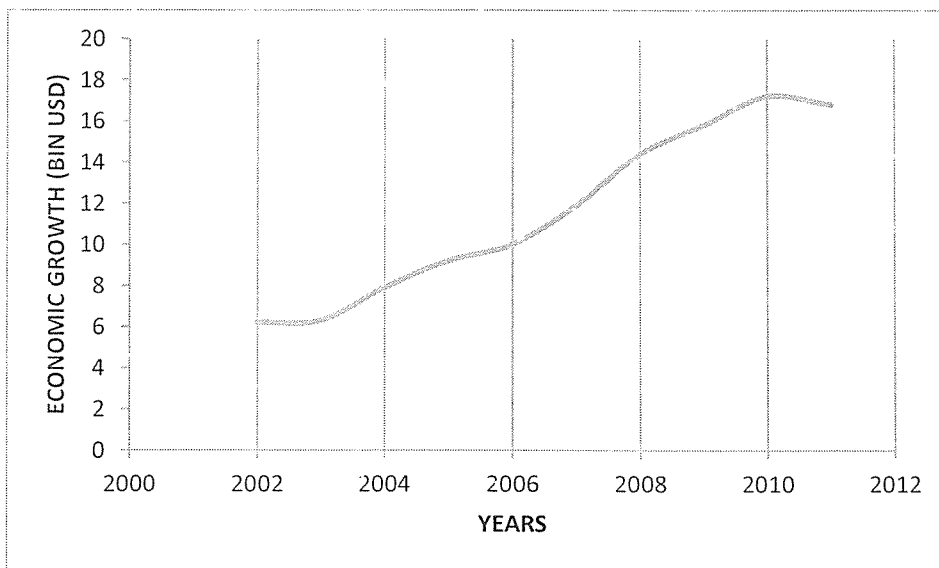
Foreign direct investment has shown a steady increase in period under study, for 1999 to 2007 there has been a general increase then there has been a cyclic fluctuation from 2007 to 2011, .an increase is as result of favorable condition which encourages investor in the country and fluctuation is as result of unfavorable condition such as high tariff, political instability among others.

The fitted regression model is **Foreign Direct Investment = -0.0046 + 0.0648(time)**, indicating that a when time is zero, investment is reduced by 0.0046 (billion USD) and a unit change in time by One year lead to FDI by 0.0648(billion USD). The percentage change of FDI for the period under study is 82.5 percent.

#### 4.2 The trend of the Economic growth in Uganda (2002-2011)

Objective two was to show the level of trend of Economic growth in Uganda. Under this, the researcher used line graph as can be seen below.

**Figure 3: Trend of Economic growth in Uganda (2002-2011)**



**Source: Researcher (2014)**

There is general increase in the Economic growth in Uganda ,in 2002 up 2010 ,a steady growth then it fluctuated in 2010.This could be due to other variable which

influence GDP growth in Uganda but it has been omitted. The percentage change of Economic growth for 1999 and 2011 has been 64.29 percentages. The regression model is  **$GDP=2.6808+1.0863(\text{time})$** . This indicates that when time is zero GDP is 2.6808 billion us dollar, Also a unit change in time by one year lead to an increment in GDP growth by 1.0863 billion US dollar

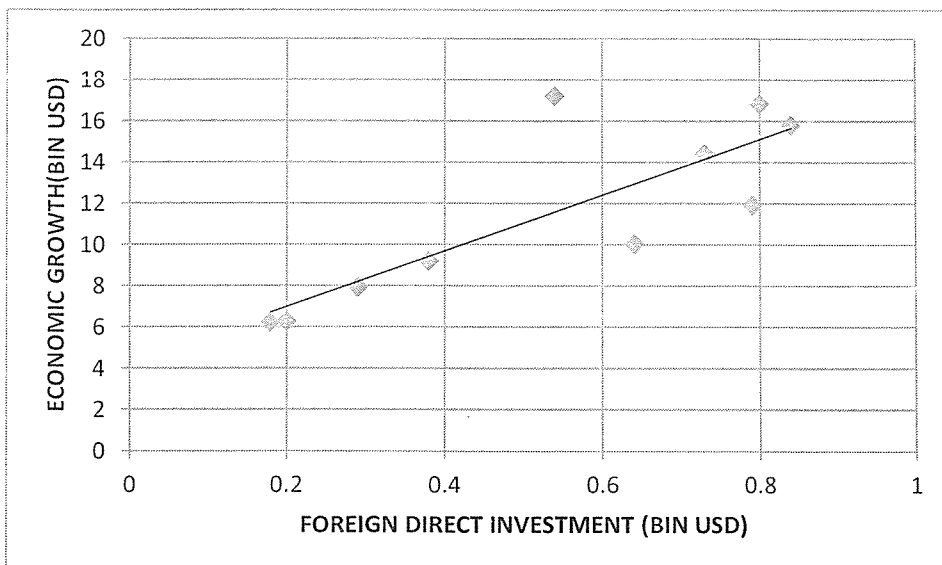
### 4.3 The relationship between Foreign Direct Investment and Economic growth in Uganda (2002-2011)

Objective three was to investigate the relationship between FDI and GDP growth in Uganda, the researcher used scatter plot graph, correlation analysis, regression analysis as can be seen observed.

