Role of Private Capital Inflows in Financial Inclusion in Uganda

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Abstract

This paper provides an empirical analysis of the role of private capital inflows in financial inclusion in Uganda. Financial inclusion was measured using three dimensions (access, usage and quality). Whereas private capital inflows where measured using two proxies of foreign direct investment and remittances. The study anchored on financial intermediation theory with its three associated theories. The target population was private organisations that have received private capital in Uganda. The study used data which were collected from Bank of Uganda and Ugandan investment Authority, Ministry of Finance for the period 2012-2016. A cross sectional descriptive designs were used while data was analyzed using descriptive statistics and multivariate Logistics regression analysis. It was found that private capital inflows did not play any significant role in promoting financial inclusion in Uganda. The study recommends that government particularly Bank of Uganda, Ministry of Finance and Uganda Investment Authority to formulate policies which will attract more investors to Uganda hence boosting FDI. For worker remittances to be deepen and widened, the Ministry of Finance and Uganda Revenue Authority should remove costs associated with receipt of remittances in-country. This way an all-inclusive and stable financial sector in Uganda is ensured.

Keywords: Private Capital, Financial Inclusion, Inflows, Uganda.

Introduction

Private sources of capital have of recent become significant inflows in not only developing but developed economies as well. In some economies for instance Zambia, private sources of capital as a proportion of Gross Domestic Product (GDP) have reached about 75% as of 2007 end. Other economies notably in sub Saharan Africa specifically the following; Uganda, Tanzania, Cameroon, and of course Gambia, it is worthy to note that private capital reached 30% of the respective country's Gross Domestic Product. (Bhinda and Martin 2009).

On the other hand, however, like it is very well known, Private sources of Capital tend to a bit volatile. A financial shock can as such result in a sudden reversal of private capital inflows and together with a sharp decline in the inflows. It is most times assumed that Foreign Direct Investment when compared to equity portfolio investment, all of which are all sources of private capital inflows, equity is more stable and reliable and at the same time less volatile. This subsequently brings development in the form of access, usage and quality of financial services and products hence financial inclusion. This simply could be one of the many reasons why some of the developing economies have designed incentive packages to attract foreign capital in the form of foreign direct investment. Some financial experts assert that foreign direct investment does trigger technology spillovers and assists human resources formation, but it is also said to contribute to globalization in the form of international trade integration (OECD 2002).

It is also worth noting that efforts to promote and encourage private sources of capital have been solely predicated on key assumption that investments will have positive outcomes. It is argued that foreign direct investment as form of private capital do have some influence on growth by increasing total factor productivity and the efficiency of other resources in the recipient country. Beyond obvious economic benefits mentioned, foreign direct investment may as well help to improve the environmental including the social conditions in the host economy by transferring cleaner technologies in country and leading to socially responsible corporate policies and practices (OECD 2002). However, a few studies conducted have indeed questioned the growth and development benefits which are said to be associated with such flows of private capital. A few researchers have

indeed pointed out that the rates of foreign direct investment are poorly correlated with job creation and poverty reduction and even some other development outcomes. (UNCTAD 2005) supplemented by the reports from (Rodrik and Subramaniam 2008) and further reported by (Action Aid 2009) including (Bhinda & Martin 2009).

In summary, private capital with its various sources like foreign direct investment and remittances have indeed become significant sources of most investments in developing economies. This therefore, indicates the high degree to which most developing economies have become integrated into the global economy and thus how exposed these economies are to financial shocks. In some economies, foreign sources of capital are significantly supplanting domestic sources of capital as the main source of investments. Having noted the volatility which are associated with capital inflows, it is, therefore, hardly surprising to find that development and growth in these economies is as well highly volatile. any such volatility means that governments of those affected economies can scarcely predict how much capital is available to them in order to plan sustainable growth strategies.

Private capital to uganda

Vision 2040 is the government of Uganda's overarching national planning framework through which Government Ministries, Departments and Agencies plans to drive the aspiration of the economy to become an upper middle-income economy by the year 2040 with a Gross Domestic Product per capita of US$ 9,500. The key building blocks of the Vision 2040 consist of nine (9) opportunities and seven (7) fundamentals which requires not only public but as well private investments that addresses the core priorities needed for development of any country. The opportunities and fundaments do require strategic intentional public investments which will subsequently attract required private investment so as to attain the envisioned middle-income status and Targets of Vision 2040.

The Government of the Republic of Uganda has over time pursued a private sector–led development strategy for its transformation. This strategy is anchored on four (4) broad policies namely; the economic liberalization, the economic diversification, the economic industrialization and the economic integration. This development strategy has delivered not only economic expansion but also diversification in many areas over the last twenty years. This is can be seen and clearly evident in the changes in the structure of the country including trade and economic outcomes. Because of these changes, the complexity and dynamism of Uganda's economy has considerably increased; and the contribution of investment to development and growth has become more critical.

