DETERMINANTS OF CAPITAL FORMATION IN UGANDA:

(1984-2016)

DOES FOREIGN DIRECT INVESTMENT AND TRADE OPENNESS MATTER?

BY

MWESIGWA AZARIA KIBOMBO

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ABSTRACT

This research investigates the determinants of Capital formation in Uganda (1984-2016) using the Bounds Approach to Cointegration developed by Persaran and Shin (1999). Since Uganda registered its highest Annual Percentage Growth in Gross Capital formation of 45% in the 1990's at a time when it embraced trade liberalization as part of the World Bank and IMF supported Economic Recovery Programme (ERP), the study specifically sought to establish the influence of trade openness and the subsequent rise in foreign direct investments arising from it on capital formation.

Using data sourced from World Bank and International Monetary Fund, the study estimates an Autoregressive Distributed Lags (ARDL) Model with economic globalization as a proxy for trade openness and foreign direct investment being some of the exogenous variables. Estimation results indicated that, in the long-run, it is trade openness, foreign direct investments, level of savings and external debt that are the key determinants of capital formation. For the short run, its only external debt rather than trade openness and foreign direct investments that determine capital formation in Uganda. The study results indicate that it is vital for the Ugandan government to continue implementing policies on trade openness and economic globalization that attract foreign direct investment in Uganda in order to stimulate investment in the country.

Keywords: Capital formation, trade openness, economic globalization, economic growth, bounds testing.