#### A scatter plot of Foreign Direct Investment against Economic growth in Uganda (1995-2011)

To show the relationship between Foreign Direct Investment and Gross Domestic Product in Uganda, the researcher used scatter plot as can be seen below.

**Figure 4: A scatter plot of Foreign Direct Investment and Gross Domestic Product (GDP) in Uganda**



**Source: Researcher (2013)**

Most of the points are closed to the fitted trend this implies there is a normal distribution between Foreign Direct Investment and GDP growth in Uganda, some of the points, which are far apart, is due to the other variable, which has been omitted. This indicates that a strong relationship between Foreign Direct Investment and GDP growth.

#### **4.3.1 Correlations analysis of Foreign Direct Investment and GDP growth of Uganda**

The researcher used Pearson’s correlation coefficient to establish the strength of relationship between Foreign Direct Investment and GDP growth in Uganda.

**Table 1: Correlation of FDI and Economic growth in Uganda (0.05)**

Variable correlate	R-Value	r <sup>2</sup>	Sign-value	Interpretation	Decision
<b>Foreign Direct Investment</b> verse Economic growth	0.8202	0.751	0.004	There is a relationship	Reject the null hypothesis

**Source: Researcher (2013)**

There is a strong positive correlation between **Foreign Direct Investment** and GDP growth as can be seen from **table 1** above ( $r=0.8202$ ) the strength of relationship between **Foreign Direct Investment** and GDP growth is determined by the coefficient of determination ( $r^2=0.751$ ). This implies that the variation in GDP growth explained by **Foreign Direct Investment** is 75.1 percent mean while **24.9 percent** is explained by other variables, this reveal that the relationship between these two variables is too strong.

### 4.3.2 Regression analysis of Foreign Direct Investment s and GDP growth in Uganda.

To establish this relationship the researcher used bivariate linear regression analysis as can be seen in the table below.

**Table 2: Regression of Foreign Direct Investment and GDP growth in Uganda (0.05)**

Variable represented	Adj. R <sup>2</sup>	F-Value	Sign-value	Interpretation	Decision
FDI and GDP	0.6319	16.45	<b>0.0037</b>	There is a relationship	Reject accept H <sub>0</sub>
Coefficient	Beta	T	Sign-value	Interpretation	Decision
Constants	4.274992	2.16	<b>0.062</b>	There is no relationship	Accept H <sub>0</sub>
FDI	13.53434	4.06	0.004	There is a relationship	Reject the null hypothesis

**Source: Researcher (2013)**

The researcher fitted the regression model using the information from **table 2** above and this is represented by;

$$\text{Economic growth} = \alpha + \beta (\text{Foreign Direct Investment})$$

The fitted model becomes

$$\text{Economic growth} = 4.274992 + 13.53434 (\text{Foreign Direct Investment})$$

This implies that GDP growth without **Foreign Direct Investment** result into **4.274992** (billion US dollars) and a unit change in Foreign Direct Investment lead to an increase of GDP growth by **13.53434** (billion US dollars).

$$t(0.025,9)=2.13$$

The slope  $t_1=13.8$ , the decision rule if  $|t| \leq t_{\alpha}$ , accept  $H_0, \alpha = 0.05$  level of significant, since  $t_1=13.8$  is greater than  $t_{\alpha} = 2.13$ . We reject  $H_0$  which states that **Foreign Direct Investment** is not part of the model and conclude that there is a relationship between **Foreign Direct Investment** and GDP growth in Uganda for the period under studied and other factors remain constant.

## CHAPTER FIVE

### DISCUSSION, SUMMARY, CONCLUSION AND RECOMMENDATION

#### 5.1 DISCUSSION

##### **The Trend of Foreign Direct Investment in Uganda**

There is a general increase in the Foreign Direct Investment of Uganda over that ten years (2002-2011), this has been because Uganda which is still a developing country depend highly on Investment in to sustain her economy.

The other factors which might have led to the general rise in Foreign Direct Investment is the exchange rate, the higher the exchange rate the higher will be the level Investment, favorable policy toward investment.