Government of Uganda's efforts to systematically address the challenges that impede any investment opportunities and the desired development outcomes are all reflected in a wide range of investment related policies including in laws and all institutional reforms. The reforms have so far yielded very significant investment feedback and results including sustained economic development and growth, poverty reduction, savings and investments, transformation in trade structure and a notable increase in the share of the development budget. The changes in the environment is duly characterized by the emergences of modern domestic and regional legislation in many areas especially those that complement the investment function, new institutional arrangements in public and private sector, advancements at the East African Community regional level to realize promotion of East African Community as a single investment destination in accordance with provisions under the Treaty establishing East African Community and of course a significant change in macroeconomic environment characterized by weak shilling, free movement of capital and growing nationalistic tendencies in management of global investments.

Uganda as a nation is currently implementing its second National Development Plan which covers the period 2015/16 to 2019/20. This plan is the second of six 5-year National Development Plans under Uganda Vision 2040. Through this plan, Government intends to drive Uganda's aspiration to a middle-income status by the year 2040 with a Gross Domestic Product per capita of US$ 9,500. The plan specifically aims to among others; strengthen the state of Uganda's competitiveness for sustainable wealth and creation, inclusive employment and growth which is planned to propel the economy and country to a lower-middle income status with a per capita income level of at least US$ 1,033 by the year 2020. Under this Vision 2040, Uganda as a country envisages to transform from a predominantly agricultural and peasantry to a competitive upper-middle income country.

Investment and its effective management are an imperative for the successful attainment of Vision 2040. GDP growth, which is a necessary condition for economic development, is derived from four components: household consumption expenditure; government consumption expenditure; net exports and investment. In the case of developing countries like Uganda with a historically large negative balance of trade (over 5 per cent of

GDP) and a limited share of tax revenue in GDP to drive public spending (14 per cent), household consumption expenditure and investment are generally the two major drivers of GDP growth. The low purchasing power of households in Uganda however means that investment is the primary lever available to Government for influencing change towards the high economic growth rates and structural transformation targeted in Vision 2040. Over the eight-year period preceding 2017 (2009 to 2016), the contribution of investment to GDP growth surpassed that of other components in all but two years (2010 and 2014).

Uganda was able to attain high growth rates in the early years of its economic recovery journey through a combination of increased investment and efficiency gains from economic reform. These efficiency gains waned in the NDP era leaving investment as the primary driver of the next wave of growth. It follows therefore that Uganda needs high and sustainable investment growth rates in the run up to 2040 to realize high and sustainable GDP growth rates. This calls for a well guided, coordinated and systemic approach to investment promotion and management by public sector actors, something which has been difficult to achieve without a dedicated policy framework.

Economic liberalization has led to increased participation of the private sector in the economy, while the economic integration agenda has seen the East African Community (EAC) and the Common Market for East and Southern Africa (COMESA) becoming Uganda's main export markets. The share of Uganda's exports to the EAC region has increased over the last decade, with the level of formal exports increasing by 49.4 percent, from $970.78 million in FY 2010/11 to $1,450.25 million in FY 2016/17. Government's economic diversification efforts have yielded an increased transformation of the structure of Uganda's exports. For instance, export earnings from coffee have declined from a high of over 90 per cent in the early 1990s to 18 per cent in FY 2015/16. Exports earnings from manufactured exports as a percentage of merchandise exports, on the other hand, grew from 2.4% in 1994 to 24.6 percent in 2015.

Also related to the investment function is the Micro, Small and Medium Enterprises (MSMEs) policy 2015, which aims to provide a framework for stimulating growth of sustainable MSMEs through enhanced business support service provision, access to finance, technical and business skills, and the creation of a conducive policy, legal and institutional framework. MSME's account for approximately 90 percent of the entire Private Sector, generating over 80 percent of manufactured output that contributes 20 percent of the gross domestic product (GDP). Furthermore, they employ over 2.5 million Ugandans and have been critical in fostering innovation and job creation in the country. Against this background, the National Investment Policy will provide a framework for streamlining investments in the country and spur product development and innovation to match changing industry needs.

Statement of the problem

Despite the remarkable benefits the Ugandan economy stands to get from private capital inflows and its known contribution to financial inclusion and standard of living of the people of Uganda, the problem arises as to what extent the Ugandan economy should depend on private capital to promote financial inclusion. The most critical challenge of poor but also developing countries in this 21st century, Uganda inclusive is over reliance on private sector as well as private capital inflows. With this heavy reliance on the private sector as well as private capital, the extend of financial inclusion is not very encouraging. This study, therefore, did investigate whether initiatives like private capital inflows is a means through which financial inclusion can be promoted and further examined the relationship between private capital and financial inclusion. The following research questions are, therefore stated. What is the level of private capital to Uganda? What is the relationship between private capital inflows and financial inclusion in Uganda?

The main objective of this study was to examine the role of private capital inflows in Financial Inclusion in Uganda. Specifically, the following objectives guided the study:

- Ascertain the level of Private capital inflows to Uganda
- Examine the relationship between private capital inflows and financial inclusion in Uganda

Furthermore, the study was guided by the following hypothesis: Ho1: The level of private capital inflows to Uganda are not significant. Ho2: There is no relationship between private capital inflows and financial inclusion in Uganda.

The remaining parts of this study are arranged as follows. Section two of the study presents literature review, section three presents the methodology whereas section four presents data and results as well as a discussion of the results. Section five presents conclusion and possible policy recommendations.

Literature review

Theoretical review

The theory of financial intermediation which analyses the role of financial intermediaries in the economy and is associated three theories namely; information problem, transaction costs and money regulation guided the study. This theory was started by (Gurley and Shaw, 1960).

The first theory of financial intermediation is the informational asymmetries argument. These asymmetries are of an ex ante nature, generating adverse selection, they can be interim, generating moral hazard, and they can be of an ex post nature, resulting in costly state verification including enforcement. The informational asymmetries issue generates market imperfections. These imperfections in the market leads to specific forms of transaction costs within the market. However, Financial intermediaries seem to overcome these transaction costs in a partial way.

(Diamond and Dybvig, 1983) do recognize that banks are seen as coalitions of several depositors that give households insurance against idiosyncratic shocks that adversely affect their liquidity position. Further, (Leland and Pyle, 1977) see financial intermediaries as information sharing coalitions. (Diamond, 1984) for instance demonstrate that intermediary coalitions do achieve significant economies of scale. Further, (Diamond, 1984) is equally of the view that financial intermediaries act as delegated monitors on behalf of ultimate savers. Monitoring will be viewed to involve increasing returns to scale, which therefore, implies that specialization may be an attractive way. Individual households will delegate the monitoring activity to such a specialist, who are financial intermediaries. The households will as such, put their cash and other deposits with the intermediary. Furthermore, depositors will positively value the intermediary's role and involvement in the ultimate investment (Hart, 1995). Also, they can be assigned a positive incentive effect for instance of short-term debt, and deposits, on bankers (Hart and Moore, 1995).

Researchers like (Qi, 1998), (Diamond and Rajan, 2001) all demonstrate that deposit finance creates incentives for bank's management. Liquid assets of the bank result in a fragile financial structure that is essential for disciplining the bank's management. Note that in the case of households that do not turn to intermediated finance but prefer direct finance, there is still a brokerage role for financial intermediaries notably among others investment banks (Baron, 1979 and 1982). Based on this, the reputational effect is equally at stake. In financing, it is important to note that the reputation of both the borrower and the financier are relevant (Hart and Moore, 1998). Furthermore, (Dinç, 2001) studies the effects of financial market competition on bank's reputation and argues that the incentive for the bank to keep its commitment is derived from its reputation, as well as the number of banks in competition including their reputation, and the competition arising from bond markets. These four aspects clearly interact (Boot, Greenbaum and Thakor, 1993).

The informational asymmetry theory focusses on the bank/borrower and the bank/lender relationships. In bank lending, one can easily distinguish transactions-based lending and relationship lending. In the former, information which is relatively available at the time of loan origination is used. In the latter, data gathered over the course of the relationship with the borrower is used (Lehman and Neuberger, 2001; Kroszner and Strahan, 2001; (Berger and Udell, 2002). The central themes in bank/borrower relationship are screening and monitoring function of the banks. The adverse selection problem as pointed out by (Akerlof, 1970), and credit rationing as pointed out by (Stiglitz and Weiss, 1981), the moral hazard problem as noted by (Stiglitz and Weiss, 1983) and of course the ex-post verification problem which was pointed by (Gale and Hellwig, 1985). The central themes in bank/lender relationship are; the bank runs, why they do occur, how they can be prevented, including their economic consequences (Kindleberger, 1989; Bernanke, 1983; Diamond and Dybvig, 1983). Another avenue in the bank/lender relationship are models for competition between banks for the deposits in relation to their lending policies and the probability that they fulfill their obligations as pointed out by (Boot, 2000; Diamond and Rajan, 2001).

The second theory of financial intermediation is the transaction costs (Benston and Smith, 1976; Campbell and Kracaw, 1980; Fama, 1980). In contrast to information problem above, this theory does not in a way contradict the assumption of complete markets. It is based on non-convexities in transaction technologies. Transactions costs, financial intermediaries act as coalitions of individual lenders and/or borrowers who exploit economies of scale. The issue of transaction costs includes just not only exchange costs (Tobin, 1963; Towey, 1974; Fischer, 1983), but as well any search costs, monitoring including auditing costs (Benston and Smith, 1976). On the transaction costs, the role of the financial intermediaries is to transform financial claims into other

types of claims which is qualitative asset transformation. Because of that, they therefore, offer liquidity (Pyle, 1971) and diversification opportunities (Hellwig, 1991). The provision of liquidity is as such a key function for savers and investors and increasingly for corporate customers, whereas the provision of diversification is increasingly being appreciated in personal and institutional financing. Invariably, researchers like (Holmström & Tirole, 2001) provide a suggestion that liquidity should play a key role in asset pricing.

The third theory of financial intermediation is the regulation of money production and saving in financing of the economy as noted by (Guttentag and Lindsay, 1968; Fama, 1980; Mankiw, 1986; Merton, 1995b). Regulation function affects solvency and liquidity with the financial institutions. (Diamond and Rajan 2000) reveal that bank capital affects bank safety, bank's ability to refinance, and bank's ability to extract repayment from borrowers. The legal-based view asserts regulation as a crucial factor that shapes the financial economy (La Porta et al., 1998). Policy makers including users of financial information view financial regulations as something that is exogenous to the financial industry. However, activities of intermediaries inherently ask for regulation. This is because banks by the way and the art of their activities are inherently insolvent and illiquid (Merton and Bodie, 1993). Furthermore, money and its value, the key raw material of the financial services industry, to a large extent is both defined and determined by the state. Safety and soundness of the financial system as a whole and the enactment of industrial, financial, and fiscal policies are regarded as the main reasons to regulate the financial industry (Kareken, 1986; Goodhart, 1987; Boot and Thakor, 1993).