##### **The Trend of Economic Growth in Uganda**

There has been a general increase Economic growth in Uganda over the period under study that is (2002-2011), an increase in the Economic growth is due to foreign Direct Investment which lead to setting up of industries hence promotion economic growth other factors which lead to economic growth apart from Foreign Direct Investment are highly level of technology, favorable government policy, and revenue which are healthy for economic growth, high earning from export leads injection into the country, technology lead high production of goods in quantity and quality which enable to promote trade ,favorable government policy that encourage Foreign Direct Investment lead to country's development, mean while taxation lead to generate revenue to the country which can be invested and we know that investment leads to economic growth.

##### **The Relationship between Foreign Direct Investment GDP growth in Uganda**

The relationship between Foreign Direct Investment and GDP growth has been significant relationship according to the fitted line and regression analysis, correlation, the use of parametric test , were performed there has been a strong positive relationship between Foreign Direct Investments and GDP growth ( $r=0.8202$  ), The

study has confirmed Njimah et al (2009) , Makii et al (2004) and Borezstein (1999) showed that Foreign Direct Investment of has a positive influential effect on economic growth . Burrige et al (2002) study the relationship between Foreign Direct Investment and GDP Growth in Ghana using OLS and found GDP has a positive significant effect on Foreign Direct Investment of which this study has confirmed of Ugandan case since is amongst the developing countries like . Other variables which have played a key role in economic growth are export, technology, government policy and others.

### **5.1. Summary of Findings**

The main objective of this study was to investigate the relationship between Foreign Direct Investment and Economic growth in Uganda. For the relationship between Foreign Direct Investments and Economic growth, the probability of the t-distribution was used based on a simple linear regression model at **0.05** level of significance. The dependent variable and the independent variables were found be normally distributed. Implying significant relationship between the two variables

### **5.3 Conclusion.**

This study has established the trend of Foreign Direct Investment in Uganda(2002-2011) and found a general increase over the period under studied, it has established the trend of Economic growth in Uganda (2002-2011) and found cyclic fluctuation due to other factors which determine GDP growth a parts from Foreign Direct Investment, the study has also investigated relationship between Foreign Direct Investment and Economic growth in Uganda using correlation ,regression analysis with the test of hypothesis and found a positive relationship, for a country like Uganda .The study was guided by the cost of capital theory (**Forgha 2009**), which states that some factors (rate of return on investment, higher productivity) that determine the inflow of foreign direct investment into developing countries, the study has accepted the theory since Uganda cannot do without Investment.

## **5.4 Recommendation**

Ugandan economy which is still a developing country with low level of skilled labor, Foreign Direct Investments may lead to economic growth, therefore I would recommend the government to embark on industrialization, and modern technique of agricultural production since this area can employ large population resulting into high productivity hence economic growth.

The government should also embark on exportation of goods and services to ensure balance of favorable balance of payment this healthy to economy leading to economic growth.

## **5.5 Suggestions for Further Research**

The results presented in this report are very not conclusive and should be treated as being preliminary. Further analysis of the survey data (Foreign Direct Investment demand and GDP growth) needs to be done to validate these findings and provide greater confidence in explaining the changes in Foreign Direct Investment and GDP growth.

- 1) Inflation and money supply in Uganda
- 2) Education investment and Economic growth
- 3) Population growth and poverty reduction
- 4) Government expenditure and inflation rate.
- 5) Inflation and exchange rate.
- 6) Household investment and economic growth



## Regression analysis between Foreign Direct Investment and economic growth

Source	SS	df	MS	
Model	109.813549	1	109.813549	Number of obs = 10 F( 1, 8) = 16.45 Prob > F = 0.0037
Residual	53.4074507	8	6.67593134	R-squared = 0.6728 Adj R-squared = 0.6319
Total	163.221	9	18.1356667	Root MSE = 2.5838

GDP	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
FDI	13.53434	3.337067	4.06	0.004	5.839046 21.22963
_cons	4.274992	1.975561	2.16	0.062	-.280659 8.830643

. correlate gdpbinusd fdibinusd

(obs=10)

| GDP~d FDI~d

GDP | 1.0000

FDI | 0.8202 1.000

## APPENDIX 1

**Table 3: Data on Foreign Direct Investment and Economic growth of Uganda  
(000, 000, 000)**

Years	FDI(BIN USD)	GDP(BIN USD)
2002	0.18	6.2
2003	0.2	6.3
2004	0.29	7.9
2005	0.38	9.2
2006	0.64	10
2007	0.79	11.9
2008	0.73	14.4
2009	0.84	15.8
2010	0.54	17.2
2011	0.8	16.8

**Source: International Monetary Fund (IMF), Balance of payment Statistics  
Year book and data, World Bank (2012)**

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