Empirical review

A study conducted in India by (Tiwari and Tayal, 2012), on foreign direct investment in Financial sector in India, using literature review methodology, reports that opening of service sector which attracts FDI is the most preferred approach to more FDI to the economy and therefore, development of the financial sector in India.

There are several short comings of this study. the study did not specify which periods were under review to give a realistic comparison with this current study. Further, both population and sample of the study were not provided. The methodology and analysis conducted was not disclosed either in the study. However, the study is advantageous in that it is specific on FDI as one of the many types of private capital inflows and determining how it translates into financial inclusion or development in an economy.

A related study conducted by (Alfaro, Ozcan and Sayek, 2009), on the effect of FDI on productivity and Financial development and markets, using factor accumulation, reports that there seem not to be any channel through which countries benefit from FDI. Conversely, however, they find that countries with well-developed financial systems do gain greatly from FDI by way of total factor productivity improvements. This finding is not isolated as they in agreement with some studies conducted in the growth literature which show that total factor productivity is important factor in explaining cross boarder income inequalities.

Further research conducted by (Aga, Ayana and Peria, 2014) is directly related to the current study. For instance, using World Bank data and 10,000 households in 5 countries in sub Saharan Africa, they investigated the link between remittances and financial inclusion for households. They found out that receiving remittances from international sources increases the chance of a household to open a bank account. This applies to all the 5 countries where the study was under taken. The result is as such robust while controlling for the potential endogeneity of remittances using indicators of migrants' economic conditions in the 5 countries.

The study done by (Aga, et al 2014) above is indeed very key to this current study in many related ways. First, the study variables are directly related. They investigated remittances and household financial inclusion which is the variables this current study did investigate. The focus is within sub-Saharan Africa which Uganda is part of. The sample were households which is the same in this current study. However, the study did not provide the scope in terms of period covered and the sample out of the 10,000 households. The analysis used, and the limitations of data were not mentioned in the study.

Relatedly, in a study conducted by (Bettin and Zazzaro, 2011) on remittances and financial development: Substitutes or complements in economic growth. In the earlier studies, the finding indicated that the effects of migrants' remittances on the economic growth or receiving countries depends negatively on the level of domestic financial sector. However, with the introduction of a new indicator of financial development to measure efficiency of the local financial system, they find out that remittances promote growth of the financial system only in countries whose banking system functions well. This result is robust to controls for other measures of financial depth and quality of the indicators. The advantage of this study is that it takes remittance

together with financial system development which is linked directly to this current study. However, the sample size, population and methodological approached used are not mentioned.

Invariably, further studies conducted by researchers like (Barbara Fritz, 2015) on remittances and financial inclusion using empirical analysis of their relationship based on evidence from Honduras; using three types of data collected from the bank, representative from the Honduran's financial sector and observational data from websites, from the data analysed, the first research question reveals that the likelihood of being poor as a proxy for income and years of receiving remittances correlate significantly with financial inclusion of remittances receivers. Results from the analysis of the quantitative data also show that half of those remittances receivers, who now own an account, did not have an account prior to receiving remittances; thus, their contact with a financial institution, which eventually led to their financial inclusion, was likely established through remittances.

Meanwhile, another related study conducted by (Anzaoategui, Demirguc and Peria, 2011) on remittances and financial inclusion: evidence from El Salvador, which investigated the impact of remittances on financial inclusion. Using household survey data, they examined use of savings and credit instruments from formal financial institutions. From the data analysed, they find that much as remittances have positive impact on financial inclusion through the promotion of household deposit accounts, they, however, do not have a significant effect on demand for credit from institutions. The advantages of this study is that it was conducted in a developing country, El Salvador, which might have similarities with Uganda in terms of household characteristics and as such, the data might be relevant. Also, the study used households which is like the current study and as such similarities in form of data. However, the study might not be useful as the scope is not mentioned and therefore, some limitations in data might be possible.

A study conducted by (Macias and Massa, 2009) used a panel cointegration regression on pooled data from selected economies across the Sub Sharan Africa (SSA) region over the period from 1980 through to 2007 although with gaps. The study was to examine the long-run relationship between economic growth and four different types of private capital inflows which included (cross border bank lending, foreign direct investment (FDI), bonds flows and portfolio equity flows). The extended version of a Dynamic OLS (DOLS) model was used to estimate long-run relationships in cointegrated panels and the model is unique in the sense that trade openness measured as the sum between exports and imports (TRADE) and government consumption (GOV) are added to the model to be estimated. The Kao test was used for testing for panel cointegration.

The outcome of the results showed that FDI and cross-border bank lending exert an important and positive impact on sub-Saharan Africa's growth, whilst portfolio equity flows, and bonds flows do not have an impact on growth. The estimates indicate that a drop by 10% in FDI inflows may lead to a 0.5% decrease of income per capita in sub-Saharan Africa, and a 10% decrease in the cross-border bank lending which may as well reduce growth by 0.7%. The study also showed that the global financial crisis played a significant role in influencing the effect of private capital inflows on sub-Saharan Africa's growth.

One of the main limitations of the study is the lack of data for the SSA region, as well as the heterogeneity of its countries. Data for SSA countries is relatively scarce hence this might cast aspersion on the results of the study. Foreign Direct Investment together with cross-border lending data are all available for some countries; whereas bond and portfolio equity flows data are less abundant.

On the other hand, the study is useful in the sense that it confirms the validity of the role of FDI on financial inclusion. FDI facilitates the transfer of new technology, helps improve workers' skill and is generally regarded as flexible in periods of distress. Although cross border lending is complex in nature, it is an important component in the on-going process of financial deepening and it also facilitates the growth of local banks in the recipient country, (Puhr et al, 2009).

In addition to the above, (Levine and Carkovic, 2002) used new statistical techniques and two new databases to reassess the relationship between financial inclusion- economic growth and FDI. First, based on a World Bank dataset by (Kraay et al, 1999), they constructed a panel dataset with data averaged over each of the seven 5-year periods between 1960 and 1995. Methodologically, they used the Generalized Method of Moments (GMM) panel estimator designed by (Arellano and Bover, 1995) and (Blundell and Bond, 1997) to extract consistent and efficient estimates of the impact of FDI flows on economic growth.

The main advantage following this study is that the GMM panel estimator exploits the time series variation in the data, accounts for unobserved country specific effects, allows for the inclusion of dependent variables taking them as regressors while taking controls for the endogeneity of all the explanatory variables, including

international capital flows. The econometric technique that was used obviously ameliorates bias, (Ahmed et al, 2005). The study however, finds that the exogenous component of FDI does not exert a robust, positive influence on economic growth. Evidence supporting the outcome of this study points out that FDI comes as a threat to national sovereignty since it may have unfair advantages over local competition and exploits critical national and natural resources, (Bartels, 2009).

Furthermore, (Suarez, 1995) found out that capital flows have severe consequences for domestic financial markets since sharp increases in domestic interest rates in connection with the crisis will weaken the solvency of short-term borrowers for instance, the economic crisis of Mexico in 1994.

Another fascinating study was done by (Rangrajan, 2000) who investigated capital flows and their impact on capital formation and economic growth taking note of variables such as net private capital flows, net direct investment, net official flows, net portfolio investment and other net investments in 22 countries from the year 1992 through to 2000. The study shows that capital inflows, in the form of foreign direct investments, are usually considered more permanent in character and they have a major impact on economic growth. The study is based on the principle that capital flows can be promoted purely by external factors which may tend to be less sustainable than those induced by domestic factors. Therefore, (Rangrajan, 2000) safely concludes that when capital inflows are large, they can lead to an appreciation of real exchange rate.

The findings from the study done by (Murinde et al, 2009) are clearly consistent with that done by (Reisen and Soto, 2001) which were mentioned above. The results point to a strong growth effect of FDI throughout the whole continent, and especially in African SANE and oil producer countries. In contrast to some previous studies, cross-border bank lending has a significant positive effect on economic growth in the whole of the African region, but its impact becomes negative once the sample is limited to oil countries alone. Amusingly, financial sector reforms and government consumption seem to have varying effects depending on the sub-sample of countries under investigation. As for non-oil producers, having good governance as well as commencing financial sector reforms seems to cultivate economic growth.

As for oil rich countries, increased government spending seems to foster economic growth and hence financial inclusion, whereas financial sector reforms have no impact on growth. The study gave a complete picture of the relationship between trade openness, inflation and economic growth. Results showed that trade openness and inflation have respectively a positive and negative impact on all African countries' economic growth. The study also safely concluded that there is a need for African non-oil countries to undertake more financial sector reforms as this can probably in the long-run offset the possible negative effects that cross-border bank lending might have on economic growth.

The study by done by (Murinde et al, 2009) is also consistent with the findings of (Yanikkaya ,2003) in terms of the positive effects that trade openness has on the growth of the economy. Openness increases efficiency and reduces costs for industries due to foreign competition; domestic companies are thereby forced to keep up with the pace of quality enhancing new technologies. On the contrary, the study found a negative relationship between inflation and economic growth since inflation erodes the purchasing power of money saved and also the fact that an environment of high inflation and financial instability leads to more entrepreneurship and less expansion of production and employment, (SARB, 2008). The study also revealed that both FDI and cross border lending are crucial for economic development.

(Kaminsky, 2003) examined the characteristics of international capital flows since1970 and summarizes some of the findings of the research conducted in the 1990's on the effects of globalization. Even if international capital flows do not trigger excess volatility in domestic financial market, it is possible that large capital flows may spark inflation in the face of a fixed exchange rate. He argued that globalization allows capital to move to its more attractive destination, fueling higher growth. He suggests that in the short run, globalization triggers bankruptcy of the financial system and protracted recession. The exploration of capital flows to emerging markets in the early and mid-1990's and the recent reversal following the crisis around the globe have ignited once again a heated debate on how to manage international capital flows. He indicates that capital outflows worry policy makers, but so do capital inflows as they may trigger bubbles in asset market and foster an appreciation of the domestic currency and a loss of competitiveness.

Two in a study done by (Moolman et al, 2006) and in tandem with the study done by (Fedderke and Romm, 2004) which focused on the determinants of inward FDI to South Africa. The study of the former invariably sought to examine among others the macroeconomic linkages between Foreign Direct Investment in South Africa and its resultant impact on output for the period 1970-2003. In so doing, they initially identified supply

side determinants of FDI before analyzing their impact on output. Their research method follows the supply side macro econometric framework, which does not consider the demand side determinants that are equally important. On the model, five (5) variables were used as explanatory variables for Foreign Direct Investment in the empirical estimation, namely, market size measured by real GDP, exchange rate proxied by the rand-dollar exchange rate, openness, infrastructure and a dummy variable for the sanctions.

The study by (Moolman et al, 2006) and (Fedderke and Romm, 2004) is unique in its own way since it focuses on the link between FDI and output ignoring other factors such as improved skills, new management techniques, etc. However, the results indicate that FDI is a better destination in those countries that have good government infrastructure. This shows that it is not only good physical infrastructure that attracts FDI but also the political environment plays a pivotal role in attracting FDI since investors feel at home when they invest in countries that have a sound and transparent government, (Globerman & Shapiro, 2003). In addition to the above, one other factor that has a significant effect when attracting FDI is market size of the recipient country and it is usually measured by GDP. (Zhang, 2000) confirmed the positive relationship between FDI and market size and suggested that foreign firms consider the size of the market before investing since their main goal is healthy returns from their investment.

Furthermore, (Bailliu, 2000), used panel data for 40 developing countries from 1975–95 and uniquely focused on the effects of a broad measure of capital flows on economic growth and indeed emphasized the role domestic financial sector play in the process linking capital flows and growth. A dynamic panel data method that controls for country-specific effects and that account for the potential endogeneity of the explanatory variables was used. The study found that capital inflows foster higher economic growth only for economies where the banking sector has reached a certain level of development. Capital flow variables employed included net private capital flows recorded through the balance of payments (BoP) and estimates of net repatriated capital flight. In addition to the capital-flow variables, the econometric specification used as explanatory variables other important determinants of the growth rate.

The article is an exploratory empirical investigation into the relationship between net private capital flows and economic growth taking a panel dataset from emerging Asian countries, notably; Indonesia, Philippines, South Korea, Thailand, and Malaysia for the period 1980– 2001. The article reveals that the net private capital helps to promote economic growth for the countries in the sample. Estimation of the results was improved by controlling for reverse causality since an econometric method that can control, for reverse causality is very important to examine the relationship between net private capital flows and economic growth. To tackle this issue, the Generalized Method of Moments (GMM) estimation technique is employed since it is an econometric technique that can handle the reverse causality using the lagged explanatory variables as instruments.

Methodology

Design

A cross sectional descriptive designs were used in the study. The data used in this study are obtained from published annual reports and websites of the World bank, Bank of Uganda, Uganda Investment Authority and thesis data. The study covered the period from 2012 to 2016.

Empirical model

$Y1= \alpha+\beta1X1+\beta2X2+\beta3X3+\beta4X4+\beta5X5+\beta6X6$ (Model 1)

Where
$Y1=$ Access to financial inclusion
$\alpha =$ Constant
$\beta i=$ Coefficients of the explanatory variables
$X1=$ Foreign Direct Investment
$X2=$ Remittances
$X3=$ Inflation
$X4=$ Interest rate
$X5=$ Exchange rate
$X6=$ Gross Domestic Product

Y2= α+β1X1+β2X2+β3X3+β4X4+β5X5+β6X6   (Model 2)

Where
Y2= Usage of financial services
α = Constant
βi= Coefficients of the explanatory variables
X1=Foreign Direct Investment
X2=Remittances
X3=Inflation
X4=Interest rate
X5=Exchange rate
X6= Gross Domestic Product

Y3= α+β1X1+β2X2+β3X3+β4X4+β5X5+β6X6   (Model 3)
Where
Y3= Quality of financial services
α = Constant
βi= Coefficients of the explanatory variables
X1=Foreign Direct Investment
X2=Remittances
X3=Inflation
X4=Interest rate
X5=Exchange rate
X6= Gross Domestic Product

Results

Level of private capital inflows

The study sought to establish in objective one, the level of private capital inflows to Uganda. Private capital inflow included Foreign Direct Investments and remittances. The level of private capital inflows to Uganda from 2012 to 2016 is as shown in the table below.

Table 4.1. Level of private Capital to Uganda

Year	FDI- US$	Remittances- US$	Total-US$
2012	1,205,388,487.79	913,264,190.72	2,118,652,678.51
2013	1,096,000,000.00	940,664,379.28	2,036,664,379.28
2014	1,058,564,540.35	887,611,309.44	1,946,175,849.79
2015	538,484,375.07	902,157,540.46	1,440,641,915.53
2016	522,638,531.58	1,015,710,344.54	1,538,348,876.12
Totals	**4,421,075,934.80**	**4,659,407,764.44**	**9,080,483,699.24**
Percentage	**33.97%**	**66.03%**	**100.00%**

Source: Primary data

The same information above can as well be shown using a chart comparing the two proxies of private capital inflows as shown below.
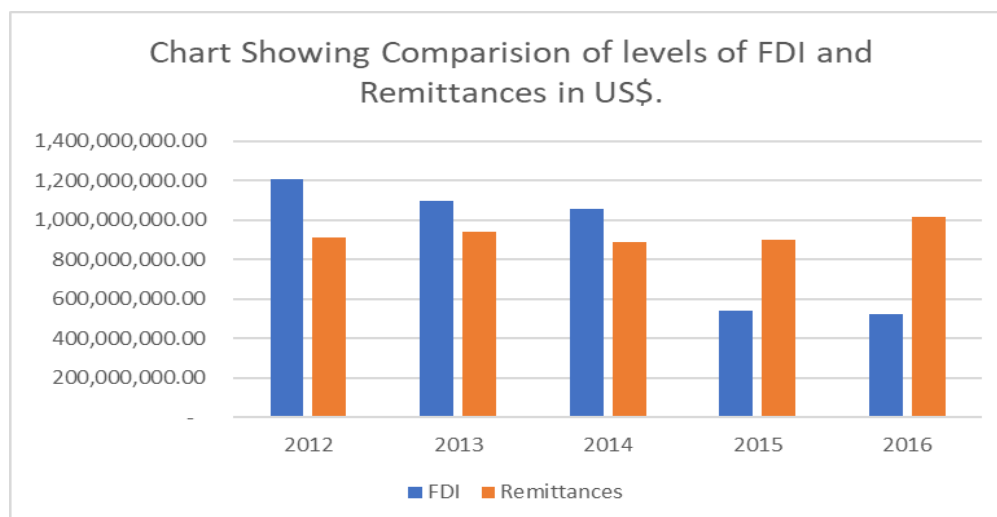
Figure 1.0 level of private capital inflows to Uganda

Source: Primary data

From the table and chart above, it is seen that two categories of private capital inflows were significant to the Ugandan economy and these are; Foreign Direct Investment and worker remittances. Of the total inflows for 2012 of US$ 2,118,652,678.51, Foreign Direct Investment contributed US$ 1,205,388,487.79 while remittances contributed US$ 913,264,190.72. In 2013, Foreign Direct Investment contributed US$ 1,096,000,000.00 while remittances contributed US$ 940,664,379.28 with the total at US$ 2,036,664,379.28. In 2014, total inflows were US$ 1,946,175,849.79 and Foreign Direct Investment contributed US$ 1,058,564,540.35 while remittances contributed US$ 887,611,309.44. In 2015, Foreign Direct Investment contributed US$ 538,484,375.07 while remittances contributed US$ 902,157,540.46 with a total of US$ 1,440,641,915.53. In 2016, Foreign Direct Investment contributed US$ 522,638,531.58 while remittances contributed US$ 1,015,710,344.54 with a total of US$ 1,538,348,876.12.

Overall, Foreign Direct Investment contributed US$ 4,421,075,934.80 while remittances contributed US$ 4,659,407,764.44 with an overall total of US$ 9,080,483,699.24. The contribution of Foreign Direct Investment to private capital inflows to Uganda represented 33.97% while worker remittances represented 66.03% during the years 2012 to 2016.

Relationship between private capital inflows and financial inclusion

The second objective of the study was to establish the relationship between private capital inflows and financial inclusion in Uganda. In this objective, the null hypothesis (H0) stated that there was no relationship between private capital inflows and financial inclusion. The table below is a correlation matrix of private capital inflows and financial inclusion.

Table 4.2. Correlations

		Private Capital Inflows	Financial Inclusion
Private Capital Inflows	Pearson Correlation	1	-.034
	Sig. (2-tailed)		.269
	N	1074	1074
Financial Inclusion	Pearson Correlation	-.034	1
	Sig. (2-tailed)	.269	
	N	1074	1074

Source: Primary data

The correlation results show that the coefficient r = -0.034 and its level of significance p = 0.269. This result show that has private capital inflows increase; financial inclusion does not move in the same direction since the

relationship is negative. Therefore, since the p value (p= 0.269) is more than the alpha value α = 0.05, (0.269>0.05), the null hypothesis (H0) is retained/accepted and the alternative hypothesis (H1) rejected. This is because there is inconclusive evidence about the significance of the relationship between private capital inflows and financial inclusion.

A regression analysis was further done to establish if private capital inflows can predict financial inclusion. The results are shown in the tables below.

Table 4.3. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.034[a]	.001	.000	8.23962
a. Predictors: (Constant), Private Capital Inflows				

Source: Primary data

Table 4.4. ANOVAb

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	83.088	1	83.088	1.224	.269[a]
	Residual	72779.490	1072	67.891		
	Total	72862.578	1073			
a. Predictors: (Constant), Private Capital Inflows						

Source: Primary data

Table 4.5: Standardized Coefficientsa

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	43.071	.959		44.915	.000
	Private Capital Inflows	-.034	.031	-.034	-1.106	.269
a. Dependent Variable: Financial Inclusion						

Source: Primary data

In the first table from top (table 4.2), the proportion of variance (R^2) is 0.001, which is an estimate for how well private capital inflows predict financial inclusion. Therefore, from the results, private capital inflows do not completely predict financial inclusion since R^2 is (0.0%).

To determine the direction and strength of the relationship between private capital inflows and financial inclusion, the standardize beta coefficient is important. In table 4.5, the Beta Coefficient is negative, β = -0.034 indicating that a decrease in private capital inflows does not influence financial inclusion. Therefore, from the above analysis as seen in the tables, the results of the regression show that private capital inflows do not predict financial inclusion; $P<0.001$(R^2 = 0.001); $F (1,1072) = 1.224$ and β = -0.034.

In the table 4.6 below, a further correlation analysis was run for all the independent variables which constituted private capital inflows (Foreign Direct Investment and remittances) against financial inclusion to determine if each of them as a relationship with financial inclusion or not.

Table 4.6. Correlations

		Foreign Direct Investment	Remittances	Financial Inclusion
Foreign Direct Investment	Pearson Correlation	1	.325**	-.039
	Sig. (2-tailed)		.000	.207
	N	1074	1074	1074
Remittances	Pearson Correlation	.325**	1	-.004
	Sig. (2-tailed)	.000		.907
	N	1074	1074	1074
Financial Inclusion	Pearson Correlation	-.039	-.004	1
	Sig. (2-tailed)	.207	.907	
	N	1074	1074	1074
. Correlation is significant at the 0.01 level (2-tailed). **Source: Primary data**				

From the above table, the correlation results between Foreign Direct Investment and financial inclusion show that the coefficient r = -0.039 and its level of significance p = 0.207. This result show that as foreign direct investment increase, financial inclusion does not move in the same direction since the relationship is negative. Therefore, since the p value (p = 0.207) is more than the alpha value α = 0.05, (0.207>0.05), the null hypothesis (H0) is retained/accepted and the alternative hypothesis (H1) rejected. This is because there is inconclusive evidence about the significance of the relationship between foreign direct investment and financial inclusion.

Further, from the table, the correlation results between remittances and financial inclusion show that the coefficient r = -0.004 and its level of significance p = 0.907. This result show that as remittances increase, financial inclusion does not move in the same direction since the relationship is negative. Therefore, since the p value (p=0.907) is more than the alpha value α = 0.05, (0.907>0.05), the null hypothesis (H0) is retained/accepted and the alternative hypothesis (H1) rejected. This is because there is inconclusive evidence about the significance of the relationship between remittances and financial inclusion.

Conclusions and Policy Recommendations

The conclusions and policy recommendations arrived at are presented objective by objective in congruence with the questions and hypothesis of the study as shown below.

Conclusion

Level of private capital Inflows

The first objective of the study was to ascertain the level of private capital inflows to Uganda. The first research question was; what is the level of private capital inflows in Uganda? From the results in Table 4.1, it is therefore, concluded that the level of private capital inflows to Uganda from 2012 to 2016 was US$ 9,080,483,699.24. With FDI contributing US$ 4,421,075,934.80 (33.97%) while remittances contributing US$ 4,659,407,764.44 (66.03%). From the findings in Table 4.1, it is further concluded that worker remittance is the biggest source of private capital inflow to Uganda followed by FDI.

Relationship between private capital inflows and financial inclusion

The second objective of the study was to examine the relationship between private capital inflows and financial inclusion. The second research question was; is there a relationship between private capital inflows and financial inclusion? And the hypothesis was stated as: There is no relationship between private capital inflows and financial inclusion. From the results in Table 4.3, it is therefore, concluded that since the p value (p = 0.269) is more than the alpha value $\alpha = 0.05$, (0.269>0.05), the null hypothesis (H0) is retained/accepted and the alternative hypothesis (H1) is rejected. This means that the study did not get any statistical evidence to suggest a relationship between private capital inflows and financial inclusion in Uganda. From the findings presented on Table 4.4, it is further concluded that both FDI and remittance did not have any relationship with financial inclusion individually either.

Policy recommendations

The recommendations from the study are presented objective by objective. From the study findings, the following recommendations are made:

- Increase the level of FDI. FDI is attractive to both local populations and the investors seeking to set up investments in other locations. This can be done through many ways. The following could be some of the ways: Develop the size and potential of the Ugandan market, Government agencies like Uganda Investment Authority to ensure quality at both institutional and regulatory levels, make efforts to ensure openness in trade, improve the quality of infrastructure like roads, communication and health, ensure there is both political and economic stability and lastly, tap and develop the abundant natural resources like oil, gold and other precious resources.
- Increase and deepen the level of remittances and ensure family, social and community remittances are also encouraged and recorded. At present, based on the available data, only worker remittance is the major source. Further, the costs of sending and receiving funds should be lowered to attract more people to send, having a National strategy on remittances, encouraging informal financial service agents like Mobile money agents to send and receive funds and reduction of remittances delivery time so that funds are received instantly instead of waiting for days.

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